Public funding of Civil Society Organizations in Latin America: How do we evaluate profitability?

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Abstract

For Latin American States, it is a common practice to channel public funds to Civil Society Organizations (CSOs) in order to meet various social needs. But what we do not understand comprehensively is the impact of this investment. We must deepen and analyze issues such as what is being financed? How CSOs use these resources? What is the impact on the individual beneficiaries of the CSOs? These are the questions we must answer if we intend to move towards optimizing the use of State resources for the common good of society in general. The main hypothesis from which we begin is not that the State generally invests little in CSOs; but instead that it invests incorrectly. If we are able to make this State funding for CSOs more efficient, in terms of positive social impact, we will make these organizations more socially profitable.

Introduction

For many Civil Society Organizations (CSOs), also called Non Profit Organizations (NPOs), a percentage of its annual budget comes from funds provided by the State (often referred to as grants). In fact, for some organizations, -which tend to be highly fragile- these contributions constitute their main source of income. Moreover, for various Latin American States (with the exception of Cuba, whose legislation does not contemplate the existence of CSOs), it is a common practice to channel public funds to these organizations in order to meet various social needs. This is not new; it has been happening for many years and this interaction is comparatively fairly uniform among the countries of the region and between their respective provinces / states / departments / regions / etc.

Where we do detect large variations is in the way that funding of CSOs is implemented by the State. It is not sufficient to analyze the amounts provided by the State or the percentages of the budget of the respective CSO recipients, in order to reach conclusions about the effectiveness or efficiency of these financing models. We must deepen and analyze issues such as what is being financed? How CSOs use these resources? What is the impact on the individual beneficiaries of the CSOs? How transparent is the account of the received funds? These are the questions we must answer if we try to move towards optimizing the use of State resources for the common good of society in general.

We must also ask ourselves which is the best way for the State to strengthen CSOs, so as to improve their performance towards this common good. After all, it is not uncommon to find organizations that received State funds for years and are also always on the verge of financial bankruptcy. In these cases, should we simply increase budgetary allocations or would it be better to concentrate on strengthening the institution to reach a more efficient financial management?

These kinds of questions are those that I wish to raise, and hopefully answer, in this paper. The main hypothesis from which we begin is not that the State generally invests little in CSOs; but instead that it invests incorrectly. If we are able to make this State funding for CSOs more efficient, in terms of positive social impact, we will make these organizations more socially profitable.

How does the State finance CSOs?

The starting point of this research was the work "Financing Organizations of Civil Society Organizations (CSOs) by the State in Argentina: What goals should be pursued?" (Beaumont, 2014)

The objective of this work was to survey the areas of investment by the State when it provides funding for CSOs, in order to better judge the effectiveness of the resources it consumes. Given that the State, at different levels, regularly invests significant amounts of money in a huge number of CSOs, it would be important to analyze the effect that this has on the organizations themselves and their beneficiaries. It will not have the same impact, for example, if the funding is used for institutional development of the CSO or that the organization is simply used as an intermediary to reach the final beneficiary. While the logic of government social programs is to channel public resources to individual final beneficiaries, when this is done through CSOs it is reasonable to analyze what percentage of these resources reach the beneficiary and what percentage is consumed in operating or management costs. If we can effectively analyze these interactions between the State and CSOs, it will be possible to understand or at least estimate, what the "social profitability" of the State´s investment is, and therefore optimize the allocation of resources. The research methodology consisted of a survey among members of various CSOs and government officials, using a questionnaire with open and closed questions.

Some of the results of the questions posed included:

-What sort of State resources has been received in the last 2 years? (You could indicate more than one)
In order of importance, participants elected:
1st Grants (money)
2nd Donations of goods and / or products for specific purposes
3rd Human Resources (volunteers)
4th Property lease
5th Technical Support
6th Debt forgiveness (mainly municipal taxes)
7th Training (direct and / or scholarships)

-In the case of grants, were they freely available or should they be used within the framework of a particular program?
Free availability: 7%
They were to be used in a given program: 93%

-In your experience, State funding is continuous or discontinuous?
Continuous: 14%
Discontinuous: 86%

-Do you think the State can better target funding for other needs of CSOs?
Yes: 97%
No: 3%

Moreover, in study published the following year (Beaumont, 2015), issues concerning training within CSOs also were surveyed:

-Do you think that you possess all the skills required for the tasks carried out within your organization?
Yes: 47%
No: 53%

Do you believe that there is an adequate supply of training for CSOs?
Yes: 8%
No: 63%
Yes, but too expensive: 29%

-Did you participate in any training (in the last 2 years) that specifically refers to CSOs?
Yes: 18%
No: 82%

If you did not participate in any training (in the last 2 years) that specifically refers to CSOs. Why?
Lack of time: 28%
Lack of resources: 51%
Found no interesting offer: 21%
Not interested: 0%

What areas do you think should be strengthened within your organization, both through training and technical assistance? (You can check more than one)

In order of importance, participants elected:

1 - Fundraising
2 - Tax issues and / or accounting
3 - General topics of management
4 - Institutional communication
5 - Legal issues
6 - Human resources
7 - Marketing

Some of the conclusions reached in this study included:

-The State funding is rarely directed to areas of technical assistance or training (direct and / or scholarships).

-However, there is an unmet need for specific training for CSOs, especially for the members of Committees / Boards of Directors.

-In general, the perception is that there is an inadequate supply of training for CSOs. However, there are an overwhelming majority of members of these organizations who are in need for specialized training.

-Therefore, promoting this training could positively influence the overall performance of these organizations, in terms of their impact on the common good for the communities in which each one works.

-Finally, the State could optimize resources by enhancing the institutional strengthening of Civil Society Organizations.

From all of this, we should delve into this area, analyzing the efficiency of social investments between the State and CSOs. The aim of this would be to try to analyze the effectiveness of State investment by providing funding for CSOs, in order to better understand the impact of the resources consumed on the final beneficiaries.

So, how do we evaluate State investment in CSOs?

Social profitability

Beyond the fact that the State regularly invests significant amounts of money in a huge number of CSOs, it is essential to analyze the effectiveness of this on each organization, its beneficiaries and society as a whole, giving priority to the efficient allocation of State resources. Although it seems that social investment is beyond traditional economic analysis, at some point we must try to analyze or at least estimate, what the “social profitability” of State investment is, as this may optimize the limited allocation of resources.

Talking about profitability when analyzing social benefits may seem out of place. However, having to cope with limited resources, any organization should prioritize the most efficient allocation thereof and from that premise, establish mechanisms that allow you to estimate the profit maximization. In 1989, as part of a research project on agricultural development at Stanford University, Monke and Pearson speak of profitability or social gain (“Social Profit”), defining it as the *“measure of efficiency or comparative advantage”* of the investment.

Obviously this cannot be analyzed with classic financial indicators for assessing the profitability of a private sector project, such as ROI (Return on Investment), IRR (Internal Rate of Return) or NPV (Net Present Value). In fact, unlike a commercial project, there is no financial formula to analyze the social benefits of a project. The evaluation of a social project should compare costs and benefits that an investment may have on a community and as a whole. But in addition to the direct benefits, one must take into account indirect, intangible effects (such as welfare in the community) and the (positive and negative) externalities generated by the project. This is perhaps where the greatest challenge lies, as Grinols & Mustard mentioned in their work “Business Profitability versus Social Profitability: Evaluating Industries with Externalities. The Case of Casinos.” (2001): *“Disregarding all components of social profitability is perhaps the most common mistake.”*

This is not the only problem; Hagan says that *“... the concept of social benefits implies that the project will generate a positive social surplus if, and only if, a greater contribution to domestic added value occurs instead of what these resources would have generated in the best alternative use. In essence, the problem of valuation is reduced to if market prices can be used to assess the social profitability.”* (Hagan, 2009)

Beyond the positive social impact generated by any project, both from the State and the private sector, a special attention is placed on the cost-benefit of those who undertaken by CSOs receiving public funding. For example, Philipson and Lakdawalla (2001) in “Medical Care Output and Productivity in the Nonprofit Sector,” spoke of *“the growing concern about productivity, or what is also called cost-effectiveness in the nonprofit sector,”* particularly dedicated to the health care industry.

Conclusions

Today, the dominant paradigm of State investment in CSOs is the “grant culture.” But this paradigm does not prove to be socially profitable, in terms of the percentage of public funds that reach the final beneficiaries, and a great amount of CSOs do not break the vicious circle of State-dependence. Instead, when we analyze the funding models of many “successful” CSOs, we see that the percentage of State funding (if they have any), is minimal.

The State does not invest little in CSOs, it invests wrongfully. Paraphrasing an ancient proverb "it gives away fish instead of teaching people how to fish."

Why not change the paradigm? By investing in institutional strengthening through training we could improve CSOs performance and their social impact.

This would have a double benefit for the State. First, it would provide a network of efficient CSOs in the provision of public goods in order to meet various social needs. This, over time, would save money as the provision of public goods through CSOs reduces State spending. Second, you also save money by not having to eternally subsidize inefficient organizations.

However, as expressed by Kuhn (1970), a paradigm shift implies a change in the way a given society organizes and interprets reality, and this change does not occur overnight.

In the sequence determined by Barker (1999), when a paradigm shift occurs, the first thing we can see is that *"the established paradigm begins to be less effective and the affected community is aware of the situation and start to lose confidence in the old rules."*

In a next step, *"those who have created or identified the new paradigm offer their solutions."* With 13 years of experience in the training of CSOs, we have found that education is a unique method for institutional strengthening and development of these organizations.

He also states that *"One of the new paradigms demonstrates the ability to solve a small set of problems that the old paradigm failed to resolve."*

To check if this paradigm proposed works and is really effective, it remains up to the State to put this to the test.

"In times of crisis people expect, actually demand, major changes," he concludes. The "grant culture" does not work. Civil Society Organizations require a paradigm shift to achieve a new relationship with the State: one of independent cooperation.

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