



CIVIL SOCIETY INDEX INITIATIVE

Case study

Financial Sustainability of Armenian CSOs



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FINANCIAL SUSTAINABILITY OF ARMENIAN CSOs: FROM DEPENDENCY TO AUTONOMY



**YEREVAN
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2010**



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**Civil Society Index
National Implementation Team
at Counterpart International / Armenia**

**Mane Tadevosyan (Researcher)
Lusine Hakobyan (National Coordinator)**



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Financial Sustainability of Armenian CSOs: from Dependency to Autonomy

Introduction

Projections about the intrinsic stability and efficiency of Armenian civil society usually revolve around the issue of financial sustainability - the most important issue facing the sector today. Throughout the development of Armenia's civil society sector, nonprofit organizations have repeatedly been reported to be financially insecure institutions, heavily dependent on foreign donor organizations.¹ A striking departure on such previous findings was however discovered during the current implementation phase of the CIVICUS Civil Society Index (CSI) which showed that 88.5% of Armenian civil society organizations (CSOs) do have a stable financial resource basis. However, it is important to note that the CSI only looks at financial stability (through changes in resources and expenses)

1 For reference see for example, Blue, R., Ghazaryan, Y. (2004): *Armenia NGO sector Assessment: A Comparative Study*. World Learning for International Development/ NGO Strengthening Program, Yerevan. Aslanyan, S., Adibekian, A., Ajabyan, N., Coe, B.A. (2007): *Civil Society in Armenia: From a Theoretical Framework to a Reality*. CIVICUS: World Alliance for Citizen Participation and Center for the Development of Civil Society. Eurasia Partnership (2009): *Evaluation of DOC (Development of Organizational Capacities) and RCCD (Resource Centers for Community Development) programs*, Yerevan.

to determine financial sustainability. Therefore this case study was designed in order to delve deeper into the issue and resolve this discrepancy between the CSI finding and previous studies on the financial sustainability of Armenian CSOs. To do this, the case study also addresses financial diversification of the CSO resources and claims that financial stability does not always translate into financially secure functioning of CSOs especially in single-donor dependent contexts such as Armenia. This is because:

1. Recent studies suggest that CSO financial stability and sustainability can only be achieved if an organization has a diversified funding base. The most “sustainable” financing strategy consists of diversifying sources of income and minimizing dependency on any single source – thus reducing vulnerability to shifts in the fund availability or donor preferences.²
2. An analysis of the quantitative data from the current implementation phase of the CIVICUS CSI project further suggests that stability does not always mean sustainability and security. In this respect three of the CSI organizational survey’s³ findings are particularly noteworthy. First, five of the CSOs (4.4%) were

2 For reference see for example: Lee, D. (2008): *The NGO Entrepreneur: Nonprofit in Purpose, For-Profit in Approach*. Retrieved October 20, 2009 from <http://www.isar.org/pubs/ST/NGOselffunding48.html> or Layton, C. (2006): *A New Paradigm in Developing Country: NGO Financial Sustainability*. Policy Brief #51: The William Davidson Institute at the University of Michigan Business School.

3 The purpose of the CSI organisational survey is to explore the data relating to the operations and governance of CSOs, among other items. Sample organisations are selected according to the regional coverage, diversity and a range of civil society organisation types and characteristics.

shown to be financially stable institutions by the CSI organizational survey.⁴ However, the survey data also indicates that they had neither revenues nor expenses during the past year. Thus, the financial resource base of these organizations was stable so far as they were stably undercapitalized.⁵ Second, the revenues of twenty-four (21.2%) of the surveyed CSOs⁶ decreased in 2008 as compared to 2007. Their expenses also decreased, likely as a result of the revenue cuts. Thus, they were shown to have a steady resource base only because of, and at the expense of, curtailed spending. Third, a significant percentage of the interviewed CSOs for the study, despite having stably secured their budgets in 2007 and 2008, either totally or extensively relied on foreign donors.⁷ Such extensive reliance on a single source of revenue, even if stably secured, jeopardizes the independent functioning and long-term security of an organization. CSOs with single source of revenue are more dependent on donor preferences and agendas, more susceptible to donor priority shifts, reduced resources or unavailability of funds.

This study suggests that a sustainable approach to

- 4 Counterpart International/Armenia National Implementation Team (2010): *The CIVICUS Civil Society Index report for Armenia: Phase 2008-2010*. Data retrieved from the CIVICUS CSI organizational survey.
- 5 There are community-based or volunteer based organizations in Armenia which, despite scarce resources or none at all, continue functioning due to the dedicated human capital only.
- 6 21.2% of the interviewed CSOs (Counterpart International/Armenia National Implementation Team (2010): *The CIVICUS Civil Society Index report for Armenia: Phase 2008-2010*. Data retrieved from the CIVICUS CSI organizational survey).
- 7 The sole source of revenue for 18.6% of CSOs in the organizational survey was reported to be external donor funding. Another 21.3% of interviewed CSOs secured the greatest part of their budget (from 60 to 90%) via external funding (Counterpart International/Armenia National Implementation Team (2010): *The CIVICUS Civil Society Index report for Armenia: Phase 2008-2010*. Data retrieved from the CIVICUS CSI organizational survey).

CSO financing is one that strikes a balance between externally and internally generated resources in order for a CSO to meet its expenses while maintaining the freedom to determine its priorities and projects. For the purposes of this study, financial sustainability is defined as the ability of a civil society organization to secure sufficient resources for its operations without excessive dependence on any single funding source. The case study hypothesizes that Armenian CSOs are in fact not financially sustainable institutions. This case study will also reveal the obstacles to and opportunities for CSO fundraising and sustainability-building efforts presented by the environment that Armenian CSOs operate in. In particular, the foci of this study are: the recently emerging effort to strengthen government-CSO collaboration and the consequent opportunities for social contracting as well as the legal barriers to CSO fundraising endeavors.

Literature Review

Sustainability is perhaps one of the most significant concerns CSOs face in the 21st century all over the world. Thinking about the importance of sustainability, especially in the framework of financial sustainability, is vital if nonprofit organizations truly

want to continue to secure enough funding to survive institutionally, provide quality services that support their constituency, and maintain a mission-driven purpose.⁸

The issue of financial sustainability has recently become a top issue of discussion and concern for civil society because (a) donor resources available to nonprofit organizations continue to decrease; (b) donor agencies worldwide have shifted and narrowed funding into specific, highly political or publicly popular regions of the world; (c) there is heightened competition between nonprofit organizations for increasingly limited funding; and (d) donors worldwide have become less willing to fund traditional overhead expenses (salaries, rent and equipment), forcing CSOs to chase more and more donor funds rather than develop long-term program strategies that support their mission.⁹

According to CIVICUS CSI findings (phase 2003-2005), financial resources for CSOs are limited in most regions of the world. The problem is especially pervasive in the countries of post-communist Europe and Eurasia where CSO work is often donor-driven.

8 Layton, C. (2006): *A New Paradigm in Developing Country: NGO Financial Sustainability*, Policy Brief #51: The William Davidson Institute at the University of Michigan Business School.

9 Layton, C. (2006): *A New Paradigm in Developing Country: NGO Financial Sustainability*, Policy Brief #51: The William Davidson Institute at the University of Michigan Business School.

The death of the Soviet system opened up sources of financial support, especially from Western Europe and the United States, to nurture the growth of civil society. Further, state support and other forms of contributions, such as individual donations or corporate social responsibility, are extremely minimal in the region. These factors have left CSOs with little choice but to find funds from international funding, which in turn has led to an increasingly strong role for donors.¹⁰

International donor funding is the major source of CSO revenue in Armenia as well. Many studies on the civil society sector show that Armenian CSOs are financially insecure institutions.

For example, a study carried out in 2004 concluded that long-term financial viability is the most pervasive issue in Armenia's non-profit sector. It also stated that most of the support for the sector comes from international donors.¹¹ Another study in 2005 demonstrates that about 4/5 of CSOs in Armenia have a chronic shortage of financial resources. It reiterates that a lack of substantial financial contributions from local sources has forced CSOs to rely heavily on international donors.¹²

10 CIVICUS Civil Society Index Team (2006): *CIVICUS Civil Society Index: Preliminary Findings Paper Phase 2003-2005*, Johannesburg: CIVICUS. Retrieved October 20, 2009 from <http://www.civicus.org/new/media/ICSI%20paper.pdf>

11 Blue, R., Ghazaryan, Y. (2004): *Armenia NGO sector Assessment: A Comparative Study*, Yerevan: World Learning for International Development/NGO Strengthening Program.

12 Aslanyan, S., Adibekian, A., Ajabyan, N., Coe, B.A. (2007): *Civil Society in Armenia: From a Theoretical Framework to a Reality*. CIVICUS: World Alliance for Citizen Participation and Center for the Development of Civil Society.

The USAID NGO Sustainability Index shows a slight positive shift in financial viability of Armenian NGOs over three consecutive years. In 2005 the score for the sector in terms of ‘financial viability’ was 5.5 on a seven-point scale (with 7 indicating a low or poor level of sustainability and 1 indicating a very advanced NGO sector), in 2006 it was 5.4 and in 2007 it was 5.2.¹³

Such a positive shift may be attributed to the efforts of a number of international donor organizations operating in Armenia to develop the financial and institutional capacities of Armenian CSOs. For example, the USAID Civic Advocacy Support Program (CASP) implemented by Counterpart Armenia has taken up the mission of supporting the development of strong intermediary service organizations (ISOs) and non-governmental organizations (NGOs), one of the programmatic functional areas being the financial sustainability of these CSOs. Realizing the importance of diversifying the funding sources so as to not rely on only one source, selected ISOs and NGOs were urged to seek opportunities for alternative funding sources. To this end, ISOs and NGOs also received various trainings and consultations on proposal

¹³ United States Agency for International Development (2005, 2006, 2007): *The NGO Sustainability Index for Central and Eastern Europe and Eurasia*, Yerevan: USAID, Bureau for Europe and Eurasia Office of Democracy, Governance and Social Transition. Retrieved September 10, 2009 from http://www.usaid.gov/locations/europe_eurasia/dem_gov/ngoindex

writing, fundraising, financial sustainability, logical framework and project management to acquire the necessary skills and capacities to fundraise. The Performance Monitoring Plan conducted by Civic Advocacy Support Program throughout the whole program from 2005 to 2009 showed that while in 2005 the ISOs and NGOs benefited from only one source of income, from then on they were successful in continuously attracting several (from three to four) new ones. Financial sustainability promoting efforts by donor organizations have not, however, resulted in tangible improvements in the sector at large. A study conducted in 2009 still suggests that international funding is regarded as a major source of revenue by Armenian nonprofit organizations.¹⁴

Thus, the CIVICUS CSI organizational survey's finding, which showed that the vast majority of Armenian CSOs are financially stable, is contradicted by all these previous studies that found that Armenian CSOs are financially unsustainable institutions. Therefore this case study is designed to take a closer look at the state of financial viability and determine the more accurate reality in the actual day-to-day affairs of Armenian CSOs.

14 Eurasia Partnership (2009): *Evaluation of DOC (Development of Organizational Capacities) and RCCD (Resource Centers for Community Development) programs*, Yerevan.

Methodology

This case study presents a qualitative analysis of interviews with representatives from eight civil society organizations and two government officials. The universe of the case study is the list of the CSI organizational survey's respondents. Accordingly, the findings of the study are derived from semi-structured interviews with two Armenian NGOs, a youth group, a cultural group, an ethnic-based community group, a business association, a sports association, an educational group, as well as two representatives of the Ministry of Social and Labor Issues in Armenia to explore the possibilities of social contracting and government funding to CSOs. A preset questionnaire was used during the interviews (the questions can be found in Annex 1). However, space was provided for additional questions when topics required further discussion. Responses were recorded during the interview and later transcribed. Transcriptions were then analyzed for pre-determined themes: 1) sources of CSO revenue - to determine the extent Armenian CSOs are balancing their externally and internally generated resources, 2) identified obstacles to and 3) opportunities for CSO fundraising and sustainability-building efforts presented by the environment that Armenian CSOs operate in.

Analysis and Findings

Sources of CSO revenue

The findings of this case study show that, contrary to the CSI organizational survey results, Armenian CSOs mostly lack the necessary funding to sustainably and efficiently conduct their operations. Two out of eight CSOs interviewed did not have any source of income within the past three years; three other CSOs were able to benefit from only one source of income and another three organizations managed to benefit from one additional source of income except for foreign funding, which still constituted the larger part of these CSOs' budgets. Thus, the representatives of two civil society organizations reported that they had not received any funding from any source for the last two consecutive years. "Our CSO has been founded only a few years ago. If you are a beginner in this field you are destined to dysfunction: you cannot attract either international foreign funding or government support since you do not have the necessary experience and expertise," explains one of these CSO representatives. Thus, this organization existed *de jure* but not *de facto*, with no projects implemented whatsoever. The other CSO did not have funding, but still managed to carry out small-scale projects due to

the volunteer input. The leader of the CSO explains, “we strive for attracting new funds, but do not succeed. So we turn to only volunteer efforts, which however valuable, do not result in sweeping changes or wider reach.” The revenues of another CSO were derived from membership fees only. “The scarce resources that we receive from our members leave us with no other choice but to implement small programs. This largely undermines our efficiency,” confesses a CSO leader. The case study further shows that Armenian CSOs, especially those who stably receive funding, are excessively dependent on international donor organizations. Foreign donor funding appeared to be the sole source of revenue for two CSOs and made up the great majority of another CSO’s budget. “It still seems unrealistic to find a local funding source that would compete with international organizations in terms of the amount of available funds. So we turn to the latter,” explains a CSO representative. For Armenian CSOs, it is still hard to lean on domestic sources of income since the local resources of the country are scarce.

Although the dependency on foreign donor funding continues, this current case study uncovered a new trend: Armenian CSOs themselves have begun to question their financial dependence due to the

practical limitations such reliance presents. “The level of international funding is unstable,” holds a CSO representative, “a previously important foreign contributor to our organization has already cut its financial assistance. As a result, the scope of our activities has also diminished.” It appears that chasing donor assistance is becoming an exponentially difficult task in Armenia, mostly because of the growing number of CSOs and the subsequent competition over resources. “Previously, it was rather easy to secure a grant. You did not have to waste time searching for other sources of revenue. Now you just have to...” comments a CSO representative.

The current financial crisis is further decreasing external funding opportunities for Armenian CSOs. “The crisis hit our budgets as well,” explains a CSO representative, “funding for development programs in various countries decreased and so did our accounts.” However, though it might seem counterintuitive, the financial crisis seems to be positively impacting CSO financial sustainability building efforts: as the funding constraints become more tangible, CSOs start to turn to, or at least consider the possibility of other sources of revenue. CSOs are beginning to realize that financial dependency presents a risk to their financial and thus operational future. A CSO representative confesses,

“only when we were left without donor funding did we understand that we needed a more varied self-sustaining plan.”

Although still mostly dependent on foreign donor funding, Armenian CSOs have started to focus their fundraising efforts on diversifying away from this traditional source of financing and into other sources such as individual donations, corporations, government agencies, membership fees and in few instances for-profit ventures. For instance, three of the CSOs interviewed for this study have managed to benefit from two sources of income: although international donor funding constituted the major part of these CSOs’ budgets, two of them also attracted government funding and another guaranteed the support of a business corporation. The findings of the CSI organizational survey also found a diversification of funding sources: in 2008, 22.1% of the surveyed CSOs reported that they made use of government funding, 31.9% received individual donations, 31% supplemented their budgets via membership fees,¹⁵ 17.7% secured resources from service fees and 8% turned to indigenous corporate funding. 32% of CSOs benefited from two sources of income; 15% from three sources of income and 5% from four. “If we do

¹⁵ Although more and more CSOs are turning to membership fees as a means of supplementing their budgets, the fees paid are meager and cannot cover an organization’s expenses.

not target diverse funding sources, we risk both our effectiveness and eventually the very existence of our organization,” acknowledges a CSO leader. This recognition presents a turnaround in mindset, as most CSOs traditionally aimed at a single source of revenue – foreign donor funding.

Legal obstacles to CSO financial sustainability building efforts

For the purposes of this study, the legal framework regulating the activities of Armenian CSOs was analyzed in relation to two specific issues: the ability to legally engage directly in economic activities; and the taxation of income from economic activities. It appears that both issues present a hindrance to CSO financial sustainability-building efforts.

Armenia’s Law on Public Organizations provides that a non-governmental organization¹⁶ may engage in entrepreneurial activities only through establishing or participating in a commercial organization.¹⁷ The law thus outlaws the right to conduct direct economic activities whether or not they serve the organization’s goals. An NGO leader complains, “creating and running a separate commercial organization is financially too

16 Non-governmental organizations are defined by RA law as organizations that do not pursue the purpose of gaining profit and redistributing this profit among their members

17 RA Law on Public Organizations (2001), article 4.

burdensome. But we cannot survive without self-generated income either. We seem to have no way out.” The situation is different for foundations, which can engage in direct economic activities if they serve the attainment of the organization’s mission.

The legislative framework does not provide for tax policy mitigations or tax privileges such as exemptions to indirect income-generating activities. Thus, income generated from NGO-created commercial organizations is taxed at the same level as other commercial enterprises, with no differentiation between the two types of businesses. A CSO representative complains, “the taxes are so high, that at the end of the day our incomes are reduced to zero. Running a separate commercial organization to sustain the operations of our organization becomes meaningless.” Fearful of such outcomes, Armenian CSOs often do not make use of their right to create commercial organizations, passing over the possibility of using the after-tax profits to support their organizations.

Government funding of CSOs

The problem of financial sustainability for Armenian CSOs has long been attributed, among other things, to the lack of dialogue and cooperation between CSOs and the government. The lack of trust and cooperation reduces the chances of government funding of CSOs to a minimum, while mutual mistrust has been the common feature of the relationship between public authorities and CSOs. As a state representative describes, “for the CSOs, a state representative was at best corrupt, and for a state representative a CSO was at best ignorant.” The White Paper on government and NGO cooperation in Armenia (2008) provides background to the problem. According to the study, government’s distrust towards nonprofit organizations has been instigated by a number of reasons. First, many nonprofit organizations are detached from general public and do not have a base of membership or constituency. As a result, government officials are not convinced that these organizations have a wide public outreach. Second, many Armenian CSOs are perceived as profit-seeking, rather than nonprofit organizations, contributing to the feeling of distrust towards such organizations. Third, the nonprofit sector in Armenia lacks the necessary competencies and skills to affect policies. Hence, government cooperates with

only a few nonprofit organizations that it believes are capable of making worthwhile contribution to its program. On the other hand, Armenian CSOs doubt the sincerity of government cooperation efforts, with many of them believing that government is simply imitating democracy in the eyes of the international community.¹⁸

Lately, however, some steps have been taken to foster the institutionalization of government-CSO cooperation. Since 2008, two Armenian state institutions, RA Ministry of Labor and Social Affairs and RA Prosecutor's Office, have adopted codes of participatory cooperation with public organizations, intended to formally institutionalize the involvement of CSOs and the public at large in the functioning of these bodies.¹⁹ Currently, efforts are being made by Armenian CSOs for the adoption of a similar code which would be implemented government-wide. The efforts are led by the NGO "Professionals for Civil Society." The NGO holds round table-discussions under the slogan "Cooperation at the national level"

18 Dulgaryan, A. et al., (2008): *White Paper on Government and NGO Cooperation in Armenia*, Yerevan: "Professionals for Civil Society" NGO. Retrieved October 15, 2009 from http://www.ngo.am/eng/index.asp?page=ecnl_materials#153

19 For detailed information, please visit the websites of mentioned agencies: www.mss.am/eng/about/message.htm <http://www.genproc.am/> Additionally, the code of participatory cooperation between RA Ministry of Labor and Social Affairs and Public Organizations can be found at http://www.ngo.am/eng/index.asp?page=search_result&id=156&table=ecnl_materials and the code of participatory cooperation between RA General Prosecutor's office and NGOs can be found at http://www.ngo.am/eng/index.asp?page=search_result&ID=198&table=news

and with participation of government officials and representatives from all ministries. The aim of such meetings is to present the code of participatory cooperation between RA Ministry of Labor and Social Affairs and public organization as a precedent and discuss the possibilities of making similar amendments in the charters of all the ministries.²⁰

In terms of other examples of recent State-CSO interaction and cooperation, a public council comprising artists, scientists and representatives of civic groups was created by the Armenian police in 2008 and is tasked with overseeing the work of Armenia's police and making police activities more transparent through public involvement. And in 2009, a public chamber was formed with the objective of serving as an inclusive, representative council where all voices from the public will have a chance to be expressed to state authorities.

However, while these examples are encouraging, all of these attempts to further civil society-government collaboration have yet to be institutionalized. These are also exemplary yet episodic practices still need to be adopted by other ministries and state agencies to ensure the inclusion and participation of civil society actors in all strategic policy decisions. Enhanced cooperation and gained trust are likely to ensure CSO

20 See <http://www.ngo.am/arm/index.asp>

credibility and provide the government with more solid grounds for funding. This improved relationship will provide CSOs with an opportunity to receive increased government support (financial support, inter alia) for their work. As a government representative states, “the process has started. Due to the recent collaboration efforts we both came to realize that we can work together, trust each other and implement joint programs to be efficient.”

At present, government funding is distributed to Armenian CSOs through two main types of financing: support, usually through subsidies or grants; and procurements, usually through service contracts.

A. Support through subsidies or grants:

1) National government level

State budget funds are provided to Armenian CSOs by both government decision²¹ and presidential decree.²² For example, since 2007, one portion of an interviewed CSO’s services has been financed through the Armenian Government’s Medium-Term Expenditures program, which accounted for 35% of the organization’s budget in the previous year. “This

21 RA Government Decree 1937 on Approving Procedure for Providing State Budget Subsidies and Grants to Legal Entities (December 24, 2003).

22 RA President Order 87 on Approving Procedure for providing Grants to Non-governmental Organizations from State Budget Funds (May 13, 2005).

funding has a tendency to grow year after year,” reports the NGO representative.

Nevertheless, these appropriations are not obligatory. Hence, they are dependent on ever changing policy priorities due to political turnover or budget constraints (the amount of money is decided upon annually when the budget is agreed upon). Yet another concern was raised by an interviewed CSO representative, “the mechanisms for distributing government funds lack sufficient levels of transparency and clear procedures. In many cases it often remains unclear why a particular group of CSOs get funding.” Despite the assertion that the funds are awarded through a competitive process, interviewees remain inherently concerned that government funding is often based on patronage and favoritism rather than a common interest in advancing social development.

Support through subsidies or grants:

2) Local level budget

The development of CSO-government collaboration efforts also present opportunities for CSOs to receive funding from local self-governing bodies. Local bodies now actively solicit NGO contributions to policy and program development and implementation, with local budget disbursements

granted to NGOs in eleven Armenian cities in 2008.²³

One of the interviewed CSOs for this case study turned out to have a long experience of cooperating with local self-government bodies. The CSO representative says, “since our organization’s very inception back in 1988, we have received support from the LSG bodies - space for operation, information sharing, work coordination, etc.” In the last three years, cooperation between the NGO and the LSG bodies has become more standardized and formally regulated through cost-sharing agreements. In 2009, the NGO concluded cost-sharing agreements with 14 municipalities, whereby the latter assumed the responsibility of covering between ten to twenty percent of the CSO’s program budget. The experience of other CSOs has also proven successful: one NGO implements a project on housing with funds from LSGBs; others participate in municipality tenders and implement projects.²⁴

According to both the interviewed CSO and government representatives however, such partnerships and the subsequent funding are still exceptions rather than a rule. In general, CSO funding opportunities from

23 United States Agency for International Development (2008): *The NGO Sustainability Index for Central and Eastern Europe and Eurasia*, Yerevan: USAID, Bureau for Europe and Eurasia Office of Democracy, Governance and Social Transition. Retrieved September 10, 2009 from http://www.usaid.gov/locations/europe_eurasia/dem_gov/ngoindex

24 Eurasia partnership (2009): *Evaluation of DOC (Development of Organizational Capacities) and RCCD (Resource Centers for Community Development) program*, Yerevan.

local sources are limited, especially when it comes to newly formed CSOs that lack the necessary expertise, image and proven track record. “Communities allocate considerable amounts of resources to social problems. The process, however, advances in an uncoordinated manner and is often ineffective. A strategy of social policy on the local level should be worked out and advanced by local CSOs,” an NGO representative recommends.

B. Procurement: Service contracts

The Armenian government and Armenian CSOs have started to build partnerships in the delivery of social services as a result of strengthening cooperation between the two sectors. The Armenian Law²⁵ provides for the creation of Social Assistance Councils, whereby the interested NGOs of a community can apply to become a member of the Council and provide social services with state financing. The law, thus, creates an arena for social contracting, with successful, although sporadic manifestations of such practices. However, as an interviewed state representative assesses, “the anticipated result has not yet been achieved – either the NGOs of certain communities are inactive, not sustainable or they still do not have the necessary

25 RA Law on Social Assistance (2005).

expertise.” Whatever the reason, the rare cases of effective cooperation within these councils have yet to be translated into wider circles.

At the national government level, the emergent experiments with social contracting with the RA Ministry of Labor and Social Affairs are particularly noteworthy. The Ministry has a long history of cooperating with Armenian CSOs. Recently this cooperation has become more substantive, with CSOs providing social services and being included in the Ministry’s policy making. In 2008, for example, the Ministry contracted out the operation of one of its disabled day care centers and three new soup kitchens to CSOs.²⁶ Another vivid example of social contracting implemented by the Ministry is the Program for Unburdening Orphanages. The program helps local self-government bodies to implement social assistance projects targeting vulnerable groups in a given community within their budget capacity together with NGOs.²⁷

Social-service delivery through contracting

26 United States Agency for International Development (2008): *The NGO Sustainability Index for Central and Eastern Europe and Eurasia*, Yerevan: USAID, Bureau for Europe and Eurasia Office of Democracy, Governance and Social Transition. Retrieved September 10, 2009 from http://www.usaid.gov/locations/europe_eurasia/dem_gov/ngoindex

27 USAID Social Protection Strengthening Project (2007): *Current Practice and Challenges in Social Contracting between the Government and NGOs*. USAID, Yerevan. Retrieved December 10, 2009 from http://www.spss.am/information_materials/SPSS_FY07QR2_Social%20Contracting%20Roundtable%20Proceedings_Final%20version.pdf

however is still not an institutionally grounded and sustainable practice in Armenia. To support the government and NGOs to collaboratively provide community-based social services through social contracting, the USAID Armenia Social Protection Systems Strengthening (SPSS) Project²⁸ has launched the Social Services Assessment Program. In 2008, the initiative was piloted in four Armenian communities after the following specific community needs were identified: plans for social service delivery were formulated and the implementation was outsourced to qualified NGOs. The next step will be for local governments, who have already contributed to the outsourced projects, to find ways to provide ongoing funding for the services. As reported by the project initiators, there is both the political incentive and commitment to secure the funds.²⁹ This model may serve as an exemplary precedent to be exercised by other communities and contexts as well.

Today, there exists a law that provides an arena for social contracting, sporadic examples of such practices as well as a tool for planning and social service outsourcing. The grounds for the sustainable practice of social contracting and, thus, increased opportunities

²⁸ Social Protection Systems Strengthening, see: <http://www.spss.am/index.php>

²⁹ USAID Social Protection Strengthening Project (2008): "From Striving to Thriving" *Armenia Social Services Assessment Guidebook*. USAID, Yerevan. Retrieved December 10, 2009 from http://www.spss.am/docs/SPSS_FY09Q1_Dec12_ArmSocServAssesGuidebook_eng.pdf

for a financially more secure civil society in Armenia seem to have already been built. In the Armenian context with civil society's poor financial sustainability and already declining donor commitment, the state is supposed to and is, in fact, on its way to becoming one of the contributors to the development of a sustainable third sector. This naturally poses problems of its own, raising questions over the credibility of a state-financed civil society sector and its undermined autonomy and role as 'watchdog'. That is why this study holds from the very outset that the sustainable approach to CSO financing lies in the diversified resource base. A CSO that mobilizes support beyond one single source, be it state or private sector support, international donor funding, membership fees or other innovative fund-raising mechanisms, reduces the risks of being co-opted.

Discussion and Implications of the Study

In spite of the findings of the CSI organizational survey, this current study and previous literature show that the majority of Armenian CSOs are still not financially sustainable institutions able to reliably secure enough funding for their operations. Those

who do secure enough funding are usually excessively dependent on a single funding source – namely and most frequently, a foreign donor. A diversified pool of financial resources, however, is one of the main prerequisites for independent and uncompromised CSO operations. This case study, therefore, builds on CSI organizational survey’s findings to also explore CSO sustainability in terms of their ability to benefit from a diversified pool of resources and, hence, have more chances of autonomous and secure functioning. Viewed through this prism, financial sustainability proves to be still a challenge for the Armenian civil society. The study, therefore, makes a number of recommendations to encourage the strengthening of financial sustainability in CSOs:

- ✓ **Recommendation 1:** Armenian CSOs should not only realize the necessity for, but also establish and foster partnerships as soon as possible with, all types of potential funders — from donors to private corporations to government to individuals. They should not wait until grants disappear to seek new funding sources.

Building a truly sustainable nonprofit sector is a multidimensional challenge. In the Armenian context, the regulatory environment fails to establish a secure and supportive environment for NGO fundraising

efforts by preventing direct income generation and refusing to implement tax mitigation for indirect income-generating activities. Here, it should be stressed that there is a particularly broad consensus that NGOs should be permitted to engage in economic activities that support the organization's statutory purposes. The taxation of income from economic activities related to the nonprofit's mission is another restrictive approach inconsistent with good practice.³⁰

- ✓ Recommendation 2: Armenian CSOs have to advocate in a more proactive and participatory way for the establishment of a legislative framework that supports the long-term growth of their organizations.³¹ CSO participation in the development of a legislative framework will render the process more meaningful and effective, since many CSOs have experienced and examined the negative consequences of gaps in legislation. The government should acknowledge the need to eliminate the mentioned legal barriers to creating a supportive arena for CSO operations.

Cooperation between state bodies and non-profits in Armenia has entered into a new stage

30 Rutzen, D., Moore, D., Durham, M. (2009): *The Legal Framework for Not-for-Profit Organizations in Central and Eastern Europe*. The International Journal of Not-for-Profit Law: Volume 11, Issue 2. Retrieved October 21, 2009 from http://www.icnl.org/KNOWLEDGE/ijnl/vol11iss2/art_1.htm

31 It should be noted that in the last five years comprehensive reform packages have been developed by various Armenian NGOs in an attempt to affect the regulatory environment governing NGO operations. These attempts have yet been unsuccessful.

of development, expanding the scope of available mechanisms for cooperation. The Armenian government and CSOs now recognize the importance of having continuous dialogue and longer term strategies for cooperation. Social contracting, as a model for social welfare secured through public funding and CSO input is already taking shape in Armenia. The government commitment to expand the practice, the numerous (although still inconsistent and sporadic) cases of cooperation, as well as the potential success of these existing cases of cooperation, lead to high expectations for government funding and social contracting in Armenia as another way to ensure a financially sustainable nonprofit sector.

- ✓ **Recommendation 3:** Efforts should continue from both sides to expand the scope and pace of such collaboration, and thus create more space for CSO fundraising and sustainability-building efforts: the continued dialogue is likely to reinforce CSO legitimacy, build CSO-government trust and, eventually, to speed up the practice of government funding to CSOs.

This brief study explored the level of financial sustainability of Armenian CS sector. Future research should possibly focus more on each of the issues uncovered by the study. Besides, the case study

explores only one additional source – government funding – as an opportunity to diversify CSO resource base. Further studies may capitalize on the practices, opportunities for and challenges in other sources of CSO income as well as identify ways to bring them into day-to-day operations of Armenian CSOs.

Conclusion

This case study supports the previous literature, demonstrating that Armenian CSOs are not financially sustainable institutions as long as they hinge on the current model of significant external funding by international donors mainly. The study holds that the only mechanism for CSOs to be able to engage any funding without the risk of being co-opted is to attract and rely on a diversified pool of revenues generated both externally and internally. Encouragingly enough, a new trend is uncovered by this study that Armenian CSOs themselves are concerned about their financial dependence. As a result, they have started to focus their fundraising efforts on diversifying resource base.

One of the major obstacles to CSO financial sustainability building efforts still remains the regulatory environment which prevents CSO direct

income generation and does not provide tax incentives for indirect income-generating activities. The elimination of these legal barriers will accelerate the establishment of a financially secure third sector. The study also shows that although government funding of CSOs has not yet developed to a level sufficient to meet demand, it has in fact started to be exploited as one of the indigenous sources to make civil society sustainable in Armenia. The expanded scope and pace of government funding as another source of revenue will provide CSOs with a wider space for independent functioning.

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Annex 1

Semi-structured questionnaire for “Financial Sustainability of Armenian CSOs” case study:

a) Question to CSOs

- 1) Based on last 2 financial years, what share of your organisation’s financial resources came from each of the following sources [insert percentage of total resources within square brackets]?

| Type of source | % of yearly budget of 2007 | % of yearly budget of 2008 | % of yearly budget of 2009 |
|----------------------------|-------------------------------------|-------------------------------------|-------------------------------------|
| Government | | | |
| Local corporate funding | | | |
| Foreign donors | | | |
| Individual donations | | | |
| Membership fees | | | |
| Service fees / sales | | | |
| Other (please specify): | | | |

- 2) How have you raised these funds? (Please, specify).

- 3) Do you expect to decrease funding from the source you received the greatest part of your budget by 2010. If yes, what percent decrease do you expect and which source will make up for that decrease?

- 4) Compared to the previous year, have your organization's revenues...

- | | |
|------------------------|----------------------------|
| increased | 1 <input type="checkbox"/> |
| remained the same | 2 <input type="checkbox"/> |
| decreased | 3 <input type="checkbox"/> |

- 5) Explain why and how? (*Probe for: Have not applied for previous sources of income? Have applied and received funding from new sources? Donors' money has been cut? The existing resources were sufficient for the organization's operation? etc.*)

- 6) Compared to the previous year, have your organization's expenses...

- | | |
|-----------------------|----------------------------|
|increased | 1 <input type="checkbox"/> |
|remained the same | 2 <input type="checkbox"/> |
|decreased | 3 <input type="checkbox"/> |

7) Explain why and how

8) How does the environment (legal, social, cultural, political, etc.) limit you in your fundraising efforts?

9) What activities have you ever initiated to address (eliminate) these limitations?

10) What opportunities does the environment (legal, social, cultural, political, etc.) present to your fundraising efforts?

11) In what ways have you made use of the opportunities presented?

12) Does your organization currently have a plan/vision of financial sustainability building?

- 13) If yes, what mechanisms of financial sustainability building does that plan envisage?

- 14) What are your recommendations? What can be done to support Armenian CSOs in their fundraising efforts?

b) Additional space for follow-up discussion

