Social innovations of NGOs and Foundations on development economics – using the market force for greater impact

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Abstract:

New approaches in reaching their goals from Foundations and Development NGOs underline the existing consciousness on the need to counterpart grant giving with market based solutions.

In 2014 OECD published a study called: "Venture Philanthropy in Development – Dynamics, challenges, and lessons in the search for greater impact" where the organisation captured an important systemic change in the social work of Foundations and NGOs. The study underlined a new direction in their interventions that have the goal to solve social issues. This direction can be defined "as an entrepreneurial approach to philanthropy that combines a variety of financial and non-financial resources to identify, analyse, co-ordinate and support self-sustaining, systemic and scalable solutions to development challenges aimed at achieving the greatest impact." (OECD, 2014). This shift in the roles and functions of these non-state and non-private actors are now posing fundamental questions on the present and future landscape of the "third sector" at the local, national but also international level. Nongovernmental organisations have gained important influence within

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broader society and especially in government and business. Complementarity has become the first term that defines those relations, and advocacy the second.

Service NGOs orientated to providing services and goods to clients with unmet needs are stepping forward where public institutions are unable or unwilling to provide for societal needs and where companies do not see an income generating activity. Worldwide, well-known examples are the relief efforts provided by the Red Cross, the medical drugs distribution by Doctors Without Borders and the efforts of WWF to monitor the natural resources.

As a case study, in Romania, this shift can be perceived in hybrid NGOs and Foundations that are combining advocacy with service for a greater impact on their target group. EU subsidies and new, stronger sustainability expectations from private donors contributed to a more entrepreneurial, professionalized, executive focused entity.

The focus on this shift can bring the debaters on the "wrong and good" scale. Whether this shift on identity also contributed to a moral decline and ignorance of the first rationale that gave them drive in the first place (solving social issues, protecting the environment, etc.) is not the subject of the present article, and it will be difficult to be the subject of any objective article. Change is the *leitmotif* of nowadays society and NGOs operate under multiple, inexplicit, incomplete, and continually renegotiated and sometimes conflicting social contracts and institutions.

Keywords: NGOs, social economy, social innovation, development economics, market failures, third sector.

Introducing the protagonist

Although there is a clear delimitation in identity between NGOs and Foundations, the first being in most cases grant receivers while the second grant givers, the current paper will include both actors in the broader definition of the NGOs. While the goal of the article will not be altered in doing so, the understanding of the scope of the phenomenon debated will be richer.

The term NGO, while still new, defines what existed for centuries or even from the beginning of ancient societies: likeminded people coming together around common ideas, needs or causes to promote collective gain. When this phenomenon exists in an organised manner, the entities emerging are known as nongovernmental organisations or NGOs.

In 1950, the United Nations (UN) coined the expression, in its first attempts to consult other than governments on specific economic development related issues. Today the UN has the following definition on NGOs: "any non-profit, voluntary citizens' group which is organized on a local, national or international level. Task-orientated and driven by people with a common interest, NGOs perform a variety of services and humanitarian functions, bring citizens' concerns to Governments, monitor policies and encourage political participation at the community level. They provide analysis and expertise, serve as early warning mechanisms and help monitor and implement international agreements. Some are organized around specific issues, such as human rights, the environment or health." (United Nations, 1998: para.1).

Depending on who is benefiting from the NGO's activities, NGOs can be found in two main typologies (Yaziji and Doh, 2009). The first typology is represented by *self-benefiting NGOs*, which are designed to primary or even exclusively serve the interest of their own members (unions, business associations, church groups, amateur sports clubs etc.). The second typology is represented by *other-benefiting NGOs* that are organisations working for a specific target group other than their own group. Labour and capital is invested for different pressing causes that need support in order to reach some basic standards of existence.

From a second perspective, NGOs can be defined either as advocacy NGOs or service NGOs. The first category are NGOs working to shape the social, economic or political system and to promote a given ideology or set of interests. They are participating in public debates, organise public protests, conduct research, hold events that gather multiple stakeholders and disseminate information to their own audiences. They are the most visible NGOs, as being visible and reaching a broad audience are their means to achieve the goals they are following. Inside this category there are two other types of NGOs: watchdog NGOs and social movement NGOs. Watchdog NGOs are usually satisfied with the status quo (economic, legal, social) and are working to make sure the rules of the game are kept by all players (state, companies). They are more technical in approaches as their staffs are usually professionals in law, economics or public administration. Furthermore their public positions are well substantiated, and their focus is on policies rather than politics. On the other hand, the second type of advocacy NGO, social movement NGOs is, by contrast, more radical being unsatisfied with the statusquo. They fight against existing social norms and trends (capitalism, globalisation, free market) advocating for a radical change.

Advocacy NGOs, while more visible, are losing ground in favour of service orientated NGOs, the current article's main focus.

Service NGOs are executive entities that are taking the problem in their own

hands. They identify specific target groups' problems, find solution and not only do they promote it as a panacea (to be introduced in public policies) but they also implement the solution with their own experts. Service NGOs are "safety nets" where weak public institutions are unable to provide basic services or develop viable legal and regulatory frameworks and where private companies are unwilling to invest due to high risk on capital or lack of a strong reliable market.

The sector has become larger since the public sector contracted, favouring the private and non-governmental to take over its functions. Eroding trust in government, cutbacks in public resources, privatization and declining state capacity left room to the expansion of both private and NGO sector.

The magnitude of the sector can be reflected in numbers. The global non-governmental sector had more than 1 trillion turnovers in 2003, ranking as the world's eighth largest economy.

Service NGOs and the concept of social economy

The emergence of NGOs (both advocacy and service) has three main preconditions. First there is the disappointment with a specific aspect of society. Secondly, there must be a basic understanding of the existing institutions and policies related to that issue. Finally, the emerging NGO must have a different strategy on that issue that can change for the better the entire relevant context. This basic steps are the social conditions that can influence the appearance of an organized group that can finally be formally organized in an NGO. The problems can be from different fields: social problems, environmental problems and health related problems, each of the fields having hundreds of sub-components. Service NGOs in the attempt to address market and regulatory failures are usually taking the action by providing the services directly to their beneficiaries.

Service provision gives NGOs two options. First is to implement the service at a local level, even if the scope of the problem needs a broader approach. Time, financial resources, staff involved are usually the main obstacles in scaling the solution. Usually this kind of approach has a normative mission. Developing small scale pilots, validating the intervention and proposing it as a policy approach are predictable steps for the actions of an NGO. The second option is to build self-sustainable solutions for the problems under discussion. With this second option, service providing NGOs are making a new step toward solving issues of all kind.

However these new directions imposed innovation in the approaches and the structures of all actors involved. These innovations can be seen in three main

structural components of the entity:

- Skills needed
- Resources invested
- Level of involvement.

From the **skills** needed perspective, providing services brings innovation in the mix of competences of the staff involved. Business skills (management, marketing, financial management, human resources management) become "a must have". Furthermore, understanding the business rationale (in each particular case) and having the capacity to analyse its development become also a new requirement for staff. More than that, importing specific technical skills for specific projects is also something new. Particular projects in different fields require a specific expertise that NGOs must import if they take the service providing approach.

The innovation in service providing also brings new approaches in transferring the financial **resources** towards the activity. From a focus on inputs and outputs to a focus on outcomes, impact and long-term effect, the traditional grant giving is now reshaped following the rationale: less funds, broader impact. Investment in revenue generating activities that can eventually become self-sustainable could represent the new answer to traditional approaches. Impact capital owned and used by service providing NGOs can have a long-term impact on addressing the market failures and also societal issues.

In this direction, revenue generating social enterprises (developed and supported by NGOs) are replacing the traditional "Give a man a fish" into "Assess the fish market and provide technical assistance for fishing net business plan and start-up funds that will be recovered from the profit of the newly born business" (OECD, 2014).

In terms of level of involvement organisation working as a catalyst of development using the rules of social economy are more and more involved in the development of their projects. Just offering grants and expecting the reports is replaced by a strong involvement in the development of the new structures, even participating in strategic decisions and being part of the executive board. This change also suggests the consciousness on the limits of old approaches and on the need to do more for achieving societal challenges that society faces nowadays. Involvement by service NGOs is placing the sector in front of numerous quandaries: Do we partner or put pressure on the public and private sector, or both? Do we set up pilot projects and send specific policy recommendations and then wait for the public actors to take the responsibility? Do we fill the vacuum in public and private sector by providing services? As more and more NGOs are

moving from advocacy to service providing it seems that the answers have been given: It is time for social innovation.

Why the need? - Market failures

Social innovation involves a new way of thinking and doing. Service NGOs are the main promoters of social innovation as their main goal is to have a social impact where needed. Where the market or the regulators are failing to build a viable social framework, an area that can be called a societal void is created. While the regulators' imperfections are approached more by advocacy NGOs as the implication of public actors is a basic precondition, in case of market failures, the collaborative scenario can be complemented by parallel interventions (developing market solution with its own resources).

There are three main types of market failures (Yaziji and Doh, 2009) that are usually talked by NGOs, each of them being approached either by advocacy NGOs, service providing NGOs or both:

- 1. Market inability to provide goods and services that are socially desirable. Either the market is not labeling them profitable to produce, either the price of production is exceeding the capacity of the general population.
- 2. Cost underestimation. Usually these market failures concern environmental issues as CO2 emissions or collapsing fish stocks but they can also be found in social issue as real-estate developing in green urban areas. The goods and services are not estimated for their real price in terms of production but also environmental or / and social impact. The debate is about the full costs of doing that specific activity and the long-term impact of their undertaking. Another example is indirect costs or specific industries such as arms manufacturers, abortion providers, alcohol providers, producers and marketers of pornography.
- 3. The imperfect competition. Monopolies are one of the biggest market failures of our times. Monopolies bring with them unfair wages, high prices, and asymmetric influential power. There are few cases of monopolies that resulted otherwise.

Besides the situations listed, the free market has exhibited many other different test cases in which the current quasi-world-wide politico-economical system fails to support all the social classes in the society.

The role of service NGOs - the scholar perspective

Developing a strong scientific opinion on the role of executive-oriented NGOs, known as "development NGOs", remains a difficult undertaking in the context of unclear boundaries regarding the functions of these actors and the lack of clear measures. Their role in supporting the wellbeing in underdeveloped regions remains to be defined and redefined taking into account their changing functions.

In their central work, "Economic Development", Michael P. Todaro and Stephen C. Smith recognize the important role played by NGOs (non-profit) in the process of economic development. Building robust economic environment on public and private sectors can overlap, in their vision, trying to build a two-legged stool: "Nonprofit organizations have been involved in many cases, providing financial and technical assistance to developing countries." (Todaro, Smith, 2012). The authors underline one of the reasons they have such an important role in economy: "because their existence (NGO) is built on trust as opposed to coercion (public actors) or individual interest (private actors) they are able to reach effective and socially acceptable allocation of goods and common services at relatively low transaction costs." According to the same authors, these actors can directly contribute to poverty reduction and build a fair social and economic system in the following aspects:

- 1) Innovation (in developing and implementing effective pilot programs and pilot projects).
- 2) Flexibility (programs implemented by NGOs are more sensitive to the external environment by contrast to those implemented by public actors. These programs are responsive to local needs).
 - 3) Possession of specialized technical knowledge, constantly updated.
- 4) Provision of public, locally relevant goods. (In many cases goods and services such as adult education, access to information technology or legal advice are the kind of services that are not economically attractive so, they are avoided by private actors and also are rarely a priority for public actors. Yet, these goods and services meet real needs of socio-economic marginalized population.
- 5) Contribution (in design and implementation) to the management of local resources. (NGOs play a major role in developing and implementing programs to protect local assets natural habitats, lakes, forests etc.)
 - 6) Developing a positive image based on trust and credibility. In most cases

NGOs enjoy greater confidence of citizens in comparison with the public actors.

7) Representation and advocacy. One of the most important role NOGs play is in representing the message of their supporting group.

The authors agree that in exceptional circumstances of market failure a vacuum is created in which NGOs can and must make "a temporary step" to fill in the void, a phenomenon called "expansion of the sector." Based on this opinion it is honest to build the first part of the plea supporting NGOs by stating that they are, on the one side, social innovators and also free market innovators and, on the other side, social correctors and market correctors of the status quo. Their institutional structure and functions and their ability to rapidly cope with change are offering them the characteristics.

Another leading work supporting the existence of this new conceptual space, a hybrid consisting of economics, international development, business, social impact finance, philanthropy and technology is Muhamad Yunus, a finance practitioner, professor and winner of the Nobel Peace Prize in in 2006. In his work: "Building Social Business: The New Kind of Capitalism that Serves Humanity's Most Pressing Needs" Yunus perceives social business as a new form of capitalism, designed to meet the most pressing needs of humanity. The author perceives poverty as the outcome of institutions' deficiencies developed so far. NGOs (as a catalyst of social businesses) can play an important role in eradicating poverty in a sustainable way by initiating such "social business" which have the following operating principles:

- 1) The main business objective is to eradicate poverty or solve one or more problems in areas such as education, health, technology and environment and not to maximize profit.
 - 2) The company must be financially sustainable.
- 3) Investors get back only what they invested. No dividend is given beyond the amount originally invested.
- 4) Once the investment is recovered entrepreneurial profit is reinvested for expansion and improvement.
 - 5) The company acts consciously and responsibly to environmental issues.
- 6) The employees receive fair wages, with better working conditions than standard.
 - 7) Do it with joy!

Building on the same foundation, Michael Edwards captures the conceptual niche represented by the role of NGOs in development economics. In his work:

"Have NGOs Made a Difference? From Manchester to Birmingham with an Elephant in the Room." Edwards and Hulme concluded that there are four distinct approaches that NGOs can take in development economics:

- 1) Work with public actors (capacity building and policy impact augmentation)
 - 2) Operational (developing branch structures in other regions)
 - 3) Representation and advocacy
- 4) Support the development of networks and replicating interventions validated by practice.

The impact of development NGOs, their ability to attract support for their legitimacy as actors of economic development remain dependent on their ability to demonstrate that they can work efficiently and can be assessed objectively for their actions. The authors put a fundamental question, relevant in the debate between supporters and critics of the above mentioned theory: "Despite the increasing size and sophistication of the development NGO sector, have NGOs really 'made a difference' in the ways the first Manchester Conference intended, or have the reforms that animated the NGO community during the 1990s now run out of steam?" Intervention priorities are changing with the emergence of the "complex political emergencies" and the binomial donor - NGO is placed in an international context where interdependencies are the leitmotif of daily activities. The challenges of this new context are related to the ability of these actors to detach from the "ivory tower" and go to the grass-root level, to the people who need support and, furthermore, show openness to technical and financial transparency.

Edwards recommends a new perspective to analyse the role of economic development orientated NGOs. Strengthening these lines, Kenneth L. Leonard, part of the Department of Economics at Columbia University, offers a relevant case study in his article published in the International Review: "When both states and markets fail: asymmetric information and the role of NGOs in African Health Care." The author presents an example of market failure joined by the immobility of public actors. Leonard states that "the free market miracle" has not acted in the case of the health system in Africa due to the asymmetric information existing about it. Although there is a demand for pharmaceutical products on the market, the suppliers did not answer with their presence as in any other parts of the world where the invisible hand was doing the magic. This vacuum was partly covered by NGOs who took over to fix a market failure with devastating socio-economic effects. NGOs developed small, local drugstores as well as mobile pharmacies, selling at a fair price drugs for those in needs.

The debate over the role of NGOs in repairing market failures is animated by opinions that call into question the effectiveness of these structures in fulfilling development goals that they take over or are ceded to them. The issue of accountability on this non-public and non-private entity is one of the main pillars of this debate. The lack of external evaluation and monitoring of the activities and of the results is the primary source of scepticism of the real impact service that providing NGOs can have.

Lucio Baccaro, in his "Civil Society, NGOs, and Decent work Policies: Sorting out the issues (2001)", states that there is less evidence that would support the cost-efficiency, innovation and impact of these structures compared to government organizations, but more evidence that would support the opposite. The author supports his opinion by emphasizing that in most successful cases it was rather "internal working philosophy" and the internal capacity developed by the management style, the author being unable to grasp the universal matrix that can be multiplied. The human factor (behavioural factor), more important than the institution itself determines the pros and cons (if any) in the recognition of the role of NGOs in economic spectrum between private and public space. However, Baccaro, an expert in social and economic forces interactions by the rules of modern capitalism, recognizes the role that NGOs can play in providing services in poor countries, where underdeveloped infrastructure and market have strong negative effects on society. Clayton, Oakley and Taylor in the article: "Civil Society Organisations and Service Provision" make a concrete analysis of the lessons that NGOs have given in providing services using a number of evaluation criteria such as the impact on poor communities, quality of service, efficiency and sustainability. A key aspect of their analysis is the NGO - state relationship. They stress the importance of eliminating the phenomenon of state dependence and that is transforming the NGOs in simply service providing companies without any special element in terms of innovation and impact specific to the nongovernmental space. However, the authors list the challenges and processes that must be passed by NGOs to actually fix market failures: 1) Performance and capacity to improve access, coverage, quality and efficiency of the services provided. 2) Responsibility - in terms of transparency of reporting to donors and the group supported by these services. 3) The correct approach to influence state decentralization and create awareness of the civil advantages; 4) the potential to develop the range of services that can lead to self-determination of the groups supported (self-sustainability).

This debate grew in the context of radically rethinking the pro-development interventions in developing states. In terms of economy development, the perpetual question: "Why do some countries have experienced economic development while others still struggle in the threshold of underdevelopment?"

brought to the forefront the policies that were successful and those that failed and underlined where small intervention had greater impact than vast programs. Abhijit Banerjee, professor of economics at MIT along with Esther Duflo in the book "Poor Economics - A radical Rethinking of the Way to Fight the world poverty", detect failures of government policies and unsuccessful efforts of NGOs. The authors consider that both sides have developed interventions based on false and invalidated assumptions and lack of real fundamentals. Their conclusions based on the experiences of "Poverty Action Lab" reveals certain actions that gave results each time: microfinance and education. The question that emerges from their suggestions becomes: who will implement these programs and who will bear the cost? This perpetual postponement and orphaned programs with potential to transform the poorest regions in prosperous ones are left in a space where there is no institution that can take responsibility of the implementation (motivated by certain interests), emphasizing the importance of the institutional framework in the development process. The importance of political and economic institutions in shaping individual constraints and opportunities is crucial in assuring chances for all those interested. This direction of the debate brings up a new question: How can small-scale interventions of NGOs contribute to the economic development of countries or regions? Conceivably the fundamental debate on the economy development lies only in the works of Walt Whitman Rostow, Raul Prebisch and other representatives of classical theories on development. William Easterly in his book "What Works in Development?: Thinking Big and Thinking Small" raises the intensity of this debate. The author questions: "What should be emphasized? - the approach of macro politics with a focus on the role of institutions, macroeconomic policies, growth strategies and other factors at the state level, or the approach from the bottom up, with a focus on micro-economic interventions such as microfinance with provision of specific services for the marginalized socio-economic?

The experience of the recent past demonstrates that a synergy between the two approaches would be the answer to increase the impact of both. In his book "The End of Poverty, Economic Possibilities of Our Time (2006)" the notorious contemporary economist Jeffrey Sachs endorses the synergistic co-existence of macro-economic and micro-economic policies. Sachs stresses the important role that can be played by international institutions like the United Nations, World Bank, International Monetary Fund, but draws attention to the groundwork in setting the local contexts for successful macro-policies. Two years later, Sachs published the book, "Common Wealth: Economics for a Crowded Planet" where, besides strengthening previous conclusions, he presented a clear correlation between economic globalization and small context-driven grassroots intervention in different countries. The author highlights issues such as subsistence agriculture in Africa showing how small NGO-driven water management interventions not

very large scale could make the difference between life and death and create a critical mass for public policies emergence.

Following Sachs's ideas on an integrated approach to economic development interventions Amartya Sen, a Nobel prize winner for economics in 1998, marks in his book "Development as Freedom", the correlation between wealth and welfare (in broader terms), a heated debate since Adam Smith. Relevant to the topic of this presentation is Sen's inclination toward a contextual approach to socio-economic issues, focusing on the individual rather than the group. Sen underlines the importance of an integrated approach in development as well as the rethinking of the institutional framework in the context of the general changing needs of people. He points out that decentralisation and subcontracting could work better than macro-institutions and implementing politics validated in a totally different context.

In addition to direct or tangential contributions, studies developed by the World Bank emphasize the importance of combining types of intervention to achieve economic development and thus acknowledging the role of NGOs in development efforts at the first level of communities (grassroots level).

Conclusions

NGOs are more and more present in the public sphere and their new approaches in solving societal issues bring a new light on their existence. The broad directions in constraining government expenditures, privatisation of public services, pressures from corporations and globalization, pending societal problems that are not addressed effectively by public policies or the free market are strengthening the perspective of the hybrid service NGOs development. Another phenomenon that will fuel this development is the rapid growth of new practices in NGOs work that are combining the innovative capability of the private sector with the service delivery of non-profits for new ways to tackle poverty, health and environmental protection.

More than that, social innovation and social entrepreneurship which are underlining the integration of economic and social goals and returns have gained traction in the world of philanthropy and economic development.

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