

AMERICAN UNIVERSITY OF ARMENIA

FINANCIAL SUSTAINABILITY OF THE ARMENIAN NGO SECTOR

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Abstract

Democracy, one of the basic values that the humanity strives for, can never be achieved unless the society is empowered with active citizens ready to drive for changes and direct policies; to oversee the activities of the government and make the public voice heard; to serve as watchdogs and disallow any possible injustice. Only a robust civil society that is sustainable and self-sustaining can perform its function of fostering democratic development of the countries within which it operates.

This research examines the “financial sustainability” dimension of Armenian civil society, making an attempt to reveal and quantify why and how is the financial viability of the Armenian NGO sector so fragile and who can fill up the gaps. It particularly focuses on the role of NGOs and donor organizations themselves in leveraging donor support toward the objective of reducing donor dependence and reorienting NGOs toward building constituencies of support and accountability within the *Armenian* society and polity.

Literature Review

What is civil society?

"Civil society" is certainly not a new phenomenon. It can be traced back to the works of Cicero and other Romans to the ancient Greek philosophers. In the 1990s, because of the democratization wave, civil society became a mantra for everyone from presidents to political scientists. The global trend toward democracy opened up space for civil society in formerly dictatorial countries around the world as well as a means of social renewal (Carothers 1999-2000; Kaldor 2003).

Today, civil society organizations serve millions of people all over the world and their reach and scope stretch to and often even eclipse both the private and public sector. This is the reason, conceivably, that, according to Fisher (2003), the society is nowadays thought of in a new light - as a three-legged stool made up of the market, government and civil sectors. If the first two create market and public capital, civil sector provides with social capital, which, if powerful and sustainable enough, can make tough demands and achieve policy changes guided by the aspirations and concerns of public (Fisher 2003).

The link between civil society and democracy was first emphasized by Alexis de Tocqueville in his book *Democracy in America*, stating that democracy in America was a success due to a great number of various voluntary citizen associations, which shaped the type of citizenry that could best sustain democratic public life (Putnam 1995).

Later Diamond and other scholars developed these ideas, holding that to pressure for democratic change, the civil society may: 1) Limit, contain and control the state power: Mobilized civil society is a strong vehicle in revealing any abuses and violations and subjecting

them to public scrutiny. 2) Foster political participation, and in doing so, increase the political efficacy and skills of democratic citizens. 3) Promote appreciation of the rights of democratic citizenship and other democratic attributes, like tolerance, and above all – respect for opposing viewpoints. 4) Create channels for articulation, aggregation and representation of interests, granting access also to the historically marginalized entities. 5) Eliminate, to the possible extent, the reinforcing cleavages, by generating a wide range of interests that may cross-cut, and thus, ease the political conflicts. 6) Recruit and train new political leaders. 7) Hold governments more accountable, also by exposing and disseminating hard-won information on government's activities that the latter tries to conceal. 8) And finally, and perhaps most importantly, legitimate state authority based on rule of law, and hence, strengthen the state (Diamond 1994, 7-11).

In their role of promoting democratization non-governmental organizations (hereinafter NGOs) hinge primarily on the link between civil society and democracy. As a result they have become a powerful force in world politics, working to alleviate poverty, protect human rights, preserve the environment, and provide relief worldwide (McGann and Johnstone 2006).

Thus, NGOs should and often do have vital role in sustainable development of any country. This can never be achieved, however, if they are not sustainable themselves...

He Who Pays the Piper, Calls the tune...

Sustainability is perhaps one of the toughest concerns NGOs face in the 21st century all over the world. Still, thinking about the importance of sustainability especially in the framework of *financial sustainability* is vital if NGOs truly want to continue to secure enough funding to survive institutionally, provide quality services that support their constituency, and maintain a mission driven purpose (Caesar 2006).

Financial sustainability, a special focus of this research, is defined for the purposes of the study as the ability of an NGO to secure and manage sufficient resources enabling it to fulfill its mission effectively and consistently over time without excessive dependence on any single funding source. In this context improved sustainability would mean broader sources of funding and an enhanced ability to deliver vital services to target populations even after the original or primary donor funding is withdrawn.

According to Caesar (2006), the issue of financial sustainability has recently become a top-priority issue because (a) donor resources available to NGOs continue to decrease; (b) donor agencies worldwide have shifted and narrowed funding into specific, highly political or publicly popular regions of the world (like Afghanistan, Iraq and the Sudan) and into specific markets (such as anti-terrorism and agriculture) that do not usually fund traditional NGO development; (c) the growth in terms of numbers of NGOs worldwide has tightened competition between NGOs for increasingly limited funding; and (d) donors worldwide have become less willing to fund traditional overhead expenses (salaries, rent and equipment) forcing NGOs to chase more and more donor funds rather than develop long-term program strategies that support their own mission (Caesar 2006).

Dependency on outside players is a concern that presently acquires growing attention and scrutiny. The amounts of funding directed to NGOs are colossal. Just a few examples speak for themselves: UNDP Human Development report shows that in 2002 more than 7 billion dollars in aid to developing countries flowed through NGOs (UNDP Human Report 2002). Another finding by the Red Cross reveals that more money goes through NGOs than through the World Bank (Vaknin 2005).

While international funding has dramatically increased the resources available to NGOs, it clearly poses problems of its own - raising questions about the credibility of an organization's activities. One particular concern that comes up is that if foreign donors are providing money for an NGO, they might as well be dictating its goals...

Indeed, the degree of independence that donor funded NGOs can exercise in relation to donor agendas varies from NGO to NGO, depending mainly on the perspectives of its leadership. In practice though, their scope for action is limited. More often than not, NGOs, not being able to meet their expenses and dependent on donor priorities and preferences, accomplish the mission of the donor organization, and not that of theirs (Shivji 2007).

Not surprisingly, existing international funds are often earmarked for particular projects or for limited project cycles. Donors frequently attach specific limitations on how money can be spent, designating particular issues or themes, or specifying support only for program expenses. NGO's are often accused of serving the donors' interests to the detriment of the public good and distorting domestic agendas; serving as long arms of their sponsoring states - gathering intelligence, burnishing their image, and promoting their particular interests. Many host governments blame NGO's for - unwittingly or knowingly - serving as hotbeds of espionage. Often unelected and ignorant of local realities, NGOs answer to no constituency and import values that provoke social polarization and cultural clashes. (Vaknin 2005, Lee 2008).

Moreover, the "CIVICUS Civil Society Index" country studies confirm that financial resources for Civil Society Organizations are limited in most regions of the world and that CSOs in post-communist Europe, particularly, are often donor-driven (Wallner 2006).

Another concern about donors' funding is that it is almost always project-based with the emphasis put on NGO activities rather than on sustaining the organizations themselves. In

practice, institutional or organizational development remains a lower priority. NGOs are forced to go “where the money is,” regardless of whether the project priorities identified by a prospective donor mesh with the long-term strategic plans of the organization. This situation has led NGOs into an endless cycle of resource dependency, with the latter often diverting from the proclaimed mission of their organization for the sake of getting funding (Alymkulova, Seipulnik 2005).

What is even more alarming about reliance on foreign donors, however, is the problem of accountability. While some NGOs may be quite involved with and appreciated by the people whom they purport to serve, ultimately NGOs, by their very nature, derive not only their sustenance but also their legitimacy from the donor-community. Hence, NGOs start to demonstrate accountability within donor community but not towards their own constituencies and direct beneficiaries (Shivji 2007).

This, for sure, does not mean that there are no NGOs set up by politically or morally motivated individuals with genuine desire to ‘do something’, genuinely meant to respond to the need of the people. However, it is also true that a substantial number of NGOs are donor-driven NGOs, set up to respond to whatever is perceived to be in vogue among the donor-community at any particular time (Shivji 2007).

To avoid any of the above mentioned problems a sustainable financing strategy – that of diversifying income sources should be developed; a sustainable approach that avoids dependency on any single source of revenue, external or internal. Rather, a balance between externally and internally generated resources is necessary to allow an organization meet its operating and administrative expenses while maintaining the freedom to determine its program priorities and projects, irrespective of donor preferences (Lee 2008).

The New NGO Entrepreneur or... Sources of NGO Income

While there is, of course, tremendous variation in the sources of NGO revenue among countries and NGOs within any sector, there are at the same time identifiable trends of NGO financing. Thus, nearly all NGO revenue falls within three broad categories. They include (1) government funding, and (2) private giving, or philanthropy, and (3) self-generated income (Moore 2005).

In 2003, the John Hopkins University Comparative Nonprofit Sector Project published a comparative analysis on global civil society, which based its findings on research in 35 countries, including 16 developed countries (Japan, France and Germany, etc.), 15 developing countries (Brazil, Egypt Mexico, etc.) and five Central and Eastern European, transitional countries (Romania, Slovakia, etc.). The results are revealing: self-generated income is the dominant source of revenue in most of the countries surveyed (53%) (Lester, Sokolowski, List 2003).

This finding is especially noteworthy in the context that in most NIS countries self-generated income opportunities are underutilized: another study conducted by Alymkulova and Seipulnik in 2006 and covering also some countries of the NIS region shows that the percentage of funding through self-generated income here is much lower than that in the NGO sectors in the Czech Republic, Hungary, Poland and Slovakia, that already receive the bulk of their revenues through self-generated income (Alymkulova, Seipulnik 2006).

Nevertheless, solutions to the challenge of sectoral sustainability must lie in a holistic approach, recognizing the relative importance of all categories of NGO income that include:

Government funding includes a broad range of direct and indirect support. Direct funding comes in the form of state subsidies, government grants for specific purposes, and contracting to perform certain work. Tax exemptions - indirect government subsidies - recognize

that NGOs are using income to pursue a not-for-profit mission, often for the public benefit. Hence, for example, income from grants and donations is typically exempt from income taxation. Besides these traditional funding mechanisms, governments in several countries have developed innovative approaches to government funding (Moore 2005):

Social Partnership is defined as a joint partnership between national or local government and the third sector in a mutually beneficial social project (Layton 2006). Social partnerships can help to decrease the cost of government services and increase their quality. This is due to the reason that NGOs are expected to know better the needs of their beneficiaries and to have sufficient professional expertise in providing better quality and targeted services. On the other hand, cooperation and contracting out NGOs for provision of social services decreases the cost of those services through cutting the cost of maintaining bureaucratic apparatus. NGOs as public benefit organizations are ideally expected to be willing to perform the same job for lower payments than regular employees of a state institution. Thus, the insertion of social partnership system introduces adequate redistribution of social responsibility between the state and the public: the state creates a relevant legal background for solving social problems and providing services by NGOs, meanwhile, public assumes the weight of solving many social problems through the organizations it established (Arakelyan 2003).

Percentage Philanthropy is a legal mechanism allowing taxpayers to allocate a certain percentage of their tax payment to beneficiaries, including NGOs. Hungary introduced the mechanism to Central Europe in 1996, where it has become known as the “1% Law.” Following Hungary’s lead, several other countries have adopted similar mechanisms: Slovakia, Lithuania, Poland, and most recently, Romania. Thus, individual taxpayers can designate 1% of their taxes

to an NGO. To be entitled to receive 1% contributions, a foundation or association must carry out public benefit activities (Moore 2005).

Privatization Proceeds: The Czech Government developed an innovative approach in its privatization process, which provided a significant boost to NGO sustainability, by distributing 1% of all privatization proceeds to a fund, for re-distribution to foundations as endowments. As a result, in 2002 alone, 27 million euro was distributed to 64 foundations of the country (Moore 2005).

Lottery Proceeds: Lotteries and games of chance offer an alternative source of revenue for NGOs. By directing a designated percentage of lottery proceeds to public benefit purposes, the Government can provide significant support to the NGO sector. In Croatia, for example, the Government directs 50% of proceeds from the national lottery to support certain public benefit purposes, including civil society (Moore 2005).

National Funds and Foundations: As another form of NGO/government Hungary and Croatia have established public funds or foundations specifically dedicated to support civil society and to provide funding to NGOs. Hungary's National Civil Fund, for instance, financed by the Hungarian government, provides matching funds based on the amount of actual taxpayer designations under the 1% tax designation law each year, and in no case contributes less than the 0.5% of personal income taxes collected. Thus, the more money designated by taxpayers, the more money contributed by the Government (Moore 2005).

Private philanthropy usually comes in the form of cash and in-kind donations from individuals, businesses, and foundations or other grant-making legal entities. The most common mechanism for encouraging individuals and corporations to make cash and in-kind donations to NGOs is through tax incentives (generally in the form of tax deductions) for donors. While

important, tax incentives are not sufficient to promote corporate philanthropy; donors give based on a variety of motivations, of which tax preferences are only one. Meanwhile, an innovative trend in the area is the *Community Foundation*, a mechanism used in Bulgaria, Slovakia, Russia and several other countries. Community Foundation is a local not-for-profit organization that works to gather, manage and redistribute local resources for the good of the community. The community foundation has a diversified funding base, fed by contributions from business, local government and NGOs, as well as individuals. Community foundations raise public awareness of local needs, increase local participation in meeting local needs, stimulate cross-sectoral dialogue and partnerships, and promote individual giving. Finally, if managed properly, community foundations can create a long-term local source of funding for civic initiatives and local NGOs (Moore 2005).

Self-generated income includes membership dues, fees and charges for services (that is, economic activity), as well as income from investments.

Social Enterprise (SE) is one of the financial-sustainability strategy components. Social enterprise is any socially responsible income-generating activity whose revenue is used to support the organization's mission utilizing private-sector entrepreneurial principles (Alymkulova, Seipulnik 2006).

The introduction of the SE concept is an effort to create a new breed of entrepreneurs and to stimulate the formation of a larger, sustainable pool of resources for NGO initiatives. Going beyond the traditional donor-grantee relationship, this approach focuses on a new organizational “hybrid” – nonprofit in purpose and for-profit in approach – using the so-called “double bottom line” concept. As a hybrid, social enterprise is driven by two strong forces. First, the targeted social change often benefits from an innovative, entrepreneurial or enterprise-based solution.

Second, the sustainability of the organization and its services requires the diversification of its funding stream, including the addition of earned income. Thus, comprehensive, well-structured programs, which complement business training and loans, legal advice and networking, increase the likelihood NGOs will successfully create sustainable social enterprises that achieve both financial viability and social impact over the long term. Ultimately in their business activities NGOs develop solid funding bases, which sustain their core social programs through earned income and incorporate the strategic use of grants for supplementary services and auxiliary social programs, establishing or expanding their income-generating activities and, at the same time, achieving their organizational missions (Alymkulova, Seipulnik 2006).

Investment Income: The use of “endowments” (referring to that part of organizational assets consisting of money and/or property dedicated to a specific purpose, which cannot be diminished during the life of the organization) as a means for creating wealth to finance grant-making foundations and other organizations is not widespread. There are, however, innovative approaches that have been adopted in some of the new EU Member States. The approach taken in the Czech Republic is particularly instructive (Moore 2005).

The Czech Law on Foundations requires foundations to have an endowment with a value of at least 500,000 CZK (approximately 16,000 Euros). Due to amendments adopted in 2002, foundations may now take advantage of a wider range of investment opportunities, offering potentially higher yields than the more restricted investments permitted under the prior law. In addition, tax-free investments now include capital gains and exchange rate gains, which should allow further growth of endowments. At the same time, the law contains rules for safe investment, limiting investment in designated high-risk instruments. Foundations are also subject to stricter governance rules and independent audit requirements. Perhaps most important,

foundations may now contract with professional financial institutions to handle their investments and provide consulting. Taken together, these improvements in law and practice have created far more stable conditions for endowed foundations – and therefore for the entire NGO sector in the Czech Republic (Moore 2005).

If you really want to save the world, you have to do more than write checks...

Certain donor organizations acting in different countries of the world have already designed and are implementing financial sustainability building strategies for NGOs to support the work of their target groups not merely within the scope of certain programs but over the time as well.

Thus, for instance, Counterpart International in Kazakhstan and Kyrgyzstan is implementing the “venture philanthropy portfolio” approach that uses a “portfolio approach” taken from venture capitalism, in which venture capitalists make both financial and technical investments in a group of new or growing businesses known as a portfolio. In Counterpart’s case, the portfolio refers to a group of NGO participants (Alymkulova, Seipulnik 2005).

Venture philanthropy is a relatively new discipline that balances the changing needs of today’s nonprofit sector with those of the new donors. These new entrepreneurial philanthropists require serious business plans, real accountability, good management, and a solid growth strategy from the entities that get the investment (Moodie 2008).

A venture philanthropy approach generally entails the following:

- **Close relationship between the foundation and the grantee:** The relationship is characterized by partnership rather than oversight; there is a mutual interest in capacity building. Accordingly, the foundation is involved in management, governance and

organizational problem solving. As partners, foundations and nonprofits will ensure they are "singing out of the same hymnal" (Moodie 2008).

- **Length of relationship:** The foundation looks beyond funding the grantee for just one year and enters into a relationship that can last for a number of years (Moodie, 2008).
- **Size of investments:** It is rare for a nonprofit to be self-sufficient. With that in mind, venture philanthropists provide not program support alone, but also support the infrastructure and overhead needed to run these programs. Hence, instead of providing a large number of recipients with project-oriented grants that cover only a small proportion of a nonprofit's costs, foundations decrease the number of grantees in order to increase the size of grants. Thus their ability to cover the majority of a nonprofit's overall operating costs is enhanced. This encourages organizational development and capacity building (Moodie 2008).
- **Risk management and accountability:** By funding only portions of projects, foundations minimize being blamed for failed projects. Recognizing that not all programs and investments will prove to be successful, foundations that practice venture philanthropy are willing to take the risk that some portion of their grants portfolio will not succeed (Moodie 2008).
- **Exit Strategies:** Instead of providing fixed-term grants that force nonprofits to spend time and resources applying and re-applying for funding, venture philanthropy withdraws its support when the nonprofit is able to sustain itself or has succeeded in its mission (Moodie 2008).

Another example of how international donor organizations can help national NGOs in developing countries to build future sustainability is the Community Fund implemented by

USAID in Bulgaria. Addressing the problem of donor dependency of civil society organizations, the five-year program of USAID introduces new models for financial sustainability of Bulgarian NGOs by increasing participation of businesses, citizens, and local governments in the third sector. Accordingly, USAID provides technical assistance and trainings to community funds in selected Bulgarian communities. The types of trainings include community fund basics, strategic planning, fundraising, project design and management, accounting and financial management, and cross-border study tours. The program also provides *ongoing* financial support through seed grants and matching grants for the implementation of community projects. It aims to develop sustainable Community Funds as local grant making organizations that increase civic participation in local decision-making and in planning local development; and revive Bulgarian traditions of philanthropy and volunteerism. By funding NGO activities from the local community, community funds ensure NGO accountability to the people they serve, rather than to external donor organizations (Community Fund and Social Enterprise Program 2008).

Development of the Armenian NGO sector

The development of the NGO sector in Armenia has been influenced by several major historical factors, including the legacy of the Soviet Union. In former Soviet times, there were very few non-profit organizations in Armenia. These organizations were created for uniting people with similar professional interests (such as the Unions of Painters, Artists, Writers, Composers, Architects, etc). Organizations such as the Committee for Cultural Relations with Armenian Abroad or Committee for the Cultural Relations with the Outside World were created to regulate relations with the Armenian Diaspora or with other governmental or non-profit structure's of foreign countries. All of these public organizations were funded mostly from the

state budget and depended on the government and Communist Party for everything (Aleksanyan 2008).

The situation radically changed in 1991 after Armenia's independence. The non-profit sector in Armenia started to develop. The first NGO-style groups were mainly concerned with environmental protection, and some of these groups later became NGOs (Blue, Payton, Kharatyan 2001).

Another phase in the Armenian civil society development was observed in response to the 1988 earthquake, the war in Karabakh and resulting blockade, the refugee influx from Azerbaijan to Armenia and growing poverty. As a result, a number of "benevolent organizations" appeared on the Armenian landscape (Aleksanyan 2008).

A new era of Armenian NGO life was observed when international NGOs began working in Armenia in 1990s. Several foreign organizations opened their offices in the country and information and terms like 'human rights', "democracy", "NGO" flooded the country from the West. As a result, international organizations promoting civil society started in some sense to dictate the possible directions and methods of Armenian NGO activities (Blue, Payton, Kharatyan 2001).

According to the study carried out by Blue, Payton and Kharatyan (2001), though many Armenian NGOs were founded to address alarming and real emergencies, very soon they began to address the issues that had international appeal. Very often NGOs were initiated by foreign players who lacked knowledge of the country specifics and hence, did not address the real challenges facing Armenia. Thus, for instance, unemployment, one of the greatest problems of Armenia at that time, was seen as challenge to a very small portion of NGOs, while out-migration, another problem, received local attention only when the International Agency of

Migration became involved. Not surprisingly, the Armenian NGO Sector Assessment in 2001 reported the belief of many NGO leaders that donors did not take into account the peculiarities of the Armenian society and served their own program interests without regard to what NGOs really wanted to do - sometimes providing money to useless and unimportant programs. Moreover, the ‘imported’ ideas and values, as a result, sometimes, clashed with local norms (Blue, Payton, Kharatyan 2001).

Another study carried out in 2004 also reveals the perception that NGO advocacy efforts have more to do with what donors want than what is genuinely in the interest of Armenia (Blue, Ghazaryan 2004, 48).

Thus, notwithstanding the great contribution of foreign financial support in developing civil society of Armenia, it also created great dependency, with most of Armenian civil society organizations heavily reliant on foreign funding.

Nevertheless, the third sector exists in Armenia and is in the process of permanent development. And although the spheres of NGO activity cross each other very often, practically each of them has its own “niche”, outlined by an exclusive financing source (a grant, received for realization of a concrete program) or by the frames of a social group (disabled children, aged people, women, etc) (Babayan 2004).

For the realization of their public mission, NGOs in Armenia use various financing sources that, according to Babayan (2004), can be divided into three blocs: foreign grants; domestic financing sources and income generated from the activities of NGOs themselves. Still, the most substantial channel for financing the activity of the public sector in Armenia is the foreign aid. What NGOs have achieved today is mainly based on the financial support from international organizations and donors. Hence, under that form of financing, dependence and

firm control on the part of donors became inevitable for NGOs. As an effect, not all Armenian NGOs are active and not all serve to some public goals in their activity: a number of organizations have a “flashing” character, functioning “from a grant to another grant”. That is why when there is no financing the activity of such organizations is frozen (Babayan 2004).

Moreover, it is obvious that foreign sponsors are inclined to fund mainly those activities that are traditionally of interest to them, which, unfortunately, do not always coincide with the most burning issues of human development in Armenia. Hence, an ability to maintain relative financial independence, amendments to the law on NGOs, and goodwill on the part of the state are necessary to ensure the real independence of NGOs (Aghamalian 1998).

A brief review of the financial sustainability status of the Armenian NGO sector reveals the following trends and developments: the Armenian NGO sector assessment in 2001 showed that 34% of the surveyed NGOs received foreign grants. What is troublesome, however, is that they also reported that they often tailored their activities on a grant-to grant basis (Blue, Payton, Kharatyan 2001).

In 2004, financial insecurity of the NGO sector as a whole was found to be still the most pervasive issue. The study obviously demonstrated that most of the NGO support came from international donors. What is more troubling is that the future expectation of NGOs too, still hinged on international foundations: 82% of NGOs reported that they planned to finance their organization over the long term through international donors. Somewhat encouraging is the finding that 48% of NGOs also planned to seek donations from the local population. Some 36% of NGOs planned to seek Diaspora support and 33% hoped for Government support. Meanwhile, 26% of the surveyed NGOs planned to survive by their LLC incomes (Blue, Ghazaryan 2004, 73).

The 2004 study also revealed the positive correlation between financial insecurity and lack of accountability. As a direct consequence of donor dependency and having more expectations of benefits from the donor community rather than from public support, NGOs cared more about being accountable to donor organizations rather than to their own beneficiaries and constituencies. They proved to be more concerned about image building in relation to donors rather than with the public (Blue, Ghazaryan 2004).

“The NGO Sustainability Index for Central and Eastern Europe and Eurasia” conducted by USAID in the last 3 consecutive years (2005, 2006, 2007) shows a positive shift in terms of financial viability of the Armenian NGO sector. Thus, if in 2005 the score for the sector in the ‘financial viability’ dimension was 5.5 in a seven-point scale (with 7 indicating a low or poor level of sustainability and 1 indicating a very advanced NGO sector), then that in 2006 was 5.4 and that in 2007 was 5.2. This slight shift, however, has not resulted in the actual improvement of the sector and it is still, according to the NGO Sustainability index, in its early transition stage (The NGO Sustainability Index for Central and Eastern Europe and Eurasia 2005, 2006, 2007).

The mentioned study, however, does not quantify why and how is the financial viability of the Armenian NGO sector so fragile and who can fill up the gaps. Hence, the present study attempts to find what efforts are made on behalf of Armenian NGOs and donor organizations themselves to leverage donor support toward the objective of reducing donor dependence and reorienting NGOs toward building constituencies of support and accountability within the Armenian society and polity.

Research questions

- What efforts are made on behalf of Armenian NGOs to secure and manage broader sources of funding without excessive dependence on any single financial source?

- How do Armenian NGOs perceive the existing legal framework: does it support or hamper them in their attempts towards financial sustainability building?
- What strategies/plans/mechanisms are designed to be used by foreign donors aimed at the financial sustainability building of Armenian NGOs?

Methodology

The method of research includes the analysis of primary and secondary research data as well as review of relevant documents. For the purposes of the study, face-to-face interviews were conducted with the representatives of 20 Armenian NGOs and 6 international organizations.

NGOs were randomly selected from the list of grantees of USAID-funded Civic Advocacy Support Program, since it is today one of the biggest donor organizations for NGOs in Armenia. 20 NGOs were selected out of 100, hence one of the limitations of the study is that the sample size selected is not representative and the findings of the research can be used only for explanatory purposes.

International organizations were purposefully chosen according to the following criteria: major donor organizations that aim at strengthening civil society sector of Armenia and have provided financial as well as technical support to various NGOs so far. Based on findings policy recommendations are made directed both to NGOs and donor community itself.

Findings and Analysis

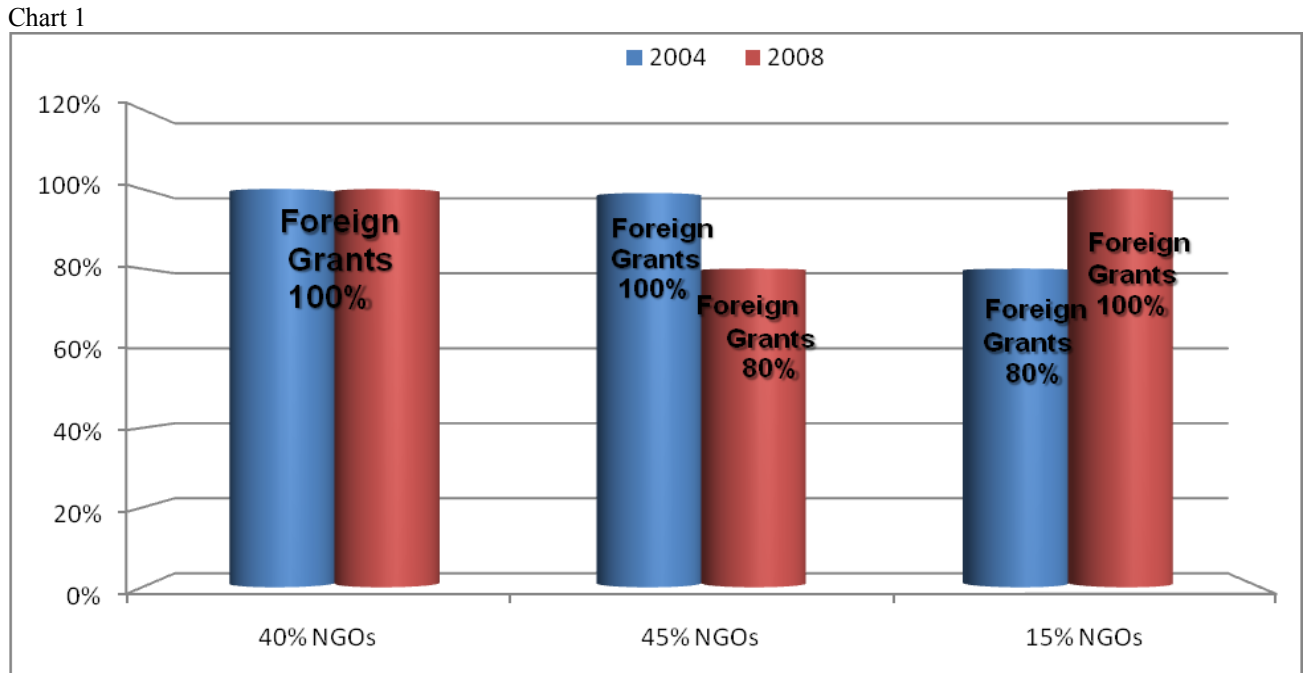
Through in-depth interviews and review of relevant documents an attempt was made to find out if Armenian NGOs recognize the importance of financial sustainability, what efforts are made on behalf of them to ensure the viability of their organizations and in what way the grant-giving organizations help them in this endeavor.

Research Question 1: What efforts are made on behalf of Armenian NGOs to secure and manage broader sources of funding enabling them to fulfill their mission consistently over time without excessive dependence on any single funding source?

To have a broader vision of the trends in the efforts of Armenian NGOs to diversify their financial sources, the NGO representatives were asked to provide an indication of their sources of revenue in 2004 and in 2008 (see chart 1). According to responses provided, 8 out of 20 NGOs (40%), whose sole source of revenue was donor funding in 2004, did not start to ensure financial sources other than foreign grants and the same picture, that is 100% of the budget formed via foreign grants, was observed in 2008 as well. Another finding is that 3 NGOs that originally received not only grants but also support from local businesses, in the form of funding for specific events and donations of space and facilities, did not ensure new sources of funding or at least did not continue their former practice, thus directing all their fund-raising efforts towards attracting grants only. This was explained by the representatives of the mentioned NGOs by the increased amounts of donor support that far outnumbered those of the local private donors. As a result, NGOs found it much easier to chase for foreign financing rather than lose time on attracting local support. Although reflecting the attitude of a smaller percent of the NGOs surveyed (15%), this finding is somewhat worrisome since it demonstrates that the increased donor support did not leverage increased community support, rather it killed the intentions of these NGOs to strive for that support.

According to findings, however, 45% of the NGOs surveyed were able to somewhat diversify their funding sources. Although the income generated from other financial sources made up only a small segment of their 2008 budget - 10 or 20%, these NGOs were able to get revenue from a diversified pool of resources - services provided, Government funding,

membership dues, private local philanthropy in the form of cash and in-kind donations and cooperation with the City Hall and Local Self-government bodies in terms of both services provided to the local bodies and grants received.



NGO financial plans:

Generally, NGO representatives turned to be quite optimistic about the future of their organizations expecting to become financially sustainable institutions, with 55% of the NGOs expecting to have stronger financial support and broader sources of funding. The overwhelming majority of the sampled NGOs (75%) reported also that their plans related to achieving financial viability differ from their present ways of fund seeking. Some of them (50%) envisaged less reliance (from 10% to 30%) on donor grants already in the upcoming 2009 year. The expectations for the next 4 years were even more encouraging: 14 NGOs (70%) reported that

they planned or at least expected to reduce donor dependency by 40 to 50% by 2012, while the leaders of two of the NGOs went even further – reflecting their plans of totally abstaining from foreign funding as a financial source for their organization by 2012.

Another finding is that 75% of the NGOs surveyed plan to seek (with 40% already having started to seek) donations from local businesses, 60% hopes for government support in terms of grants and another 15% plans to survive by their LLC incomes. Surprisingly enough, not many NGOs (only 10%) plan to attract Diaspora support.

However promising financial expectations of the NGO representatives may seem, they do not appear to be grounded. Certainly, today most of the NGOs understand the necessity of having a diversified pool of financial resources and they also expect for broader funding sources. Still, they seem to make not much effort to themselves turn their expectations into reality. The following findings come to support this perception.

When asked if their organizations possess or at least have in mind a plan for financial sustainability building, only 4 NGOs answered negatively. Out of the other 14 NGOs who do reported to have financial sustainability building plan, however, 6 NGOs could not tell what that plan specifically aims for or what mechanisms of financial sustainability building are envisaged by that plan. Another leader of one of the NGOs reported to have a plan for financial sustainability building. The plan, however, did not envisage new funding sources. What in fact it aimed at was the constant chase for foreign grants so as to be able to continuously secure grant-getting opportunities - obviously reflecting the limited perception about financial sustainability in general. The plans of the other 8 NGOs were elaborated only to seek for one additional funding source for their organizations – thus, 3 NGOs aimed at creating LLCs, 2 NGOs planned

to provide paid services in the future, and another NGO had just hired a specialist with good fundraising skills to develop the financial sustainability plan of their organization.

This study also aimed to find out if Armenian NGOs were aware of financial sources other than grants, practiced in other countries with successful experience. The findings pose serious concerns: 25% of NGO leaders were unable to name any financial source other than grants. While the financial sources mentioned by the representatives of another 50% were rather trivial – thus, 15% of NGOs named membership fees only, 15% – allocations from the state budget and 20% pointed to the donations from local businesses. Discouraging enough, only 20% of NGO leaders could name more than one funding source other than grants practiced in other countries, the sources mentioned being social partnership, social enterprise, private local philanthropy and endowments.

When asked what relevant skills and capacity have the NGOs developed so far to be able to make use of funding sources other than grants practiced in other countries and apply them in the Armenian context, 12 (60%) NGOs reported having developed neither any skill nor any capacity to take advantage of other financial sources. The other 8 (40%) NGOs stated that the skills they developed derived from the trainings, seminars and lectures provided by international organizations. They themselves, however, have not tried to develop any...

The NGO representatives were also asked to talk about their expectations from donor organizations and tell in what ways donors can contribute to the financial viability of their NGOs. NGO leaders expected from donors to: develop the institutional and human capacity of the NGO rather than finance some specific programs; invest in long-term programs and support the self-financing programs that NGOs themselves initiate. Although the NGO leader with the latter expectation also reported that his organization had not yet developed any self-financing

program, still, his anticipation of donor funding directed at organizational development and capacity building, prompts at least that the NGO was in a right direction.

Other suggestions to international donor organizations included: teaching NGOs how to wisely attract funding from different sources thus developing the fundraising capacities of the organization; lending a hand to the NGO initiative for bringing about legislative changes; introducing and developing the idea of endowment funds into the Armenian context; and one NGO leader proposed to organize seminars not for NGOs but for the government to change the attitudes and way of thinking of the latter. Another suggestion was to cut off the grant giving altogether, since as the NGO leader explained, only that could be a valid technique to make NGOs and government finally think about the financial sustainability of NGOs. This explanation, perhaps, reflects the dependency and the disincentive for some Armenian NGOs to pay attention to developing a strong base in their own society produced by the impressive amounts of donor funding.

Research Question 2: Does the existing legal framework foster Armenian NGOs in their attempts towards financial sustainability building?

Currently the legislative framework of NGOs consists of three laws – Law on Charity, Law on Foundations and Law on Public Organizations. Although the new Law on Public Organizations (2001) provides NGOs with more autonomy and freedom to function, mostly relating to the registration process and clear definition of NGO and its rights and obligations, some legislative issues involving the transition of NGO community to financial sustainability pose problems.

Thus, the RA Law on Public Organizations prohibits the right of NGOs for direct income generation. NGOs do have the right to engage in entrepreneurial activities but they are entitled to

do this only through participating in or creating a separate commercial organization that is Limited Liability Company (LLC) that will give NGOs the opportunity to generate funds for their budget. The income generated from the LLCs, however, is taxed by profit tax similarly as taxation of other businesses, with no differentiation between the two businesses (RA Law on Public Organizations, 2001). Still NGOs can use this right and use the after tax profits to support their NGO.

Another obstacle for fund-raising might serve the provision in the Law on public Organizations (2001), according to which NGOs cannot participate in tenders announced by government and have no right to provide paid services – they can only get subsidies (Blue, Ghazaryan 2004).

Another structural choice made in the Law is the lack of any broad based tax incentive to stimulate or reward Armenian public philanthropy and charitable giving (RA Law on Public Organizations 2001).

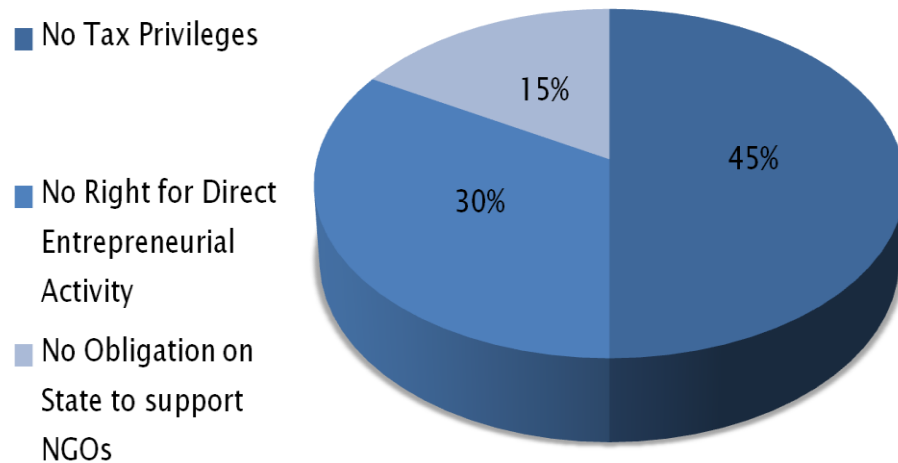
These are the concerns that RA Law On public Organizations raises. In this study an attempt was made to find out what the perception of the NGOs themselves is towards the law regulating their activities and what steps they take to challenge the provisions deemed to hinder them on their way to financial sustainability building.

The study shows that there is no consensus within the NGO community itself with regard to the legal environment regulating NGO financial operations in Armenia. Thus, if 50% of the NGOs sampled disagreed or strongly disagreed with the statement that the legal environment in Armenia supports NGOs on their way to financial sustainability building, the other 50% either agreed or strongly agreed with the same statement. Some of these NGOs even stated that RA law

creates a broad room for new opportunities which can wisely be made use of if one is enough knowledgeable and imaginative.

When asked to name the obstacles that the Armenian legal system presents to NGOs on their way to financial sustainability building (see chart 2), the most frequent obstacle mentioned by 45% of NGOs (9 NGOs) was the severity of the existing tax policy – NGOs emphasized the need for tax policy mitigations whenever income generated from NGO-created LLCs is taxed as well as the provision of NGOs with some tax privileges such as exemptions. Secondly, 30% of NGOs (6 NGOs) stated that they should be given the right to directly engage in entrepreneurial activities and provide services for fee. Another portion of the NGOs sampled (15%) considers that the State should be obliged by legislation to support the NGO sector in terms of favorable policies.

Chart 2



What is interesting but at the same time troubling to find out, however, is that none of the NGOs that are dissatisfied with the present legislation and consider it to be hampering them in

their attempts to be financially sustainable, have ever made any endeavor to change the present state of affairs - no campaigns launched, no NGO partnerships built, no lobbying for legislative changes, no drafts and proposals written, no public mobilization - nothing. And the only explanation of the “dissatisfied” NGOs is that it is not in the mission of their organization to advocate for changes in the law that has been by themselves identified as a hindrance to their financial sustainability.

Out of the other 50% of NGOs that perceived the legal environment being supportive to financial sustainability building efforts, two organization representatives stated to have undertaken actions directed towards legal reforms. One of them, for instance, reported to have investigated the existing legal environment as well as that of other countries, to have worked out a proposal for legislative changes and achieved relative success - 6 out of the 33 proposals were included in the law. These provisions and suggestions to the legal framework, however, were not related to non profits, not to speak even of being intended to be supportive of NGO financial sustainability building efforts...

Research Question 3: What strategies/plans/mechanisms are devised to be used by foreign donors in Armenia aimed at the financial sustainability building of Armenian NGOs and making their funding contingent on increases in Armenian based financial support?

Six major international donor organizations (Eurasia Foundation, OSCE, Soros Foundation, World Bank, UNDP, USAID) were asked if they have worked out or are working on a plan or mechanism that will aim at building or developing the financial sustainability of Armenian NGOs, will help them to diversify their financial sources and become less dependent on donor organizations themselves. The representatives of the 5 donor organizations answered that financial sustainability strengthening is not proclaimed a priority issue for their organization

at least in their strategy for the upcoming years. They do recognize NGOs as partners, they are ready to provide project based financing within the limit of certain topics, but the financial sustainability building is not in the goals or objectives of their organizations. Only for one of the organizations surveyed NGO sustainability building is recognized as a priority and a problem that is planned to be addressed within the upcoming 5 years, a priority that is pronounced by the organization's 2009-2013 strategy (USAID Strategy Paper on Programmatic Directions for 2009-2013, 2008). Still, when asked about the mechanisms for supporting NGO financial sustainability, the interviewee representing the organization answered that they are not clear on that yet and still do not have the funding to launch that endeavor.

Conclusion and Recommendations

Thus, it becomes apparent that NGOs in Armenia struggle with insufficient resources and for the most part, they find themselves limited to just one financial instrument—donation—and most of what they do is financed on a pay-as-you-go basis. Moreover, although already recognizing the need and importance of reduced donor dependency, NGOs do not take action to bring this need to life. On the one hand, they are mostly unaware of the broader range of financial tools that may be available and do not even make an effort to examine the field and insert the best practices into Armenian reality with necessary adjustments. On the other hand, they themselves do not develop relevant skills and capacity to be capable of ensuring new sources of funding, sometimes only making use of some seminars or trainings, again provided by international organizations...Furthermore, although many of them claim that the existing legal framework is to be blamed for not giving them the opportunity to strive for and rely on other sources of revenue, almost none of them, at least among the NGOs interviewed, launches any endeavor to change the current state of affairs. After all, since Armenian nonprofits are chronically undercapitalized and dependent on

foreign grants, they often do not achieve their objectives, that in turn makes it less likely they will receive the resources they need. And so the cycle continues...

The grant-giving organizations, on the other hand, although support and finance national NGOs in their short-term goals, within the scope of certain programs, rarely do they help them to build sustainability and assist NGOs in making the solutions once provided affordable and replicable in the future as well, not to speak of figuring out how to get them to a scale that fulfills the nonprofits' mission - a challenge that requires new strategies and new tools.

Therefore, the present study makes the following recommendations:

Recommendations to NGOs:

- ▶ Strengthening skills/organizational capacity to expand the scope of *fundraising efforts*;
- ▶ Developing and implementing *Financial Sustainability Action Planning*: a long-term financial sustainability action plan, a comprehensive work plan designed to provide NGOs with a business-oriented financial diversification plan with a clear sustainability vision, goals, objectives, indicators, issues and strategies. Only with a well thought out plan in place can NGOs acquire realistic, adaptable and usable strategic financial planning skills that will allow them to properly plan for a profitable financial future.
- ▶ *Lessons learnt* and exchange of experience;
NGOs should examine and become aware of financial sources, successfully practiced in other countries. This analysis and then brainstorming is necessary to help NGOs weed through different financial sustainability ideas and models before investing critical resources in ideas that never really had a chance of success in the first place.
- ▶ **Networking and coalition building** among NGOs to advocate and ensure a legislative framework that will support long-term growth - establishing a more secure and

supportive resource and regulatory environment. Thus, NGOs have to work with, and advocate to, governments in a proactive and participatory way to ensure they establish a legislative framework that supports long-term non-profit growth of their organization.

Recommendations to donor organizations:

- ▶ Taking serious and strategic measures to **strengthen financial sustainability of NGOs** with specifically tailored and focused donor programs. Donors' funding should reflect a greater recognition of the need for fortifying capacity - the strength of the NGO itself to develop and expand the programs and services, the ultimate objective of institutional development being to enable NGOs to become organizationally and financially sustainable and, thus, viable for the long term.

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Appendix A: Questionnaires for in-depth interviews

a. Questionnaire for NGOs

1. What were your main sources of funding in 2004 and in 2008?
2. What are your future financial plans? What financial sources do you expect or plan to rely on in 2009 and in 2011?

Type of source	% of yearly budget of 2004	% of yearly budget of 2008	% of yearly budget of 2009	% of yearly budget of 2012
Membership dues				
Revenues from services				
Private local philanthropy (cash, in-kind donations, from individuals, businesses, and foundations or other grant-making legal entities)				
Foreign donors				
Social enterprise				
Diaspora philanthropy				
Government funding				
Endowments				
Other				

3. Do you expect to decrease funding received from foreign donors by 2012? If yes, what percent decrease do you expect?

4. Does your organization currently have a plan/vision for financial sustainability building?

- a. Yes (go to question 6) b. No (go to question 5)

5. Do you plan to have or are you currently elaborating a plan that will aim at financial sustainability building of your NGO?

- a. Yes b. No (go to question 7)

6. What specifically it aims for or what mechanisms of financial sustainability building are envisaged by that plan?

7. What financial sources other than grants do you know that are practiced in other countries?

8. Are they applicable in the Armenian Context?

- a. Yes b. No

9. Explain why and how?

10. What skills and capacity have you developed so far to make use of such sources when applying them in the Armenian context?

11. Using your own personal opinion, would you say you strongly agree, agree, disagree or strongly disagree with the following statement: the legal environment in Armenia supports NGOs in their attempts to be financially sustainable.

- a. Strongly agree
- b. Agree
- c. Disagree
- d. Strongly disagree

12. What obstacles does Armenian legal system present to Armenian NGOs on their way to financial sustainability building?

13. If you had the chance to change one legal provision that would contribute to the financial sustainability of your organization, what it would be?

14. What activities have you ever initiated to eliminate the obstacles that the legal framework presents?

15. What do you expect from donor organizations: what can they do to support you on your way to financial sustainability building?

b. Questionnaire for international donor organizations

1. What strategies/plans/mechanisms are designed or thought of to be used by your organizations aimed at the financial sustainability building of Armenian NGOs?