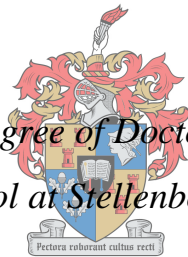


**Understanding the financial vulnerability and the financial decisions of  
non-governmental organisations: an empirical study of Ugandan NGOs**

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*Dissertation presented for the degree of Doctor of Philosophy in the Faculty of  
Business School at Stellenbosch University*



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March 2018

## **Declaration**

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## Abstract

Non-governmental organisations (NGOs) are key providers of essential services in developing countries, where government capacity is often limited. Despite their important role in socio-economic development and poverty reduction, NGOs in developing countries tend to be reliant on either a few foreign donors or on local communities' contributions. In addition to the short contract periods and associated project risks, foreign funding is challenging and onerous as a result of information asymmetries and lack of transparency. Only a minority of larger and well-established NGOs can access reliable funding from international donors, whilst the remaining NGOs are financially vulnerable and struggle to survive. This is of grave concern to the societies within which these organisations operate as it can lead to the interruption of the delivery of critical services to beneficiaries.

There are a number of studies on the financial vulnerability and associated coping strategies of NGOs in developed countries, but not in developing countries. This research aims to address this gap in the literature by investigating the nature of financial vulnerability and exploring the effective coping mechanisms implemented by NGOs in such contexts to deal with financial challenges and to ensure sustainability of the organisation and its programmes.

To achieve the stated objective, the research investigates the financial vulnerability and stability of NGOs, focusing on the country case study of Uganda. The research adopts an empirical approach, using methodologies that have previously been used for developed countries to investigate the possible relationship between an organisation's characteristics and its financial vulnerability. It subsequently focuses more narrowly but also more in depth on the subsample of NGOs in Uganda that have experienced a large decrease in revenue, applying a comparative technique that respects the organisations' heterogeneity and allows testing for conditional relationships between different organisational factors (i.e. conditions that can mitigate the impact of financial vulnerability on programme expenditures). Finally, the research applies a qualitative, interpretive approach in order to gain a better understanding of the preliminary findings and the funding environment of Ugandan NGOs. It draws from 35 in-depth interviews with Ugandan NGO managers conducted during 2016. The respondents provide valuable insights that help to explain financial decisions and outline the coping strategies of NGOs to ensure financial survival and safeguard their commitment to their mission and to service delivery.

Findings from the research indicate that financial vulnerability is a persistent and prevalent problem that affects the majority of local NGOs in Uganda as a consequence of uncertainty of funding flows. However, the way an organisation is affected depends on its expenditure and financial structure. A large variety of proposed coping strategies amongst organisations were identified. NGOs in Uganda have been proactive and innovative in exploring alternative funding sources to protect themselves against financial risks, especially those related to dependence on foreign funding.

The lessons learnt from this research are useful both for NGO managers who are concerned about financial risk and vulnerability, but also more broadly for the community of development practitioners. The recommendations can assist NGOs to sustain their programmes on the ground and improve the financial stability of the NGO sector. This research contributes to the academic dialogue on financial vulnerability by providing a credible voice to NGOs, explaining their fears and their challenges. Further research is recommended to investigate the financial vulnerability of NGOs in other country contexts.

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Writing this thesis has been an interesting and life-changing learning experience. It has been a challenging and a wonderful journey at the same time. Along the way I was blessed to meet people who, in their own unique way, made an invaluable contribution to this study and to my own life. When I look back, I realise that each person came on board at the right time. I owe all of them my profound thanks.

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While the institutions and individuals cited here have been pivotal in enabling this work, I remain solely responsible for any errors or inaccuracies.

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## KEY DEFINITIONS AND TERMINOLOGY

Definitions of the key concepts used in this research are provided below.

- A **nonprofit organisation** (NPO) is part of the nonprofit sector. This is because the sector is neither a part of the government nor of the private sector (Anheier & Ben-Ner, 2003, p. 4). The NPO sector includes national, regional and international organisations, such as NGOs and foundations. The form of an NPO is generally defined through the non-distribution constraint as organisations in the nonprofit sector do not distribute the financial surplus (i.e. earnings, profits or dividends) from operations to the organisation's stakeholders (Hansmann, 1980; Anheier & Ben-Ner, 2003). It should be noted that an NPO is not barred from generating revenue (or a surplus), but the revenue should be retained and used to support the organisation's mission.
- An **non-governmental organisation** (NGO) (hereafter also refer to as 'organisation') is a legally constituted private voluntary grouping of individuals or associations established to provide services to communities and to increase citizen participation in policy-making processes and development issues. An NGO can be local, national or international depending on its scope of operation and legal status. Another differentiating factor within the NGO sector is the way they operate, which can be either as an 'intermediary' if it works between community level and other level of society (such as donors and governments) or as a membership-based organisation delivering the services directly to its members. NGOs are included among NPOs.
- A **community-based organisation** (CBO) is an organisation that operates at local level (or sub-county level) to improve the quality of life of beneficiary communities. CBOs are typically smaller (in terms of size and resources) than NGOs and constituted by local members – community individuals who are often beneficiaries.
- An **international non-governmental organisation** (INGO) is a non-governmental organisation controlled and governed by a foreign country, but operating in Uganda under a certificate of registration.
- A **fundraising strategy** is a structured plan, the purpose of which is to obtain the necessary resources to implement the organisation's mission and objectives. The fundraising plan outlines the activities of the organisation (products and services) in a coordinated and integrated way over a certain period of time.

- A **donor** is a local or foreign individual or entity, including development banks, multilateral and bilateral institutions, state and federal agencies, that contributes directly or indirectly, financially or in kind (i.e. goods), for programmes run by NGOs to support their goals and missions.
- **Grants** are non-repayable funds disbursed by some institution (i.e. government, foundation, or international NGO) to a recipient NPO. The process usually starts with the submission of a proposal. After approval of the proposal and the signing of the contract or agreement, the grant institution disburses the funds. Most grants require some level of compliance and reporting to the grant provider. The types of requirements and conditions, however, can vary among institutions.
- **Financial vulnerability** (hereafter referred to as ‘vulnerability’) is defined as a situation where an NGO does not have a sustainable (i.e. continuous and reliable or secure) revenue stream. In Chapters 2 and 3 financial vulnerability is defined as a decrease in revenue or decrease in expenditure based on the typical operationalisation of the concept for quantitative analysis. In Chapter 4 the concept takes a broader meaning that includes uncertainty of funding flows, financial risk and financial distress that threatens the continuation of programmes and the survival of the organisation.
- **Financial volatility** is defined as the fluctuation of revenue streams.
- **Sustainability** is the ability of an organisation to fulfil its mission and to serve its stakeholders over time. Three elements of sustainability are considered: financial sustainability, organisational sustainability and programme sustainability. Financial sustainability refers to the ability of the organisation to generate sufficient financial resources to fund its project activities and operations. Organisational sustainability refers to the capacity of the organisation to make arrangements to continue providing a framework through which services can be delivered over time, including partnerships with government, the private sector and other organisations. Programme sustainability refers to the continuation of service delivery after the end of the projects.
- **Beneficiaries** are individuals or organisations that benefit from the interventions of NGOs (i.e. activities) and therefore experience a change of state in their lives.
- **Stakeholders** are individuals, groups, institutions or governments with an interest or concern in an NGO’s work.

- **Coping mechanisms** are the means that an organisation uses and adopts in order to manage external or internal challenges.
- **Organisational capacity** includes internal elements and internal processes (quality and standards), such as governance, leadership and management performance, human resources structure and skills/professionalisation, organisation logistics and processes, financial management and internal policies, infrastructure, public and external relations, networks and partnerships, systems of information and communication technologies, information and knowledge management (documentation) and resource mobilisation.

*Your work is going to fill a large part of your life, and the only way to be truly satisfied is to do what you believe is great work. And the only way to do great work is to love what you do. If you haven't found it yet, keep looking. Don't settle. As with all matters of the heart, you'll know when you find it. And, like any great relationship, it just gets better and better as the years roll on. So keep looking until you find it. Don't settle.*

(Steve Jobs<sup>1</sup>)

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<sup>1</sup> [https://www.brainyquote.com/quotes/steve\\_jobs\\_416859](https://www.brainyquote.com/quotes/steve_jobs_416859)

# CHAPTER 1

## INTRODUCTION

### 1.1. INTRODUCTION

The research investigates the financial vulnerability and financial decisions of non-governmental organisations (NGOs) in developing countries, with a specific focus on Ugandan NGOs. The concept of financial vulnerability is central to this thesis. The research structure of the PhD allowed me to consider financial vulnerability from a variety of perspectives and employing different methodologies: in Chapters 2 and 3 it was operationalised as a decrease in revenue. In Chapter 4, although the same definition of the concept was used as a sampling criterion to select an initial group of participants, financial vulnerability was explored inductively and could attract a much wider operational meaning associated with the *vulnerability* of NGOs on the ground. The concept ‘financial decisions’ includes any actions undertaken by NGO managers to overcome or mitigate the impact of financial vulnerability, and includes short-term coping decisions and longer-term strategic changes.

NGOs represent a highly diverse range of organisations, the main purpose of which is to provide public goods and services to disadvantaged communities. In order to pursue their mission and organisational commitments, NGOs in developing countries rely mostly on donor funding. Yet NGOs in developing countries often depend on a few highly volatile foreign funding sources. This is partly attributable to limited local resources because of low-income economies which restrict both the ability to raise revenue from beneficiary communities and potential support through government contributions.

The funding situation for NGOs in developing countries has deteriorated since the 2008 global economic crisis. The available funding has been reduced and is granted over shorter periods. As a result, some NGOs have not had their projects renewed, because of either changing donor policies or changing strategies. Uganda, for instance, received a great deal of funding for HIV/AIDS projects, but the progress of the disease is now under control and donors have thus diverted the available funding to other countries or other development areas. Donor requirements have also tightened (USAID, 2010; USAID, 2011). Specifically, NGOs are required to apply in partnership with others and to contribute pro rata to the project, and restrictions on the use of funds have tightened (i.e. direct project implementation), all of which impede organisations’ ability to grow, develop and execute projects. Donor funding



has therefore become increasingly challenging, especially for relatively small and young organisations with few international links. While the inequality between the vulnerability of local and international NGOs is an important aspect, the main focus of this study is to explore the reasons behind the financial vulnerability of local NGOs as well as possible solutions to their vulnerability. In considering solutions, we are mindful that much of the financial vulnerability is structural and due to the power imbalances between donors and aid recipients. And it is acknowledge that space for innovation around more sustainable funding is achieved only because some donors are willing to create such space.

The impetus for this research is the concern about the impact of financial vulnerability on the functioning of NGOs and the communities of their beneficiaries in developing countries, and the way donor conditions and requirements affect organisations' capacity and ability to effectively implement projects on the ground.

To understand the financial challenges, as well as the manner in which Ugandan NGOs respond to those challenges and the kind of strategies that can be implemented to ensure organisational and programme sustainability, this research investigated the nature of financial vulnerability, the responses of Ugandan NGOs to their own financial vulnerability, and the extent to which such responses can effectively encourage the sustainability of the organisation and their programmes. It is equally important, however, to understand the environmental contexts within which NGOs function.

## **1.2. PERSONAL MOTIVATION**

My professional background has been that of manager of the Aga Khan Foundation in both Portugal and Mozambique. When I became interested in the subject of development finance, I read Easterly's *The Elusive Quest for Growth: Economists' Adventures and Misadventures in the Tropics* (2001). This book provides many examples of unsuccessful implementation of foreign aid programmes, which did not deliver as promised. The failure of these programmes was mainly the result of the lack of pragmatism and a clear understanding of the circumstances on the ground. Since then I started asking questions about why this happened and how aid could be channelled to be used more effectively.

Easterly's points became clear and real to me when I moved from the developed country context of Portugal to the developing country context of Mozambique. This was particularly the case in terms of the way in which programme funds were managed, the types of

restrictions imposed by donors and the mechanisms of monitoring and evaluation used which did not really match the conditions on the ground.

This clear perception of the two different contextual realities was further underlined when I read studies on the financial vulnerability of NGOs and how this can be effectively mitigated through the implementation of a uniform set of organisational management practices. I increasingly questioned this perspective, which neglected to take the specific context into account. My questions started about the way that the authors of those studies defined financial vulnerability. Some authors defined it as the probability that an organisation would decrease programme expenditure (Tuckman & Chang, 1991). Others measured financial vulnerability as a decrease in equity balances as a proportion of total revenue (Trussel & Greenlee, 2001; Trussel, 2002) or a decrease in total revenue larger than 25 percent of total revenue (Keating, Fisher, Gordon & Greenlee, 2005). However, in my experience financial vulnerability is not well captured by these ex post and retrospective financial ratios. There may be a decrease in these expenditures that was based on a strategic decision and not driven by financial need. For instance, an organisation may show a reduction in programme expenditure as a result of the termination of projects or as projects wind down and have fewer financial needs in their final phases. This poses a related question about the real meaning of financial vulnerability, both on a conceptual and empirical level.

The other issue that raised my interest within the literature is related to the strategies that could be used to mitigate financial risks and to decrease financial vulnerability. Considering that the bulk of the literature focuses on developed countries, the empirical evidence fails to represent the reality of developing countries. This raises questions about whether some of those strategies highlighted to mitigate financial risk can really be implemented in a developing country context, or whether they can have any impact on improving the financial position of NGOs in developing countries. For example, whereas widening the revenue base through revenue-generating activities can be effective in a developed country context, where large financial contributions can be obtained, in low-income communities local funding opportunities are much more limited. Another interesting issue that was brought to my attention relates to the strategy of building institutional capacity (Bowman, Keating & Hager, 2006; Calabrese, 2012). Even though I agree with the importance of this strategy to secure the financial sustainability of an organisation, it is not always possible to sustainably build capacity, regardless of organisational size. For example, finding qualified staff is a problem

for organisations that operate in remote areas. This fact raised a further question related to how NGOs respond to such constraints.

There are, therefore, two personal motivations that drove me to conduct this research. The first is my own professional experience with the frustrations of financial vulnerability and financial decisions within a developing country NGO, and the second is my personal interest in helping to identify coping mechanisms (i.e. strategies) that can contribute to solving or mitigating some of the financial problems and challenges faced by NGOs.

### **1.3. RATIONALE**

This section explains the reasons for conducting this research by locating it within the existing body of knowledge. The following premises underlie the research:

- The degree of financial vulnerability in developing countries is not only considerably higher, but such vulnerability impacts on society much more significantly than in developed countries;
- There is a lack of transparency on how and why donor funding is allocated because of the lack of reliable and accurate data available to effectively assess NGOs in developing countries. This contributes towards aggravating the power imbalance between donors and NGOs based in developing countries;
- Only a minority of larger NGOs in developing countries can access reliable donor funding. The remaining organisations, mostly small and local NGOs, are financially vulnerable.

#### **1.3.1. Importance of defining the problem of financial vulnerability**

Many governments in developing countries face severe financial and managerial constraints, which limit their capacity to provide critical social and economic services such as food, medicine and education (Edwards & Hulme, 1996; Burger & Owens, 2013). The origins of these constraints are multidimensional, but the most seriously binding constraint is often the small tax base available to fund public goods and services (Martens, 2002). Consequently, NGOs play a crucial role in such contexts. They do not provide additional choices or cater for minority preferences – more often they are the only providers of public goods and fill the gap attributable to government constraints. Despite this important role of NGOs in developing countries, they often have to rely on short- to medium-term project-based contract funding from foreign donors.

The research, therefore, argues that financial vulnerability in developing countries is different from that in developed countries: not only is the extent of financial vulnerability considerably higher in developing countries, but also the nature of it. Such vulnerability impacts on society much more deeply, potentially interrupting the provision of critical services such as HIV treatment, orphan care, and medical treatment in remote areas. For this reason it is important to understand the problem of financial vulnerability of NGOs in developing countries and to identify factors that adversely affect their financial stability.

### **1.3.2. Importance of finding appropriate tools to assess NGOs**

According to Burger and Owens (2013), donors do not allocate funding in an effective way, but rather based on habit. Donors also favour NGOs with higher-quality proposals and more observable outputs (Easterly, 2001). The ineffectiveness of mechanisms of funding allocation has been widely attributed to the lack of reliable and accurate data, inappropriate tools of evaluation, and the existence of information asymmetries between donors and organisations<sup>2</sup> (Martens, 2002; Burger & Owens, 2013). It is therefore difficult to effectively assess how organisations work, especially when they operate in remote areas and the target beneficiaries have little space to provide feedback on services delivered. In fact, donors are usually unfamiliar with local conditions and only rarely visit the project sites (Easterly, 2001). Additionally, donors impose a number of restrictions (such as conditions related to submission and printing of frequent and detailed reports) to ensure effectiveness of their contributions as a result of the information asymmetries. Eventually, these conditions often cause more harm than good, especially for small organisations that do not have the capacity to comply effectively (Elbers & Arts, 2011; AbouAssi, 2013).

This research argues that the existence of information asymmetry and the lack of transparency of NGO performance add further uncertainty to the funding environment. This may plausibly intensify the power imbalance in favour of the donors as it contributes to the lack of transparency and accountability to the donor community. The power imbalance between donors and NGOs is not explicitly studied in this research, partly because it is beyond the scope of the study and partly because there is not enough reliable data available

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<sup>2</sup> NGOs often respond and act strategically in the ways that donors would like in order to secure funding (Balsler & McClusky, 2005; Van Puyvelde, Caers, Du Bois & Jegers, 2012).

on the subject; yet it is at the heart of this research as many of the concerns around the financial vulnerability of NGOs are rooted in the power imbalance between donors and NGOs.

### **1.3.3. Importance of identifying differences in patterns of financial vulnerability**

Studies by Fafchamps and Owens (2009) and Burger and Owens (2013) observe differences in patterns of survival between two groups of organisations according to their different funding sources, i.e. donor-funded and community-funded. Donor-funded NGOs were found to be older, larger and more sustainable than community-funded NGOs and therefore they are more likely to survive. Similarly, Foster and Fine (2007) and Chikoto and Neely (2013) find that organisations that rely on private contributions experience higher average income volatility and therefore show higher financial vulnerability. NGOs in developing countries rely mostly on external funding, but there is evidence that only a minority of larger organisations can access reliable donor funding (Fowler, 2016). The remaining organisations, mostly small and locally supported, are unable to access these grants and are financially vulnerable as a result. Eventually, organisations struggle to survive financially and to continue delivering services.

Another factor of relevance, with regard to the level of financial vulnerability and the way NGOs are able to cope with financial challenges, is the type of NGO organisation. For instance, extant literature addresses the uneven access to funding between international non-governmental organisations (INGOs) and their local counterparts (Elbers & Schulpen, 2013; Fowler, 2016).<sup>3</sup> This is especially true for southern NGOs where most are funded by international donors from northern NGOs (CIVICUS, 2015). INGOs are usually larger and often in a better position to bid for donor contracts than small local NGOs. INGOs have stronger organisational networks and preferable contacts with official donors back home, more visibility, better records and reporting systems, which in turn results in stronger donor applications (Fowler, 2016). Fowler (2016) also points out the degree to which INGOs are better able to cope with financial uncertainty, for example by bridging cash-flow gaps, by cross-financing from other sources of funding (e.g. headquarters) when there are delays in payments.

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<sup>3</sup> Also available: [http://civicus.org/images/SOCS2015\\_ESSAY8\\_NGOsAndAid.pdf](http://civicus.org/images/SOCS2015_ESSAY8_NGOsAndAid.pdf).

This research acknowledges these findings about structural differences within the NGO sector and therefore includes a wide spectrum of organisations in the analysis in terms of the NGO type, size, funding structure and subsector.

#### **1.4. STATEMENT OF THE PROBLEM**

NGOs play a crucial role in developing countries by providing essential services, which means that interruptions can be extremely harmful for development as communities do not have alternative ways of obtaining those services. Yet NGOs in developing countries often depend on uncertain funding flows mainly from foreign donors and are thus financially vulnerable. Furthermore, access to donor funding and compliance with the associated requirements became more problematic after the global economic crisis of 2008, especially for relatively small and young organisations.

The problem of this research, therefore, relates to the specific nature of financial vulnerability of NGOs in developing countries, the responses of Ugandan NGOs to their own financial vulnerability, and the extent to which such responses can effectively encourage the sustainability of the organisations and their programmes.

#### **1.5. PURPOSE OF THE RESEARCH**

Given the research problem outlined in the previous section, the overriding purpose of this research is twofold: firstly, to investigate the nature and correlates of the financial vulnerability of NGOs in Uganda, and secondly, to explore the financial decisions and strategies implemented by NGO managers to deal with financial challenges. Because of the lack of representative panel data, including financial data for developing countries, this research can also be useful for other developing countries. The research analysed financial data for a sample of Ugandan NGOs for the years 2000, 2001, 2006, 2007 and 2016. The analysis documents factors involved in financial vulnerability as well as current strategies and coping mechanisms that contribute towards sustaining the organisations and their programmes in developing countries. Based on the existing literature, the study examines to what extent the mechanisms proposed in the literature that is focused on developed countries can be implemented by NGOs in developing countries and also what other steps are taken by NGOs in developing countries that are not mentioned in the literature.

## 1.6. RESEARCH QUESTIONS

Following the statement of purpose and the debates about financial vulnerability and financial decisions of NGOs managers, the research was driven by the following questions and sub-questions, which frame the subsequent chapters.

In Chapter 2, financial vulnerability as based on current literature is examined, and the following question is asked:

- What are the factors correlated with financial vulnerability of NGOs in developing countries and how does the significance of these correlates change across types of NGOs?

In Chapter 3, the conditions that potentially explain the ability of NGO managers to make decisions in order to mitigate the impact of financial vulnerability are examined. The following question is asked:

- What are the institutional conditions that enable organisations to mitigate the impact of a decrease in revenue on programmes?

Lastly, drawing from the findings of the previous chapters, in Chapter 4 the aim is to understand the financial decisions and strategies of NGOs from the perspectives of practitioners and based on their experiences or perceptions of being vulnerable. This presents an ex ante and more subjective perspective on financial vulnerability.

## 1.7. RESEARCH LAYOUT

This section provides an overview of the structure of the research. The research is organised as three self-contained studies focusing on specific research sub-questions which relate to the core research questions (see Section 1.6). Each of these studies corresponds to one of the subsequent chapters. Each chapter commences with a review of the literature related to the topic being studied as well as a short description of the data being analysed. Consequently, there is some overlap in the contents of these chapters.

Chapter 1 presents an overall introduction to the research topic by positioning the research in the current body of knowledge. Specifically, this chapter provides a personal motivation and underlying rationale. It includes the statement of the problem and the purpose of the research, outlines the research questions and how they were addressed, and provides outlines of the

chapters of the thesis. The chapter also clarifies key definitions and terminology and concludes with a contextualisation of the Ugandan NGO sector.

Chapter 2 addresses the questions on how to measure financial vulnerability and what type of NGOs experience more fluctuations in their revenue by exploring the determinants of financial vulnerability and the differences between different types of NGOs. The chapter is mainly based on the work of Greenlee and Trussel (2000) and Tuckman and Chang (1991). It attempts to measure financial vulnerability by analysing determinants of financial vulnerability of NGOs in a developing country context. This chapter expands the existing literature on the topic by including additional variables that are more appropriate to the context of developing countries. It also explores differences between donor-funded NGOs and community-funded NGOs, based on the premise that these divergent funding models are associated with different sets of risks and vulnerabilities.

Chapter 3 builds on the preceding chapter and the literature related to strategies that help NGOs to deal with financial vulnerability. It addresses the question of what features and conditions can mitigate the impact of a decrease in revenue on NGO programmes by examining patterns of revenue fluctuations and organisational features, and the conditions that are positively associated with the maintenance of programme expenditure (i.e. that can prevent the negative impact of a reduction in revenue on the work of NGOs). In this chapter it is assumed that as a result of a large decrease of revenue as a proxy of financial vulnerability, NGOs are forced to decrease their programme expenditure.

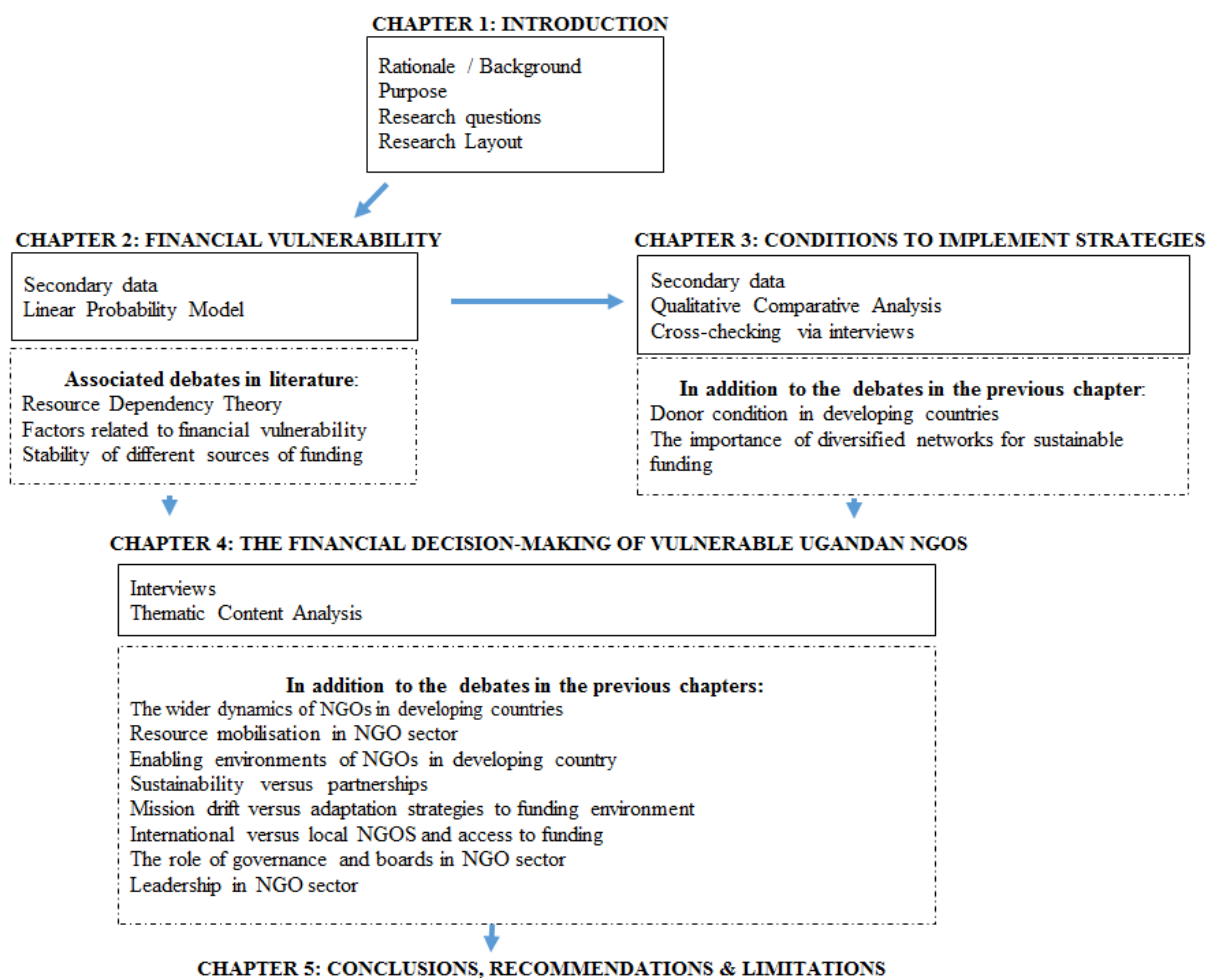
Chapter 4 investigates answers to questions related to how NGOs respond to financial uncertainty, to what extent the use of specific strategies mitigates the impact of financial vulnerability on the organisation and its programmes, and how NGOs protect themselves against future financial risks. It draws on the findings from the previous chapters and interviews with Ugandan practitioners. From the field work it became evident that there are broader issues about the financing of NGOs and strategies that can be more effectively implemented than may be derived from the existing literature. This chapter focuses on understanding the environmental context and financial vulnerability of the NGO sector and makes sense of the experiences of Ugandan NGOs. Specifically, it explores the sources of financial difficulties to understand in depth the actual impact of financial problems on NGO operations, and examines possible and effective strategies to deal with financial vulnerability.



This chapter also provides valuable insights into the new funding trends and the current challenges for NGO sustainability in developing countries.

Figure 1.7.1 below presents a diagrammatic roadmap of the whole research project. It serves as a summary of the contents of each chapter and illustrates the logic of the layout of the chapters.

**Figure 1.7.1: Diagrammatic roadmap of the research**



## 1.8. RESEARCH METHODOLOGY

In this section, the methodology used to accomplish the research purpose is addressed. The research applies both quantitative (Chapters 2 and 3) and qualitative (Chapter 4) analysis in order to strengthen and check the results obtained.

In Chapter 2 a Linear Probability Model is applied. It uses a panel data set of 295 NGOs in Uganda surveyed in 2000 and 2001 and in 2006 and 2007.<sup>4</sup> The questionnaires in both studies included the same questions about organisational assets, revenue, expenditure, networks and leadership characteristics, governance, activities, funding sources, target groups, staff, grants and donor requirements.

In Chapter 3, the conditions that might help NGO managers to make decisions in order to mitigate the impact of financial vulnerability were analysed. The sample used in the previous chapter was narrowed down from 295 NGOs down to 22 NGOs, which were selected based on their experience of a reduction in their revenues between 2000 and 2001. Qualitative comparative analysis (QCA) was used to identify the conditions present that related to the ability of NGOs to maintain programme expenditure. The method is based on the assumption that the ability of an NGO to safeguard programme expenditures when faced with a decrease in revenue, can have different explanations depending on the existence (or absence) of specific conditions.

The analysis of the secondary data was supplemented with interviews with Ugandan NGO managers in 2016. The purpose of the field work was, firstly, to gain a deeper understanding of the differences encountered in relation to the findings of Chapter 2 and 3 and related literature and to address some of the data limitations (e.g. actual reasons for the decrease in revenue and consequently the actual impact on the programme delivery); and secondly, to gain deeper insight into the current financial strategies of NGOs and to what extent they can be implemented in a developing country such as Uganda. Thirty-five in-depth interviews were conducted with a sample of Ugandan NGO practitioners. The sample for this study was obtained in two ways. A core sample of 15 NGOs was purposively selected from the panel survey used in Chapters 2 and 3 based on the criterion that they have experienced a big reduction in their revenue. The sample was then expanded through referrals, i.e. snowball sampling, by the initial participating NGOs to other NGOs that could make valuable contributions. The contributions of the participants' NGOs and the identification of specific

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<sup>4</sup> In the 2008 survey (including 2006 and 2007) the researchers interviewed the NGOs that were surveyed in the first wave (during 2000 and 2001). They were very precise in classifying each organisation and noting actual changes to their structures, finances and activities.

conditions or combinations of conditions were fed into the subsequent Chapter 4 on the strategies that can be successfully implemented to protect against financial vulnerability.

In Chapter 4, practitioner interviews and thematic content analysis (Creswell, 2013) were used. This method is particularly suitable because of the lack of reliable secondary data and since existing theories do not entirely apply to NGOs in developing countries, because they are focused more on NGOs in developed countries.

Finally, Chapter 5 offers a conclusion by consolidating the main research findings from each of the previous chapters and relating them to the existing literature. Based on the conclusions, the chapter offers recommendations for practice. The chapter also acknowledges the limitations of the research and the factors that limited the methodology used. Finally, it outlines the importance of the research to practice.

## **1.9. BACKGROUND: THE UGANDAN NGO SECTOR**

Any NGO operates within a context; this is relevant to be able to understand the specific situation of the Ugandan NGOs and the way in which they operate. It is also important to identify the variables that will help to strengthen the performance of NGOs to enable them to meet their mission in a sustainable way.

The subsequent chapters should be understood in the light of the context outlined below.

### **1.9.1. Country context**

#### ***1.9.1.1. Political environment***

Uganda became a multiparty democracy after 2005. This created an opportunity for NGOs whose activities focused on advocacy and human rights. It also enabled a more diverse sector because the state no longer regards NGOs as a political threat, since political opposition in the form of several political parties was now considered legitimate. In addition, the NGO Act 2016<sup>5</sup> protects legitimate NGO activity that contributes towards the strengthening of the political process and democratisation by promoting civic education, human rights protection and lobbying related to policy and other public issues, particularly those which concerns neglected groups.

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<sup>5</sup> Available from: <https://www.ulii.org/node/25931>.

NGOs generally work quite closely with the Ugandan government or its agencies. Some policy documents, such as the National Development Plan (NDPI from 2010/11–2014/15 and NDPII 2015/16–2019/20) and the Karamoja Integrated Development Program (2005–2008), acknowledge the important contribution of NGOs to socio-economic development. This is reflected in the NGO policy (2010), whose main purpose is to provide a framework under which the government and NGOs work together to promote service delivery, advocacy and empowerment. Despite the fact that the Ugandan government recognises NGOs as important delivery mechanisms of services, cases of state funding of sub-contractors under the Public-Private Partnership initiative remain rare.

Three key political situations that affected the financial sustainability of Ugandan NGOs during the period 2000 to 2016 were: firstly, the Anti-Homosexuality Bill that was signed into law by the Parliament of Uganda in December 2013<sup>6</sup> which negatively affected contributions towards human rights initiatives; secondly, the elections in 2011 and 2016, which shifted donor priorities towards NGOs that focused on advocacy and civic education in order to ensure fair and transparent elections (USAID, 2011; USAID, 2015); and thirdly, the reality that Uganda is the largest host country for refugees in Africa (the third largest in the world), receiving on average 2,000 displaced people per day in 2016, mainly from South Sudan (*Mail & Guardian*, 2017<sup>7</sup>). The country provides emergency relief and other services such as education and health for which it receives funding from more than 50 aid donors. The flow of refugees is likely to continue to increase, as is the funding for emergency relief.

#### ***1.9.1.2. Economic and demographic environment***

According to the World Bank and the Government of Uganda (2015), the Ugandan economy grew at an average of 7 percent per year from 2000 to 2010. After that the GDP growth rate was 3.3 percent in 2013/14, 5 percent in 2014/15 and 4.6 percent in 2015/16 (according to the same memorandum). This was the result of a stable macroeconomic environment, high export growth, high foreign direct investment and increased private investment. However, according

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<sup>6</sup> It was recalled by the Constitutional Court in 2014.

<sup>7</sup> Available from: <https://mg.co.za/article/2017-06-20-crisis-and-hope-in-uganda>.

to the World Bank's classification for 2016, Uganda is still a low-income economy with GNI per capita (PPP) of \$1.82 in 2016.<sup>8</sup>

This relatively strong economic growth performance was accompanied by a decline in poverty rates (from 64.1 percent in 2000 to 41.5 percent in 2010 and 34.6 in 2015), using the international poverty line of \$1.90 per day (2011 PPP) (World Bank, 2015). Although the proportion of the population living below the poverty level declined, the absolute numbers increased as a result of the larger population size. In addition, income inequalities increased, with the Gini coefficient rising from 0.37 in 1992/3 to 0.43 in 2009/10 and 0.4 in 2012/13 (UBOS, 2013),<sup>9</sup> especially in urban areas.

Uganda's economic structure has changed over the past three decades, with a gradual shift from the agriculture sector to the manufacturing and services sector. Coffee and cotton are the main export products, accounting for almost 40 percent of total exports, followed by manufactured products (24 percent). The country is about to become an oil-producing country, which is expected to have a positive impact on the country's fiscal performance and socio-economic development, as a result of which the country will attract foreign direct investment towards infrastructure development (World Bank and the Government of Uganda, 2015).

This economic growth has not been able to absorb the growing labour force.<sup>10</sup> Unemployment among the youth stood at more than 60 percent in Uganda in 2015. According to a study undertaken by Action Aid Uganda (AAU), the Ugandan NGO National NGO Forum and Development Research Training (DRT) entitled "Lost Opportunities" (2013), the main causes of this were low levels of employable skills,<sup>11</sup> a conservative and risk-averse financial sector, which limits the opportunities for youths to access to financial

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<sup>8</sup> Available from:

[http://databank.worldbank.org/data/Views/Reports/ReportWidgetCustom.aspx?Report\\_Name=CountryProfile&Id=b450fd57&tbar=y&dd=y&inf=n&zm=n&country=UGA](http://databank.worldbank.org/data/Views/Reports/ReportWidgetCustom.aspx?Report_Name=CountryProfile&Id=b450fd57&tbar=y&dd=y&inf=n&zm=n&country=UGA).

<sup>9</sup> Available from: <http://www.ubos.org/publications/statistical-abstract/>.

<sup>10</sup> Activists from civil society have pointed at the cultural issues created by the neoliberal economic reforms in the 1990s and early 2000s from the IMF and the World Bank that favoured the multinational and large business corporations, while negatively affecting small enterprises and the participation of young people.

<sup>11</sup> The state of Uganda population report of 2014 refers to the educational system as being a provider of job seekers rather than job creators, because academic qualifications (i.e. passing exams and acquiring certificates) do not necessarily mean the individual has learned skills to be employed. Available from: <http://npcsec.go.ug/resources/reports/>.

resources, and cultural attitudes such as gender discrimination. Such trends resulted in an educated and young labour force that was unemployed and prone to becoming vulnerable to marginalisation, crime and delinquency.

The demographic profile of the Ugandan population is characterised by a high fertility rate, high child and youth dependency (under 15 years old), and a young unemployed population (between 15–34 years). The high fertility rate together with a decline in the mortality rate<sup>12</sup> translates into a scenario whereby the country has the youngest and most rapidly growing population in the world, increasing at a rate of 3.3 percent (World Bank, 2011).<sup>13</sup> The fertility rate is high because of cultural traditions (widow inheritance and reluctance to use contraception), early child-bearing, marriage at a young age, and high school dropout rates for the girls, especially in rural areas.

Despite the rapid economic growth, the country's population remains poor, with increased social and economic inequality. The vulnerability of the employment situation of young people poses enormous challenges to social development as well as to the role of NGOs in this regard.

## **1.9.2. Developments in the Ugandan NGO sector**

### ***1.9.2.1. Evolution and structure of the Ugandan NGO sector***

The Ugandan nonprofit sector is relatively large and active in comparison to that of other developing countries because of the country's deep tradition of communal activity. Since colonial times Catholic and Protestant missionaries have been well established and they have provided services such as schools and hospitals. Muslim communities also started their own development projects after many Indians moved to East Africa (Salamon & Sokolowski, 2003). The sector expanded most rapidly from late 1980s upon a return to political stability under the new regime of Yoweri Museveni, after the despotic military government of Idi Amin (Nyangabyaki et al., 2004).

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<sup>12</sup> The decrease in the mortality rate is an aspect of the decrease in the infant and child mortality rates.

<sup>13</sup> Available from: [http://databank.worldbank.org/data/Views/Reports/ReportWidgetCustom.aspx?Report\\_Name=CountryProfile&Id=b450fd57&tbar=y&dd=y&inf=n&zm=n&country=UGA](http://databank.worldbank.org/data/Views/Reports/ReportWidgetCustom.aspx?Report_Name=CountryProfile&Id=b450fd57&tbar=y&dd=y&inf=n&zm=n&country=UGA).

NGOs grew rapidly in terms of numbers and as important role players in service delivery and advocates for policy change (Dicklich, 1998). Until 2007 the country was faced with a rising HIV/AIDS pandemic, which attracted large amounts of international funding (Wallace et al., 2006, p. 79). The sector also grew as the country adopted structural adjustment programmes, which resulted in a reduction of public spending and in the employment of public sector employees, as a result of which people decided to move to the nonprofit sector.<sup>14</sup> The increase in the number of NGOs was partially a consequence of corruption that affected public service delivery, the desire to reduce poverty and concerns about national governance (Wallace et al., 2004; Wallace et al., 2006, p. 25). A large increase of aid in response to positive political changes in recipient countries, such as the end of dictatorial regimes, was a common occurrence. The period from the 1980s to 2007 was marked by a relaxed approach from donors, where many local NGOs were formed to take advantage of available funding (USAID, 2009). However, the new local NGOs were inexperienced and lacked capacity. According to a USAID report (2009), there were approximately 200 NGOs in 1986, while 8,385 NGOs were registered in 2009, which reflected a dramatic expansion.<sup>15</sup>

Since 2008 the sector has witnessed a tremendous change in the relationship between donors and local NGOs. The competition for funding increased steadily as the mechanisms of financial support became more stringent as a consequence of the global financial economic crisis and changes in donor funding mechanisms – for example, the creation of a basket of funds usually made available by a consortium of donors for specific purposes and the reluctance to support organisational capacity (USAID, 2009; Wallace et al., 2006). According to the latest USAID Sustainability Index (2015), approximately 13,000 NGOs were registered in Uganda at the end of 2015, i.e. an increase of 55 percent between 2009 and 2015.<sup>16</sup>

The sector was initially dominated by international organisations driven by traditional service delivery and humanitarian interests, supporting ‘civil society’ through capacity building and

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<sup>14</sup> For instance, considerably more aid was provided to Mozambique at the end of its civil war (mid-1990s) (Bulif & Hamann, 2003).

<sup>15</sup> According to USAID (2015), the statistics are underestimated as less than 30 percent of NGOs were registered.

<sup>16</sup> The figures may not capture the real number of organisations operating in the country, as some of them work without registering. According to Makara (2000), the registration process under the NGO Registration Act Cap 113 is difficult and onerous.

disseminating religiously focused ideas (Cannon, 1996; Wallace et al., 2004; Barr, Fafchamps & Owens, 2005). NGOs have, however, increasingly expanded their roles to advocacy and awareness activities, facilitating processes to engender more responsible government action to deliver services and check whether policies are being implemented, and protection of the environment (Wallace et al., 2006).

According to the NGO Forum (2017), which assessed the current state of the nonprofit sector in Uganda, the majority of NGOs are Ugandan origin (52 percent of NGOs are national and 35 percent are district networks), while only 2.4 percent are international organisations. More than 85 percent of the organisations are registered with the NGO Board. Most of the organisations are involved in service delivery, such as children and youth services (60 percent), education (56 percent), health (44 percent), agriculture and rural livelihoods (42 percent), water and sanitation (35 percent), women empowerment (51 percent), and half are engaged in advocacy work (50 percent).

The majority of NGOs in Uganda are small community-based operators (NGO Policy, 2010). NGOs are mostly local and concentrated in the Central and Southern regions (including Kampala): about a quarter work in the Eastern region, a fifth in the Western region and the rest operate in the North, which is Uganda's poorest region (Wallace et al., 2004; Burger & Owens, 2008). The Northern and Eastern areas have been politically more unstable and the dire humanitarian concerns of these regions have prompted the influx of international and better-resourced NGOs, which involve themselves in post-conflict rehabilitation and poverty eradication through agricultural, health and educational programmes. The Central and Southern regions have attracted a greater range of interventions from more diverse local NGOs. These organisations operate more fully in community development, lobbying and advocacy, focusing on local-level human rights issues, government transparency and public debt relief (Wallace et al., 2004).

NGOs in Uganda can be distinguished from those of other African countries for their high level of activity, the close relationship between CBOs and local communities, and the increased initiatives that have resulted in the formation of networks or umbrella organisations (e.g. Uganda NGO Forum, Uganda National Association of AIDS Service Organisations (UNASO), and Development Network of Indigenous Voluntary Associations (DENIVA)) that facilitate NGOs' work (e.g. training and providing support service) (USAID, 2015).



### ***1.9.2.2. Funding structure and funding trends***

Regarding funding structure, more than 25 percent of NGOs receive less than 3,000 US dollars and only 7 percent receive more than 3 million US dollars per year (NGO Forum, 2017). The Ugandan NGO sector is also characterised by a high concentration of funding among a few NGOs and little funding for the majority of NGOs (Barr, Fafchamps & Owens, 2005). International NGOs and bilateral donors are the primary source of NGO funds, and account for more than 90 percent of sectoral revenue (USAID, 2013). Funding for local NGOs is limited and comes from membership fees and subscriptions fees, donations and government support (Wallace et al., 2006, p. 78).

The heavy reliance on donor funding renders NGOs financially vulnerable, which leads them to seek other source of funding, such as income from business activities<sup>17</sup>. However, the fraction of revenue from business activities is relatively small when compared to the situation in other countries. Regarding government contributions, it is very rare that organisations receive funding from the Ugandan government either through sub-contracts or other types of partnerships. The most common situation is complementary support, such as the use of health and education facilities for activities. The remaining funds come from membership contributions and annual subscriptions (NGO Forum, 2017).

Donor funding to Ugandan NGOs has decreased as a consequence of the global financial crisis in 2008 and changes to development policies of donors (Wallace et al., 2006, p. 80; USAID, 2010; USAID, 2011). Another reason for the decrease of funding to Ugandan NGOs was the restored peace in the Northern region that shifted funding for humanitarian relief towards other countries. However, support from the international community is expected to slowly increase, because the country is receiving a mass influx of refugees from South Sudan.<sup>18</sup> The manner in which international donors dispense funds to NGOs also changed; they moved away from supporting NGOs directly to creating a basket of multi-donor funds (e.g. Democratic Governance Facility and Civil Society Fund), where NGOs have to join a consortium to apply (Wallace et al., 2006, p. 80). Another requirement relates to the matching

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<sup>17</sup> Uganda National NGO Forum (2013). Available from: <http://ngoforum.or.ug/wp-content/uploads/downloads/2014/01/Final-Capacity-Development-Report-submitted-by-HURINET.pdf>.

<sup>18</sup> New Vision (July 12, 2017). Available from: [http://www.newvision.co.ug/new\\_vision/news/1449103/uganda-ranks-refugee-hosting-nations-world](http://www.newvision.co.ug/new_vision/news/1449103/uganda-ranks-refugee-hosting-nations-world).

funding principle, according to which NGOs have to match the funding of the donor by contributing pro rata to the project. Increased competition within the sector because of the decrease in the number of donors (as a result of the basket of funding), together with the establishment of a minimum contribution of the matching grant, are especially harmful for the majority of small and local NGOs with weak capacity in terms of resources (financial and non-financial). As a result, funding reaches only a small number of larger organisations (USAID, 2014).

However, it is worth noting that because of the constraints of the current funding mechanisms, the Ugandan NGOs have been particularly successful in comparison to other African countries in exploring new and creative ways of generating revenue, including income-generating activities. These initiatives have contributed to their financial viability by covering part of the operational costs (USAID, 2014). In addition, a larger number of NGOs rely on volunteers and part-time staff as they are unable to pay competitive salaries. Thus, the sector suffers from high staff turnover (USAID, 2010).

### **1.9.3. Legal environment and self-regulation**

There is legislation, stipulating specific requirements, to regulate the sector. It confers legal existence on NGOs in Uganda and thereby facilitates NGOs to engage with other development players. The NGO legislation also provides for government oversight and support to the NGOs and CBOs via the NGO Registration Board that operates under the auspices of the Ministry of Internal Affairs.<sup>19</sup>

Finally, the NGO Act (as amended in 2006) also governs the NGO sector. It is important to note regulation 13, which states that “an organisation shall (...) not make any direct contact with the people in their area of operation in Uganda unless it has given seven days’ notice in writing of its intention to the local councils and Resident District Commissioners of the area”; in other words, NGOs have to give seven days’ notice to the government officials before

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<sup>19</sup> There has been a long debate around the location of NGO Board in the Ministry of Internal Affairs, whose mandate is specific and has little to do with NGO sector. For further information consult NGO Memorandum for the Review of the NGO Act CAP 113 (as amended in 2006).

accessing communities.<sup>20</sup> Moreover, the operational scope for NGOs remains subject to government discretion.

The registration process entails multiple endorsement stages and multiple requirements, which makes it extremely laborious and bureaucratic; letters and approvals are required from Local Council (LC) I, II and III, from the Resident District Commissioner (RDC) and sometimes from the District Internal Security Office (DISO). In addition, applicants have to provide letters from sureties, a constitution and work plan, among other things. Notwithstanding this, the NGO Board has been incapable of monitoring the growing NGO sector because of inadequate staff and finances.

The NGO Act requires all NGOs to submit annual returns (including audit reports) to the NGO Registration Board, among other reporting requirements to a wide range of bodies at the national and sub-national level. This has been a challenge, because of the low capacity of some NGOs and of the NGO Board to verify and make use of these reports. INGOs face another challenge regarding access to funding locally through district government. The government requires INGOs to disclose information about programmes and declare their revenues, while local NGOs are only required to mobilise local resources in future (Wallace et al., 2006, p. 81).

With regard to tax benefits, not all NGOs qualify for tax exemptions, which are in any case difficult to access i.e. the exemptions are difficult to gain because of the large number of bureaucratic procedures. Moreover, there is no tax benefit to individuals and the corporate sector through the corporate social responsibility requirement that would incentivise private companies and the public in general to remit a certain percentage of their revenue to charity, or to organisations that would support the work of NGOs. NGOs are generally allowed to engage in any legitimate fundraising activity including campaigns, fundraising events and financial investments.

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<sup>20</sup> Currently under NGO Act 2016, section 44 states that “an organisation shall not carry out activities in any part of the country, unless it has received the approval of the DNMC and Local Government of that area and has signed a memorandum of understanding with the Local Government to that effect” but, in addition also has “a memorandum of understanding with its donors, sponsors, affiliates, local and foreign partners, if any, specifying the terms and conditions of ownership, employment, resources mobilised for the organisation and any other relevant matter.”

There is a self-regulating instrument, the NGO Quality Assurance Certification Mechanism (QuAM), launched in 2006, that is intended to promote accountability and transparency among NGOs. It provides generally accepted ethical standards and operational norms such as policies and procedures for good internal governance of NGOs. Through their certification, NGOs seek to improve their internal governance and capacity, and to enhance their credibility among constituents, donors and government. Organisations are increasingly prepared (USAID, 2014, p. 184) to adhere to QuAM on a voluntary basis to demonstrate their capacity, legitimacy and integrity.

According to Africa NGO Sustainability Index, 2015,<sup>21</sup> the main challenges faced by NGOs to achieve sustainability are: i) the financial viability of the sector; ii) the legal environment; and iii) weak infrastructural support to the NGO sector. In practice, the NGO sector remains heavily dependent on external funding, with some of them relying on foreign donors for more than 95 percent of total revenue (NGO Memorandum, 2012; Uganda National NGO Forum, 2013; Wallace et al., 2006). The Ugandan NGOs still show weak organisational capacity as a result of their low financial viability, especially to attract and retain qualified staff.<sup>22</sup> In addition, many Ugandan NGOs, especially small organisations, do not maintain proper accounts or have audited financial statements because of a lack of funding and a poor understanding of proper financial management principles by staff and auditors.

## **1.10. SPECIAL NOTE: RESEARCH PUBLICATIONS AND PRESENTATIONS AT CONFERENCES AND SEMINARS**

By the time of writing this dissertation, each of the components (i.e. chapters) of the work contained herein has been presented at conferences and seminars, and as such the work has benefited from informal peer review and feedback. The papers were presented and written by me but I included my supervisor as a co-author in the first working paper.

Chapter 2 was presented as a paper entitled “Financial Vulnerability an empirical study of Ugandan NGOs” at the 5<sup>th</sup> CIRIEC International Research Conference on Social Economy in

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<sup>21</sup> Available from: [https://www.usaid.gov/sites/default/files/documents/1866/2015\\_Africa\\_CSOSI.pdf](https://www.usaid.gov/sites/default/files/documents/1866/2015_Africa_CSOSI.pdf).

<sup>22</sup> Uganda National NGO Forum (2013). Available from: <http://ngoforum.or.ug/wp-content/uploads/downloads/2014/01/Final-Capacity-Development-Report-submitted-by-HURINET.pdf>.

2015. The paper is a published working paper with Ronelle Burger, in CIRIEC's series of working paper (no. 2015/15).<sup>23</sup>

Chapter 3 was presented as a paper entitled "Examining how Ugandan NGOs respond to a reduction in revenue", at the International Society for Third-Sector Research (ISTR) PhD Seminar, at ERSTA SÖNDAL University College (Sweden), in 2016. The main purpose of this presentation was to receive methodological advice in order to analyse the available data.

Chapter 4 was presented as a paper entitled "Looking back, looking forward: lessons learnt from Ugandan NGOs" at the following conferences during 2017:

- Conference of the Association for Research on Civil Society in Africa (AROCSA) in Johannesburg;
- Biennial Conference of the Economic Society of South Africa (ESSA) in Grahamstown; and
- Global Development Finance Conference provided by Africa Growth Institute in Cape Town.

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<sup>23</sup> Available from: <http://www.ciriec.ulg.ac.be/en/publications/wp/>.

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## CHAPTER 2

### FINANCIAL VULNERABILITY: AN EMPIRICAL STUDY OF UGANDAN NGOs<sup>24</sup>

#### Abstract

Non-governmental organisations (NGOs) pursue wide-ranging and very diverse projects and they have become more vital than ever for developing countries. They raise public awareness of human rights, promote the development of democratic institutions and seek to improve the well-being of communities by being increasingly engaged in different aspects of socio-economic development, such as health and education.

However, most local NGOs are dependent upon their external environment, especially the financial resource environment. The financial situation of most organisations is negatively affected by constraints to credit, and their inability to raise their own capital and to engage in profit-making activities, which renders them financially vulnerable. The more financially vulnerable an NGO is, the more difficult it is to pursue long- and medium-term organisational commitments and goals. This may even result in decreased, interrupted or terminated programmes.

This study adapts the methodologies that have previously been used for developed countries to predict financial vulnerability in developing countries. It contributes to the body of empirical literature on development finance by investigating alternative proxies to assess the financial vulnerability of the NGO sector, including donor conditions, endowments (investment funds or equity) and savings. It adopts an empirical approach and examines a selection of studies on the financial vulnerability of NGOs, using data from 295 NGOs in Uganda to explore the possible relationship between organisational characteristics and financial vulnerability.

The study confirms the results of previous studies. The analysis shows that revenue concentration and the presence of assets are significant correlates of financial vulnerability.

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<sup>24</sup> This chapter is an adapted version of a published working paper, Silva, B. & Burger, R. (2015). "Financial vulnerability: an empirical study of Ugandan NGOs". CIRIEC-Université de Liège, Working paper (WP15/15). Available from: <http://www.ciriec.ulg.ac.be/en/publications/wp/>.

## 2.1. INTRODUCTION

The objectives of NGOs, particularly in developing countries, are wide ranging and very diverse, but most pursue long-term goals that seek to improve the well-being of communities, such as the delivery of social goods (e.g. health and education). They promote the development of democratic institutions through awareness training and advocacy work. They place issues of human rights and poverty alleviation on the global agenda and put pressure on nation states to take appropriate action. Therefore, NGOs are widely recognised for their contribution to development initiatives and poverty reduction, especially in the poorest countries of the world and in fragile states where government capacity is often very weak.

However, the NGO sector in general suffers from high volatility<sup>25</sup> and uncertainty of income flows, which exposes it to financial vulnerability. This is important since it may constrain organisations from achieving organisational goals, such as strengthening the capacity of community health services and other community institutions, enhancing food security in rural communities and promoting gender equality. This is a concern for all relevant stakeholders of NGOs (donors, governments and individuals) as it can force them to scale down or even interrupt the provision of programme services during times of financial distress. This situation is aggravated by the inadequate buffering of NGOs against financial difficulties as a result of their difficulty in gaining access to credit, their inability to raise capital and to engage in profit-making activities.

Most of the literature on financial vulnerability and the related assessment of financial risk tends to focus on the for-profit sector. Studies have found a statistically significant relationship between financial distress and some accounting indicators, as well as between financial distress and organisational size. In a similar way, this study addresses NGOs' susceptibility to financial vulnerability from an internal perspective by examining internal factors that are associated with vulnerability and may help to anticipate distress. Specifically, it addresses the question of what are the factors correlated with financial vulnerability of NGOs in developing countries and how the significance of correlates may vary across types of NGOs.

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<sup>25</sup> Financial volatility refers to the degree of variation of income over time. The concept is associated with the unstable nature of funding flows.

It contributes to the literature on development finance by specifically focusing on NGOs in developing countries and it expands the set of indicators that can be considered to assess financial vulnerability by incorporating the unique attributes of the NGO sector in developing countries. It proposes that in addition to the standard measures used for developed country analysis, the set of indicators in the case of developing countries should be expanded to include rigid institutional arrangements that inhibit NGO flexibility, such as donor conditions (e.g. time frame of expenditures), the existence of physical assets (e.g. land and buildings) and access to financial services. It compares the flexibility of different sources of NGO income and explores the relationship between vulnerability and organisational characteristics, including size, asset holdings and donor conditions.

The study is based on the work of Greenlee and Trussel (2000) and Tuckman and Chang (1991). It employs accounting ratios indicated in Tuckman and Chang (1991) to consider the likelihood of financial distress, but also draws upon the expanded analyses in Trussel and Greenlee (2004) and Trussel (2002) in which they include additional control variables, such as organisational size, sector and debt ratio in recognition of organisational heterogeneity.

Using panel data collected from Uganda's NGO sector in 2002 and in 2008, this chapter applies a Linear Probability Model to predict financial vulnerability. It distinguishes between donor-funded and community-funded NGOs, based on the premise that these divergent funding models are associated with different sets of risks and vulnerabilities. The model relies on accounting ratios and institutional features, such as the possession of assets, budget flexibility and dependence on external sources of finance.

The chapter is structured as follows: Section 2.2 presents an overview of relevant literature; Section 2.3 describes the data and methodology and gives an outline of the empirical approach; Sections 2.4 and 2.5 present the descriptive and econometric analysis respectively, while Section 2.6 offers a conclusion.

## **2.2. LITERATURE REVIEW**

The aim of the review is to gain insight into the factors that cause NGOs to be financially vulnerable. It relies mainly on relevant studies that used datasets from developed countries, particularly from the National Center for Charitable Statistics (NCCS) (USA). Greenlee and Trussel (2000) considered a sample of approximately 7,000 NGOs (for the period 1992 to 1995) from the IRS Statistics of Income dataset. Trussel (2002) used the IRS Core Files database and considered a sample of 94,000 NGOs for the period 1997–1999. Keating,

Fisher, Gordon and Greenlee (2005) cover approximately 290,000 organisations during the period of economic contraction 1998–2000.

### **2.2.1. Defining financial vulnerability**

Previous studies have used multiple measures of financial vulnerability, and have considered different cut-off percentages or periods. Tuckman and Chang<sup>26</sup> (1991) defined financial vulnerability as the probability that an organisation would “cut back its service offerings immediately” for three consecutive years when it faces adverse economic conditions or when donors interrupt funding. Greenlee and Trussel (2000) viewed NGOs as financially vulnerable if they had a reduction in programme expenses (as a proportion of total revenues) during three consecutive years. Keating et al. (2005) considered a drop larger than 25 percent in programme expenses in a year. Later, Andrés-Alonso et al. (2015) used 20 percent reduction in programme expenditure over three years. Other studies on NGOs have adopted a definition of financial vulnerability as a decrease in the equity balance as a proportion of total revenue. Some authors considered a decrease of 20 percent in net assets over 3 years (Trussel & Greenlee, 2004; Trussel, 2002; Andrés-Alonso et al., 2015), while others used a cut-off of 25 percent reduction in net assets in a year (Keating, Fisher, Gordon & Greenlee, 2005). Trussel and Greenlee (2004) used a cut-off of 50 percent reduction in net assets over three years. Another common measure in the literature is the reduction in total revenues. Keating et al. (2005) considered a decrease in total revenue larger than 25 percent in a year as an indicator of vulnerability.

### **2.2.2. Factors related to financial vulnerability**

Financial vulnerability of an NGO is caused by external as well as internal factors. External factors relate to economic shocks, cutting off of donor funds and delays in the receipt of funds<sup>27</sup> (factors which may be interrelated). Many organisations, irrespective of size, face problems to obtain funds as predicted and need to change their plans of action or use alternative financial sources to cover expenditure. Bulíř and Hamann (2003) claim that uncertainty about aid disbursement, even when donors are generally committed, is high. The

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<sup>26</sup> Also adopted by Greenlee and Trussel (2000).

<sup>27</sup> The kinds of economic shocks that can affect the revenue of NGOs are: a decrease of amount donated by the corporate sector and the general public (as their own incomes decline during adverse economic conditions); a reduction of NGOs’ endowment portfolios; and a decrease in government budget funds.

authors also examined the causes of financial aid volatility in relation to aid dependency, considering each category of aid, and concluded that the relative volatility of aid flow increases with the degree of aid dependency. This is in line with a recent study by Prentice (2016) in which the author highlighted the importance of considering environmental variables such as household income when assessing financial vulnerability of NGOs in addition to organisation specific financial measures (intra-organisation factors). While such a wider lens is useful and commendable, the required data for such an analysis is not available. The analysis of environmental context as a relevant influence in the study of financial vulnerability will be explored in Chapter 4 using a qualitative approach. Additionally, it can be argued that while environmental factors should be taken into account for strategic planning, NGOs should focus most of their energy on internal and controllable factors to have a more sustainable financial position. Organisational characteristics, such as access to alternative sources of funds and years of experience, can reduce the impact of financial stress. The general objective of the study was therefore limited to ascertaining the factors resulting in financial vulnerability within NGOs. Specifically, it sought to identify and examine the factors that affect the financial sustainability and stability of NGOs in Uganda.

#### **2.2.2.1. *Instability of revenue streams***

As previously mentioned, NGOs are dependent on their external environment, especially to finance required for project expenditures (Nunnenkamp, Öhler & Schwörer, 2013). In general, they rely on a variety of funding sources: grants and contracts from governments, international and philanthropic agencies; and donations from private donors and corporations. Unlike the profit sector, NGOs may find it difficult to raise the required finance. As there are no private owners, they do not have access to equity capital (Rose-Ackerman, 1986; Bowman, 2002). However, NGOs can generate (equity) funds from charitable contributions (Froelich, 1999; Gentry 2002). Debt finance is also limited because NGOs possess fewer assets to provide as collateral (Rose-Ackerman, 1986).

The financial structure of an NGO is related to its sources of funds and determines its risk profile, which might affect its capacity and management of programmes. Yan, Denison and Butler (2009, p. 48) confirmed that the financial structure of NGOs “plays a crucial role in their sustainability and development”. Froelich (1999) advocated for an optimal combination of revenue sources to minimise financial risk (i.e. uncertainty in terms of the expected amount and time of receiving those funds). This is in accordance with the *financial portfolio*

*theory*, relating to the selection of the best portfolio combination of funding sources, with different degrees of volatility (Carroll & Stater, 2009; Anheier & Ben-Ner, 2003, p. 293). Chang and Tuckman (1994) and more recently Carroll and Stater (2009) confirmed this result, showing that NGOs are able to decrease revenue volatility and hence their financial vulnerability through portfolio diversification.

The *resource dependence theory* highlights this concern about relying on only a few revenue sources. Organisations are accordingly encouraged to reduce their funding dependence on only a few sources and so reduce the risk associated with uncertainty of funding by diversifying their revenue base (Pfeffer & Salancik, 1978; Chang & Tuckman, 1994). In similar vein, Bulíř and Hamann (2003) examined financial aid volatility and aid dependency, and concluded that the relative volatility of aid flows increases with the degree of aid dependence. Foster and Fine (2007) support a more moderate view: that an NGO should gradually shift from relying on a few sources (or on one single and dominant type of funding source, such as government grants) to a greater diversity of funding sources, especially within funding sources (e.g. by receiving funds from different levels of government).

In contrast, Chikoto and Neely (2013) refuted these theories by stating that revenue concentration and reliance on a few stable sources of finance enhance growth through providing greater financial stability. These studies investigate the variability of four different sources of funds: donations from individuals and corporations, grants and contracts from agencies<sup>28</sup> and governments, commercial activities (e.g. selling goods and services, fees for programme services), and investment income from endowments. They found that organisations that relied on private contributions/donations experience higher average income volatility and show higher financial vulnerability resulting from resource dependency (e.g. when the main source of funds is commercial activities) (Carroll & Stater, 2009), and that organisations that relied on government grants tend to experience greater stability in their revenue flows (Froelich, 1999).

Another way of stabilising revenue streams is through borrowing. Yan, Denison and Butler (2009) studied the factors that determine the revenue structure and borrowing decisions of

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<sup>28</sup> The agencies concept includes international governmental organisations (e.g. World Bank and United Nations), foundations (e.g. Ford Foundation) and other national and local nonprofit organisations.



NGOs. They claimed that organisations with a low degree of fund concentration, as well as those with financial support from governments, are more likely to issue debt. This supports the notion that NGOs with more government funding are in a stronger financial position and have higher debt capacities to raise long-term loans. Bowman's (2002) study confirmed that well-endowed NGOs issue more debt relative to the value of their physical assets. These findings are consistent with the *static trade-off theory* of capital structure, where managers balance the cost of financial distress (including the risk of collapse) and tax savings benefits.<sup>29</sup> In other instances, NGOs can borrow through tax-exempt debt contracts where lenders do not pay taxes on interest on loans to NGOs. This benefit is attractive and encourages NGOs to use debt as a way to increase the amount of revenue (Boris & Steuerle, 1999; Gentry, 2002). However, donors may restrict the use of the donated assets as collateral (Yan, Denison & Butler, 2009).<sup>30</sup>

Bowman (2002) also found that community support is negatively related to leverage ratio,<sup>31</sup> which shows that donations reduce the need to borrow. Hence, equity financing is preferred to debt financing. His findings are consistent with the *pecking order* theory as organisations always prefer to use equity finance sources (such as retained earnings) to borrowing or asset conversion (Bowman, 2002).

#### **2.2.2.2. Flexibility versus conditionality of funds and administration costs**

Different types and sources of funds often differ in terms of donor conditionalities and the extent of flexibility in the use of funds. The problem is often not the scarcity of funds or the number of sources of funds, but rather the possibility (or not) of re-allocating funds to other projects. This relates to the fungibility of funds. Agencies, particularly donors, often impose stringent rules and accounting practices (for example, monitoring of budget expenditure and reporting standards) because of problems of asymmetric information and associated difficulties with assessing the performance and programme effectiveness of NGOs. A factor highlighted by Chikoto and Neely (2013) is the level of flexibility from providers as the fund

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<sup>29</sup> NGOs are often exempt from corporate income tax, property tax, sales and value-added taxes, on either their primary activities or their commercial activities, as they assist governments in the provision of social services and the delivery of public goods (Anheier & Ben-Ner, 2003).

<sup>30</sup> These studies were unable to separate tax-exempt debt from taxable debt.

<sup>31</sup> The financial leverage is the extent to which a firm relies on debt financing. The more debt an organisation has, the less likely it is that the organisation is receiving community funds.

balance may be restricted to specific budget lines, limiting management discretion and the financial capacity of the organisation. It is particularly important in donor funding, where conditionalities are set a priori and often leave little space for modification.<sup>32</sup> This increases not only the administration costs of NGOs by creating a need for more skilled workers and leading to greater bureaucratisation (e.g. government funds) (Froelich, 1999), but it increases the financial vulnerability of NGOs whenever disbursements are conditional to the fulfilment of these requirements (Buliř & Hamann, 2003; Burger & Owens, 2013). Stiglitz (2002) claimed that many conditions, even well-intentioned ones, undermine the central purpose of aid. He explained that in several studies of World Bank intervention, the extent of conditionalities did not “ensure that money was well spent” (Stiglitz, 2002, p.46) and that loans would be repaid. He argued that counterproductive conditions are the reasons for the failure of conditionality.

A measure that can capture the degree of ‘rigidity *versus* flexibility’ of donor funds could be the number and frequency of required reports that the NGO needs to submit to the donor.<sup>33</sup> Reporting requirements are linked to the monitoring of budget expenditure and activity plans, and whenever there is a discrepancy between the budgeted and actual figures, organisations are required to explain the difference. Concentration of revenue sources alone, however, is not the main problem. A high concentration of revenue sources together with great flexibility in allocating funds may still leave an organisation less financially vulnerable to shocks compared to an agency with highly diversified income resources but with rigid donor budget and reporting standards.

The proportion of total expenditure allocated to overheads is another critical donor constraint faced by NGOs. Overheads are administrative costs or operational costs and fundraising expenses. Donors consider these costs as an indicator of organisational inefficiency and prefer to rather fund direct programme activities (Trussel & Parsons, 2007; Tinkelman & Mankaney, 2007; Ashley & Faulk, 2010; Nunnenkamp, Öhler & Schwörer, 2013). Tinkelman and Mankaney (2007) define these costs as the ‘price’ of output, or the cost of obtaining a

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<sup>32</sup> Barr, Fafchamps and Owens (2004) mentioned in their study on governance of NGOs in Uganda that the costs of monitoring and reporting are onerous and information was either not available or reliable at the time when requested.

<sup>33</sup> The level of written reporting is associated with tight budgeting controls and higher level of accountability on funds to donors (Ebrahim, 2005).

dollar's worth of the programme output. Nunnenkamp and Öhler (2012) use the terms 'efficiency price' as overheads are regarded as unproductive expenditures. Nunnenkamp, Öhler and Schwörer (2013) showed that higher administrative expenditure increases financial vulnerability and therefore the probability of non-survival for NGOs, particularly in the case of public funding.

In contrast, other authors (Tuckman & Chang, 1991; Greenlee & Trussel, 2000; Trussel & Greenlee, 2004; Trussel, 2002) claimed that the existence of considerable administration costs increases financial flexibility, which decreases financial vulnerability. This is possible through the reduction of administrative expenses to release funds for programme activities. This enables NGOs to continue delivering programme services.

On the other hand, Chikoto and Neely (2013) argue that these types of costs are important drivers of growth in the capacity of NGOs, helping them to comply with donor conditions,<sup>34</sup> such as meeting monitoring and reporting requirements.

If overhead costs are reduced, this can have a negative impact on programme services as their main function is to provide supporting and facilitating mechanisms. The impact of cutting these costs could even outweigh the decrease of programme expenditure. Szper and Prakash (2011) show that pressure to reduce overhead expenditures below a certain threshold "may be counterproductive". Nunnenkamp, Öhler and Schwörer (2013) support the idea of setting ceilings as well as floors on these cost ratios.

The fundraising variable is a proxy for the amount spent to provide information about the organisation's mission and its operations to potential donors (i.e. it reveals the cost of generating information) (Trussel & Parsons, 2007). Tinkelman and Mankaney (2007) state that this type of cost can have a direct positive impact on donations, as it creates awareness of and gives publicity to the work of NGOs. However, it also may have a negative and long-term indirect impact on the perceived 'price' of output. Research on the impact of fundraising costs on revenue shows a positive and statistically significant relationship between the growth of NGOs (measured as an increase in total revenue) and fundraising expenditures (Chikoto, Neely & Gordon, 2013).

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<sup>34</sup> These conditions are also referred to as "requirements" and "conditionality" (Stiglitz, 2002).

### 2.2.2.3. *Accounting variables*

Typically, accounting variables are used to predict the financial vulnerability of an organisation, whether for profit or not for profit. The equity ratio is measured by net assets divided by total revenue (Tuckman & Chang, 1991; Greenlee & Trussel, 2000) or the total liabilities divided by net assets (Ohlson, 1980; Trussel, 2002). The use of such a ratio can highlight a potential liquidity problem, because some assets, particularly capital items, cannot easily and quickly be converted into liquid funds. Capital items are usually purchased with donor funds and, even when they are under the control of NGOs (and depreciated every fiscal year), they belong to donors, and only after the completion of projects and with special approval can they be disposed of or sold. These items, therefore, do not really serve as a resource that NGOs can quickly use to address immediate financial vulnerability.

Another accounting variable that can predict financial vulnerability is the surplus margin. This is calculated as net income (i.e. revenue minus expenditure) divided by total revenue. It measures the cash flow position of NGOs. Some authors (Chang & Tuckman, 1994; Greenlee & Trussel, 2000; Trussel, 2002) agree that surplus margins (i.e. operational margins) work as a buffer against financial vulnerability and are important financial resources to stimulate the growth of organisations. However, in the context of NGOs in developing countries, with strict budgets and where organisations aim to provide public benefit and maximise social welfare rather than profits, surplus margins are not expected to play a significant role.

Previous studies (Tuckman & Chang, 1991; Greenlee & Trussel, 2000; Trussel & Greenlee, 2004; Trussel, 2002; Tevel, Katz & Brock, 2015) found that the accounting variables equity balance, revenue concentration, surplus margin and administrative costs, are reliably associated with financial distress. In a recent study Tevel, Katz and Brock (2015) examined the validity of the existing models used by Tuckman and Chang (1991), Ohlson (1980) and rating agencies of NGOs, using a sample of performing arts organisations. It was found that Tuckman and Chang (1991), who relied on these parameters, provided the best prediction of financial vulnerability compared to the others. However, later Keating et al. (2005) compared the models used to predict bankruptcy in the business sector (Ohlson, 1980 and Altman, 1968) with the model used by Tuckman and Chang (1991) to predict financial distress in the nonprofit sector and concluded that none of the models can successfully predict financial vulnerability. The explanatory variables were either not statistically significant or were characterised by an unexpected predicted signal of estimated coefficient. Therefore,

accounting indicators have value and should be taken into consideration, but they also have their limitations (Szper & Prakash, 2011).

Another important limitation of accounting ratios is the institutional space within which NGOs operate. Different institutions may interpret the ratios differently. NGOs need to negotiate with and report to both state institutions and market institutions with different and sometimes conflicting expectations, and they respond and strategically act (i.e. shape their performance) in the ways that donors would like in order to manage good relationships (Balsler & McClusky, 2005; Van Puyvelde, Caers, Du Bois & Jegers, 2012; Nunnenkamp, Öhler & Schwörer, 2013).<sup>35</sup>

#### **2.2.2.4. *Size and years of experience***

Intrinsic features of NGOs, such as size (measured by number of employees and volunteers, by value of assets or by amount of annual revenue), stage of development (i.e. start up, regular operations, growth) and years of experience are other important correlates of financial stability (Fafchamps & Owens, 2009; Trussel & Greenlee, 2004; Trussel, 2002).

The size of an organisation is an institutional factor that reflects its reputation and should be considered when analysing levels of financial vulnerability (Trussel & Parsons, 2007). Underlying theories are the '*liability of smallness*' (Hager et al., 1996) and the '*liability of newness*' (Stinchcombe & March 1965). According to the former, small organisations are less able to benefit from economies of scale and also lack supportive networks, whilst the latter relates to a lack of organisational field experience, established strategies and procedures to cope with unexpected situations.

Empirical evidence supports the abovementioned theories. Cariño (1999) emphasised that smaller and less experienced NGOs may receive fewer grants because of their lack of information about funding possibilities, less experience in preparing and presenting project proposals, or weaker reputations when compared to larger and older NGOs. Ruben and Schulpen (2009), in their critical assessment of the allocation of public funding by Dutch NGOs, claimed that larger organisations have a higher probability of being selected to receive

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<sup>35</sup> Cariño (1999) studied the challenges faced by Philippine NGOs, one of which is the funding received from government that can limit the independence and autonomy of the recipient organisation. As an example, organisations that receive funding from government are unlikely to engage in policy advocacy initiatives to secure funding as state the state may regard the organisation as a political threat.

funding and are deemed to have better networks and opportunities for partnerships than smaller organisations.<sup>36</sup> Fafchamps and Owens (2009) observed a positive association between NGOs that obtain grant funding and duration of the operation. In a recent study Burger and Owens (2013) confirmed that larger organisations are likely to have more and stronger network connections and stronger reputations. A similar situation was found in the case of microfinance institutions (MFIs), where larger organisations were more profitable and received better performance rating scores (Beisland, Mersland & Randøy, 2014).

## **2.3. DATA AND METHODOLOGY**

### **2.3.1. Data**

This study uses a panel data set inclusive of 295 NGOs in Uganda gathered in 2002<sup>37</sup> and again in 2008. In 2008 the research team surveyed the same NGOs that were interviewed in 2002. The team tracked those organisations through field visits and they only categorised a demise of an NGO after this had been confirmed by either the community development officer or a former member of staff. Field workers were also required to provide a short description of the time of the demise and reasons for non-survival. The survival rate for NGOs (i.e. those still functioning in 2008) in Uganda was 83 percent. In the first phase of this survey of nonprofit organisations, differences in characteristics were observed between two groups of agencies according to their different funding sources (grant vs community). The former group was assumed to be older, larger and more sustainable. In the second wave of the panel survey, surviving NGOs were interviewed (Burger & Owens, 2013).

The questionnaires were similar for the 2002 and 2008 surveys, including detailed questions about assets, revenue, expenditure, networks, leadership characteristics, governance, activities, funding sources, target groups, staff, grants and donor requirements.

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<sup>36</sup> It is important to mention that the main criterion used in the Dutch programme assessment procedures is that organisations have to be able to mobilise at least 25 percent of their own (internal) funding. This criterion naturally excludes smaller organisations.

<sup>37</sup> The sample was drawn from the NGO Registration Board in the Ministry of Internal Affairs (which includes information since 1989) after checking the organisations that were actually operating. For instance, they were still operating, but had not renewed their licences or, in other cases, they had already terminated their operations.

### 2.3.2. Methodology

The literature on which this study is based measured financial vulnerability through programme expenses instead of using income data, based on the fact that the nonprofit sector aims to maximise social well-being (partially through programme services). The other common measure of financial vulnerability in the literature is the reduction in net assets over the years (the difference between assets and liabilities) (e.g. Trussel, 2002; Trussel & Greenlee, 2004; Keating et al., 2005; Andrés-Alonso et al., 2015). This manifests as a decrease in revenues or an increase in expenses. However, because the available Ugandan survey data do not have sufficient information about programme expenditure, and because records on expenditure are generally regarded as less reliable than revenue (Verbruggen & Christiaens, 2012),<sup>38</sup> this study uses income as the dependent variable. This alternative and simple way of measuring financial volatility was also used by Keating et al. (2005, p. 11), who called it “funding disruption”. In line with the previous studies, NGOs would likely reduce their services offerings when they experience a significant decrease in revenue.

Thus, first, a dummy variable is created that takes the value 1 if the organisation experiences a drop of funding of 25 percent or greater as a proportion of total revenue over the period 2000 and 2001. Then, it calculates the same variation for the period 2006–2007, as a second dependent variable. The analysis runs the model using the explanatory variables of 2000 (initial period) and checks if coefficients vary significantly when examining a drop in revenue over the two different periods.

Motivated by the literature review, the empirical analysis considers the following potential correlates of financial vulnerability:<sup>39</sup>

- Surplus Margin (*MARGIN*): This measures low income generation from operations cycles as the difference between the amount of recurrent revenues and recurrent expenditures as a percentage of total recurrent revenue. It reflects the short-term cash surplus available that may affect management decisions in adverse financial contexts.

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<sup>38</sup> According to Verbruggen and Christiaens (2012) the records on expenditures may not always be reliable because NGOs tend to drive their results towards zero profit in order to: i) show performance to donors by increasing programme expenses, ii) reduce their taxable income by overstating taxable expenses, and iii) attract more contributions.

<sup>39</sup> The data do not allow consideration of all indicators of financial vulnerability as discussed in the literature.

Prior researchers found that NGOs with relatively low surplus margins, i.e. less funds to draw on in the case of financial shock, have more probability of being financially vulnerable than those with relatively high surplus margins (see e.g. Tuckman & Chang, 1991; Greenlee & Trussel, 2000). Thus, NGOs with low surplus margins are expected to be financially vulnerable.

- Revenue Concentration Index (*CONCEN*): This is a measure of the amount and number of revenue sources that an organisation has. The index is constructed by summing the square of the percentage share that each of the revenue source represents to total revenue. If an NGO receives all of its revenue from one source, its revenue concentration index will be equal to one, while an NGO with similar shares of revenue from multiple sources of revenue will have an index close to zero. This study divided the revenue sources into grants, membership fees, fees paid by beneficiaries, income from services provided, donations and others, including endowment income. Authors have shown that NGOs are able to decrease their financial vulnerability through diversification of their revenue sources (e.g. Chang & Tuckman, 1994; Carroll & Stater, 2009). Thus, an NGO that presents a low concentration index is expected to be less financially vulnerable as it has more alternative sources of revenue from which to fund operations than those with fewer alternative sources of funds. A positive relationship is expected between this indicator and the dependent variable.
- Reporting requirements (*REPORT1 and REPORT2*): This measures rigidity of donor requirements regarding funds/budgets. Previous studies showed that conditionalities attached to the disbursement and use of funds can increase the financial vulnerability of NGOs (Bulíř & Hamann, 2003; Burger & Owens, 2013). Organisations that receive grants from donors or funds from government, which are subject to stricter compliance with reporting conditions, might face delays in payments of committed funds and will have fewer options to reallocate expenditure. This factor is measured based on the reporting requirements.<sup>40</sup> If an NGO is required to produce monthly, quarterly and/or half-year progress reports and/or interim accounts, the explanatory variable REPORT1 takes the value 1, and 0 if it is not required to produce such reports at all. If an NGO is

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<sup>40</sup> The data also provide information on visits from granting agencies to head offices and field visits to activities sites. However, this study considered only reporting requirements (i.e. progress reports and interim accounts).



required to report annually, the explanatory variable REPORT2 takes the value 1 and 0 if it does not. A positive relationship between the independent and dependent variable is expected from the results.

- Access to funding sources (*SAVINGS*): This is represented by a dummy variable for the existence of a savings accounts. It takes the value 1 if an NGO has a savings account and 0 if it does not. NGOs in general have limited access to banking products such as credit lines, savings accounts and overdraft facilities, which in turn limits their capacity to manage their revenue streams (Bowman, 2002; Yan, Denison & Butler, 2009). Thus, NGOs with savings accounts are expected to increase their financial stability (i.e. decrease their financial vulnerability).
- Size (*SIZE*): This measure reflects the reputation of the NGO which is positively related to the ability to attract contributions (Trussel & Parsons, 2007). Size is measured by the total number of employees (i.e. salaried staff). It is expected that larger organisations with stronger and more established reputations than smaller NGOs will be less prone to financial problems.
- Capital and equipment assets (*ASSETS*): Previous research has shown that NGOs that possess assets have better access to alternative sources of revenue (e.g. debt finance) and, therefore, are able to decrease their financial vulnerability (Rose-Ackerman, 1986; Bowman, 2002). Another reason to consider this variable is related to the ability of NGOs to use capital assets to generate internal financial resources. This measure includes three dummies that take the value 1 if the organisation owns capital assets, i.e. land and building, vehicles, and equipment and machinery, and 0 otherwise. The rationale for using three variables is related to the degree to which each of them can be converted into liquid funds in order to compensate for the loss of income to cover programme costs. NGOs that lack this equity are expected to experience higher levels of financial vulnerability.
- Types of NGO according to source of main funds (community funded or donor funded): This variable takes the value 1 if an NGO receives any amount of revenue from donors

and 0 otherwise.<sup>41</sup> This appears to be an important distinction based on the work of Burger and Owens (2013) that used the same Ugandan data. Their empirical work showed that NGOs funded mainly by donors are typically larger, richer and with lower levels of fund fluctuations (even though they may be less diversified) than community-funded NGOs.<sup>42</sup> However, dependence on donor funding is also related to higher uncertainty of fund disbursements (Buliř & Hamann, 2003). Therefore, it is expected that the sign of the coefficient for this variable can be either positive or negative.

Table 2.3.1 presents the indicators and the way they were calculated. The expected sign of each variable relates to whether they have an expected partial positive or negative impact on NGOs' financial vulnerability.

**Table 2.3.1: Indicators, measure and expected sign**

<i>Indicator</i>	<i>Measure</i>	<i>Expected sign</i>
Surplus Margin ( <i>MARGIN</i> )	$\frac{\text{Total revenues} - \text{Total expenses}}{\text{Total revenues}}$	-
Revenue Concentration Index ( <i>CONCEN</i> )	$\sum \left( \frac{\text{Revenue } j}{\text{Total Revenues}} \right)^2$	+
Reporting Requirements ( <i>REPORT1 and REPORT2</i> )	Dummy variable <sup>a</sup>	+
Savings Accounts ( <i>SAVINGS</i> )	Dummy variable <sup>b</sup>	-
Size ( <i>SIZE</i> )	Total salaried staff	-
Capital and Equipment Asset ( <i>ASSET</i> )	Dummy variable <sup>c</sup>	-
Donor Funded	Dummy variable <sup>d</sup>	?

- The variable REPORT1 takes the value 1 if the organisation is required to report once a year and 0 if it does not report. The variable REPORT2 takes the value 1 if the organisation is required to report more than once a year and 0 if it does not report at all.
- The variable is measured as 1 if the organisation has a savings account and as 0 otherwise.
- This measure includes three dummies that take the value 1 if the organisation owns capital assets (i.e. land and buildings, vehicles, and equipment and machinery) and 0 otherwise.
- The omitted variable of donor-funded is community funded.

<sup>41</sup> The frequency distribution of the donor-funded variable is provided in Appendix A.

<sup>42</sup> The same study found that grant allocation by donor agencies is based on practice and tradition, which means that those funds are more likely to go to NGOs that have received funds in the past.

Due to the limitations of the available survey data for Ugandan NGOs, some variables from the literature could not be included in this analysis.

## **2.4. DESCRIPTIVE ANALYSIS**

In this chapter, an NGO is deemed to be financially vulnerable when there is the probability of a decrease equal to or higher than 25 percent in its total revenue.<sup>43</sup>

The sample shows that 10 percent of NGOs were considered financially vulnerable for the period 2000–2001 (with 190 total observations) and 14.74 percent for the period 2006–2007 (total number of observations equal to 251).

The data for all selected independent variables are 2000-2001 data. The study uses the selected indicators to predict current funding disruption (i.e. significant decrease in recent revenue, in this case 2000-2001) and future funding disruption (i.e. significant decrease in future revenue, in this case 2006-2007).

Table 2.4.1 displays summary statistics for the independent variables considered in the study for each group of NGOs (i.e. financially vulnerable and non-financially vulnerable) in 2000–2001.

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<sup>43</sup> Appendix A provides the results for a cut-off of 15 percent (i.e. decrease of revenue of 15 percent or greater) as a robustness check.

**Table 2.4.1: Summary statistics: Financially vulnerable NGOs (FV) and Non-financially vulnerable NGOs (NFV) in 2000–2001**

<i>Variable</i>	<i>Financially Vulnerable (FV)</i>		<i>Non-financially Vulnerable (NFV)</i>	
	<i>Obs.</i>	<i>Mean<sup>a</sup></i> <i>(Standard Deviation)</i>	<i>Obs.</i>	<i>Mean<sup>a</sup></i> <i>(Standard Deviation)</i>
<i>MARGIN</i>	19	0.11 (0.57)	167	0.16 (0.37)
<i>CONCEN</i>	19	0.90 (0.17)	171	0.57 (0.40)
<i>REPORT</i>				
<i>REPORT1</i>	15	40.00%	93	20.43%
<i>REPORT2</i>	15	53.33%	93	63.44%
<i>SAVINGS</i>	19	47.37%	171	47.95%
<i>SIZE</i>	19	13.37 (22.11)	170	18.63 (35.06)
<i>ASSETS</i>				
<i>Land &amp; Building</i>	19	52.63%	171	45.61%
<i>Vehicle</i>	19	57.89%	171	50.88%
<i>Equipment &amp; Machinery</i>	19	57.89%	171	70.76%
<i>Donor Funded</i>	19	94.74%	171	59.65%

Note: <sup>a</sup> the difference between the mean values of FV and NFV NGOs for CONCEN variable is significant at the 1% level using a two-tailed t-test for equal means. The REPORT1 and Donor Funded variables are significant at the 10% level and 1% level respectively, using a contingency table analysis with chi-square statistic to determine whether the variables are statistically independent or not. The tests are presented in Appendix A.

Financially vulnerable NGOs show an average concentration index of 0.90, while non-financially vulnerable NGOs show an average concentration index of 0.57. The difference between these two means is significant at the 1 percent level. The level of reporting (REPORT1) is also higher for financially vulnerable NGOs. While 40.00 percent of financially vulnerable NGOs report once a year, only 20.43 percent of non-financially vulnerable NGOs have to report annually. This difference between these two groups of NGOs is statistically significant at the 10 percent level. However, more non-financially vulnerable NGOs have to report more than once a year (REPORT2) (63.44 percent) compared to 53.33 percent of financially vulnerable NGOs.

There are also differences of financial vulnerability regarding the type of NGOs. Almost 95 percent of financially vulnerable NGOs receive funding from donors, while 59.65 percent of non-financially NGOs are community-funded. The mean value for this variable is significant at the 1 percent level of significance.

The mean margin is lower for financially vulnerable NGOs (11 percent) compared to 16 percent for non-financially vulnerable NGOs. The average figures for the existence of a savings account are similar for the two groups of NGOs. Non-financially vulnerable NGOs are larger (i.e. have more salaried staff) than financially vulnerable NGOs. In terms of assets, the main significant difference is related to ownership of equipment and machinery. Almost 71 percent of non-financially vulnerable NGOs reported having equipment and machinery, while 58 percent of financially vulnerable NGOs reported having these assets. However, the means for each of these variables are not statistically significant.

Table 2.4.2 displays summary statistics for each independent variables for the period 2006–2007.

**Table 2.4.2: Summary statistics: Financially vulnerable NGOs (FV) and Non-financially vulnerable NGOs (NFV) in 2006–2007**

<i>Variable</i>	<i>Financially Vulnerable (FV)</i>		<i>Non-financially Vulnerable (NFV)</i>		
	<i>Obs.</i>	<i>Mean<sup>a</sup></i> <i>(Standard Deviation)</i>	<i>Obs.</i>	<i>Mean<sup>a</sup></i> <i>(Standard Deviation)</i>	
<i>MARGIN</i>	16	-0.04 (0.46)	74	0.19 (0.36)	
<i>CONCEN</i>	16	0.69 (0.44)	76	0.53 (0.39)	
<i>REPORT</i>	<i>REPORT1</i>	14	28.57%	69	18.84%
	<i>REPORT2</i>	14	50.00%	69	72.46%
<i>SAVINGS</i>		20	55.00%	116	50.00%
<i>SIZE</i>		19	17.32 (23.86)	116	18.66 (34.82)
<i>ASSETS</i>	<i>Land &amp; Building</i>	20	35.00%	116	45.69%
	<i>Vehicle</i>	20	60.00%	116	54.31%
	<i>Equipment &amp; Machinery</i>	20	70.00%	116	68.97%
<i>Donor Funded</i>		16	62.50%	76	71.05%

Note: <sup>a</sup> the difference between the mean values of FV and NFV NGOs for MARGIN variable is significant at the 5% using a two-tailed t-test for equal means. The REPORT2 is significant at the 10% level a contingency table analysis with chi-square statistic to determine whether the variables are statistically independent or not. The tests are presented in Appendix A.

Similarly to the previous analysis, financially vulnerable NGOs show a lower surplus margin (-4 percent) than non-financially vulnerable NGOs (19 percent). The difference between these two means is significant at the 5 percent level. This means that NGOs that experienced

a sharp decrease in 2006–2007 had a lower surplus margin (in 2000–2001) than NGOs that did not. The level of reporting (REPORT2) is higher for non-financially vulnerable NGOs: while 72.46 percent of non-financially vulnerable NGOs report frequently (i.e. more than once a year), 50.00 percent of financially vulnerable NGO have to report more than once a year. The difference between these two groups of NGOs is statistically significant at the 10 percent level.

The average figures for the savings account variable, number of salaried staff and assets are similar for the two groups of NGOs. The means for each of these variables are not statistically significant.

The results of the differences in means for each of the independent variables, for NGOs that are financially vulnerable and those that are not, are shown in Appendix A. The differences between the mean values of continuous variables were tested by using a t-Test for equal means. Contingency tables analyses (cross-tabulations) with chi-square statistics were used to determine whether the categorical variables are statistically independent or not.

#### *Correlation Analysis*

A correlation analysis for the continuous independent variables is useful to understand the expected coefficient signs, as well as the magnitude of the relationship between variables. Generally, the independent variables analysed present a low level of correlation and should not present a serious threat to the estimation of the linear probability regression model (i.e. no problem of multicollinearity).

VAR01 and CONCEN have the highest correlation. Changes in concentration index (CONCEN) is negatively correlated with recent funding disruption (-0.39) and negatively correlated with future funding disruption (-0.23). The correlations between these variables are significant at the 1 percent level and 5 percent level respectively.

Changes in MARGIN is also negatively correlated (-0.29) with decrease in current revenue at the 1 percent level significance. Contrary to what is theoretically expected, this means that a positive variation in margin is related to a decrease in current revenue.

Larger NGOs are negatively correlated (-0.13) with sharp decreases in current revenue at the 10 percent level significance.

The correlation between the dependent variables is positive and low, however, not significant. A significant decrease in 2000–2001 revenue is correlated 0.08 with a significant decrease in revenue between 2006 and 2007.

**Table 2.4.3: Correlation matrix (Spearman pairwise correlation)**

<i>Variables</i>	<i>Variables</i>	<i>Spearman</i>	<i>p-value</i>	<i>No. cases</i>
<i>VAR01 (2000–2001)</i>	<i>VAR2 (2006–2006)</i>	0.08	0.47	90
<i>VAR01 (2000–2001)</i>	<i>MARGIN</i>	-0.29	<0.01	185
<i>VAR01 (2000–2001)</i>	<i>CONCEN</i>	-0.39	<0.01	189
<i>VAR01 (2000–2001)</i>	<i>SIZE</i>	-0.13	0.08	188
<i>VAR02 (2006–2006)</i>	<i>MARGIN</i>	0.02	0.86	89
<i>VAR02 (2006–2006)</i>	<i>CONCEN</i>	-0.23	0.03	91
<i>VAR02 (2006–2006)</i>	<i>SIZE</i>	-0.11	0.21	134
<i>MARGIN</i>	<i>CONCEN</i>	0.32	<0.01	191
<i>MARGIN</i>	<i>SIZE</i>	0.15	0.04	190
<i>CONCEN</i>	<i>SIZE</i>	0.24	<0.01	197

Note: VAR01 is the variation of revenue from 2000 to 2001 (as a percentage of 2000). VAR02 is the variation of revenue from 2006 to 2007 (as a percentage of 2007).

## 2.5. REGRESSION ANALYSIS – LINEAR PROBABILITY MODEL

This section presents an empirical analysis and uses the Linear Probability Model (LPM) to explore the impact of several possible determining factors on the probability of a negative variation in total revenue as proxy of financial vulnerability. The reason for choosing this model is because it is easy to draw a *ceteribus paribus* analysis of independent variables on the probability of financial vulnerability (i.e. it controls for other factors that simultaneously affect the income variation). However, there are some shortcomings related with LPM, specifically: it is possible to get predictions/results either less than 0 or greater than 1. Such results are difficult to interpret as the dependent variable is a probability ranging from 0 to 1. The other shortcoming is that a probability cannot be a linear function of independent variables (e.g. an increase of 10 percent in surplus margin is expected to reduce the probability of financial problems, but a more than 10 percent increase is expected to have a smaller marginal effect).

As a first step, this study calculated the dependent variable, defined as the variation of recurrent revenue as a percentage of total recurrent revenue for two periods between 2000–2001 and 2006–2007. Then it creates a variable defined as 1 if the organisation had a drop

equal to or greater than 25 percent as a percentage of total income in 2000 and 0 otherwise (i.e. it does not take into account positive variations). The same calculation was done for the years 2006 and 2007 and transformed into a binary variable. Finally, a variable was calculated that takes the value 1 if the organisation presents the value 1 in periods 2000–2001 and 2006–2007, and 0 otherwise (i.e. consider any of the two variations).

The regression model was estimated using the explanatory variables outlined in the previous section. Table 2.5.1 also includes results for the dummy variable for type of organisation (community-funded is the omitted variable).

**Table 2.5.1: Estimates of the Regression Model**

<i>Variables<sup>a</sup></i>	<i>VAR1 (2000–2001)</i>		<i>VAR2 (2006–2007)</i>	
	<i>Coefficients</i> ( <i>SE</i> )	<i>Coefficients</i> ( <i>SE</i> )	<i>Coefficients</i> ( <i>SE</i> )	<i>Coefficients</i> ( <i>SE</i> )
<i>MARGIN</i>	-0.1220 (0.1002)	-0.1272 (0.0986)	-0.2269 (0.1673)	-0.2244 (0.1703)
<i>CONCEN</i>	0.3008*** (0.0787)	0.2817*** (0.0802)	0.2941* (0.1655)	0.2851 (0.1752)
<i>REPORT</i>				
<i>REPORT1</i>	0.1342 (0.0983)	0.1336 (0.0968)	-0.0174 (0.1524)	-0.0165 (0.1549)
<i>REPORT2</i>	-0.0200 (0.0684)	-0.0246 (0.0688)	-0.1442 (0.1393)	-0.1423 (0.1404)
<i>SAVINGS</i>	0.0351 (0.0729)	0.0252 (0.0734)	-0.0649 (0.1105)	-0.076 (0.1106)
<i>SIZE</i>	-0.0005 (0.0005)	-0.0006 (0.0005)	-0.0005 (0.001)	-0.0005 (0.001)
<i>Donor Funded<sup>b</sup></i>		0.1165 (0.0779)		0.0555 (0.1568)
<i>ASSETS</i>				
<i>Land &amp; Building</i>	0.0250 (0.0703)	0.0327 (0.069)	-0.0765 (0.1145)	-0.0710 (0.1101)
<i>Vehicles</i>	0.0451 (0.0727)	0.0395 (0.0739)	0.1463 (0.1463)	0.1431 (0.1502)
<i>Equipment &amp; Machinery</i>	-0.2688** (0.1247)	-0.2868** (0.1263)	-0.2465 (0.1606)	-0.255 (0.1636)
<i>Constant</i>	0.1174 (0.1215)	0.0589 (0.1167)	0.3364 (0.2266)	0.305 (0.2119)
R-square	0.1987	0.2113	0.2196	0.2214
Number of obs.	105	105	54	54

Notes: The Linear Probability Model robust for error terms uses a sample of 105 NGOs for the period 2000–2001 and 54 observations for the period 2006–2007.

\*Represents 10% level of significance; \*\*5% level of significance; \*\*\*1% level of significance.

a. The latent dependent variable equals 1 if the NGO is financially vulnerable and 0 otherwise.



b. The omitted variable of donor-funded is community-funded.

Overall, the first attempt to identify organisations that have a higher probability of being financially vulnerable showed a low predictive and explanatory power based on R-squared. This can be due to small sample size, possible omitted explanatory variables, or the existent of proxy variables that do not effectively measure the factor related to financial vulnerability, and the way the cut-off point of the dependent variable was defined. However, a few points can be noted about indicators of future financial vulnerability.

The magnitudes of the coefficients are often large, however the relationships are not precisely estimated (and are not significant), due to small sample size. To avoid repetition, it should be assumed that the relationship is not significant, unless stated otherwise.

Conversely to the correlation signal between margin and dependent variable for 2000–2001 variation, the margin is shown to be negatively associated with the probability of being financially vulnerable in both periods.<sup>44</sup> An increase of 10 p.p. in an NGO's surplus margin is expected to decrease by approximately 1.2 p.p. the probability that they faced a financial downturn from 2000 to 2001 and approximately 2.3 p.p. in 2006 to 2007, keeping all the other variables fixed.

The concentration index was shown to be a positive and significant correlate of financial vulnerability across models, except for column four. The coefficients are consistent with the correlation signals between the concentration index and dependent variable for both periods. This finding is also in line with the expected direction of causality. An organisation with low diversity of income sources is likely to be more financially vulnerable. A variation of 10 percent in the concentration index is predicted to increase the probability of financial vulnerability by approximately 3 p.p. in both periods, keeping all the other variables fixed.

In terms of the existence of assets to cope with liquidity issues, the table shows that only equipment and machinery are negatively related to the independent variable for the period 2000–2001. All other factors being equal, NGOs that own equipment and machinery have 2.69 p.p. lower probability of having a sharp decrease in current revenue. This probability

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<sup>44</sup> The difference between Spearman pairwise correlation and the signal of the coefficient in the regression is because of the sample sizes. The pairwise correlation considers a larger sample than the regression sample, which controls for other variables.

increases slightly (by 2.87) if the variable for the type of NGOs is included. The existence of donor restrictions on the liquidity characteristics of capital items can explain the difference in significance between equipment and machinery (more liquid) and land and building and vehicles (less liquid).

The other variables were not statistically significant, however, the models provide insights into the signs of the variables when used to predict current and future financial vulnerability.

Annual reporting (REPORT1) is associated with an increase the probability of an NGO being considered financially vulnerable in the current period but the variable is negatively related to future financial distress. Conversely to what was expected but in line with the analysis of frequency distribution in the two groups (i.e. contingency tables), higher reporting requirements (REPORT2) are negatively associated with financial vulnerability of NGOs. The descriptive analysis showed that non-financially vulnerable NGOs have higher reporting requirements than financially vulnerable NGOs. This can be explained by the fact that NGOs subject to higher monitoring and evaluation (i.e. higher reporting requirements) also have higher organisational capacity (e.g. fundraising capabilities) and therefore are in a better position to apply for other sources of funding and manage financial distress.

The variable SAVINGS is inconsistent with a positive association with current financial vulnerability and a negative association with future financial vulnerability.

The larger the organisation, the less likely it is to be financially vulnerable. As expected, the estimated coefficient on size is negative, meaning that there is a negative relationship between the size of the organisation (measured by the number of salaried staff) and financial distress.

Evidence shows that an NGO considered as donor funded is expected to have 11.65 p.p. higher probability of facing a decrease in current revenue, and 5.55 p.p. decrease in future revenue than NGOs which are community funded (columns 2 and 4). This result is in line with the analysis of the distribution of these two groups for the first period (i.e. 2000 to

2001).<sup>45</sup> Donor-funded NGOs are usually more concentrated in terms of revenue sources and, therefore, more financially vulnerable than community-funded organisations.

Considering the debate around the definition of financial vulnerability of NGOs (and the appropriate cut-off point) the study examines the results for a different cut-off point of 15 percent decrease in revenue (i.e. dependent variable) as a robustness test. The results obtained for regression coefficients estimates are similar to the ones presented above. The results are presented in Appendix A.

## **2.6. CONCLUSION AND LIMITATIONS**

The nature of this chapter was exploratory as the aim was to get new information on the topic in the context of developing countries. The focus was on the vulnerability of NGOs in developing countries as well as on possible differences between the financial vulnerability of donor-funded NGOs and community-funded NGOs.

Based on the literature review and the available data of NGOs in Uganda during two periods (2000–2001 and 2006–2007), the variables that could potentially predict a variation in total revenues were identified. The explanatory variables included the surplus margin, the revenue concentration index, whether the organisation has a savings account as a proxy of funding resources, two dummy variables that reflect the different levels of reporting requirements, the size of the organisation measured by total number of salaried staff, and ownership of several capital assets.

Using the above data, the intention was to answer the key question of what financial ratios and organizational features are associated with financial vulnerability of NGOs in developing countries. Financial vulnerability was defined as a minimum drop of 25 percent in recurrent revenue (net of divestment) as a percentage of total revenue, during two separate periods of time: 2000–2001 and 2006–2007. As stated earlier, a linear probability model was used to predict variations of revenue. The findings show similar results to the study by Greenlee and Trussel (2000) and related literature. The revenue concentration index was found to be a significant correlate of financial distress in both periods. The assets variable, particularly equipment and machinery, seems to help to cope with decreases in recurrent funding. The

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<sup>45</sup> The donor-funded variable is significant at 10 percent for a cut-off point of 15 percent in the dependent variable. The results are presented in Appendix A.

other variables used to be related to financial vulnerability of NGOs were often large in magnitude and with a consistent sign, but not accurately estimated (i.e. not statistically significant).

The second part of the question relates to possible outcome differences according to type of organisation. It was found that NGOs that receive donor grants appeared to have a higher probability of being financially vulnerable than their community-funded counterparts. However, these results were not statistically significant.

This study contributes to the literature in three ways. First, the most notable contribution is the use of data from a developing country where the financial vulnerabilities of NGOs are undoubtedly different from developed countries. Secondly, new potential correlates of financial vulnerability were identified and introduced to the model. Thirdly, the study distinguished between NGOs with donor funding and NGOs with community funding.

Nevertheless, some limitations should be noted for additional work. Firstly, the definition of financial vulnerability was operationalised as the reduction in total revenues, which is not totally accurate because not all reductions in revenues result in a reduction of services offered by NGOs. In fact, the organisation may be able to manage programme expenses and try to safeguard programmes (Tuckman & Chang, 1991). In this way, a decrease in revenue reflects a financial problem if expenses cannot be decreased by the same proportion. Secondly, the data available on NGOs is not entirely complete and reliable. A more comprehensive data set would allow the improvement of the model by including better proxy and more factors and to reduce the problem of omitted variables and measurement error in the model. A larger sample size with more complete data should also increase the consistency of the estimators as well as the significance of the model. Ideally, such a model would examine the volatility in revenue over a longer period. Finally, as the study is in essence a replication of previous studies on predicting financial vulnerability of NGOs with a focus on intra-organisational factors, it does not consider extra-organisational factors or environmental variables. Following Prentice's (2016) study, further research could be done to take into account factors that might affect the financial stability and vulnerability of NGOs.

This chapter laid the foundation for an investigation of the conditions that could help NGOs to successfully implement strategies to deal with financial distress, which is the subject addressed in the next chapter.

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## APPENDIX A

### Appendix A 1: Frequency distribution of Donor Funded NGOs

<i>Variable</i>	<i>Frequency</i>	<i>Percent</i>	<i>Cum. Percentage</i>
Donor Funded = 0	107	53.77%	53.77%
0 < Donor Funded < 0.3	6	3.00%	56.77%
0.3 ≤ Donor Funded < 0.5	3	1.50%	58.27%
0.5 ≤ Donor Funded ≤ 1	83	41.71%	100.00%
<b>Total</b>	199	100.00%	

### Appendix A 2: Test of equal means for financially vulnerable NGOs and non-financially vulnerable NGOs 2000–2001

<i>Variables</i>	<i>Mean diff.</i>	<i>Standard Error</i>	<i>[95% Conf. Interval]</i>		<i>p-value</i>
<i>MARGIN</i>	0.0498	0.0957	-0.1390	0.2387	0.6033
<i>CONCEN</i>	-0.3277	0.0931	-0.5114	-0.1440	0.0005
<i>SIZE</i>	5.2610	8.2320	-10.9785	21.5000	0.5235

### Appendix A 3: Cross tabulation and Chi Square for financially vulnerable NGOs and non-financially vulnerable NGOs 2000–2001

<i>Variables</i>		<i>Financially Vulnerable (FV)</i>	<i>Non-financially Vulnerable (NFV)</i>	<i>Pearson Chi Square</i>	<i>p-value</i>
<i>REPORT</i>	<i>REPORT1</i>	40.00%	20.43%	2.7807	0.0950
	<i>REPORT2</i>	53.33%	63.44%	0.5603	0.4540
<i>SAVINGS</i>		47.37%	47.95%	0.0023	0.9610
<i>ASSETS</i>	<i>Land &amp; Building</i>	52.63%	45.61%	0.3387	0.5610
	<i>Vehicle</i>	57.89%	50.88%	0.3372	0.5610
	<i>Equipment &amp;</i>	57.89%	70.76%	1.3346	0.2480
	<i>Machinery</i>				
<i>Donor Funded</i>		94.74%	59.65%	9.0476	0.0030

**Appendix A 4: Test of equal means for financially vulnerable NGOs and non-financially vulnerable NGOs 2006–2007**

<i>Variables</i>	<i>Mean diff.</i>	<i>Standard Error</i>	<i>[95% Conf. Interval]</i>		<i>p-value</i>
<i>MARGIN</i>	0.2308	0.1042	0.0236	0.4379	0.0294
<i>CONCEN</i>	-0.1648	0.1099	-0.3832	0.0535	0.1372
<i>SIZE</i>	1.3394	8.3022	-15.082	17.7608	0.8721

**Appendix A 5: Cross tabulation and Chi Square for financially vulnerable NGOs and non-financially vulnerable NGOs 2000–2001**

<i>Variables</i>		<i>Financially Vulnerable (FV)</i>	<i>Non-financially Vulnerable (NFV)</i>	<i>Pearson Chi Square</i>	<i>p-value</i>
<i>REPORT</i>	<i>REPORT1</i>	28.57%	18.84%	0.6766	0.4110
	<i>REPORT2</i>	50.00%	72.46%	2.7301	0.0980
<i>SAVINGS</i>		55.00%	50.00%	0.1706	0.6800
<i>ASSETS</i>	<i>Land &amp; Building</i>	35.00%	45.69%	0.7907	0.3740
	<i>Vehicle</i>	60.00%	54.31%	0.2233	0.6370
	<i>Equipment &amp; Machinery</i>	70.00%	68.97%	0.0086	0.9260
<i>Donor Funded</i>		62.50%	71.05%	0.4566	0.4990

**Appendix A 6: Estimates of the Regression Model (reduction in revenue  $\geq 15\%$ )**

<i>Variables<sup>a</sup></i>	<i>VAR1 (2000–2001)</i>		<i>VAR2 (2006–2007)</i>	
	<i>Coefficients (SE)</i>	<i>Coefficients (SE)</i>	<i>Coefficients (SE)</i>	<i>Coefficients (SE)</i>
<i>MARGIN</i>	-0.0525 (0.2915)	-0.0585 (0.2694)	-0.1800 (0.1714)	-0.1895 (0.1704)
<i>CONCEN</i>	0.2915*** (0.0832)	0.2694*** (0.0857)	0.2600 (0.1721)	0.2937 (0.1833)
<i>REPORT</i>				
<i>REPORT1</i>	0.1587 (0.1040)	0.1580 (0.1020)	-0.0210 (0.1549)	-0.0244 (0.1517)
<i>REPORT2</i>	-0.0710 (0.0751)	-0.0764 (0.0755)	-0.0789 (0.1443)	-0.0858 (0.1446)
<i>SAVINGS</i>	0.0017 (0.0770)	0.0096 (0.0774)	-0.1825 (0.1255)	-0.1409 (0.1222)
<i>SIZE</i>	-0.0006 (0.0005)	-0.0008 (0.0005)	-0.0007 (0.0010)	-0.0004 (0.0010)
<i>Donor Funded<sup>b</sup></i>		0.1345* (0.0806)		-0.2078 (0.2121)
<i>ASSETS</i>				
<i>Land &amp; Building</i>	-0.0193 (0.0758)	-0.1040 (0.0739)	-0.0411 (0.1308)	-0.0616 (0.1228)
<i>Vehicles</i>	0.0635 (0.0766)	0.0570 (0.0783)	0.1501 (0.1520)	0.1622 (0.1562)
<i>Equipment &amp; Machinery</i>	-0.2570** (0.1261)	-0.2779** (0.1271)	-0.3655* (0.1867)	-0.3334* (0.1821)
<i>Constant</i>	0.1741 (0.1275)	0.1065 (0.1228)	0.4738 (0.2345)	0.5912 (0.2760)
R-square	0.1827	0.1979	0.2034	0.2257
Number of obs.	105	105	54	54

Notes: The Linear Probability Model robust for error terms uses a sample of 105 NGOs for the period 2000–2001 and 54 observations for the period 2006–2007.

\*Represents 10% level of significance; \*\*5% level of significance; \*\*\*1% level of significance.

c. The latent dependent variable equals 1 if the NGO is financially vulnerable and 0 otherwise.

d. The omitted variable of donor-funded is community-funded.

## **CHAPTER 3**

### **CONDITIONS TO IMPLEMENT STRATEGIES TO DEAL WITH FINANCIAL VULNERABILITY**

#### **Abstract**

Over recent decades NGOs have become known as sources of development finance, as well as for their active engagement in different aspects of the socio-economic development of countries, such as education and health. In order to fulfil their mission they depend on a diversity of funding sources from charitable corporate enterprises, governments and private donors. In practice, funding providers may delay the transfer of committed funds, interrupt the funding or even end projects during periods of economic downturn, or in the case of non-compliance with donor requirements. Consequently, the NGO sector in general is characterised by unpredictable and unstable income flows, as a result of which NGOs are often considered to be financially vulnerable. Some NGOs can experience a large drop in revenue without this affecting their programme delivery; however, in many instances the interruption or a dramatic decrease of funding can cause NGOs to decrease expenditure on service delivery programmes or, in the worst scenario, force them to shut down operations. This is of grave concern to all relevant stakeholders (i.e. board members and donors) as it harms those that are supposed to be the beneficiaries of the programmes.

This observation raises the research question related to how institutional conditions and stakeholder relations combine to shape NGOs' responses to a sharp decrease in revenue and the impact of this on programmes. This chapter explores this question and aims to identify those features or conditions that must apply for NGOs to successfully implement strategies to deal with financial vulnerability. This entails an analysis of the impact of a decrease of revenue on the operations of NGOs, with a specific focus on those conditions that mitigate the impact on an organisation's operations. Specifically, it is argued that NGOs with a diversified structure of revenue sources and a significant surplus margin are more likely to maintain programme expenditure and essential services. Strong institutional capital in the form of networking and donor relations can contribute to effective negotiation between NGO managers and funding providers to ensure the survival of the organisation, either through the relaxation of donor restrictions or through access to grants.

To explore the research question, a case-orientated analysis is presented of 22 NGOs in Uganda that all experienced a drop in revenue between 2000 and 2001. The NGOs are matched by core activity of operation, but they differ in terms of structure, assets base, years of experience, size and networks. The analysis builds on earlier research on financial vulnerability and understands the term broadly as a minimum drop of 15 percent in recurrent revenue as a percentage of total revenue. The study uses a (crisp-set) qualitative comparative analysis (csQCA), a methodology deemed to be suitable to identify and test conditional relationships between different conditions and outcome for small N samples. This is particularly appropriate for the purpose of this research, as the ability of an NGO to safeguard programmes when faced with a drop in revenue can have different explanations depending on the presence or absence of specific conditions. To the best of this researcher's knowledge, this methodology has never been applied as a comparative technique within the research area of the nonprofit sector.

The study offers a conceptual framework that highlights the possible configurations of conditions that can mitigate the impact of financial vulnerability on programme expenditure. It is of particular relevance to managers and fund providers who manage financial resources and donor funding. It should help all those involved in development partnerships to think through the best approaches to development management strategies in order to achieve the stated goals of financial stability and efficient programme delivery.

In agreement with earlier empirical evidence, a preliminary finding is that where combined conditions such as higher diversification of funding and flexible donor restrictions are present, NGOs are more likely to maintain programme expenditure in response to shrinking revenues. Furthermore, particular combinations of conditions thus explain differences in terms of outcomes among NGOs that experience a similar drop in revenue. There is strong evidence that institutional capital is a necessary causal condition that can improve the ability of NGOs to respond resourcefully and creatively to a drop in revenue.

### 3.1. INTRODUCTION

NGOs experience fluctuations in their revenue. Decrease of revenue as a result of, for instance, delays in the transfer of committed funds or termination of projects, can compromise service delivery programmes. Under such circumstances, programme expenditure is often under strain, and this can result in the scaling down or closing of specific programme activities. This raises concerns about unreliable and highly volatile funding sources in the NGO sector, on the one hand, and on the other, the need to implement development programmes, such as adult education or the provision of palliative care, that require long-term investment and commitment. Of interest is the extent to which the latter is compromised by the former. The study examines NGOs that do not reduce programme expenditure as well as those that do so after a drop in revenue. Specifically of interest are features and conditions that combine to determine the outcome of a decrease of revenue and its impact on programme delivery.

This chapter aims to identify the features and conditions that must be present for NGOs to be able to successfully implement strategies to deal with financial vulnerability. This entails an analysis of the impact of financial vulnerability on the operations of NGOs, with a specific focus on the existing conditions that could mitigate the impact. It is argued that NGOs that have a high diversification of income sources or that face a low level of restrictions imposed by donors on the utilisation of funds are more likely to maintain programme delivery. According to earlier research, the effect of a drop in revenue can be also reduced when there is strong and efficient networking and good relations with stakeholders that contribute towards effective negotiations between NGO managers and funding providers.

The study uses a unique panel data set from the NGO sector in Uganda. The Ugandan nonprofit sector is relatively large, active and well-regulated in comparison to that of other developing countries, which make it suitable for a case study to understand financial decisions and the management responses to financial problems. An analysis of 22 Ugandan NGOs that experienced a drop in revenue between 2000 and 2001 is presented. The organisations differ in terms of size, mandate, asset base, funding levels and years of experience.

The study builds on the previous chapter on financial vulnerability. It considers a minimum drop of 15 percent in recurrent revenue as a percentage of total revenue.<sup>46</sup> The study uses a crisp-set qualitative comparative analysis (csQCA), a pioneer methodology in this field which is suitable to test conditional relationships between different factors for small population (N) samples. By using this technique, it is possible to combine complexity with the principle of parsimony in order to understand what causal mechanisms are at work and what is driving the impact. Secondly, interviews were conducted with key individuals of the sample of the NGOs selected. This was done in an attempt to gain an understanding of the findings and to test the validity of the results.

The chapter proceeds as follows. Section 3.2 presents the background to contextualise the operations of the Ugandan NGOs. Section 3.3 reviews previous research on the conditions that are perceived to reduce the impact of financial vulnerability. Section 3.4 outlines the case-oriented research by describing the features and conditions that help NGOs to mitigate or offset the impact of a decrease in revenue, while their absence may increase the risk of a decrease on programme expenditures. The section also describes the empirical strategy adopted by introducing the methodology of csQCA. Conditional relationships between conditions and outcome are tested using 22 organisations operating between 2000 and 2001. The section then tests the model by presenting the initial impressions from recent field work and discusses the findings in the light of the literature. Section 3.5 interprets the results, and finally Section 3.6 presents the general conclusions and research contribution to the debate on financial vulnerability and sustainability of the operations of NGOs.

## **3.2. BACKGROUND**

This section presents the background of the NGO sector in Uganda to help in understanding the features and conditions that can influence the impact of a decrease of revenue.

After decades of political instability, social and economic challenges, Uganda experienced a period of relative economic growth and peace after 1986 (Nyangabyaki et al., 2004). During this time, and especially after 2000, NGOs grew fast in terms of numbers and as important role players in service delivery and advocates for policy change (Dicklich, 1998). In 2007 the

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<sup>46</sup> In order to get a larger sample, this chapter considers a lower percentage of a decrease in revenue as a proxy of financial vulnerability compared to 25 percent considered in the previous chapter. The main purpose of this strategy was to increase the number of cases through which to identify important causal factors.

Ugandan government estimated that there were approximately 7,000 registered NGOs, which reflected a dramatic expansion since 1992 when, according to the World Bank (1994, p. 21), there were fewer than 500. During this period the country was faced with a rising HIV/AIDS pandemic, which attracted large amounts of international funding (Hanson & Twaddle, 1988). According to the USAID Sustainability Index (2015), approximately 13,000 NGOs were registered in Uganda at the end of 2015.<sup>47</sup>

The NGO sector in Uganda is funded mainly by international NGOs and foreign donors and they are formed in response to the funds available (Barr, Fafchamps & Owens, 2005; USAID, 2013). According to a USAID Report (2013), grant<sup>48</sup> income represents over 90 percent of total revenue, with the majority of NGOs relying on one or two donors. Although many NGOs charge membership fees, the relative contribution to total revenue is low, usually less than 10 percent (Burger & Owens, 2008).

Despite being providers of those state services that are not adequately provided by the state, such as health and education (Cannon, 1996), NGOs in Uganda receive little financial support from the government, especially at local level. However, organisations are required to follow the National Plan<sup>49</sup> and work with some line ministries, such as the Minister of Gender, Labour and Social Development (USAID, 2009).

Initially NGOs in Uganda focused on areas that targeted the poor and most vulnerable, where the government was not able to provide assistance, given that the private sector was almost non-existent and inaccessible to the poor (Nyangabyaki et al., 2004). NGOs were particularly active in the fields of education, health, HIV awareness and prevention, support for farmers and community development activities – areas that were badly affected during times of conflict and when funding was readily available (such as for HIV/AIDS interventions). In the mid-1990s the organisations became more involved in advocacy work, public awareness programmes and monitoring of government policy as a result of donor priorities, which had shifted to human rights issues and governance (Wallace et al., 2004). At the same time many donors changed their implementation strategies from direct project implementation (i.e. direct

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<sup>47</sup> See Section 1.9.2.

<sup>48</sup> Grants are funds disbursed by one institution (i.e. government, foundation or intergovernmental organisations) to a recipient nonprofit entity.

<sup>49</sup> <http://npa.ug/wp-content/uploads/NDPII-Final.pdf>.



transfer to specific NGOs) to more indirect support<sup>50</sup> by transferring funds to a pool of funds managed by an intermediate agency such as the Democratic Governance Facility and Civil Society Fund. This agency then forwards the funds to local organisations.

Another important factor is the lack of funding from donors to build institutional capacity. Usually donor resources are targeted directly to project activities and accompanied by conditions (USAID, 2009) which reduce the extent to which NGOs are able to guarantee the sustainability of their programmes and the survival of the organisations. The organisations therefore join networks to benefit from training and other support services. According to USAID (2009), more than 70 percent of organisations registered in 2009 belong to umbrella organisations, such as the well-known National NGO Forum and Uganda National Association of AIDS Service Organisations (UNASO).

Ugandan NGOs are characterised by a high dependence on donor funding, a project-driven approach and lack of institutional capacity.

The following section presents a perspective on previous research related to the conditions that help NGOs to mitigate the impact of financial vulnerability on programmes, followed by the case-oriented research, which was chosen to examine and analyse the diverse range of NGOs in the data set.

### **3.3. RESEARCH ON CONDITIONS FOR EFFECTIVE RESPONSE TO FINANCIAL VULNERABILITY**

This section presents an overview of the findings of earlier research related to specific conditions that can mitigate or even prevent the negative impact of financial vulnerability on the operations of NGOs.

#### **3.3.1. Diversified revenue base**

A diversified revenue base, i.e. not being dependent on a single source of funding, is a condition that allows NGOs to overcome a drop in one source of revenue, as managers are able to reallocate expenses to another revenue source. Yan, Denison and Butler (2009) studied a sample of 1,387 arts, culture and humanities nonprofit organisations in the USA

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<sup>50</sup> Or as Wallace et al. (2006, p. 26) refer to it as Sector Wide Approach (SWA).

between 2000 and 2003. They claim that financial structure (i.e. sources of funds and their respective weights<sup>51</sup>) plays a crucial role in the financial sustainability of nonprofit organisations. This is in agreement with the resource dependence theory, according to which reliance on a few sources of funding increases the risk of financial vulnerability (Pfeffer & Salancik, 1978; Chang & Tuckman, 1994). Organisations are accordingly encouraged to reduce their dependence on only a single source of revenue.

### ***3.3.1.1 Diversification index, type of funding source and crowding-out***

Chang and Tuckman (1994), who measured the financial vulnerability of nonprofit organisations in the USA based on four financial ratios (the concentration ratio, surplus margin, equity balance and administrative costs), studied the determinants of revenue diversification. They developed a diversification index<sup>52</sup> that was applied to US nonprofit organisations. Their findings are interesting: firstly, the sector to which an organisation belongs and the proportion of fundraising costs affect an organisation's ability to diversify its revenue base; secondly, organisations do attempt to diversify their revenue sources in order to reduce financial vulnerability.

Apart from the number of revenue sources, the types of sources (i.e. the variety of funders) that constitute the financial structure also matter. In fact, NGO managers need to balance the level of volatility of each revenue source, the nature of restrictions and time frame of each funding source and the organisational efficiency in terms of programme life span and administrative costs.<sup>53</sup> For instance, funds from international agencies or government grants have underlying grant agreements that determine the management framework, terms and conditions. These types of sources are based on agreements that prescribe specific terms of payment, technical responsibilities, rules of financial compliance and accountability, reporting requirements, and timelines to which all programme partners are subject throughout the grant period. NGOs thus have fixed amounts of expected funds and times of payment on which donors are unlikely to default should the recipient organisations fulfil all the

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<sup>51</sup> Weights refer the contribution of each funding source as proportion of total funding.

<sup>52</sup> The diversification index determines the number of sources from which an organisation receives funds and the extent to which the funds are dispersed across sources.

<sup>53</sup> Administrative costs relate to the requirements imposed by donors around the approval and disbursement of funds, such as reports, monitoring and evaluation. See Section 2.2.

requirements. Conversely, other types of revenue sources, such as donations from private individuals and revenue from programme services, are less predictable (i.e. more volatile) in terms of amounts and times.

However, some researchers detected a crowding-out effect between different sources of funds (Jegers, 2008; Ribar & Wilhelm, 2002; Okten & Weisbrod, 2000). For instance, donors may perceive their grants as less necessary when governments increase their contributions and, subsequently, are likely to reduce their future contributions. Kingma (1989) and Kingma and McClelland (1995) found evidence of a partial crowding-out between private donations and government support (less than dollar-per-dollar rate). Donors' reactions towards an increase in revenue from the commercial activities of an organisation can be similar (Desmet, 1998; Yetman, 2003). A more recent study by Ribar and Wilhelm (2002) that analysed the relationship between private donations and government support of international relief organisations found that crowding-out disappears as the number of donors increases.

In contrast, Okten and Weisbrod (2000) found a positive effect between revenue from government or from commercial activities and donor contributions by using a model developed by Weisbrod and Domingues (1986).<sup>54</sup> Similarly, Callen (1994), using the same model, did not find support for the hypothesis that government financing crowds out private donations.

### ***3.3.1.2 Endowment and excess funding***

Endowments include long-term investments, such as assets that may have legal restrictions attached and which are usually used to protect organisations from bankruptcy. Excess funding refers to funds without legal restrictions on their use which are held to be invested in highly liquid investments or as a measure of contingency. Both are reserves that organisations use for precautionary savings or to fill the gap of unfunded expenditures (Fisman & Hubbard, 2005; Gentry, 2002). Bowman, Tuckman and Young (2012) highlight reasons why excess funding is important as a source of revenue to finance the long-term needs of organisations, future programme expenditures, organisations' expansion plans and/or new programme developments. Excess funding enhances the capacity of the organisation to borrow and

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<sup>54</sup> The model was extended by Posnett and Sandler (1989). It had been applied to nonprofits in the USA to determine the factors that can affect donations in the sector.

safeguard against financial vulnerability (Jegers, 2008; Strydom & Stephen, 2014). Excess funding can, however, cause the problem of crowding out of future contributions, because donors are concerned about mismanagement of excess funds for personal use. According to Calabrese (2011), donors encourage NGOs to use excess funding for financial stability (i.e. to hedge against uncertainty and risk to increase financial independence) and to smooth programme expenditure, but they impose restrictions on the use of funds and the amount to be retained. By using an ordinary least squares regression model of 182,801 NPOs in the USA, the author found that excessive reserves negatively affect future contributions by donors (i.e. excessive wealth crowds out donor contributions) and he recommended strategies that allow organisations to build moderate reserves.

### ***3.3.1.3 Capacity to borrow***

The capacity to borrow is an alternative option to access funding and to diversify the revenue base (Boris & Steuerle, 1999). There are two categories of financial debt: market debt provided by banks or other commercial institutions at market conditions, and non-market debt provided by individuals, such as board members or donor institutions supportive to the organisation's mission (Jegers, 2008). Borrowing enables managers to stabilise revenue streams, which in turn decreases the likelihood of cutting back on service delivery when a significant decrease in revenue is experienced. It permits organisations to distribute cost across the lifespan of a capital asset, thus avoiding the running down of financial resources that are earmarked for daily operations (Denison, 2009).

Organisations that have long-term investments are able to issue more debt relative to their physical assets, as they hold more capital that can serve as collateral. Bowman (2002) and Gentry (2002) show that endowment is an important factor for the capital structure and the decision of an NGO to borrow by using a dataset of a diverse field group of large US organisations. In a similar vein, Yan, Denison and Butler (2009) found that an increase of government contributions is positively associated with the leverage ratio, supporting the idea that financial stability and a strong debt capacity increase the likelihood of borrowing. The authors also verified that organisations with more diversified revenue streams are more likely to take on long-term debt. However, according to Jegers and Verschueren (2006) and Khodjamirian (2008), NGOs face constraints imposed by capital markets (i.e. lack of collateral and assessment of creditworthiness) and borrowing is not always an option. Furthermore, donors such as CIDA and USAID do not allow NGOs to use the donated assets as collateral to borrow.

### 3.3.2. Donor flexibility and allocation of resources

Donor flexibility as a condition is related to restrictions imposed by donors on the use of resources and the eligibility of expenses. Fund providers expect resources to be utilised efficiently, and they therefore often impose specific conditions and restrictions on the use and allocation of funds (e.g. specifying programme frameworks such as themes, target groups, detailed work plans, geographical areas). While endowments have no donor restrictions and allow organisations discretion in the use of funds, restricted funds limit organisations to using funds only for specific purposes (Wallace et al., 2006, p. 12; Edwards, 2008; AbouAssi, 2013). The number and nature of restrictions imposed by donors determine the level of flexibility that NGOs have to reallocate expenses (i.e. to deviate from the original planning of projects) (Foster & Fine, 2007; Chikoto & Neely, 2013). In general, NGOs receive three types of funds depending on their degree of rigidity vs flexibility: endowments, ‘restricted’ and ‘non-restricted’ contributions (Rossouw, 2006).

The use of restricted funds for a purpose other than the one agreed to between donor and the organisation is difficult and costly, because it is subject to donor approval prior to the expenses being incurred<sup>55</sup> (including elaboration of financial and project reports and accounts) (Moore & Stewart, 1998; Ebrahim, 2005; Rossouw, 2006; Banerjee, 2006).<sup>56</sup> This is particularly difficult in the case of development projects with often unpredictable outcomes and dynamic conditions, where NGOs frequently need to adapt to changes in the project environment and local priorities (Wallace et al., 2006; Doornbos, 2003; Sanyal, 2006; Elbers & Arts, 2011; Fisher & Mendonça, 2002). Khodjamirian (2008) claims that the adjustment costs allocated among sources of revenue are potentially large as they require conscious or discretionary decisions to be made only after an internal deliberative process. In fact, one of the challenges of organisations in poor countries, as noted by Moore and Stewart (1998), is

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<sup>55</sup> Donors usually allow a variance of approximately 10% to 20% over or under the approved line budget without prior approval of expenditure being incurred. For example, general conditions applicable to grants from the Norwegian Ministry of Foreign Affairs, clause number 3.3 allows up to 10% variation between the approved budget and the expenses charged. Available from: <https://www.nrc.no/globalassets/pdf/transparency/part-ii-general-conditions.pdf>. Another example can be found on the USAID Grant Manual, clause 11.5. Available from: [http://pdf.usaid.gov/pdf\\_docs/Pnad1393.pdf](http://pdf.usaid.gov/pdf_docs/Pnad1393.pdf).

<sup>56</sup> Financial reports including accounting requirements, financial audits and the use of specific procedures such as timekeeping policy (i.e. time-sheets for staff that are being charged to a specific donor project). In this way, donors intend to control and assess performance of the recipient organisation (Wilson & Kattelus, 2004 cited by Rossouw, 2006).

the formalities and bureaucratic discipline that are imposed by a diversity of external funding sources (i.e. submission and printing of frequent and detailed reports, recruitment and training of skilled staff).

Elbers and Arts (2011) identify problems associated with donor rigidity in terms of their impact on institutional systems and programme intervention. They have noted, for instance, that there is a reluctance to fund overhead costs (i.e. expenses not directly related to the project, such as institutional/capacity building, costs of premises and fundraising expenses). Even when donors provide an allowance for overhead costs, it often excludes costs such as capital expenditures (e.g. vehicles) and construction costs (CIDA agreement).

Another donor restriction is related to the time period to use funds. Funds not used within the period of the grant are often required to be returned to the donor (Rossouw, 2006; Elbers & Arts, 2011; Banerjee, 2006). This is problematic, especially for new projects, which usually take time and can face unforeseen challenges, such as the recruitment and training of staff, familiarisation of the target communities with the implementation plans, and setting up the systems required by donors that are needed for financial and narrative processes (e.g. accounting software). Such circumstances are likely to delay projects that can only start when funds become available. In addition, the funds are often made available for the short term (Elbers & Arts, 2011; USAID, 2011, p. 5; USAID, 2012, p. 6), which challenges the autonomy and the strength of the organisation, as it lacks the resources to retain high-quality staff, invest in research and innovation, and plan for the long term. In fact, Chikoto and Neely (2013) found that organisations with a higher proportion of expenditure on administrative costs are associated with higher financial capacity and are therefore more financially stable.

Organisations that do not comply with these requirements are often perceived as illegitimate (Suchman, 1995). Non-compliance often implies the cessation of funding and/or the donor may demand that the funds should be paid back (Rossouw, 2006). This diminishes the attractiveness of the organisation in the case of other funding agencies, forfeiting future donations and ultimately compromising its financial sustainability. This is of special

importance for most Southern NGOs,<sup>57</sup> which depend on donor agencies for their financial sustainability (Tvedt, 2006; Riddell, 2008; AbouAssi, 2013; Dunn, 2010).

However, NGO managers attempt to obtain more freedom and flexibility to reduce dependency on donors' restricted funds in order to decrease their financial vulnerability (Banerjee, 2006; Dunn, 2010). As an example, they use compensatory measures of drawing money from other sources to cover the costs that donor agencies are unwilling to fund<sup>58</sup> (Rossouw, 2006). Other managers report inaccurate information and misrepresent performance by pushing expenses such as fundraising or administrative expenses under project lines in the budget and the discretionary use of accruals and deferred income (Healy & Wahlen, 1999; Ballantine, Forker & Greenwood 2007; Verbruggen & Christiaens, 2012; Boterenbrood, 2014).

Other organisations shift their focus in order to attract donor funding. Rahman (2006) reports on a case in Bangladesh where the NGO reallocated its focus from promoting good governance to the delivery of basic services to secure financial survival. Such action diminishes an organisation's ownership of its intervention goals and much of its identity. Edward and Hulme (1996, p. 961) point out that "if you have your hands in another man's pocket, you must move when he moves". Consequently organisations become accountable to donors who control funding and not to their constituents (Ebrahim, 2003).

### **3.3.3. Institutional capital**

Institutional capital relates to, among other things, the leadership (management) of NGOs, informal networks of the leaders, direct involvement of the board of directors, experience of the financial manager.

#### ***3.3.3.1 Leadership, informal networks and donor relations***

The nature of the leadership of an NGO is a strategic factor that can contribute towards the survival of the organisation when it faces periods of financial vulnerability. Donor conditions and requirements can be subject to negotiation and adaptation in practice (i.e. a certain degree of flexibility concerning the use of funding) in such a way that organisations are able to

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<sup>57</sup> 'Southern NGOs' is the term used to refer to NGOs located in the southern hemisphere as opposed to the Northern NGOs. Southern NGOs are usually supported by Northern NGOs.

<sup>58</sup> Refer to Section 3.3.1 related to diversification of funding sources.

manage and secure service delivery and sustainability of programmes (Banerjee, 2006; Rossouw, 2006). NGOs need donors for survival as well as government support,<sup>59</sup> but donor agencies also need to be associated with well-performing NGOs (Elbers & Arts, 2011; Aliyev, 2015).<sup>60</sup> Thus, managers are able to influence the decisions of donors and align interests, and in this way find some ‘room to maneuver’. This is done by approaching donors to relay concerns and to give feedback, or involve them more directly in the organisation’s work.

Exchange of information (through reports and evaluations) and good communication between organisations and donors are used as mechanisms to build legitimacy and confidence between parties. This is especially important when existing donors revise funding priorities and organisations need to secure funds (Ebrahim, 2003; Frumkin & Kim, 2001; Dunn, 2010; AbouAssi, 2013). For instance, a donor may decide to fund a water and sanitation programme when it was previously funding a civil society project. However, parties may agree to allocate resources to both projects as civil society can enhance water and sanitation outcomes through training of communities on maintenance of water and sanitation facilities. This tactic, however, requires solid performance by NGOs and personal contact with a certain degree of trust that enables constructive negotiation (Stiles, 2002; Elbers & Arts, 2011; AbouAssi, 2013). Wallace et al. (2006, p. 126), in their study on the role and importance of interpersonal relations, called for more face-to-face contact between donors and recipient NGOs. An interesting study by Aliyev (2015) that relies on qualitative in-depth interviews with the elite of the not-for-profit sector (including founders of NGOs, CEOs, board members, NGO employees and donor representatives) in Azerbaijan and Georgia reveals that the use of informal networks by NGO leaders (personal connections, contacts, or kinship ties) is widely practised by the majority of organisations in those countries.<sup>61</sup> Moreover, informal networks are regarded as effective mechanisms for the survival of organisations through the

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<sup>59</sup> The government in Uganda govern the operations of the NGO sector. NGOs are required to be registered with the NGO Registration Board in the Ministry of International Affairs to operate in the country. In addition, all registered organisations need to get a recommendation from the line ministry in terms of technical advice to implement any activity. The stated reason for this policy is to reallocate organisations to areas where communities need the services (see also Section 1.9.3.).

<sup>60</sup> Aliyev (2015) refers to this relation between NGOs and their donors as patron-client relations, where NGOs seek patronage to receive funding and political support from donors and, in return, they provide services or public goods to communities.

<sup>61</sup> Over 80 percent of those interviewed.



circumvention of complex and corrupt state bureaucracies,<sup>62</sup> forming partnerships with other organisations<sup>63</sup> that help them to access funds from donors and individuals, and strengthening organisations' positions within the community (Barman, 2002). In the same study a representative of an international donor drew attention to the importance of the representative's personality where NGOs were referred to by the name of their founders or executives. Their reputation and the use of personnel networks are important criteria to attract donations and contributions including volunteers or hiring employees to work for the organisation.

### ***3.3.3.2 The role of the board of directors and finance manager***

Another aspect of institutional capital is the nature of the role played by the board of directors. Many authors consider the board of directors as the most direct measure of governance as they run the day-to-day affairs of the organisation (Eldenburg et al., 2004; Bradshaw, Murray & Wolpin, 1992; Van Puyvelde, Caers, Du Bois & Jegers, 2012). Some authors refer to the board as the '*interface stakeholder*', a crucial link between the organisation and its environment that can influence the ability to get funds (Balsler & McClusky, 2005; Van Puyvelde, Caers, Du Bois & Jegers, 2012). A strong board is linked with organisational effectiveness (Herman & Renz, 1997), and the frequency that it is informed about NGOs operations and the timeline of their members' decisions are relevant to an organisation's performance (Stone & Ostrower, 2007). Callen et al. (2003) found that the presence of donors on the board acts as a positive signal to other donors.

Strydom and Stephen (2014) examined the use of financial management practices on the ability to cope with financial distress, and drew attention to the experience of the financial manager related to budgeting, forecasting and management of cash resources. The authors found that organisations with less experienced financial managers are more likely to be financially vulnerable. This is comprehensible as adequate execution and monitoring of the budget and resources enable financial managers to take proper measures to hedge financial risks and to mitigate the impact of financial problems. For instance, programme activities

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<sup>62</sup> This is of special importance for NGOs that work with government institutions on projects or which require permits from officials.

<sup>63</sup> Some donors such as USAID and EU require recipient NGOs to collaborate with other NGOs on joint projects in order to apply for funding.

should be planned and implemented according to available cash flow, and the contracts of direct project staff should be conditional on donor agency funding.

### ***3.3.3.3 Community contributions***

Community contributions in the form of money, in-kind and volunteer labour contribute towards the sustainability of programmes and the survival of the organisations. AbouAssi (2013) studied the possible response of NGOs to shifts in donor funding, and acknowledged that one of the strategies to a drop in revenue is to mobilise the grassroots and to rely more on volunteer labour. Callen (1994) investigated the relationship between money donated, volunteering and technical efficiency of NGOs, and found that money donations and volunteer labour are complementary at the organisational level. The more efficient the organisation is (i.e. in terms of good reputation), the more able it is to attract community contributions.

### ***3.3.3.4. Size and years of experience***

According to recent studies, the size and age of an organisation are institutional factors that signify the reputation of an NGO (Trussel & Parsons, 2007; Strydom & Stephen, 2014). Ruben and Schulpen (2009) in their critical assessment of the allocation of public funding on Dutch non-governmental development organisations, found that larger organisations have a higher probability of being selected to receive funding and are deemed to have better networks and opportunities for partnerships than smaller organisations. An analogous situation was found with microfinance institutions, where larger organisations were shown to be more profitable and receive better rating scores on performance (Beisland, Mersland & Randøy, 2014). Age is another feature that reflects the reputation and experience of an organisation, which impacts positively on the amount of donations and scale of donor interest (Trussel & Parsons, 2007).

In summary, there are specific conditions, such as the diversification of revenue sources, flexibility of donor funds and institutional capital that can explain the different impacts of a decrease in revenue on the operations of NGOs.

Based on the foregoing, this study considered the following propositions:

***Proposition 1.*** The **diversification of revenue sources** is likely to help the NGO to **maintain programme expenditure**, because of the access to alternative sources of revenue, when an NGO loses funding from one source.

*Proposition 2.* High **flexibility of donor funding** (i.e. low level of restrictions on the utilisation of funds) enables NGO managers to reallocate expenditures and, therefore, to **maintain programme expenditure** when revenue decreases.

*Proposition 3.* NGOs' **institutional capital** contributes as a positive effect on **maintaining programme expenditure** in case of financial difficulties because of the potential to access alternative resources within the network. Institutional capital was seen as an experienced manager (CEO), who would likely be more connected to strong networks that can contribute to effective negotiation with stakeholders and the ability to attract donations, which could enable organisations to maintain programme performance following a drop in revenue.

### **3.4. CASE-ORIENTED RESEARCH ON UGANDAN NGOS**

The presence or absence of specific conditions or combinations of conditions is analysed for a sample of Ugandan NGOs that all experienced a large drop in their revenue over the period 2000–2001. The reduction in revenue may be the result of a delay in the transfer of funds or delay in renewal of contracts, termination of contracts as a result of projects being closed or even as per donor policy,<sup>64</sup> non-compliance with donor requirements or non-performance, or a consequence of an economic downturn.

Based on the literature review and field work, it can be stated that, as a result of the decrease of funding, NGOs are forced to decrease their programme expenditure. Expenditures directly linked to the provision of services, such as salaries of programme staff and provision of services (e.g. training and workshops, school fees, drugs) are immediately cut back. Other expenditures, such as rent and salaries of administrative staff, are maintained to ensure organisational sustainability. However, these operational costs are also negatively affected as a result of the downscaling of the number and scope of programme activities.

#### **3.4.1. Data and sample selection**

The base sample consists of 22 organisations of a panel survey of approximately 300 Ugandan NGOs for the years 2000 and 2001. These NGOS experienced a drop of

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<sup>64</sup> For instance, US agencies do not fund NGOs for longer than 10 consecutive years. Even though in these cases the drop in revenue is expected, the problem is related to the perceptions of NGOs. They expect the funding to be renewed and are not always well informed regarding the policy of donors. Wallace et al. (2006, p.125) showed that NGOs, especially local and smaller NGOs, have a lack of understanding about the funding process of donors and their policies.

more than 15 percent of their revenue between 2000 and 2001.<sup>65</sup> Of these 22 organisations 20 are local NGOs, and the remaining two are branches of an international NGO. In some cases organisations have offices in more than one geographical location. Only 30 percent of the sampled NGOs have offices in the capital, Kampala, and the others maintain offices across the country from where they implement projects. Each of these NGOs is dedicated to the provision of services and community development, raising public awareness, and advocacy and lobbying (see Table 3.4.1). The selected NGOs ranged from having only volunteers up to having 98 salaried staff. The CEOs of 11 of the NGOs have more than 10 years of professional experience.

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<sup>65</sup> This study considered a decrease in revenue for the period 2000–2001. It was not possible to consider the years 2006 and 2007, because detailed information on expenditure which is needed to investigate the impact of a drop in revenue on programme performance was not available.

**Table 3.4.1: Research sample characteristics**

<i>NGO ID</i>	<i>Core Activity</i>	<i>No. of staff and volunteers</i>	<i>VAR in revenue (%)</i>	<i>VAR Programme Expenditure (%)</i>
23	Raising public awareness	36 [20 staff, 16 volunteers]	32%	45%
41	Raising public awareness	24 [15 staff, 9 volunteers]	31%	31%
53	Provision of services – elderly	8 [8 volunteers]	45%	-
60	Provision of services - relief	53 [53 staff]	17%	20%
61	Provision of services - religious	62 [32 staff, 30 volunteers]	55%	64%
79	Provision of services - enterprises	18 [9 staff, 9 volunteers]	71%	40%
115	Provision of services - religious	18 [2 staff, 16 volunteers]	33%	-
118	Advocacy & lobbying	10 [10 volunteers]	34%	-
125	Provision of services - religious	9 [8 staff, 1 volunteer]	30%	-
135	Provision of services – training to women	3 [3 volunteers]	31%	-
140	Provision of services - education	10 [2 staff, 8 volunteers]	19%	-
152	Raising public awareness	8 [8 volunteers]	80%	66%
159	Provision of services	12 [12 volunteers]	17%	-
168	Provision of services – training	13 [3 staff, 10 volunteers]	80%	-
173	Provision of services - training	19 [11 staff, 8 volunteers]	32%	50%
187	Provision of services – health and education	11 [11 staff]	30%	-
195	Provision of services - training	26 [9 staff, 17 volunteers]	56%	-
199	Provision of services -elderly	8 [8 volunteers]	53%	-
208	Provision of services - agriculture	8 [8 staff]	26%	32%
216	Provision of services - health	98 [98 staff]	31%	-
278	Provision of services - training	10 [6 staff, 4 volunteers]	22%	-
300	Provision of services - agriculture	15 [12 staff, 3 volunteers]	37%	33%

### 3.4.2. Method of analysis and operationalisation

The study used QCA<sup>66</sup> to analyse the sample. It is particularly well suited for the purpose of this study as it is grounded in case-oriented research. The method entails the assumption that the ability of an NGO to safeguard programme expenditures when faced with a decrease in revenue can have different explanations depending on the existence or absence of specific conditions. This is the equifinality principle<sup>67</sup>, which applies when the same outcome can result from different causes (i.e. conditions) and from a variety of different combinations. Another principle is causal asymmetry, which is the combination of conditions leading to a specific outcome of interest which may be different from those leading to the absence of the outcome (Ragin, 2008).<sup>68</sup> The method requires in-depth knowledge of cases by analysing cross-case patterns (i.e. by comparing cases) and identifies key conditions that lead to the same outcome (Ragin, 2008; Berg-Schlosser et al., 2009). Furthermore, QCA respects the diversity of characteristics of NGOs and their heterogeneity with regard to their different causally relevant conditions and contexts by comparing cases as combinations. The possible combinations of causal conditions (INUS<sup>69</sup>) that generate the same outcome (i.e. negative variation on programme expenditures) attempt to assess complex causation in a very simple way through a set of relations of necessity<sup>70</sup> or sufficiency<sup>71</sup>. Consequently, the relevant issue of the method is on testing each complex combination of conditions rather than examining the net effect of each independent variable in a given outcome (Hsiao, Jaw, Huan, & Woodside, 2015). The method is particularly appropriate for small to intermediate N samples, as was the case in this study.

QCA includes three distinctive methods of configurations (i.e. combinations of conditions): crisp-set QCA (csQCA), fuzzy-set QCA (fsQCA) and multivalued QCA. This study uses

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<sup>66</sup> To the best of the researcher's knowledge QCA has never been applied as a comparative technique within the field of the non-profit sector.

<sup>67</sup> As opposed to 'unifinality' that assumes the occurrence of only one optimal combination.

<sup>68</sup> For example, an experienced CEO can help the NGO to maintain programme expenditure. But the absence of CEO experience does not mean that the NGO is not able to maintain programme expenditure.

<sup>69</sup> 'INUS' conditions are conditions that are not sufficient but a necessary part of the combination of conditions.

<sup>70</sup> A condition is necessary if it must be present in order for a certain outcome to occur (Ragin, 1987). However, a necessary condition might also be present even when the outcome does not occur.

<sup>71</sup> A condition is sufficient if a condition can lead to a specific outcome by itself. Sufficient conditions are not present if the outcome does not occur (Ragin, 1987).

csQCA for two reasons. Firstly, is the simplest and most straightforward and is thus easy to present because it uses binary variables (0 or 1). A value of 1 indicates the presence of a particular condition and 0 its absence. Secondly, the results are more directly comparable with previous research because of the dichotomous nature of the outcome. The Boolean minimisation technique<sup>72</sup> allows for a reduction of the complexity and results in more parsimonious combinations of conditions linked to the outcome. For instance, if two configurations differ in only one causal condition, yet produce the same outcome, then the causal condition that distinguishes the two configurations is not relevant and the two configurations can be combined into a single configuration (Ragin, 1987).

The use of csQCA includes three technical components of analysis (Basedau & Richter, 2014): the truth table, the solutions of combinations of conditions, and the measures of fit. The truth table displays the data showing the conditions as columns, the number of cases associated with the combination of conditions listed in the row (i.e. the distribution of cases across causal combinations), the value of the outcome and consistency of each combination of conditions. The solutions of combinations of conditions show the causally relevant conditions that lead to the occurrence of the outcome. In the solution of combinations of conditions uppercase letters signify the ‘existence’ of a condition or outcome (i.e. having the value 1) and lowercase letters signify the ‘absence’ (i.e. having the value 0) of a specific condition or outcome. The measures of fit are consistency and coverage. Consistency refers to the percentage of causal combinations of similar composition which result in the same outcome. In other words, if consistency of a given combination (or condition) is low, it means that is not supported by empirical evidence (i.e. cases). Coverage refers to the number of cases for which a combination of conditions (or condition) is valid (analogous to  $R^2$  in statistical analysis). When there are several causal combinations, the coverage may be small. Nevertheless, they are still useful to explain those cases that result in the outcome. The guidelines used in this study are that a csQCA model is useful when its consistency is equal to or greater than 0.85 and its coverage is above 0.00. A high score indicates high membership scores in the outcome.

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<sup>72</sup> Further information on this technique can be found in the *The comparative method* (Ragin, 1987).

### ***3.4.2.1. Outcome: maintenance of programme expenditure as a proxy of programme performance***

Programme performance (i.e. the outcome) of csQCA refers to the ability of the NGO to at least maintain programme expenditure. It takes the value 1 if the NGO increases or maintains the amount of programme expenditure from 2000 to 2001; and 0 otherwise (i.e. if programme expenditure decreases). This study considers programme expenditure as the sum of (i) direct programme expenditure that goes to the beneficiaries: drugs, school fees and materials, and training sessions and workshops; and (ii) subsistence allowance per diem to NGO staff, and number of volunteers and beneficiaries to go to the field.<sup>73</sup> The cost structure and the relative percentage of each cost as a total of expenditure is provided in Appendix B.

For the selected sample of NGOs, two organisations that reported a decrease in the amount of programme expenditures did not decrease the share of expenditure allocated to programmes to the same extent. Those organisations were considered able to safeguard programmes and to limit the impact of the drop in revenue on programmes by shifting resources from another cost category towards affected programmes.

### ***3.4.2.2. The conditional effects of programme performance***

Based on the relevant literature and previous research findings (from Chapter 2) the following variables are considered to reflect the conditions that may influence the outcome of a decrease in revenue:

#### **(1) Two variables for the diversification of the revenue base**

- *Diversification index.* In Chapter 2 it was found that the revenue concentration index was a significant predictor of financial distress. If the total revenue comes from one source, then the index is equal to 1, and it decreases as the number of sources increases. The value of the index also falls as the share of the several sources of revenue also increases and becomes more equal. The cut-off point selected was 0.7 based on analysis of revenue structure of the sampled NGOs and on Chang and Tuckman's (1994) study. The authors considered NGOs as having concentrated revenue if the value of the index is higher than

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<sup>73</sup> To be accurate it should include other costs, such as project staff (i.e. professionals and skilled labour) and fuel expenses that are incurred in the pursuit of programme activities. However, these costs were not specified in the data.



0.65. An NGO that exhibits a high diversification of its revenue is assumed to have more options through which to fund operations, i.e. to shift another source of revenue toward the specific programme activities.

- *Grant penetration.* Burger and Owens (2013) found that Ugandan NGOs are funded mainly by donors and are less financially vulnerable than community-funded NGOs. Therefore, in this chapter, access to donor funding was used as a proxy of financial stability. According to the same authors, access to grant funding is also associated with a higher probability to access other sources of revenue (Burger & Owens, 2008). Once an NGO has received a grant, it is likely to have other proposals accepted and approved by other donors<sup>74</sup> and it is therefore in a stronger position to secure and continue with projects. This variable is operationalised by taking the value 1 if the NGO receives funding from donors and 0 otherwise.<sup>75</sup>

(2) Two variables for the flexibility of funds

- Availability of *unrestricted funds*, which include membership fees, other fees paid by beneficiaries, income from services rendered, income from commercial activities and private donations (i.e. financial contributions). This type of revenue can generally be used in a discretionary manner by NGOs to cover unfunded expenses and financial shortfalls. It is expected that the presence of unrestricted funds or the likelihood of increasing the amount of these funds can mitigate the impact of a drop in other sources of revenue on programme expenditure. The cut-off point was set to 15 percent based on the percentage used to select the financially vulnerable NGOs (i.e. the sampled NGOs). The variable takes the value 1 if the NGOs have more than 15 percent of their revenue from unrestricted funding sources, and 0 otherwise.
- *Overhead costs* as a percentage of total expenditures. The proportion of overhead costs on the total expenditure is a proxy for flexibility of donors. Donors that fund overhead costs

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<sup>74</sup> Burger and Owens (2008) showed that there is a ‘funding allocation mechanism’ according to which NGOs that have received grants previously have a higher proportion of total revenue derived from grants.

<sup>75</sup> The same criterion was used in the previous chapter based on the analysis of the distribution of the variable to identify donor-funded NGOs (page 47). The grants include revenue from international NGOs, Ugandan NGOs, UN organisations and bilateral donors.

only allow a small percentage,<sup>76</sup> which ranges from 5 percent to 15 percent. This study considered a threshold of 5 percent. As stated earlier, NGOs with a larger share of overhead costs are expected to be able to shift expenditure towards affected programmes and therefore to reallocate expenditure in order to continue with operations.

(3) Three variables for the institutional capital

- *Professional experience of CEO* equal to or more than 10 years of experience. The CEO's previous and current work experience is a proxy for CEO competence as well for his/her networks. Leaders, such as a CEO who is better connected, are in a better position to secure funding. This variable takes the value 1 if the CEO has more than 10 years of experience, and 0 otherwise. This operationalisation was based on a commonly applied minimum requirement for the CEO position.<sup>77</sup>
- *Community contributions* in the forms of in-kind, financial or labour contributions. NGOs that are able to mobilise communities to contribute resources towards programmes are more likely to maintain programme expenditures. It takes the value 1 if the NGO receives any contribution from beneficiaries and 0 otherwise.
- *Size* in terms of the number of salaried staff. Larger NGOs with more visibility and more internal capacity are more likely to attract resources through their organisational networks and personal relationships in order to maintain programme performance. It takes the value 1 if the NGO has more than 10 workers, a value based on examining the typical size of NGOs in the sample.

Table 3.4.2 details the variables and measures and the threshold used to make the data feasible for the csQCA. The information about each condition and its calibration (i.e. operationalisation of each variable) across the set of cases being assessed is presented in the data matrix in Appendix B.

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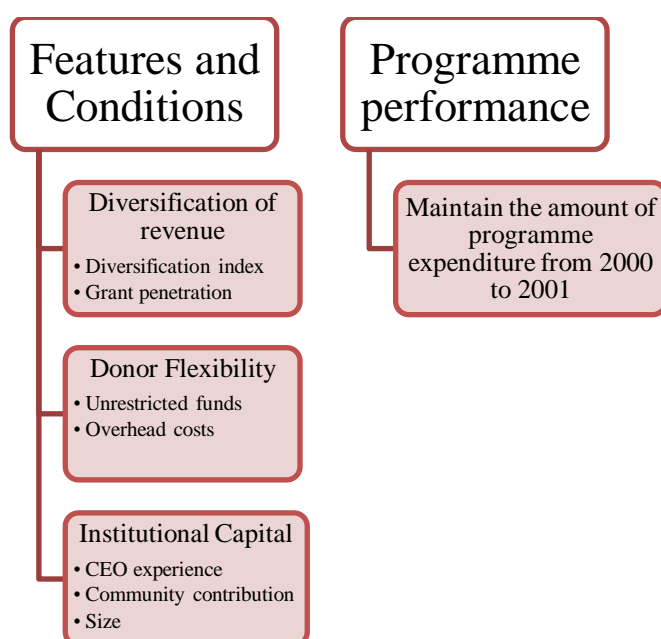
<sup>76</sup> For example, Global Affairs Canada allows 12% indirect costs. Available from: <http://www.international.gc.ca/development-developpement/partners-partenaires/bt-oa/overhead-compensation.aspx?lang=eng#app1>. USAID do not allow indirect costs. Available from: [http://pdf.usaid.gov/pdf\\_docs/Pnadi393.pdf](http://pdf.usaid.gov/pdf_docs/Pnadi393.pdf).

<sup>77</sup> To define the cut-off point for CEO experience variable several recruitment websites were consulted.

**Table 3.4.2: Conditions to mitigate the impact on programmes and threshold points**

Conditions	Variables	Measure	Threshold points
Diversification of revenue base	Diversification index	$\sum \left( \frac{Revenue\ j}{Total\ Revenues} \right)^2$	> 0.7 concentration index
	Grants penetration	NGO grants, UN organisation or bilateral donor	Receive funding from grants
Flexibility of funds and resource allocation	Unrestricted funds	Proportion of unrestricted funds	> 15% in 2001
	Overhead costs	Services rendered, grants, donations and other contributions, and other non-operational costs	> 5% amount of overheads as a percentage of total costs
Institutional capital	CEO experience	No. of years with the NGO and previous work with another NGO	> 10 years
	Community contribution	In cash, in kind, in labour contribution	If beneficiaries pay or contribute for NGO' services
	Size	Number of salaried staff	> 10 no. of salaried staff

Figure 3.4.1 presents a summary of the conditions, variables and the outcome considered in the study.

**Figure 3.4.1: Summary of the research**

### 3.4.3. Empirical analysis

This section presents the results using four variables of the three possible causal conditions that were explained in the previous section. Each condition was assigned to each case and compared outcomes (i.e. if the NGO maintained programme expenditure or not) across cases. The data matrix is presented in Appendix B. The conditions presented in this section are the set of variables that explain the outcome better (i.e. higher consistency and coverage). For transparency, the results from other models and conditions are presented in Appendix B.

#### 3.4.3.1 Model and truth table

The model uses csQCA to test for the necessary and sufficient conditions to avoid a decrease of programme expenditure.

*Maintenance of programme expenditure = f (diversification of revenue, flexibility of donors, institutional capital) (1)*

Table 2.3.1 presents the truth table for Model (1) (to simplify the presentation, only rows with cases are shown). There are eight possible configurations combining three binomial conditions ( $8 = 2^3$ ): not all are covered by empirical cases (i.e. no logical remainders).

There are two non-contradictory rows: one that is uniform in displaying the outcome, i.e. maintain programme expenditure (consistency = 1.0; rows 1; NGO 195), and one that is uniform in not displaying the outcome (consistency = 0.0; row 8; NGO 41).<sup>78</sup> There are six contradictory rows (rows 2, 3, 4, 5, 6, 7), i.e. consistency scores not equal to one or zero<sup>79</sup>. Two of the contradictory rows (rows 3 and 7) can be explained by using a deeper analysis through interviews of the specific cases, namely NGOs 23 and 300. The programmes of both organisations were not affected by the decrease in revenue because they reallocated costs in order to protect programmes (i.e. increasing the share of resources allocated to programmes) (see cost structure in Appendix B).<sup>80</sup> Since the inconsistency of these two cases could be

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<sup>78</sup> The consistency is measured by the percentage of the cases in each row that display the outcome. If the consistency is equal to 1, it means that all cases were able to maintain programme expenditure. See Section 3.4.2.

<sup>79</sup> According to Ragin (1987), it is acceptable to relax the standard of consistency cores if the consistency case can be explained by its specific circumstances.

<sup>80</sup> Interviews with key informants of NGO 23 and 300 confirmed these specific situations.

explained, the cases were not relevant to the combination of conditions and therefore were set aside.

**Table 3.4.3: Truth table**

Row	<i>Conditions</i>			<i>Outcome</i>			Consistency
	<b>D</b>	<b>O</b>	<b>E</b>	<i>n. Cases</i>	<i>n. Adjust (NGO ID)</i>	<i>n. Not Adjust (NGO ID)</i>	
1	0	1	1	1	0	1 (195)	1
2	0	1	0	4	1 (61)	3 (199/216/159)	0.75
3	1	1	1	3	1 (300)	2 (118/140)	0.66667
4	1	0	1	3	1 (79)	2 (53/278)	0.6667
5	1	0	0	2	1 (152)	1 (168)	0.5
6	0	0	0	4	2 (208/60)	2 (135/125)	0.5
7	0	0	1	4	2 (173/23)	2 (115/187)	0.5
8	1	1	0	1	1 (41)	0	0

Note: D=diversification of revenue; O=overhead costs; E=experience of the CEO; P=maintain programme expenditure

A comparison of the positive and negative cases in rows 2, 4 and 6 reveals that the cases (NGOs 60, 61, 79, 208) do not have unrestricted funds, whilst all other organisations that maintained programme expenditure have unrestricted funds. This suggests that having unrestricted funds is a necessary condition to maintain programme expenditure. The variable is thus added to the model.

In the revised

Table 3.4.4 the cases that safeguard programme expenditure are removed (i.e. NGO 23 and 300) and two contradictory cases of the previous table are resolved.

**Table 3.4.4: Revised truth table**

Row	<i>Conditions</i>				<i>Outcome</i>			
	<b>D</b>	<b>O</b>	<b>E</b>	<b>U</b>	<i>n. Cases</i>	<i>n. Adjust (NGO ID)</i>	<i>n. Not Adjust (NGO ID)</i>	Consistency
1	0	1	1	1	1	0	1 (195)	1
2	0	0	0	1	2	0	2 (125/135)	1
3	0	0	1	0	2	0	2 (115/187)	1
4	1	0	1	1	2	0	2 (53/278)	1
5	0	1	0	1	3	0	3 (159/199/216 )	1
6	1	1	1	1	2	0	2 (118/140)	1
7	1	0	0	1	2	1 (152)	1 (168)	0.5
8	0	0	0	0	2	2 (60/208)	0	0
9	1	1	0	0	1	1 (41)	0	0
10	1	0	1	0	1	1 (79)	0	0
11	0	1	0	0	1	1 (61)	0	0
12	0	0	1	1	1	1 (173)	0	0
13	1	1	1	0	0	-	-	-
14	1	1	0	1	0	-	-	-
15	1	0	0	0	0	-	-	-
16	0	1	1	0	0	-	-	-

Note: D=diversification of revenue; O=overhead costs; E=experience of the CEO; U=unrestricted revenue; P=maintain programme expenditure. “-” indicates that there are no empirical cases with the combination of conditions listed in the row.

According to Ragin (2008) consistency scores should be as close to 1.0 as possible. Consistency scores below 0.85 make it difficult to assert that a set relation exists, therefore it is coded as 0. In fact, NGO 168 (row 7) has experienced the highest drop in its revenue (80 percent), which is expected to affect programme expenses negatively. But, surprisingly the organisation reported an increase in programme expenditure. According to Barr, Fafchamps

and Owens (2005), the data are not fully accurate and transparent. In addition, NGO 168 is funded by donor grants and therefore may be tempted to misreport information in order to satisfy donor interests by hiding operational costs under programme costs.<sup>81</sup>

### 3.4.3.2 Identifying the necessary conditions to maintain programme performance

There is no single necessary condition for maintaining programme performance (i.e. none of the consistency values reaches a value of 1.00 in Table 3.4.5. and Table 3.4.6 for the eight different values of the four binomial conditions that are tested).<sup>82,83</sup> In other words, none of the conditions is always present when organisations are able to maintain programme performance.

**Table 3.4.5: Results for the necessary conditions tests of maintenance of programme expenditure**

<i>Configurations</i>	<i>Consistency</i>	<i>Coverage</i>
DIVERSIFICATION	0.3846	0.6250
diversification	0.6154	0.6667
OVERHEAD	0.4615	0.7500
overhead	0.5385	0.5833
EXPERIENCE	0.5385	0.7778
experience	0.4615	0.5455
UNRESTRICTED	0.8462	0.8462
unrestricted	0.1538	0.2857

Note: uppercase letters represent the ‘existence’ of a condition (i.e. having the value 1) and lowercase letters represent the ‘absence’ of a specific condition (i.e. having the value 0).

<sup>81</sup> According to Verbruggen and Christiaens (2012) donors evaluate programme expenses of NGOs as a proxy of “good use” of organisation’s money when they make decisions about donating money. This fact results in NGOs shifting expenses from one category to another in order to attract more donor funding.

<sup>82</sup> The consistency value of a necessary condition refers to the degree to which this specific condition overlaps with a particular outcome relative to all cases with the same outcome. If a given condition is presented in all cases and all have the same outcome, the consistency value will be 1.00 – indicating that is a necessary condition. For example, the first row of the Table 3.4.5, shows that 38.46 percent of the samples of NGOs that maintained programmes expenditure (i.e. outcome equal to 1) has a diversified revenue, which means that five NGOs (NGOs 53, 118, 140, 168, 278) that have a diversified revenue (i.e. diversify variable equal to 1) out of thirteen NGOs, were able to maintain programme expenditure (i.e. outcome equal to 1).

<sup>83</sup> The coverage value of a necessary condition refers to the number of cases with the same outcome that overlaps with the necessary condition. For example, the first row of the Table 3.4.5, shows that 62.5 percent of the sampled NGOs that has a diversified revenue (i.e. diversified variable equal to 1) were able to maintain programme expenditure, which means that five NGOs (NGOs 53, 118, 140, 168, 278) out eight NGOs (NGOs 41, 53, 79, 118, 140, 152, 168, 278) that have a diversified revenue (i.e. diversify variable equal to 1) were able to maintain programme expenditure (i.e. outcome equal to 1). The interpretation of the coverage coefficients of the necessary conditions is only meaningful at consistency values of 1.00.



Similar to the necessary tests for the maintenance of programme expenditure, there is no necessary condition for reducing programme expenditure (i.e. the contrary of the outcome).

**Table 3.4.6: Results for the necessary conditions tests of reduction on programme expenditure**

<i>Configurations</i>	<i>Consistency</i>	<i>Coverage</i>
DIVERSIFICATION	0.4286	0.3750
diversification	0.5714	0.3333
OVERHEAD	0.2857	0.2500
overhead	0.7143	0.4167
EXPERIENCE	0.2857	0.2222
experience	0.7143	0.4545
UNRESTRICTED	0.2857	0.1538
unrestricted	0.7143	0.7143

Note: uppercase letters represent the ‘existence’ of a condition (i.e. having the value 1) and lowercase letters represent the ‘absence’ of a specific condition (i.e. having the value 0).

### 3.4.3.3 Identifying sufficient and INUS conditions of programme performance

Boolean minimisation is used to test for sufficient conditions in relation to the outcome. The Boolean operationalisation has three possible solutions: the parsimonious solution, the complex solution and the intermediate solution. For the purpose of this study the parsimonious solution that includes assumptions about logical remainders (that are not represented through empirical cases) is presented.

The parsimonious solution points to five different combinations (i.e. equifinal) that help organisations to maintain programme expenditure.

**Table 3.4.7: Parsimonious solution for maintaining programme expenditure**

<i>Combinations</i>	<i>Boolean expression</i>	<i>Raw coverage</i>	<i>Unique coverage</i>	<i>Consistency</i>
1.	diversification*EXPERIENCE*unrestricted	0.153846	0.153846	1
2.	diversification *experience* UNRESTRICTED	0.384615	0.153846	1
3.	DIVERSIFICATION *EXPERIENCE* UNRESTRICTED	0.307692	0.153846	1
4.	OVERHEAD* EXPERIENCE	0.230769	0	1
5.	OVERHEAD *UNRESTRICTED	0.461538	0	1

Solution consistency: 1, solution coverage: 0.923077

Note: uppercase letters represent the ‘existence’ of a condition (i.e. having the value 1) and lowercase letters represent the ‘absence’ of a specific condition (i.e. having the value 0).

Raw coverage measures the proportion of cases in the outcome explained by each term in the solution (Ragin, 2008). Unique coverage measures the proportion of cases in the outcome explained solely by each individual solution term, which are not covered by other solution terms (Ragin, 2008).

\* indicates the conjunctive ‘and’.

In the first combination the existence of manager experience, low diversification of income and the absence of unrestricted funds together are sufficient conditions to maintain programme expenditure. This combination is compatible with Proposition 3 (see Section 3.3), where the manager and his network are important tools to manage the restricted funds available. Manager experience and his/her strong networks with donors play an important role in the reallocation of restricted donor funds. The two cases (NGOs 115 and 187) that fulfil the combination present a consistency of 1 and a raw coverage of 15.38 percent.<sup>84</sup>

The second combination is comprised of five organisations, NGOs 125, 135, 159, 199 and 216, that have unrestricted income, low diversification of income and low manager experience. This combination highlights the importance of the existence of unrestricted funds, whether they come from a single source or not. The consistency for this combination is 1 and a raw coverage of 38.46 percent.

The third combination is comprised of four NGOs (NGOs 53, 118, 140 and 278) that have diversified income sources, unrestricted income and management experience and were able to maintain programme expenditure. This combination is in line with the two previous combinations. The organisations that have experienced managers who can use the diverse sources of funding in a discretionary manner are able to maintain programme expenditure. The consistency for this combination is 1 and a raw coverage of 30.77 percent.

The fourth combination (NGOs 140, 118 and 195) shows that a minimum share of overhead costs, together with manager experience, are sufficient conditions to allow NGOs to maintain programme expenditure. These organisations also have unrestricted income which is consistent with the previous combinations. Three out of 13 NGOs were able to maintain programme expenditure (23.08 percent).

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<sup>84</sup> Raw coverage measures the proportion of cases in the outcome explained by the cases that fulfil solely that particular combination (Ragin, 2008). In other words, the degree to which a specific combination “accounts for” the number of cases of the outcome. For example, two NGOs (NGOs 115 and 187) that fulfil the combination of conditions in the first row were able to maintain programme expenditure (out of the thirteen NGOs from the sample that maintained programme expenditure).

Finally the last combination reflects the importance of flexibility of donors and the low level of restriction on the utilisation of funds and supports Proposition 2 (see Section 3.3). This combination leads to the outcome in 46.15 percent of the NGOs (NGOs 118, 140, 159, 195, 199 and 216) that were able to maintain programme expenditure (i.e. six NGOs that have unrestricted funds and overhead costs) with a consistency level of 1 (i.e. all cases that fit in this combination of conditions were able to maintain programme expenditure).

All four conditions in the model are relevant in explaining the ability of organisations to maintain programme expenditure. They form the INUS conditions as part of the five sufficient explanations. The consistency for this solution is 0.9231, which means that the cases covered by the five combinations are a subset of membership in the outcome (i.e. number of NGOs that maintain programme expenditure). The results suggest firstly, that there are different combinations of conditions that lead to the outcome, and secondly, and in accordance with earlier research and empirical evidence, the presence of unrestricted donor funding and manager experience are important conditions to cope with financial problems and to protect programmes.

### **3.4.4. Test of the model**

#### ***3.4.4.1 Robustness***

According to Skaaning (2011), there are three possible methods to check for robustness: change of case selection, model specifications, and/or the operationalisation<sup>85</sup> of the outcome and conditions. This study firstly uses the change of model specification through the addition of an explanatory condition (i.e. unrestricted revenue). Secondly, the study uses the replication of the model QCA by replacing the explanatory condition of diversification of revenue sources with access to grants and the explanatory conditions of institutional capital (i.e. manager experience) with size and community contribution. Thirdly, it tests the effect of different ways to operationalise the explanatory conditions (i.e. the thresholds of the conditions or thresholds), specifically overhead costs (from 5 percent to 10 percent) and years of experience (from 10 years to 5 years) and explores the similarity of findings. Overall, the results are consistent with the outcomes presented in the study. The model presented in this chapter was the one with the highest level of consistency and coverage, which means that the

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<sup>85</sup> As used in the QCA model.

set of conditions explains the outcome better than the alternative models tested. The results of the robustness tests (i.e. the alternative models) are presented in Appendix B.

#### ***3.4.4.2 Testing the quantitative analysis through interviews***

To test the empirical results and to add more granularity and texture to the research (e.g. reasons for the drop in revenue and consequently the real impact on programme delivery), in-depth interviews were conducted with a few NGOs that experienced a drop in revenue between 2000 and 2001. The interviews were carried out in Uganda during 2016. The purpose of the fieldwork was to gain further insight into the financial and operational vulnerability of NGOs. It also provides insight into how managers cope with financial problems and anticipated risks (a theme that will be further explored in Chapter 4). The questionnaire consisted of six open-ended questions that helped to facilitate structured as well as open-ended discussion to explore participants' experiences. Specifically, it investigated how individuals perceive their financial situation, the type of financial problems they faced, how they responded to such problems, how they were affected by a decrease in revenue, and the type of coping mechanisms they employ to mitigate such impacts. The questionnaire is set out in Appendix B.

The informants were individuals who manage NGOs and they all had more than five years of experience. The participating NGOs were selected from the panel survey of approximately of 300 NGOs in Uganda for the years 2000 and 2001 based on the criterion that they had experienced a reduction in revenue of more than 15 percent. The final sample of NGOs interviewed was 8 out of 22 NGOs (NGOs 23, 53, 79, 115, 118, 152, 208 and 300), which represents approximately 36 percent of the entire sample used in this chapter.<sup>86</sup>

The insights that follow from the interviews are perceived to be reasonably well aligned with and generally supportive of the findings of the QCA method. During the interviews the respondents frequently mentioned the importance of access to unrestricted funds, especially related to the funding of overhead costs to secure organisational sustainability. In our sample only two NGOs (NGO 115 and NGO 187) (

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<sup>86</sup> Although the pre-selected list of NGOs included many more NGOs than the ones interviewed based on NGOs that had experienced a large drop in revenue it was not practical to interview all of them due to changing circumstances (e.g. some NGOs stop operating). Another reason was because it was difficult to access NGOs on the ground as an independent academic and foreign researcher.

Table 3.4.4) out of 13 that were able to maintain programme expenditure (i.e. 15 percent) had restrictions on their income. On the other hand, three NGOs (23<sup>87</sup>, 152 and 173) of the seven NGOs that experienced a drop in programme expenditure had unrestricted funds (i.e. 43 percent). However, they reported no overhead costs. Where the two conditions were considered together as a proxy of donor flexibility (all cases had more than 30 percent of funding from donors), there was no reported case with room to reallocate expenses that had decreased programme expenditure when faced with a shortfall in revenue. The field work strongly supports Proposition 2 (see Section 3.3) with the majority of respondents mentioning the issue of unfunded overhead costs when asked if they were worried about the organisation's financial sustainability. The lack of funding for overhead costs did not allow organisations to build capacity and to expand (i.e. build assets such as premises/infrastructure).<sup>88</sup> One participant, from NGO 118, which had been able to maintain programme expenditure, said: "Donors don't want to give you money for administrative costs. They always tell you only 10 percent for administration as if you are going to hang on air to implement the activities". A few respondents even stated that they do not apply for grants when the support for core costs is very small relative to the project's implementation needs.

Regarding the diversification of revenue sources over the period, broadening the financial base was not a priority for NGOs in Uganda. The country experienced an influx of international funding, particularly from the USA, to fund long-term projects (as mentioned in Section 3.1). The sample is comprised of organisations that rely mainly on a few stable sources of funding from donors. Eighteen out of 22 organisations (82 percent) received more funding from grants (i.e. donor funded) than from any other sources of revenue. The remaining four NGOs (18 percent) received revenue from memberships. Moreover, all cases in the sample that had to decrease programme expenditure had access to grants (i.e. nine NGOs), which implies that access to grants is not a sufficient condition to ensure financial sustainability. Four of these nine NGOs were interviewed: three (NGOs 152, 208 and 300) of

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<sup>87</sup> The participant NGO 23 reported having a well-diversified funding structure including financial investments on the stock market as a strategy to deal with financial vulnerability.

<sup>88</sup> Three interviewees referred to the Global Fund as an example of a grant that empowers organisations by providing unrestricted funds which enable them to set up infrastructure. This donor based its monitoring method on result-oriented reports, i.e. whether organisations achieve the objectives and goals agreed.

which reported that the drop in revenue was a result of termination of projects or the end of donor contracts. They also reported difficulties in getting more donors on board to continue funding their activities, despite their performance. The participant from NGO 300, which had not been able to maintain programme expenditure, remarked: “for a long time we were working with one donor so it was difficult for us to have a second donor. It took us time”. The reasons they provided were mainly related to changes in donor priorities, such as mandate and location. This situation is illustrated by the participant of NGO 23, which works in advocacy for human rights: “Uganda is not a priority as such anymore. Before there was a lot of interest as its democratic declined donors’ interest also declined”. NGO 79 reflected a decrease in programme expenditure, but this was a result of a change in the organisation’s strategy in delivering services from being a project-based organisation to becoming a project-driven organisation (i.e. advocacy) using experienced volunteer labour, particularly retired people who wanted to continue working.<sup>89</sup>

In terms of institutional capital as condition and regarding the last proposition, it was found that the experience of the manager plays an important role in sustaining the finances of the organisation. Two of the organisations (NGOs 23 and 53), which performed well in terms of protecting programmes from financial vulnerability, had managers with 15 and 29 years of experience respectively. They emphasised that the reputation of the manager is a crucial factor in times of financial vulnerability. For instance, NGO 23<sup>90</sup> was able to go through many structural changes in terms of strategic plan because the manager, who was about to leave the organisation, was asked to stay since he had strong networks. The words of the manager of NGO 23 serves as illustration: “Me I am an asset because my presence adds value to the organisation ... the benefits are more in terms of visibility, knowledge and networks. My role is to open grounds.” NGO 53 was able to maintain programme expenditure because of the support of its executive director, who had provided an office for the continuation of activities and who had also mobilised resources from his friends. The general secretary of NGO 53 added: “One of the Board members had provided us an office ... he had given it for free.” This serves as one of the reasons why NGO 53 was able to maintain programme expenditure.

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<sup>89</sup> This organisation did not consider itself financially vulnerable.

<sup>90</sup> This organisation had a drop in revenue but increases the share on programme expenditure.

### **3.5. INTERPRETATION OF THE RESULTS AND LIMITATIONS**

Despite the importance of having diversified revenue sources as highlighted in the literature review (see Section 3.3.1) and in the previous chapter, the findings show that NGOs in Uganda were able to maintain programme expenditure despite having only a few sources of funding. This can be explained by the fact that, during the period under investigation, the funding for most organisations that were receiving long-term funding and grants were renewed, as shared by the participating NGOs. However, reliance on just a few donor sources still increases the risk of financial vulnerability as donors can change their strategies and priorities, as was reported by practitioners in the interviews. Another possible explanation derives from a limitation of the data to construct a reliable diversification variable, as the data do not accurately reveal how many sources are in each category, for example, the numbers of donors that are inside the grant category. There is strong evidence that unrestricted funds and flexibility of donors are important conditions to maintain programme expenditure. Four of the five possible combinations of conditions include the presence of unrestricted revenue or overhead costs to maintain programme expenditure when NGOs experience a decrease of revenue. The same conclusion was found in the interviews. Practitioners frequently reported the challenge of the absence of support for overhead costs and the number of restrictions imposed on the use of funds. Interviewees specifically mentioned the difficulties they face in building financial capacity that can sustain the organisations in times of financial difficulty. This finding is in agreement with the research of Chikoto and Neely (2013) (and others as discussed in Section 3.3.2), who show that organisations with higher capacity are likely to be more financially stable.

The leadership was verified to be an important condition of the model to sustain programme expenditure. This is consistent with the literature (see Section 3.3.3). The findings from interviews substantiate this as participants mentioned that the good networking of leaders contributes to the building of trust and the good reputation of the organisation in the international community. This fact raises a question about the sustainability of young and less experienced organisations with usually weaker networks, as explained earlier (see Section 3.3.3).

There are certain limitations to the study that warrant further research. The approach used focuses on particular cases to identify different combinations of conditions that are important for a given outcome in a given context. In developed countries financial needs are much

smaller and NGOs have other funding structures (such as a higher share of private and corporate contributions). It would be interesting to replicate the model in different contexts, including in developed countries, in order to test the wider applicability of this model.

The second limitation is the small overlap between the secondary data used for the analysis and the interviews conducted. The time gap between the secondary data collection and the interviews limited the number of cases that could be accessed for confirmation of the initial findings. It would be interesting to extend the investigation to more recent years to broaden the sample by also considering organisations that did not experience a decrease in revenue.

The third limitation is related to the sample selection criteria, which was focused on financially vulnerable NGOs only. It would be relevant to extend the study to financially non-vulnerable NGOs (as per the criteria used in the study) and investigate how they perform in face of financial difficulties.

The last limitation is related to the extent to which the decrease of programme expenditure actually reflects a negative impact on programmes and beneficiaries. Certain programmes may be implemented efficiently without requiring high budgets, for instance, using volunteers instead of paid staff. In addition, projects in the final phase of implementation typically rely less on financial support.

The more in-depth exploration of the NGOs revealed that some organisations that were classified as financially vulnerable based on the chosen criteria and the nature of the available data were, in fact, not truly financially vulnerable. This reality, which was only accessible through more in-depth study methods, may have played a role in the lack of statistical significance of certain variables tested in Chapter 2. The research will therefore expand into a more ground-level exploration of, for example, the reasons behind decreases in revenue, the ways in which programmes are affected by decreases in revenue, and the financial decisions made by practitioners, which forms the purpose of Chapter 4.

### **3.6. GENERAL CONCLUSIONS**

This chapter follows from the previous chapter on the financial vulnerability of NGOs. It explored the presence of specific conditions in organisations that should be present so as to enable NGOs to successfully implement strategies to deal with financial vulnerability. Specifically, based on the previous chapter, it was proposed that a diversified revenue base,



flexibility in the use of donor funding and a high level of institutional capital would assist organisations to maintain programme expenditure.

By using the QCA method, which is new in the NGO field, it was found that unrestricted revenue and donor flexibility as well as manager experience are important conditions to mitigate the impact on NGO programmes when a drop in revenue is experienced. In addition, there is no single condition that can secure sustainability of programme delivery following a decrease in revenue, but rather certain combinations of conditions.

In order to strengthen the results and considering the limitation of the QCA method (i.e. the degree of arbitrariness for operationalisation), some robustness tests were firstly performed and then field work was conducted to collect primary data from key informants of a number of NGOs from our sample. The results from the robustness tests and the interviews largely confirm the propositions and the empirical analysis. The interviews with key individuals also shed light on current coping mechanisms in the case of financial vulnerability, and this will be analysed in more detail in the next chapter.

This research makes an important contribution to the literature on the financial vulnerability of NGOs and the impact of this on programme delivery. The impacts of a decrease in revenue on either programme expenditures or operation of the organisations are obviously not equal among NGOs and there are different combinations of conditions that can contribute towards the programme sustainability of NGOs. This study assists managers to design strategic plans for sustainability and development. For instance, organisations with unrestricted income are likely to build endowments that ensure financial stability during hard times, such as renting out of premises or vehicles. The findings also leave room for further research, for example, examining the mandate and core activity of each organisation and equifinal pathways that lead to maintain programme expenditure.

This chapter set the ground for the next chapter because it was realised that the data available and the methods used to study financial vulnerability of NGOs in developing countries do not offer a clear understanding of the whole system within which NGOs operate. For example, impoverished environments, typically in developing countries, limit the ability of organisations to raise significant community contributions which makes the variable of community contribution insignificant. In addition, many of the systematic factors are not well capture through quantitative methods. The awareness that other variables can affect the financial stability and vulnerability of NGOs and their capacity to manage the impact of such

vulnerabilities on programmes will be addressed by shifting the focus away from secondary empirical data exclusively towards primary qualitative data.

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## APPENDIX B

### Appendix B 1: Cost structure of the sampled NGOs

NGO	<i>Personnel</i>		<i>Travel</i>		<i>Operational</i>		<i>Indirect</i>		<i>Capital</i>		<i>Programme</i>	
	2000	2001	2000	2001	2000	2001	2000	2001	2000	2001	2000	2001
<b>23</b>	12%	43%	0%	0%	2%	4%	0%	1%	65%	13%	21%	40%
<b>41</b>	15%	19%	2%	3%	2%	2%	14%	21%	17%	6%	50%	48%
<b>53</b>	15%	17%	0%	0%	0%	0%	0%	0%	0%	0%	85%	83%
<b>60</b>	21%	22%	1%	1%	3%	3%	0%	0%	0%	2%	75%	72%
<b>61</b>	10%	21%	11%	14%	2%	8%	9%	10%	7%	4%	62%	43%
<b>79</b>	7%	17%	0%	0%	12%	16%	0%	0%	0%	0%	82%	67%
<b>115</b>	0%	0%	0%	0%	0%	0%	1%	1%	99%	99%	0%	0%
<b>118</b>	0%	0%	1%	1%	7%	8%	14%	27%	10%	0%	68%	64%
<b>125</b>	20%	47%	0%	0%	49%	33%	0%	0%	0%	0%	31%	21%
<b>135</b>	0%	0%	0%	0%	70%	71%	0%	0%	0%	0%	30%	29%
<b>140</b>	78%	87%	1%	1%	0%	0%	9%	6%	12%	7%	0%	0%
<b>152</b>	42%	48%	0%	0%	36%	37%	0%	0%	0%	0%	22%	15%
<b>159</b>	0%	0%	58%	20%	0%	0%	8%	0%	0%	0%	33%	80%
<b>168</b>	14%	30%	1%	4%	61%	15%	0%	3%	0%	7%	23%	41%
<b>173</b>	10%	24%	0%	0%	0%	0%	4%	13%	2%	1%	84%	62%
<b>187</b>	94%	85%	0%	0%	1%	1%	0%	1%	0%	0%	6%	14%
<b>195</b>	9%	9%	5%	3%	2%	1%	29%	27%	0%	0%	56%	60%
<b>199</b>	28%	14%	0%	0%	0%	0%	59%	31%	13%	51%	0%	3%
<b>208</b>	13%	22%	2%	4%	1%	13%	0%	0%	14%	6%	69%	55%
<b>216</b>	12%	16%	0%	0%	1%	2%	27%	19%	60%	63%	0%	0%
<b>278</b>	31%	35%	10%	11%	10%	9%	8%	12%	40%	34%	0%	0%
<b>300</b>	41%	65%	3%	4%	7%	12%	37%	6%	0%	0%	12%	13%

**Appendix B 2: Data matrix**

<i>Cases</i>	<i>D</i>	<i>G</i>	<i>U</i>	<i>O1</i>	<i>O2</i>	<i>E1</i>	<i>E2</i>	<i>C</i>	<i>S</i>	<i>OUT</i>
23	0	1	1	0	0	1	1	0	1	0
41	1	1	0	1	1	0	0	1	1	0
53	1	1	1	0	0	1	1	0	0	1
60	0	1	0	0	0	0	1	1	1	0
61	0	1	0	1	1	0	1	0	1	0
79	1	1	0	0	0	1	1	0	0	0
115	0	1	0	0	0	1	1	1	0	1
118	1	1	1	1	1	1	1	1	0	1
125	0	1	1	0	0	0	0	0	0	1
135	0	0	1	0	0	0	1	1	0	1
140	1	0	1	1	1	1	1	1	0	1
152	1	1	1	0	0	0	0	0	0	0
159	0	0	1	1	1	0	0	0	0	1
168	1	1	1	0	0	0	1	0	0	1
173	0	1	1	0	0	1	1	0	1	0
187	0	1	0	0	0	1	1	0	1	1
195	0	1	1	1	1	1	1	1	0	1
199	0	0	1	1	1	0	0	1	0	1
208	0	1	0	0	0	0	1	0	0	0
216	0	1	1	1	1	0	0	1	1	1
278	1	1	1	0	0	1	1	1	0	1
300	1	1	1	1	1	1	1	1	1	0

Note: D=diversification of revenue; G=grant penetration; U= unrestricted funds; O1=overhead costs (5%); O2=overhead costs (10%); E1=experience of the CEO (10 years); E2=experience of the CEO (5 years); C=community contribution; S=size.

### Appendix B 3: Robustness test of the QCA model

#### Parsimonious solution for maintaining programme expenditure (replacing diversification with grant penetration)

<i>Combinations</i>	<i>Boolean expression</i>	<i>Raw coverage</i>	<i>Unique coverage</i>	<i>Consistency</i>
1.	grant	0.307692	0.076923	1
2.	OVERHEAD*UNRESTRICTED	0.461538	0.230769	1

Solution consistency: 1, solution coverage: 0.538462

Note: uppercase letters represent the 'existence' of a condition (i.e. having the value 1) and lowercase letters represent the 'absence' of a specific condition (i.e. having the value 0).

Raw coverage measures the proportion of cases in the outcome explained by each term in the solution (Ragin, 2008). Unique coverage measures the proportion of cases in the outcome explained solely by each individual solution term, which are not covered by other solution terms (Ragin, 2008).

\* indicates the conjunctive 'and'.

#### Parsimonious solution for maintaining programme expenditure (replacing CEO experience with community contribution)

<i>Combinations</i>	<i>Boolean expression</i>	<i>Raw coverage</i>	<i>Unique coverage</i>	<i>Consistency</i>
1.	OVERHEAD*UNRESTRICTED	0.461538	0.153846	1
2.	COMMUNITY CONTRIBUTION* UNRESTRICTED	0.461538	0.153846	1

Solution consistency: 1, solution coverage: 0.615385

Note: uppercase letters represent the 'existence' of a condition (i.e. having the value 1) and lowercase letters represent the 'absence' of a specific condition (i.e. having the value 0).

Raw coverage measures the proportion of cases in the outcome explained by each term in the solution (Ragin, 2008). Unique coverage measures the proportion of cases in the outcome explained solely by each individual solution term, which are not covered by other solution terms (Ragin, 2008).

\* indicates the conjunctive 'and'.

#### Parsimonious solution for maintaining programme expenditure (replacing CEO experience with size)

<i>Combinations</i>	<i>Boolean expression</i>	<i>Raw coverage</i>	<i>Unique coverage</i>	<i>Consistency</i>
1.	UNRESTRICTED*OVERHEAD	0.461538	0.230769	1
2.	UNRESTRICTED*size*diversification	0.384615	0.153846	1

Solution consistency: 1, solution coverage: 0.615385

Note: uppercase letters represent the 'existence' of a condition (i.e. having the value 1) and lowercase letters represent the 'absence' of a specific condition (i.e. having the value 0).

Raw coverage measures the proportion of cases in the outcome explained by each term in the solution (Ragin, 2008). Unique coverage measures the proportion of cases in the outcome explained solely by each individual solution term, which are not covered by other solution terms (Ragin, 2008).

\* indicates the conjunctive 'and'.

**Parsimonious solution for maintaining programme expenditure (overhead cost threshold 10%)**

<i>Combinations</i>	<i>Boolean expression</i>	<i>Raw coverage</i>	<i>Unique coverage</i>	<i>Consistency</i>
1.	UNRESTRICTED*OVERHEAD	0.307692	0.076923	1
2.	UNRESTRICTED *experience* diversification	0.384615	0.230769	1
3.	unrestricted *EXPERIENCE* diversification	0.153846	0.153846	1
4.	UNRESTRICTED*EXPERIENCE* diversification	0.307692	0.230769	1

Solution consistency: 1, solution coverage: 0.923077

Note: uppercase letters represent the 'existence' of a condition (i.e. having the value 1) and lowercase letters represent the 'absence' of a specific condition (i.e. having the value 0).

Raw coverage measures the proportion of cases in the outcome explained by each term in the solution (Ragin, 2008). Unique coverage measures the proportion of cases in the outcome explained solely by each individual solution term, which are not covered by other solution terms (Ragin, 2008).

\* indicates the conjunctive 'and'.

**Parsimonious solution for maintaining programme expenditure (CEO experience of 5 years)**

<i>Combinations</i>	<i>Boolean expression</i>	<i>Raw coverage</i>	<i>Unique coverage</i>	<i>Consistency</i>
1.	diversification*experience2*UNRESTRICTED	0.307692	0.076923	1
2.	OVERHEAD* UNRESTRICTED	0.461538	0.076923	1
3.	DIVERSIFICATION *EXPERIENCE 2* UNRESTRICTED	0.384615	0.230769	1

Solution consistency: 1, solution coverage: 0.769231

Note: uppercase letters represent the 'existence' of a condition (i.e. having the value 1) and lowercase letters represent the 'absence' of a specific condition (i.e. having the value 0).

Raw coverage measures the proportion of cases in the outcome explained by each term in the solution (Ragin, 2008). Unique coverage measures the proportion of cases in the outcome explained solely by each individual solution term, which are not covered by other solution terms (Ragin, 2008).

\* indicates the conjunctive 'and'.

**Appendix B 4: Questionnaire**

1. Where you ever worried about your organisation's finances or their financial sustainability? Or do you consider the NGO's financial position to be sustainable and secure?
  - a. If you were worried about finances, did you make any changes?
2. If you experienced financial difficulties in the past, how did you respond?
  - a. Did you anticipate the financial difficulties and act early? What did you do?
  - b. Did you only react to the financial problems after it happened? [Surprised by it and caught unaware] What did you do?
3. Have you ever experienced a large drop in your income? Could you please explain why and how it happened?
  - a. Did this drop in income affect your programme activities and the community beneficiaries?
  - b. How were they affected?
  - c. If the programme was not affected why not?
  - d. Did you reduce expenditure, and if so, which categories [e.g. staff and personnel cost; administrative cost; programme costs]?
4. What did you learn from that experience?
5. How did you intend to prevent that happening again and to reduce the negative effect on organisation's work?
6. Do you think that the reputation of the organisation can help to protect against financial problems?
  - a. If so, in what way?

## CHAPTER 4

### THE FINANCIAL DECISION-MAKING OF VULNERABLE UGANDAN NGOS FROM A PRACTITIONER PRESPECTIVE

#### Abstract

Donor funding for non-governmental organisations (NGOs) is not guaranteed, especially for NGOs in the developing countries of Africa that are funded mainly by external donors. However, the funding situation for NGOs has deteriorated since 2008 as a result of the global economic crisis. In addition to the difficult application requirements, donor funding is usually restrictive and intended only for specific purposes; it is often also granted for a specific time period. Because of the impoverished environments in which NGOs operate, raising funds locally is not as easy as it is for NGOs in developed countries. Donor dependence has therefore become an increasingly challenging issue.

The bulk of the existing literature on NGOs relates to developed countries, especially the United States and United Kingdom, with little coverage of issues of financial vulnerability in developing countries. The main reason for this is the lack of reliable data on NGOs in developing countries. To address this gap, this study aimed to gain an understanding of how NGO practitioners in developing countries respond to the financial challenges.

The study involved interviews with a sample of 35 Ugandan NGO practitioners during 2016. The participants were individuals who played key roles in the management of their NGOs. By using qualitative analysis, the study provides insight into the financial decisions and the strategies of NGOs to survive and to continue delivering services.

The study finds that there is a mismatch between donor expectations in terms of the actual capacity to deliver services and the reality on the ground, the result of which is that NGOs often battle to survive while still continuing to deliver services as per donor requirements. Accordingly, NGO practitioners implement a variety of strategies, such as to strengthen capacity to handle donor applications, to create financial reserves, to improve efficiency, to creatively seek alternative sources of revenue, and to build reputation through partnering and networking. The study also finds additional factors that influence the system and the extent to which NGOs can effectively respond to their specific local conditions and challenges. For instance, experienced and forward-looking, innovative leadership is likely to take advantage

of opportunities and to manage adverse events more efficiently than less experienced and less involved leaders.

Through a better understanding of the dynamics under which NGOs operate, the study makes two main contributions. Firstly, it adds value to the current body of literature by providing additional evidence on the strategies and coping mechanisms of NGOs to deal with financial vulnerability and by covering aspects that had been previously neglected, such as the impact of high staff turnover, which seems to be typical of the NGO sector in developing countries, and its impact on the efficiency of service delivery. The second contribution relates to the practical knowledge and insights gained from the experience of Ugandan NGOs that can be shared with practitioners in developing countries who may experience similar circumstances.



## 4.1. INTRODUCTION

This study builds on the earlier studies (presented here as Chapters 2 and 3) by adding field work to gain a deeper understanding of the previous research findings and their limitations. In Chapter 2 it was found that diversification of revenue sources and owning assets help to manage financial vulnerability. Donor-funded NGOs seemed to have a higher probability of being considered financially vulnerable than community-funded NGOs. The second study (Chapter 3) also found that fewer restrictions on the use of revenue, flexibility of donors, and manager experience assist NGOs after a negative financial shock. However, these studies have two shortcomings: first the studies relied on secondary data collected prior to the 2008 financial crisis (which greatly affected the sector worldwide); and second, the data did not provide sufficient and totally reliable information to have a comprehensive overview of the entire system. In a country where the majority of NGOs are heavily dependent on donor funding to survive, a few relevant questions persist: what are the current factors behind financial vulnerability of NGOs in developing countries such as Uganda? Are those financial vulnerabilities caused by reliance on donor funding? Are NGOs that rely on community funding better off than donor-funded NGOs? And, what are the possible financial decisions and strategies that can be implemented by managers to cope with financial vulnerability and future risks? The relevance of these questions call for a deeper study to understand Ugandan practitioners' experience based on personal empirical evidence.

Stable funding for non-governmental organisations (NGOs) is not guaranteed, especially for NGOs in the developing countries of Africa, which are funded mainly by foreign donors. The funding situation for NGOs has deteriorated since the 2008 global economic crisis and donor dependence has therefore become an increasingly challenging issue<sup>91</sup>. In addition to the difficult application requirements, donor funding is usually restrictive and intended only for specific purposes, and often also granted for a specific time period. Because of the impoverished environments in which NGOs operate, raising funds locally is not as easy as in developed countries.

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<sup>91</sup> See also Section 1.9 about funding structures and funding trends.

The bulk of the existing literature on the financial vulnerability of NGOs is based on the experiences of developed countries, especially the United States and the United Kingdom (see e.g. Tuckman & Chang, 1991; Greenlee & Trussel, 2000). The main reason for this is the lack of reliable data on NGOs in developing countries. This is a considerable gap in the literature given that the nature and source of financial vulnerability differ dramatically for NGOs in developing and developed countries. This study aims to address this gap by examining the financial vulnerability and financial decisions of Ugandan NGOs as an example of a developing country in Africa. According to the USAID report for 2015, Ugandan NGOs have been largely funded by foreign donors, whose funding has been reduced over the last decade, as has the support provided for institutional capacity building. As a result, Ugandan NGOs have been under pressure to find ways to become sustainable, which makes them particularly suitable for the purpose of this study as a representative example of an NGO sector in an African developing country.

Drawing from in-depth interviews with a sample of 35 Ugandan NGO practitioners during 2016, the study's intention was to gain a deeper understanding of the findings in the literature as well as the findings from the two studies reported in the previous chapters. This focus was twofold. Firstly it was about gaining deeper insight into the nature of financial vulnerability of Ugandan NGOs, and secondly, it was about their financial strategies and coping mechanisms to address their situations of vulnerability.

The rest of this chapter is organised as follows. Section 4.2 presents a review of the existing literature on NGO strategies to deal with financial vulnerability, with a focus on the context of developing countries. Section 4.3 explains the method of data collection and data interpretation. Sections 4.4 and 4.5 outline the findings and present a discussion of the findings in the context of the literature, respectively. Section 4.6 offers a number of recommendations. Section 4.7 describes the contribution of the study to the existing body of knowledge related to NGOs in developing countries.

## **4.2. REVIEW OF THE LITERATURE**

The financial conditions of NGOs in general are characterised by scarcity and uncertainty of funding, making these organisations financially vulnerable and dependent on resource providers (Froelich, 1999; Nunnenkamp, Öhler & Schwörer, 2013). Typically, NGOs in developing countries are more dependent on a few important sources of external funding from foreign donors than NGOs in developed countries (USAID, 2015). While NGOs in

developed countries have a more diverse range of funding sources, which include grants from foundations and governments, earnings from commercial activities and contributions from individuals and companies (Anheier & Ben-Ner, 2003), NGOs in developing countries receive only small contributions from local individuals and the business sector, and little financial support from governments (USAID, 2015). The environmental dimension of NGOs financial health was previously highlighted by Prentice (2016), who includes several environmental factors, such as median household income and gross domestic product, to explore the determinants of the financial health (or financial vulnerability) of NGOs.

Several authors point out the uneven concentration of financial resources in a few INGOs based in the North Europe and America (Elbers, 2012; Fowler, 2016; Houghton, 2016). These INGOs, in turn, transfer funds to their southern partners. Further, foreign established NGOs and local NGOs differ in terms of their levels of financial vulnerability, resource mobilisation capacity, visibility, coping abilities, and responsiveness to financial challenges (Fowler, 2016). Foreign NGOs<sup>92</sup> are perceived to be larger, to have better access to more diversified sources of funds, and to experience lower financial risk than local NGOs. The funding sources of the latter are more limited because of their geographical location and lack of networks. Foreign NGOs also benefit from more support in terms of fundraising activities, lobbying, and administrative support from their intra-organisational networks than local NGOs. Indeed, international donors favour funding to their national partners as they have better accounting, higher capacity to comply with their requirements and offer a lower level of risk (Sriskandrajah, 2015). A study by Wallace et al. (2006, p. 81) shows that funding from the Department for International Development in the UK (DFID) goes to UK-based NGOs. On the other side, foreign NGOs face local country challenges as they are susceptible to geopolitics that might translate into obstructive legislation such as formal registration, funding limits, and financial reporting requirements (Houghton, 2016). As a result, foreign NGOs often shift to other regions or delegate their operations to established national organisations.

Tinkelman and Mankaney (2007) and Nunnenkamp and Öhler (2012), who examined donor motivation, found that donors are motivated more by specific targeted services or

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<sup>92</sup> The author refers to these organisations as Northern NGOs as opposed to Southern NGOs based on their geographical location.

communities than by disclosed information on the use of funds (e.g. narrative and financial reports). This is in agreement with Aldashev and Verdier (2010), who found that NGOs diversified their services to match donor interests as a strategy to attract funding. Ebrahim (2005), Elbers and Arts (2011) and AbouAssi (2013) stated that the need to satisfy donor interests and requirements may have an adverse effect on NGOs at the expense of commitment to beneficiaries. The authors call for more flexibility in the use of donor funds and a change in programme evaluation, from process-based evaluation to result-based evaluation.

The risk of drifting away from the original core mission of the organisations in order to attract available funding is another concern raised about satisfying donors to ensure financial sustainability (Ebrahim, 2003; Edwards & Hulme, 1996). In other words, NGOs start focusing more on survival objectives than on fulfilling their original missions (Wallace et al., 2006, p. 82). This problem also arises when NGOs engage in commercial, profit-making activities to generate revenue for their operations. However, some authors regard commercial activities as a positive strategy for NGOs to generate internal resources towards fulfilling their social missions (Fowler, 2000; Svidroňová & Vaceková, 2012).

The study by Elbers and Arts (2011) shows that NGOs in developing countries struggle to comply with such donor requirements. Easterly (2002) had warned about donors placing considerable demands on the weak and scarce administrative skills in developing countries, hence the human resource capacities of NGOs can barely keep up with the number of conditions imposed by donors.<sup>93</sup> Further, Wallace et al. (2006, p. 129) make a point about the relative power of many donors and the tension NGOs have to face between the need to comply with donor requirements in order to secure funding and their own realities.

Of special concern is the reluctance of donors to fund overhead costs (Trussel & Parsons, 2007; Ashley & Faulk, 2010). In this respect, Chikoto and Neely (2013) showed that overhead costs are important for helping NGOs to comply with donor conditions, such as monitoring and reporting requirements. Overhead costs also include fundraising costs, which Tinkelman and Mankaney (2007) and Nunnenkamp and Öhler (2012) found to influence positively donor contributions.

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<sup>93</sup> The author refers to the high demands on staff in developing countries in terms of skills and time.

Several authors recommend a diversification of funding sources as a strategy to minimise the risk of financial vulnerability (e.g. Tuckman & Chang, 1991; Greenlee & Trussel, 2000; Yan, Denison & Butler, 2009; Carroll & Stater, 2009). In contrast, a few other studies suggest that concentrating funding on a few stable sources enhances the growth of organisations by providing greater financial stability (e.g. Foster & Fine, 2007; Chikoto & Neely, 2013). Frumkin and Keating (2002) also point out that funding concentration saves costs associated with fundraising. Similarly, Prentice (2016) finds that revenue diversification is not a reliable strategy to increase financial stability in human services NGOs.

The volatility of donor funding and the imposed restrictions have led several authors to highlight the importance of building capacity and the accumulation of reserves or precautionary savings (e.g. Bowman, Keating & Hager, 2007; Calabrese, 2012). The literature shows that reserves are positively associated with lower financial vulnerability and allow organisations to manage their expenditures (Chang & Tuckman, 1990; Greenlee & Trussel, 2000; Calabrese, 2012). The value of building reserves is also highlighted by Fisman and Hubbard (2005), who claim that NGOs use reserves to guard against unpredictable shocks in revenue. The authors also identified the benefits of building reserves in the form of long-term investments. Investments enable NGOs to have a source of revenue for discretionary expenses (Bowman, Tuckman & Young, 2012).

Partnerships are common strategies among NGOs as a way to improve services, for legitimacy purposes, and for access to resources such as information and financial resources (O'Brien & Evans, 2017). The authors investigated partnerships within northern NGOs in developed countries in light of the resource dependency theory. They found that access to financial resources was not the primary motivation but rather non-financial resources (e.g. knowledge). The authors also shed light on the value of partnerships in achieving the missions of organisations and in reaping collective gains, even when there are power imbalances<sup>94</sup> and costs associated with those partnerships, which might include losing autonomy and independence in favour of larger NGOs. Similarly, Wallace et al. (2006, p. 140) showed the extent to which partnership relations between INGOs and Ugandan NGOs

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<sup>94</sup> Power imbalances refer to when one NGO has more control over resources than the other partner NGO and because of that the first NGO has power to dictate the terms of partnership over the second.

affect and influence the identity and autonomy of partner organisations. The authors also highlighted the difficulty of building strong and long-term relationships between INGOs and local NGOs because of the distance and lack of good communication as well as interest and cultural differences.

Another concern raised in the literature on developing countries is that external funding is usually channelled directly to NGOs without the involvement of governments and the use of local resources (Cannon, 1996; Collier, 1996). Moreover, CIVICUS reports (2011) that many NGOs are not only 'disconnected' from governments but also from the private sector, other organisations and the public in general. These authors claimed that working closely with the government and other institutions would increase the potential of NGOs being sustainable and would also enhance the legitimacy and credibility of these organisations.

The literature seems to give little attention to governance in the NGO sector in developing countries of Africa (Tandon, 1995; Barr, Fafchamps & Owens, 2005; Kreutzer & Jacobs, 2011). The debates they deal with are mostly related to monitoring and overseeing NGOs.

NGO governance is generally associated with the role of NGO boards, the structuring of organisations and the culture of the organisations, which is viewed as the work ethic and value systems shared across the members (Tandon, 1995; Brown, Ebrahim & Batliwala, 2012; Costa et al., 2012). NGO boards are generally viewed as covering a range of functions. One is about playing a more active role in providing strategic direction and taking operational decisions, in comparison to the way boards function in the for-profit sector (Coombes, Morris, Allen & Webb, 2011). It is argued that the function of NGO boards is to oversee the NGO's operation and to ensure that it keeps to its social mission (O'Regan & Oster, 2005; Coombes, Morris, Allen & Webb, 2011; Brown, Ebrahim & Batliwala, 2012; Kreutzer & Jacobs, 2011). Moreover, boards are seen as responsible not only for monitoring management, but also for strategic planning and fundraising (Kreutzer & Jacobs, 2011; Jaskyte, 2015).

Coombes et al. (2011) and Jaskyte (2015) found that active boards positively influence the ability of NGOs to innovate, exploit external opportunities and take advantage of their resources as they are likely to encourage the NGO to be active in adapting to changes. Inactive boards, according to Tandon (1995), are those that neglect their supportive and

advisory roles to NGO management.<sup>95</sup> A strong board reputation is often found to relate to the effectiveness and trustworthiness of NGOs (Herman & Renz 1997; Eldenburg et al., 2004; Szper & Prakash, 2011). Moreover, Barr, Fafchamps and Owens (2005) emphasise the role of governance in the Ugandan NGO sector to retain credibility and reputation of integrity of the sector as a whole, which positively influences the capacity of the sector to attract funding from donors.

The roles that board members could play also receive frequent attention by researchers. For example, board members can, together with executive directors, influence donations positively through their valuable links and networks (Callen, Klein & Tinkelman, 2003; O'Regan & Oster, 2005; Ostrower & Stone, 2006; Coombes, Morris, Allen & Webb, 2011; Kreutzer & Jacobs, 2011). Board members could also be valuable resources with a variety of skills, knowledge and experience that are important to meet the needs of the NGO (O'Regan & Oster, 2005; Coombes, Morris, Allen & Webb, 2011; Jaskyte, 2015). Several authors have thus recommended taking these aspects into consideration by electing board members with specific characteristics and competences (Kreutzer & Jacobs, 2011; Jaskyte, 2015).

Another function within the definition of governance is related to accountability (Brown et al., 2012; Steen-Johnsen, Eynaud & Wijkström, 2011). Brown et al. (2012) show that international advocacy NGOs face several demands for accountability from multiple constituents (e.g. donors, boards, staff, government, regulators and beneficiaries) and their governance and structures are shaped by accountability priorities. For example, NGOs that prioritise constituents that benefit directly from their activities would typically have boards with several representatives from their beneficiaries.

Steen-Johnsen, Eynaud and Wijkström (2011) highlighted the need to consider the link between internal governance, which is embedded in the NGO structure, and the external governance that involves a range of different actors such as donors and government. The increasing control and accountability mechanisms required by donors and government, for example, require NGOs to have an internal system of rules and procedures to insure compliance and sustainability (Steen-Johnsen, Eynaud & Wijkström, 2011).

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<sup>95</sup> The author refers to an inactive board as a 'sleeping' or 'invisible board'. Kreutzer and Jacobs (2011) refer to an inactive board as an apathetic and ineffective board.

It is also suggested that the size and age of NGOs contribute to their reputation, which in turn are associated with higher financial stability (e.g. Fafchamps & Owens, 2009; Trussel, 2002; Trussel & Parsons, 2007). While size reflects the ability of growing and attracting contributions, age represents the capacity to be financially sustainable. According to Ruben and Schulpen (2009), larger Dutch NGOs have a higher probability of being selected for funding and are deemed to have better networks and opportunities for partnership than smaller NGOs. Other researchers found a positive relationship between size and more experienced organisations and their survival, both in developed countries (Nunnenkamp, Öhler & Schwörer, 2013) and in developing countries (Burger & Owens, 2013).

Previous studies on Ugandan NGOs find that foreign donors are the main resource providers for NGOs in developing countries (Barr, Fafchamps & Owens, 2005; Burger & Owens, 2013; Wallace et al., 2006). Researchers have shown that INGOs in Uganda have better access to resources, donors and networking than local NGOs (Wallace et al., 2006). The majority of local and small NGOs have difficulty in accessing funding, especially from the international donor community, because of their limited organisational capacities to compete with larger and better resourced NGOs to meet the donor requirements (e.g. bidding and grant management).<sup>96</sup> According to Barr, Fafchamps and Owens (2005), the most common reason for low access to donor grants is because the grant application process is too complicated and time-consuming. A study on the impact of funding requirements of UK NGOs and donors on NGOs in Uganda and South Africa (Wallace et al., 2006, p. 82) revealed that NGOs found reporting requirements to be intense, complex and time-consuming, which limits time for downward accountability (Wallace et al., 2006, p. 111).<sup>97</sup> Moreover, there is an unequal relationship between donors and recipient NGOs because of the financial dependence of NGOs, a situation which results in donors imposing certain conditions and restrictions on how recipient NGOs may use their funds; NGOs often struggle to comply (Rossouw, 2006; Elbers & Arts, 2011; Elbers & Schulpen, 2013; Wallace et al., 2006).<sup>98</sup>

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<sup>96</sup> Donor mechanism for funding became stricter on accountability and reporting requirements. See Section 1.9.2.

<sup>97</sup> For more details about the broad concerns about reporting, see Chapter 7 of Wallace et al. (2006).

<sup>98</sup> These restrictions are meant to ensure the efficiency and transparency of the use of funds and may include time boundaries, specified application of funds, usually only for direct programme activities, and prescribed reporting and accounting procedures (Elbers & Arts, 2011).



The asymmetrical power relationship is more severely felt and the ability to generate funds for overhead costs is more limited in developing country contexts than in developed country contexts. This study, then, sought in particular to add value to the body of knowledge on NGOs by providing richer and more coherent insights into the functioning of the NGO sector in a developing country.

### **4.3. RESEARCH METHOD AND DATA COLLECTION**

In-depth interviews were conducted with a sample of 35 Ugandan NGOs practitioners during 2016.<sup>99</sup> Participants were individuals who played key roles in managing NGOs and they all had more than five years of experience. The interviews explored their experiences relating to the following themes through open-ended discussions:

- how individuals perceive their financial position;
- the way individuals respond to financial difficulties;
- their concerns when the funding decreases and how they are affected;
- what they learn from their experiences in managing NGOs; and
- the kind of strategies and coping mechanisms they implement to protect them against financial risks and to reduce the impact of financial problems.

The questions were deliberately few in order to stimulate a largely open discussion on their experiences in order to allow deeper issues related to the operation of NGOs to emerge, themes that might add richer understanding to the existing research findings from previous chapters as well to literature.<sup>100</sup>

The questionnaire is set out in Appendix C. The sample for this study was obtained in two ways. A core sample of 15 NGOs was purposively selected from a panel survey of approximately of 300 NGOs in Uganda for the years 2001 and 2008 based on the criterion that they had experienced a reduction in revenue of more than 15 percent. The sample was then expanded through referrals (i.e. snowball sampling) by the initial participating NGOs to other NGOs that could make a valuable contribution for the purpose of this study. Twenty-

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<sup>99</sup> According to the NGO Board which oversees the NGO sector in Uganda, there were more than 13,000 organisations registered in 2015. However, the number is an underestimate, because there are many organisations operating in the country without registration (USAID, 2015).

<sup>100</sup> The questionnaire was designed based on previous chapter findings in a more practitioner-oriented language. For example, the concept of financial vulnerability was approached as a financial issue.

five (25) percent of the total sample was endorsed by the Uganda Networks of AIDS Service Organisation (UNASO),<sup>101</sup> of which NGOs are members. The list of NGOs per method used is presented in Appendix C.

The sample consisted of 35 NGOs. Out of those, 37 percent work with youth and children by providing education services, 23 percent are involved in the health sector, 14 percent work in agriculture, livelihoods and community development, 9 percent are dedicated to empowering women and advocacy of women's rights, 6 percent work with the elderly, and the remaining 11 percent focus on cultural issues, transport and environmental matters, emergency relief and human rights advocacy. Seventy-seven (77) percent of NGOs have offices in Kampala – Central region (i.e. 27 NGOs), six operate in the Eastern region (i.e. 17 percent), and two operate in the Western region.

Thematic content analysis was used to analyse the data. The purpose was to derive the sense that the practitioners make of their organisation's financial position, to understand their approaches to sustaining their organisations and programmes, and how their financial contexts shape the way organisations respond and draw up their risk mitigation strategies. The analysis incorporated the data-driven approach of Boyatzis (1998), where themes emerge from the data using inductive coding. The process to identify the themes involved a "careful reading and re-reading of the data" (Rice & Ezzy, 1999). The study was also influenced by the principles of Blom and Nygren (2010), according to which the degree of heterogeneity of the data determines the method of analysis and the identification of themes.

The first step was, through repeatedly working through the interviews and notes from the field, to gain a 'naïve' (Blom & Nygren, 2010) understanding of the underlying narratives as a whole. The emerging picture was further developed by regular discussion between co-researchers before a coding structure underlying the data emerged and a comprehensive framework could be constructed. Then, the data were categorised individually using codes and terms derived directly from the transcriptions and matched with the underlying bigger picture. The relevant quotes were grouped together in memos per code in MS Word. In the following step, the first-order concepts were grouped under higher level concepts through

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<sup>101</sup> UNASO is an umbrella organisation formed in 1996 to provide coordination and representation among Civil Society AIDS Services Organisations (ASOs) in Uganda.

interpretation of the transcriptions by looking for negative instances that contradict prior observations. This phase included regular discussion and critically testing the grouping of concepts leading to further refining and reallocation of quotes. The themes were presented to other academic researchers at conferences and colloquiums, and where necessary they were refined. Finally, in the last step, the data were aggregated to a more abstract dimension and relevant literature was drawn upon to refine labels.

The plausibility and credibility of the study were addressed by conveying the richness of verbatim examples shared by practitioners to illustrate the findings in a transparent way. Subsequently, interactions with peers allowed the notions of the researcher to be scrutinised and subjected to alternative interpretations before the final coding structure took shape.

The data from the interviews also achieved a satisfactory degree of saturation, as the same themes started to recur and hardly any new insights emerged from further interviews.

#### **4.4. FINDINGS**

From the transcribed interviews it can be derived that most contributions fell into two broad categories, which formed the higher-level themes produced by the data. These were: *the environment within which these NGOs operate* (Context) and *the responses of NGOs to this environment* in order to sustain themselves (Response). Each of these categories has, in turn, been broken down into a number of sub-categories. In addition, from the experiences that participants shared, two other categories that do not fit clearly into the two main categories emerged: specifically moderating factors that influence the system within which NGOs operate, and the size of the organisation that determines its capacity to secure funds and implement strategies. These categories help to provide a more holistic picture of NGO survival and service delivery in developing countries.

The following sections present, first, the two main categories in terms of their identified sub-categories, and second, the other two categories. Verbatim responses by the participants are used throughout to provide transparency as to the choice of conceptual codes.

##### **4.4.1. Context: The environment in which NGOs operate**

The context within which NGOs in Uganda operate presents real challenges to their sustainability. This is most likely also the situation in many other developing countries, especially in East Africa. The study finds a set of factors that may well apply to NGO environments in other developing countries, but which are not usually considered in the

standard literature. The data associated with the context were further grouped into the following six sub-categories:

- High donor dependence;
- Funding application restraints;
- Restrictions on the use of donor funds;
- Uncertainty of donor flows;
- Close and tightly-knit donor community; and
- High turnover of staff and low salaries.

The first five sub-categories have to do with the problematic context created through the way in which donors operate and the unaccommodating environment of a poor developing country. The last sub-category is the almost inevitable consequence of losing staff in difficult times. The sub-categories are discussed in the following sub-sections.

#### **4.4.1.1. High donor dependence**

NGOs in Uganda rely largely on funding from donors, e.g. foundations and external governments. Other potential forms of funding, such as membership fees, payments for services rendered, and even income from entrepreneurial activity, seem relatively small because of the low income level of the communities where they are located.

*[T11]: “we don’t even raise a small fraction of our income from members. [They want] ... to gain from the organisation, not to provide for the organisation as it is.”*

*[T19]: “Yes, we thought about getting a place and put some entrepreneurship activities like having sowing machines and put that somewhere ... But when we put the sowing machines there, many people don’t have the money. We cannot run a business there.”*

#### **4.4.1.2. Funding application restraints**

In a context that is already highly donor-dependent, funding application has become quite difficult, especially for small and young organisations. Recent mechanisms for funding applications expect organisations to apply in partnership, as well as to contribute pro rata for

the duration of project (i.e. the matching funding principle).<sup>102</sup> The pro rata contribution may be drawn from their own resources or from other external sources.

*[T14]: “Now donors do not fully fund, they prefer cost sharing. So that means your reserves are being reduced.”*

*[T18]: “I saw two / three calls for proposal saying that should be at least a minimum of three organisations and it should be at least two countries. So if you operate in Uganda you need to know another organisation in Kenya or in Tanzania to partner with ... Trying to fit in to the donor, the donor conditions.”*

*[T05]: “One of my problems is basically regarding of the new concept of matched funding – it’s just likely to crash the organisation.”*

*[T20]: “Especially UK and US. They don’t like giving you money unless they are partner a UK base organisation who is going to manage it for you. If you are partners they can give you part of that money. That one cannot empower organisations.”*

The requirements required by donors pose a lot of heavy demands in terms of staff time and financial resources, which is difficult for organisations to meet. Furthermore, some donors are changing their strategies of funding through a basket of funds managed by a local agency to fund local NGOs instead of channelling their funding directly to NGOs.

*[T13]: “I stopped writing proposals even under those organisations [larger organisations] ... I’ve wasted a lot of time ... writing a proposal here in Uganda is expensive. And when you write, put it there and then it does not pass through. Yet you lose the money. Why don’t I use that money and put it on the ground? ... I don’t know how to make it. I need to get somebody ... Then you put all that money and when it comes doesn’t pass through.”*

*[T20]: “Raising funds to sustain the organisation is very hard including now attracting staff who can stay and do the work.”*

*[T30]: “but now in Uganda we have a centralised pool which is Democratic Governance Facility ... All donors are in one basket. Because of basket funding now you can’t go individual, because we now have a pool the number have gone down ...*

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<sup>102</sup> See Chapter 1 Section 1.9.2.

*The basket is a donor management basket. They have a management unit which oversees that. It is put in place by the donors themselves.”*

#### **4.4.1.3. Restrictions on the use of donor funds**

In addition to the cumbersome application requirements, donor funds are usually restrictive and granted only for specific purposes, often also for a limited period. Given the impoverished contexts in which NGOs operate, donor dependence has even become more challenging.

*[T09]: “everything has to be strictly in pursuit of the project objectives.”*

*[T11]: “you can’t have a focal person just for fundraising because no donor will give you money to maintain the fundraising ... It’s mainly direct implementation.”*

*[T35]: “most of the funders don’t plan long-term funding. They plan short-term funding ... comes in for 1 year, 2 years, 3 years.”*

*[T27]: “That is the biggest problem. For an NGO if it does not get capacity building support.”*

*[T32]: “The project has ended. What next? You keep on pressure; how am I going to get money ... We wanted to build our own offices ... we don’t know where to get money because all the donors we have they can’t allow to build an office.”*

From the evidence it seems that in rare cases NGOs receive support from donors to build capacity. Thus, after implementation of projects, organisations are left with few resources. It is difficult for them to build assets, such as premises, to sustain the organisation after the period of the grant, or while waiting for new funds to be approved.

#### **4.4.1.4. Uncertainty of donor flows**

Funding from donors is uncertain, because there is no guarantee that it will continue. Donors may withdraw at times and they may simply reappear again. This uncertainty may stem from donor policies or priority changes.

*[T05]: “So as the fact that the cycles come to an end it means that you have to re-apply and because of uncertainty of re-applying even if you have been with the donor for some time is not a 100% guarantee you going to get a grant.”*

*[T03]: “The last 10 years have been very tough and we always worried because projects are for short time. You get your funding for 6 months, 1 year, 2 years, then*

*they are getting over, you have to get worried and terrified. I have been always worried.”*

#### **4.4.1.5. Close and tightly-knit donor community**

Participants generally felt that the international donor community was communicating among themselves, and influencing each other's decisions, more than in the past. Donors usually ask for references of current and past funders as a way to assess an NGO's work before granting funds.

*[T12]: “each donor that is given you money wants to know who has been given you money or who is currently giving you money ... and you know donors communicate.”*

*[T11]: “any donor will look for references. Who have you worked with before and the donor in community is also small community. Donors also speak.”*

*[T34]: “they [donors] usually have several meetings, so people usually actually are very close. The minute you have a bad reputation and one of the donors blacklist you is really likely that the rest of them will blacklist too. The reputation matters a lot.”*

*[T10]: “the paradigm is changing, there is more talk within the international community.”*

#### **4.4.1.6. High turnover of staff and low salaries**

Because of the difficulty of securing funding and the low contribution from donors to cover staff costs, most organisations are not able to retain staff. Therefore, when projects are phased out, the contracts of staff directly allocated to the project terminate and many of them leave. Usually NGOs negotiate with these staff to become part-time staff or even to work as volunteers until new projects are funded. However, from the experiences shared, NGOs (especially the small and local NGOs) are often unable to retain them.

*[T15]: “We had requested them to volunteer but nobody can work with an empty stomach.”*

*[T20]: “once staff salaries are not constant, staff are looking elsewhere for a job. So you have a high staff turnover.”*

*[T15]: “This is obvious you are paying somebody little money ... that is why people are running away.”*

[T20]: *“You find international NGOs getting a lot of money. They are paying their staff very well, but when it comes to local NGOs when you make a proposal they say ‘no we are not paying staff’, then you wonder how are they going to work without a salary.”*

[T31]: *“projects don’t normally contribute a hundred percent of the administration salaries. We have about three projects and each project is contributing maybe 10 percent of the salaries.”*

[T22]: *“some donors are not paying salaries.”*

Losing skilled staff affects the organisation in many ways and is particularly harmful for smaller organisations that see their capacity draining quickly.

[T31]: *“We had to let staff go which we had trained for many years.”*

[T18]: *“is like you can’t rest, even the staff you work with in the second year will be looking for jobs because they know the project is ending next year and when it ends they have no job. It puts a lot of stress around on the final year of the project.”*

[T20]: *“Without funds people lose morale, so the work is not so good ... is no longer motivated.”*

[T25]: *“If they [staff] get affected, even the organisation gets affected and also beneficiaries get affected.”*

[T03]: *“And if you reduce on their hours of work and the remaining staff gets overloaded.”*

In conclusion, the strict funding application procedure as well as restrictions on the use of funds together with the high degree of uncertainty of funding flows from international donors present enormous challenges for NGOs in a country such as Uganda, which relies heavily on foreign funding.

The next section focuses on the ways NGOs try to sustain themselves in this difficult funding context.

#### **4.4.2. How NGOs respond to the environment**

Contributions about responses and plans, or strategies for survival formed the second main category of themes extracted from the data. The ways in which organisations respond to different challenges were grouped into seven sub-categories:



- Strengthening donor applications;
- Repositioning strategically;
- Institutional reformation;
- Building reputation, partnering and networking;
- Building reserves and income-generating assets;
- Seeking additional income opportunities;
- Focus on efficiency; and
- Focus on retaining key staff.

#### **4.4.2.1. Strengthening donor applications**

The low income of communities and restrictions set by donors on the use of funds force NGOs to continue sourcing other funds to broaden their revenue base. A common practice among NGOs is to scan for additional donors on a continuous basis and to write proposals, as well as upgrading their techniques of applying for funds. Some NGOs have even created dedicated teams for proposal development and ensuring compliance.

*[T06]: “continue looking out for more donors to have a wider base of income.”*

*[T15]: “We prepare concepts, proposals written to different donors in a bid to solicit funding ... The organisation is really trying to tap from different donors left and right.”*

*[T09]: “It was one of the first organisations, if not the first in Uganda with a grant office. An office which just look for money, regularly, without the pressure.”*

*[T34]: “The main change was having a fundraising committee ... people who are actually in charge of fundraising on top of their other jobs.”*

#### **4.4.2.2. Repositioning strategically**

NGOs reposition themselves strategically in the international community environment and seek new mechanisms of funding. Some organisations have tried to widen their scope of operations by going beyond their core focus areas to cross-subsidise their main work with projects that are more easily fundable.

*[T12]: “come up with a shopping list with annual budgets ... We have through our interaction with different donors they are interested in this shopping list. They pick out one or two items to fund. You pick out what the donor is most interested in.”*

*[NGOs prepare a plan of resources needed to donors from which they can select items to contribute, based on the whole discussion with participant]*

*[T33]: “Because of the nature of the programme which we are doing is agriculture and the current situation of climate is changing ... we now have a second donor who is bringing money for climate-change interventions”*

*[T09]: “a lot of money in HIV but you have to look at other infectious diseases that may not have so much money now but can sustain if once they find the cure for HIV.”*

*[T29]: [NGO whose target beneficiaries are the elderly] “because we found that it was very difficult to get funds for the elderly, many people look at them as just finished ... so we decided to form another organisation ... working for the children because these elderly had children who are orphans, so at least we get individuals [donors] easily, sometimes at least more easily than getting for elderly ... [NGO] started in 2004 as a strategy to raise some support for the families.”*

*[T17]: “we had to look at our culture [NGO focus on culture] and see how it aligns with other issues that donors finance. How culture influences the spread and prevention of HIV/AIDs at the time.”<sup>103</sup>*

#### **4.4.2.3. Institutional reformation**

Other NGOs have undertaken institutional reforms, for example, by scaling down, by rebranding themselves, or by operating as subcontractors for larger NGOs to gain visibility and experience.

*[T08]: “We start to think about how could we make ourselves relevant and attractive to the donors. The fact what we did was downscale from about 6 districts to 1 district that was our strategy. We downscaled to attract the donors, to be focused so that the donors can say where you work you must have focus.”*

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<sup>103</sup> The two main causes of the spread of HIV/AIDS are sexual relations between young people and the culture practice of widow heritage. Thus, in order to control the spread of HIV/AIDS the NGO promoted abstinence until youths get married and, instead of having young people inherit the widow, the widow is taken by an older person who will be responsible for providing her with protection within the family and not having sexual relations.

[T08]: “we had to even look at the kind of business we were doing was not related to the name of the organisation. So we had to rebrand. We changed our name to focus on what we were supposed to do ... we were so wide so we changed our name.”

[T08]: “what we did was to look for an organisation who can't implement their own activities so we became activity-based organisation ... we started to become too small, the fact that we were implementing for other organisations and here the purpose was to ensure that we do it very well ... become credible and reliable... So we started working for others who had the funds.”

[T30]: “You try as much as possible to live within your means to engage strategically. We are also exploring how best to broaden our investments. To be realistic you have to cut your clothing according to what you have.”

#### **4.4.2.4. Building reputation, partnering and networking**

The evidence collected shows that NGOs are well aware of the need to build their reputations, not only in working with current donors, but also by satisfying beneficiaries and by networking and working with other important bodies such as the government.

[T33]: “This one donor that we have referred to since 2001 we are together. We can now discuss programmes, discussing budgets and says ‘no here I can manage, here I can't manage’. It is through the mutual understanding and the capacity that we are building together.”

[T08]: “because the project expired and it is not renewed ... but the people would always be very positive about you. This was one of our key strengths that when we lost funding we had a satisfied client ... they will talk good of us.”

[T11]: “So, uhm, your reputation is actually helped by you doing these things and other people talking for you.”

[T31]: “We've got a lot of support because of the good reputation we have had ... We have worked with Global Fund, with USAID fund all these websites and I'm sure they put us there, so the reputation is good. Our work is continuing protecting it, continuing to ensure that because it contributes directly to this fundraising.”

The other aspect brought out by the evidence is that several NGOs go the route of partnering with other NGOs. This not only helped with strengthening the submission of applications,

which was listed as a donor requirement earlier, but also helped to strengthen the capacity to deliver services.

[T12] *“We have found out that we are much stronger in applying for funds as a consortium and not as an individual NGO ... It also helps us build network and expertise and on how to handle money but also big coverage in terms of service provision. We can always support each other here and there.”*

[T22]: *“we plan for our networking because in case I am not there to do ... Then you are able to do what I would do; in case you have the money I don't have the money at this time, then you are able. They call it sustainable networking.”*

[T27]: *“By joining networks and working with others. It's very easier to get funding when you work with others and when you look around ... The project has more visibility and they can even replicate it. Working with others allows them to replicate when the organisation is not able to continue.”*

#### **4.4.2.5. Building reserves and income-generating assets**

Another strategy adopted by NGOs for dealing with the uncertainty of funding is to build reserves, particularly acquiring physical assets such as premises. NGOs need such assets for implementing their projects, but these also help in different ways to sustain them in difficult times.

[T09]: *“We really want to invest significantly so that we can increase our budget in the long run if you don't get donor money. Where are you going to get the money to run? In terms of future funding that should be a real priority. If we have the income, we would invest it in treasury bills and so on.”*

[T14]: *“[by building reserves and savings] you're able to be sustainable in financial challenges, growing ourselves by taking other income avenues, sometimes liquidity, selling assets you don't need.”*

[T22]: *“We have learnt to save. Everything that we do we try to save for the harder times. For example, even if we are implementing activities we try as much as possible to save money from those activities to be able to invest.”*

This strategy also helps to fulfil donor requirements of matching funding.

[T08]: *“Another contribution we say ‘we contribute with offices’ ... or we have several motorcycles, we are contributing transport. So it is easier for us to contribute, so once you have several resources then you can contribute. That one also brings on board more donors.”*

Participants expressed a particular desire to acquire land and build infrastructure, such as offices, training centres and schools, because these not only help NGOs to save on the cost of renting, but premises can also supplement income through, for instance, renting out space.

[T21]: *“We were not here if we don’t have an office ... That one is a must.”*

[T03]: *“That is a very important thing for an organisation. This land here is ours even that building, even though is not completed. Right now paying rent in Uganda either for individuals or organisations is very difficult. If you don’t have a stable funding, you keep on shifting and moving from bad places. So ya very unstable. One way of keeping organisation to grow is to own premises.”*

[T15]: *“[NGOs] with their own premises] they are raising a lot of money from those buildings when things get tough, they get their rent.”*

[T18]: *“I’ve seen our friends who have their own premises they are better off. They survive better than us. They have that kind of income coming in.”*

#### **4.4.2.6. Seeking additional income opportunities**

The problem of uncertainty of donor funding together with the restrictions imposed by donors makes organisations financially vulnerable, particularly during times when organisations are waiting for further funding. The lack of available reserves makes it hard for organisations to sustain themselves. Against this background, practitioners reported that they attempt to save out of donor funding and put more effort into other income-generating activities and community contributions.

[T09]: *“What continue help us to diversify is not necessarily from the funders that we are seeking money from, but from the activities side.”*

[T28]: *“We have ECD centres. The ECD centre they enrol these young, babies and children and they contribute some little money. Just very little to help run the schools.”*<sup>104</sup>

[T03]: *“if you have a car ... you can charge miles to the new donor or to the new project ... [donors] have to contribute with fuel and then some little money for maintenance ... and it helps you to maintain the car. ... We negotiate with the donor we tell them please provides with miles for our car.”*

[T15]: *“They hired us to develop a training module for how best their counsellors can counsel people on telephone.”*

[T12] *“The catering classes hire out to go and give services on weddings and also do some baking on internal workshops.”*

[T21]: *“most schools don’t have computers so they want to set exams for the end of term so they come and write, and we give someone to type for them and produce for them and make copies. They are charged for that.”*

[T23]: *“we also raise money through these projects like this medical facility. As people are getting treatment, receiving access in the health services, they are also bringing in some little money. The health service charges a fee. They are not free. That is how we are able to raise income.”*

#### **4.4.2.7. Focus on efficiency**

In most cases the uncertainty of donor funding and difficulty in generating sufficient local funding led practitioners to look at the efficiency of their operations. Efficiency was enhanced by organisations using available funding wisely and, in terms of programmes, by ensuring their sustainability. It was very interesting to note how practitioners were pressed to make positive changes. They started planning and thinking strategically in order to ensure the sustainability and continuation of their activities and the survival of the organisation.

[T31]: *“we’ve now done, we reorganised, we are restructuring to fit within the changing environment. I’ve used my experience and interactions that I’ve had and lessons that I’ve learnt to now reinvent the organisation and say ‘this is what we*

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<sup>104</sup> ECD refers to Early Childhood Development projects.

*want'. We have to work with a strategy and list a proper strategy so we are not everywhere, we have these objectives and we've these strategies. We also have fundraising strategies which was also not in place; we are trying to put in place. Two, we are looking at programmes ... We don't want to do a project that is not sustainable."*

From the institutional perspective, practitioners have started making adjustments to administrative costs and by using their resources, including human resources, more effectively. For example, some NGOs use government facilities to implement projects such as training, and staff are used in more roles.

*[T16]: "We had more staff than this but we had to lay-off some in order to fit the money we have ... Actually the slogan is 'more for less'. More people you have to add people but at a less of whatever amount of money ... We try to use the resources diligently."*

*[T16]: "For example we have people who are entering data ... the doctors knew how to enter their own data in the system, you may do it without a data keeper and then you just remain with a data manager who can make reports. Having multi-task staff ... The nurses can also act as counsellors. We don't have counsellors fully. If you can train the nurses to both to do counselling. The drivers can also do counselling, they don't have to sit always in the cars. For example, if you go out to in outreaches, you can have the driver also counselling."*

Some practitioners have redesigned their projects to provide them with a greater degree of self-financing to build sustainability. For instance, NGOs provide short-term vocational training when donors fund for shorter periods. This training provides skills that can help children or youths generate income to sustain themselves and their families after a year.

*[T23]: "We thought to reduce on some of the programme. Some we decided to merge them such that they are under one supervisor ... So we go for one activity at a go so that we are able to track the results and the impact. Few activities, efficient and creating impact."*

[T02]: “We form VSL<sup>105</sup> groups and train CBT [community-based trainers] ... they link their groups to us ... In the end they become qualified at no cost, which guarantee the sustainability of the project.”

[T15]: “The volunteers create a lot of sustainability ... This mechanism of using the communities’ persons to disseminate information or any other resources are very significant. It creates a lot of financial sustainability.”

[T17]: “needs to identify more activities that they can do in the community with less funding ... if the community appreciates that they need to preserve the heritage, they can identify a space within the community, they can offer land within the community and so put up a structure and call it our community museum. They’ll collect items for the museum within the community. Like community contributions.”

[T33]: “this project is ... self-sustained because it involves selling the solar systems to the communities ... demand that has been generated from the sells will create an evolvment fund [after the project ends].”

[T33]: “we [NGO] give you a goat, you take care of the goat, after kidding, you pass the first kid to your friend, to a neighbour in the group. So those goats also kept moving in the groups up to all people have and we having over like 700 goats in the community.”

[T14]: “when we place livestock [with a beneficiary], then they ... pass on the first-born to your group member, then the last person to receive it in the group, passes on to [NGO] [give it back]. So meaning, we have livestock, so we can sell that as a source of income. When we are cost sharing, we can use that as our contribution ... advertise that, that is in fact our biggest source of income.”

#### **4.4.2.8. Focus on retaining key staff**

By widening their funding providers and by interlinking projects, it is also possible for NGOs to secure their staff, especially for NGOs that do not have many financial resources. With this

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<sup>105</sup> VSL is the term used for village savings and loans group. These are community-based groups whose main purpose is to provide access to financial services such as small amounts of local capital to poor people.



strategy, they attempt to avoid losing knowledgeable and experienced staff when projects end, and so save the cost and time of recruiting and training new staff.

*[T17]: “the organisation has tried to do is to manage the staff in such a way they are not tied to a specific programme ... So what the organisation does is collect support or contributions to personnel costs from the different projects into a pool and then from that pool is where staff are paid for ... at least we keep the staff so we have not had a situation where we had to lay off staff.”*

*[T15]: “We are lucky because some of the staff is attached to some other projects ... So we managed to maintain them.”*

*[T08]: “ensure that one staff had to do more than one programme, one activity so that you are maximising skills.”*

#### **4.4.3. Moderating influences**

Ultimately, the NGO community in a country is about delivery of services to people in need. In the previous sections the focus was on how the context within which NGOs operate demands different responses in order to survive and be sustainable. However, the sector is ultimately about how much of the capacity of NGOs is channelled towards effective delivery to beneficiaries as opposed to their own survival activities. In other words, the issue is the efficiency of the system within which NGOs operate. Other influences were picked up that seem to play a further role in moderating the different factors in the system and the extent to which NGOs can channel their capacity and efforts to render effective service to beneficiaries.

##### **4.4.3.1. Government’s role**

Firstly, the government can influence indirectly, or even directly, the flow of donor money to NGOs and consequently the success of NGOs as it governs the regulatory environment in the country,<sup>106</sup> provides established structures and certainly influences the willingness of the donor community to channel development funding to the country.

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<sup>106</sup> To operate in the country organisations need permission from government and give an account of their activities to it (see Chapter 1 Section 1.10.3).

[T34] *“That time was a bit worrying because many donors were pulling out ... It came up when our government said anti-homosexuality. Then of course that human rights organisation weren't happy about it, and some governments.”*

[T03]: *“And also sometimes the conditions at home. If I told that the government has political and democratic issues, it can lead donors to turn away ... and sometimes donor priorities change, they may leave Uganda to go to Congo and therefore the NGOs suffer.”*

Participants seemed to attempt to work with government for sustainability purposes.

[T14]: *“as an NGO you cannot work outside the government, before you enter into an area of operation then you need to seek government's approval. So in a way you cannot operate without government's support. If you're going to operate within a district, you need to get the district officials' support and give us a go-ahead in terms of implementing.”*

[T08]: *“without work through government establishment systems and structures that one help us to ensure sustainability and cost effectiveness. For instance, if I am going to work with schools, I don't need to go and establish a new system when I know that the whole infrastructure is in position.”*

[T18]: *“we work with government staff, because then they will continue to interact with the same farmers and offering the same advice. It's very rare we do things on our own.”*

#### **4.4.3.2. Board's role**

Secondly, an active and experienced board can positively contribute to fundraising efforts through their networks and reputation and, for the effectiveness of NGO activities, through their financial status and knowledge.

[T11]: *“board members have networks ... they will move with us to some donors, they will know some donors that say oh, you will need to contact these donors, they will know something about what is happening.”*

[T21]: *“The Chairperson is also a leader in the church ... For mobilising community contribution because they know her ... So they think that the children will be well protected ... That is what should be the role of the Board to raise funds; to create a good image among the public; to speak for the organisation.”*

[T08]: *“They can be able to advocate, including resources, does not only mean finance but also networking”*

[T17]: *“their [board members] reputation earns the organisation quality profit value, so value addition to the organisation, their presence in the organisation as added value in terms of reputation because they are known people.”*

[T09]: *“a certain skills set we want on the board which that person because of the international status will bring to the board ... one of our most really influential board members right now is Dutch. He was working for McKinsey ... So he brings a certain level ... the standards he had set for us in terms of reporting, in terms of certain analytics it’s nowhere amongst our peers.”*

However, in many cases they seemed not to be so active and committed in Uganda.

[T23]: *“The Board has not been so much effective as far as fundraising is concerned and they are not readily available. They are busy people.”*

[T13]: *“ you make an organisation here in Uganda especially an NGO they [board members] think that ... you are going to get sponsors from America ... They are going to bring in money ... so some members come with those kind of thinking. When ... they’ve not seen those kind of things, some start pulling out slowly.”*

#### **4.4.3.3. NGO leadership**

Thirdly, the leadership character and mindset represented by the executive of the NGO determine the kinds of strategies that are implemented and how programmes are designed to be sustainable. Throughout the sample one could see how qualities of innovativeness, tenacity, commitment to the values underlying the NGO services kept certain NGOs going, while others seemed more desperate and were hardly surviving. For instance, one executive director of an NGO had the vision to request a donor to provide the budgeted amount for rent in the beginning of the project to acquire land to save future costs of renting.

[T09]: *“Having business sense. Saying ‘this is not good for us even if is a lot of money’. Having some analytical skills to see. Move away from the programme. Programme will do wonderful things in one way or another... So it will go and give people food, will give people drugs. But you, who is doing it, what are you getting out of it and how is it helping you to develop as an institution ... Foreseeing how do you*

*sustain yourself on a regular basis ... but ultimately we don't want to do good and sink."*

*[T33]: "We [NGO] have realised the need of sustaining the activities if donor funding ceases. As an organisation we started a business arm ... The products that they [beneficiaries] are getting from their farms, especially maize, are being marketed through the company and the organisation is getting some commission, profit from the sell. It's a shareholding company where the farmers have shares and the organisation has shares ... if the donor funds cease for the organisation, the farmers will have gained the knowledge on how best they can produce quality maize and they will continue supplying the company to go to the markets. And the company still gets dividends that will sustain the organisation."*

*[T16]: "We have been trying. We have been thinking and we have failed. The only thing I think of is writing more proposals."*

#### **4.4.3.4. Flexibility and involvement of donors**

And, fourthly, the donor approach in grant-making decisions and the level of their involvement in building institutional capacity of organisations can not only ensure that money is efficiently spent, but can also enhance the quality of services delivered. Thus, the flexibility of donors in showing interest in improving the capacity of NGOs may play quite a substantial role in the effectiveness of the sector. The sample showed that very few organisations received institutional support from donors, although there is reason to believe that the ones that did receive support performed better and were able to strengthen their capacity.

*[T08]: "[donors] now wanted to come and evaluate – due diligence where they found that we were a very weak organisation because we didn't have systems in place."*

*[T32]: "Some donors have changed strategy, they don't put call for proposals but they come to the districts and say 'can you give us a good partner here to work with?' ... around 3 grants through that process ... The donors come to our office and assess us. They find you some needs, some weaknesses that you have. They will tell you: before we can give you money, can you fill those needs. For example, they may find your policies are outdated or your accounting system is somehow weak ... So they will tell you first do that, after doing that, we can talk. Because they fear, we don't want*

*any risk use their money. So they want their money to be in safe hands. They will make sure that you can perform.”*

*[T09]: “The money [from donors] helped us to do the first construction, set up the clinic.”*

*[T20]: “they gave us funds not restricted and it empowered this organisation to the level that it is still alive when most of the organisations have died.”*

*[T17]: “they offered to give us administrative support ... And it was really good money.”*

*[T28]: “[The umbrella organisation] that comprises of four communities ... They are independent but they just federate ... [Donor] said: let’s have an umbrella .... Then, [donors] posted their managers to [NGO], one programme manager and the finance and sponsorship. Their staff are sitting here. So it’s an extension.”*

#### **4.4.4. The influence of NGO international affiliations and size**

Besides the moderating influences encountered in the data, international connections of NGOs and size were observed as further relevant factors that change the dynamics of the system. NGOs with international contacts seem to be in a better position to apply for funding, they experience lower financial vulnerability, and they manage their financial problems relatively better than local NGOs. For example, one advantage is the possibility of getting international volunteers to assist. These people, in turn, market the organisation abroad and are also sometimes able to go back and mobilise financial as well as non-financial resources for the organisation.

*[T17]: “it didn’t take so long [to get funding] because one taking the advantage of the fact that [co-founder and programme advisor who is a well-known international consultant] had worked in other organisations. They were able to sell the subject to local organisations”*

*[T22]: “We are working with an organisation ... in German and they are sending us volunteers for one year. Professionals they come and work with us for one year. We don’t pay them but then they pay them...They mobilise resources and we are able to come out with projects.”*

*[T12]: “we receive quite a number of international interns. They witness what is happening. They mobilise money. They talk to their friends even when they are here*

*... and when she goes back she contacts family ... Others just come and visit their daughters or sons while they are internship ... and all of a sudden they say 'well I think we are going to support them'.*"

Another form of international connection is through intra-organisational networks – with international NGOs (INGOs). These INGOs, who are based overseas, support Ugandan NGOs to gather funds in two ways: applying for funds internationally on their behalf, and providing support to their local partner NGOs in terms of professionalisation, experience, lobbying with donors in their home country, and serving as a reference when applying for funding.

*[T14]: "Depending where the call is coming from. If there's a call in UK, [UK NGO] can apply, implementation will then done in Uganda but funding will be going through UK to Uganda. If is a local call (like the government) it will be done through [NGO] in Uganda."*

*[T14]: "I think we are better [position than local NGOs] in the sense that we are very fast. If the call is coming from the UK we have better chances to apply from there than through us, if the call is local, we have more chances of applying than through the UK. So in a way if you limit yourself to being local then you lose a lot on those international calls. And yet, you can be both, apply locally or you apply from UK."*

*[T14]: "Here we apply as [NGO] Uganda, but we can get assistance from UK. It puts the organization in a better position, because you can get support from UK. They have experience. If you don't have skills here you can go to UK to support my proposal."*

*[T18]: "When we started the fundraising was internationally done at [mother international organisation]. All the fundraising was been done in Washington ... we didn't have very many such big problems. Then when the whole thing was localised to national level you have a situation where you cannot access funds unless there is a call."<sup>107</sup>*

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<sup>107</sup> A few NGOs in the sample started as INGOs but later transformed into local NGOs because of finance advantage in access to local and government funding, and tax exemptions. Another reason for INGOs to become

The international partners also contribute to the financial stability of NGOs. For example, in the case of a delay in payments from donors, the INGO is able to bridge the gap of their local partner and therefore ensures the continuation of programmes.

*[T26]: “This is a German subcontractor NGO ... No I am not worried [about finances] because I’m sure it’s there.”*

*[T14]: “They [mother and international NGO] do, when we run low on our budget, when we short in balance they always come ... they would advance our money [when there is a delay in payment]. They always come when there is a financial challenge”*

Eventually, the NGOs without these international connections seek for such connections as a possible strategy to improve their financial stability.

*[T12]: “We are also considering to have international embassers for the organisation that would be also part of board members.”*

Similarly, based on practitioners’ statements, larger NGOs are in a better position to have their funding approved because of their greater visibility and reputation. Moreover, larger NGOs are also more capable of dealing with different challenges as they have more capacity and also better developed processes and policies than smaller NGOs. The smaller NGOs appeared to be struggling more to survive.

*[T19]: “They [donors] want to see organisations that are famous, which have big branches, which have directors who go out in conferences ... and those people at the grassroots ... They are under looked.”*

*[T30]: “they [donors] want to listen people who have records, have experience, knowledgeable, who have something to offer.”*

*[T13]: “Especially people who work in big organisations don’t understand. They don’t take us serious who have these small organisations. Yet we are the people on the ground.”*

*[T11]: “Of course the big organisation ... donors go to them. They don’t go to donors. Donors go to them for them to implement.”*

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national organisations is to circumvent disclosure of information regarding income and budgets for programmes required to access local funding from government (see Section 1.9.3)

[T09]: “And we [big NGO] always went for the best. The best system, the best setting up even before we grew the volume to an extent to build all that systems, they were there because we had the money.”

[T09]: “You get a certain level of clout when you reach a certain size and value. Because you can afford to be audited by the best in the world and standards, global standards. You can afford to do, have a lot of controls, which small organisations might not be able to afford.”

[T32]: “Because when you see most donors now, they are not investing in small organisations. You find donors giving money to national organisations ... They don’t come here. But we who are here we keep on struggling.”

[T09]: “For us as [NGO] cash flow is not such a big problem but for some small organisation even cash flow is a problem.”

[T19]: “these donors need to be educated. They should look out to those small organisations at the bottom there. Because those people at the bottom they have passion ... We have not so big expenditures, so I think donors should come down and look at this people at the grassroots. In fact the project we brought is because of that. That donor said instead of funding big and established organisations with branches and so on, wanted to look at the small CBOs on the ground. That how we got that opportunity, otherwise, we wouldn’t.”

## **4.5. DISCUSSION**

### **4.5.1. Discussion in light of the literature**

This section interprets the research findings in the light of the literature and explains any new insight into the way NGOs operate and respond to financial challenges.

#### ***Continuous tension between survival and service delivery***

In line with Wallace et al. (2006), this study found that there is a mismatch between the donors’ expectations of the capacity of NGOs to deliver services and the country context in which these NGOs operate. This study provides evidence and a better understanding of how the funding conditions affect the way Ugandan NGOs work on the ground. In order to satisfy donors, NGOs appear to be under constant pressure. While they are striving to remain committed to the delivery of their services, NGOs are putting in much effort just to survive.



For example, an uncertainty of funding in the poor resource environment of a developing country constrains the ability of an NGO to retain staff and continue implementing projects while it is unable to generate sufficient local revenues.

### ***Richer evidence about the effect of stricter donor requirements in a donor-dependent context***

As Barr, Fafchamps and Owens (2005) found, NGOs in Uganda are highly dependent on donor funding. Another finding consistent with the literature (Easterly, 2002; Trussel & Parsons, 2007; Ashley & Fauk, 2010; Elbers & Arts, 2011) is the negative impact of donor requirements on NGO operations. For example, NGOs often use their resources to comply with the growing number of policies and procedures instead of using those resources in programmes. This is particularly severe for small and young organisations with low capacity and fewer resources. A paradoxical situation exists whereby extensive procedural requirements are imposed by donors, such as comprehensive proposals and progress reports, while they are unwilling to pay for staff and administrative capacity to fulfil those requirements. Even in countries like Uganda with a young and qualified population, small organisations have difficulties in attracting and retaining skilled staff because of the low salaries that NGOs can afford. This is of special concern as it overburdens existing staff with paperwork instead of letting them focus on programmes.

### ***High staff turnover as a major capacity constraint***

Although literature on the impact of donor restrictions is vast, research on the human resources situation has not yet gained prominence. Elbers and Arts (2011) in a qualitative research in India and Ghana showed the adverse consequences of funding conditions and unwillingness to fund overhead costs, especially to retain staff, while NGOs are struggling to fulfil donor requirements and deliver services efficiently. The responses from participant NGOs in this study illustrate the same reality and existence of high staff turnover in Uganda. This study expands Elber and Arts's (2011) study by providing NGOs' strategic responses to those conditions. In an effort to overcome the staff problem, some Ugandan NGOs try to retain staff by interlinking projects and allocating staff time among different funding sources.

### ***Better justification for commercial activities to supplement donor funds***

The way NGOs in Uganda generate internal resources to ensure an organisation's sustainability by allocating resources to sustain their mission is consistent with the view of Svidroňová and Vaceková (2012), Bowman, Keating and Hager (2007) and Calabrese (2012).

However, certain authors argue that, based on research in developed countries, commercial activities remove the real focus of the NGO's work (e.g. Ebrahim, Battilana & Mair, 2014; Mersland & Strøm, 2010). This study has shown that most Ugandan NGOs, regardless of size, have alternative sources of revenue. Because of the uncertainty and restricted nature of donor funding, other sources of finance and even commercial activities should be seen as crucial for survival and effective implementation of programmes, and not as a way just to accumulate profits that deflect from their core missions.

The study provides detailed examples of alternative ways of mobilising financial resources. These could take many forms, from simple ones such as renting out premises and vehicles, to establishing more complex business arms. Moreover, the need to generate additional revenue has also led organisations to change their programme approach by stopping the traditional 'handouts' (i.e. providing goods or services for free) that could create dependence on the NGO, and requiring community contributions where beneficiaries pay a small price for the services provided. From the development point of view, this turns out to be more efficient as it shows commitment from beneficiaries, while ensuring project sustainability by empowering the communities.

### ***Practical examples of adaptation strategies to survive in funding environment***

The contextual realities and funding mechanisms pointed out earlier – such as the matching funding principle, applications in partnership, and a close donor community that relies on referrals and endorsements – pose significant challenges for small and young NGOs. Several examples of rescue strategies, and even restructuring, were found as ways to survive in this challenging environment. A particularly interesting finding, which is counter-intuitive when compared with the for-profit sector, was that downscaling seemed to be a viable, even positive, option for revitalisation by NGOs. Other examples include opting to work as subcontractors for larger NGOs, which is seen as an opportunity to gain experience, visibility and partners. This is a practical evidence of Malunga's (2009, p. 73) lessons to improve leadership of NGOs. Self-assessment by NGO managers and willingness to learn from others are important elements to gain recognition, achieve organisational stability and improve the work of organisations.

In line with O'Brien and Evans (2017) some participating NGOs emphasised working with others to fulfill the mission of the organisation unlike those that were aiming only at survival. However, several authors are concerned that such strategies (i.e. organisational

transformation) and adaptation to donor conditions may lead to losing some of the NGOs' identity and autonomy (AbouAssi, 2013; Wallace et al., 2006, p. 143). Even though that is a possible consequence of such strategies, participant NGOs showed more concern regarding 'staff migration' to larger and better resourced organisations. This is a reality, especially for the small and local NGOs, and is a common phenomenon in developing countries as observed by Fowler (2016).

Contra the study of Wallace et al. (2006) NGOs try to align their work to match the available funding or to accommodate a shift in donor interests without necessarily compromising their mission and identity. From the examples studied, NGOs integrate their development and social objectives with newer opportunities emerging from changing donor interests. One can say that organisations were able not only to create synergies among projects, but also to cross-subsidise projects in their efforts to attract funding. An example verified in the research was an environmental project that pays for itself. Solar panels are sold for a small price to beneficiaries that are also involved in an agriculture project. The NGO gets money from the sales, which subsidises both projects, especially for administrative expenditures (e.g. office costs). This model of selling solar panels has been shown to be significantly more effective than simply giving them away. Beneficiaries from agricultural projects attend to agriculture training to receive or to access a subsidised solar panel. In addition, everyone who buys solar panels uses them, whereas it is not guaranteed that beneficiaries who receive them for free will use them.

### ***Partnerships towards sustainability***

The success of NGOs in surviving and making progress is not solely a function of the organisation and its strategies. This is reflected by practitioners' work toward partnerships with government and other organisations. Consistent with Wallace et al. (2006, p. 140) Ugandan NGOs are willing to work for others to ensure financial and operational sustainability even though sometimes it comes at the cost of losing some autonomy and identity (as noted in the previous heading).

### ***The weight of the government influence in NGOs' operations***

Generally, NGOs cultivate good relationships with government agencies in order to obtain permission to operate and implement projects as well as to get support in the form of infrastructure they can use, rather than financial contributions. This study makes a contribution to the discussion of regulation in the NGO sector and the creation of an enabling

environment for NGOs to operate in. A more detailed understanding of the impact of such conditions (e.g. the legal framework) on the functioning of NGOs and their capacity to implement projects, emerged from the research.

### *A different approach from donors*

Unlike typical studies about donor restrictions (e.g. Trussel & Parsons, 2007; Ashley & Faulk, 2010; Elbers & Arts 2011), this study showed that some donors are interested in helping organisations to build capacity. Donors of Ugandan NGOs come on the ground in order to i) assess the capacity of their recipient NGOs to effectively deliver services before even granting funds; and ii) to work closely with its grassroots to enhance impact and outcomes.<sup>108</sup> Wallace et al. (2006, p. 124-125) presented a similar Ugandan case study on how donors recognise and address organisational weaknesses by providing training to recipient NGOs. This study provided additional evidence of undergoing donor approaches and demonstrated the potential of such trends in improving the work of organisations.

### *Unexploited potential of boards*

The potential benefits of active boards, as highlighted by Coombes et al. (2011) and Jaskyte (2015), are pointed out as not fully used by Costa et al. (2012) and Steen-Johnsen et al. (2011). This study provides further evidence of this finding. In cases of strong and active boards, boards are reported as having a positive influence in overcoming negative financial setbacks, whereas some struggling NGOs felt that their board members were not only absent but also sometimes in there for their own benefit.

This study also contributes to the current literature by adding practical evidence of the way external context shapes the form of NGOs' governance as reflected by institutional reforms conducted by some participant NGOs. One is the creation of fundraising committees to specifically focus on fund raising activities and reporting to donors. Another finding, in line with the definition of governance of Duncan and Schoor (2015), was the way some NGOs seek to recruit potential board members, especially foreign individuals. Based on participants

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<sup>108</sup> The importance of being close to grassroots is also depicted in the recent decision of Oxfam International (INGO) to move its headquarters to Kenya. Available from: <https://blogs.oxfam.org/en/blogs/16-07-22-oxfam-international-signs-historic-deal-move-nairobi-kenya>.

interviewed these foreigners improve organisation's communication and are effective facilitators of international contributions.

### ***A more elaborate concept of development of capacity***

Notwithstanding the importance of building capacity to improve financial stability and organisational sustainability highlighted in the literature (Bowman, Keating & Hager, 2007; Chikoto & Neely, 2013) this study supports a wider concept of capacity development. The concept of capacity development includes the links between NGOs and multiple actors such as governments and other organisations. In some respects, the development of capacity ties with the efforts towards partnerships (O'Brien & Evans, 2017). This study shows that Ugandan NGOs embark on these initiatives by forming effective partnerships and connect themselves with government institutions and other partner NGOs in order to secure the continuation of their projects and to survive. Nevertheless, the study shows a significant gap between NGOs and the private sector, from which there is a low level of involvement in development processes.

### ***The way NGO size and international affiliations change the dynamics of the system***

The study is in line with the literature on the comparative advantage of foreign NGOs to access to international funding and experience lower financial vulnerability compared to local NGOs (Fowler, 2016). The study analysed the extent to which international connections increase resource mobilisation, and enhance financial stability and organisational sustainability. The contribution of this study to the topic lies in the fact that international NGOs are locally registered, and not identifiable as international in the commonly reported data. It was only through interviews that these international links could be ascertained.

Finally, according to the literature (Ruben & Schulpen, 2009; Burger & Owens, 2013), larger NGOs usually have higher capacity and more visibility and, hence, are more likely to receive donor funding. This is partly because donors' assessments of potential recipient NGOs are often based on office evidence rather than on services delivered. Donors rarely show an interest in conducting field visits, especially when programme interventions are not easily accessed. Therefore, it is especially difficult for small NGOs to get access or proximity to donors to attract funding.

Smaller NGOs have to deal with a type of vicious circle in that they have difficulty hiring quality staff and have fewer resources to document their experiences to promote the organisation; they typically would put forward relatively lower-quality proposals. In a

competitive market for funding, they would likely be unsuccessful with funding applications, and remain in a situation of having a financial capacity that is too weak to implement projects and build systems.

#### **4.5.2. Discussion in light of the previous findings**

This study contributes to a better understanding of previous findings of NGOs financial vulnerability. In Chapter 2, which explored the internal factors affecting financial vulnerability, revenue diversification was found to be negatively associated with financial vulnerability. Ugandan NGOs with different revenue sources experience less variation in revenue as they are less likely to be affected by a financial shock or termination of donor funding from several sources at the same time. In addition, organisations that rely mostly on donor funding have their revenue sources less diversified, therefore, they are more likely to be financially vulnerable. This chapter provided further evidence that donor-funded NGOs with more concentrated funding experience higher variation in their revenues than community-funded NGOs. Donor funding is usually bigger than community funding, however, it is less reliable and predictable. When the contracts terminate, funding cuts have a higher impact on NGO revenues and their financial conditions. The second variable that was found to be negatively related to financial vulnerability was the possession of assets. NGOs with assets such as equipment, vehicles and premises are in better position to manage financial current and future financial shocks and maintain their operations. This chapter not only confirmed these results but also showed that these assets improve financial sustainability of NGOs. The availability of assets allows NGOs to not only save costs (e.g. rent costs) but also to generate additional revenue in order to supplement other sources of revenue.

In Chapter 3 the conditions that were likely to assist NGOs to manage financial vulnerability and the impact of such problems on the operations of NGOs were investigated. It was found that the experience of the CEO helps to manage financial distress. In this chapter details about the way in which leadership experience and skill of the CEO made a difference in times of financial problems were shown. Several practical examples emerged from the data to explain how skillful leaders went about to change or realign strategies, or to downscale when necessary to ensure the continuation of programmes and the organisation; and how business-minded leaders had been pro-active in investing in assets and in developing other income-generating activities. The other conditions tested in Chapter 3 and which was seen as potentially important for mitigating the impact of a significant decrease in revenue in

programmes, were the donor flexibility and the availability of unrestricted revenue. This chapter offered important examples of donor contributions to build capacity (e.g. build premises) and new approaches of assessing organisations towards improvement of their capacity to effectively deliver services. The importance of unrestricted revenue sources to supplement the contribution from donors was well demonstrated by the findings of this study. Examples included the use of assets as income generating mechanisms and the selling of products and services.

Moreover, as acknowledged by Prentice (2016) these factors do not capture all dimensions that affect the financial position of NGOs as they are influenced by other external factors. This chapter extended the analysis of the determinants of financial vulnerability by identifying other environmental factors such as the nature of funding flows, the type of funding sources and other moderating influences that also affect the financial position of NGOs.

Based on the above research findings and discussions, certain recommendations can be made. These are presented in the next section.

#### **4.6. RECOMMENDATIONS**

In view of the above realities, the following recommendations can be made to the three main stakeholders groups, namely NGOs, donors and the Ugandan government.

The first recommendations are directed to **NGOs**. NGOs should consider alternative ways to sustain themselves, either by generating alternative sources of income and/or by becoming more efficient in the use of the available resources. In fact, NGOs should remember that they are not the final consumers of donor funding and the donor is not responsible for fully funding their core costs. This idea is shared by Fowler (2016, p. 570) who stated that NGOs have “a large share of co-responsibility for funding themselves”. A strategy to deal with uncertainty and dependency on donor funding that is not being adequately tackled by Ugandan NGOs, is to provide services to the private sector and link their projects to the market. The study found that NGOs seldom mentioned the participation or involvement of the private sector in the NGO sector, while it has the potential to be an important source of resources and also to enhance the impact of NGOs’ programmes. This situation may be a result of little attention that NGOs pay to private sector compared to other actors such as government and international donors. This research challenged NGOs to think in new ways

about how they can attract and engage the private sector in their operations, whether as a source of revenue or as development partners.

An example of improving efficiency is to ask for a community contribution, e.g. in-kind contributions (such as labour) to the project. In this way, the organisation is able to ensure continuity of the work and decrease the reliance on donor funding.

Equally important for the design of sustainable strategies is the leadership of the NGOs that should be able to do a proper risk assessment of their environment, to take advantage of opportunities and cope effectively with challenges. When we looked at the role of leaders on decision-making process and their ability to anticipate and handle changes, it was clear that having a strategic thinking and ‘business mindset’ helped NGOs to manage financial distress. Thus, it is recommended that NGOs consider appointing managers with specific attributes and competences to run the organisation. Yet it is critical that board executives remain aligned with the social mission of the NGO. Additionally, board members can also potential fulfil a strong role as linkages to funding as well as enhancing the credibility of NGO. As so, the research suggests that NGOs pay more attention to the constitution and the composition of the board.

The second set of recommendations is directed to **donors**. The study showed new trends of donors for assessing the capacity of NGOs and investing in their capacity to deliver services by coming down to the ground and asking for references locally. Evidence showed that such trends improved the ability of the organisations to deliver services, as well as building up trust and ensuring alignment in terms of project objectives between donors and recipient NGOs. If the donor is involved and allows an open dialogue with implementing NGOs, it is more likely that projects will be suitable for their context and meet the real needs of target communities. The other advantage of working together, especially in the initial phase, is to create the grounds for the projects to be sustainable and have impact. As a result of gaining trust in the partner NGO, donors will likely reduce the number of restrictions (and costs of monitoring and supervision), in turn allowing NGOs to focus on programme delivery rather than on complying with donors’ requirements. Thus it is recommended that donors continue to support building NGOs capacity and strengthening their relationships. Given the importance of NGO leadership, one recommended way of building NGO capacity is providing training to NGO executives and project managers to enhance their capacities such as management skills, strategic planning and management of human resources.



Another finding highlighted in this study was the value of having unrestricted funds to reduce financial vulnerability and build capacity, especially, when organisations wait to renew their funding or have new funds approved. A possible action that donors might consider is to include a special fund drawn from the total amount approved that should be retained until completion of the project and after final evaluation. This fund is meant to be a reserve for capital investment, which includes an underlying investment plan. This will not only empower NGOs by giving them the resources (financial or physical assets) to use at their discretion, after good completion of projects but it will also create an incentive to implement projects well.

The last recommended actions are directed to the **government**, which should consider creating a more conducive environment to NGOs and donors to work together. This study noted how government is a critical factor in the system within which Ugandan NGOs operate. First, as the oversight and monitoring body of the work of NGOs, it should integrate efficient NGOs into programmes to be undertaken where they are most needed and provide structures to improve and maximise the provision of services. This can be reached directly through the relationship with NGO networks that can support in the development of national strategic plans. In an indirect way the government should consider the reduction of bureaucracies in order to attract international development funds and create space for effective negotiations between donors and NGOs.

#### **4.7. CONTRIBUTION OF THIS STUDY**

This study has offered detailed analysis rooted in empirical evidence about the specific challenges faced by NGOs in a developing country context and how organisations are responding to them. This specific chapter brings together themes emerging from the ongoing researches such as sustainability of NGOs (Hayman, 2016), governance and accountability (Ebrahim, 2005; Coombes et al., 2011; Duncan & Schoor, 2015), challenges in relation to funding (Elbers & Arts, 2011; AbouAssi, 2013), political and regulatory enabling environments (ICNL, 2014; USAID, 2015), and domestic resource mobilisation (Fowler, 2016).

By understanding the dynamics in which NGOs operate and the decisions taken by practitioners, this study enriches the current body of literature in three ways. First, it provides a holistic examination of the impact of funding environments on the function of Ugandan NGOs. This broader set of dynamics is not readily available and can be used by organisations

such as USAID and CIVICUS to assess the health of the civil society sector in Uganda (Hayman, 2016).

Second, it covers fields in which the existing research lacks detail and the focus is too narrow. For example, there is little survey-based research on the governance of NGOs in developing countries. This study provided an overview of the benefits of ‘good’ governance on organisation sustainability by focusing on responsiveness rather than control. Another under-researched field that emerged from the interviews was the importance of the human resources component. Human resources, whether paid staff or volunteers, are the main resource of NGOs to effectively implement projects and, therefore, the main concern of NGOs. This study showed how the scarcity and uncertainty of funding affected the performance of the staff and ultimately the projects. It also highlighted the adverse consequences of high staff turnover on the capacity of the organisations. Another important contribution to the existing literature is related to a broader way of analysing sustainability (Hayman, 2016; O’Brien & Evans, 2017) which includes internal capacity (financial and non-financial resources), external context and the relationships amongst different actors. This study showed that financial sustainability is not crucial for the long-term survival and effectiveness of all types of organisations as some NGOs were able to effectively implement projects with little financial resources by articulating a variety of internal and external factors. However, such analysis should not detract from the importance of financial sustainability as an essential condition for organisational growth and the expansion of programme interventions.

A final contribution of the study is the thoughts shared by practitioners on the topic of research. The analysis relies on primary data that provides a level of nuance and specificity, which is typically not found in the literature.<sup>109</sup> This also adds the possibility of understanding better the actual point of view and revised concepts. This revision involved “re-seeing” and critically examining previous findings, which helped to refine the research and generate new ideas that were not originally considered. For example, NGOs that rely on small and stable community contributions are not necessarily less vulnerable financially than

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<sup>109</sup> As indicated by ICNL (2014), studying the NGO sector worldwide and related issues typically relies on secondary data because of the cost of collecting primary data. As a result, the geographical coverage and frequency of publications are still limited with the exception of the CSO Sustainability Index, which provides regular reports.

larger and donor-funded NGOs because they always drawn on small scale, and sometimes insufficient, revenue to carry out their activities (and limited in terms of their full potential). Thus, as mentioned earlier a reduction in revenue does not entirely reflect the degree of financial vulnerability. On the other hand, by sharing personal experiences and lessons learned – learning from experience – whether positive or negative, practitioners reveal “good practices” that suggest how and why different strategies work in different situations (i.e. valuable information that needs to be documented). It is also important to note that the experiences reveal challenges and possible situations that others can learn from. For example, the success of different fundraising initiatives/options depending on the context where they are implemented in terms of resources available. In more crowded and wealthier environments such as urban areas the promotion of events as a fundraising strategy is more effective than renting out assets (e.g. laptops) where the market competition is stronger (e.g. internet cafe).

In sum, this study hopes to expand the current knowledge about NGOs in developing countries and to provide practical insights to practitioners who might be facing similar dilemmas.

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## APPENDIX C

### Appendix C 1: Questionnaire

1. Where you ever worried about your organisation's finances or their financial sustainability? Or do you consider the NGO's financial position to be sustainable and secure?
  - a. If you were worried about finances, did you make any changes?
2. If you experienced financial difficulties in the past, how did you respond?
  - a. Did you anticipate the financial difficulties and act early? What did you do?
  - b. Did you only react to the financial problems after it happened? [Surprised by it and caught unaware] What did you do?
3. Have you ever experienced a large drop in your income? Could you please explain why and how it happened?
  - a. Did this drop in income affect your programme activities and the community beneficiaries?
  - b. How were they affected?
  - c. If the programme was not affected why not?
  - d. Did you reduce expenditure, and if so, which categories [e.g. staff and personnel cost; administrative cost; programme costs]?
4. What did you learn from that experience?
5. How did you intend to prevent that happening again and to reduce the negative effect on organisation's work?
6. Do you think that the reputation of organisation can help to protect against financial problems
  - a. If so, in what way?

**Appendix C 2: List of NGOs per method of data collection**

<i>Purposive Sample</i>	<i>Snowball Sample</i>
T01	T02
T13	T03
T14	T04
T15	T05
T16	T06
T17	T07
T18	T08
T19	T09
T20	T10
T21	T11
T22	T12
T23	
T24	
T25	
T26	
T27	
T28	
T29	
T30	
T31	
T32	
T33	
T34	
T35	

*What students know is no longer the most important measure of an education. The true test is the ability of students and graduates to engage with what they do not know, and to work out a solution. They must also be able to reach conclusions that constitute the basis for informed judgements. The ability to make judgements that are grounded in solid information, and employ careful analysis, should be one of the most important goals for any education endeavour.*

(His Highness the Aga Khan)

## CHAPTER 5

### CONCLUSIONS AND RECOMMENDATIONS

The aim of this research was twofold: first, to explore the concept of financial vulnerability as it applies to NGOs; and second, to investigate how NGOs respond to financial vulnerability, especially with regard to donor funding. This was done along with a thorough examination of the funding environment and the impact of financial vulnerability on organisations' work. To derive practical lessons, the research adopted a holistic perspective on the Ugandan NGO sector by considering the system and how various aspects relate to one another (including government, donors, other NGOs, and communities). The research adds to the body of knowledge available to practitioners and other individuals involved in the NGO sector, especially in East African countries, and provides valuable insight into the financial challenges of NGOs and how these affect programme delivery and operations.

#### 5.1. CONCLUSIONS

##### 5.1.1. Specific conclusions

The following conclusions are directly related to the research questions.

###### 5.1.1.1. *The concept and measurement of financial vulnerability*

*Financial vulnerability is a persistent and prevalent problem* for NGOs in Uganda. Most organisations rely on grants, yet grant opportunities are uncertain. The problem is caused by uncertainty of funding flows and difficulty in accessing funding from international donors. Respondents frequently reported having some kind of financial concerns and shared their concerns about the continuation of donor funding, i.e. some guarantee that the project will be renewed. The inherent risks of sourcing funds pose various challenges to NGOs, as managers are not able to plan future expenditures and it is difficult to manage their cash flow volatility to cover the organisations' current and future needs. However, financial vulnerability on the level of perceptions makes it difficult to distinguish objective risk from perceived and actual problems.

The way in which financial vulnerability impacts on each NGO depends on the organisation's expenditure and funding structure. Even large organisations that receive a relatively large amount of funding from donors complain about the way funding is provided, especially regarding the lack of support for core expenditures. For example, a large, human-resource-intensive NGO that is reliant on a small number of foreign donors for its project funding can

be considered financially vulnerable. If funding flows from donors cease, the organisation will not be able to sustain its existing expenditures, including current staff salaries, unless it gets another donor. This is just one example. What the interviews illustrated very clearly is that financial vulnerability is varied and can take different forms. Also, an organisation can rightfully identify a huge risk and experience financial vulnerability, and if such a risk does not materialise, it will not be categorised as having experienced financial vulnerability ex post. Hence, the research emphasises that *financial vulnerability is prospective and multidimensional*.

Because of the nature of the concept, financial vulnerability cannot be limited to ex ante or ex post accounting ratios based on financial records, as suggested by the bulk of the literature in this field. The *development of measurement tools should include and capture the environmental challenges and prospective risks*, given the actual organisational capacity and required needs (i.e. features and conditions). One should also not forget that the quality of financial data available in developing countries is poorer than in developed countries. Indeed, the data are not available for long time horizons and often have issues around possible measurement errors caused by misrepresentation,<sup>110</sup> with many informal or small organisations in developing countries lacking robust and reliable financial management systems (see Chapter 1, Section 1.3.).

While this research does not provide final answers and admits that it remains difficult to evaluate with accuracy whether an NGO is financially vulnerable based on financial data, the combination of empirical work presented helps to draw some conclusions about the structure of financial vulnerability and financial stability. As shown in the first and second studies (Chapters 2 and 3), diversification of revenue sources, ownership of resources in the form of physical assets, the availability of unrestricted income and flexible donor conditions provide resources and options in times of financial distress. However, according to the findings of the second study (Chapter 3), it is rather a combination of simultaneous conditions that determines the level of financial vulnerability. Both the first and second studies found that

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<sup>110</sup> On the one hand, the majority of organisations do not conduct annual financial audits and usually do not have proper accounts or audited financial statements, because of a lack of funding and a poor understanding of proper financial management by staff. On the other hand, larger and resourced organisations often report inaccurate numbers as they are under pressure to demonstrate efficiency to donors (USAID, 2015).

larger organisations and experienced leadership also contribute towards greater financial stability.

#### **5.1.1.2. *The responses of NGOs to financial vulnerability***

Chapter 1 highlighted that very little research has been done on how NGOs respond to financial problems and how they protect themselves against future risks in developing countries. Following this, the research explored the strategies that can be effectively implemented to mitigate the impact of financial vulnerability. This was done through field work with NGO practitioners in Uganda. The findings indicate that despite the manifold challenges confronting these organisations, many of them have been resilient and proactive in finding solutions to their financial difficulties. They explore alternative funding sources that can help cushion them against the risk associated with reliance on foreign funding.

In this research the diversification of risk as a strategy within an organisation is considered from three different perspectives. The first is the so-called strategy advocated in the literature, i.e. the *diversification of revenue sources*. The second relates to the *diversification of project areas*, i.e. multi-projects, for instance, the delivery of maternal and child health services through community projects related to HIV and AIDS. The third relates to the *diversification of programmes* in terms of programmatic scope (e.g. delivering of health services and research on diseases). Alongside widening their sources of revenue and the scope of projects, NGOs attempt to *retain key staff*, especially skilled and experienced individuals, *by interlinking projects*.

The findings of the third study (Chapter 4) show that NGOs pursue greater self-reliance than before to reduce the pressure from donors (i.e. increase financial independence) because the existing patterns of support for local NGOs are not sustainable. This means that local resource mobilisation is essential for the long term sustainability of NGOs and their programmes. Most NGOs *engage in some sort of alternative income-generating activities and strive to build reserves* (i.e. generate unrestricted income) *and income-generating assets*. In contrast to the situation in developed countries, the earnings from such activities (e.g. renting out office space) do not raise concerns among the general public or government, as they are usually small and are used to pay for unfunded expenditures. As stated in Chapter 1 (see Section 1.9.3) the Ugandan government allows NGOs to engage in any legitimate fundraising activity as long as they comply with regulation and pay the associated taxes.

According to the literature as well as the empirical findings of the third study (Chapter 4), the lack of resources and capacity are the main reasons why NGOs interrupt their services and implement strategic plans which render them financially vulnerable. The data shows that in the face of revenue shortfalls – as a result of, for instance, the termination of grants or a delay in disbursement of funds – organisations are likely to scale back their services and to reduce staffing, especially when activities need skilled individuals to continue. NGOs expressed particular interest in protecting themselves against such risks through *the acquisition of land and assets* (e.g. office equipment and premises). Such assets not only help organisations to save by cutting the cost of renting, but can also contribute to income generation.

Furthermore, participants recognise their capacity limitations and *seek to establish partnerships* with other organisations, the government and local communities that can continue and replicate their projects. Project partnerships with local and national government are of particular importance, as they allow organisations to benefit from existing government infrastructure, enhance their reputation and ensure government approval for project implementation (see Chapter 1, Section 1.9.1 and Chapter 4). In addition to strengthening the capacity to deliver services, partnerships also help to gain visibility and garner the recognition and trust of donor agencies, government officials and the public in general. NGOs build their reputations by working with others and satisfying beneficiaries. As stated in the third study (Chapter 4), various donors allocate funding based on second-hand information from other donors. Thus, through networks and their reputation, NGOs can increase their access to donor funding, i.e. by applying in a consortium and providing references.

The uncertainty of funding flows and the difficulty of acquiring sufficient resources to continue their projects led NGOs to change their project designs, *improve efficiency on resource allocation* and associated strategies to achieve project goals. The third study (Chapter 4) finds that many NGOs are using *participatory methods by involving communities* (i.e. in-kind and financial contributions). Moreover, the analysis provides evidence that the NGOs believe that the participation of communities and their contributions have improved their efficiency and effectiveness in terms of programme delivery. The participation of communities not only improves community responsiveness, but also the sustainability of programmes through a sense of ownership.



The *development of annual work plans, strategic plans and fundraising strategies* to mitigate future financial risks (see Chapter 4) also reflects interest in improving efficiency of resource allocation. It is very clear that NGOs are aware of the inadequacy of donor funding and the increasing risk associated in relying on external funding (and depending on donor priorities and their overall economic and social policies). NGOs have become increasingly aware of shifts in funding priorities and funding allocation mechanisms as well as the increased bureaucratic burden. Thus, managers start long-term planning and make careful assessments of the wider social and funding environment in order to identify opportunities and map out potential strategies that can help to stabilise income flows.

In the light of these findings, NGOs *develop a capacity development strategy*, which is a wider concept than capacity building, to ensure sustainability of programmes (see Chapter 4). Capacity development includes the involvement of different individuals, groups, NGOs and the government that work together (i.e. collaborate) and articulate resources, skills and competencies to deliver services. This includes interventions that incorporate the strength of the system of the NGOs' operations as a whole and not only capacity enhancement of a particular organisation (directly related to capacity building).

### **5.1.2. General conclusions**

The initiative and success of any strategy depends to a large extent on an organisation's internal governance. The third study (Chapter 4) found that *active boards contribute positively to innovation and encourage organisations to explore new opportunities*; this helps NGOs to respond effectively to the financial challenges they face.

*A leadership mindset thus determines the effective implementation of NGOs' responses to their environmental challenges and opportunities.* A few cases were observed where the board appointed executives with a specific combination of skills, i.e. experience, proactive orientation and business mindset, to drive the organisation strategically, and these had brought significant benefits to their organisations.

Finally, the third study (Chapter 4) found that *donors often have unrealistic expectations of NGOs and underestimate the constraints and burdens of the environment in which NGOs operate*, where income flows remain precarious. As a result, organisations are often under continuous pressure, especially smaller NGOs who struggle to attract funding because of their limited organisational capacity and their low visibility. When it comes to funding, smaller organisations continue to lose out to more well-resourced organisations. On the one

hand, NGOs that receive extensive funding from donors are more likely to have sound financial management systems and better capacity. On the other hand, NGOs with little or no funding are less likely to have the capacity and resources to even apply for funding, and therefore they remain in a situation of low financial capacity to implement projects and build systems, which becomes a vicious circle.

While some NGOs may be more vulnerable than others, appropriate *coping strategies are relevant for all NGOs*, even for the ones deemed financially stable, as Uganda has seen significant changes in the traditional funding mechanisms and policies, which increases the level of uncertainty of funding flows. However, the resource landscape is being reconfigured in a way that is advantageous to larger NGOs in Uganda. Larger NGOs are in a better position to access funding and have sufficient resources to mobilise domestic funding which is not the case with their local counterparts. NGOs with forward-looking managers will put protective measures in place and make changes in their ways of operating to protect their organisations against future funding problems.

## **5.2. RECOMMENDATIONS**

In the light of the above conclusions and also taking into account the practical issues raised by participating NGOs, the following guidelines, which can in some cases help to inform future policies and programmes in the sector, are recommended. These recommendations do not purport to cover all aspects of the NGO sector in detail as some ideas are already being implemented (e.g. through the reform of Uganda's NGO Act). In the discussion below the emphasis falls on the areas where the distance between current practices and solutions is greatest.

### **5.2.1. Mechanisms to build up financial reserves**

The research shows that the majority of NGOs do not have any financial reserves (see Chapter 4). This poses risks to the viability and sustainability of the NGO sector. Donors are concerned about unspent project funds. NGOs are encouraged to spend the whole budget, as returning money to the donor is a sign that the organisation did not implement the project effectively. However, some fund providers allow organisations to keep the funds not spent and these can be used to build up financial reserves. It is recommended that where *NGOs have donor funding balances, they should be able to consult with the donor and motivate for permission to retain a portion of unspent project funds.*

The absence of financial reserves seriously affects programme delivery when the projects terminate (see Chapter 4). This is not surprising given the fact that funding is often restrictive and time-bound, which means that after the completion of the project, many NGOs – and in particular, small NGOs with low capacity – are suddenly left without resources to even retain staff. As a result of this, organisations are continuously under stress, especially in the last phase of the project. In order to build financial reserves, it is recommended that *NGOs negotiate with donors and develop budgets (including a schedule for funding disbursements) that include a ‘hold’ fund<sup>111</sup> out of the total amount approved at the end of the project.* This fund is meant to be a reserve or an investment fund (e.g. for capital investment) with an underlying plan such as an investment plan, i.e. money that is set aside and made available upon successful completion of the project. This will provide NGOs with capital-secure funds that can be used to strengthen organisational capacity and ensure the required conditions to continue delivering services after the project terminates. In addition to the benefits accruing to the organisation, these funds also contribute to motivate organisations to implement projects well.

### **5.2.2. Exploring partnerships with multinational companies**

Although projects of NGOs are being implemented with a greater degree of self-sustainability and improved efficiency through partnerships with other organisations, government and community participation, the Ugandan government and communities have a very limited financial capacity to contribute towards sustaining the financial sustainability of NGOs (see Chapter 4). However, the country is experiencing a change in economic structure as the mineral resource industry is creating numerous economic opportunities by attracting multinational companies and large foreign investments (see Chapter 1, Section 1.9.1). Government policies should exploit possible opportunities for strengthening ties between the private sector and NGOs. It is therefore recommended that the Ugandan *government creates a strong legal framework and makes the required fiscal adjustments conducive to an enabling environment to promote corporate social co-responsibility in order to engage multinational companies and encourage social contributions.* Past experience of successful resource-rich

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<sup>111</sup> This fund is different from an endowment fund or a contingency fund. While an endowment fund is an investment fund, the ‘hold’ fund can be used to cover costs after project completion and not necessarily to invest. A contingency budget is money set aside to cover unexpected project expenditure and therefore cannot be used in a discretionary way.

countries such as Australia and Zambia<sup>112</sup> shows that cooperative ventures can have a positive impact, especially in underdeveloped towns and settlements where such companies normally operate. Cooperative ventures or joint projects with NGOs can therefore be funded under the banner of corporate social responsibility.

Considering the difficulty that NGOs, especially smaller and local NGOs, have in accessing funding from foreign donors, it is also recommended that *NGOs target multinational companies specifically to establish partnerships by leveraging their local goodwill and involvement as well as their existing track record with social development projects*. NGOs based in local communities are best placed to understand the needs and social norms of the towns and settlements where these multinational companies operate and they would therefore make the best partners for international corporates.

### **5.2.3. Platforms for sharing information and scarce skills**

The research shows that many organisations have strategic plans and fundraising strategies; however, these plans are seldom executed (see Chapter 4). In fact, organisations find fundraising activities challenging and costly. The main causes are lack of financial resources, lack of expertise and, specifically, lack of qualified staff to write proposals and look for funding opportunities. This situation has been aggravated by the new funding vehicles that require NGOs to apply in partnership as well as to contribute pro rata to projects. Such requirements will move smaller organisations with poor networks to the back of the queue, regardless of their social development track records and the strength of their reputation in the community. Conversely, larger and well-resourced organisations would more easily adjust themselves to fulfil such new obligations. At the same time the Ugandan NGO sector offers a wide variety of active network groups and umbrella organisations (see Chapter 1, Section 1.9.2) that NGOs can benefit from in order to coordinate fundraising efforts. It is recommended that *NGOs share knowledge and information, and learn from each other through umbrella organisations and other shared platforms*. Additionally, *NGO umbrellas should consider offering fundraising services*, for example, writing proposals and reports at a

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<sup>112</sup> See *Social responsibility in the mining and metals sector in developing countries*, available from [www.industry.gov.au/resource/Documents/LPSDP/DEPRES.pdf](http://www.industry.gov.au/resource/Documents/LPSDP/DEPRES.pdf); and *Corporate social responsibility across Africa in mining sectors*, available from <http://www.africanreview.com/construction-a-mining/excavation/corporate-social-responsibility-across-africa-in-mining-sectors>.

low fee to other NGOs. Shared NGO platforms are also crucial for other stakeholders such as donors and government. By providing reliable information about NGOs and their work (i.e. reports, experience) donors will have access to cheaper and better information to assess and evaluate NGOs, which in turn could enhance the sector's credibility, transparency and accountability. Such peer oversight and monitoring mechanisms could also help to reduce the risk of misreporting information. The platforms will facilitate the dissemination of relevant information from government and other regulatory institutions, i.e. information on legislative reforms in the NGO sector.

Despite the increased competition for funding, NGOs, especially at grassroots level, tend to collaborate (see Chapter 4). Participants feel they are stronger in applying for funds as a consortium rather than as individuals. Collaboration with other organisations helps NGOs to gain visibility and to ensure sustainability of programmes. Furthermore, this is also the direction in which donors are moving with requirements of partnership for applications and asking for references from NGO partners. Given the weak capacity of NGOs in applying for funding, *consortiums and cooperation could become increasingly important and need to be promoted on the appropriate platforms*. This could help to reduce the cost of grant management and work related to applications, for example, having to hire staff, while also satisfying donors and promoting collaboration among organisations working in the same field without losing their identity and independence.

#### **5.2.4. Improve research on the ground**

The research shows there is a gap in the literature on the NGO sector in developing countries as a result of a lack of reliable and accurate data available (see Chapter 1, Section 1.3.2), which contributes to a lack of understanding of the sector and the challenges that NGOs face. As a consequence, financial reporting requirements, financial restrictions, development project evaluation and project management tools designed and proposed by donors are often inappropriate and even at odds with the objectives of the project. *Further research and more conversations are necessary to improve such tools*.

Another issue identified in the research is that the mechanism of funding allocation, which is largely based on self-reported data and imperfect performance indicators, often does not capture the complicated project situation in the context of developing countries. Parallel to this, major international donors, in an attempt to improve their own staff capabilities, invest large sums of money in sending their staff to expensive management training programmes at

top universities in developed countries (Easterly, 2001). Such training seldom helps to expose or prepare donor staff for the developing country context. It is recommended that *donors reallocate part of their budget to expose their staff to the social development and institutional context of the countries where they will be funding projects*. Pertinent to the country case study of Uganda, it is important to note that Uganda has an excess supply of vibrant, young, educated and unemployed individuals who could be a valuable resource for data collection and field work (see Chapter 1, Section 1.9.1). The *empowerment of researchers on the ground* will provide practical evidence that will assist in the design of effective development programmes by obtaining more information on the needs and priorities of community beneficiaries and by developing, piloting and assessing new approaches to monitoring and evaluation.

### **5.2.5. Strengthen recruitment of board members and managers**

Effective governance by NGO boards is rare in developing countries and board members are not usually actively engaged in the day-to-day operations (see Chapter 4). Participants acknowledged the lack of leadership and management skills and the role of such shortcomings in undermining the internal structure of the organisation (see Chapter 4). However, boards are supposed to provide strategic direction and support managers with their skills, network and experience. Furthermore, powerful boards can attract grants. It is recommended that *NGOs should be governed by board members with specific strategic management skills and competencies* to ensure that the organisations not only accomplish their missions efficiently, but also encourage new practices and devise coping mechanisms against financial challenges. A strong and experienced board can help to identify and assess risks, anticipate a crisis and prepare the organisation for the necessary adjustments.

Managers with experience (see Chapters 2 and 3) and a business ‘mindset’ may positively contribute towards more innovative thinking and exploit new market opportunities, which will improve efficiency and strengthen the financial position of their organisation (see Chapter 4). It is therefore recommended that *boards should select and appoint managers with specific entrepreneurial and management skills* to steer NGOs.<sup>113</sup> A careful assessment of the needs of an organisation in terms of human resource capacity can greatly improve the quality

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<sup>113</sup> This recommendation applies only to cases where managers are recruited.

of service delivery and performance of the NGO in the long term. However, some may fear that the original mission of the organisation may be compromised, but a board with absolute integrity will protect an organisation's reputation.

### **5.2.6. Planning and risk-mitigation strategies**

The research shows that organisations' financial vulnerability is in fact often attributable to a lack of planning and the absence of risk-mitigation strategies (see Chapter 4). It is recommended that NGOs start *planning and incorporating risk-mitigation strategies into their operations* before reaching the point where they are desperate to survive. Strategic plans, analysis of current financial environment and risk-mitigation strategies can enhance the performance of NGOs in the long run. In the words of John F. Kennedy "the time to repair the roof is when the sun is shining" (quote from the State of the Union Address, 11 January 1962).<sup>114</sup>

## **5.3. LIMITATIONS**

*Shortcomings of the data:* Chapters 2 and 3 relied on secondary data from surveys conducted in 2002 and 2008. The survey data contained self-reported data for 2000 and 2001 and 2006 and 2007. However, organisations may often report financial data strategically and many NGOs do not share their financial reports (Burger & Owens, 2013). In addition, the available data suffers from two limitations. One is the absence of sufficient and adequate accounting ratios to measure the financial volatility of NGOs, which restricted the analysis in Chapter 2. In addition, it did not include an expenditure breakdown for 2008, which restricted the analysis in Chapter 3. Given that, it was not possible to measure financial vulnerability based on decrease in total expenditure or to gauge the extent of the drop in each line of expenditure in the budget (i.e. detailed record-keeping accounting) to accurately evaluate the actual impact of a decrease in revenue on an organisation's operation. The other limitation is that the absence of financial data over a longer time horizon limits how accurately financial volatility can be measured (i.e. 2001–2002 and 2006–2007 from the two surveys conducted in 2002 and 2008). The problem with data reliability and number of observations is likely to amplify measurement error, reducing the signal to noise ratio.

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<sup>114</sup> Available from: <http://www.presidency.ucsb.edu/ws/?pid=9082>.

*Heterogeneity of the NGO sector:* The analysis incorporates a variety of NGOs. Because of the heterogeneity of the NGO sector this analysis thus includes a large range of activities, approaches and resource structures, and this variation makes it more challenging to identify patterns that hold across the various subsectors. Chapter 3 tried to address this issue by using QCA analysis. The technique of QCA is based on comparison of cases as combinations that respect the diversity of characteristics of NGOs and their heterogeneity, with regard to their different conditions and context, by using binary variables. However, it may be reasonable to work with a variety of NGOs rather than focus on a particular subsector, given that developing country NGOs frequently work across many subsectors, and it is therefore difficult to find sufficient data in one particular sector. Furthermore, many Ugandan NGOs work across a variety of subsectors and their accounting is often too weak to provide accurate information on the different project activities.

*Access to relevant and reliable data:* The access to recent and reliable data on the NGO sector in Uganda was another challenge. The NGO Registration Board, the government agency responsible for government oversight, is weak and its mandate is restricted to registered NGOs (USAID, 2013; USAID, 2014).<sup>115</sup> The State of Civil Society Report prepared by the NGO Forum (2016) was, to the best of this researcher's knowledge, the first document containing updated and detailed information about NGOs (450 NGOs registered and non-registered). This report includes information about revenue structure, types of organisations, NGOs' financial viability and sustainability. Unfortunately given that the full report became available only in June 2017 (deadline for submission of full research), it was only possible to access the summary of key preliminary findings. This research hopes to supplement the NGO Forum report with case studies of specific NGOs and their experiences, as both were prepared during the same time period. Case studies can portray issues and other aspects of the sector in more detail and useful lessons can be drawn from them and validated.

*Limited understanding of the area under research:* The area under research is not fully understood by many individuals, including development practitioners who are based in developed countries. The understanding of the real issues by the public in general is limited and narrow, because of their unfamiliarity with developing country contexts. This constrained

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<sup>115</sup> There have been many earlier reports (pre-2010) such as World Bank (2004), Nyangabyaki, Kibikyo, Barya, Sokolowski and Salamon (2004) and Fafchamps and Owens (2009).



the debate and contributions to some degree, especially with regard to possible strategies and coping mechanisms, during the research period. A more informed understanding of the context in developing countries is needed to help improve the research in this field.

Ultimately, the research relied mostly on the primary data collected by the researcher to present main findings and contributions, as it not only validates primary analysis but also provides greater understanding and detail of Ugandan practitioners' experience based on personal empirical evidence. More research needs to be done to attend to some of the above limitations.

#### **5.4. RELEVANCE**

The research adds value to the current body of literature by offering a comprehensive measure of financial vulnerability as a multidimensional and prospective concept. This measure may allow greater insight into future studies on the determinants of financial vulnerability. Recent literature based on developed country NGOs (United Kingdom) recognises the multidimensional nature of financial vulnerability, as shown in the work of de Andrés-Alonso, Garcia-Rodriguez and Romero-Merino (2016). However, these authors still used a retrospective perspective to describe financial vulnerability, which it is argued here is not ideal. This thesis has highlighted the importance of anticipating financial vulnerability (see Chapter 1) to impede or at least mitigate the impact on delivery of critical services, yet future research still needs to identify variables that capture future financial risks to present a valid definition of a financially vulnerable NGO.

The research is important for development practitioners, particularly in Uganda, because it provides practical cases and lessons from other practitioners in similar circumstances. Through the documentation and dissemination of personal experiences by practitioners in similar contexts, the research may create a sense of 'solidarity' among organisations facing the same situation and also provide a level of credibility. By realising that other NGOs share the same problem or difficulties, practitioners may be encouraged to continue and replicate strategies rather than letting things drift in their frustration. This is especially true for those practitioners interviewed in this research, who are also seeking solutions for their financial concerns.

The research is also useful for donors to learn how their restrictions may hinder the activities of NGOs and can place at risk valuable organisations that serve communities.

Finally, the research also encourages governments to adopt policies that provide a supportive and enabling environment that improves NGOs' capacity to deliver services. Specifically, this research highlights aspects or specific areas that government should focus on while monitoring service delivery and guiding policy decisions that will ultimately improve the system within which NGOs operate, such as passing adequate legislation to attract non-traditional funding sources.

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