

4 PARTNERSHIP BUSINESS MODELS: MIXED FINANCIAL MODELS REQUIRE DONOR FLEXIBILITY

What kind of business models do partnerships for sustainable development rely on and what implications do these models have for the management and success of partnerships? This question has become one of the focal points of attention in the discussion about partnerships, especially for donors and the private sector.²⁷

While it is fairly clear what a business model entails for corporations, the application of the term to sustainable development partnerships can create confusion. This chapter therefore first discusses the term and its meanings when applied to partnerships. It then focuses on the financial models used by partnerships before the next chapter discusses partnership business models as tools for planning and management.

The Seed partnerships rely on different financial models that can change over time. They range from partnerships that receive all their financial resources from partner organisations or external donors to those that generate sufficient revenues from their own operations to cover all costs or even create profits. Most partnerships, however, rely on a mixed financial model. Thus, they do require support from donors or partner organisations, but also cover parts of their costs through commercial activities.

The Seed partnerships reveal that partnership progress is not directly linked to any specific financial model. Rather, the Seed partnerships show the importance of mixed financial models and emphasise the need for flexible financial instruments that can match their specific needs.

WHAT ›BUSINESS MODEL‹ MEANS FOR PARTNERSHIPS

Recent discussion in the development community has focused on ›business models‹ of sustainable development partnerships and other

CONCEPTS AND DEFINITIONS (II)

Business model describes the goals, strategies and key mechanisms used by a business to generate profits.

Business plan outlines the concrete steps and actions to translate a business model into practice.

Financial model is that part of a business model that describes how an organisation plans to generate the financial resources necessary for its operations.

Entrepreneurship describes the ability of individuals to drive change. It presupposes vision, leadership qualities and a willingness to bear risks.

initiatives. When transferred from the corporate world to sustainable development discourse, however, the term ›business model‹ can create confusion.

For a corporation, its ›business model‹ describes the way it plans to generate revenues and profits by serving its customers. This generally includes a definition of the customers, as well as the products or services offered and the way the operations are organised and profits generated. A business model thus describes the main activities and structures of a corporation with a special emphasis on the mechanism used to generate revenues and profits. When this emphasis is transferred directly to partnerships, ›business model‹ is taken to mean ›how the partnership generates its financial resources‹.

ADAPTING BUSINESS MODELS TO PARTNERSHIPS

A business model defines*:

the value proposition or vision



potential customers and sources of revenues



the firm's position in the value chain or how it contributes to realising the vision



an estimate of the cost structure and profit potential



the firm's position in relation to complementors and competitors



the firm's competitive strategy



A partnership business model defines:

which sustainable development goals are pursued

how the partnership intends to generate necessary resources for implementation

how the partnership intends to contribute to the stated goal

how the partnership plans to allocate resources in pursuit of the goal

what alternative strategies exist for reaching the same sustainable development goal

what advantages the partnership can offer compared to those competing for resources

* Adapted from Chesbrough & Rosenbloom (2002)

Confusion can arise because the idea of a ›business model‹ can also be adapted in a deeper sense to sustainable development partnerships. In the corporate world, a business model ultimately includes the ideas, structures, resources, and activities employed by an organisation to achieve its main aim. For a business, this aim is usually defined as the generation of profits, though more recently, an increasing

number of businesses have added social and environmental goals to this. Organisations promoting sustainable development, however, typically focus mainly on development goals. The generation of resources is a means to an end. A partnership business model therefore includes all ideas, activities and structures used to reach the goal defined by the partnership. Generating the resources needed for implementing these ideas is thus certainly an important, but by no means the only, component of a partnership business model.

Understood in this way, the concept of a business model and the business plans developed from them have two very important meanings for partnerships. External to the partnership, many donors and investors assess the soundness of a partnership business model for deciding whether or not to support the initiative. Within the partnership, business models and their corresponding business plans are one—though certainly not the only—essential tool for partnership planning and management.²⁸

As it is impossible to discuss the merits of each individual business model of the Seed partnerships, the following analysis will concentrate on the different models used to generate resources. The next chapter, building on this analysis, focuses on the importance of sound planning, management, and governance that typically are core components of a functioning business plan.

FOUR FINANCIAL MODELS FOR PARTNERSHIPS

Unlike businesses, partnerships for sustainable development usually do not have the creation of revenues and profits as their main aim. Nevertheless, they do need to find ways to generate the necessary resources for implementing their activities. Compared to the private sector, the possible sources of partnership resources are more diverse. In principle, resources can come from the partner organisations themselves, external donors, or can be revenues generated by the partnership, which may require an initial investment or loan.

Based on these different sources, we can distinguish four ideal typical models for providing partnership resources. The models do not necessarily reflect how partnerships generate resources in the very early stages of their development. Rather, they refer to the way partnerships envisage their finance and support in the medium- to long term.

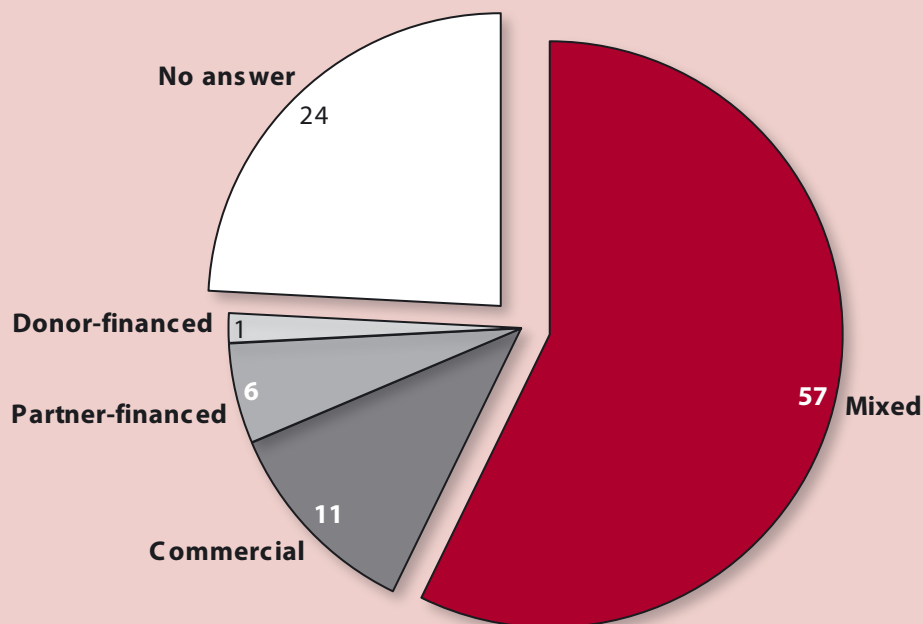
◉ Partner-financed partnerships

The organisations forming a partnership almost always provide a critical contribution in terms of time, expertise, will, and sometimes money to the early development of the partnership. For the medium- to long term, however, most partnerships plan to gain access to external sources of finance, such as grants, loans or revenues from commercial activities.

Of the Seed partnerships, only 6 percent plan to remain mostly dependent on partner contributions once the partnership is fully functional. These partnerships all share a basic characteristic: they provide services intended to mainly benefit the partner organisations themselves.

MOST PARTNERSHIPS RELY ON MIXED FINANCIAL MODELS²⁹

Percent of partnerships



The *Global Marketing Partnership for SRI Indigenous Rice* is the only Seed winner based on this financial model. To set up its marketing network, the SRI partnership requires external support. Through its operation, however, the partnership intends to enable the participating collectives of SRI rice farmers to sell their produce at better prices. Farmer cooperatives can then use part of their extra profits to finance the operation of the partnership that supports them.

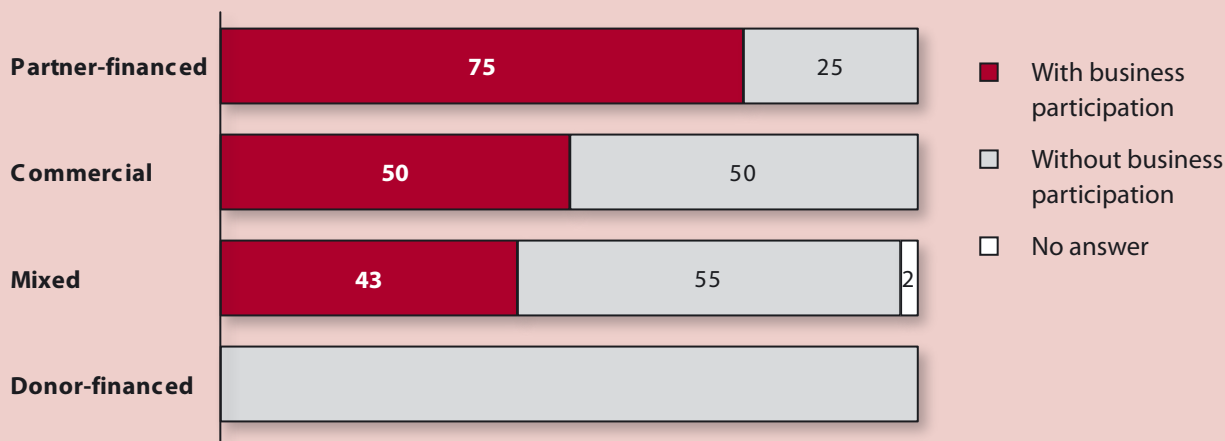
◦ Donor-financed partnerships

Financial support from donor organisations plays an important role in the resource planning of most partnerships. Nonetheless, among the Seed partnerships, only one percent plans to rely exclusively on donor funds in the medium- to long-term.

How dependent partnerships plan to remain on donor support depends strongly on their area of work. Partnerships providing services to very disadvantaged communities, especially in health, education, or disaster relief, often have little choice but to opt for donor-dependent financial models.

PARTNER-FINANCED PARTNERSHIPS SHOW THE HIGHEST BUSINESS INVOLVEMENT

Percent of partnerships



◦ Commercially self-sustainable partnerships

The counterpart to the donor-dependent financial model is the commercially self-sustainable model. Here, partnerships sell products or services to third parties. If revenues are restricted to covering the operating costs, the partnerships must rely on partner contributions or grants as start-up capital. If they generate profits, the partnership can also try to attract equity investors or take out a loan.

This financial model is very appealing: If partnerships manage to become commercially self-sustainable, they can ensure their continued operation and scaling up more easily than when they rely on external contributions. These partnerships still differ from business ventures as social and environmental goals continue to be their main focus. Eleven percent of the Seed partnerships are based on commercially self-sustainable financial models.

The *Cows to Kilowatts* partnership illustrates these advantages clearly. It needs a relatively large initial investment to develop the appropriate technology. But revenues from gas sales are projected to create significant returns on investment within three years. This means not only that the continued operation of this first water cleaning and gas production facility would be assured, but also that the approach could be replicated in other similar situations.

But partnerships based on a commercial business model often find it hard to raise conventional capital. This is especially the case in the early phases of development, because the projects are often seen as too small and too risky by investors. To fill this gap, donor institutions are increasingly providing capital for the planning, pilot, and commercialisation phases of small and medium enterprises whose operations have a positive development impact.³⁰ Once these initiatives have

proven to be commercially viable, it is hoped that they will be able to attract conventional investors.

The *Cows to Kilowatts* partnership is benefiting from one of these programmes. Facilitated by the Seed Initiative, the Programme in Energy and Environment of the United Nations Development Programme in Nigeria is providing a substantial share of the necessary start-up capital.

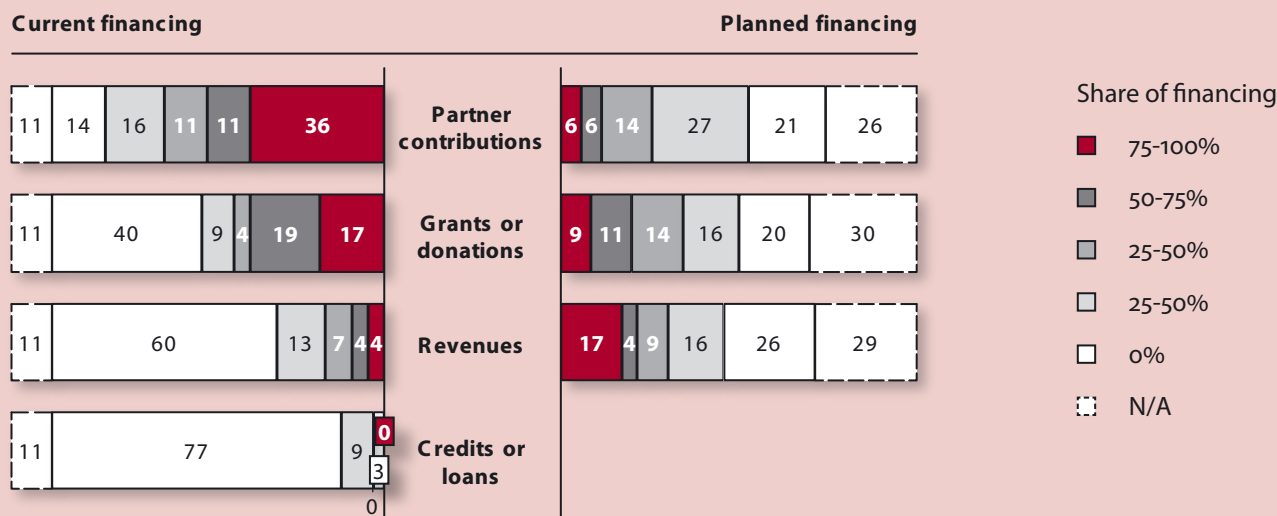
◦ **Partnerships based on mixed financial models**

Much attention has been focused on commercially self-sustainable partnerships because of the advantages described above. In reality, though, mixed financial models play a much more important role. A large number of sustainable development partnerships combine financial or in kind contributions from partners, resources from external donors, and revenues from commercial activities or commercial loans. Of the Seed partnerships, 57 percent rely on a mixed resource base, including three of the five award winners.

The *Agua para Todos* partnership demonstrates this mixed financial approach. As the partnership is concerned with providing water services to residents in Cochabamba, it is financed in part by the groups who benefit from the services, and in part by the local government, which sees service provision as one of its tasks. By contrast, when the partnership engages in training and health education among the local population, it relies largely on grants from development organisations.

PARTNERSHIPS PLAN TO SHIFT FINANCING FROM OWN CONTRIBUTIONS TOWARDS REVENUES

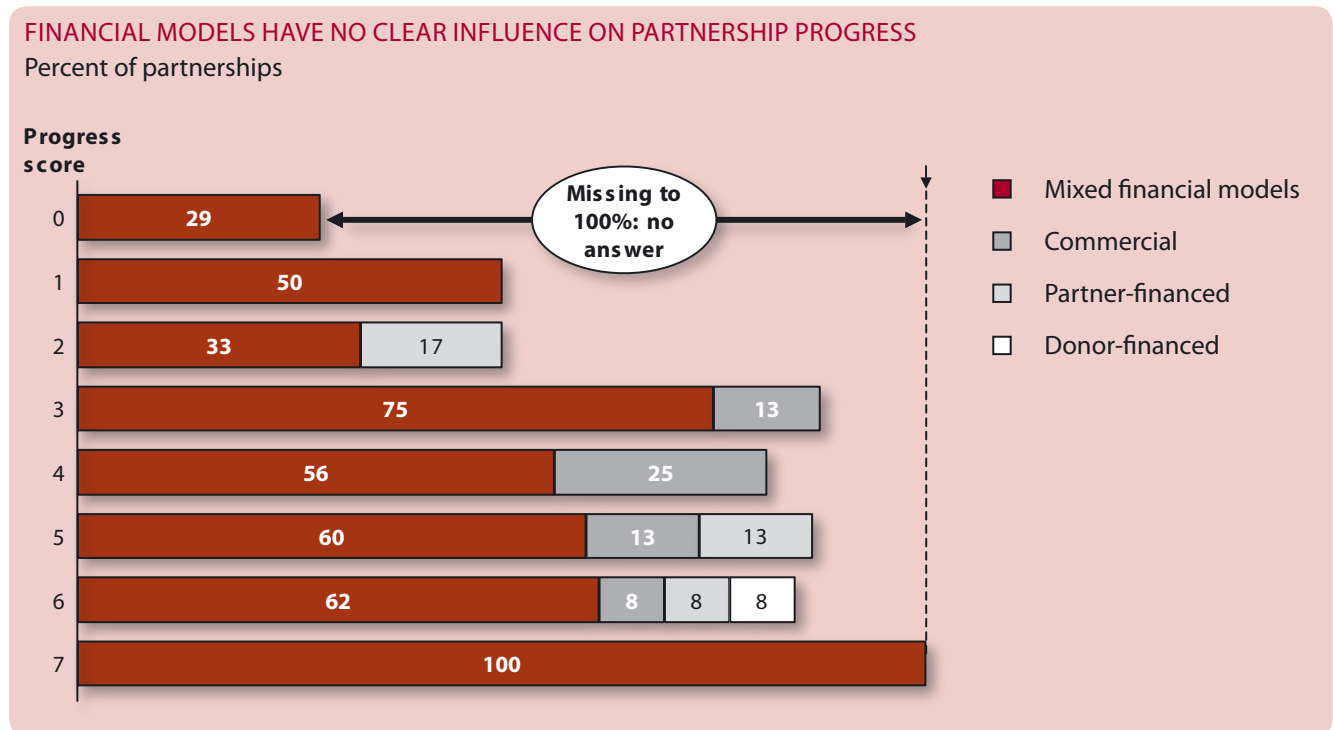
Percent of partnerships



The financial models described here are part of the partnerships' business models. This means that they represent how the partnerships plan to raise funds once they are fully functional. It is instructive to compare this with the way the partnerships are currently financed. Clearly, in the beginning, partner organisations and donors provide the bulk of financial support. Over time, though, many partnerships envisage that revenues from commercial activities will contribute a more important share to their financial resources.³¹

PARTNERSHIP PROGRESS DOES NOT DEPEND ON A SPECIFIC FINANCIAL MODEL

The choice of a financial model is central to the conception, planning and running of a partnership. As the examples above indicate, it determines not only what types of resources are accessible for partnerships, but also reflects the dominant logic underlying partnerships and influences their planning and evaluation standards. Still, this does not mean that the financial model in itself is a good indicator of the likely success of a partnership.



Rather, a partnership business model must be internally consistent to be successful. The general logic of the partnership should correspond to the financial model chosen. Partnerships seeking to derive their resources predominantly from the partner organisations, for example, must be able to make a convincing case about what kind of benefits they will provide to these organisations. Partnerships depending mainly on government and donor funds, by contrast, need to demonstrate that they contribute to an important public good and that they do this in an effective and sustainable way. Partnerships seeking equity investments or credits, finally, must show how they plan to generate returns on investment and how they manage risks.

As the graph shows, the Seed partnerships show no clear pattern that would suggest that one financial model is inherently superior to the others.³²

THE APPEAL AND CHALLENGES OF MIXED FINANCIAL MODELS

The majority of the Seed partnerships, and especially of the Seed Award winners and finalists, rely on mixed models of resource provision. What, then, constitutes the special appeal of mixed financial models? And what particular problems do partnerships encounter when they use mixed models of generating resources?

One reason for the strong reliance on mixed financial models lies in the special properties of partnerships. They tend to combine organisations with different typical approaches to problems and integrate different goals into one project. Governments and large corporations, for example, often preside over substantial resources and may be more likely to contribute directly to the partnership. Charities, on the other hand, might prefer to raise donor funds, and businesses may be more likely to focus on the commercial potential of the project.

Another reason is that in multifaceted projects, different parts of the work programme may lend themselves more readily to different sources of support. For example, where nature conservation projects are linked to ecotourism, the conservation element may appeal to donors focusing on environmental issues, whereas the ecotourism part may attract a commercial investor. In the area of sustainable development, much importance is attached to the integration of the economic, social, and environmental dimensions of development. Partnerships based on mixed financial models have a special appeal in this context because they believe their activities can make both a convincing business and development case.

But the combination of such diverse fields of work also brings with it acute challenges. When partnerships seek financial support or start-up capital both from donor organisations and commercial institutions, existing financial mechanisms may not be flexible enough to adjust to this dynamic approach. Donor-support, for example, is often restricted to entities that are officially registered as charities.³³ Abiding by this regulation makes it officially impossible for these partnerships to also approach private investors, who demand good rates of return, to cover their remaining financial needs.

Some of the more innovative public instruments of development finance seek to mix public and private resources. These include programmes to encourage the development of small and medium-sized enterprises or funds hedging investment risks in public infrastructure projects.³⁴ *Cows to Kilowatts*, the only winning partnership based on a commercially self-sustaining business model, has benefited from such an instrument. The Programme in Energy and Environment of the United Nation's Development Programme provides a substantial part of the necessary initial investment. But even these programmes are ill prepared to deal with mixed financial models: *Cows to Kilowatts* is required to register as a business, thus cutting it off from more traditional donor funds.

Most problems of formality, though, also have formal solutions. Thus, the problem of whether a partnership should officially establish itself as a charity or as a business can simply be circumvented by avoiding formal incorporation. In this case, the partnership can rely on its constituent members for channelling different financial contributions. The downside of this approach is that it renders the institutionalisation and formalisation of partnerships very difficult—a step that is important especially when partnerships scale up their activities and seek a more stable, transparent, and predictable governance structure.

Agua para Todos is an example of a partnership that relies on various financial sources and has avoided formal incorporation. It is constituted as a partnership through a series of contracts or memoranda of understanding between the partner organisations. Each benefiting from their distinct formal status, the business partner is in charge of attracting credits for the expansion of the commercial part of the partnership's activities, the officially recognised community organisations qualify for government support under a special program, and the non-profit organisations apply for grants. Difficulties arose, however, when the partnership wanted to use municipal funds to pay for the services of the commercial partner. Introduced by the Seed Initiative, UNDP now plays an intermediary role facilitating the transfer of funds between the two partners. Evidence from the entire group of Seed partnerships shows that avoiding incorporation is quite common: only 37 percent of the partnerships are formally incorporated either as charities or businesses.

Yet, even when the formal hurdles to receiving funds from different sources have been cleared, problems pertaining to the policies and perceptions of funding institutions often persist. Despite the widespread partnership rhetoric in the sustainable development community, many donor and most financial institutions remain principally committed either to supporting non-profit or to investing in promising commercial enterprises. Partnership projects that are part charity and part business often do not fit into existing grant and support programmes or are met with suspicion.

Finally, partnerships relying on mixed financial models can have trouble shifting between the distinct skills sets of the private and public sectors. Grant applications look very different, use different languages, and argue different cases than applications for commercial funding. Correspondingly, the skills needed to be able to engage in both kinds of processes are complex and diverse. For example,

the leader of the *Harvesting Seabuckthorn at the Top of the World* partnership is very experienced and successful in soliciting contributions from individual donors, but these skills have proved to be less effective when trying to engage with commercial partners to convince them about an up-front investment in equipment.

LESSONS



LESSON 7

SUCCESSFUL PARTNERSHIPS CAN BE BASED ON DIFFERENT FINANCIAL MODELS

Partnerships can rely on resources from their partner organisations, donors, commercial activities, or a mix of the above. None of these financial models was found to be inherently superior to the others.

Most Seed partnerships rely on mixed financial models. These are particularly suited to initiatives in which different kinds of organisations cooperate and where economic and social or environmental goals are pursued at the same time.



LESSON 8

THE ENABLING CONDITIONS FOR MIXED FINANCIAL MODELS NEED TO BE IMPROVED

Partnerships based on mixed financial models often do not fit into existing donor or investment programmes as those are geared either towards businesses or towards charities. The creation of financial instruments with the corresponding flexibility should be encouraged.

- ²⁷ The concern about business models for partnerships stems from a debate relating to the contribution of businesses to development. A strong group of advocates argues that »Development will only pick up speed if we encourage private sector-led development by fostering business solutions to development challenges«, especially if companies build »inclusive business models that create new revenue streams whilst serving the needs of the poor through sound commercial operations«. World Business Council for Sustainable Development (2005, p. 78 and preface). Similar arguments are promoted by the World Economic Forum (2005), the Shell Foundation (2005), the Commission on the Private Sector and Development (2004), Prahalad (2003), and Holliday, Schmidheiny and Watts (2002).
- ²⁸ This is widely accepted in the business community, where analysts for example frequently attribute failure of many e-business ventures to the fact that their business model is lacking or ill defined. Cf. Alt & Zimmermann (2001).
- ²⁹ The sample size for partner-financed partnerships is very small: only four of the Seed partnerships are based on this financial model. We can therefore not draw any strong conclusions from the distribution (the likelihood that the differences are due to chance is 52 percent). The graph is intended to illustrate the composition of the Seed partnerships.
- ³⁰ The Rural Energy Enterprise Development (REED) initiative of the United Nation's Environmental Programme is an example. It supports entrepreneurs in setting up local energy enterprises to provide renewable energy to rural communities. It offers them a combination of enterprise development services and start-up financing. Once the enterprises have reached a commercial stage, it is hoped that they will be in a position to attract conventional investment to scale up and replicate their operations. See <http://www.areed.org>.
- ³¹ The REED experience also shows how local entrepreneurial projects go through different phases with respect to funding. The early stages of »proofing the concept« and »early stage commercialisation« are typically financed by foundations and donors who are interested first and foremost in the real impacts of the project. In their »more mature replication« phase, attracting commercial capital becomes crucial. This is where the conditions under which the project can pay back loans become the centre of attention. Cf. <http://www.areed.org>.
- ³² To calculate the progress score, we assigned one point each if: the partnership was still active; if it had started implementation; if it had secured new financial resources; if no partner organization had left it; if it received positive external feedback. In the partnerships' self assessment of success, we scored one point if it stated that it was »meeting some difficulties, but dealing with them«. If it indicated that it was meeting many or all of the goals it had set itself for this time, we assigned 2 points. Ideally, we would have included a measure for the external impact achieved by the partnership. Partly because the partnerships are too young, partly due to data-limitations, this has not been possible. Based on the available material, the current score provides the best possible indications whether a partnership is advancing or not. Partner-financed partnerships have a mean progress score of 4.5, with a standard deviation (SD) of 1.7. Donor-financed partnerships have a mean of 6 (SD = 0, since the sample only contains one donor-financed partner-

ship). Partnerships based on mixed financial models have a mean progress score of 4.3 (SD=1.7) and commercial partnerships have a mean of 4.4 (SD = 0.9). The likelihood that these small differences are random is 80 percent.

- ³³ Eligibility criteria for donor funds are usually defined separately for each programme. For example, »many USAID programs require an organization to be a »nonprofit organization« in order to be eligible for funding.« United States Government (2005)
- ³⁴ The Emerging Africa Infrastructure Fund (EAIF), for example, has been set up by DFID, SIDA, DGIS and SECO and provides US\$ 100 million in equity to underwrite the risks of commercial loans for infrastructure projects in developing countries. The United Nations Development Programme's Growing Sustainable Business Initiative also focuses on fostering enterprise solutions for development and provides capital to reduce investment risks (see <http://www.undp.org/business/gsb/>). The Equator Ventures initiative supports small and medium sized enterprises with a positive impact on biodiversity (see <http://www.undp.org/equatorinitiative/equatorventures/EquatorVentures.htm>).