Handbook for Creating Endowed Institutions

sponsored by the

United States Agency for International Development

Bureau for Africa

(AFR/ARTS/FARA)

in cooperation with the

Department of Agricultural Economics
University of Missouri
Columbia, Missouri 65211

by

W. Paul Weatherly

Weatherly Consulting, Inc.
1748 Hobart Street, N.W.
Washington, D.C. 20009
Telephone: (202) 462-8528 Fax: (202) 387-3371

5 May 1994

Part I—The Case for Endowments

A. Introduction

A.1. General Forward to Handbook Users

This handbook offers donors, governments and leaders of civil society advice for considering the use of endowed funds to build local institutions. The handbook contains three parts Each of them give progressively specific advice for establishing an endowment:

- Part I makes a case for endowments. It describes the role of endowments in making development more sustainable by making key institutions more stable. This will contribute to making civil society more robust by making the non-profit sector a better partner for the governmental and for-profit sectors. This advice will help decision makers and political leaders.
- Part II looks at endowment design issues. It gives a conceptual framework for thinking though the strategic relevance of an endowment–the vital and complex roles in a civil society that an endowment can fill–and design alternatives for different situations. This advice will help those who are responsible for creating an endowment
- Part III gives practical advice on creating an endowment and sources of additional information which can helpful in that s endeavor. This section will be useful to donors, the organizers and directors, and constituency groups of a new foundation.

A.2. How this handbook fits into the Sustainable Financing Initiative

This handbook is the first in a series being sponsored by the *Sustainable Financing Initiative*, managed by the University of Missouri—Columbia. The initiative has four aims:

- to identify and promote innovative financing tools as a way to strengthen the institutions essential for sustainable development (with a first priority on agricultural research and natural resource management);
- to advance the theory and practice of creating endowed institutions *de novo*, as well as endowing existing institutions, as a strategy to address long term

needs in these two sectors;

- to link unfolding experience among African countries and between Africa and other regions, especially Latin America, so as to identify a set of conditions and actions necessary to successful creation of innovative mechanisms; and,

- to design and disseminate products (handbooks, papers, training) for a broad audience.

In addition to this handbook, the Sustainable Financing Initiative plans to issue three additional handbooks on other innovative financing techniques:
1) check off programs (useful in supporting agricultural research);
2) commercialization; and, 3) "debt for development" swaps. As interest develops, the initiative will write and distribute additional handbooks and papers which address specific topics.

The Initiative maintains an electronic bulletin board accessible via the internet. To obtain the latest information about its use, please contact the Initiative at the following internet mailbox: **<muccgw.ssvaldiv@ssgate.missouri.edu>**. Persons who have access to the internet will be able to access files either as text or WordPerfect files. These files contain the text of the handbooks, charters of already established foundations and endowments, and other useful information such as surveys of the present financial status of foundations in developing countries.

A.3. Handbook scope

This handbook gives guidance on the development and use in Africa of endowments to foster and support development activities. It provides a conceptual framework for understanding and choosing among alternative " creation paths" of an endowed fund, whether the fund is established with an existing institution or a new foundation is created for this purpose. The alternatives considered break down into five key areas: 1) the purpose of the endowment; 2) how endowment revenue is used; 3) who has oversight on assets and grants; 4) how funds are moved to an endowment; and 5) what process creates and endowment. It also makes recommendations on designing key areas of an endowment– its governing and management structure, relationship to the community and public sector activities, investment programs, and duration. These recommendations will need to be fitted to the specific sectors and purpose of any individual endowment that is created.

This handbook offers practical advice that is relevant for the entire spectrum of sector and purpose in development. The issues considered range from budget support for an existing institution to the creation of a new institution dedicated to building up capacity in a sector by operating as a grant making foundation. The sectors examined include the fullest variety of development activities. However, as most well known examples are in the two fields of agricultural research and environment, the handbook will emphasize those sectors.

This handbook envisions that if a new institution is to be created to manage the endowment, that it would be modeled on U.S. community foundations. Typically community foundations are governed by boards of directors representing a broad cross section of the community that is served by the foundation.

Finally, it's the perspective of the authors of this handbook that creating an endowed fund as a sustained, private-sector financing mechanism for development activity beyond the three-to-five time frame of normal donor programs represents a risk in power sharing. Donors and recipients of an endowed fund need to acknowledge this up front and approach their common task with an attitude that encourages a shared approach to risk management among pubic sector entities and non-governmental private sector entities. While the advice provided in this handbook can be applied to any situation, each particular situation will have its own peculiar opportunities and constraints. Because of this, endowment creators should allocate funds to the exploratory and design phases sufficient to allow for false starts, blind alleys, etc., that they will encounter on the path to success.

B. Why Endowments are needed

B.1. How donors should see endowments

Endowments are an effective mechanism for accomplishing certain types of development tasks. For example, they can be used to strengthen institutions that have critical roles in high priority sectors (e.g. environment, agriculture, health) by making institutions more financially and managerially independent. Or, endowments can empower constituencies whose day to day activities are essential for the success of a long term sectoral strategy. Endowments can give those who hold a stake (i.e. "stakeholders") in a sector a means of participating in decisions and management. Endowment are also a way for donors to build up local institutions which can sustain a participatory dialogue on sectoral priorities and programs. As such, endowments are a cornerstone of sustainable development.

Why an endowment *A primary reason for a donor to consider an endowment stems from a need to provide responsible elements within society with a long term source of financing to help them build commitment to the solution of development problems. Achieving this purpose, i.e. long term commitment to "sustainable development" goals, requires that various communities, both local and national, identify with this purpose through participation in shaping endowment-funded programs.*

Solutions to issues arising in the course of economic development demand responsible tradeoffs between conflicting, but legitimate desires. Often these conflicts are rooted in antagonisms between different groups within society. No foreign donor or international NGO has the moral authority that an indigenous institution has to claim an ongoing role in determining how these tradeoffs should be worked out. It is more effective for tradeoffs to be worked out through local initiatives that take into account different viewpoints while balancing present aspirations and future needs. Donors can support this by building capacity in local institutions.

For example if donors want to see environmental viewpoints flourish, their best strategy would acknowledge that ultimate responsibility rests with the society. Environmental problem solving is on better footing when it occurs through a mechanism by which a broad cross section of society participate in setting local and national priorities and responses. In this case, a donor's most sustainable intervention would be to plant "environmentalism" at the grassroots of society and nurture its growth.

An endowment must marshal local political and financial support if it is to have a policy role at any level in any particular country. Donors can support the development of this kind of legitimacy with financial, technical and morale support that strengthens the efforts of an endowment to preserve as appropriate, protect where necessary, and develop when possible, the nation's natural, human, and social resources. Whether preserving biological diversity, cleaning up water resources, or setting research priorities, the endowed institution needs financing that is secure in the face of shifts in national policy, political party, or donor priority.

Examples of well regarded uses of endowment mechanisms, some with donor support and some independent, are particularly plentiful in Latin America: *Fundación Chile, Fundagro* (Ecuador), *FHIA* (Honduras), *PROFONANPE* (Peru). Where institutions were missing altogether, donors have created a new endowed institution that brings together a new critical mass of talent and leadership. This was the case for establishing the Philippine *Foundation for the Philippine Environment.*

B.2. How governments see endowments

Donor aid for development activities will continue to shrink in the foreseeable future. This change brings to a head the issue of how to sustain public sector and non-profit private sector institutions that are necessary for meeting long term development goals. Endowments that build the capital base of strategic institutions present an alternative for donors to approach this issue.

In Africa, many countries face additional challenges that stems from the rapid pace of development of their for-profit private sectors. This growth gives the for-profit private sector enhanced sophistication, financial resources, and political clout. Neither the public sector (e.g. governmental regulatory agencies or research institutions) nor the non-profit private sector (e.g. NGOs or local community groups) can match this influence without undergoing their own growth and evolution.

Comparable levels of sophistication in all sectors are needed to make civil society robust. Endowments can stimulate the development of comparable sophistication in, and provide the means for effective work among independent organizations, business, and public sector institutions.

Both donors and countries share a need to find innovative ways to promote the sophistication and clout of key governmental agencies and non-governmental institutions. Traditionally foreign donors have supported and funded innovation in both the public and for-profit private sectors. This source, however, grows less useful as aid levels drop. Endowments can help key institutions become an ever renewing source of innovation.

C. The case for endowments in promoting institutional development

An endowment provides a revenue-yielding asset that can give financial stability to a non-profit organization. If the interest from the asset is sufficient to make grants, an endowment makes it possible for an institution to diversify its activities and build capacity of other institutions in government or the nonprofit sector. A diversified activity base opens up opportunities for diversifying sources of support among local and foreign donors. A "captive" source of assets generating revenue gives an endowment a significant leveraging power for raising additional funds from potential donors.

Endowed institutions can build mutually beneficial bridges among the governmental, for-profit and the non-profit sectors. Just having community leaders from all sectors sitting on the board of directors of an endowed institution builds a bridge. Investing endowment funds in local capital markets strengthens the for-profit private sector. If those investments are large, then business will pay attention to the social and environmental concerns of the endowed institution. Grants made from endowment funds that support high risk and long term research and technology transfer have an effect of stimulating enterprise and markets. Endowments, with governmental help via tax policy reform, gives the for-profit private sector a channel through which to address community and societal concerns.

Endowed funds can be managed so as to meet unique institutional needs and provide an anchor for other ways to generate revenue for specific purposes. For example, check-offs (whereby a producers association contribute a portion of their profits to a research institution to promote agricultural research) might be a preferred alternative for a agricultural research institution. Selling donated birth control devices might be a way for a family planning NGO to raise money. Direct appeals to individuals and corporations might be the alternative of choice for an institution that helps orphans. In all cases an endowment, because it confers stability, will make the institution more attractive to its donors or members.

C.1. The environmental case for endowments

Many countries have struggled since the 1992 UNCED conference in Rio de Janeiro to implement their National Environmental Action Plans (NEAPs). In most cases, governments lack the institutional critical mass and the budgetary resources to shoulder the responsibility for all NEAP mandated programs. In such cases the best alternative may be to create a new, endowed foundation that is dedicated to building the institutional capacity to implement NEAP mandated strategies. Sustained activities are essential to the ultimate success of NEAP programs. This requires both continued financial support and maintenance of a critical mass of competent and dedicated human resources. Environmental sector projects, especially efforts to preserve biological diversity, need patient work by skilled persons in an atmosphere of steady financial and institutional support. In other, more traditional development sectors a longer history provides a sense of which approaches work. Relatively less experience in tackling environmental problems means that stability in the level of resources committed to a long-term goal, from problem identification through to evaluation, occupies a prominent place among factors determining success.

Donors should work with host country governments to explore alternatives for committing resources to environmental problems when existing mechanisms and institutions do not have sufficient reach and capacity to assure a long term support. One alternative in this case would be to set up a new institution with a local currency endowment to provide a relatively stable stream of support for environmental activities.

C.2. The agricultural case for endowed foundations

In the area of agricultural research, institutions have traditionally been supported through national government budgets supplemented by annual donor grants. However, declining foreign aid has raised concern about the continued viability of these institutions which are key to the economic development strategies of most African countries. Further, as economies grow more complex, there is a need to empower consumers, defined broadly to include both those who use new technologies and those who purchase agricultural products, by giving them a meaningful voice in setting of agricultural research priorities.

As agricultural research institutions evolve as a result of gaining new and independent sources of funding, they will be able to build coalitions based on common interest in sustainable economic development. To do this institutions need to be strong, independent and capable of debating and tempering private interests with public welfare and short term growth with long term viability.

Endowments will help the development of agricultural research in another way by helping endowed institutions provide a greater number, and richer mix, of career opportunities for the growing number of highly trained professionals in the developing world. For example, donor investment in training has tripled the number of agricultural science Ph.D. holders (to ~4500) in Africa in fifteen years. Endowments will help create a better funded and more secure institutional framework which will enable these countries to attract and put in positions of responsibility a greater number of the best minds and talent their society has to offer.

D. How interest in endowments evolved

Within the last four years, interest in establishing new endowments has grown rapidly throughout the world. It is derived from two bodies of experience. One, primarily in Latin America, represents experience with endowments for existing institutions. Most of the experience with this kind of endowment grew from the financial needs of established institutions, i.e. the need anticipates the money. A second and more recent body of experience comes from a desire to make the funding of environmental conservation more long term. The driving force behind this is an attempt to promote the growth of new or greatly expanded institutions. In the second type money anticipates the need.

There are several efforts underway or under discussion to establish endowments. USAID has begun to establish a $12,000,000 (local currency) environmental fund in Madagascar and a $36,000,000 (local currency) orphan trust in Tanzania. In addition USAID missions have expressed interest in an agricultural endowment in Guinea (Conakry) and Uganda, and both agricultural and environmental endowments in Cameroon. The GEF has proposed an endowment in the Congo and Uganda. Other endowments are under discussion in Zimbabwe and Mozambique, Abidjan, Côte d'Ivoire with NESDA (Network for Environmentally Sustainable Development in Africa) .

IUCN's program to support endowments *The IUCN (the World Conservation Union) has begun a program to promote the concept of national funds, typically with endowments, in environmental sectors. IUCN's program, called the "Global Initiative for National Environmental Funds," calls for increasing support from donors and governments for national funds. Their initiative describes eight attributes of endowments which make them attractive to donors, governments and civil society"*

- *Participatory: National funds encourage the participation of interested parties (government agencies, the independent and business sectors, and relevant interest groups) in all aspects of environmental projects. They become democratic and accountable nodes of empowerment capable of moving beyond narrow sectoral interests.*
- *Representative: National funds encourage the representation of diverse interests in common activities that require cooperation and shared control.*
- *Ethos building: National funds promote value systems that feature democratic principles, cooperation, and accountability, and that move beyond the limitations of particular professions or sectors.*
- *Robust: National funds can be designed with multiple accounts, and multiple sources of funding. Diversity encourages stability, growth, self-reliance, and independence.*
- *The right level: When developed at the national level (or, where circumstances warrant, at the regional level) environmental funds are at the most effective level for striking the balance between international, national, and local objectives.*
- *Growth with minimal displacement: Because of their ability to deal with multiple sources of income and multiple clients, national funds help distribute l infusions of capital so that they do not build one institution or program at the expense of others, or result in "all or nothing" competition. This encourages greater efficiencies within the system, and greater net benefits overall.*
- *Absorptive capacity: National funds can accommodate donors' needs to move l sums of money with fewer staff, while respecting recipients' needs for stability, steady growth, multiple small initiatives, and long-term institutional growth.*
- *Focus: National funds create an ideal focal point for donor and recipient interactions. They can jump-start long-term processes that encourage synergy among donors and recipients, create platforms of potential interest to an ever-widening spectrum of capital sources, and serve as a vehicle for building local capacity for responsible decision making.*

D.1. Alternative endowment uses and creation paths

Endowment creators should carefully consider five key areas of concern of an endowment before settling on a final alternative. These are:

A) PURPOSE: What purpose(s) will the endowment serve?

B) USE: How is the endowment's income to be used?

C) GOVERNANCE: Who has oversight on assets and grants?

D) ASSETS: How are funds to be moved into the endowment?

E) CREATION: What process creates the endowment?

This handbook provides a framework for analyzing the basic set of alternatives in each of these areas. These alternatives are summarized in Table I:

TABLE I

Options to consider when designing an endowment

A. *What set of purposes will be served*	B. *How is the endowment's income used*	C. *Who has oversight on assets & grants*	D. *How funds are moved to endowment*	E. *What process creates an endowment*
defined goal with explicit task, e.g. managing a national park, educating AIDS orphans, funding agricultural research	budget support for programs implemented by the endowment's manager	under the management of an existing institution	debt swap (exchange rate leverage)	through a partnership between International NGO and local group(s)
set of long-term goals, with flexibility in strategy chosen to reach goals, e.g. NEAP	grants to local NGOs	under the management of a new institution created for a specific purpose	non-project assistance or structural adjustment loan (policy leverage)	through a national consortia of local NGOs
empowerment, i.e. giving society the means both to set priorities and choose strategy	grants to local communities	under the management of a foundation with a broad mandate	direct grant to an existing or new institution (possibly for an account in US $)	through participation of local communities

Options offered in this table are listed as alternatives in columns under five key decisions which will determine the structure of the endowment as well as whether a new institution, i.e. an endowed foundation will be created. Each alternative Table 1 is more complex than the alternative listed before it. The alternatives for each key aspect can be considered independently of any other aspect. Rather than focus on all alternatives, this handbook concentrates on the more difficult, less well understood ones so that endowment creators may consider them more fairly.

The most complex alternative is creating an endowed foundation. Considerable effort must go into the planning phase in advance of making any irrevocable decisions. An endowed foundation will need a mandate from society to be able to function effectively in the "public interest" as a kind of national donor agency, to take a lead in convening public debate about sectoral priorities, national policies, and program strategies, and to have the stature to launch fund raising efforts.

Developing a broad societal mandate for a new institution is a complex and lengthy process. For example, it requires widespread participation, including local community groups, in the process of establishing the endowment and institution. And a broad cross section of society will need to understand and be ready to support the work of the foundation. Because the work done in this preparatory phase is crucial to the ultimate success of a newly created endowed foundation, this handbook will focus primarily on an approach for creating an endowment in a way that builds and maintains a relevant mandate.

The alternatives in Table I are a basic set that would be useful in most all situations. As such, Table I is used in this handbook to stimulate an analytical process. However, this set of alternatives does not exhaust all possibilities. For example, the Bolivian government has set up a fund with a board of both governmental and nongovernmental representatives. This fund, "FONAMA", has special subaccounts for each gift or donation from donors. These subaccounts are a kind of restricted gift. FONAMA plans to add an endowment to what started as a channel for coordinating donor support of environmental projects in Bolivia.

Part II—Alternatives: endowments & foundations in Africa

A. How to articulate a rationale for purpose & use

The choice among possible purposes, ways of using income, and institutional home for an endowment must have an explicit rationale. Endowment creators should be able to articulate a rationale which covers the following:

- A statement of mission which is bigger than the endowment.
- A convincing argument that a purpose and an institution should be given perpetual life
- A clear grounding in a national goal which has broad support within all elements of society

The three attributes of a convincing rationale apply to all the alternatives listed in the first three columns of Table I (purposes, use and management). However, if endowment creators wish to consider the more complex alternative of creating not only an endowment, but a new institution to manage it, then the rationale needs to be expanded to cover additional questions. These questions arise not just because the task is more complicated, but because to have credibility as an independent institution, decision making and governance of the new institution will be vested in its board of directors and not with the donor source. Thus, at a minimum, clear expectations and explicit conditions about the use of the endowment for a specified period of time need to be established during the creation process.

B. Choosing a purpose (column A) and a use (column B)

The first step in creating an endowment is to distinguish between its potential purpose and use. Purpose and use answer the "why" and "how" questions respectively. A purpose is the goal statement for an endowment, e.g., supporting agricultural research, building environmental management capacity, or providing for the care of AIDS orphans.

Defining how endowment funds will be used requires strategic thinking to determine the best strategy to achieve any desired long term goals. The use of the endowment should address its intended purpose and be a cost-effective way to spend endowment revenue given the social, political and economic realities of a particular country.

To illustrate the relation between purpose and use consider an endowment to help orphans. The endowment's income could be used to build and maintain an orphanage for 2000 children. But if a country faces, as does Tanzania because of parents dying from AIDS, the problem of helping several hundred thousand orphans by the year 2000, then the endowment's income would have wider impact if it were spent helping local communities impacted by AIDS strengthen their capacity to help orphans in a community setting. If the endowment creators choose a strategy of working with others to leverage the impact of the endowment's income, then running a grants program becomes more complex because it involves a wider variety of organizations and client groups operating with different abilities to receive and use income from the endowment. In such a case the creation process is necessarily more difficult.

Virtually all long term sustainable development goals could be advanced by an endowment for a single purpose or for a range of purposes. The alternatives in Table I for an endowment's purpose range from the relatively inflexible, dependent, and straightforward, e.g., an endowment for a readily defined purpose, to the flexible, independent, and complex, e.g. an endowed foundation. Each alternative requires careful consideration in light of the alternatives for other key aspects of an endowment. This will result in being able to select an appropriate purpose and articulate the objective arguments in support an the endowment.

The middle alternative of the first column offers flexibility, but not necessarily independence of management. It could allow for the participation of community groups and other key elements in the development of program strategies and approaches in response to national and local problems.

An endowed foundation, which correlates to the last alternative in the first column, could provide funding with the support of a broad cross-section of society. This type of foundation could have the ability to set not only strategy within given priorities, but also set the priorities themselves. Such an institution, equivalent to a national donor agency, could influence the setting of development priorities and policies at a national level.

Choosing among the alternatives in the first column is a strategic move. It should be based on an analysis of contextual factors and a clear understanding of how each alternative fits the particular need of a given situation. This is illustrated in the following discussion.

B.1. Long-term funding–lasting beyond the project cycle

Endowment creators may wish to start with the aim of making the support to key sectoral programs less vulnerable to changes in donor priorities, to shifting relations between host country governments and foreign donors, and to host country political and policy shifts.

A long-term goal may be to create an independent and stable source of funding for these programs. This goal can be reached by endowing an existing institution with a positive and proven track-record or by creating a new institution. The decision should be based on the presence of existing institutions that have a similar organizational goal and the organizational capacity and desire to carry out the mandate on a national level. If a new institution is created, the governance structure and its base of legitimacy will be critical factors. For a new institution to be effective the national environment (including social and political setting) must be favorable. In either alternative endowment creators will have to work carefully to avoid substituting a dependency on international donor aid for one on endowment income.

B.2. Innovative mechanisms–fostering institutional development

Sustainable development strategies and renewable natural resource conservation strategies require long term and sustained support in order to find and nurture the behaviors and attitudes that regard resources as a trust to be cared for in light of the needs of future generations. The mechanisms for accomplishing this may include decentralizing decision-making about how resources are used, strengthening NGOs and local community groups, and developing new and innovative partnerships among NGOs, local community groups, government agencies and the private sector.

Short term and fragmented support that is provided on a one-to-five-year project basis begins to address these issues; however, by definition it cannot address it completely. An endowed foundation could. It could provide direct grants to local communities for the purpose of funding local NGOs and others, to help them identify resource problems, develop plans, and get technical assistance. If these grants fund activities that require closer collaboration among local communities, NGOs and governmental extension agents, the foundation's support would create an indirect incentive for NGOs and governmental agencies to strengthen their field presence in order to fulfill their role in partnerships with local communities. It could pledge to support this process for a long period of time.

An endowed institution would also need to support the institutional development of NGOs and local community groups and to carry out key functions such as training, information gathering, planning. These are the functions that international donors find it most difficult to fund because they are difficult to measure and because the funds are sunk into "process" activities rather than "product-oriented" activities. However, strengthening the capacity of NGOs and local community groups is a prerequisite for these groups to be effective at the policy table. An endowed institution would be able to serve these two levels not only directly in the form of sustaining financial support but also indirectly through board level decisions which set priorities for the foundation's approach to issues.

How endowed national funds can work toward environmental goals illustrate the value of this kind of institutions. Renewable natural resources management problems are intimately linked with problems of economic development, poverty alleviation, livelihood creation, social organization, etc. Solutions to these problems require innovation, cooperation, and the mobilization of all sectors of society. Success will depend on creating and sustaining cost-effective ways to tackle renewable natural resources problems and economic development opportunities. Endowed institutions provide a means whereby different societies can find their own path to solving their own unique "sustainable development" conundrums

An endowed foundation would be better able than purpose specific institutions to respond to opportunities to try new ways to manage resources with whatever combination of institutions and services is most effective. These combinations may be partnerships or formal collaborations between public and private sector, between NGOs and entrepreneurs, between NGOs and government agencies, etc. Even though the guiding purposes of a foundation have specific ends, a foundation needs to be able to support innovative partnerships which can find and demonstrate the most effective approaches to renewable natural resources management problems.

B.3. Local control–promoting innovation

Endowment creators which seek to engage host governments and local NGO communities in discussions on the use of endowments (the second column) need to write down general guidelines for what the endowment would do. These guidelines should relate more to the type of organizations to be supported rather than to the particular technology or technique to be used.

If the purpose of an endowment is to provide support for innovative action, then procedural barriers to new approaches and methods of funding need to be minimized. At the same time flexibility in management must not compromise accountability—both to the peer community of local NGOs or to donors. No type of activity should be ruled out of bounds *a priori* without clear reasons presented by donors which the NGO community understands and accepts.

The rationale for choosing among the alternatives in the second column should outline the scope of programming activities with several statements of general aims, e.g. the endowment seeks to reach a broad range of NGO types and an ever increasing number of individual organizations, or, the endowment seeks to develop NGO capacity as regards financial management, activity planning, and project direction.

If the endowment will be managed by an independent foundation, its use of the endowment would have to be subject to review and modification by the board. This choice represents the fullest commitment to the philosophy that participatory processes should have great influence on the setting of priorities. It also may lead to conflicts with donors that are more interested in specific issues rather than the growth of local institutions dedicated to grassroots determination of priorities. In such a case, manager of the endowed funds should be flexible to negotiate time-limited program restrictions on donor contributions to an endowment which would give the donor agency assurance yet not negate the principle of local control.

B.4. Increasing participation–empowering communities

If an endowment is to provide the most secure base of funding for the long term, then it would be prudent to provide a funding base for local NGOs and local community groups which is independent of, and complementary to, the funding resources available to the international NGOs, i.e. foundations, corporations, and the concerned public of the developed world. Further, in light of the growing tension between NGOs of the North and South over issues of program direction and management, donors should evaluate their dependence on international NGOs as agents of long term development. The increasing level of sophistication and capability of southern NGOs presents donors with alternatives. Establishing an endowed source of local funding for long term development activities carried out by southern NGOs can be an effective means for getting to those alternatives.

The process of forming a board for the endowment's management (which is necessary under those alternatives calling for a new institution) is crucial to the issues of participation and legitimacy. If the process is open to a broad range of groups that hold a stake (i.e., "stake holders") in the community, regional or country, whatever the appropriate level of concern would be for the purpose of the endowment, then key NGOs and groups would be much more likely to participate in the endowment's activities thereby giving it the credibility that is needed to operate effective. On the other hand, if the this process is limited to a few and conducted in secret, then many might well view the result as an institution under the control of a small, elite group.

The concept of a locally managed foundation derives from three bodies of experience. That of community foundations in the U.S., of the Foundation for the Philippine Environment, and a local currency environmental endowment that is being developed in Madagascar. These endowments are managed by and for the people of those communities and seek to have an impact at a national, a regional, or a local level. They have a representative board of directors and established procedures for the use of endowment funds. The process by which these endowments were established included local, national and international groups, government agencies, and international NGOs and donors. These endowments can be termed a "democratic" foundation.

Community foundations in the U.S. operate to serve the public good in a specific community. There are community foundations dedicated to public education, local arts, community services, poverty alleviation, civil rights, and local social needs. Many were established by local philanthropists, others by church councils and social service organizations as cooperative funding vehicles. Many have as an explicit purpose to empower disadvantaged groups.

Funds in addition to an endowment generally are solicited or received by the foundation staff and board from businesses, philanthropists, and other sources. Reputation is a critical factor in gaining community support particularly from local donors. Board members are carefully selected from the community on strategic basis for their competence, reputation and interest in the work of the foundation. This body of experience offers lessons in how to conduct a process of recruiting a board of directors which the community the foundation is intended to serve can accept as representative.

C. Managing assets and making grants (column C)

The alternatives in the third column differ more in their implications for management of grants than they do for the management of assets to generate income for making grants. Therefore the following section does not distinguish between the alternatives in terms of their implications for asset management.

C.1. The donor's responsibility to track its grant moneys

Before addressing the questions of how an endowment manages its assets and grants, endowment creators need to understand and define precisely their responsibility for oversight of the process of creation and their continuing obligation to track funds, if any. The aim of this should be to foster the endowment's ability to manage its own affairs. Donors need to consider several degrees of oversight and a sequence by which a transition is made from one degree to another. This should be backed-up with a set of objectively verifiable criteria and a clear statement of roles and responsibilities for the board and staff of the endowment and the donor(s).

The most straightforward case arises if the endowment's assets come from national government money, in which a donor supports a policy reform program with a low interest loan or grant. As part of the contract with the donor, the national government agrees to an agenda of reform and other actions. Such concessional, non-project aid "frees up" an equivalent amount of local currency. The national government might agree to use its own, newly freed up budgetary resources in furtherance of the policy reform agenda. For example a national government might agree to increase the salaries of civil servants or increase support to an environmental agency. Or, it may agree to fund an endowment for either an existing or a new institution. Whatever funding agreements called for by the reform agenda, a donor has no obligation to track the money beyond the conditionalities stated in the policy reform agreement.

In other cases a donor may wish to contribute its money directly to seed an endowment. In this case, the donor might retain oversight on use of income from investments for a period of time comparable to the life of a typical donor project, e.g. five years. The donor and the national government should also agree on how much oversight, and for how long, the donor would exercise on the assets of the endowment. If feasible, the donor might also set a limit to this oversight, e.g. ten years. As an example such an agreement might state that for ten years the endowment's managers would have to obtain the donor's permission to alter the nature of the investments of the endowment's assets, but not after that period.

Rather than being focused on a set period of time, the donor could relinquish oversight on the endowment's use of interest income contingent on a successful track record of the endowment's activity during a defined period of time (such as three grant cycles). An independent evaluation can make this assessment for both the donor and endowment manager. In keeping with this approach a donor's best strategy would be to find and nurture an indigenous organization that has credibility rather than create a new organization. One donor should not attempt this one their own. Consulting among other potential donors increases the likelihood of co-funding and stronger institutions.

C.2. Managing assets: investing capital

The financial *raison d'être* of an endowment is to protect the value of assets while generating income from the use of those assets through investments. Traditionally, private donors and bilateral and multilateral aid agencies focus on short term projects, approximately five years, which often fail to have a lasting impact when the money runs out. Endowments can extend the commitment to long term goals over a longer period of time by overcome budgetary and political fluctuations. Fulfilling this objective necessitates acquiring and managing assets so as to maintain their value and revenue-yielding potential.

An endowment's assets need to be managed to keep a principal intact with a net interest and investment revenue available to support project activities of local community groups and NGOs. An investment strategy and management plan needs to be negotiated initially between donors and endowment managers. Ideally, an endowment portfolio should generate at least a four to five percent return after adjustment for inflation and the cost of portfolio management. This level of asset management while possibly achievable in a few developing countries, will prove difficult in many.

Numerous alternatives are open to the managers of an endowment's assets. Among these are: deposits in local private commercial banks, holding of government bonds or notes, equity or debt of privatized national companies (e.g. the telephone company), real estate, etc. Limits on the mix should be determined at the time of the endowment's creation.

The value of the principal in perpetuity and unstable or nonexistent local currency markets may force asset managers of endowments denominated in local currencies to step back from this goal. In this situation, managers would draw the endowments assets down over time (i.e. a sinking fund) and need to manage donations so as to stretch them beyond the normal donor life-of-project cycle.

Sinking Funds *In some countries, the financial, social or political climate may make the notion of an endowment in perpetuity untenable. In this case, the idea of a "sinking fund," might be a better aim. Such fund would use investment income to augment its initial assets to be able to fund a worthy purpose for ten or fifteen years. Such a case is a intermediate structure between the perpetual endowment and a grant fund. If successful, then consideration could be given by a donor to "eternalizing" the institutional framework with another grant at a much later date*

Regardless of the state of local financial markets, building financial management capacity will pay off when local financial markets develop to the point where an endowment can be managed in perpetuity. An endowment's financial managers should anticipate the various pressures on a endowment's assets, including: donor gift restrictions; reporting requirements of national governments, and donors; and, the need for transparency and avoidance of conflicts of interest in asset management decisions. Anticipating and dealing with these pressures effectively will enhance the endowment's attractiveness to potential donors.

C.3. Making grants: a participatory process

If the endowment has a broad mandate to be responsive to changes in the social, economic and resource conditions, then it needs to operate in a manner that is flexible and responsive to local needs. It also needs to create opportunities for popular participation by stake holders and constituent groups. These preconditions are likely to rule out a governing structure that holds a veto for a host government. However, this does not negate a host government's legitimate interest in how the endowed institution manages its finances or how grantees use its money.

C.4. Arrangement for the Dissolution of the Endowment

It is important that terms and conditions for the dissolution of the endowment should be agreed to as part of the process of establishing an endowment. This is crucial to the reputation of the endowment and the ability to raise additional funds. The plan for the disposition of the assets of the endowed organization needs to be explicit and agreed to by all parties in advance.

C.5. Achieving credibility: models for governance

The importance of the process of selection of the members of a governing board cannot be overemphasized. The board, whether an existing institution or a new, endowed foundation, will be responsible for all decisions affecting endowment generated funds, including: personnel, investments, grants, and priorities. They are ultimately responsible for maintaining good relations with all the groups important to the endowment including: foreign donors, local and international NGOs, the host government, local and international private sector.

The major question concerning the board's make-up revolves around how best to ensure that board is free enough to rise above the "web of obligation" binding each board member, yet structured enough so that through time as board members change the overall composition of the board does not drift toward a particular viewpoint, i.e. become a runaway board. For foundations to succeed, the organizers must create an "ethos" of service to society. The board must be dedicated to nurturing this ethos.

Alternatives for selecting a governing board are listed in the last column of Table I. Two concerns should guide choice of a board selection method: the need for accountability and the need for independence.

There are several models that address the makeup and restrictions on the composition of the board. Three common ones are:

1. representative: members represent different interest groups or organizations
2. self-perpetuating: members elect their own replacements
3. restricted: members occupy seats with different, restricted qualifications

These types of boards, respectively known as "representative," "self-perpetuating," and "restricted" are not the only models, though they are the predominant ones.

One important consideration in the structure of any board is to find and be able to replace board members who have a demonstrated ability to think creatively with a minimal obligation to a fixed point of view or philosophy or a particular group. A representative board would likely tend to reinforce a member's obligation to the group which chose him or her. Even if members were to be limited to only one term, the possibility of that member returning to that group will exert a strong influence over that member's decisions while he or she is on the board. On the other hand a purely representative board would more likely keep the endowed foundation from drifting in its understanding of issues and in its choice of priorities. Such a drift would only be possible if the groups chosen to select board members become marginalized within the community of local NGOs and local community groups.

Self-perpetuating and restricted boards would expect that their members would be less bound by old associations with particular philosophies. The self-perpetuating board would be the freest in this regard, but the danger is that it can over time and replacement drift to extreme positions. In the U.S. there are cases of non-profits whose boards developed particular views which were extreme in the context of the times and mainstream social concerns. As a result, contributions, both from the public and from foundations, declined as the board "drifted."

The restricted board offers a compromise between the self-perpetuating and representative board. The charter of an endowed foundation may specify specific seats on the board with special qualifications, e.g. experience of a minimum period in the community development field, residence outside the capital city of specific duration, indications of leadership on particular issues as evidenced by published articles or speeches, etc.

As U.S. experience offers few examples of boards other than self-perpetuating (although a few U.S. environmental organizations have boards elected by member groups), it is wise to look to local traditions of self-governance for inspiration. Boards whose membership selection derives at least in part from local models may offer promise of wider acceptance locally; however, this gain needs to be weighed against the same need for international donors to see a structure recognizable from their own experience.

Whatever board structure and scheme for selecting board members, endowment creators need to address the issue of how broad a base of experience can be tapped. In essence the question is: Does the endowed foundation derive its mandate only from NGOs active in the same sector as the endowed institution or from a broader constituency, such as stake holders in a community. Stake holders might include consumers, women's groups, local community organizations, agricultural exporters, labor unions, teachers, urban poor, or farmers. This broad range needs to be included both in the process of formal establishment (writing a charter) as well as in the initial and subsequent selection of board members.

Recommendations about governance of an endowment *No matter how carefully crafted, an endowed foundation's prospects rest upon the character of the organizers and board members. Attracting these persons requires that the foundation not only offer the promise of creativity, but also the security of fair, realistic, and effective governance. The way the foundation governs its own affairs, how the national government exercises oversight, and how donors influence foundation activities all contribute to the framework of a governance. Together this framework of governance and the character of the foundation's staff and board members lay the foundation for the growth over time of a foundation ethos.*

Over time funders will be able to see clearly if this ethos has matured. The indicators can be determined clearly. One sign of maturity is if the foundation's structure and procedures promote honest appraisal of priorities and proposals. Another is if the board members break out of their personal "web of obligation" to support agendas and programs which address interests *beyond their own.*

While the ultimate responsibility for fair and effective governance rests with the foundation organizers and administrators, donors may take steps to encourage, or at least not discourage, the growth of good governance. Donors should help strike a balance between the strictness of procedures on the one hand and the freedom of majority decision making on the other. The following suggestions are intended to raise issues which should be examined in the light of the need to find this balance. These suggestions are drawn from the legal section of "Review and Additions to the Guidelines" [see references]. Note that this document contains a detailed discussion of legal issues as well as draft model documents for a foundation charter and bylaws. Donors which wish to undertake a process to create a foundation should request a copy from the ARTS/FARA office of the Africa Bureau.

- *Avoid drafting new national laws, rather seek a special agreement with the national government (reflected in the charter and bylaws) to write down the rules by which the government oversees the foundation.*
- *Government power to regulate foundation affairs should be explicit, e.g. that the use of grant money conforms to national law.*
- *The foundation should maintain a transparent record of all actions, including agreements with governmental agencies and donors—there should be no secret files or reports.*
- *Agree in advance of funding the endowment by what process and by whom can questions be raised about foundation activities and by what process can the foundation be dissolved and how would it assets be redirected.*
- *Have explicit requirements for reporting—both to the foundation by grantees and by the foundation to the public.*
- *Retain local legal counsel to assist in drafting the charter and bylaws.*

D. Method of moving money to the endowment (Column D)

This section of the handbook reviews the major alternatives for, and describes the steps involved in designing endowments through a combination of alternatives in Table I.

Recent legislative acts by the U.S. Congress and pending USAID policy allow economic security funds, development assistance funds, PL 480 funds (Title I), local currency accounts and debt to be used to capitalize an endowment. They also allow an endowment to be established with an NGO and allow the NGO to retain any interest revenue that is generated by the endowment. US government funds, however, cannot be used to establish an endowment held by a public agency or a profit-oriented business (see Lion, Hanson).

Authorization
The current appropriation bill (PL 391) for USAID states: "Sec. 567. In order to enhance the continued participation of nongovernmental organizations in economic assistance activities under the Foreign Assistance Act of 1961, including endowments, debt-for-development and debt-for-nature exchanges, a nongovernmental organization which is a grantee or contractor of the Agency for International Development may place in interest bearing accounts funds made available under this Act or prior Acts of local currencies which accrue to that organization as a result of economic assistance provided under the heading 'Agency for International Development' and any interest earned on such investment may be for the purpose for which the assistance was provided to that organization."

D.1. Use of a debt swap to fund an endowment

In Africa and in other regions, many endowment creators and international NGOs have viewed debt-for-nature swaps as an attractive alternative for programming in the natural resource area. Endowment creators have favored working with international NGOs to establish a newly endowed foundation because international NGOs, for the most part, have the managerial and administrative capacity to account for the funds. International NGOs offer a complete service: they arrange the swap with banks that hold the debt; they coordinate with the host country Central Bank to exchange purchased debt for local currency; they find a local NGO to serve as a counterpart; and, they manage the local currency to support biodiversity and conservation activities which they and their local partner program and manage.

The international NGO community has been particularly attracted to swaps because of their beneficial terms: leverage on the conversion of their funds to local currency; publicity; and, opportunities to work cooperatively with Central Banks and private commercial banks which have traditionally not been actors in the conservation of biological diversity.

Donors interested in addressing environmental problems —the public, foundations or corporations including banks—have not sought out many direct alternatives to using international NGOs as intermediaries in the process of creating an endowment. Partly this represents a bias toward the familiar as well as an absence of alternative, more direct channels to support projects and programs managed by local NGOs. And, in many, but not all, cases, "debt-for-nature" swaps have been used to generate the money in local currency.

Traditional debt swaps based on typical "debt-for-nature" transactions involve the following steps which are usually taken in the order given (note that variations are possible):

i. A donor makes available cash in a hard currency (say US$1 million) to an international NGO for the purposes of funding a sustainable development project in "Ruritania."

ii. The international NGO negotiates in advance with the Central Bank of Ruritania for a swap **"quota"** (say US$5 million in face value of debt) which would allow the NGO to swap notes it would purchase for local currency obligations of the Central Bank at a set exchange rate. Note that this swap may occur in several tranches up to the total of face value agreed to by the Central Bank.

iii. The international NGO then goes to the secondary market in the debt of Ruritania to purchase Central Bank obligations from international commercial banks at the prevailing **market discount** of 60% in Ruritania (i.e., buys notes with a face value of $2.5 million for 40% of the face value—note that the market discount is different in different countries and varies over time in each country as a result of many factors, including political change, shifts in international commodity prices, debt restructuring plans, as well as the supply of money from donors for the purchase of debt instruments in the secondary market).

iv. The international NGO then swaps the notes for local currency obligations of the Central Bank, often at a **redemption discount** on the official exchange rate, say 20%, and often with staggered dates of maturity and interest (thus the international NGO would get a package of cash and obligations worth $2 million in the local currency of Ruritania).

v. The international NGO then turns over the local currency proceeds of the swap, whether in cash or **Central Bank bonds** to its counterpart local NGO which may or may not be an affiliate of the international NGO for funding of a program of activities. In a typical "debt-for-nature" swap the activities might include: surveying biological resources of particular note, determining what land is worthy of status as a national park or protected area, buying land found to be prime habitat for endangered species, setting up park management plans, sponsoring research into endangered species and their habitat, paying for the services of park rangers and guards, educating the public about conservation, training park staff, employing local residents as guides, informants, etc.

vi. If the money needed (say only $250 thousand worth of local currency) is less than the amount proceeding from the swap, then the rest ($1.75 million) may be put into a bank to earn interest. Such an account may be managed as a sinking fund which is slowly depleted over several years or it may be managed as an endowment where only the net interest earnings are spent each year.

Each of the participants in a debt swap benefits. The donor gains a bigger impact from its grant through the leverage of the secondary market discount. The international NGO gains funding and valuable free publicity from arranging a swap. The Central Bank of Ruritania retires debt. And, the local NGO partner or affiliate of the international NGO gains support.

D.2. Dealing with inflation: asset transfer

In either approach to the creation of an endowment, a donor and an international NGO, if involved, will negotiate with the host government over the terms of endowment. Traditionally, in a debt swap the international NGO deals directly with the host government's Central Bank to set the terms of the swap, i.e. the discount rate, the period of maturity of notes if it is not a cash transaction, etc. A concern of the Central Bank is the inherent inflationary impact of a swap which involves an increase in the money supply. The donor funding the swap is often indirectly involved in these negotiations as a member of the donor committee for the host country.

Donor committees usually follow the lead of the IMF and the World Bank in placing a high priority in the development of sound fiscal and monetary policies. Such policies include: maintenance of low inflation of domestic prices, a stable money supply, sound Central Bank policies, and movement along a path toward fully tradable currency. At times issues can become entangled. For example, if a Central Bank opens a debt swap window for the purposes of attracting investments, they may find that it may also allow persons of means to repatriate their holdings of foreign exchange at an exchange rate premium (this happened in the Philippines after the Marcos era). Such a phenomenon could adversely impact the poor through domestic price inflation. Thus both Central Banks and donor committees look carefully before taking steps which encourage l amounts of debt swapping and do look to limit swaps if inflation is feared.

If a donor pursues a policy reform alternative, then the host government might favor an endowment that was established with assets combining cash and notes of the Central Bank according to agreed terms. One scenario would be for the Central Bank to issue notes which have a staggered series of maturities lasting several years. In order to protect the endowment from loss of value of the notes, the Central Bank would pay interest at a rate several points over the rate of domestic price inflation as published by the World Bank annually. This rate, called the "indexed rate," would be set in the agreement and in the notes themselves. The notes can be assigned in order that the endowment may be able to sell them or deposit them with a local private commercial bank as loan collateral in order to raise cash if needed in advance of the maturity dates of note. Being assigned also affords more protection against default in payments.

If a debt swap alternative is favored, one way to minimize inflationary impact is for the swapping NGO to purchase foreign debt of a l company such as the national telephone company or electric power company. Because this debt is often guaranteed by the Central Bank it usually sells for the same discount in the secondary market as sovereign debt of the Central Bank. Consequently the Central Bank would still have to approve a swap, but swap arrangers could finesse the inflation question by swapping the debt not for local currency, but for equity in the private company. These share holdings could immediately become the endowment's capital. As the endowment needed cash, it could sell the shares for local currency. The net result is little pressure to increase the inflation rate.

Governments are likely to favor this mechanism if the foundation board which controls the endowment is comprised entirely of local citizens. This means that there is less danger of control of important companies passing into foreign ownership.

A similar swap may be arranged in countries where the host government is in the process of privatizing national companies. As part of the privatization deal, the endowment could be given holdings in the publicly offered stock of the newly private company in exchange for foreign debt purchased at a discount.

Limitations of debt-for-nature swaps as programming tools *Recent experience–primarily with debt-for-nature swaps–has highlighted some of the limitations of debt swaps. There may be a lack of buyable (scheduled) debt at the time the purchaser, who will set up the endowment, has funds for the purchase. Administering and managing a sudden l infusion of local currency can cause problems and if not handled appropriately can have an inflationary impact. Criticisms have also be leveled against endowments that have not created a sense of buy-in from the local community in which endowment funds are supporting new activities (this is a particular problem in protected area conservation and development schemes.) There is a growing perception that "sustainable development" is really a code work for concealing a foreign agenda; and, the perpetuation of a senior-junior relationship between international NGOs and local NGOs.*

A apparent pitfall in debt swaps is that the technicalities for executing the swap has tended to take precedent over the patient, less glamorous work of program development. The negotiations necessary for arranging a debt swap must take place according to the pace of business of the international banking *community and in response to market opportunities for getting a favorable leverage in a debt purchase. In other words the process of making a swap can drive the program that will be funded by the swap rather than the reverse. In such an atmosphere it is difficult to follow a process that provides local communities a sense of ownership and control.*

The stated aims of a proposed swap and the programming alternatives for local currency should be carefully analyzed by the entity that provides the funds for the purchase of debt. The use of a direct grant (i.e. keeping funds in dollar accounts) or a government grant linked to a policy reform process may offer a preferable alternative if a goal is constructing a institution with widespread participation in advance of funding.

Another alternative is wait to consider a debt swap until after an the process for establishing an endowment for an has been agreed upon and progress made. Since this could take several years, the choice of method of creating a source of local currency may not be on the table until after the optimal secondary market opportunity for purchasing debt has passed.

D.3. Use of policy reform conditionality to create an endowment

Because the process of writing a program document for policy-based aid follows a sequence parallel to the writing of a traditional project paper, there is ample opportunity to explore in systematic fashion a process for the use of freed up local currency funds for creation of an endowment. The process is similar to a debt swap in that there are multiple parties involved and that local currencies wind up in an endowment managed by a local corporation. However, a major difference of great interest to donors is that they trade the currency leverage of a debt swap for the policy leverage of reform-linked aid.

In a policy reform-linked endowment the host government agrees to use its own revenues of local currency, which had been budgeted to use for the purchase of foreign exchange to pay debt service, and give it to the endowment. As these local currencies are not generated as the direct result of a donor grant, then the donor has no fiscal or programmatic responsibility over the use or accounting of those funds.

A policy reform linked endowment process follows these steps:

i. The donor offers a hard currency grant or confessional rate interest loan (say US$20 million) to "Ruritania" with the intention of making the grant conditional on a series of policy reforms in a particular sector -- say natural resources.

ii. As part of the agenda of reforms, the national government agrees to work with local NGOs and community groups to develop a plan for an endowed foundation or institution. This institutions would provide long term support for a key need in that sector, for example agricultural research or building up capacity of a national park service. As part of its counterpart contribution to the policy reform, the national government agrees to donate $5 million worth of local currency to the foundation for its endowment.

iii. As a part of the policy reform agreement the donor and the government of Ruritania would set out the terms under which Ruritania's Central Bank would agree to turn either cash or notes or a combination over to a new entity when both the national government and the donor certify that the new entity has met established criteria.

iv. The donor would also commit to fund (or arrange funding) for technical assistance for a period of approximately three years to work with the local NGOs and community groups to develop a plan, a charter, an administrative structure, and a board of directors for the endowment. Perhaps this technical assistance might cost $750,000. The source of the technical assistance would likely involve professionals experienced in working with local NGOs and also from the international community of NGOs concerned with issues of the sector in which the foundation would be active.

v. The donor and the national government could under the terms of the policy reform agreement require that certain program areas be given primary attention. For example if the foundation is intended to work in the environmental and natural resource areas, then the foundation might give priority to implementation of Ruritania's NEAP. However, such restrictions need to be broadly sketched so as not to constrain the latitude of the new foundation's board to develop its own approaches and goals. The new foundation should be able to accept donations to its endowment either in foreign exchange or local currency to extend and enhance its programs. Host country tax law may need review and reform to encourage this fund raising as the potential to raise additional funds serves as a powerful incentive to maintain the highest standards of accounting and administrative control.

D.4. Use of direct grant

Other approaches which combine aspects of a debt swap and policy reform conditionality are possible. The variety is limited only by the creativity and openness of the process of negotiations between a donor and the host government. In the Philippines, the USAID mission developed a hybrid approach. The endowed foundation was set up under the terms of a $125 million non-project assistance (policy reform) agreement in the natural resources sector. However, instead of the money coming from the Philippine government, USAID earmarked $25 million for funding a debt-for-nature swap as the way of moving local currency into the new foundation's endowment.

The USAID mission, the Government of the Philippines and two consortia of local Philippines NGOs agreed on a process by which a board of directors dominated by local nongovernmental leaders would be selected as the governing structure for the endowment. The funds for this endowment are to be generated through a "debt-for-nature" swap to be carried out by a U.S. NGO —the World Wildlife Fund (WWF). All parties have agreed that WWF will eventually turn over management of the endowment funds to the board once the administrative structure capable of managing the endowment, its assets and grant making operations, has matured.

The Philippine experience offers lessons about how a process involving an equal say for the local NGO community can be started and conducted. This case example combines aspects of a policy reform grant with the more traditional debt-for-nature swap. The money will be moved via a U.S. NGO, but the swap will be linked to a policy reform program which does address some of the policy (and regulatory) questions surrounding the activities of the nonprofit sector. Because it happened first, the Philippines offers a transitional example which has led to the Madagascar case. In Madagascar, USAID is currently making the first use of the policy reform mechanism to fund an endowment to encourage the host government to institute reforms which will support the aims and operations of the endowed foundation.

E. Alternatives for the process of setting up an endowment (Column E)

There are concerns that are likely to arise in the course of designing an endowed foundation, whether local currencies device from a debt swap, via a policy reform grant through action of the host government. Many of these concerns are familiar, ones which every institution building project must address: the potential to drain human resources from other critical efforts; setting up reliable, but not burdensome accounting procedures; minimizing rivalries within the nonprofit sector; conflicts between international and local NGOs on leadership; dependence on decreasing donor aid; and, the struggle for more democracy and participation.

The act of choosing a design is the first step of the creation process. Drawing a line between the process of settling on a design and the process of setting up the endowment is an arbitrary exercise especially if the goal is to set up a newly endowed foundation. In this case, participation in the discussion of alternatives is critical for the institution to be develop or acquire its mandate from the non-governmental community, including both local NGOs and local community groups.

Any proposed approach to establishing an endowment will require that a number of groups–the host government, the local NGO community, the foreign donor community, and the local private sector– be involved and become active supporters of the effort. An endowment cannot be designed in isolation from these groups and their interest in how the design is done, how the board is selected, and what the ultimate institution can and cannot do. Other groups may have roles, too, depending on the alternative chosen. These others groups can include: international NGOs, multinational corporations, and philanthropic foundations.

Table II frames discussion points to guide the choice among alternatives that have been described earlier in this handbook. Major groups participating in the design discussion are listed along the left side of the table, and the areas of concern are listed across the top of the table. Each box raises illustrative issues which should be considered as part of the design process. The following sections discuss briefly the questions and issues contained in each box of Table II.

E.1. Selecting among alternatives

The following subsections discuss major questions which will arise in discussing how a donor goes about the process of setting up an endowment for an existing institution or an endowed foundation. The three areas under which concerns are collected are: people, money, and governance.

People: Human resource development and manpower allocation have been traditional concerns of donors and governments. In most countries the lack of skilled persons limits the growth of new institutions. Even in situations where the number of skilled persons is sufficient, often the need for advanced training, whether degree or non-degree, limits the pace of development.

Money: Maintaining adequate accountability for project management requires constant attention. There is a tension between the need to have enough flexibility to pursue creative ideas and the need to have reliable systems for accountability. The discussion of this section emphasize innovations which have incentives built in to establish and maintain accountability.

Governance: Endowments are operated within a framework of rules which are set by donors or contributors of gifts, the host government and the charter of the endowed institution. The key feature which distinguishes an endowed foundation and allows, even requires, it to behave in ways which are unlike traditional NGOs or other public sector institutions is its ability to change its own rules, negotiate restrictions with donors, and advocate reform of national policy.

TABLE II

Issues to consider when designing an endowment

	People	Money	Governance
National Government	Will a new, endowed foundation drain skills from government?	Will an endowment need a special agreement with the government to avoid taxes on earnings of its investments?	What oversight does the government have on use of endowment funds?
Local NGOs & local community groups	How can local groups participate effectively in the formation of an endowment?	How can local groups participate in grant making, monitoring and evaluation?	How can the endowment set an example for transparency?
Donors	What are the best ways to provide technical assistance as free of bias as possible?	What are the requirements for documentation of the use of funds?	What policy should guide restrictions on gifts?

The issues raised in this table are arranged by groups (listed along the left side) which have important roles to play and by areas of concern (listed across the top).

E.2. The endowment's relation to government

Endowment creators should be careful to avoid draining off critical skills and talent from ongoing and critical government programs as well as already established NGO activities and projects. Design teams should be instructed to justify salary levels and number of professional staff in the context of prevailing rates and shortages of manpower. If an endowed foundation is set up as part of a policy reform program, then it is possible that the issue of civil service salaries would be a subject of analysis as part of the policy reform agenda.

A critical aspect of the relationship between an endowed foundation and the host government is the tax status of earnings which an endowed foundation receives on investments. In some countries it may be possible to use the policy reform process to create a more favorable tax climate for all types of endowed institutions. National governments which are persuaded of the value of a strong and creative nonprofit sector should be willing to consider broad and clear guidelines for the income earning and other activities which they will allow endowed institutions to engage. In others the tax arrangement may have to be negotiated on a case by case basis.

The government's role *Early on in the design process, donors and other involved in creating an endowment obtain the host government's commitment to the need for an endowed foundation. If a donor can get a solid expression of support, then an early effort should be made to review national law and regulation governing the nonprofit sector. The goal of this review is to define as clearly as possible what the current regulatory and legal framework is as well as how influential this framework is on the actual activities of local NGOs and community groups. If this framework is influential and would likely limit activities of the endowed foundation or its anticipated community of NGO grantees, then reforms will be needed.*

The reforms might address a series of issues which arise out of the operations of nonprofits, including endowments. The review should explore aspects of the current and desired relationship between nonprofits, including endowed foundations and other institutions, and the government. Most national governments will have definite, but not necessarily clearly declared, views on which types of activities and range of issues they find acceptable for nonprofits.

E.3. An endowed institution's relation to local NGOs and communities

The endowment needs to cement its good relations with the local communities in several ways. The first way is to seek to include a broad range of groups in the process of formation. As has been described earlier, an endowed foundation's credibility rests on its mandate from the community it serves. Preserving a mandate means that an endowed foundation will seek ways to increase opportunities to work with local communities.

One way to build working relationships is to create mechanisms for broad input into the grant making process. Such input could be in the form of peer review, with representatives of groups having an opportunity to evaluate and advise on proposals submitted to the foundation.

Another way would be having annual occasions for public comment on an endowed foundation's funding priorities. The model for this exercise in participatory governance might be a "town meeting," in which every person who attends has an opportunity to speak.

E.4. An endowed institution's relation to foreign donors

Foreign donors will have an important role to play in the affairs of an endowed foundation from the beginning and continuing for some time. Most critically they should provide technical assistance to help establish an endowed foundation. The key point to consider in identifying appropriate consultants is to emphasize the institution building aspects of the work rather than particular environmental issues and the technical skills which those issues require. The purpose of the technical assistance is to help set up an endowed foundation which serves the NGO community and local communities both as a source of funds as well as a mirror of their concerns and priorities.

Whichever route to endowment, donors and other donors need to be careful that personnel providing the technical assistance are not strongly identified with one or another philosophical viewpoint. If the technical assistance has a built-in bias, then a fear is raised unnecessarily in the minds of many local communities that an endowed foundation cannot easily serve to forge a local consensus on priorities.

After being established, an endowed foundation must have procedures for management and accounting of funds which satisfy the requirements of potential donors. It may well be worth while during the early technical assistance to explore alternatives for satisfying these requirements in ways which do not overly burden an endowed foundation's administrative capability.

Another area of contention between potential donors and an endowed foundation is the desire of donors to put restrictions on gifts. The early technical assistance should examine alternatives for a clear policy on gift restrictions so that the potential for these conflicts is minimized. Policy alternatives include limiting the life of restrictions, limiting the percentage of a gift which can be restricted, limiting the types of restrictions, and, pushing donors to focus on the process of funding rather than the subject areas to be funded.

E.5. The endowment's relation to local private sector

An endowed foundation's relation to the local private for-profit sector offers a great deal of promise for innovation. To this point there has been little effort to bring local private businesses into a constructive role in dealing with the issues the endowed institution is being set up to address. There are several ways that an endowed foundation can help to build a bridge to the local private sector.

One approach for incorporating local private sector is to seek out local business persons who are manifestly dedicated to sustainable development and recruit them for the board of directors of an endowed foundation. Local businesses in countries with a large private sector can become contributors to an endowed foundation. However, if this is to become a major source of funding for an endowed foundation, then national tax law will need to be changed to provide an incentive for such charitable giving. Such review could be a part of the technical assistance leading to the establishment of an endowed foundation.

Tax Reform Issues *An endowed foundation is a special type of nonprofit distinguished by the fact that it holds assets and is expected to manage those assets in such a fashion so as to be able to provide a steady and increasing amount of grant money to its target beneficiaries.*

An important key to success is the development of laws and regulations which exempt the endowed foundation from paying taxes (i.e. tax exempt status for it, revenue from the investment of its assets, asset worth including property, and imported goods. The decision as to what kinds of tax exemptions would be given to the endowed foundation need to be determined on a case by case basis in each country. National governments and foundation organizers need to agree on explicit statements of activities which a foundation can support and which it cannot.

A second tax issue relates to laws which regulate gifts from local corporations and persons of wealth. In many countries, it may be feasible to establish tax deductions which encourage domestic corporations and individuals as well as foreign companies operating in the host country to make gifts to the endowment.

If it is determined that there is a need for reform, then a donor should be *prepared as either part of a policy reform agreement or through follow-on technical assistance to work with the host government to develop a reform agenda. This agenda needs to avoid simply copying a developed country tax and regulatory framework, but rather tailor recommendations to the specific conditions of each country.*

No matter which alternative chosen for an endowment, the charter of an endowed institution can allow a variety of ways to help the private sector become more supportive of national sustainable development. Many of these ways parallel how U.S. foundations work with the private sector, but many are also different. An effort to find or set up precise analogs should be avoided because the complicated interactions between non-profit and for-profit private organizations in the US reflect an unique social and political context. Some examples are: support for research and development; feasibility study support; program related investment; no-interest loans; and, endorsements for marketing arrangements.

Developing countries vary greatly in the vibrancy and depth of private entrepreneurship. Thus a strategy to help local, socially beneficial and "green" businesses must be tailored to local conditions. In a country with a strong private sector, the provision of a limited amount of credit may begin to stimulate business interest. In countries with nascent private sectors, there may be justification for committing substantial resources to feasibility studies. In either situation an endowed foundation could provide more than token support for the private sectors.

The private sector can become an important vehicle for tackling national development needs if an endowed foundation has programs which enable it to influence how local private capital investment flows. Without such influence an endowed institution would miss an opportunity to bring in important determinants of national development—that is the collective impact of a wide variety of for-profit activities.

E.6. Choice of technical assistance for the design process

Whatever alternative is chosen, donors will have to commit to a substantial amount of technical assistance at all stages. However, the sequence of the technical assistance required differs with the alternative. In addition requirements for donor oversight, both management and administrative back stopping, vary in timing.

If donors make the initial decision to consider an endowment, then the choice of alternatives is a crucial step which will set the process on fundamentally different paths which have implications for what kind of endowment is eventually set up. Therefore, donors may well seek help from consultants in making that choice. The consultants which donors select for this early exploratory work should be as free as possible from conflicts of interest. One conflict might come from retaining an NGO which is in the business of arranging debt-for-nature swaps for the initial work of characterizing and choosing among alternatives. Donors should also be careful to be certain that individuals do not have an extensive history of work for an NGO which stands to gain from the choice of alternative. However, such NGOs can be valuable sources of expertise which donors can tap after a local process has yielded priorities which turn out to be appropriate to the U.S. NGO's area of interest and experience.

If donors can avoid the appearance of conflict of interest they will find that obtaining the support of the local NGO community will be much easier, because the local NGO community will more likely feel that they are on an equal footing with foreign NGOs at the beginning of the process of establishment. Maintaining this favorable climate must be one of the prime responsibilities of the consultants the donor hires for the second phase, which is helping to negotiate an agreement with the government. This step marks the beginning of the creation process.

Part III—Steps: How to start an endowed foundation

A. A proposed sequence with technical assistance

This section discusses a sequence of activities or steps leading to the creation of a grant-making foundation with an endowment fund.

The process of creating a foundation starts with an agreement among the interested parties on how to obtain the broadest possible participation. This is a critical consideration if the goal is to establish a foundation that is perceived as being greater than the interests of the donors who have contributed the initial endowment fund. If an NGO consortia exists that is representative of the needs and priorities of local community groups, it should be involved at an early stage in promoting discussion among the NGO community and local community groups on the foundation concept and possible ways to go about its creation. The following sequence, if followed, will spur discussion within the NGO community and local community groups.

STEP 1: Secure agreement on the role of local community groups & NGOs

An initial agreement to explore creating a foundation should be between the national government and USAID, or another donor. However, if the foundation is to claim a status as an indigenous nongovernmental institution, then the first concrete proposal for a way to create the foundation would more appropriately come from the local NGO community or jointly from a meeting of representatives of that community and USAID. The initial proposal will need to have a strong identification with a constituency and community based NGOs. Out of such a meeting should come an agreement on the sequence of steps to create a foundation. For purposes of credibility, this agreement should cover the first two or three steps described below in detail with subsequent steps only characterized in broad terms. However, the participants should thoroughly work out the process for agreeing on subsequent details.

STEP 2: Form organizing committee; select board

If local NGO consortia decide to play a leadership role in setting up the foundation creation process, then a group or groups of local NGOs might start by proposing a way to govern the process. Assuming that they propose some form of organizing committee, the question becomes how to set it up. This process will need to be guided most likely by the donor or a small group that includes donors, community representatives and, if appropriate the host government, who act as a nominating committee. They can solicit the candidacy of individuals for the organizing committee. For the purpose of credibility, the committee should be broadly representative of the ultimate constituency base, and represent the values of the foundation (e.g. dedicated to environmental concerns, broad social equity goals, community development, or some other worthy aim).

Overseeing the selection of the foundation board would be the final act of the organizing committee. The same concerns for credibility and reputation apply to the process of selecting board members as to the organizing committee. The board would have the further responsibility of finishing the creation process. These last steps include: adopting the charter and bylaws; choosing alternatives for asset management; seeking formal registration of the foundation from the national government; planning programs; establishing administrative procedures; and, when assets are transferred, of making the first grant(s).

The process of selecting an organizing committee could take two to six months. Once established, the organizing committee should immediately begin the process of finding and hiring an interim coordinator.

The organizing committee should have clearly defined duties, including: hiring the interim coordinator; overseeing the convening of regional forums for discussing the foundation concept; agreeing with the donor on the nature, extent, and timing of technical assistance that is needed; choosing the technical assistance; ensuring broad participation in drafting the foundation's charter and by-laws; preparing communications documents, and overseeing the process of selecting a board.

STEP 3: Retain interim coordinator

The organizing committee would have the responsibility of finding an interim coordinator. Several considerations argue strongly that this person should be a local citizen. A foreign interim coordinator would project the image of foreign donor driven and created foundation. On the other hand, a local person would be more likely to understand local political currents, both inside and outside the NGO community.

The donor may or may not participate in the selection of the interim coordinator, depending on the terms of the initial agreement. If the donor funds the interim coordinator, then the donor may want a say in filling this position. On the other hand, should the organizing committee use other funds, then the donor may not have a say.

The organizing committee would need support for its expenses, the costs of the interim coordinator, and the costs of regional meetings, newsletters, media outreach, etc. The organizing effort would need grant support, which the organizing committee could seek from another donor, or a U.S. foundation, to cover its expenses, the cost of the interim coordinator, and perhaps the costs of broad participation in the foundation's creation. Having such a grant would give the local NGO community a small, but perhaps crucial measure of independence as it works with the donor during the creation process.

The interim coordinator area of responsibility would include: promoting participation in the creation process; staffing the work of the organizing committee; preparing communications materials for internal and external audiences; promoting public discussion of the foundation; and working with any donor-supplied technical assistance. The interim coordinator would likely cease his or her work before the organizing committee transfers management to the board. In this scenario, a technical assistance grant gradually assumes the costs of continuing activities of the interim coordinator. An alternative scenario could call for the interim coordinator to continue until the board is formed. In this case, the technical assistance grant presumably could pay the costs of the interim coordinator.

STEP 4: Hold regional meetings of NGOs & local community groups

During the first year of work, a key goal is broadening the participation in the creation process. The organizers could hold a series of regional meetings in which they present the foundation concept and solicit the ideas of local groups and communities. Issuing newsletters in local languages as well as the publication of articles in newspapers would help this process. It seems most efficient if the interim coordinator, with oversight of the organizing committee, manages this participation process.

STEP 5: Provide Technical Assistance

The donors, either by itself or in partnership with other donors, should declare its willingness to provide both long term and short term technical assistance to support the process of foundation creation. This section discusses the timing of this technical assistance and its relationship to other elements of the foundation creation plan.

The technical assistance might supply one long term, eighteen months or more, person who should either serve as the interim coordinator or work closely with the interim coordinator. Under one alternative the technical assistance could pay the interim coordinator. Under another alternative, the interim coordinator would continue to be paid by whatever funding sources were used to hire the interim coordinator in the first place.

A third alternative exists. If the technical assistance includes the role of the interim coordinator, then the selection of the interim coordinator could occur via a process involving the participation of the organizing committee. In other words, the organizing committee could have an equal vote in evaluating the qualifications of proposals to the donor for supplying the technical assistance. Under this alternative the activities of the interim coordinator could not begin until the technical assistance is in place. This scenario argues for advancing the process of putting out the scope of work of the technical assistance for bids. To do so would delay the start of the efforts to build public participation and shorten the time available for a thorough review and discussion of the charter and bylaws.

STEP 6: Prepare Charter and By-laws

At a point approximately midway through step 3 (holding regional meetings) the process of drafting a charter and bylaws should begin. This process will require skillfully interweaving two different sources of ideas and constraints. The first source represents technical expertise, which would come equally from outside as well as from inside the country. Such expertise includes financial advice and planning, legal advice, administrative structure and procedures, and the experience of other foundations. The second source represents the results of public discussions which involve as many different local groups and communities as possible. All sources of ideas need to be melded into a coherent whole.

The organizing committee should supervise the interim coordinator and the technical assistance in the drafting process. This process aims to write a charter and bylaws acceptable to all entities, including local community groups, the local community of NGOs, foreign donors, and the national government.

Organizers should allow one year for this process to be certain to tap all sources of ideas and technical knowledge and to allow for time for reflection. After reaching consensus, selecting a board, and adopting the charter, the organizers submit the charter and bylaws to the government to secure recognition of the foundation as a nonprofit entity under national law.

STEP 7: Review alternatives to manage assets

The organizing committee needs to examine all alternatives for managing the foundation's assets. A subsequent section of this report offers a series of alternatives, describes their pros and cons and makes recommendations for their further evaluation. This analysis should continue after the board is in place to allow the new board the opportunity to exhaust all questions and alternatives. Once the new board chooses an asset management plan, a continuing need would exist for financial advice which the board can obtain via a retainer contract with a local firm backed up by an international firm.

STEP 8: Register endowment; transfer assets

Once in place, the new board would proceed to make a formal request to the government for registration as a nonprofit association. This registration may involve negotiating special privileges for the foundation, including, but not limited to, tax reductions on earnings and imports, tax incentives for donations from local private individuals and corporations, etc. This process may take as long as three or four months. If the organizers choose to register the foundation as an association of public interest, this process could take much longer. After a foundation completes the next step, the national government can transfer the first tranche of assets.

The transfer of funds cannot take place until all previous steps are either complete or in place. If during the early steps, it becomes apparent that delays would prevent meeting a date for fund transfer, then organizers must revise plans and budgets to accommodate the extra time needed.

STEP 9: Hire staff, plan program & make first (pilot) grants

The interim coordinator should work under the guidance of the board to recruit staff and work with local groups to plan the first grants program. This process can take from six to eight months or longer. To the extent possible, the process of hiring staff and launching a program should take place at least six months prior to the first round of grant making.

The process of determining the shape, approach and priorities of the first grant programs will present the foundation with the first test of its ability to function in accord with the lofty goals set for it. The grants program must be at the heart of the rationale which started the whole process. From that point until now the subject of how, who and why grants are to be used for what benefit and purpose is at the core of all discussions. Hence, donors are best advised to facilitate these discussions with suggestions along the lines of the following:

- there should be explicit criteria for grant eligibility
- the process of arriving at criteria, quotas, etc., should be transparent
- there should be clear and simple guidelines for proposals, the review process, monitoring, reporting, etc.
- the board should review proposals rapidly
- there should be programs which assist illiterate and inexperienced local community groups and NGOs in writing proposals and administering grants
- there should be an aggressive media campaign to build awareness of the foundation's purpose and activities
- the foundation's staff should keep exemplary records and conduct all work in a transparent fashion
- there should be explicit procedures for addressing conflicts of interest

A.1. Supplying technical assistance for the establishment process

For the foundation to succeed, its form, programs and priorities all must grow out of a process substantially under local control. Thus an overall recommendation calls for paying careful attention to the type of organization, whether nonprofit or for profit, contracted to supply the technical assistance so that the principle of local control is not compromised.

While creating a functioning endowment serves as a the overall goal of the technical assistance, a key strategy towards achieving this goal is assisting the local community of NGOs in *their* process of creation—rather than creating an institution and turning it over to local management at the end of the creation process. Thus the technical assistance needs to be provided in such a way as to minimize an "donor" imprint. Providing technical assistance in a way which avoids branding the resulting endowment as a donor creation has two real benefits. Local society will feel a greater ownership of the resulting institution and other donors, both bilateral and multilateral, would be more likely to provide funds for further institutional and program development and/or the foundation's endowment.

A donor needs also to minimize, for the same set of reasons, allowing the technical assistance to put an imprint on the endowment. When drafting a Request for Proposal (RIP) for technical assistance, a donor should pay careful attention to not only the terms of reference for the specific types of technical assistance requested and the experience profile of the individuals sought, but also to the "character" of the institution or firm which would provide the technical assistance. For example, an international NGO with a specific agenda necessarily brings baggage of public perception.

One way to avoid a reputation of being overly influenced by developed country donors and international NGOs would be to build, from the start, a network of cooperative relationships between the endowment and similar institutions in other countries.

An effective technical assistance plan requires a combination of local and foreign technical expertise. The technical assistance serves a dual purpose: to assist the creation of the endowment/foundation; and to build up local capacity to manage the foundation's affairs. This capacity must include both expertise within the foundation and available to it to from other local consulting firms, accountants, lawyers, financial advisors, etc. Therefore the technical assistance strategy should pair local expertise and foreign expertise whenever possible.

As several endowments in different countries begin to take shape, there may be an opportunity to form a network for sharing experiences. Such a network could make available key persons from one country to another for the purpose of helping supply technical assistance. If the network idea grows, then it may be worth considering using the network as a vehicle for all types of technical expertise. In essence the network could function as a kind of secretariat for promoting cooperation among developing country foundation and for building up a body of experience and expertise needed by foundation pioneers.

A technical assistance secretariat, if it were under substantial control of the emerging community of foundations, could provide a buffer protecting foundation organizers from donor pressure and manipulation. It could also provide a channel for multi donor support of the creation process. Lastly, it could provide an agenda-neutral source of technical assistance.

B. Recommendations for asset management

The following list, not necessarily in order of importance, summarizes key recommendations for an approach to asset management.

B.1. Develop a realistic asset management plan.

A plan should provide a level of financial support from endowment income adequate for the anticipated expenses of staff administration and programs. This plan must address a range of issues including: explicit strategies for managing the investment risks, ratios of liquidity needed to provide security for both staff and grantees, whether to permit invasion of the endowment and if so under what circumstances, and explicit fund raising targets to maintain the endowment's value. The plan should consider worst case scenarios.

B.2. Establish a core endowment free of donor restrictions.

Despite the desire of many donors to restrict the use of their gifts to a foundation, a foundation will need to seek, and set apart in a separate account, irrevocable contributions. This account will provide the foundation with an unrestricted, internal funding source. These core funds will give the foundation significant leverage in negotiating with other donors on joint programs.

B.3. Establish "sub accounts" for restricted gifts.

Many donors will limit the use of their gifts to such specific purposes as management of a particular national park, promotion of public awareness about soil conservation, or women's role in sustainable agriculture. In addition, some donors may specify certain reporting requirements for their contribution. In these cases, a foundation should create sub accounts with explicit provisions to address the donors' restrictions. These provisions may include clauses allowing the donor to suspend or cancel the gift in cases of mismanagement or malfeasance and receive the remaining balance.

B.4. Raise funds from "in-country" sources.

While the international donor community will probably contribute the majority of funds, a foundation will need to develop alternative funding sources should donors cut back their support. Moreover, such a strategy would help promote self-sufficiency. While some foundations may raise funds from private citizens and local businesses, a more likely source lies in partnership with government. For example, a government could dedicate user fees at a national park or special tourist taxes to the foundation. A government could also make an in-kind contribution of its civil servants or other resources to the foundation. If a foundation uses such sources, however, a government's influence on the foundation would expand—perhaps at the expense of NGOs and local community groups. Donors should also consider a country's opportunity cost in not fully exploiting its natural resources—on which the donor community may place a premium because of those resources' perceived value to the global community of nations.

B.5. Adopt an asset management plan before establishment.

A foundation's charter should describe the foundation's assets and their origin. Such a plan should project other sources of support, which could include: bilateral and multilateral contributions, charitable donations, bequests and legacies, government grants, foundation grants, tax revenue and user fees, membership fees, dues and assessments, and investment income. The plan should specify what percent of total support will come from various sources and the type of fund raising activities contemplated. The plan might, for example, set a specific limit on the portion of annual budget devoted to administrative expense or have a minimum devoted to training.

On the basis of this plan, anticipated staff expense and initial programs, the foundation organizers should determine the minimum endowment necessary to justify the expense and effort of creating a foundation. Experience, limited to the few efforts which have already begun grant making, indicates that $4 million represents a minimum amount to commence operations with a short term goal of reaching approximately $10 million so as to provide a sense of stability. Of course, for the foundation to be truly effective and to achieve a stature approaching that of established donors would require a much larger endowment.

B.6. Establish a board finance committee.

As an early act, a foundation's board should establish a finance committee. This committee would set investment policy, retain investment managers, oversee investment managers, hire outside auditors, review audit reports and prepare budgets, long range plans and annual fiscal reports. The investment policy should identify objectives, funding needs, and tolerable risk. Conventional wisdom suggests that the policy seek long term investments, strive for stable income which will support slowly growing funding needs, try to preserve the real value of capital, and emphasize conservative investments of lower risk. Highly unstable economies, however, may necessitate other policies. In any case, diversification of investments represents a good strategy. The finance committee will have to determine the best asset mixes that offer the highest return for the risk that the foundation can tolerate.

B.7. Define an explicit conflict of interest policy.

A foundation's board of directors should fully disclose their financial interest and refrain from discussing and voting on investment decisions which could affect their interests or the interests of their families and business associates. The directors should set similar policy for contracts and procurements.

B.8. Retain outside investment managers.

Choosing an investment manager will be an early important board decision. At the same time, the board needs to set clear procedure for oversight of the manager's work. For example, the board or the finance committee may want to reserve the right to approve any investment decision above a certain amount, but allow the outside manager to shift assets within clearly defined limits.

Part V—References

ECLAC, "**Sustainable Development: Changing Production Patterns, Social Equity and the Environment,**" Economic Commission for Latin America and the Caribbean (ECLAC), Casilla 179-D, Santiago, Chile, 1991.

Gachuki, David, "**Harambee in Kenya: A Case for its Regulation,**" Occasional Paper No. 19, July 1982. Revised version of one of nine papers presented at the AID/Shambaugh Conference on Local Political Organization and Rural Development Policy in Less Developed Countries held at the University of Iowa, Iowa City, Iowa, September 24-26, 1981.

Gibson, J. Eugene & William J. Schrenk, "**The Enterprise for the American Initiative: A Second Generation of Debt-for-Nature Exchanges -- With an Overview of Other Recent Exchange Initiatives,**" Vol. 25 The George Washington Journal of International Law and Economics 1991.

Hanson, Gary, "**Terms of Endowment,**" published by AID's CDIE, 1990.

Hopkins, Bruce R. & Cynthia L. Moore, "**Developing Philanthropy Internationally: Legal Issues for Policymakers to Consider in Formulating a Country's Law of Charity.**"

Hyden, Goran, "**From Dispensing Political Patronage to Generating Social Capital: African Development in Transition,**" Paper presented to the ATLAS Seminar/Conference on "Governance in Africa" held in Dakar, Senegal, April 21-26, 1992, under the auspices of the African-American Institute.

Lee, Judith F. et al, "**Realizing Investment Objectives Through a Morgan Diversified Portfolio,**" Morgan Guaranty Trust Company report prepared for the World Bank Second Trust Fund Workshop, July 31, 1992.

Lion, Donor M., **Endowments and Intermediary Institutions,**" Labat-Anderson, Inc., Paper in draft form prepared for the Private Sector Initiative for Africa, USAID, 1991.

Nair, Govindan et al, "**Madagascar, Financial Policies for Diversified Growth: Choices for a Market Economy,**" The World Bank, October 28, 1991.

Rigby, John T., Joan Goodin, Elaine Robbins, "**Report to USAID/Ecuador: Health and Family Planning Project - 518-0084**, New TransCentury Foundation, March 1991.

Simmons, Emmy, **Notes on Malagasy Banking Sector**, September 3, 1992, U.S.

Agency for International Development, Regional Economic Development Services Office for East and Southern Africa.

Tourreilles, Francisco A., "**Establishing a Trust Fund,**" The Nature Conservancy, July 31, 1992.

Weatherly, W. P. and Warnken, P., **Programming Agricultural and Environmental Endowments and Foundations in Africa: Lessons from Latin America.** A report to the USAID Bureau for Africa. 7 January 1994. (12 pages with five summary case examples)

Weatherly, W.P., **Recommendations for development of the Tanzania AIDS Orphan Trust**. Report to USAID/Tanzania. 19 March 1993. (29 pages with two figures)

Weatherly, W. P., **Guidelines for planning and programming endowments and endowed foundations in Africa.** Revised draft report to AID's Africa Bureau: 7 January 1993. (42 pages with two tables and bibliography)

Weatherly, W. P., Gibson, J. E., and Callahan, D., **Notes on 1 December 1992 Endowments Colloquium**, a report to the Africa Bureau of AID. 5 January 1993. (14 pages with list of participants and organizations)

Weatherly, W. P., and Gibson, J. E., **Review and Addition to Guidelines for Endowments to Environmental NGOs in Africa**, a report to the Africa Bureau of AID. November 1992. (57 pages)

Weatherly, W. P., and Gibson, J. E., **Report on the Foundation for the Environment of Madagascar**, a report to USAID/Antananarivo. 10 October 1992. (29 pages with three figures, plus annex of 5 pages listing contacts in Madagascar)

Weatherly, W. P., **Guidelines for the Africa Bureau of AID for Programming Local Currency Endowments**, draft report to AID's Africa Bureau: October 1991. (Superseded by the 7 January 1993 version)

Weatherly, W. P., **A proposal for the establishment of "MEENS" or the Madagascar Endowment for the Environment, Nature, and Society.** 8 June 1991. (45 pages)

Weatherly, W. P., **Two case studies: the Puerto Rico Community Foundation, and the Philippine National Environmental Foundation,** a report to the Global Environment Facility, The World Bank, Washington, DC, 2 March 1991. (8 pages)

Weatherly, W. P., **Creating a National Environmental Foundation in the Philippines**, a proposal contained in the Natural Resource Management Program, USAID/Manila, the Philippines. 24 June 1990. (53 pages with two figures, plus 2 page annex on inflation)

Weatherly, W. P., **Beyond Debt for Nature Swaps: Opportunities and Strategies for Environmental Activities in Asia,** A report to the Asian Development Bank, Manila, the Philippines. January 1990. (20 pages with three figures, plus three page annex of persons interviewed.)

Annex: Innovative methods to raise funds for endowments

This annex is used by permission of IUCN (The World Conservation Union). This annex was prepared for IUCN's concept paper for the **Global Initiative for National Environmental Funds** (GINEF).

This annex lists innovative ways to create financial resources for use of national funds, defined broadly to include a spectrum of institutions including endowments and trusts.

Experience with early attempts to multiply the amounts of money available for environmental purposes—especially biodiversity conservation—centered around "debt-for-nature" swaps. However, in many cases the proceeds of swaps greatly exceeded ready-to-start projects. Consequently many swap arrangers sought to "bank" the swap's yield of local currency in interest-bearing accounts and draw them down over a fairly long time, i.e. a kind of "sinking fund."

About four years ago the idea of using new money to endow a permanent foundation arose in several places. In the Philippines AID proposed using a "debt-for-nature" swap to endow a foundation. At about the same time a provision was added to the Enterprise for the Americas Initiative to create permanent foundations as part of bilateral debt restructuring. Since then support for the idea of creating independent, endowed foundations has grown rapidly. Now, the need has come full circle and supporters of endowed foundations are seeking additional innovative ways to generate financial resources which can be added to the endowments of national funds.

The mechanisms listed here are offered as food for thought to stimulate more creativity in the dialogue among supporters of national funds, governments, potential donors, and the international finance community.

The first three mechanisms discussed below would require close cooperation with bilateral and/or multilateral donors. For most to be workable, there would be a need for reform either of donor policy or recipient country policy or both. The second three would call for more entrepreneurial efforts with either the private sector or nongovernmental organizations taking a leading role.

This discussion lists mechanisms which are described more fully in GINEF Technical Paper #1. The reader should contact IUCN/Washington for a copy of this paper.

1. **Bilateral policy reform grants & multilateral policy loans**

Policy grants "free up" local currency in an amount equal to the size of the grant at official exchange rates. This happens because the grants allows a government to save the local currency resources which it had budgeted to buy foreign exchange to service debts or pay for imports. Ordinary grants are tied to the procurement of goods and services and do not have this consequence. Therefore it is possible for donors to negotiate an agreement (as a complement to a policy reform agenda) with a recipient government whereby that government places a portion of the freed up local currency in a national fund which the government does not control. Such has happened in Madagascar with the local currency equivalent of $12 million.

Similar opportunities, of a much larger scale, exist with multilateral bank policy based lending. However, it must be noted that some environmentalists, who oppose such "structural adjustment" lending on grounds that its effects are sweeping and unpredictable, will likely oppose an initiative to use such lending to capitalize national funds. The idea is offered here because it is possibly the largest and most easily effected way to move considerable resources into national funds.

1. **Generated counterpart funds**

Another approach which bilateral donors could use is to negotiate a condition on the use of local currency generated in payment for a bilateral grant used for financing imports. Many donor countries provide grants to pay for imports of commodities or manufactured goods which a recipient government sells on a local market for local currency. The agreement governing such a import program can stipulate that all or a part of the local currency generations be turned over to a national fund. Such has happened in Tanzania for $36 million worth of local currency.

2. **Debt write downs**

One bilateral donor (U.S.) has linked the creation of endowed national funds to bilateral debt restructuring. This program is called the Enterprise for the Americas Initiative (EAI). Informally, the U.S. is considering extending the EAI program to other debt burdened countries, particularly those of sub-Saharan Africa. Given that African countries as a whole carry upwards of $300 billion in foreign debt, the scope for generating local endowments as has been the case with EAI may be considerable.

However, there are several factors which may limit the spread of an EAI program. The EAI model is limited to U.S. bilateral debt and other donors have already simply forgiven their debtor's obligation to pay.

A larger scope could come if the MDBs allowed a small fraction of the debt service owed to them to be paid in local currency to a national fund. Even 5% of the annual inflow to the MDBs would be a considerable sum.

3. Real estate investment funds

One of the most contentious issues between North and South is the ownership of land. Many, if not most, nations of the South, anxious to preserve their sovereignty, prohibit foreign ownership of land. (Even the World Bank's charter prevents its loan funds from being used directly to purchase land.)

However, "additionality" (i.e. creating a way for a country to get new funds "additional" to customary assistance or investment flows) may be sufficient to convince a government to alter established policy. One way would be to link ownership to a critical environmental need such as management of flood plain land. A specific example can best illustrate the point.

In many tropical cities, there is a persistent problem of squatters in the urban portion of flood plains of major rivers where frequent floods not only endanger both residents and their houses, but also lead to significant pollution of the rivers as trash dumps and pit latrines are washed up by flood waters. At the same time the value of urban land which has clear title has increased enormously.

A land trust could be set up to secure clear title to flood plain lands by swapping land and housing in other areas with squatters. The environmental benefits of the trust could provide the government sufficient reason for granting it an exclusive government charter to engage in land deals in flood plain area.

Foreign investment could be attracted because local developers would be quite willing to invest in clear title flood plain land which carried a number of environmental restrictions such as requirement for levees and/or flood control works, percent lot coverage restrictions, etc. A critical role would be played by local NGOs to ensure that all interests are represented fairly.

4. Privatization for endowment

In many countries where the government is the sole shareholder in national companies, the idea of a debt for equity swap may be attractive. In other countries where the Central Bank guarantees repayment on foreign borrowings of major companies, such private debt may be purchased on the secondary market at approximately the same discount as sovereign debt. In both cases a debt swap would give a national fund equity (shares) in company rather than local currency. These shares could serve to endow the national fund with income producing assets which might appreciate as well.

This suggestion was first made in connection with the early design of the Foundation for the Philippine Environment. Because of economic conditions in the Philippines then (1990) and because of the size of the swap, the Central Bank of the Philippines raised concern about the inflationary impact of the sudden release of that amount of local currency into the economy. One suggested way to avoid these problems was to purchase the debt of Philippine companies (then in the process of being privatized) such as the Philippine Long Distance Telephone Co. (PLDT) or the Manila Electric Railway and Light Co. (MERALCO). The idea of swapping for equity was rejected at the time in favor of a conventional "debt-for-nature" swap; however, if PLDT stock had been obtained the *holdings would have tripled in the last three years.*

Some objected that holding assets of major companies would raise the possibility of pressure being put on the board of directors of the endowment to vote on one side or another of an issue at shareholders' meetings. Of course, the reverse of this latter concern is the positive benefits which might come from having a board of directors representing a cross section of society exercising significant influence over public utilities and important companies.

5. Trade of sustainable products

Many environmental groups are trying to create positive incentives to influence the way new trading patterns, products, markets, industry, etc. interact with the environment. Some of these examples are already becoming well known to the extent that they have captured a market niche. To name four: Ben & Jerry's Ice Cream (with wild gathered nuts from the South American rainforest); Banana Amiga (a green seal given by a consortium of U.S. and Costa Rica environmental NGOs); Café Monteverde (a partnership for sustainable coffee production between

Montana Coffee Traders, Costa Rican coffee farmers and The Nature Conservancy); vegetable ivory (a material for buttons and jewelry harvested sustainably in rain forest buffer zones in South America by indigenous people in conjunction with Conservation International).

To encourage such creativity on a larger scale will require a more accessible framework for structuring the deals and efforts to reduce the risk to all parties involved. At the moment each participant in such a sustainable marketing scheme is assuming risk well beyond what is traditional in their own sphere. Environmental groups who endorse or sponsor "sustainable' schemes or investments risk damage to their fund raising activities which might come from publicity about a failure. Marketing entrepreneurs risk loss of their market share if they lose an endorsement. Local producers and farmers risk loss if their investment fails to allow them to penetrate a new market which would give them a higher selling price. Local groups (e.g. farmers cooperatives, community organizations, local NGOs) risk loss of future grants from donors.

A national environmental foundation or trust could help lesson all these risks and hence improve the climate for the growth of sustainable use of resources. The trust could help lesson the risk of private investment in sustainable activities by certifying the claims of all involved in a sustainable scheme. Such a service would have a great potential value, which could be the basis for generating income.

A straightforward idea could call for a few percent of the market value of each sustainable to be donated to the endowment. A more difficult to set method of funding might be through direct investment of the trusts assets in joint ventures. Since this approach raises the potential of conflicts of interest, careful attention should be paid to defining the relationships among the various parties.

The potential to raise money could be enormous. One new source would be capital with social goals attached. Not only does the general public have an interest in investing in businesses with social and environmental benefits, the managers of pension funds, church funds, university and foundation endowments, etc. also have a desire to put part of their assets to work with social and environmental criteria. So far the growth of this kind of investment has been limited by the paucity of services available to certify the social and environmental benefits of investments. National trusts can provide a way to develop those services.