ESJ Social Sciences

Effect of Funding Diversification on the Financial Performance of Nongovernmental Organizations in Kenya: A Case of Kenya Red Cross Society

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Doi:10.19044/esj.2022.v18n9p64

Submitted: 20 January 2022
Accepted: 16 March 2022
Published: 31 March 2022

Cite As:
Wakasa Nato J. & Gaiku P. (2022). *Effect of Funding Diversification on the Financial Performance of Nongovernmental Organizations in Kenya: A Case of Kenya Red Cross Society*. European Scientific Journal, ESJ, 18 (9), 64. https://doi.org/10.19044/esj.2022.v18n9p64

Abstract

Financial performance has been a matter of an on-going concern for non-governmental organizations, with scarcity of resource and mounting societal needs. The enduring problem has been on how to attain financial sustainability and reduce over-dependency on donor funding. It is hypothesized that engaging in funding diversification will enhance financial performance of non-governmental organizations. The main aim of this research was to examine the effect of funding diversification on financial performance of non-governmental organizations in Kenya. Stakeholder theory and resource dependency theory were adopted to anchor the study. A descriptive research design was used in this research. The population of the study were the 10 Kenya Red Cross Society departments in Nairobi. The unit of observation was the 389 employees in these departments. Sample size was 198 employees stratified according to their departments. Primary data was collected using questionnaires. The questionnaires were administered through emailing as well as drop and pick later method. Upon collection of the data, it was coded in quantitative format so as to enable analysing through use of statistical package for social sciences (SPSS) version 24. Descriptive and inferential statistics generated were presented in tables and figures. The correlation findings showed that the relationship amongst funding

 ISSN: 1857-7881 (Print) e - ISSN 1857-7431

diversification and financial performance was positive ($r=0.429$, $p<0.001$). The regression coefficient results indicated that funding diversification positively and significantly affected financial performance ($\beta=0.558$, $p=0.000$). This suggested that a unit increase in funding diversification would result in 0.558 increase in financial performance. This study concluded that funding diversification is an essential practice for NGOs to use in their endeavor to improve on their financial performance. The study recommends that management of NGOs should implement funding diversification in their operations to enhance financial performance.

Keywords: Funding diversification, financial sustainability, donor funding, self-financing, charity events and financial performance

Introduction

Non-Governmental Organizations (NGOs) perform a huge part in the social advancement process in the different countries of the world (Lewis & Kanji, 2017). As Wright (2018) pointed out, the services provided by these organizations are crucial as they focus on the gaps not addressed by the government and private sectors. However, as the world population and economy grows, the gaps seem to bourgeon beyond the means of nongovernmental organization with sustainability becoming a far-flung goal.

When considering the financial performance of non-governmental organizations, financial sustainability is a recurrent theme (Shivairo & Were, 2017). More often than not, and particularly in recent times, many of the NGO's have a continuously increasing programmes agenda of and activities that need consistent and sufficient financing but are faced with minimal opportunities to generate extra income (Mian, Khan, & Alhashmi, 2019). If sustained funding is not emphasized in funding an NGO's activities and operations, it runs the risk of failure to achieve its objectives and risk of closure because it cannot sustain operations (Kristin, 2016). This is the most critical factor in an NGO's long-term financial viability. Financial sustainability for non-governmental organizations refers to the availability of resources that enable them to take opportunities and overcome threats while sustaining long-term operations (Pratt, 2018).

Owing to the declined economic performance in the United States of America, there has been significant reduction in funding of NGOs from the country. The non-governmental organizations in the United States suffered financial crisis due to cuts in the federal and the state funding that was directed to the operations of the organization in the nation for them to run their operational activities as intended (Horak, Arya & Isamil, 2018). Financial resources are critical to non-governmental organizations because they are required for growth and survival; as a result, it is important for them to

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maintain a stable financial position and perform well in order to fulfill their obligations (Kumi & Hayman, 2019).

In the United Kingdom major non-governmental organizations in the globe seem to have been deemed irrelevant due to the funding issues that have led to their collapse. For example, a major British Non-governmental organization known as Childhood Development and Aid went down in 2002 due to poor financial management practices within the organization (AIKhouri & Arouri, 2019). The organization had negative reserves for five consecutive years with reliance on restricted grants which indicated income fluctuations falling by almost 50 percent between 2000 and 2001. Another NGO known as Academy for Educational Development also collapsed and ceased its operations since it suffered the financial crisis immediately after USAID suspended its funding option due to corporate misconduct as well as lacking internal control measures associated with the organization (Simone, 2017).

In Central Asia financial sustainability has been a major obstacle to many non-governmental organizations. The organizations in Central Asia are unable to sustain funding of their operations due to accrued financial sustainability which decreases donor funding, decreased resource allocation in the region and donors seem to be focusing on new areas and decreased amounts of social programs (Aboramadan, 2018). Despite various financing methods used in Indonesia and China while recovering from large-scale disasters, stakeholders usually face certain post-disaster reconstruction such as competence of implementing agencies, transportation capacity, legislation and governance and the market conditions. Specifically, the community-based hosting features were critical in donor-driven resourcing practice in Post Indian Ocean tsunami reconstruction in Indonesia. On the other hand, factors associated with project control and management primarily had an impact on resourcing performance of the Chinese reconstruction specialists following the Wenchuan earthquake (Ghauri & Wang, 2017).

In South America, Aponte (2019) cites that weak networks and collaboration among NGOs and other stakeholders has been a great hindrance towards the sustainability of the nongovernmental sector in Peru. In Kazakhstan, Kabdiyeva and Dixon (2017) observes that legal regime was frustrating efforts of NGO collaboration with business sector. D'arcy (2019) argues that one of the fundamental reasons most international NGOs struggle to establish themselves in South America is due to poor strategic partnership. The researcher clarifies that staff in international NGOs have damaging negative attitudes towards their local partners and believe they are superior since they hold the finances.

In Africa, the non-profit sector has continued to expand rapidly. For instance, currently, South Africa has more than 100,000 registered non-profit organizations while in Kenya the annual rate of growth has remained relatively

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high approximated at 20% (Mathews, 2017). However, Mohamed and Muturi (2017) notes that many NGOs have continuously struggled in the last decade with Africa being dominated by smaller, privately owned and short-lived NGOs. With such structural weaknesses, it remains difficult for the non-profit making entities to either achieve long-term, consistent or improve their performance.

In Zimbabwe, most of the local NGOs are not leveraging their assets in generating income, and most do not participate in income generating activities. This therefore implies that donor reliance is a major impediment towards sustainability of NGOs across Zimbabwe. A study in Zimbabwe by Mutale (2016) found out that in spite of the efforts made by the NGO's, the poor found in rural Zimbabwe still lack adequate social services. The study concluded that the government, NGOs, donor organizations and communities have a substantial role in the success of NGO interventions in delivery of social services in Luunga ward, Binga.

A major challenge facing NGOs in Kenya today is sustaining and supporting their activities financially. The NGOs therefore must formulate new strategies to be sustainable in the long run. This has been necessitated by: reduced donor funding, the region continually receiving reduced allocations, the focus of the donor has shifted to new markets and there is generally reduced funding for the social programs (Miriti & Karithi, 2020). To remain financially sustainable, NGOs need to invest in building strong relationships of working with key stakeholders especially their donors, supporters, volunteers, staff and the community benefitting from the NGO; diversify their income sources; restructure their governance structures; enhance their financial management practices; enhance their internal capacity to foresee and cut down risks resulting from funding; engage in human capital training and development; build ample cash supply and bring down all organizational costs and overheads (Olando, 2020).

Statement of the Problem

Currently in Kenya, most NGOs do not have sufficient, appropriate and continuous funding for their projects and which often delays their work. Many local NGOs do not have the capacity to mobilize resources and often do not seek local financing, preferring to rely on donor aid. The situation is worsened by tough global economic times buoyed by global recession which have shrunk donor funding, stringent donor funding conditions, weak financial sustainability practices and questionable organization/management governance practices which have further dent the NGOs' ability to access external funding (Milelu, 2018).

A number of studies have been done on NGOs financial performance and sustainability. For instance, Park and Cho (2020) sought to examine the

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determinants of donation intentions influenced by television fundraising campaigns in order to boost financial sustainability and revealed that emotional sympathy was the most important factor. Miriti and Karithi (2020) focused on determining the factors affecting the sustainability of NGOs in Kenya and revealed that sustainability of NGOS was enhanced by donor-relationship management. These findings are supported by Olando (2020) who aimed to determine the factors affecting sustainable funding of NGOs in Nairobi County with a case of UHAI East African Sexual Health and Rights Initiative (EASHRI). These studies did not however establish the influence of funding diversification on financial performance of non-profits in Kenya which was the focus of the current study.

Over the last few years, the operations of NGOs in Kenya have been affected by the changes from internal and external environment in which the organization operates in. Specifically, the COVID-19 pandemic has increased the demand for nonprofits' services while damaging their finances and staffs. If the NGOs fail to develop effective response strategies to the pandemic and other environmental changes, their ability to meet their objectives will be in doubt. There was therefore need to investigate how funding diversification influence NGO's financial performance. This study therefore sought to investigate the effect of funding diversification on financial performance of NGOs in Kenya using KRCS as proxy for NGOs in Kenya.

Objectives of the Study

To establish the effect of funding diversification on financial performance of NGOs in Kenya

Research Question

What is the effect of funding diversification on financial performance of NGOs in Kenya?

Literature Review

Funding diversification refers to the sourcing of funds for the Non-Governmental Organizations from many sources. The sources may include the public, external donors, the business community and governments whereby donor funding is limited with the Non-Governmental Organization using the resources only for specific purpose for which it is intended in support with the activities of the NGO. According to McElwee and Wood (2018), diversification of funding is the number of activities aiming to reduce dependence on a certain type of funding, specific donor, dominating consumer and currency in which most of the funds are released form. Aguilar and Hansen (2018), studied financing of NGOs and found out that approximately 60 percent of the income for the NGOs are from a minimum of five sources of

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funding their projects. The authors also indicated that diversifying sources of income for the NGOs protect it from external shocks and the challenges arising from volatility of donor funding.

A lot of effort has been put by NGOs to ensure that financial resources become key in determining what they aim to achieve and how they operate with the given budget and not attempting to be profit making. Park and Cho (2020) sought to examine the determinants of donation intention which are influenced by campaigns in television fundraising so as to enhance financial stability. Data was gathered from the respondents using online surveys founded on donation experiences and applied analyses for instance ANOVA, regression and factor analysis. The study's findings revealed that, regardless of previous donation experiences, emotional sympathy was the most important factor, whereas economic benefit was relevant only for novice donors. The findings showed that television fundraising have consequences on nonprofit organizations, thus there are aspects that need to be tackled in ways that can inspire donors to give. This study focused on determinants of donation intention while the current study will focus on how funding diversification influences financial performance among NGOs in Kenya and specifically at KRCS. In addition, this study was conducted in Korea which has a different socio-cultural and economic environment from Kenya where the current study was undertaken.

While reviewing the factors influencing financial sustainability of NGOs in Columbia, Moreno (2019) found that funding in Columbia NGOs was a challenge and their over-reliance on external donors for funding meant that the NGOs were highly limited in the scope of decision making as allocated funds had to be expended as instructed by the donors. The study applied an exploratory case study using a two staged approach while the target population was the 48 NGOs approved by FIFA Foundation to participate at the 2018 World Cup in Russia social festival. The study concluded that financial sustainability is dependent on international aid agencies funds and corporate partnerships. This study was anchored on dependency theory while the current study will be anchored on systems theory. Further the study did not relate funding diversification with financial performance which was addressed in the current study.

Islam (2016) observed that in a bid to achieve financial sustainability when faced with declining financial support from external donors, NGOs in Egypt have scaled up their activities aimed at sourcing for funds at community levels and made use of local corporate donors in an effort to raise money and other support as well as seeking local and national government support. This study was a review of a focused selection of literature and case studies. The study concluded that financial dependence on a single or few donors basically imply that the NGO sacrifices autonomy, credibility, and in some cases their

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core mission and values leading to a situation in which the donor has the ability to influence the organization for their own desire. To have full control over their own activities and programs, NGOs should therefore develop alternative funding strategies that would enable them to become less reliant on external funding and the restrictive donor conditions. This study was a review of literature while the current study was empirical in nature focusing on NGOs in Kenya and specifically a case study of KRCS.

Despard, Nafziger-Mayegun, Adjabeng and Ansong (2017) study found that the need to cover rising operation costs remains one of the major reasons as to why NGOs should pursue funding diversification. Non-governmental organizations, just like other business enterprises have to incur various operational costs in their day to day running and with donor funding being restricted to execution of identified programs, the need for the NGOs to have other income sources to meet their daily expenses has grown. The study concludes that funding diversification provides a viable mechanism through which the NGOs can raise much needed finances, outside their donors, and which can support their daily operational expenditure. The study recommended the need for strategies to raise additional funding given that donor funding may not be adequate to meet all the costs of an NGO. This study focused on NGOs in Sub-Saharan Africa and it was cross-sectional in nature cutting across 170 NGOs while the current study will be an in-depth case study of KRCS. Further, the study did not establish the effect of various funding sources on financial performance which the current study will focus on.

Theoretical Framework

This section is a review of theories explaining the association amongst financial sustainability practices and financial performance. The study was anchored on stakeholder theory and the resource dependency theory. According to stakeholders' theory, organizations should be accountable to both external and internal stakeholders as their activities impact the external environment. Stakeholders' theory, which as originally developed by Freeman (1984) was to be used as a managerial instrument. It has however since evolved to become a theory of the firm that has high explanatory potential. The stakeholder theory is like a conceptual framework of organization ethics and organizational management which addresses moral and ethical values in the management of a non-profit organization or other organizations. Stakeholder theory majorly focuses on equilibrium of the interests of the stakeholders as the core determinant of organization policy. The theory has a large contribution to risk management coming up as an addition to implicit contracts theory as well as other forms of contracts, including financing (Fontaine, 2006).

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Stakeholder theory was relevant to this study because it is aimed at ensuring that the diverse needs of all the stakeholders are well represented. This is achieved through establishing a network of relationships with the stakeholders of the NGO who include the donors, suppliers, employees, regulators and the consumers. This is part of the goal of the non-profit organization. In this study, managers of KRCS should aim at meeting the needs of all stakeholders. To achieve this goal; they should ensure they communicate all the relevant information to stakeholders and ensure accountability and transparency. The theory connects all the objectives of the study with financial performance.

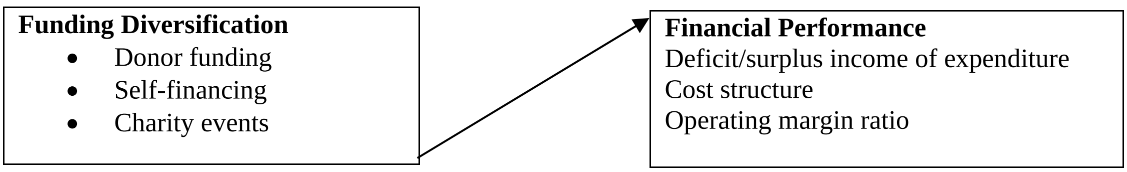
Resources adequacy and availability is critical to the effective and efficient performance of any organization both for-profit and non-profit. Resource dependency theory was founded by Pfefer and Salancik (1978). It states that organizations should transact with other players and organizations in its environment to acquire resources. The proposition of the theory is that actors who lack essential resources are required to seek relationships with (that is, depend upon) others with the goal of acquiring the necessary resources. The theory further states that organizations and institutions are seen as coalitions that align the structure and behavioral patterns to acquire and maintain the required resources. In a similar perspective it is believed that the acquisition of external resources required by an organization is implemented by lowering the organization's dependence or by increasing its dependence on other entities (Medcof, 2001).

In relation to the resource dependency theory, non-governmental organizations are dependent on other entities (mainly the donors) for their survival and attainment of financial sustainability. However, this dependence has affected the NGOs making them lose their power. This is manifested in the requirement made by donors to have the NGO's function in accordance to their regulations. Resource dependency theory was therefore used in this study, an anchor to specific objectives 1-3 of this study.

Conceptual Framework

This study was guided by the following conceptual framework that shows diagrammatized representation of the relationship between the variables. This is shown in Figure 1.

Figure 1: Conceptual Framework



Source: Author

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Research Methodology

The study adopted a descriptive design to determine the effect of financial sustainability practices on financial performance. The population of the study was the 10 departments in KRCS. The unit of observation was the 389 employees in these departments. The study adopted Yamane (1967) formula with assumption of 95% of confidence level to estimate the sample size. The sample size for the study was 198 respondents. Simple random sampling was used to arrive at the individual respondents in each department. This study collected primary data by aid of a questionnaire. The study issued the questionnaire to selected KRCS employees through Google forms. A Pilot study was done in determining the feasibility of conducting a complete study. This involved 39 KRCS employees (10% of the target population) who filled the questionnaires and its accuracy tested. The 39 respondents were not involved in the final study to ensure non-compromise of the research data.

The data was reviewed for completeness and the variables with missing or incomplete data removed. Version 24 of the Social Sciences Statistical Package (SPSS) method was used to analyze data. The data was analyzed for descriptive statistics as well as correlation analysis. Diagnostic tests such as normality, multicollinearity, and autocorrelation and correlation analysis were undertaken to test if the multi-regression model was well specified as per the assumptions of linear regression. Multiple regression analysis was also applied while ANOVA, F-test and t-test were carried to test the relationship between financial sustainability practices and financial performance. The research hypothesis was tested using the regression analysis. The following empirical model was adopted.

$$\mathbf{Y = \beta_0 + \beta_1 X_1 + \varepsilon}$$

Where:

Y is ‘financial performance’

$\mathbf{B_0}$ is the ‘Constant’

$\mathbf{X_1}$ is ‘Funding diversification

$\boldsymbol{\varepsilon}$ represents ‘Error Term’

$\boldsymbol{\beta_1}$ represent ‘Regression coefficient of predictor variable

Both descriptive and inferential statistics results were presented in tables and figures which were accompanied by pertinent interpretations and discussions.

Results of the Study

Descriptive Statistics for Funding Diversification

Table 1 shows the study findings. The findings revealed that most of the respondents concurred that the most significant and relevant factor is that funding diversification reduces the risk of KRCS closing down in case of

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withdrawal of donors (Mean=4.45, std. dev=0.5). The findings further revealed that there was agreement by the respondents that funding diversification enables KRCS to be able to reject funding whose sources do not fit into its agenda and values (Mean=4.33, std. dev=0.53). Respondents further agreed with foreign donations as sources of funding being on the decline at KRCS (Mean=4.24, std. dev=0.55). Additionally, findings discovered that majority of the respondents agreed that creating other income generating activities increases KRCS financial sustainability (Mean= 4.21, std. dev=0.73). The findings, furthermore, showed that most respondents agreed on the statement that reliance on donor funding forces KRCS to align its plans with donor priorities (Mean=4.03, std. dev=0.63). Lastly, the findings revealed that most respondents concurred that, funding diversification increases KRCS ability to fund its projects based on its own priorities (Mean=3.55std dev=0.86). On average the respondents concurred that KRCS practices funding diversification (Mean=4.14 std dev=0.65).

Table 1: Descriptive Statistics on Funding Diversification

Statements	**N**	**Mean**	**Std. Dev**
Foreign donations as sources of funding are on the decline at KRCS	133	4.24	0.55
Creating other income generating activities increases KRCS financial sustainability	133	4.21	0.73
Reliance on donor funding forces KRCS to align its plans with donor priorities	133	4.03	0.63
Funding diversification increases KRCS ability to fund its projects based on its own priorities	133	3.55	0.86
Funding diversification reduces the risk of KRCS closing down in case of withdrawal of donors	133	4.45	0.50
Funding diversification enables KRCS to be able to reject funding whose sources do not fit into its agenda and values	133	4.33	0.53
Funding diversification enables KRCS meet its overhead costs and other expenses not met by the donors	133	4.03	0.63
Overall mean Score	**133**	**4.14**	**0.65**

Correlation Analysis for Funding Diversification and Financial performance

The correlation findings shown that the relationship amongst funding diversification and financial performance was positive ($r=0.429$, $p<0.001$). The implication here was that funding diversification positively impacted financial performance at KRCS.

Table 2: Correlation Matrix for Funding Diversification and Financial Performance

		Financial performance
Funding diversification	Pearson Correlation	.429**
	Sig. (2-tailed)	0.000

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Regression Analysis for Funding Diversification and Financial Performance

Table 3 demonstrates that the findings showed that the R square was 0.184 indicating that funding diversification explain 18.4% of the variation in financial performance and therefore 81.6% is of the variation is explained by other factors not included in this study.

Table 3: Model Fitness for Funding Diversification and Financial performance

R	R Square	Adjusted R Square	Std. Error of the Estimate
.429a	0.184	0.176	0.5181863

The ANOVA results in Table 4 exhibited that the overall model used to assess the relationship between funding diversification and financial performance was significant. This was supported by a significance level of 0.000 that was below 0.05 with confidence level being at 95%.

Table 4: ANOVA Results for Funding Diversification and Financial Performance

	Sum of Squares	Df	Mean Square	F	Sig.
Regression	5.881	1	5.881	21.902	0.000
Residual	26.046	131	0.269		
Total	31.927	132			

The regression coefficient results indicated that funding diversification positively and significantly relate with financial performance (β=0.558, p=0.000). This suggested that a unit increase in funding diversification would result in 0.558 increase in financial performance as in the model.

Table 5: Regression Coefficients for Funding Diversification and Financial Performance

	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	1.408	0.496		2.841	0.005
Funding diversification	0.558	0.119	0.429	4.680	0.000

Summary of Findings

The descriptive analysis findings revealed that NGOs in Kenya had adopted funding diversification to a great extent. The results further revealed that funding diversification reduces the risk of KRCS closing down in case of withdrawal of donors and enables KRCS to be able to reject funding whose sources do not fit into its agenda and values. The regression results revealed that funding diversification had a significant positive influence on financial performance.

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Conclusion

The study concluded that funding diversification influenced NGO's financial performance positively. The study further concluded that funding diversification among NGOs have been adopted to a great extent. Funding diversification reduces the risk of closing down in case of withdrawal of donors and enables NGOs to be able to reject funding whose sources do not fit into their agenda and values.

Recommendation

The study revealed that funding diversification influenced NGOs financial performance positively. The study recommends that the management of NGOs should formulate and implement relevant funding diversification strategies that uphold the desired financial performance and avoid overreliance on a single donor. Similarly, the study recommends that regulatory authorities should assess the suitability of the current funding regulations for NGOs to ensure they have enough legislation protection when pursuing any funding diversification.

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