Effect of Budgetary Process on Financial Performance of Ngos in Heath Sector in Kenya

Sammy Kimunguyi
PhD Candidate
Jomo Kenyatta University of Agriculture and Technology
P.O Box 62,000-0202, Kenya

Dr. Florence Memba

Dr. Agnes Njeru
Lecturer
Jomo Kenyatta University of Agriculture and Technology
P.O Box 62,000-0202, Kenya

Abstract

The main objective of this study was to establish the effect of budgetary process on financial performance of NGOs in health sector in Kenya, applying priority based budgeting theory. Regression results revealed that budgetary process had significant influence on financial performance of NGOs in health sector in Kenya and tests for significance also showed that the influence was statistically significant (r=0.419). Good budgetary management practices therefore positively influence financial performance of NGOs in health sector in Kenya. On formulation of policy, both management of NGOs and the Government should explore and implement sustainable policies and regulations that are geared towards improving, budgetary management as a way of accelerating financial performance of NGOs.

Key Words: Budgetary process, Priority based budgeting theory, financial performance

1. *Introduction*

In this paper, the term NGO will be used to define an agency that has no government control but receives aid and donations from national and international agencies to carry out poverty alleviation activities on humanitarian sectors (Perkins, 2005). The beginning of NGOs is inherently related to capitalism and failure of states to meet the needs of its citizens. NGOs have not only grown in number and capacity, but also with regard to their political influence. The numbers of NGOs with consultative status at the United Nations (UN) were limited in 1945 but the number increased to 3,289 in September 2009 (UNDESA, 2009) The World Bank reports that projects with some degree of civil society' involvement increased from six percent in the late 1980s to over 70 percent in 2006 (Werker and Ahmed, 2008).NGOs render welfare services and help in all such sectors of society, which aim to improve the life of the people in the community. NGOs can perform a major role because of having features for the promotion of micro- level development (Nzimakwe, 2008). NGOs are often seen as more trustworthy and credible than governments or private firms (Todaro, 2009). NGOs also provide public goods to sections of the population that might be socially excluded.

1.1 NGOs Global Perspective

The period between 1978 and 1985 saw an 'explosion of donor aid' in Sri-lanka when 70% of the total \$6,140 million aid was received between 1960 and 1985 (Bastian, 2007). The rapid influx of foreign funds allowed overall government expenditure to rise. This 'minor Keynesian boom' helped to entrench and extend existing modes of governance and expanding police and military sectors (Spencer, 2008).Total aid to Sri Lanka increased significantly after the war ceasefire, rising from \$572 million in 2002 to \$991 million in 2003 (ERD, 2003). In 2003, donors pledged \$4.5 billion to help development and reconstruction in Sri Lanka and delivery of these funds was contingent upon progress in peace negotiations.

As well as attempting to avert the resumption of conflict by applying peace conditionality's, aid was designed to address both the consequences and the causes of conflict (Goodhand and Klem, 2005).NGOs in Bangladesh claim to operate in over 90% of villages (Fruttero and Gauri 2005), benefiting 35% of the population (Thornton et al, 2000). It's believed that the root cause of poverty was social injustice and that poverty could not be eradicated until there was a 'basic change in the social structure' (Rutherford, 2010). A few NGOs, such as Bangladesh Rural Advancement Committee (BRAC), became agents for multinational companies such as Monsanto and Information Technology businesses. (Aminuzzaman et al, 2003).

They also take responsibility to market the produce as a further extension of NGO business (Makita, 2009). In 1992 the government was forced to withdraw its order to cancel the registration of a few NGOs for financial irregularities. In 2007, NGOs resisted the government's attempt to modify the 1978 regulation on NGOs (Agarwal et.al. 2007). However, in 2006 the government was forced to implement the regulations on NGOs because of widespread financial corruption and swindling of the poor's money by many NGOs (Jumma and Nasir 2007).

In Botswana the local NGOs play a huge role by bringing the much needed services to the communities in which they operate (Hans, 2003). Helen et al. (2005) identify the strengths of the local NGOs as being flexible as opposed to government bureaucrats to respond to community needs and priorities. In the initial phases of Africa Comprehensive HIV/AIDS Partnership (ACHAP) activities in Botswana, they faced a lot frustration from government bureaucrats and red tape and they choose to engage local NGOs to facilitate quick implementation of their projects (Ramiah & Reich, 2006).

1.2 NGOs in Health Sector, Kenya

Mbote (2000) notes that the proliferation of NGOs in the 80s and 90s in Africa and particularly in Kenya was as a result of the escalation of poverty, civil strife, internal displacements of people following war and conflicts and the general degradation or near collapse of socio-economic and political systems. For the first time in 1978, Kenya experienced a proliferation of civil society organizations (CSOs) that could be distinguished from the state (M'boge and Doe, 2004).The Kenyan health system is impacted by the work of NGOs. According to the NGOs register at the NGOs Co-ordination Board, as at 28 February 2015, there were 16,844 NGOs operating in the 47 counties in Kenya (NGO Board, 2015). In the NGO sector as a whole, reliance on donor funding is often the limiting factor that prevents facilities from offering a broader service spectrum, or offering services to more people (Turin, D. R., 2010).

This study attempts to contribute to the existing literature focusing the debate on budgetary process and financial performance of NGOs from a developing country perspective and examines the budget practices and financial performance that represents Kenyan NGOs in health sector based on priority based budgeting theory. Therefore this study attempts to fill the gap in finance literature addressing the research question "How does budgetary process affect financial performance of NGOs in the health sector in Kenya". The study is organized as follows; section two provides literature review that examines priority based budgeting theory; the methodology is developed in section three while section four provides analysis and discussion of the results. The last section provides summary, conclusion and recommendations.

2. *Review of Literature*

2.1 Theoretical Review

A theory is a systematic explanation of the relationship among phenomena that provide a generalized explanation to an occurrence (Kombo &Tromp, 2009, Smyth, 2009). This study was guided by priority based budgeting theory.

2.2 Priority Based Budgeting Theory

The Priority-based budgeting theory was propounded by Kavanagh, Johnson and Fabian (2011). The theory focuses on corporate priorities and allocates growth and savings in budgets accordingly but does not require zero-sum. The underlying philosophy of priority-driven budgeting is about how an entity should invest resources to meet its stated objectives. Kavanagh et al. (2011) argues that SMEs, like all other business have their budgeting process governed by the need to have proper funding, transparency and accountability at all levels. Priority based budgeting model was linked to this study for it provided a possible explanation as to how budgeting in NGOs is affected by prioritization through planning and budgetary information systems that enhance transparency and accountability in budget management.

2.3 Budgetary process and financial performance

Horngern (2002) defines a budget as a set of interlinked plans that quantitatively describe an entity's projected future operations. An earlier definition by Yang (2010) views a budget as a management tool concerned with the planning and management of the firm’s financial needs, concerning the alternative sources of and costs of finance. Relying on certain standards and General Accepted Accounting Principles (GAAP), the accountant of an organization develops and reports data that measures financial performance of a firm and that assess its financial position in compliance with and filed reports needed by interested parties (Yang, 2010).

A budget is an economic tool for facilitating and realizing the vision of an organization in a given fiscal year, and if a budget is to serves as an effective tool, proper linkages and management of all the stages of budgeting is necessary. Apparently public-sector’ budgets have same characteristics as private-sector budgets. Olomola (2009).

As Horngern (2000) and Covaleski and Dirsmith and Jablonsky (1985) and Ahrens and Chapman (2006) and Yang (2010) have argued if administered wisely budgeting drives management planning, provides best framework for judging financial performance. Diamond and Khemani (2006) studied accounting systems among businesses in the developing countries, focusing on Africa deduced that budget execution and accounting processes were either manual or supported by very old and inadequately maintained software applications and hardware. He found that this had damaging effects on their functioning due to the consequent lack of reliable and timely revenue and expenditure data for budget planning, monitoring, expenditure control, and reporting negatively impacting budget management.. In this study, it will be established whether computerization of budgeting functions affects financial performance of NGOs in Kenya.

McLaney and Atrill (1999) argued that the value of the budget as a plan of what is to happen and as a standard against which actual financial performance will be measured, depended largely on how skillfully budget negotiation is conducted. When setting a budget, members of the organization should participate in explicitly defining budgetary goals. The members also have to be involved in subsequent revisions to these goals with the management (Chalos & Poon, 2000). Most NGOs have the inability to employ a skilled labor force due to the small budgets to manage specialized areas of their business such as budgetary planning and management. During favorable economic conditions, many organizations embrace training and development than during unfavorable economic conditions (Obokoh, 2008). A study conducted by Chidi and Shadare (2011) in Nigeria focusing on challenges confronting human capital development in small medium enterprises (SMEs) in Nigeria found that budgeting among SMEs faced challenges by the businesses not taking ownership .These researchers confirm that the skill that managers have concerning budgeting affect the budgeting process.

A study by Njeru and Thuo (2013) on budgetary process in SMEs in hospitality industry in Nairobi Central Business District found out that skills and power of managers had positive and significantly related to budgeting. The results suggest that a positive development on skills and power of managers improves budgeting process in SME’S in the hospitality industry in Nairobi CBD. This concurs with the findings by Chidi and Shadare (2011) who found that the skill that managers have concerning budgeting have an effect on the budgeting process. Hilton, Maher and Selto (2000) established that most people will perform better and make greater attempts to achieve a goal if they have been consulted in setting the goal. The idea of participative budgeting is to involve employees throughout an organization in the budgetary process.

Chai (2011) conducted a study aimed at establishing the capital budgeting techniques and how those techniques impact to the financial performance of courier companies in Kenya. He then concluded that there was a significant relationship between the capital budgeting techniques and the financial performance of courier companies. Joshi et al., (2003) posited that budgetary participation is expected to be a crucial channel to improve the information exchange and sharing among all levels of management and when this process is pursued by a firm, it is expected that the realization of the set target is improved.

2.4 Empirical Review of previous studies

Diamond and Khemani (2006) studied accounting systems among businesses in the developing countries, focusing on Africa deduced that budget execution and accounting processes were either manual or supported by very old and inadequately maintained software applications and hardware.

He found that this had damaging effects on their functioning due to the consequent lack of reliable and timely revenue and expenditure data for budget planning, monitoring, expenditure control, and reporting negatively impacting budget management. Further, the study found that there was poorly controlled commitment of resources. This meant that the nature of the computerization of accounting affected the budgeting process.

A study conducted by Chidi and Shadare (2011) in Nigeria focusing on challenges confronting human capital development in SMEs in Nigeria found that budgeting among SMEs faced challenges by the businesses not taking ownership or not being accountable, there being a lack of cooperation and/or participation and a lack of understanding of the budgeting process or what's required. This was compounded by the inability to meet, deadlines, padding their budgets/providing unrealistic numbers and sheer ignorance of the importance of budgeting by the business owners.

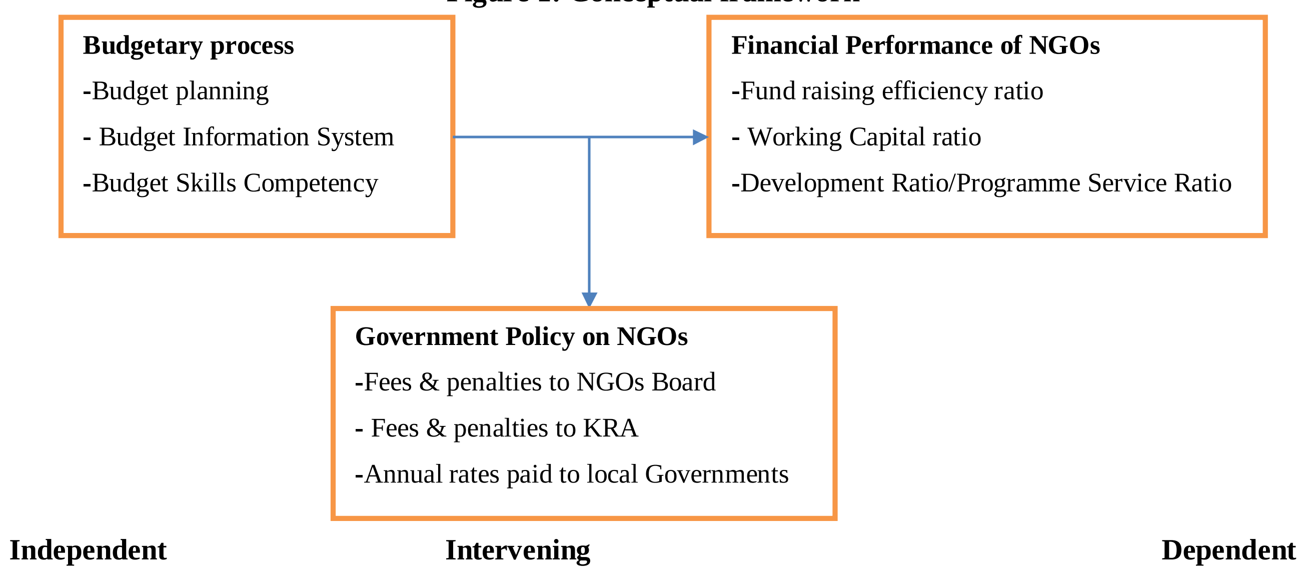
2.5 Critique of past studies /Research gaps

Diamond and Khemani (2006) studied accounting systems among businesses in the developing countries .He focused mainly on effect of budgeting processes on financial performance of commercial profit making firms. Chidi and Shadara (2011) studied effect of budgetary process on financial performance. However, the areas of focus were State Corporations Sectors. Previous studies have therefore concentrated on budgetary process and financial performance of commercial companies in developed countries leaving a gap of literature on effect of budgetary process on financial performance in NGOs in Africa and Kenya specifically. This literature gap is addressed by this study.

2.6 Conceptual Framework

A conceptual framework is a set of broad ideas and principles taken from relevant fields of enquiry and used to structure a subsequent presentation (Kombo and Tromp, 2009). It forms part of the agenda for negotiation to be scrutinized, tested, reviewed and reformed as a result of investigation and it explains the possible connections between the variables (Smyth, 2009).A conceptual framework for the study shows the relationship of budgetary process on financial performance of NGOs in Kenya and has been depicted in the figure below.

Figure 1: Conceptual framework



3. *Research Methodology*

Kumar (2005) observes that research is the process of collection, analysis and interpretation of data in order to answer questions. This study targeted 16,844 NGOs registered to operate in health sector by the NGOs Co-ordination Board as at 28 February 2015.The population is considered ideal for the study since the major bilateral and multilateral actors in international health have increasingly channeled aid to the health sector in poor countries through NGOs (World Bank, 2000). Further, high levels of corruption have resulted in the degradation of financial performance of NGOs in health sector in Kenya (World Bank, 2008). The study used stratified random sampling technique adopting a sample of 270 NGOs operating in health sector in Kenya.

The sample size was arrived at using the following formulae by Mugenda and Mugenda, 1999 for computing sample size for larger sample:

$$\text{Necessary sample size} = \frac{(Z - score)^2 \times std\ \ Dev \times (1 - stdDev)}{(M\arg in\ of\ \ error)^2}$$

The research was conducted at 90% confidence level, 0.5 standard deviation, and a margin of error (confidence interval) of +/- 5%. From Z tables, the corresponding Z score is 1.645.

$$\text{Necessary sample size} = \frac{(1.645)^2 \times 0.5 \times (1 - 0.5}{(0.05)^2} = 270.6$$

Therefore 270 respondents from NGOs were interviewed out of 16,844 NGOs registered to operate in the health sector in Kenya. A pilot study was conducted in 27 NGOs in Nairobi County. Baker (1994) notes that a pilot study is used to pretest a research instrument and a sample size of 10-20% of sample size is adequate to consider for pilot study.

The study employed both structured and unstructured questionnaires as instruments for data collection. The research instruments were given to supervisors who scrutinized the questions in the tool to assess their appropriateness in addressing key issues of the study .This ensured internal and external validity. Ecological validity was ensured by use of real data obtained from NGOs. The instruments were subjected to peer review where questions were restructured and language use reviewed where deemed necessary. Reliability is if the analyst measures the same variable several times, and the results are approximately the same (Rabianski, 2003).Secondary data was collected from audited financial statements verified and inspected by licensed Certified Public Accountants of Kenya. Key ratios were calculated a few times before implementing them in this paper, this was to make sure that all the calculations were right to ensure reliability.

3.1 Research Hypothesis

A number of researchers have provided empirical evidence suggesting that organization that embraced good budgetary processes had a superior level of financial performance. Diamond and Khemani (2006) established that inadequate budget management leads to poor financial performance. Chidi and Shadare (2011) found out that ignorance in the budgeting process was a major determinant of poor performance in Small and Medium Enterprises (SMEs).

Therefore based on theoretical and empirical evidence reviewed, the researcher formulates the following hypotheses:
Ho1: Budgetary process has a negative influence on financial performance of NGOs in the health sector in Kenya.

3.2 Model and Data Description

The variable under study was analyzed by applying the following econometric model:
$FP = \beta 0 + \beta 1BP + \varepsilon$
Where:
FP= Financial performance of NGOs in health sector
$\beta 0$= Model constant
$\beta 1$ = Sensitivity of budgetary process to financial performance of NGOs in health sector
BP= Budgetary process
ε = Error term with an expected value of zero
Hypothesis testing was done at 5% significance level ($\alpha = 0.05$). Statistical Package for Social Scientist (SPSS) software was used to compute t tests to give results of critical values (p value). The decision rule applied was if $p \leq \alpha$, then reject H0 otherwise fail to reject the H0.

3.1 Variable Definition and Measurement

Ritchie and Kolodinsky (2003) concluded that fiscal performance and fund raising ratios are reliable and appropriate to evaluate financial performance of NGOs. The Charity Navigator in United Kingdom uses program service ratio and fundraising ratios as a means of measuring the financial health of NGOs.

Program service ratio refers to budget burn out rates on development expenditure obtained by dividing development expenditure and the total expenditure. Fundraising expenses is a ratio of fundraising expenses over the total expenditures. (Charity Navigator, 2006). Working capital ratio is the ratio of current assets to current liabilities. In this study, fiscal performance, fundraising efficiency, and working capital ratios are used. Budgetary process was measured as a weighted average of the number of budget planning meetings held per year, annual expenditures on budgetary information system and number of trainings on budgeting held in a year.

4. Data Analysis, Results and Discussion

4.1 Response Rate

Two hundred and seventy (270) questionnaires were issued to managers from 270 NGOs operating in the health sector in Kenya. Two hundred and twenty two (222) questionnaires were returned representing an 82% response rate. The response rate is considered adequate given the recommendations by Mugenda and Mugenda (2003) who advise on response rates exceeding 50% and Arora and Arora (2003) who consent that a response rate of 75% is adequate.

4.2 Budget process in NGOs in Health Sector

4.2.1 Budget Planning

The results indicated that most (90%) of NGOs in the health sector held annual budget planning meetings while ten percent (10%) indicated they did not. This finding agree with findings by Horngern et al (2000) who argued that if administered wisely, budgeting drives management planning, provides best framework for judging performance and promotes effective communication and coordination among various segments of business organizations. Similar observations were made by Yang (2010).

The results further indicated that majority of respondents held between 5-7 budgetary planning meetings in a year while only 0.5% held over ten budgetary planning meetings in a year. This finding corroborate with studies conducted by Hilton, et al (2000) which established that most people will perform better and make greater attempts to achieve a goal if they have been consulted in setting the goal. The idea of participative budgeting is to involve employees throughout an organization in the budgetary process. It is also similar to that of Joshi et al., (2003) who posited that budgetary participation is expected to be a crucial channel to improve the information exchange and sharing among all levels of management and when this process is pursued by a firm, it is expected that the realization of the set target is improved.

The findings also proved that NGOs have various planning horizons which were in consensus with what other scholars observed and concluded (Awino, 2007; Aosa, 1992; Judge & Robinson, 2008) who noted that for implementation to effectively occur, a planning horizon must be set.

4.2.2 Budget Information System

The results indicate that most (55%) of NGOs in the health sector have computerized budget systems while only 45% were operating manual budgetary systems. This diverges from the observation by Diamond & Kehemani (2006) who found out that budget execution and accounting processes were either manual or supported by very old and inadequately maintained software applications and hardware. However, the findings are in agreement with observations by Alin et al. (2006) who argued that financial control is achieved by designing systems and procedures to suit the specific needs of an organization.

4.2.3 Budget Skills Competency

The study sought to establish the budgetary skills competency of the respondents. This was measured by the number of budget trainings attended in a year. The results indicated that most (65%) of NGOs in the health sector held between 1-3 trainings while only 5% did not hold any training. This finding corroborate with a study by Obokoh (2008) who observed that during favorable economic conditions, many organizations embrace training and development than during unfavorable economic conditions.

4.3 Normality of Data

The testing of normality of financial performance (Dependent Variable) in this study was done by using the box plot to evaluate whether data conforms to Gaussian distribution in order to apply data analysis methods such as; t-test, ANOVA, and regression which depend on the assumption.

That data were sampled from a Gaussian distribution (Indiana, 2011). The results are approximately bell-shaped normal distribution and therefore eligible to be subjected to data analysis such as; t- test, ANOVA, and regression (Gujarati, 2003).

4.4 Correlations and Regression of Budgetary process and Financial Performance

Table 1 reports the results of the correlation coefficients of budgetary process and financial performance:

Table 1: Correlations of Budgetary Process and financial performance

Study variable		Financial performance	Budgetary process
Financial performance	Pearson Correlation	1	0.419
	Sig. (2-tailed)		0.000
	N	222	222
Budgetary process	Pearson Correlation	0.419	1
	Sig. (2-tailed)	0.000	
	N	222	222

The correlation matrix presented in table 1 shows moderate positive linear correlation between independent variable (budgetary process) and dependent variable (financial performance).This finding corroborate with studies by Diamond and Khemani (2006) who established that inadequate budgetary management leads to poor financial performance. Chidi and Shadire (2011) also argued that ignorance in the budgeting process was a major determinant of poor performance in small and medium enterprises.

Table 2: Regression coefficients of budgetary process and financial performance

Study Variable	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.934	0.155		12.491	0.000
Budgetary process	0.212	0.031	0.419	6.819	0.000

The regression matrix presented in table 2 shows the calculated t = 6.819 and the critical t/sig value 0.000. Therefore, since the calculated t is greater than the critical t, the study rejected the null hypothesis and failed to reject the alternate hypothesis. The results further indicate a Beta coefficient of 0.419 and a p value of 0.000. Since p value is less than 0.05, the study rejected the null hypothesis and failed to reject the alternate hypothesis. The relationship between Budget process and financial performance followed a linear regression model of the nature $FP = 1.934 + 0.212\ BP + \varepsilon$, Where FP is financial performance, BP is budgetary process while ε is the error term with zero expected value. From the regression equation above, a unit increase in budgetary process will result to 21.2% increases in financial performance of NGOs in the health sector.

This implies that budgetary process is significant in explaining financial performance of NGOs in health sector in Kenya. This leads us to reject the null hypothesis and conclude that budgetary process has a positive influence on financial performance of NGOs in Kenya. This finding concurs with a study by Suberu (2010) who observed that for any organization to perform creditably, budget and budgeting should facilitate effective utilization of available funds, improve decision making, provide a bench mark to measure and control performance, increase general communication and analysis within the organization and establish understanding between managers about goals and objectives. Ashok (2009) also noted that budget as management tools can be used as performance measures among employees.

5. *Summary, Conclusion and Recommendations*

The objective of the study was to establish the influence of budgetary process on financial performance of NGOs in health sector in Kenya. The results showed that budgetary process had a significant positive influence on financial performance of NGOs in health sector in Kenya ($r=0.419$, $p <0.000$). The significance test showed that influence of budgetary process on financial performance was statistically significant and hence the null hypothesis was rejected. This thesis concludes that good budgetary management processes through budget planning, training and budget information systems improve financial performance of NGOs in health sector in Kenya.

The NGOs Co-ordination Board should develop budgetary management policies that embrace budget planning initiatives, Budgetary Information Systems and budgetary skills competency to improve effectiveness of NGOs.

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