Project Resource

Project resources are materials which were originally produced during support from the Business Innovation Facility team to a specific inclusive business project. They include inputs provided as part of technical assistance and summaries of findings and outputs. They are adapted for wider use so that other practitioners can also make use of the material.

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Transitioning from NGO to a business

Options for XYZ financial services provider

What is this resource?
This document is an edited version of a report produced for a three-month Business Innovation Facility project. This project supported a Malawian NGO to determine the optimal strategy for turning one of its (then donor-funded) activities into a self-sustaining, revenue-generating business. The client provides micro-credit services, so the detailed options for commercialisation relate to financial services. However, the management considerations involved in commercialisation of an NGO are relevant to NGOs in many sectors.

Who is it for?
This report will be helpful to other projects where an organisation is making the transition from NGO to sustainable business. It will also be useful to emerging businesses developing their operations in micro-credit and related services, as well as to emerging organisations undertaking business strategy analysis or review of their operating models.

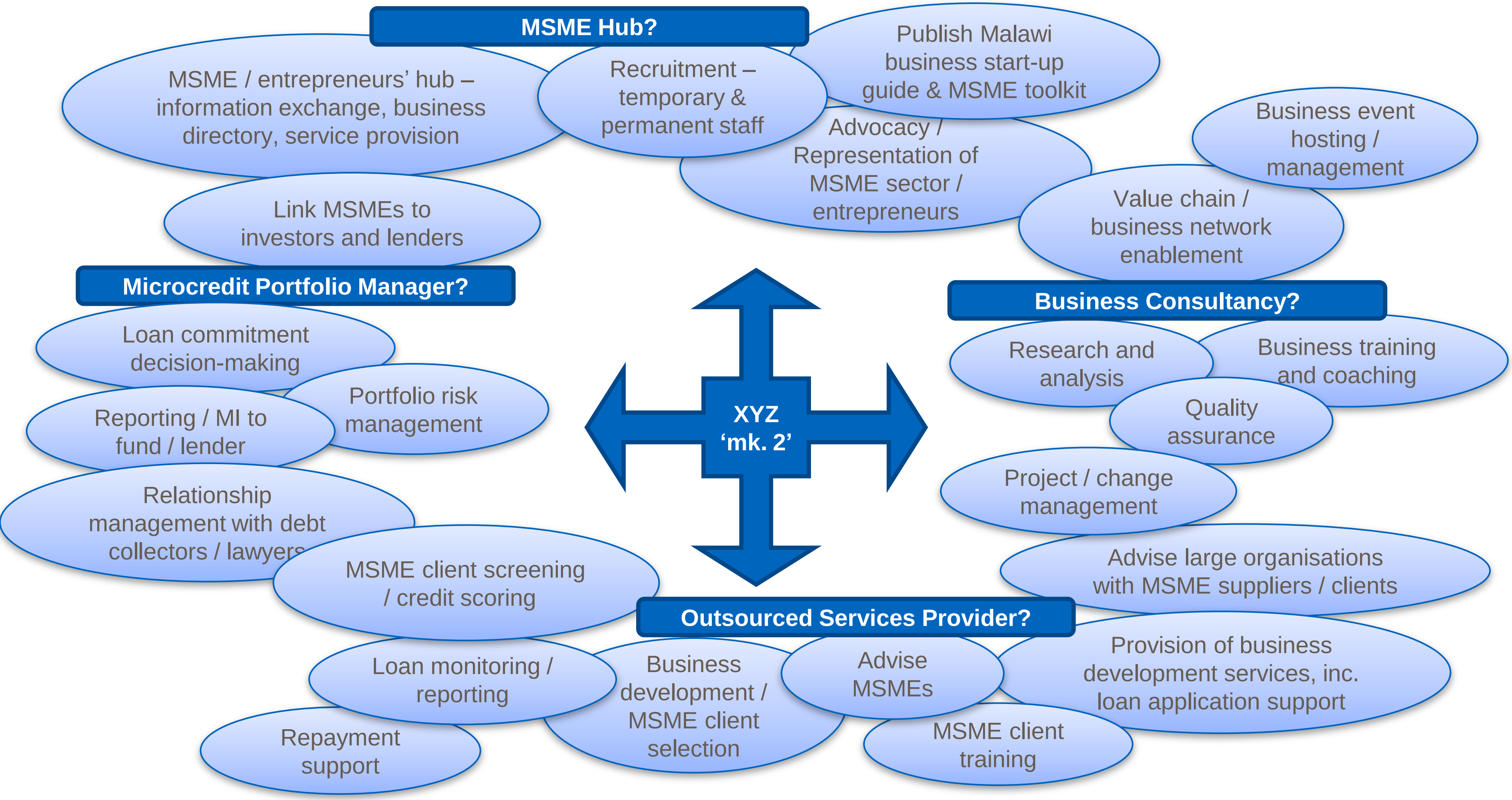
Contents

The challenge

- Support was sought from the Business Innovation Facility to help the client move, in a relatively short period of time from a donor-funded operation to an independent entity and, eventually, a profit-making business.
- The client was operating as a unit within the NGO parent, assisting micro-business clients to improve their planning, helping them apply for loans where appropriate and then assisting in managing repayments. The unit had several years of good track record to show and had more recently provided loan-vetting services to a bank and was trying to build on this relationship.
- The key issue was that the client could see the potential to be a service provider to microfinance institutions but required a new revenue model in order to continue sustainable operations in the long term. This ambition meant stepping into a gap in the local market – no banks outsource loan-vetting and management so this would be breaking new ground.
- The move would mean a big shift in culture for the team to take up the new challenge of operating commercially.
- The Business Innovation Facility explored various options for its future, including measurable goals and ways forward.

1. Summary

The question: what could XYZ become?



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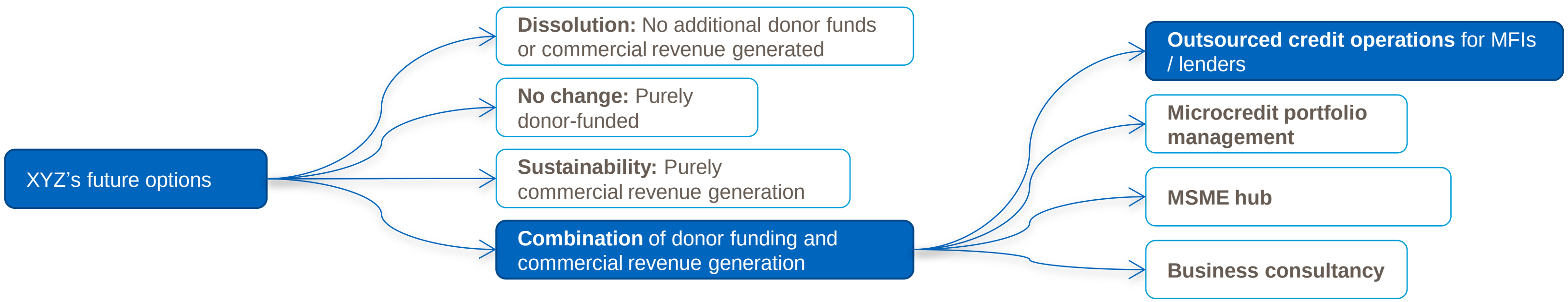
This is an illustrative (not exhaustive) summary of XYZ's potential options. Note there is some natural overlap between these options: XYZ could focus on just one of these options, some of them, or all of them

Summary of options and recommendations

As XYZ's donor funding comes to an end (Sept 2012), its future options include:

- **Dissolution:** Close down XYZ's operations and help team members find new roles
- **No change:** Seek additional donor funding to continue current operations
- **Sustainability:** Evolve into an income-generating, inclusive business
- **Combination** of donor funding and commercial revenue generation



Under the income-generation objective, 4 strategic options have been assessed:

1. Provision of **outsourced credit operations** to banks / MFIs that lend to MSMEs
2. Management of a microcredit portfolio **('direct intermediation')** on behalf of a fund / lender
3. Establishment and operation of an **MSME hub** for Malawi
4. Provision of more broadly-based **business consultancy** services to the private, public and NGO sectors

The outsourced credit operations option is proposed as the priority option for XYZ to pursue:

- Potential profit of approx. MWK 5m – 6m over first 2 years of operation (MWK 225k / month)
- Break-even point potentially 21 – 24 months after start-up
- This takes into account multiple scenarios but note that variables are hard to validate – not a projection!
- The other options are compatible with outsourcing (building on XYZ's unique knowledge of the MSME market), so one or more of them could be considered in future to replace or add to outsourcing.

This following pages describe the agreed strategy, provide supporting analysis and set out a structured transition plan

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Critical success factors for commercialisation

Critical to the success of the agreed strategy are several factors:

1. Buy-in and full project sponsorship from Parent NGO
2. De-prioritisation of current non-core activities in order to free up time and resource to focus on the project
3. Sound project management and governance (formal project steering committee to be appointed and to meet once a month, and project roles to be clearly defined up front)
4. Continued focus on seeking additional donor funds for 'incubation' period
5. Funding for additional specialist resource to support the successful transition from NGO to commercial enterprise

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Action: Parent NGO management should determine swiftly whether the above are realistically achievable in the short term. If critical success factors are not in place, stop and review

Assessment of strategic options against criteria

The table below assesses each of the strategic options against four criteria:

- Revenue potential during the first year (including start-up phase)
- Monthly set-up and running costs over first year (including start-up phase)
- Time to market (length of start-up phase)
- Stretch (how far each strategic option is from XYZ's current service and skillset)

Assessment:

Strategic Option	Assessment against criteria				
	Revenue Potential - Year 1	Cost (MWK / month) - Year 1	Time to market (months)	Stretch	Overall
XYZ today (for comparison)	Zero	1.4m	0	Low	Not viable
1. Outsourcing	Good	2.1m	3	Medium	Preferred initial option
2. Microcredit Portfolio Management	Good	2.2m	6 – 12	Medium - High	Potential future option
3. Hub	Poor	3.5m	12+	High	Potential future option
4. Consultancy	Poor	2.2m	6 – 9	High	Potential future option

Conclusion:

- The outsourcing option offers the greatest chance of early, stable revenue generation for the least amount of up-front investment and minimal 'stretch' from XYZ's current services and skillset. The other options are compatible with outsourcing and could benefit from the foundation that a successful outsourcing operation would provide. They should be reassessed after 6 – 12 months.

Financial estimates under alternative scenarios

Scenario 1: Base Case

- Variables: Oct 2012 start and fee and loan portfolio size are in line with targets.
- Outcome: Profit of MWK 5.5m over first 2 years and break-even point after 21 months of operating.

Scenario 2: Reduced Fee (-0.5%)

- Outcome: Loss of MWK 9m over first 2 years and break-even point after 30 months of operating.

Scenario 3: Reduced Loan Portfolio (-25%)

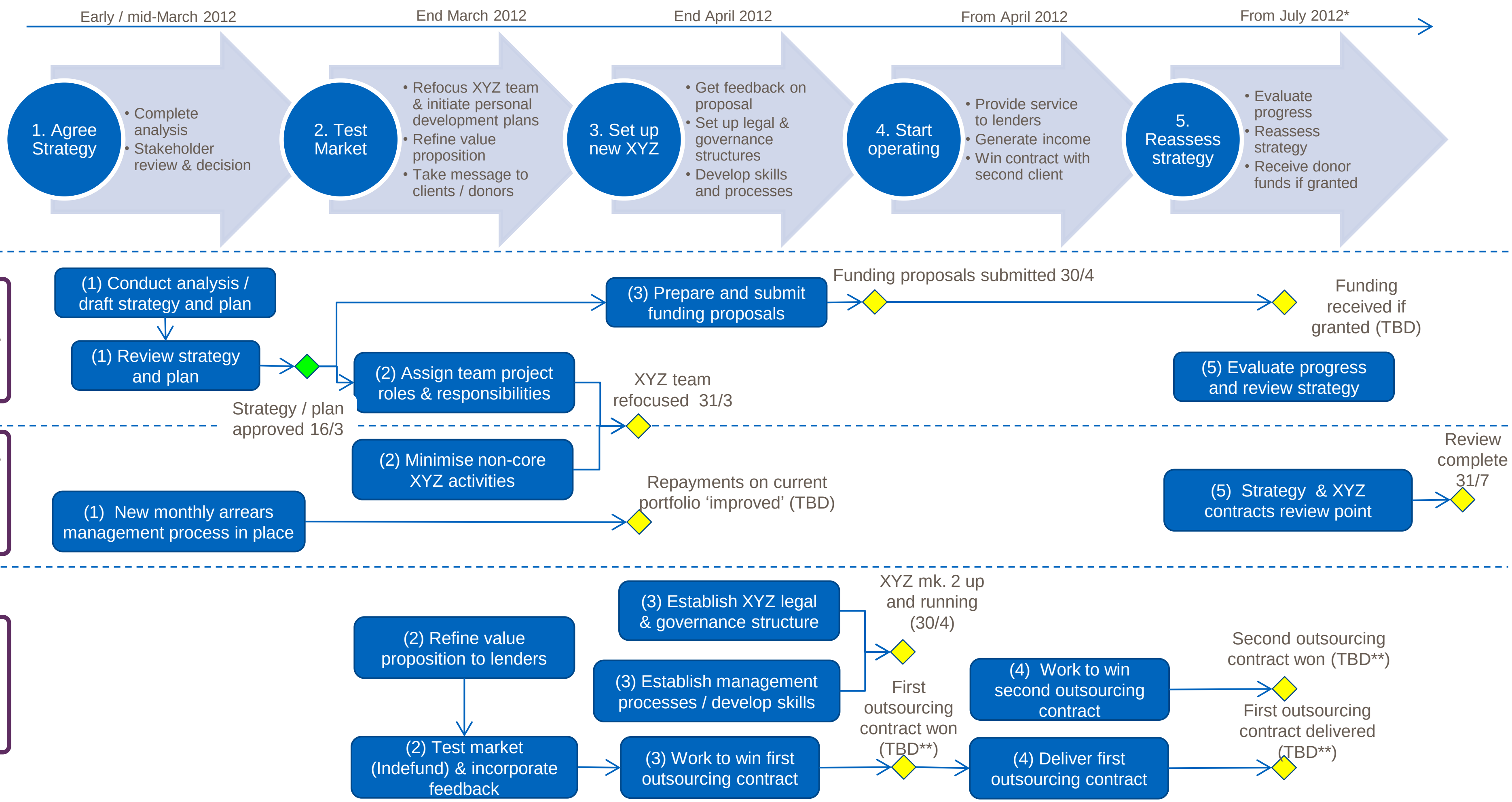
- Outcome: Loss of MWK 14m over first 2 years and break-even point after 48 months of operating.

Scenarios	Total costs up to breakeven point	Breakeven (months)	Profit			Revenue			Portfolio			
									Disbursed	Outstanding	Disbursed	Outstanding
			Yr 1	Yr 2	2 yr total	Yr 1	Yr 2	2 yr total	Yr 1	Yr 1	Yr 2	yr 2
1. Base scenario	62,500,410	21	-9,142,800	14,650,980	5,508,180	25,104,000	52,322,460	77,426,460	408,000,000	340,320,000	636,000,000	587,129,000
2. Reduced fee scenario (0.5% lower)	102,997,251	30	-13,378,800	4,420,365	-8,958,435	20,868,000	42,091,845	62,959,845	408,000,000	340,320,000	636,000,000	587,129,000
3. Reduced portfolio scenario (25% lower)	124,752,531	48	-15,418,800	1,570,260	-13,848,540	18,828,000	39,241,740	58,069,740	306,000,000	255,240,000	477,000,000	440,342,000
Original proposal	12,000,000	12	5,054,918	9,936,838	14,991,756	7,200,000	14,400,000	21,600,000	120,000,000		240,000,000	

The following will also have a bearing on profitability and breakeven point:

- Start date for revenue earning – October has been used for the base case but an earlier start is targeted
- The extent to which XYZ can take advantage of Parent NGO office and logistics facilities after September 2012
- Loan portfolio ramp-up rate
- Changes in either macro- and micro-economic conditions, such as they impact both lenders and MSMEs

Transition plan



* Timeline dependent on when contracts are won and when service provision begins

** Timeline for winning business is aspirational only. Note that financial business case assumes no revenue is generated prior to October 2012

Milestone in the future

Milestone achieved

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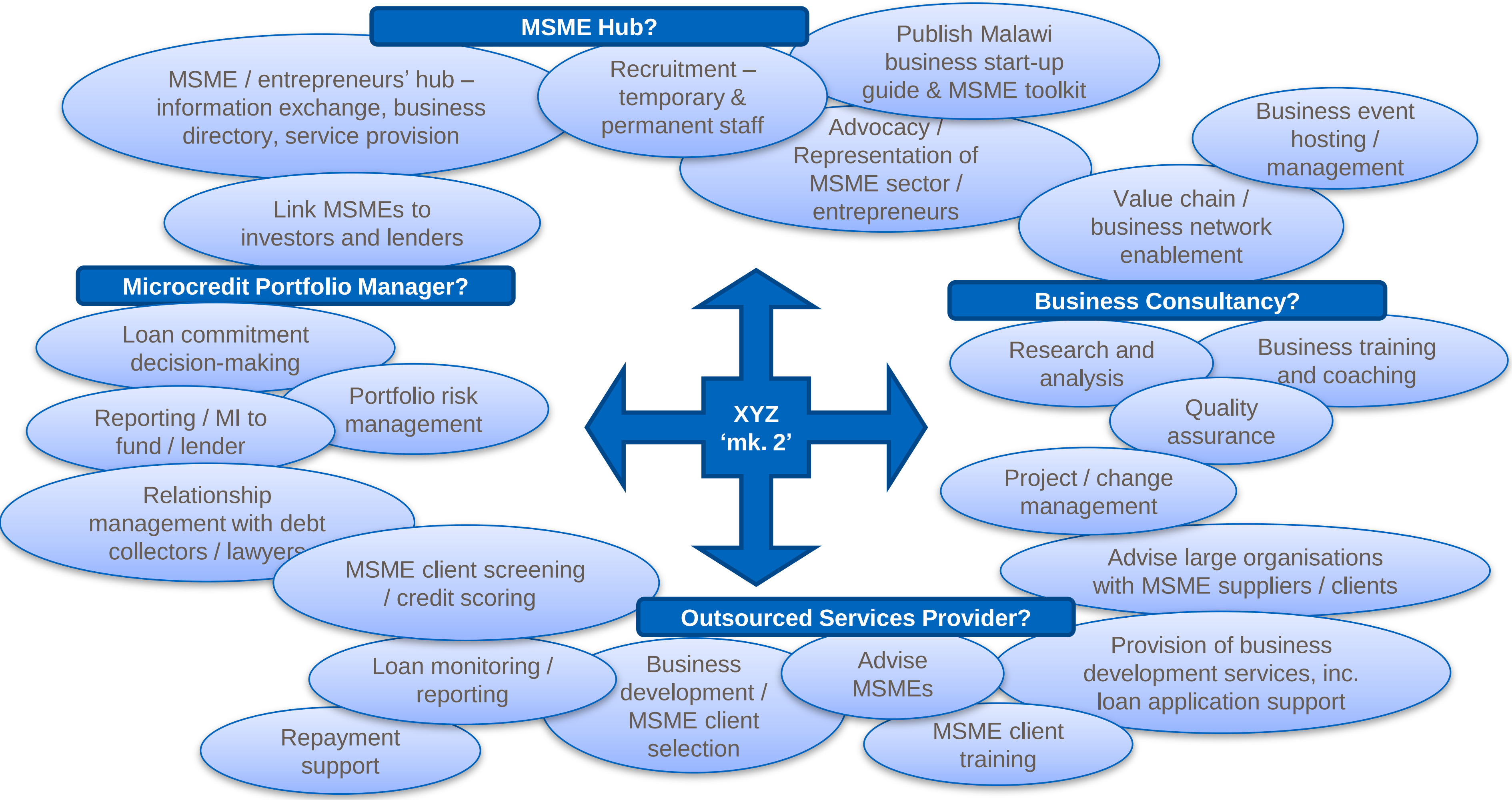
Decisions required by management/next steps

In order to proceed, the parent NGO needs to agree the following :

1. That the ‘outsourcing’ option is the priority strategy for XYZ to pursue (even if one or more of the other options may be pursued in future)
2. That XYZ should focus on winning a first outsourcing contract as a top priority (so XYZ resource needs to be partially refocused to achieve this)
3. The target legal and governance structure
4. That legal advice should be sought as soon as possible to confirm the target legal and governance structure is the most appropriate option
5. Financial business case assumptions, particularly with regard to the continued sharing of Parent NGO resources and subsidising of office / logistics and other costs
6. The proposed transition plan
7. The date in 2012 when wind-down procedures would need to be initiated for XYZ if the agreed strategy does not succeed

2. Analysis

The options: What could XYZ become?



This is an illustrative (not exhaustive) summary of XYZ's potential options. Note there is some natural overlap between these options: XYZ could focus on just one of these options, some of them, or all of them

Business model: provide outsourced MSME financial services to banks

Business Model Element	Description
Customer Segments	**Institution type: Banks** offering bridging loans, working capital loans and asset financing loans, and **deposit-taking MFIs.** **Institution client type:** Banks with an established **(M)SME** business, MFIs that either lend to **individuals** (rather than just to groups) or are expanding into the individual lending market. NOTE: Segmentation and screening of borrowers is essential - this business model must be predicated on sound lending practices to deserving, high-potential borrowers, and not on purely volume-driven targets. **Location: Blantyre** and **Lilongwe** to begin with but analysis needed on both banks / MFIs geographic spread, their expansion plans and on potential MSME clients. **Mzuzu** is a potential first additional location. Long-term potential for XYZ to go back to its rural roots or to be exported.
Value Proposition	1. Business development / MSME client selection 2. MSME client screening / credit scoring 3. MSME client training 4. Provision of business development services, inc. loan application support 5. Loan monitoring / reporting 6. Repayment support
Channels	**Sales:** Direct sales through the leverage, and development, of XYZ's existing network with banks and MFIs. The existing link with Parent NGO's VSLA and IGA programmes should remain as a source of potential MSME clients. **Communications:** Direct to target banks and MFIs
Key Internal Resources	**Headcount:** 7.5 (i.e. 2.5 incremental) **Roles:** General manager, general manager support (new: full-time for 6 months or half-time for 12 months), 4 loan officers, 2 admin / analyst (new) **Processes:** Comprehensive credit operations processes, and strengthened internal management processes. **Skills:** Development of skills to match required processes, in particular credit operations expertise .
Key External Resources (Partnerships)	Establishment of strong working partnerships with **client banks / MFIs** is essential – there may be other benefits from such partnerships, such as positive PR, leveraging of resources (e.g. Standard Bank provided office space for NASME). Good links with **universities / business schools** could be important for the longer-term recruitment pipeline as the business grows. A strong network amongst the **lending / microfinance sector** in Malawi, including MAMN and service providers to the sector, will be of increasing importance, e.g. in providing expertise / services (ideally free or at reduced cost if they can see the benefit of association with XYZ). Potential support should be sought from **big corporates, banks, consultancies in Europe / US**, potentially targeting their CSR commitments
Customer Relationships	**Client banks and MFIs:** 1 – 2 key relationships over first 6 – 12 months. **'Client' MSMEs:** retained subset of existing clients, plus 15 – 30 new clients per month once operational.
Revenue Streams	Revenue to be generated directly from client banks and MFIs by charging fees for screening and credit scoring MSME clients who wish to take out loans, MSME client training, and loan monitoring / reporting and repayment support. There is also the potential to charge some SMEs for XYZ support, including loan application help, negotiation of interest rates, etc. This potential is recognised but has not been reflected in the business case as the proportion of current clients believed to be able to afford these services is seen as minimal.
Cost Structure	Costs arise predominantly from headcount and overheads associated with the enlarged XYZ operation. There will be losses associated with credit and operational risk which can be minimised through an effective risk management and internal control framework.

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Business model: Direct intermediation between MSME and MFIs

Business Model Element	Description
Customer Segments	**Client type:** Micro-entrepreneurs **Location: Blantyre** and **Lilongwe** to begin with but analysis needed on geographic spread of potential microfinance clients
Value Proposition	1. Social mission: working to improve micro-enterprise business practices 2. Relatively better ability to bridge, through BDS provision, the information asymmetry (inadequate knowledge of clients) that makes most MFIs opt for group lending or none at all . XYZ can provide the individual lending preferred by clients 3. Provision of financing is a value add to BDS clientele 4. May be able to provide relatively cheaper priced micro-loans , dependent on the extent of its grant funding and concessionary institutional loans compared to commercial funding
Channels	**Sales:** Direct sales through the leverage, and development, of XYZ's existing geographical network **Communications:** Direct to target clients in the course of provision of business development services banks and MFIs
Key Internal Resources	**Headcount:** 8 (i.e. 3 incremental) **Roles:** General manager, general manager support (new), 4 loan officers, 2 admin / analyst (new) **Processes:** Comprehensive credit operations processes, and strengthened internal management processes. **Skills:** Development of skills to match required processes
Key External Resources (Partnerships)	Establishment of strong relationships with social investors like Kiva, Grameen Foundation, Triple Jump and others
Customer Relationships	Client Microenterprises: Core clients will be XYZ's existing BDS clients and the ones currently facilitated with financing through XYZ partnership with Indefund and MSB. Others will be acquired through word of mouth marketing conducted through BDS clients
Revenue Streams	Revenue to be generated directly from clients by charging fees (training, appraisal and monitoring) and interest on microcredit loans.
Cost Structure	Costs arise predominantly from headcount and overheads associated with the enlarged XYZ operation. There will be losses associated with credit and operational risk which can be minimised through an effective risk management and internal control framework.

Business model: MSME Hub

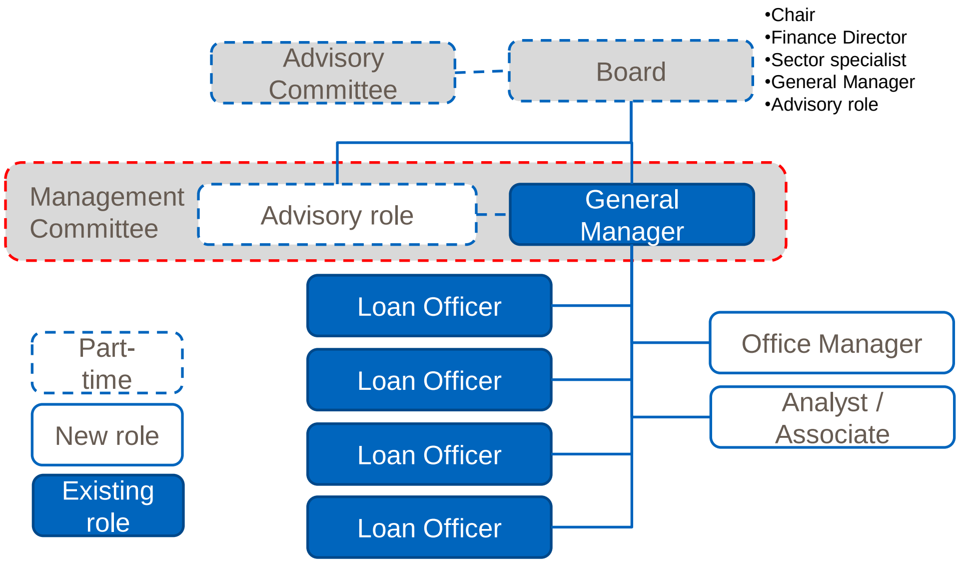
Business Model Element	Description
Customer Segments	**Institution type:** All Malawian MSMEs. **Location:** Throughout Malawi.
Value Proposition	1. Membership of hub: Information exchange, business directory, service provision 2. Linking of MSMEs and lenders / investors 3. Recruitment services (temporary and permanent staff) 4. Advocacy / representation of MSME sector / entrepreneurs 5. Publication of business start-up guide / MSME toolkit 6. Value chain / business network enablement 7. Business event management
Channels	**Sales:** Either directly with MSMEs who become members / customers or through trade associations or other business networks **Communications:** Advertising in the printed press and other mass media as appropriate, plus targeted marketing communications through trade associations and other business networks.
Key Internal Resources	**Headcount:** 9 (i.e. 4 incremental) **Roles:** General manager, general manager support (new), 4 consultants, 3 admin / analyst (new) **Processes:** Comprehensive service delivery, customer relationship management and communications processes, and strengthened internal management processes. **Skills:** Development of skills to match required processes, in particular customer relationship management and communications skills.
Key External Resources (Partnerships)	Establishment of strong working partnerships with multiple partners – trade associations and other business networks, banks / MFIs, advertisers, business-to-business organisations, press / media, government, NGOs. Establishment of good links with universities / business schools could be important for the longer-term recruitment pipeline as the business grows.
Customer Relationships	**Advertisers:** see above. **MSMEs:** Strong relationships with large number of MSMEs throughout Malawi is essential.
Revenue Streams	Membership fees, advertising fees and one-off fees for specific products or services offered.
Cost Structure	Costs arise predominantly from headcount and overheads associated with the enlarged XYZ operation. There will be losses associated with operational risk which can be minimised through an effective risk management and internal control framework.

Business model: MSME Consultancy

Business Model Element	Description
Customer Segments	**Institution type:** Larger organisations – private companies, government departments, NGOs or other public sector organisations that are in the market for consultancy services. Financial institutions would be the logical preference, at least initially (given experience and historical interactions). **Institution client type:** Organisations dealing with MSMEs as clients or suppliers **Location: Blantyre** and **Lilongwe** to begin with but analysis needed on clients' geographic spread and expansion plans.
Value Proposition	1. Research and analysis 2. Quality assurance 3. Business training and coaching 4. Project / change management 5. Advise large organisations with MSME suppliers / clients 6. Provision of business development services, inc. loan application support
Channels	**Sales:** At the outset, predominantly through partnerships with other consultancies, providing consulting resource to them on an associate basis (and their end clients) as demand dictates. As experience and reputation grow, sales would increasingly be made directly to end clients. **Communications:** Direct to target consultancies, and subsequently to potential clients.
Key Internal Resources	**Headcount:** 8 (i.e. 3 incremental) **Roles:** General manager, general manager support (new), 4 consultants, 2 admin / analyst (new) **Processes:** Comprehensive business consulting and service delivery processes, and strengthened internal management processes. **Skills:** Development of skills to match required processes, in particular consultancy skills
Key External Resources (Partnerships)	Establishment of strong working partnerships with other consultancies is essential – there may be other benefits from such partnerships, such as positive PR, leveraging of resources. Establishment of good links with universities / business schools could be important for the longer-term recruitment pipeline as the business grows.
Customer Relationships	**Consultancies:** 1 – 2 key relationships over first 6 – 12 months. **End Clients:** Longer-term relationships with end clients, where the aim will be to sell to them directly as soon as the opportunity arises.
Revenue Streams	Revenue to be generated from consultancy services provided.
Cost Structure	Costs arise predominantly from headcount and overheads associated with the enlarged XYZ operation. There may be losses associated with operational risk which can be minimised through an effective risk management and internal control framework.

Development of operating model: Governance and processes

- Legal structure: form a company limited by guarantee (provided there are no constraints on planned operations) and consider becoming a standard company limited by shares at a subsequent phase (perhaps 1 – 2 years after start-up). See appendix for key questions on legal structure.
- Governance:
  - 3-tiered governance structure proposed: Staff => Management Committee => Board
  - The role of the board will be crucial, particularly in the early stages of transition: a ‘hands-on’ role.



Guidelines for the composition and activities of XYZ’s Board

1. The Board should be composed of people whose experience, skills and style will complement the XYZ team and be well-matched to the activities that the Board will be undertaking.
2. The Board should consist of 5 or fewer people, including the General Manager and the advisory role. One option is to select a chairperson who can advise on strategy and operations, thereby removing the need for a separate advisor role.
3. The Board should consist of predominantly Malawi-based individuals, albeit with membership or support as required from outside Malawi.
4. The Board should meet monthly (for the first quarter) and quarterly from then on (and ad hoc as needed), and should always meet in person.
5. A Management Committee should be established to oversee the running of the company, comprising the General Manager, the advisory role and potentially one additional Board member. The Management Committee should meet monthly (fortnightly in initial phase).
6. An Advisory Committee should be established to bring additional expert resource into specific strategy discussions. It should meet twice-yearly (possibly quarterly in the initial phase)

See appendix for generic overview of Board responsibilities.

- Organisation:
  - Flat reporting structure: all staff report into the General Manager
  - Loan officers can have dual roles, e.g. head of training, head of monitoring / reporting

Operating Model: Processes to develop

- Everything XYZ will need to do can be summarised in a ‘process model’. Process areas comprise a number of processes which should be mutually exclusive but which invariably have a degree of interaction. The test of completeness is whether there are any activities envisaged or happening that are not described by one of the defined processes. There should not be.
- Below is the proposed high-level process model for XYZ under the outsourcing option. The ‘Gap vs Target State’ column shows where most work is needed to build XYZ’s processes to be ready for operation.

Process Area	XYZ Processes – Current State	
	Gap vs Target State	Comment
Product Development	High	
Sales & Marketing	High	
Operations & Service Delivery	High	
People and Performance Management	High	
IT & Information Management	Medium	
Strategy & Planning	Medium	
Financial Management	Low	
Risk Management	High	

Action: Management to develop action points for each process area, particularly those that are highlighted in red.

Summary of steps for commercialisation of NGO activities

1. Identify the parameters and objectives of transition from an NGO to a business model: shift to blended finance or pure commercialisation, continued Head Office link
2. Are the key success factors in place to move forward: buy-in, ability to scale down existing work, resources for the transition?
3. What are the options: what services and activities could be provided that build on existing strengths and market?
4. Assessment of each option: the value proposition, customer segment, channels, revenues, costs, staffing, time to market, degree of 'stretch' from current position.
5. Use matrix assessment of options to identify 'preferred option(s)
6. More detailed financial modeling of preferred option to check feasibility
7. Map transition plan – what must happen in each month from now?
8. Assess core NGO/company processes: where is the gap between current and necessary, what action will fill it, can existing processes that will no longer be needed be stopped?
9. Identify new governance framework – role and composition of Board, legal parameters, accountability
10. Based on above, identify immediate decisions, next steps, and timeline for a yes/no decision, then action and resourcing.

2. Appendices

Legal questions

Board responsibilities

Additional Resources

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Appendix: Legal questions

- Is Company Limited by Guarantee the most appropriate legal form?
  - Local legal and regulatory advice needed (two separate areas)
  - Will CLG constrain the types of contract XYZ can enter into or the type of business it can do (eg lending and lending-related)?
  - At what point would XYZ's activities need to be regulated (if not immediately)?
  - What future constraints are there in terms of how XYZ can evolve, if for example a high level of profits are earned, ownership changes occur, or other fundamental shifts?
- Are there any other legal constraints to be aware of?

Appendix: Board responsibilities

1. Determine mission and purpose. It is the board's responsibility to create and review a statement of mission and purpose that articulates the organization's goals, means, and primary constituents served.
2. Select the chief executive. Boards must reach consensus on the chief executive's responsibilities and undertake a careful search to find the most qualified individual for the position.
3. Support and evaluate the chief executive. The board should ensure that the chief executive has the moral and professional support he or she needs to further the goals of the organization.
4. Ensure effective planning. Boards must actively participate in an overall planning process and assist in implementing and monitoring the plan's goals.
5. Monitor, and strengthen programs and services. The board's responsibility is to determine which programs are consistent with the organization's mission and monitor their effectiveness.
6. Ensure adequate financial resources. One of the board's foremost responsibilities is to secure adequate resources for the organization to fulfil its mission.
7. Protect assets and provide proper financial oversight. The board must assist in developing the annual budget and ensuring that proper financial controls are in place.
8. Build a competent board. All boards have a responsibility to articulate prerequisites for candidates, orient new members, and periodically and comprehensively evaluate their own performance.
9. Ensure legal and ethical integrity. The board is ultimately responsible for adherence to legal standards and ethical norms.
10. Enhance the organization's public standing. The board should clearly articulate the organization's mission, accomplishments, and goals to the public and garner support from the community.

Reference: Richard T. Ingram, *Ten Basic Responsibilities of Nonprofit Boards, Second Edition* (BoardSource 2009).

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Additional resources

You will find more ideas, information and resources on innovation and inclusive business on the **Practitioner Hub for inclusive business: www.businessinnovationfacility.org**

There is a 'know how' section on **Commercialising NGOs**: http://businessinnovationfacility.org/page/know-how-commercialising-ngos

Within this section you can find another Project Resource based on a BIF project which supported an NGO as it transitioned into a successful inclusive business: **Building an operating model and governance structure for NewCo (now Jita):** http://bit.ly/U2cGjb

This project is also the subject of the Inside Inclusive Business report: **Striking a balance between profits and impact: How scenario modelling can be used to create a successful inclusive business plan:** http://bit.ly/11aEoRg

We welcome feedback on our publications – please contact us at enquiries@businessinnovationfacility.org

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