TECHNICAL NOTE

Resource Mobilization in CSOs Part II • Nov. 2012

Contributing to stronger, more sustainable, country-led HIV/AIDS programs

*This Technical Note, as part of the November 2012 Capacity Building Knowledge Exchange eAlert, is the second in a three part series which focuses on **resource mobilization in civil society organizations.***

In the first technical note in the resource mobilization series sent to you on November 6, 2012, we provided an overview of resource mobilization and five broad methods that a civil society organization (CSO) can use to obtain funding. This issue focuses mainly on **cost recovery strategies**. Cost recovery strategies can only be successful if an organization has a strong financial management system involving 1) controlling, 2) conserving, 3) allocating, and 4) investing an organization's resources. An organization's resources can include personnel, equipment, supplies, and non-monetary contributions, such as goodwill, intellectual property, and in-kind donations. It is the role of an organization's financial management team to maintain a balance between the money and funding an organization receives and its financial outlays.

Today, many non-profit, non-governmental, and civil society organizations are attempting to address the challenges of recovering their operating costs by diversifying their revenue streams and seeking new and expanded markets for their products (goods) and services.

There are 4 steps to cost-recovery:

1. Analyze financial reports to identify funding gaps
2. Explore untapped sources of revenue in your organization's value chain
3. Develop a new business model for the business opportunity
4. Draft a compelling business plan to generate funding for your new business opportunity

Analyze financial reports to identify funding gaps

There are three essential financial reports in any organization: the Balance Sheet, the Income Statement, and the Statement of Cash Flow. Although you may not be completely familiar with your organization's financial statements, the purpose of the next section is to help you converse more easily with your finance staff, so together, you can identify funding shortfalls or gaps.

A **Balance Sheet** is always divided into two parts. The top half shows the organization's assets, while the bottom half shows the organization's liabilities and equity. The balance sheet can be understood as:

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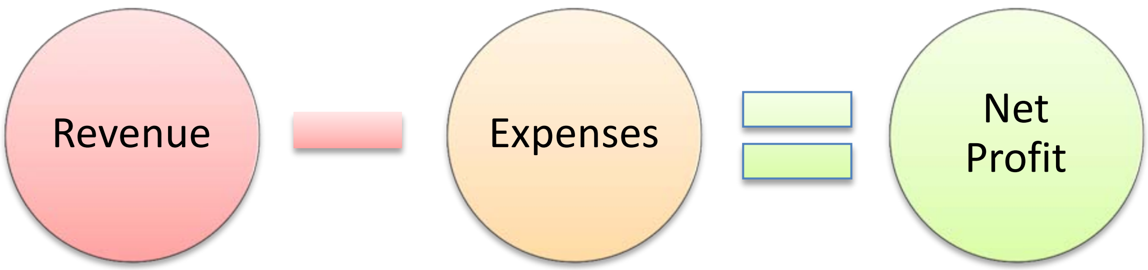
The top and the bottom halves are always in balance; that is, they add up to the same amount. This is because the top half shows what the organization owns and what others owe the organization; while the bottom half shows what the organization owes and has to pay-out. The entries under each line of the balance sheet provide important information about the financial health of the organization.

In short, the Balance Sheet simply breaks all the financial and material assets into those that you own and those that you owe. They balance because the money that comes into your organization is often used to pay for services, salaries, benefits, inventory, etc. If there is money left over, it goes into your fund balance, or reserves, which, if not used in the fiscal year, often need to be returned to the donor or reinvested (spent on the organization). Therefore, any money that comes in will have a destination, which is why the balance sheet does, in fact, balance.

An **Income Statement** records all the revenue your organization earns and the expenses it incurs over a predetermined period of time. By adding all the revenue your organization receives from selling goods or services and then subtracting the total cost of operating your organization, the income statement shows net profit, which can be expressed as:



The income statement should cover a period that makes the most sense for your organization. The fund balance, which is reported at the bottom of the balance sheet, allows an organization to sustain its current services, survive in periods of low cash flow, and reinvest money in the organization for important new activities and projects.

Simply put the Income tells you where your money goes once it comes into the organization. Any money left over at the end of the reporting period goes into the fund balance (also known as "equity" on the Balance Sheet).

The **Statement of Cash Flows** monitors the flow of cash in and out of your organization over a period of time. This statement also identifies the sources and uses of your organizations cash. Having income after expenses, also known as profit, does not mean that an organization has cash readily available to support new activities or projects. If too many of your organization's assets are tied up in your inventory, (e.g. equipment and property), or if you do not generate enough revenue to meet your regular operating costs (personnel, supplies, rent, utilities, promotion), an organization may have difficulty meeting short-term expenses and may even run out of cash.

As you review these financial statements with members of your finance department, discuss the following questions:

- What are the costs associated with delivering a product or service, or implementing a project or program?

- How can we better manage our resources in order to reduce excessive costs?
- What are our sources of revenue? Are they sufficiently diversified?
- What is the breakdown in revenue from contracts and grants and the sale of products and services?
- What is the relationship between the fee we charge (if any) and the cost of providing a service?
- How will client demand for products or services increase or decrease if fee structures are changed?

This analysis will help you identify funding short-falls, i.e. where are costs exceeding revenues? What activities or programs are at risk of being underfunded?

Examine your Value Chain to identify new business opportunities

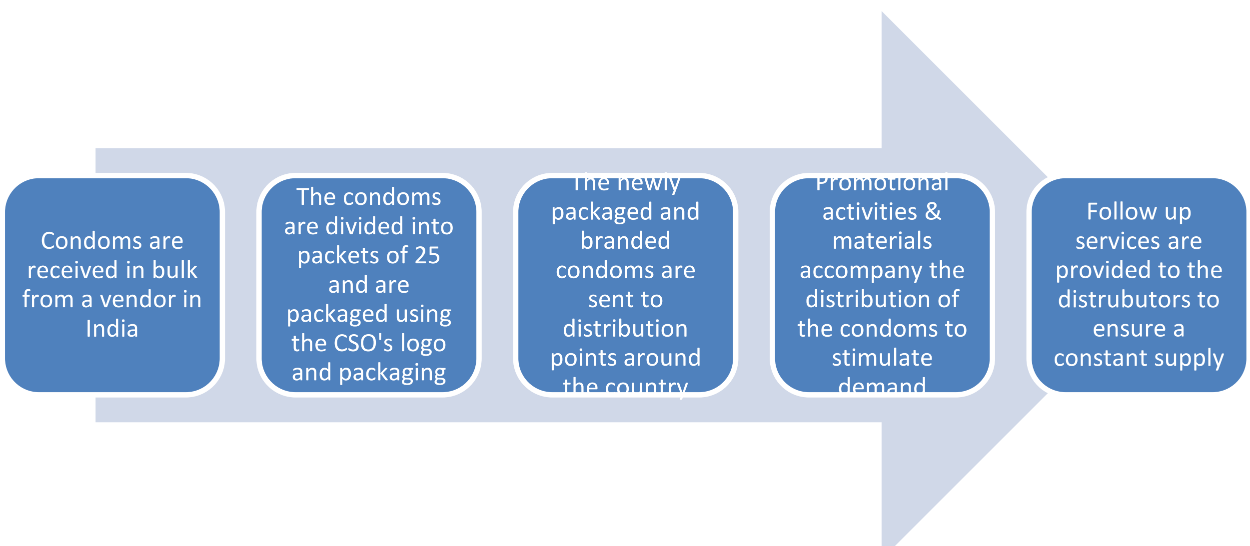
Once you have identified the funding short-fall, either due to reduced demand for fee-based products and services, or the termination of donor-funded programs and projects, it is time to look at your value chain for new business opportunities.

A **Value Chain** is a chain of activities for an organization operating in a specific industry or sector. A value chain is comprised of a series of activities that convert incoming goods or base materials into products and services that are of value to clients. A value chain typically consists of[1]:

1. Goods coming into the organization as base materials, such as supplies
2. The transformation of those goods into products and services that meet client needs
3. The distribution of these products and services to the clients
4. Promotional activities to make clients aware of these products and services
5. Client support and follow-up

An example of a value chain is found in **Figure 1** below.

Figure 1: An Example of a Value Chain for the Distribution of Condoms



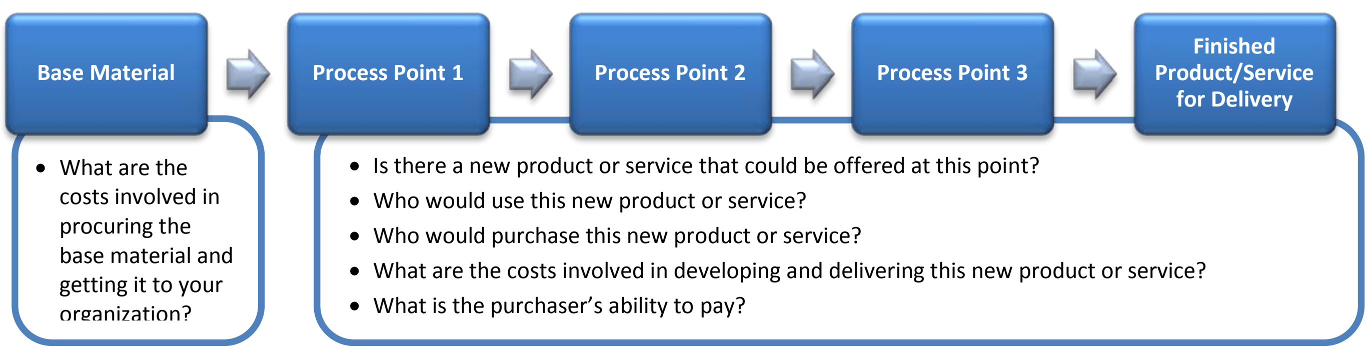
[1] http://www.businessdictionary.com/definition/value-chain.html#ixzz2B4DQrVXF

Incoming goods pass through all activities of the chain in order, and at each activity, the good gains some value, resulting in useful products and services. The chain of activities gives the products and services more added value than the sum of the value of the independent activity.

To explore the value chain of your organization, first identify one of your main services, such as conducting field research, delivering Maternal Child Health care, or designing capacity building programs. Let's say that one of your core services is providing small enterprise development program to People Living with HIVAIDS (PLHIV).

How can you convert this into cost-recovery endeavor? Here are some steps to take (see **Figure 2**):

Figure 2: The Value Chain and Cost-Recovery



Let's take this example of providing small enterprise development program for PLHIV and apply it to the value chain model above.

1. **Incoming Goods or Base Material: Inputs to Design.** Review your organization's financial statements, particularly the income statement, to establish the costs of the basic materials needed for designing the small enterprise development program for PLHIV. This would include: staff time, materials, editing and layout costs, and production costs.

2. **Process Point 1: Developing the Curriculum.** As you convene your curriculum development team, look at the modules and tools contained in the small enterprise development program for PLHIV and ask the following questions:
    - Is there a new product or service that could be offered at this point?
    - Who would use this new product or service?
    - Who would purchase this new product or service?
    - What are the costs involved in developing and delivering this new product or service?
    - What is the purchaser's ability to pay?

    You may find that the program contains a nice module on market research that could be offered as a unique new service to other CSOs or to small businesses seeking to understand the market reach of a new product or service. The costs for repackaging this market research module for a paying clientele would be minimal, since it already exists and has been tested in the market. Still, you would have to do some market research to determine if the module needs to be refined in any way, the best delivery mechanism, and the ability of the market to pay for such a service.

New Business Opportunity #1: Offering market research services and capacity building to small businesses.

3. **Process Point 2: Package the Curriculum.** Once the curriculum is developed, think about how you package the curriculum. Is it packaged as a manual, a CD-ROM, a binder? Does your organization have the in-house expertise and facilities to package training curricula for client organizations? Perhaps there are other training organizations or institutions of higher learning that need help packaging their capacity building materials. Perhaps they want to deliver virtual or blended learning programs and need help with this. Again, you need to ask the driving questions:
    - Who would use this new product or service?
    - Who would purchase this new product or service?
    - What are the costs involved in developing and delivering this new product or service?
    - What is the purchaser's ability to pay?

New Business Opportunity #2: Offering curriculum packaging advice to training organizations and institutions of higher learning.

As you continue to review the process for developing and delivering the small enterprise development program for PLHIV, you will undoubtedly find more core functions that can be sold to a target market, such as training of trainers, financial management of small enterprises, scaling a small enterprise, etc.

Once you identify the new business opportunities you should conduct a **Competitive Scan**[2] of each to determine their likelihood of thriving in a competitive marketplace.

The competitive scan considers four critical criteria:
1. client demand
2. ease of entry
3. cost of failure
4. threat of competition

Within each of the four criteria, there are several factors to help you decide the competitive positioning of the new product, service, or market segment.

1. **Client demand**
   This criterion looks at the power of the buyers (clients), in terms of their potential number and their ability to pay for your organization's new or current product or service. It also assesses the availability of substitutes offered by competing organizations. Ideally, you should introduce your

[2] Adapted from Michael E. Porter, Competitive Advantage, New York: The Free Press, 1985.

new or current product or service to a large and growing market that has access to few substitutes and has an ability to pay for any product or service.

Specifically, this criterion is composed of:

- Potential size of market
- Availability of substitute products or services
- Clients' ability to pay

Client Demand		***Least likely to succeed***	***Neutral***	***Most likely to succeed***		**Evidence to support ranking**
Potential size of market	**Small**				**Large**	
Availability of substitutes	**Many**				**Few**	
Clients' ability to pay	**Low**				**High**	

2. Ease of entry

This criterion looks at the barriers you need to overcome to gain entry in to the sector in which you do not already have an established market. If your new product, service, or market segment will require you to enter in to a new sector, such as microfinance, environmental health, or agriculture, you need to examine the potential barriers you may confront. This will help you determine the level of attractiveness of the new products and/or services.

Specifically, this criterion is composed of:

- Brand identification or identity (i.e. will clients recognize your organization?)
- Relationship to existing products or services
- Access to distribution channels (i.e. do you have pre-existing distribution channels that you can utilize?)
- Access to appropriate technology (i.e. medical devices, laptop computers, etc.)

Ease of Entry		*Least likely to succeed*	*Neutral*	*Most likely to succeed*		**Evidence to support ranking**
Brand identification or identity	**Low**				**High**	
Relationship to existing products or services	**Weak**				**Strong**	
Access to distribution channels	**Restricted**				**Ample**	
Capital requirements	**High**				**Low**	
Access to appropriate technology	**Restricted**				**High**	

3. **Cost of failure**

This criterion looks at the barriers you may need to overcome to phase out the new product or service, or to exit from a new sector or market segment if you do not succeed in attracting clients, or if funding is not available. Ideally, the cost of exit should not out-weigh the possible social or financial gains to be made from the organization's investment in developing the new product or service, or entering a new market or sector.

Specifically, this criterion is composed of:

- Degree of product or service specialization (i.e. is a high degree of specialization required? The more specialization, the higher the cost.)
- Cost of exit
- Strategic relationship with other organizations (i.e., can you partner with another organization that already works in the new market segment or that has already established distribution channels?)
- Emotional barriers
- Investment made in complying with government regulations

Cost of Failure		*Least likely to succeed*	*Neutral*	*Most likely to succeed*		Evidence to support ranking
Degree of product or service specialization	**High**				**Low**	
Cost of exit	**High**				**Low**	
Strategic interrelationship with other organizations	**Many**				**Few**	
Emotional barriers	**High**				**Low**	
Investment made in complying with government regulations	**High**				**Low**	

4. **Threat of competition**
This criterion looks at the relationship of your competitors to your organization in terms of the number of competing organizations, the degree to which their products or services are specialized, the growth of the target market, and the diversity of the competition. Specifically, this criterion is composed of:
    - Number of competitors)
    - Growth of target market
    - Product features
    - Emotional barriers
    - Service features

Threat of Competition		*Least likely to succeed*	*Neutral*	*Most likely to succeed*		Evidence to support ranking
Number of competitors	**Large**				**Small**	
Growth of target market	**Slow**				**Fast**	
Product features	**Common**				**Unique**	
Service features	**Common**				**Unique**	

The Competitive Scan requires that evidence (data) be presented for all variables corresponding to each of the four criteria. The product or service that gets the highest score is that which is most likely to be successful.

Overall Assessment		***Least likely to succeed***	***Neutral***	***Most likely to succeed***		**Evidence to support assessment**
Client Demand						
Ease of Entry						
Cost of Failure						
Threat of Competition						

Develop a new business model for the business opportunity

Now it is time to create a viable business model for your new business opportunity. This business model will include: your mission, product and service scope, market scope, geographic scope, revenue points and sources, and marketing mix. **Figure 3** below is a template for how to view your organization's business model.

Figure 3: Business Model Template

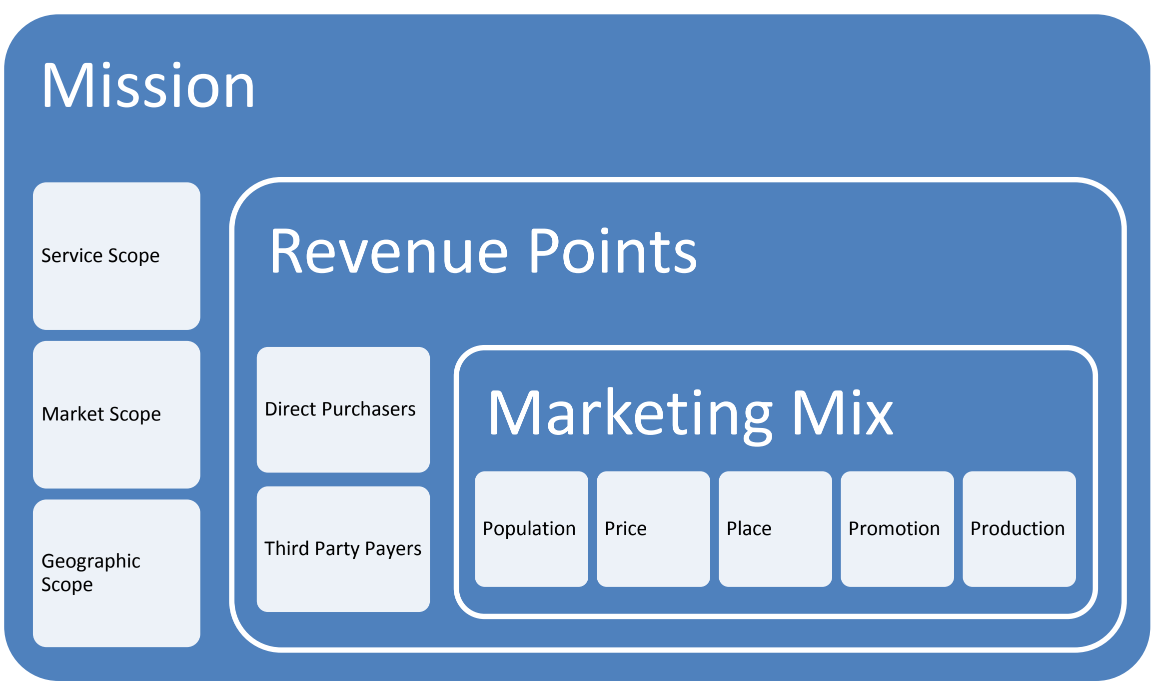


Figure 4, below, provides an example of a completed business model, based on the idea of spinning off market research services and capacity building.

Figure 4: Sample Business Model

The sample business model above illustrates that this new business opportunity can be an effective source of revenue to recover costs incurred by delivering the small enterprise development program for PLHIV – a clientele that cannot easily pay for these services. By spinning off a portion of the program to a new, paying clientele, surplus revenue can be reinvested in two activities: 1) the core enterprise development program, leading to greater organizational self-sufficiency; and 2) the development of a virtual market research training curriculum for small businesses that would reach a greater market at a reduced cost, leading to an increased margin.

Draft a compelling business plan to generate funding for your new business opportunity

Like positioning for and responding to a competitive procurement such as a request for proposals (RFP) or a request for applications (RFA), drafting a business plan is a fairly involved process.

A **Business Plan** is a plan used to secure funding for a new business opportunity to be offered by the organization, or to expand current products and services to new or larger markets. The business planning process makes it possible for an organization to advance its mission, while meeting market needs.

Once you have identified a “good bet” business model for recovering costs through the delivery of a new product or service, you may want to secure some seed funding to launch this new business opportunity. For example, you may need to increase office space, procure high-powered computers and complex data analysis software, if you decide to offer market research services. Likewise, you may need to purchase special production equipment if you decide to offer curriculum packaging services. These are what are considered start-up costs that will help you launch the new service, so you can begin generating revenue.

A business plan is a good way to secure start-up funds. A strong business plan generally includes six chapters, each concisely written and punctuated with clear graphics and figures.

- **Chapter 1: The Organization's Mission** – This chapter describes the unique features of your organization to engage a prospective funder or investor. It includes information on the current array of products and services the strategic positioning and core competencies of your organization.
- **Chapter 2: The Business Opportunity** – This chapter outlines the new business opportunity, and its competitive edge in the marketplace. It also explains why your organization is uniquely capable of delivering this new product or service.
- **Chapter 3: The Market for the Business Opportunity** – This chapter contains the findings from your market research and shows the potential demand and price points for the new product or service. It also describes your marketing plan, the messages and media you will use to communicate the availability and benefits of your new product or service.
- **Chapter 4: The Design Team and Implementation Schedule** – This chapter details the unique skills and qualities of the design and implementation team, and provides a clear schedule of activities that will lead up to the eventual launch of the new product or service.
- **Chapter 5: The Financial Requirements for the Business Opportunity** – This chapter covers the presentation of your organization's financial statements to ensure goodwill and to demonstrate financial absorptive capacity. The chapter also includes a comprehensive budget outlining the financial requirements for launching the new product or service.
- **Chapter 6: The Social and Financial Return Projections** – This chapter highlights the measurable improvements in health status, access to services, and quality of care that will result from the target population using your new product or service. The chapter also articulates the anticipated financial return on investment from the sale of the new product or service to end users or third party payers. This chapter must contain data that will show projected changes in baseline figures, demonstrating the success of the new product or service in contributing to your organization's mission

More information on business planning will be offered in the upcoming technical note, the third in a series on resource mobilization. If you have any questions on material presented in this technical note, please feel free to contact us at AIDSTAR-Two@msh.org.

APPENDIX: Financial Statements

The Balance Sheet

Better Health International		
Balance Sheet	**2012** *Local Currency*	**2012** **US $**
exchange rate used	1	8.25
ASSETS		
Current Assets		
Cash (Bank Accounts)	812,759	98,516
Accounts Receivable	89,201	10,812
Inventory	256,186	31,053
Total Current Assets	1,158,146	140,381
Fixed Assets		
Other Fixed Assets	340,601	41,285
Equipment	1,536,913	186,292
(Less accumulated depreciation)	(309,099)	(37,467)
Total Equipment	1,227,814	148,826
Total Fixed Assets	1,568,415	190,111
TOTAL ASSETS	2,726,561	330,492
LIABILITIES		
Current Liabilities		
Accounts Payable	408,998	49,576
Credit Line	-	-
Current Portion Long-Term Debt	57,815	7,008
Total Current Liabilities	466,813	56,583
Long-Term Liabilities		
Long-Term Debt	169,079	20,494
Total Long-Term Liabilities	169,079	20,494
TOTAL LIABILITIES	635,892	77,078
EQUITY		
Fund Balance	2,090,669	253,414
TOTAL EQUITY	2,090,669	253,414
TOTAL LIABILITIES & EQUITY	2,726,561	330,492

The Income Statement

Better Health International		
Income Statement	**2012** *Local Currency*	**2012** **US $**
exchange rate used	**1**	**8.25**
Revenue		
Clinic-based services	4,600,000	557,576
Ancillary services	506,180	61,355
New Product or Service	-	-
Total Revenue	5,106,180	618,931
Grants / External Funding		
Existing Financing	250,000	30,303
Financing for New Product or Service	-	-
Total Grants/External Funding	250,000	30,303
Total Revenue (including Grants/External Funding)	5,356,180	649,234
Costs		
Direct Costs		
Direct Labor	750,000	90,909
Other Direct Costs	1,536,913	186,292
Inventory	-	-
Total Direct Costs	2,286,913	277,202
Gross Operating Margin	3,069,267	372,032
Indirect Costs		
Indirect Labor	725,000	87,879
Administrative	460,000	55,758
Corporate	200,000	24,242
Depreciation	150,000	18,182
Facilities	595,620	72,196
Marketing and Selling	256,000	31,030
Other Indirect Costs	435,220	52,754
Total Indirect Costs	2,821,840	342,041
Net Operating Margin	247,427	29,991
Other Costs		
Interest Expense	-	-
Unallowable Expenses	75,000	9,091
Total Other Costs	75,000	9,091
Total Revenue in Excess / (Deficit) of Expenses	172,427	20,900

The Statement of Cash Flows

Better Health International		
Statement of Cash Flows	**2012** *Local Currency*	**2012** **US $**
exchange rate used	**1**	**8.25**
Cash In		
Operating Activities		
Cash Received From Billings (90%)	5,106,180	618,931
Accounts Receivable (10%)	89,201	10,812
Total Cash From Operating Activities	5,195,381	629,743
Financing Activities		
Credit Line	-	-
Total Cash From Financing Activities	-	-
Investment Activities		
Grants / External Funding	250,000	30,303
Unprogrammed Funding	-	-
Sale of Used Equipment	-	-
Total Cash From Investment Activities	250,000	30,303
Total Cash In	5,445,381	660,046
Cash Out		
Operating Activities		
Direct Labor	750,000	90,909
Indirect Labor	725,000	87,879
Accounts Payable	3,633,753	440,455
Inventory	256,186	31,053
Total Cash For Operating Activities	5,364,939	650,296
Financing Activities		
Interest	75,000	9,091
Credit Line	-	-
Long-Term Debt	-	-
Total Cash For Financing Activities	75,000	9,091
Investment Activities		
Equipment	-	-
Total Cash For Investment Activities	-	-
Total Cash Out	5,439,939	659,387
Cash Flow Activity		
Beginning Cash Balance	807,317	97,857
Ending Cash Balance - Operating Funds	812,759	98,516
External Funding Sources (Detail)		-
	-	-