# Business-NGO Partnerships and NGOs' primary missions

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**Abstract**

From handicraft shops to cell phone service, NGOs have become increasingly involved in profit-generating business ventures. Such commercialization may take the form of a business-NGO partnership, whereby the NGO "outsources" the commercial activity. This paper presents a simple model to analyze how the benefits to an NGO depend on the characteristics of its commercial partner. First, the business partner's investment may generate a technological benefit for the NGO's primary mission. For example, in Bangladesh, Grameen Phone's network coverage benefits the microcredit operations of its NGO partner, the Grameen Bank. Second, a business may earn a "respectability premium" from being associated with an NGO. For example, Grameen Bank's reputation in the country helped make the project well accepted. After both parties' investments are sunk, bargaining takes place in which the NGO seeks a monetary transfer. I find that the size of the transfer is decreasing in the technological benefit, but increasing in the "respectability premium". Thus, it may be the case that the NGO pays the commercial partner, and not the other way around. The results suggest that NGOs primarily seeking supplemental revenue from such partnerships should pair with businesses that: 1) do not provide any technological benefit (because these benefits weaken the NGO's bargaining position ex post); and 2) have a large stake in improving their social image. Moreover, investment in the business venture is always lower than its first best level when technological benefits are positive. However, in the opposite case where association with a business makes the NGO's primary mission less efficient, business investment may be higher than the first best when the respectability premium is too strong. This second set of results suggests that we may not see enough NGO commercialization in cases where it could greatly improve NGO projects' efficiency, while we may see too much of it when it constitutes a drag for the primary mission.

**Keywords: non-governmental organizations, business-NGO partnerships**

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# 1 Introduction

From handicraft shops to cell phone service, NGOs have become increasingly involved in profit-generating business ventures. Such commercialization may take the form of a business-NGO partnership, whereby the NGO "outsources" the commercial activity. This paper presents a simple model to analyze how the benefits to an NGO depend on the characteristics of its commercial partner. First, the business partner's investment may generate a technological benefit for the NGO's primary mission. For example, in Bangladesh, Grameen Phone's network coverage benefits the microcredit operations of its NGO partner, the Grameen Bank. Second, a business may earn a "respectability premium" from being associated with an NGO. For example, Grameen Bank's reputation in the country helped make the project well accepted. More generally, corporations such as The Coca Cola Company and Nike sponsor international NGOs that advertise such contributions on their website.

The model provides some important insights on different types of NGO-business collaborations (examples are discussed in section 2). The timing od decisions in the model is as follows. First, the NGO and its business partner contract. Second, they invest simultaneously: the NGO invests in its primary mission activity, while the business partner exerts effort in the commercial venture. After both parties' investments are sunk, bargaining takes place in which the NGO seeks a monetary transfer. I find that the size of the transfer is decreasing in the technological benefit, but increasing in the "respectability premium". This suggests that NGOs primarily seeking supplemental revenue from such partnerships should pair with businesses that: 1) do not provide any technological benefit (because these benefits weaken the NGO's bargaining position ex post); and 2) have a large stake in improving their social image.

Furthermore, if the technological benefit for the NGO is relatively more important than the respectability gain for the business partner, the partnership does not necessarily result in a payment by the commercial entity to the NGO. Indeed, although the literature tends to emphasize the income-generating purpose of NGOs' commercial ventures, in the present model, bargaining between NGO and business may result in a payment by the NGO. Examples are discussed to illustrate this seemingly odd result.

Moreover, investment in the business venture is always lower than its first best level when technological benefits are positive. However, in the opposite case where association with a business makes the NGO's primary mission less efficient, business investment may be higher than the first best when the respectability premium is too strong. This result suggests that we may not see enough NGO commercialization in cases where it could greatly improve NGO projects' efficiency, while we may see too much of it when it constitutes a drag for the primary mission.

This paper relates and contributes to two strands of literature. First, the economic literature on nonprofits recognizes the existence of commercial income in these organizations. For example, Glaeser and Shleifer (1998) propose a model in which nonprofits derive their income both from donations and the sale of their services, and Weisbrod (1998) gathers papers covering a broad range of issues regarding nonprofits' commercialization. Weisbrod (1998) considers that commercial activities, because they are unrelated to the NGO's core mission, generate a disutility for the NGO. In this framework, commercial ventures are viewed as a necessary evil for NGOs, for the sole purpose of supplementing donations. A second, related view, especially common among critics of NGO commercialization, could be called the "private gain hypothesis".[1] It views NGOs as deriving utility from two sources, namely, the provision of charity and commercial profits. The former is considered the noble and charitable face of the NGO, while the latter represents the profitmaximizing side of the organization's motives, which may make it drift away from its charitable mission. Then, following Glaeser and Schleifer (2001), the not-for-profit constraint commits the NGO to higher quality in its mission-related output, and donors can be less worried about the risk that the NGO's profit motive may induce a mission-drift. In the present paper, the possibility of beneficial spillovers of business activities on mission-related activity suggests that NGOs' profit motives are not necessarily harmful from the point of view of donors and beneficiaries.

Second, the paper contributes to the literature on firms' corporate social responsibility (Fisman et al. 2006, Besley and Gathak, 2007), by making the form of a firm's contribution to the public good more explicit. In the present paper, the firm forms a partnership with an NGO. However, as shown below, it may well be the case that public relations benefits are not the most important feature of the collaboration. Then, the NGO may well pay the for-profit entity, rather than the other way around.

[1] Brunel (2002) blames "the emergence of 'supply side economics' or the trend towards favoring profitable markets rather than responding to the real need of people in distress". She also points out that NGO workers themselves disagree with strategies that make their organizations look like businesses. Criticisms of NGOs' commercialization in developing countries can be found in Ahmad (2001) and Reddy (2003).

## 2 Business ventures and NGOs' primary mission activities

Partnerships between NGOs and businesses can take many forms. First, many NGOs have corporate sponsors who finance a variety of projects around the world. This is the most basic form of NGOs' movement toward the commercial sector: they can get financial support and in exchange provide public relation benefits to their sponsors' for profit activities. Some examples can be found on the website of the international NGO Save The Children (STC).[2] Foot Locker and Western Union support the organization's education programs worldwide. In 2008, Target supported STC's emergency relief interventions in India and China. Other corporate sponsors include Microsoft, Verizon, and Premier Oil, among many others. In such cases, reading the advertised collaborations indicates that the firms' contributions are simply donations. While these funds are helpful to fund important NGO projects, such arrangements may be better termed "sponsorships", rather than true partnerships (Environmental Defense Fund and GMI, 2008). The benefits to the NGO are monetary, while the firms benefit by meeting their corporate social responsibility goals, which may translate into profits down the road (Fisman et al. 2006). Moreover, such collaborations are not without cost for NGOs, who must maintain and develop (and sometimes convince) a network of sponsors, as well as expose themselves to the risk of a firm engaging in socially indesirable behavior that may affect the NGO's own reputation.

While corporate donations may be a useful form of interaction between NGOs and businesses, some NGOs are more directly involved in commercial activities. NGOs sometimes set up separate for-profit entities, thus pairing with a business they help create to generate additional revenues. In Bangladesh, the NGO BRAC runs (at its large headquarters' building) a four-star hotel with conference facilities and a panoramic restaurant. This NGO's commercial activities also include a for-profit bank and a real estate company. Thanks to multiple sources of commercial income, BRAC is largely self-financing (Ly, 2006). However, such commercialization of an NGO may create an additional administrative burden on the organization, raise suspicion about the use of charitable contributions, or even generate complaints from competiting for profit firms on the markets the NGO enters (Stiles, 2002).

The business-NGO interactions discussed so far involve a monetary benefit, but have the potential to negatively impact the efficiency of NGOs' primary mission activities. However, other forms of commercialization have moved beyond the revenue-generating motive, and are designed specifically to benefit NGOs' development projects. This is the approach advocated by Muhammad Yunus, founder of the Grameen Bank. By forming a partnership with Telenor, a Norwegian telecom company, the for-profit cellular phone service provider Grameen phone was created. While this joint venture is highly profitable and serves well-off consumers in urban areas,

[2] http://www.savethechildren.org/corporate/, accessed on January 31, 2009.

cell phones have also been introduced in poor Bangladeshi villages. The initiative is called the village phone program and is run by the bank's sister company Grameen Telecom.[3] The project is arguably both a commercial success and has greatly contributed to Grameen's microcredit operations.Similarly, Grameen Cybernet Ltd, which was created in 1996, is not only one of the main Internet providers in Bangladesh, but also part of Yunus' view of « the role of... information technology in reducing poverty ».[4] Grameen Communications, another member of the « Grameen family », was originally established to provide support services for Grameen Bank, such as developing software to facilitate the management of microcredit operations.[5]

# 3 The model

An NGO $N$ is involved in a development project and a commercial venture. The commercial venture is run by a business partner $P$, who invests a level of (non contractible) effort $e$ in it. The utility they gain from working together depends on the NGO's valuation for the project $V$ and $P$'s profit $\pi$ in the commercial venture. $\pi$ can be influenced by $P$'s investment, $e$: $\pi(e) = \pi e$ . However, $V$ is affected by both $e$ and the NGO's investment in the development project, $i$. For simplicity, it is assumed that $V(i, e) = (B + \alpha e)F(i)$. $B$ is a positive constant reflecting the productivity of the NGO's investment, regardless of $e$. $F(.)$ is increasing and concave. The parameter $\alpha$reflects an externality that the commercial investment generates on the development project.[6] The cost of effort $e$ for $P$ is given by $\phi(e)$ (with $\phi(.)$ increasing and convex).

One important purpose of NGOs' commercial activities is to generate an additional source of funds, independent of the generosity and preferences of donors. In the model, for simplicity, once investments are sunk and returns are realized, $P$'s monetary transfer $t$ to the NGO is determined by 50:50 Nash bargaining.

Then, $P$ and $N$'s payoffs are respectively given by:

$$U_P = \pi e - \phi(e) - t \tag{1}$$

and

$$U_N = (B + \alpha e)F(i) + t - i \tag{2}$$

[3]For an in-depth study, see Chowdhury (2004)

[4]http://www.grameen-info.or g/bank/Commonlth.html, accessed on January 31, 2009

[5]h ttp://www.grameen.com/gc/index.phtml, accessed on January 31, 2009

[6]The main case for the following discussion is that where $\alpha \geq 0$. Although the model also sheds light on cases where $\alpha$ may be negative.

## 3.1 First best investments

First best investments $i*$and $e*$maximize the total surplus $(B+\alpha e)F(i)-i+\pi e-\phi(e)$. They are given by the following first order conditions:

$$(B+\alpha e^{*})F'(i^{*})=1 \tag{3}$$

and

$$\alpha F(i^{*})+\pi=\phi'(e^{*}) \tag{4}$$

In the presence of a technological benefit ($\alpha>0$), the development project investment $i^{*}$is increasing in the commercial effort undertaken by the business partner. Moreover, then, the optimal commercial investment is increasing in the technological benefit.

## 3.2 Non-contractible investments and renegotiation

### 3.2.1 How much money can the NGO get from its commercial venture?

Now, the case where investments are non-contractible is examined. First, $N$ and $P$ simultaneously invest in $i$ and $e$, respectively. Once investments are sunk and returns are realized, $P$'s monetary transfer $t$ to the NGO is determined by 50:50 Nash bargaining. To understand how much the NGO can get from its business partner, we need to define the benefits to each party from staying in the relationship. This requires a discussion of disagreement payoffs.

Since the NGO and its business venture are separate entities, $P$ owns the business venture. In the event that bargaining breaks down, the NGO does not get any transfer from the venture. Moreover, it is assumed that the externality $\alpha$on the NGO's primary mission activity disappears in the event of break up of the partnership.

Furthermore, assume that the commercial venture benefits from a respectability premium if it remains associated with the NGO. Thus, in negotiating with the NGO, $P$ faces a trade off between having to pay $t$ and the loss of profitable public relations benefits. This is modeled as $P$'s profit becoming $\pi_0<\pi$ in the event that bargaining breaks down.

Then, disagreements payoffs are given by

$$\bar{U}_N=BF(i)-i \tag{5}$$

and

$$\bar{U}_P=\pi_0 e-\phi(e) \tag{6}$$

Taking $i$ and $e$ as given, the bargaining stage is examined first, in order to determines $t$, the amount transferred to the NGO by the business venture. Assuming 50:50 Nash bargaining, $t$ is determined by maximizing $(u_N - \bar{u}_N)(u_P - \bar{u}_P) = [\alpha e F(i) + t]\,[(\pi - \pi_0)e - t]$. Deriving the first order condition leads to the following value for $t$:

$$t = \frac{\pi - \pi_0}{2} e - \frac{1}{2}\alpha e F(i) \tag{7}$$

This simple expression is useful to think about how NGOs can benefit from different types of commercial ventures. It emphasizes two key ingredients of the relationship between the NGO and its partner commercial activity. First, note that the transfer $t$ to the NGO is higher the more important the respectability premium is for the business partner. Second, when $\alpha > 0$, $t$ may well be a transfer from the NGO to the commercial venture.

The commercial partner's benefit from the partnership with an NGO, $\pi - \pi_0$, may not only be thought of as a "respectability premium". There are reasons other than public relations for why corporations may benefit from such collaborations. In the case of Grameen Phone, the cooperation of the Grameen Bank is essential in serving otherwise hard to reach rural customers and collecting fees from them. Furthermore, it would have been difficult for the Norwegian partner in the venture, Telenor, to enter the Bangladeshi market, without being backed up by the Grameen Bank's good reputation at all levels in the country.

The case $\alpha = 0$ represents a well-known class of corporate NGO collaborations, where the benefit to the NGO is primarily monetary and no technological benefit in terms of its primary activity is provided by the corporate partner. Here, $t$ is always positive, i.e., a monetary contribution from the business venture to the NGO in exchange for the respectability gained through partnership. Such examples abound, as discussed in section 2.

However, as noted above, $t$ may well be negative in the case where $\alpha > 0$, if the technological benefit for the NGO is relatively more important than the respectability gain for the business partner. Then, bargaining between NGO and business results in a payment by the NGO. Although the literature tends to emphasize the income-generating purpose of NGOs' commercial ventures, examples discussed above help illustrate this seemingly odd result. In the case of Grameen Phone, an important role of the NGO Grameen Telecom is to collect revenue from users, thanks to Grameen Bank's existing rural activities. Here, the NGO pays its business partner for the service and collects revenue from rural users as part of its development activity.

Another relevant example is Grameen Shakti, an NGO that provides renewable energy solutions in rural Bangladesh. Its suppliers of solar panels are BP solar (India) and Kyocera (Japan). One may argue that producing solar panels is a noble enough activity, so that public relation benefits are unlikely to be the main driver of their collaboration with a particular NGO. However, for the NGO, the technological benefit is large, and it is worth paying for the input. It is worth noting that in other cases where such crucial inputs are provided by a business to an NGO, they are often provided for free, i.e. as a corporate donation in kind. For example, the online microfinance organization Kiva benefits from a variety of such partnerships.[7]

### 3.3 Second best investments $e$ and $i$

Plugging the value of $t$ into the objective functions of $N$ and $P$, we can now solve for the second best investments chosen by the NGO and the business venture. The first order conditions for $i$ and $e$ are respectively given by:

$$(B + \frac{1}{2}\alpha e)F'(i) = 1 \tag{8}$$

and

$$\frac{\pi + \pi_0}{2} + \frac{1}{2}\alpha F(i) = \phi'(e) \tag{9}$$

For more convenience in the discussion below, (9) can be rewritten as follows:

$$\pi + \alpha F(i) - \left[\frac{\pi - \pi_0}{2} + \frac{1}{2}\alpha F(i)\right] = \phi'(e) \tag{10}$$

First, for a given $e$, the second best $i$ is always below the first best value. Second, investment $e$ in the business venture is always lower than its first best level when technological benefits are positive ($\alpha \geq 0$). However, it is worth noting what happens when one considers the opposite case where association with a business makes the NGO's primary mission less efficient ($\alpha < 0$). Then, business investment may be higher than the first best when the respectability premium is too strong.

This suggests that we may not see enough NGO commercialization in cases where it could greatly improve NGO primary mission activities, while we may see too much of it when it constitutes a drag for the primary mission.

## 4 Restricted donations and commercial income

In the above analysis, it was implicitly assumed that the NGO's investment $i$ was easily financed by existing available funds, including donors' charitable contributions. The present paper thus ignores financing constraints. However, one important issue regarding donor funding can be discussed in light of the results. This

[7] http://www.kiva.org/about/supporters/, accessed on February 12, 2009.

is the purpose of this section.

Donor funding to NGOs often comes with strings attached. NGOs themselves advertise the way donations will be earmarked, often in great detail. Donations raised for a specific purpose, like those following the tsunami appeals in 2004, are reported as "restricted", in the sense that they are supposed to be used only for tsunami-related expenditures. Child sponsoring programs, and the commitment to donors that they will regularly receive news about and pictures of the sponsored child, are a way to signal that related donations are used for the intended purpose. Given that NGOs must cover administrative expenses, and possibly use some funds to start commercial ventures, donors who hope their money will be used directly to help the poor worldwide may have concerns. Earmarking (and heavy advertising thereof) of charitable contributions is thus a useful fundraising strategy. As a result, a large portion of an NGO's income often has restricted uses, which may prevent NGOs from allocating resources as effienciently as they would like (Action Aid, 2004). For example, unforeseen contingencies or needs may require a whole new campaign to generate new funds, although existing funds could be partly reallocated instead.

In the model above, the NGO's commercial income is the amount $t$. Focusing first on the case $\alpha \leq 0$, $t$ is positive. As discussed in section 3, this is the case where the NGO's motive to start or form a partnership with a commercial venture is purely monetary. As derived above, the NGO's commercial income is given by

$$t = \frac{\pi - \pi_0}{2} e - \frac{1}{2} \alpha e F(i) \tag{11}$$

Assuming all donor contributions $D$ must be used to increase investment in the development project, the NGO may have to increase output $F(i)$ to $F(i+D)$, so that $t = \frac{\pi - \pi_0}{2} e - \frac{1}{2} \alpha e F(i+D)$. Thus, in this case, commercial income increases with donations.

However, in the case where the commercial venture provides a technological benefit to the NGO's primary mission, i.e. when $\alpha > 0$, the opposite result occurs. An increase in donor funds restricted to raising the value of $F(.)$ now leads to a decrease in commercial income $t$ (when $t > 0$).

When $\alpha > 0$, we must also consider the last case where $t < 0$. This is when the NGO finds it profitable to subsidize its commercial venture, rather than extract income from it. The payment is larger the higher $\alpha$, and the higher $D$.

Thus, we should not necessarily expect to see an increased commercialization of NGOs' income when charitable contributions fall. This is certainly one possibility, but it may be viewed as a response to the restricted use of donations, combined with commercial activities that benefit the implementation of development projects. This is because more donations raise $F(.)$ and thus make $t$ relatively less important for the NGO. In the absence of technological benefit (when $\alpha \leq 0$), donations raise the NGO's disagreement payoffs, and allow it to raise more from its commercial venture.

However, when there is a technological benefit, an expansion of the NGO's mission output make the partnership even more valuable, which worsens the NGO's bargaining position. Donations may then actually be justified to fund NGOs' commercial partnerships.

## 5 Conclusion

The present paper emphasizes the importance of key ingredients of business-NGO partnerships: potential technological benefits for NGOs, respectability benefits for firms. The relative importance of these two factors determine whether the partnership involves a payment by the firm to the NGO (a common form of corporate sponsorship) or a payment by the NGO to the firm. This provides a coherent framework to think about a variety of collaborations between NGOs and the for-profit sector.

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