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**Working Paper**

## NGO's and Donors' Funding: Evidence from Uganda

CESifo Working Paper, No. 10055

**Provided in Cooperation with:**

Ifo Institute – Leibniz Institute for Economic Research at the University of Munich

*Suggested Citation:* Bougheas, Spiros; Isopi, Alessia; Owens, Trudy (2022) : NGO's and Donors' Funding: Evidence from Uganda, CESifo Working Paper, No. 10055, Center for Economic Studies and ifo Institute (CESifo), Munich

This Version is available at:

<https://hdl.handle.net/10419/267288>

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# NGO's and Donors' Funding: Evidence from Uganda

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## **Impressum:**

CESifo Working Papers

ISSN 2364-1428 (electronic version)

Publisher and distributor: Munich Society for the Promotion of Economic Research - CESifo GmbH

The international platform of Ludwigs-Maximilians University's Center for Economic Studies and the ifo Institute

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Editor: Clemens Fuest

<https://www.cesifo.org/en/wp>

An electronic version of the paper may be downloaded

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# NGO's and Donors' Funding: Evidence from Uganda

## Abstract

We develop a screening model to analyse the funding allocation criteria of institutional donors towards NGOs. The model shows that when donors care about efficiency, they screen NGOs and concentrate their funding on those that comply. Combining two waves, 2002 and 2008, of a unique survey data set of 412 NGOs in Uganda we show that local donors do not implement efficiency selectivity criteria but focus on the geographic location of the NGO and the manager's network. International donors, instead, follow efficiency proxies of both the NGO and the manager, including the manager's level of education, the appointment procedure, and external feedback on community needs. From focus group interviews with beneficiaries it appears they too reward efficiency proxies and show a higher appreciation for those NGOs funded predominantly by international donors.

JEL-Codes: F350, D820.

Keywords: foreign aid, funding allocation, NGO.

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# 1 Introduction

The last two decades have been marked by a rapid growth of the NGO sector. The number of NGOs operating worldwide and their involvement in economic development has increased significantly. From less than 200 reported in 1909 to nearly 1,000 in 1956, 20,000 in 2005 (Union of International Associations, 2005), and 40,000 by 2021 (UN ref).<sup>1</sup> Not only have NGOs become an important policy lobby, leading campaigns on development issues - such as climate change, debt relief, universal provision of primary education and HIV/AIDS awareness, they have also increased their contribution to pro-poor service delivery, especially in areas that local governments struggle to reach.

The rapid growth of the sector in part reflects frustration and impatience with what is perceived to be a failure of governmental development assistance to reach the poor. In response to this underperformance of official aid programs (Asher et al., 2016), the donor community has focused on increasing developing country ownership via the involvement of their civil society organizations. Alongside this increase in size of the sector, there has been an increased flow of money that transits through NGOs for both development and humanitarian assistance. According to Deserrano et al. (2020), the amount of aid from major donors disbursed by non-government organizations (NGOs) has quadrupled in the past twenty years (e.g., Faye and Niehaus, 2012; Werker and Ahmed, 2008). Last year both the UK government and OECD allocated 5% of their development budgets to NGOs.

This paper studies the criteria according to which institutional donors (international and local) provide funding to NGOs in Uganda, a country where the number of registered NGOs increased from 160 in 1986 (Barr et al., 2003), to 14,000 by 2021 (Kiai, 2021). To do so, we develop a theoretical model, in which a donor chooses how to allocate funding to more than one NGO where the efficiency of the NGO is hidden information. The model predicts that when donors value NGO's efficiency, they adopt a screening mechanism and allocate funds rewarding NGOs with the greater outreach. When instead intrinsic features of the NGOs are key for the donor, the model predicts efficiency and, hence outreach, may not play a determining role in the donor's funding allocation strategy.

We test our model's predictions using two unique data sets of NGOs operating in Uganda: 1) building on a nationally representative survey of NGOs conducted in 2002 we use a second wave conducted in 2008 that gathered information on both NGO and managers characteristics for 412 NGOs, and 2) a matched community survey for a smaller subset of 118 focus groups interviews conducted with beneficiaries in 2002. Our results suggest that international donors rely on (imperfect) proxies for the efficiency of both the NGO and/or its manager when they allocate funds, rewarding NGOs whose manager has a higher level of education, was appointed by a formal process and signals financial transparency and accountability. Local donors, instead, take into consideration the knowledge gained through their proximity to both the NGO and its manager. They are more responsive to the geographic location of the NGO and the networking activity of its manager. The results are robust to sample specification and concerns about endogeneity discussed later.

Our paper contributes to the literature that studies the allocation of foreign aid and NGOs in two ways. First, to date NGOs have been studied as an alternative type of donor, where their pro-poor attitude and humanitarian orientation are rarely questioned, rather than as an intermediate player in the donor-recipient relationship.<sup>2</sup> Instead, we look at NGOs in their role as recipients of institutional donors that manage funds to fulfil their

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<sup>1</sup>These numbers do not include the hundreds of thousands of community-based organisations operating worldwide.

<sup>2</sup>See for example, Nancy and Yonchceva, (2006); Dreher et al., (2012); Buthe et al., (2012).

role of service providers<sup>3</sup>. Using a novel micro empirical approach, we look at the aid allocation criteria of donors towards NGOs using a sample of Ugandan NGOs who, at least in principle, care about the poor and most vulnerable in the population.

Understanding donors' selection criteria and what drives their funding allocation to these NGOs is important for a host of reasons. For instance, identifying the determinants of foreign aid allocation towards NGOs could improve an NGO's chance of receiving funds and hence the likelihood of their survival (Burger and Owens, 2013). As importantly, given the potential economic and social impact of NGOs for service provision to reduce poverty and inequality, it is crucial from the policy maker's perspective understanding how to design funding contracts (if any) that incentivize NGOs to improve their effectiveness.

Our second contribution is to establish a link between the selectivity criteria (from the donor's perspective) and the beneficiaries via client-community assessments. Foreign aid effectiveness has been questioned mainly (but not only) because of difficulties in establishing a link between foreign aid and economic growth free from endogeneity issues. (Burnside and Dollar, 2000; Hansen and Tarp, 2001; Clemens et al., 2012). The focus group data we use in our analysis, where beneficiaries of the NGOs are interviewed, allows us to make a step towards establishing a causal relationship by looking at the existence of a correlation between those NGOs that receive a higher percentage of funds from donors and those that have been rated considerably better as service providers by the community. Our results support the strategy adopted by the international organizations, according to which aid effectiveness cannot be obtained without a selective approach, where donors condition aid allocation to the fulfilment of certain requirements (World Bank Report, 2000).

In the following section we take a closer look at the funding patterns of Ugandan NGOs. In section 3 we present the theoretical model. Section 4 describes our data, section 5 describes the methodology, section 5 reports the results and section 6 concludes.

## 2 The System of Funding to NGOs

Due to their flexible structure, it has been argued NGOs can provide basic services and global public goods, improve access through local accountability mechanisms and advocacy functions for the poor and marginalized. Governments, therefore, have been outsourcing more of their development aid delivery to NGOs, following a trend amongst all organizations to outsource non-core functions.

The number of international NGOs has therefore risen dramatically in the last century. While definitive cross-country numbers are not easy to find, the numbers above indicate the substantial presence and increasing importance of NGOs in developing countries.<sup>4</sup> The increase in numbers has corresponded to an increase in the range of activities that NGOs are involved in, spanning from advocacy to service delivery either through stand-alone or major multilateral programs conducted by institutions such as the United Nations and the World Bank (Ghatak and Besley, 2017).

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<sup>3</sup>DAC donors provide official development assistance to Civil Society Organizations mainly in two ways: either via core contributions to programmes, directly managed by the CSOs; or funds channelled through CSOs and other private bodies to implement donor-initiated projects. In this paper, we focus on the second type of funding.

<sup>4</sup>According to the Department of Social Development Republic of South Africa (2015), an average of 68 new NGOs is registered every day with the total number recorded as 136,453 in 2015. The NGO sector in Kenya represents more than 290,000 full-time employees, 2.1% of Kenya's economically active population (Maracci, 2013). In emerging economies, non-profit organisations are also multiplying: an estimated 700 national NGOs opened every day in India in 2011 (<https://devinit.org/resources/ngo-resources-development/> Accessed 20/06/22)).

With both the quality and quantity of services provided by NGOs depending heavily on generating a steady income over time, for project and administrative purposes, securing funding has become a major focus within the NGO sector. Three main sources of funding available to NGOs are: i) donor funding - usually granted through a formal application process; ii) income-generating activities - including membership or subscription fees, publications, sale of products, in-kind contributions; and iii) investments - these sources include fixed deposits, financial investments, trust funds, and endowment funds which are usually generic or non-project specific but often only associated with the biggest NGOs.

The weight associated to each of these sources varies considerably depending on where the NGO operates. For instance, the predominance of private funds is highlighted by McCleary and Barro (2006) for a sample of United States NGOs between 1939 and 2004 where on average over the period, almost 80% of NGO revenues came from private sources. In a related work, McCleary (2009) shows that from the 1960s there is a negative trend in the federal share of NGO revenues in the United States. Similarly, for Swiss NGOs private funds are almost 6 times the average contribution from public funds (276 million USD against 46 million USD). Excluding the US, Koch (2009) reports that for other countries, the dependency on public funds is high. Smillie (1995) finds that in many European countries, the government is one of the biggest financers of NGO activities. For instance, in Norway and Sweden public funds account for between 80% and 100% of NGOs funds. The UK aims to keep the ratio of public funds to an NGO's own funds below 50%.

This pattern does not apply to developing countries (Wang, 2006). While it is possible to secure government contracts for social service delivery, it is less likely that an NGO will receive funding for more politically sensitive activities such as promoting democracy (Darkwa et al. 2006; Ibrahim, 2006; Kamstra and Lau Schulpen, 2014). In the 1990s, Edwards and Hulme (1996) argued that development NGOs were becoming increasingly dependent on official aid: from the mid-1980s to the mid-1990s the level of public financial dependence among the five largest British development NGOs increased from 15% to 52% (while among the smallest the level increased from 7 to 18%). Fowler (1991) found similar evidence in OECD data from 1975 to 1988: the growth of NGO income from public sources outstripped that from donations.

Donor funding (Overseas Development Assistance (ODA) from Development Assistance Committee (DAC)) channelled through NGOs has increased by 8% from \$16 billion to \$18 billion over the period 2010 and 2019 (OECD, 2021). The majority of funding has been through donor country-based NGOs which has remained stable around \$13 billion, whereas the funding to and through international and developing countries NGOs, smaller in comparison, has almost doubled over this period from \$4 to \$8 billion. Some donors stand out in terms of disbursing funds through and to NGOs: EU institutions, and governments of the UK, USA, Germany, Netherlands, Norway and Sweden account for 75% of these funds. Some donors prefer to set targets for ODA to be channelled through NGOs. For example, Luxembourg legislation requires at least 20% the country's ODA to go through NGOs. The French Government has also declared that it would double the share of ODA that goes through NGOs over 2013-18. In the UK, the sector's expenditure in 2015 was £6.96 billion. This is a large sum, equivalent to just over 55% of UK ODA for the same year.

## 2.1 NGOs in Uganda

As an illustration of these funding models, we investigate the Ugandan NGO sector which has also experienced enormous growth in the number of registered NGOs going from fewer

than 500 in 1992 to 3,500 in 2002, close to 7,000 in 2008, 8,500 in 2011 and finally 14,000 by 2021 (Ministry of Internal Affairs, 2021). Some NGOs are national i.e. operate across the country, while others only operate in one or a few districts at most. Some NGOs are involved in multi-sectoral activities, while others are mono sectoral/thematic in their program focus. The range of NGO activities in Uganda has greatly expanded in recent years to include work in the areas of macro policy advice; advocacy on a wide range of issues including human and civil rights, integrity, and accountability in public office; good governance and democracy; lobbying and research (Ministry of Foreign Affairs, 2010). This growth is partly due to the role that the Government of Uganda has encouraged NGOs to assume, namely providing formal modalities for operationalizing partnerships in service delivery but also because of “a perceived failure of governmental development assistance” (Barr and Fafchamps, 2006).

Despite this phenomenal growth, most Ugandan NGOs are still small, fragmented and community based with one manager and a small board of governors and limited funding possibilities. As highlighted by the Ministry of Foreign Affairs (2010) constant fund-raising is one of the most important tasks that these NGOs undertake. The first nationally representative survey conducted in Uganda in 2002 (Barr, Fafchamps, and Owens, 2005) found most NGOs survived with very little revenue. Four large, international NGOs accounted for well over half of the revenue. The average annual revenue per NGO was around 478 million Ugandan shillings (275,000US\$2002 prices) but this masks a median of only 38 million Ugandan shillings (22,000US\$). Most funding from outside sources (international NGOs and bilateral donors) was allocated to a selected group of large NGOs, while small NGOs depended more heavily on membership fees, local fund-raising, and income derived from another business. Because the principal activities reported by Ugandan NGOs in Barr, Fafchamps, and Owens (2005) were “raising awareness” and “advocacy” their limited budgets may not have been an obstacle in achieving their goals or may have led them to concentrate on “talking as opposed to the delivery of physical goods or services”.

Notwithstanding the recent Non-Governmental Organisations Act in 2016 which was seen as a way to restrict civil society in Uganda (Mbazira Namatovu, 2018, p. 76), for those that register the relationship between local government and/or authorities and NGOs is very strong.<sup>5</sup> There are several line ministries, departments, agencies, and districts with direct involvement in the NGO Sector. All NGOs engaged in development activities within a district, for instance, should share their program activity plans and budgets with the Local Government Authority for purposes of harmonization of such program activities into the broader sectoral or area development plans and resource estimates. While Barr et al. (2003) report that 70% of Ugandan NGOs were in partnership with a line ministry, the majority were involved in “talking”, which tends to not attract significant government support. Reinikka and Svensson (2007a and 2007b) suggest that where NGOs are involved in specific sectors such as education and health these partnerships are more likely to be matched with government funding.

The multiple bodies behind the funds channelled through NGOs motivates the research question we address in this paper. We consider the differing emphasis of international donors and the Ugandan government towards NGOs. The emphasis amongst international donors to improve aid effectiveness via promoting country ownership has turned NGOs (in developing countries) into favoured recipients. At the same time the Ugandan government

<sup>5</sup>The 2016 Act replaced 1989 legislation which had been amended in 2006. Under the 1989 law, the Non-Governmental Organisations Registration Act governed NGOs: all had to register with the National Board of Non-Governmental Organisations (NGO Board) (Mbazira Namatovu, 2018, p. 10). A 2006 amendment put representatives from the state security agency on the NGO Board and gave the board the discretion to refuse to register NGOs (Mbazira Namatovu, 2018, p. 85).

claims that the growing number and diversity of NGOs in the country has presented a challenge in ensuring all NGO actors exercise responsible and accountable behaviour to protect the basic interests of the different sector stakeholders, especially the vulnerable segments of society. Neither of these claims have been scrutinized in the literature. In the next section, we propose a theoretical framework to investigate the elements that drive the funding allocation of these institutional donors towards NGOs. We focus on international versus local donors as being the most relevant players NGOs interact with. By comparing their allocation strategies, we aim to identify similarities and differences between these donors to highlight the factors they most respond to when allocating funds.

### 3 A Simple Screening Model of Funds Allocation

Consider two NGOs seeking funds from a potential donor. Each NGO can invest the funds in a specific project to benefit a certain number of clients. The donor wants to maximize the programs' outreach. We assume therefore, the donor cares about the number of people benefiting from the NGO's project. The utility function of the donor is given by:<sup>6</sup>

$$U_D(\gamma) = (n_1)^\gamma + (n_2)^\gamma; \quad 0 < \gamma \leq 1$$

where  $n_1$  and  $n_2$  denote the number of beneficiaries reached by each NGO the donor has allocated funding to;  $\gamma$  defines the degree of substitutability between the projects in the donor's utility function. Let  $V > 0$  denote the size of funds that a donor plans to allocate to the NGOs. NGOs differ by their level of efficiency. To keep things simple, we assume the total costs of an NGO's project to be proportional to the number of people that benefit from it. Let  $c_i (i = 1, 2)$  denote the cost per beneficiary of NGO  $i$ . The cost is private information to the NGO, while potential donor's beliefs about this cost are given by:

$$c_i = \begin{cases} c_L & \text{with probability } \theta \\ c_H & \text{with probability } (1- \theta) \end{cases} \quad (1a)$$

$$(1b)$$

where  $c_L < c_H$ ;  $c_L$  is equal to the lower cost of the efficient NGO. The two cost types are independently distributed. The donor can choose to screen the NGOs by incurring a cost  $z > 0$  and to learn about their true efficiency. Consider, first, the case where the donor decides not to screen. As long as  $\gamma < 1$ , it is optimal for the donor to allocate to each NGO  $V/2$ , in which case:

$$n_i = \begin{cases} \frac{V}{2c_L} & \text{with probability } \theta \\ \frac{V}{2c_H} & \text{with probability } (1- \theta) \end{cases} \quad (2a)$$

$$(2b)$$

With no screening, the utility function of the donor,  $U_D(\gamma)^N$ , is given by<sup>7</sup>:

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<sup>6</sup>By raising the whole utility function to the power  $1/\gamma$  we can transform it to a CES function. To keep simple the illustration of the trade-off that the donor faces we opted for the simpler form.

<sup>7</sup>For  $\gamma = 1$  the donor is indifferent about the exact funds' allocation. As we will see below this is not a relevant case. The first and the third term are multiplied by 2 because, in each case, both NGOs are equally efficient, while the second term is multiplied by 2 because there are two states of the world: one where the NGO is low-cost and the other where is high cost.

$$\begin{aligned}
U_D(\gamma)^N &= 2\theta^2 \left( \frac{V}{2c_L} \right)^\gamma + 2\theta(1-\theta) \left[ \left( \frac{V}{2c_L} \right)^\gamma + \left( \frac{V}{2c_H} \right)^\gamma \right] + 2(1-\theta)^2 \left( \frac{V}{2c_H} \right)^\gamma = \\
&= 2 \left( \frac{V}{2} \right)^\gamma \left[ \theta \left( \frac{1}{c_L} \right)^\gamma + (1-\theta) \left( \frac{1}{c_H} \right)^\gamma \right]
\end{aligned} \tag{3}$$

Equation (3) shows the total utility a donor has when allocating funds to NGOs weighted by the joint probabilities of meeting an NGO of a certain cost type.<sup>8</sup>

Consider, now, the case where the donor decides to screen. If the two NGOs have the same cost profiles, it is optimal for the donor to distribute funds in equal proportion. This implies that each NGOs gets  $n_1 = n_2 = \frac{V-z}{2c_L}$  when efficiency is high, whereas  $n_1 = n_2 = \frac{V-z}{2c_H}$ , when efficiency is low. Let  $\delta$  denote the proportion of funds allocated to the low-cost NGO (i.e. the efficient one) when screening reveals a different cost profile between the two NGOs. The donor chooses the level of  $\delta$  to maximize his utility function, given by :

$$\begin{aligned}
\max_{\delta} U_D(\gamma)^S &= \left[ \delta (V-z) \frac{1}{c_L} \right]^\gamma + \left[ (1-\delta) (V-z) \frac{1}{c_H} \right]^\gamma = \\
&= (V-z)^\gamma \left[ \left( \frac{\delta}{c_L} \right)^\gamma + \left( \frac{1-\delta}{c_H} \right)^\gamma \right]
\end{aligned} \tag{4}$$

The optimal choice,  $\delta^*$ , is given by:

$$\delta^* = \frac{1}{1 + \left( \frac{c_L}{c_H} \right)^{\frac{\gamma}{1-\gamma}}}. \tag{5}$$

Given that  $c_L < c_H$ , from equation (5) we can see that as  $\gamma \rightarrow 1$ ,  $\delta^* \rightarrow 1$ . As  $\gamma$ , i.e. the substitutability of the projects run by the NGOs in the donor's utility function increases, the donor chooses to allocate all funds to the more efficient NGO: since the donor does not have a strong preference for a specific type of NGO, funding decision are based on efficiency only. In contrast, as  $\gamma \rightarrow 0$ ,  $\delta^* \rightarrow 1/2$ . In this case, homotheticity implies that the donor does not allocate funds on an efficiency basis but mainly on his preference for an equal share, despite the differences in the cost profile.

To establish when it is optimal for the donor to screen, we need an expression for ex ante utility conditional on screening,  $U_D(\gamma)^S$ , given by:

$$U_D(\gamma)^S = 2\theta^2 \left( \frac{V-z}{2c_L} \right)^\gamma + 2\theta(1-\theta) (V-z)^\gamma \left[ \left( \frac{\delta^*}{2c_L} \right)^\gamma + \left( \frac{1-\delta^*}{2c_H} \right)^\gamma \right] + 2(1-\theta)^2 \left( \frac{V-z}{2c_H} \right)^\gamma \tag{6}$$

Now, the donor's optimal decision about screening is obtained by comparing his ex ante utility function when screening,  $U_D(\gamma)^S$ , given by (6) with his corresponding utility when he does not screen,  $U_D(\gamma)^N$ , given by (3). Given that  $z > 0$ , for  $\gamma$  sufficiently close to 0 (i.e.  $\delta$  close to 1/2), the difference between  $U_D(\gamma)^N - U_D(\gamma)^S$  is positive, i.e. there are no benefits for the donor in screening. When the degree of substitutability between the NGOs is low, the donor has a strong preference for the project to be run by a specific NGO. In this case, learning about the efficiency of the NGOs via the screening process is the least preferred option, since the donor's funding choices will not rely on this information. Therefore, the donor is better off not screening.

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<sup>8</sup>With probability  $\theta^2$  both NGOs are low-cost, with probability  $\theta(1-\theta)$  one NGO is low-cost and the other is high-cost, and with probability  $(1-\theta)^2$  both NGOs are high-cost.

Suppose, now,  $\gamma = 1$ . Then, as  $z \rightarrow 0$ :

$$\text{sign} \{U_D(\gamma)^N - U_D(\gamma)^S\} = \text{sign} \left\{ \frac{1}{2c_L} + \frac{1}{2c_H} - \frac{1}{c_L} \right\} = \frac{1}{2} \left( \frac{1}{c_H} - \frac{1}{c_L} \right) < 0 \quad (7)$$

In this case, even if the two NGOs have a similar level of efficiency, the donor is better off screening. This is due to two assumptions: the first is that the cost of screening is very low and, second, the degree of substitutability is very high (the donor is indifferent between the two NGOs if  $\gamma = 1$ ). We can see, therefore, that when the donor is indifferent between the projects managed by the NGOs, despite them having a similar cost profile, he still has an incentive in screening: since his utility is maximized by choosing the most efficient NGO, the donor wants to find out which one it is. When, instead, the projects (and hence the two NGOs) have a low degree of substitutability (i.e.  $\gamma = 0$ ) but the cost of screening is non negligible, the donor decides not to screen: the donor is not indifferent between the two NGOs, therefore his preference towards a specific type drives the funding allocation not the cost profile. Since screening is costly and the information is not going to affect the donor's choice, the donor does not screen.

Our simple framework shows how the decision to screen (or not) is driven by two parameters:  $\gamma$  and  $z$ . When the donor is indifferent between the two NGOs ( $\gamma \rightarrow 1$ ), the cost of screening is a relevant parameter: the lower the cost, the higher the incentive for the donor to screen. When, instead, the donor has a specific preference for an NGO, fund allocation is independent of the cost profile of the NGO and the cost of screening becomes redundant.

No screening is optimal when, despite the NGOs having a different cost profile, the donor is not interested in this information ( $\gamma = 0$ ). The same happens when notwithstanding the NGOs have a very similar cost profile, screening is very costly.

Our results provide us with predictions to test in the next section. The first concerns how relevant the cost profile of the NGO is for the donor. Our model suggests that a donor that allocates funds to NGOs which are highly substitutable screens according to efficiency proxies. Whereas when a donor has either a strong preference for a particular NGO or those among which he allocates funds have a very similar cost profile (maybe because they all operate in the same sector) then the donor does not screen. In the next section, we use a newly created dataset to investigate the funding allocation decisions to Ugandan NGOs by two types of donors, international and local donors, to understand what criteria drive their funding allocations and whether it is possible to establish a link between the source of funding and the satisfaction of their beneficiaries.

## 4 Data

We use a unique panel survey of NGOs in Uganda to study funding allocation criteria of the main institutional funders to Ugandan NGOs. The survey is rare in that it is the first nationally representative panel survey of NGOs in a developing country. Two survey instruments were designed. The first is a questionnaire administered to either the manager or a senior representative of the organization via an interview, and the second a structured focus group interview of representatives of the beneficiary communities of these NGOs. Reflecting the growth of the sector, the original 2002 sample of 300 from Barr et al. (2005) was doubled in 2008 (Burger and Owens, 2010). All original 300 NGOs were tracked and of the 235 surviving NGOs all were interviewed. Of the target 300 new NGOs, we surveyed 262 producing a total sample of 486. It is worth noting that 90% of the NGOs in our sample are indigenous, 7% are international NGOs and 3% are branches of international NGOs.

Table 1: Percentage of funding to Ugandan NGOs by source, 2008

Variable	Observations	Mean	Std. Dev.
International Donors	412	34.9	42.9
Local Donors	412	7.8	22.1
Membership fees	412	10.6	24.9
Donations	412	23.5	36.1
User fees	412	6.1	18.8
Business Income	412	11.1	25.6
Other	412	5.7	18.3

Source: Authors' calculations collated from NGO annual reports and websites.

In 2008, we collected information on the percentage of funding the NGOs received from different sources: 74 NGOs did not give information - because they said they received no funding or they simply did not know or the person who knew was not available. Given that we cannot distinguish "no funding" from "didn't know", we have excluded these observations reducing our sample to 412.<sup>9</sup> The majority of Ugandan NGOs who receive international funding are dependent on one or two donors. Many diversify their funding sources in the form of business income, membership fees and subscriptions. It is also the case that those NGOs that are funded by international donors, among which we also include charities and churches, receive the majority of their funding from this source.

Table 1 reports the sources of funding for Ugandan NGOs. The percentage of donations from international sources accounts for 35% of NGOs funding; local sources accounts for 8%; whereas 40% comes from contributions in the form of membership and user fees, and private donations, i.e. by individuals who do not represent a unified body. To describe the sector, we collected additional information on the sources of funding indirectly (not available in the survey). From trawling through Annual reports and websites we collected information on the identity of their main funders. Of the 412 NGOs in the sample 60% (245) had websites. From the websites 207 reported information on their sources of funding (38 with websites reported no information on funding source).

Sources of institutional funding to Ugandan NGOs can be characterized by institution and country. We identified three core institutions: governments, charities and churches (see Table 2). By country the USA, UK and Netherlands were the most generous countries giving to Ugandan NGOs. Most NGOs reported only one source of funding. However, one NGO reported 15 sources. Funding from international donors including bilateral donors (such as USAID, DFID, CIDA), and multilateral donors (such as the UN, World Bank, EU) accounted for the main source of funding for 34% of the sample (Table 2, columns 1 and 2 which reports first the main source of funding and then all other sources). Funding from other charities accounted for the main source of funding for the majority of our sample

<sup>9</sup>For robustness we run our estimations with these NGOs included, thus implicitly assuming they received no funding and find that the results do not change.

Table 2: Main Source of Funding of Ugandan NGO

	Government		Charity		Church	
	Main	Other	Main	Other	Main	Other
USA	11	4	25	45	19	10
UK	5	11	33	40	9	4
Austria			1	1		
Australia					2	
Bangladesh			1			
Belgium		2		1		1
Canada	4		4	10	2	
Denmark	6	5	5		1	
Finland	1			1		
France			4	5	1	
Germany	1	5	8	5	1	1
Netherlands	4	2	11	12	2	1
Iceland		2				
Ireland	1	5	3	6		
Italy						1
Sudan			1	1		
Sweden	2	1	2	5		2
Switzerland			6	3		2
Norway	2	2	2	1		1
Japan	2	2		1		
Uganda	5		7	6	3	
UAE		1			2	2
<hr/>						
African Development Fund				1		
European Community	3	9				
United Nations	25	28				
World Bank	5	1				
Global Fund	4	3				
<hr/>						
Sub-total	81	83	114	143	42	25
Percentage of Total	34%		48%		18%	

Source: Authors' calculations collated from NGO annual reports and websites.

(48%), while churches, Muslim organizations and other Christian groups represented the main source of funding for 18% of the sample (see Table 2 columns 5 and 6). Despite a perception that many NGOs are driven by a religious motive in Uganda this proved unfounded - only 24% report having a religious affiliation and only 18% report funding from a religious organization. Those NGOs that are funded by international governments receive much larger volumes of funding than those funded by charities or churches.

## 5 Methodology

Our aim is to investigate what drives both international and local funding allocation criteria to NGOs and whether differences in their strategies can be found. With that in mind we use the Percentage of Funding from international and local donors, respectively, as dependent variables. Other things equal, we would expect that international donors are in a better position to cover costs related to screening while local donors are more concerned about addressing problems in their locality. If that is the case then funds allocated by international donors will be more responsive to variables that proxy efficiency while those allocated by local donors to be responsive to community needs. Therefore, the variables on the right-hand side are divided into three groups; namely, variables that proxy for efficiency, variables that capture local needs and other control variables.

The first group of variables can be broadly arranged into two categories: those reflecting the characteristics of the NGO and those related specifically to the manager. For NGO characteristics, we include two measures to proxy for accountability and financial stability such as whether the NGO pays taxes to control for its official status inside the country (Registered to pay taxes) and whether the NGO's accounts are externally audited using a question asked to NGOs to check if they produce a balance sheet that was audited (with the variable labelled Audit). Manager's characteristics include whether the manager has a degree to account for his skills/ability in doing his tasks (Education Degree) and a dummy for how the manager was appointed. If the manager applied and was interviewed by a committee (such as a board of trustees or members of the NGO) the variable takes the value of one and zero if self-appointed, (Appointment Interview).<sup>10</sup>

To measure how effectively NGOs are in their role as service providers and meet the needs of the community, we include a set of indicators to capture whether the probability of receiving more funds from either donor is affected by the relationship and the perception of the community towards the NGO. The question asks, "How does the NGO evaluate the needs of the community it assists?".<sup>11</sup> We group the responses into three categories: 1) own observations and experience of staff (Community Needs-Own Staff); 2) local feedback from the community including, other NGOs, local government, and opinion leaders in the community (Community Needs-Loc. Opinion Leaders); and 3) independent surveys and participatory assessments with community members (Community Needs-Ind. Surveys).

Lastly, as control variables we use the number of staff employed by the NGO (N. of Staff) to control for size; the geographic location of the NGOs headquarters (a dummy variable labelled Kampala) which proxies for local knowledge; whether the NGO is indigenous (a

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<sup>10</sup>There may be concerns that the proxy for the manager's appointment and for whether the NGO conducts an audit may be endogenous: in section 6, we present Instrumental Variables (IV) estimates separately for each endogenous variable.

<sup>11</sup>There may be concern that this variable is endogenous due to a donor requiring an NGO to assess the community. In the survey there was another more specific question on whether a donor requires the NGO to assess the community. This variable is not significantly correlated with the variable we are using in the analysis.

dummy variable labelled Indigenous) to explore whether the origin of the NGOs matters for funding, i.e. to see what types of funding NGOs setup by Ugandan nationals are more likely to attract.

Our empirical model is given by:

$$\begin{aligned}
 \text{Percentage of Funding} = & \alpha + \beta_0 N.\text{ofStaff} + \beta_1 \text{Kampala} + \beta_2 \text{Indigenous} + \beta_3 \text{Registeredtopaytaxes} \\
 & + \beta_4 \text{CommunityNeeds} - \text{OwnStaff} + \beta_5 \text{CommunityNeeds} - \text{Loc.OpinionLeaders} + \\
 & \beta_6 \text{CommunityNeeds} - \text{Ind.Surveys} + \beta_7 \text{Audit} \\
 & + \beta_8 \text{Education} - \text{Degree} + \beta_9 \text{Appointment} - \text{Interview} \\
 & + \beta_{10} \text{N.ofNationalCivilServants} + \beta_{11} \text{N.ofLocalCivilServants}. \quad (8)
 \end{aligned}$$

The choice of the variables that constitute our empirical model aims to test the main implications of our theoretical framework. We argue that a donor that values efficiency rewards NGOs that promote accountability and transparency with more funding; whereas a donor that is instead focused on specific features of the NGO, as for example the NGO's mission, might not be influenced by efficiency proxies. We test our empirical model via Ordinary Least Squares (OLS) and Instrumental Variables (IV) to identify which are the leading factors affecting the probability of receiving funding from either an international or a local donor.

## 6 Results

### 6.1 NGO Survey

Table 7 shows our first set of results. For our OLS estimates in column (1), where our dependent variable is the percentage of funding from an international donor, we find international donors provide more funding when the NGO has a financial structure and is registered to pay taxes; local donors instead, provide more funding to NGOs located outside of Kampala.<sup>12</sup> In column (2) where our dependent variable is the percentage of funding from a local donor, we control for whether the NGO is indigenous and find that both donors favor their own type: indigenous NGOs are less likely to have funding from international donors, whereas they are more likely to receive local funding. The size of the NGO does not seem to be a key factor in the funding allocation of either donor.

Aligning with our theoretical model, international donors appear to act according to a screening mechanism to identify the more cost-efficient NGO ( $\gamma = 1$ , i.e. perfect substitutability). This implies they are indifferent to the NGO's activity, and instead prefer to

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<sup>12</sup>We are aware that we are dealing with data that takes values ranging between zero and one. For robustness we ran a nonlinear specification - a Generalized Linear Model (GLM) which is a way to predict values that do fall between 0 and 1. The results do not change. The full set is available on request. The problem with estimating OLS is that the dependent variable is bounded. A linear specification can predict values that are not possible, that is, values below 0 and above 1, and conceptually the marginal effects can be low (tend to zero) for observations that are close to 0 and 1. There is a growing literature that argues that an appropriate functional form is less important than correct identification. Angrist and Pischke (2008) show that the causal effects present no special challenges whether the dependent variable is binary, non-negative or continuously distributed. Instead, they argue that once output from nonlinear models are converted into marginal effects the differences in the OLS and nonlinear models are indistinguishable. They conclude that the complexities that arise from nonlinear models (deciding on within scheme, derivatives versus finite differences, and complexities of IV and drawing inferences from marginal effects) outweighs the advantages of using standardized OLS estimates. We therefore present our OLS estimates in the main text.

fund the most efficient. For local donors, it seems that  $\gamma \rightarrow 0$  implying that the funding allocation happens independent of efficiency considerations. This might be due to local donors having strong preferences for specific NGO's features/nature and hence efficiency considerations are not key; or it might be that the NGOs they usually fund have a very similar cost profile/efficiency. Since screening is usually costly it becomes not worthwhile. Their allocation strategy appears to follow their preferences for specific aspects of the NGOs such as the location and their network activities, rather than any assessment of their performance.

With respect to specific characteristics of the manager, we find the level of education has no impact on the probability of receiving more funding, perhaps because most of the managers in the sample do have a degree and therefore, a screening mechanism has been used at an earlier stage. We do find that appointing a manager by a formal process is more likely to be associated with a higher level of international funding but is irrelevant for local funders.

Lastly, we include two variables to capture how an NGO evaluates the needs of the community and the donors' concern for an NGO's transparency. Results show that international donors are more likely to be associated with NGOs that have their accounts audited and go through independent evaluations, whereas they do not rely on those made by the staff of the NGO: being aware of the lack of incentives they have in reporting negative feedback, international donors favour only those evaluations done by a third party. Local donors, on the other hand, do not appear to take any external evaluation nor any auditing procedure into consideration.

Our results suggest that when funding NGOs international donors do implement a form of screening where funding is made conditional upon efficiency proxies. This seems to confirm the trend observed in the bilateral aid allocation literature. As suggested by Molenaers et al., (2015) policy conditionality must extend beyond democratic reform and include wider bureaucratic procedures. General institutional aspects which represent objective signals are now seen as important drivers of donor funding allocations in an international environment. Local donors, instead, seem not to have been influenced by the selectivity campaign, promoting fund allocation orthogonal to efficiency principles maybe because they believe they have better knowledge of the entities which they fund.

## 6.2 Beneficiary Focus Group Interviews

In the previous section we analysed allocation patterns for both international and local donors toward Ugandan NGOs and concluded that international donors do screen among their recipients, rewarding those organization that comply to efficiency measures and standards. We now extend our analysis to establish whether there is a causal link between efficiency measures and a higher quality service provision.

We present the results from our second source of data, the focus group interviews in Table 5. Community members were asked to assess NGO staff quality, motivations, and the value of NGO services. We use two specific questions from these interviews to test whether efficiency and/or targeting the poor is relevant to a donor allocation decision. First, we collected information on efficiency through a bean count (Beans Efficiency). Community members were told a hypothetical scenario where the NGO was about to go out of business. They were given a pot of money - in the form of beans - which they could contribute all, some or none to the NGO to help keep it in operation. Second, there was a question on whether the NGO targets the poor (Targets the Poor). We use this variable to test whether the probability of getting funding is affected by community perceptions of the target group.

Column 1 shows that international donors are more likely to be associated with NGOs

whose performance is positively evaluated by the community, whereas column 2 shows local donors are negatively affected by the community's assessment of the performance of the NGO. These results are in line with those previously reported in Table 4 regarding the evaluation of the community needs, confirming that international donors appear to have established mechanisms in place to retrieve feedback from beneficiaries that are effective. Local donors' behaviour may have a twofold interpretation: either they tend to favor the less efficient NGOs that otherwise would have had a small probability of surviving, or it might simply be that their level of substitutability is very low ( $\gamma = 0$ ) and they allocate funds following their own (less observable) criteria.

Neither donors' allocation criteria appear to reward NGOs that target the poor. For international funding the sign is negative, for local funders it is positive but insignificant. The reason could be twofold. First, the majority of NGOs report they target the poor so there is little variation in the variable. Second, from trawling through the websites and identifying who the international donors were, reported in Table 2, we found a significant and negative correlation between targeting the poor and international government funding. Unfortunately, the sample matching the FGIs and origin of funder is small (60) making any definitive statements difficult but it appears this may be driving this negative coefficient for international funding. Recognising small sample sizes it appears that this result is being driven by multilateral organisations who are the least likely to target the poor. Splitting funding into multilateral and bilateral we find multilateral donors are significantly less likely to target the poor compared to all other funders.

### 6.3 Endogeneity Concerns

To address the endogeneity concerns discussed at the outset, we start by testing for the possibility that the Appointment variable is endogenous (for instance it may be the case that the funders insist on a particular appointment procedure) by using a Durbin-Wu-Hausman test. We find that for the international funding specification this is in fact the case. The F statistic is 5.20 with a p-value of 0.02. To address this endogeneity, we estimate an Instrumental Variable (IV) regression reported in Table 6. We identify variables that predict whether an NGO uses a formal interviewing procedure but are not correlated with funding. We select the employment market in the area that the NGO operates. We found that where other businesses and NGOs provided similar services, the NGO in question was less likely to use a formal procedure. It could also be argued that the internal workings of the NGO affects the appointment procedure. Therefore, we also include a variable concerning whether the NGO has a membership system. Similarly, where a membership system exists within the NGO, the NGO is again less likely to use a formal procedure. The inference is that the members know the manager and appoint using alternative mechanisms. In the first stage estimations these variables are highly significant in determining Appointment, but do not help the NGO raise international funds. The instruments are jointly significant, the F-statistic is 8.86 significant at the 1% level, which might suggest weak instruments. Accordingly, the estimated p-value from a corrected likelihood test proposed by Moreira (2009) is reported. Several specification tests are conducted. Over-identifying restrictions are tested and not rejected. The Sargan statistic has a value of 0.34 and a p-value of 0.85. Instrumented regression results confirm that Appointment remains highly significant as a factor related to international funding. International donors are interested in managers that have been appointed through a transparent procedure.

The other variable we fear might be endogenous is Audit: donors may provide funding conditional on NGOs auditing their accounts. Testing for endogeneity using the Durbin-Wu-

Hausman test we find the F-statistic is 3.59 with a p-value of 0.05 for international funders; it is not significant for local funders. To address the endogeneity of Audit, we identify whether the NGO owns land, whether the manager has other employment, and whether he/she has travelled abroad as instruments. The first variable captures the stability and how well established the NGO is; the second is informative regarding the level of transparency of the NGO. In the first stage estimations these variables are highly significant in determining whether an NGO audits its accounts, but do not help the NGO raise international funds. The instruments are jointly significant, the F-statistic is 9.36 significant at the 1% level. Since the F-statistic is on the cusp of suggesting weak instruments, the estimated p-value from a corrected likelihood test proposed by Moreira (2009) is reported. Several specification tests are conducted and reported in Table 6. Over identifying restrictions are tested and not rejected. The Sargan statistic has a value of 3.34 and a p-value of 0.19. When we control for endogeneity, our results hold which leads us to conclude that indicators of transparency and performance are important for international funders but not for local.

## 7 Conclusions

We study the determinants of institutional donors' funding to NGOs in Uganda to understand their allocation strategies. Our framework predicts donors screen when the NGO has similar outreach and/or mission, rewarding those NGOs managed according to transparency and accountable procedures with higher levels of funding. When instead donors are strongly interested in specific elements of the NGO, they are better off not screening and allocating funds independently of the cost profile of the recipient. Our results show international donors do screen and trust formal procedures which provide them with observable, verifiable and cost-effective indicators of their recipients' activities. Whereas local donors, rely on information available through local experience and knowledge: knowing the founder of an NGO and their motivation matters more to them than appointing staff through a formal process. Interestingly, the difference in the approach translates into the satisfaction of their customers, showing that accountable and transparent NGOs better serve their communities.

In addition to improving the understanding of the principles underlying funding allocation strategies of institutional donors to NGOs, our findings highlight the importance of looking at NGOs not only as public service/good providers with their own fund raising activities, but also as recipients of funds themselves. The existing literature, despite occasional and growing criticism, has considered NGOs highly committed to the most neglected and in need, making the analysis of incentives to which they respond to unimportant. This paper highlights NGOs may be operating under a more complex set of incentives. By focusing on their intermediary role between governments and local communities, we provide further evidence that the altruistic principle of NGOs should be considered alongside their more business-oriented objective.

Finally, our paper complements the findings on bilateral aid allocation and provides a simple yet powerful policy implication: by conditioning development aid upon requirements of transparency, accountability and efficiency, donors provide incentives to NGOs to comply with those principles in order to attract more resources in the future, which ultimately translates into serving the community they operate in with higher quality public good provision.

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Table 3: Descriptive Statistics

Variable	Obs.	Mean	Std. Dev.	Min	Max
Proportion from international funding	412	0.349	0.429	0	1
Proportion from local funding	412	0.078	0.220	0	1
Education/Degree	412	0.635	0.481	0	1
N. of Staff	412	2.876	0.939	0.693	7.158
Headquarters in Kampala	412	0.378	0.485	0	1
Indigenous vs International NGO	412	0.902	0.296	0	1
Registered to pay taxes	412	0.116	0.321	0	1
Appointment/Interview	412	0.5	0.500	0	1
Evaluation of Community Needs- Own Staff	412	0.514	0.500	0	1
Evaluation of Community Needs- Ind. Survey	412	0.567	0.495	0	1
Evaluation of Community Needs- Opinion Leaders	412	0.871	0.335	0	1
Audit Accounts	412	0.575	0.494	0	1
Beans Efficiency	118	0.648	0.331	0	1
Target the poor	118	0.905	0.293	0	1
Number of National Civil Servants	260	2.712	1.562	0	8.987
Number of Local Civil Servants	260	3.425	1.397	0	10.308

Table 4: OLS Estimates

N. of Staff	0.011	0.001
	0.018	0.012
Kampala	0.034	-0.058***
	0.038	0.02
Indigenous	-0.264***	0.043**
	0.07	0.018
Registered to pay taxes	0.200***	0.007
	0.067	0.028
Education- Degree	0.058	0.001
	0.044	0.028
Appointment - Interview	0.190***	0.012
	0.042	0.025
Community Needs-Own Staff	-0.130***	0.027
	0.037	0.023
Community Needs-Loc.Opinion Leaders	0.043	0.017
	0.039	0.024
Community Needs-Ind.Surveys	0.100*	0.009
	0.056	0.036
Audit	0.164***	0.021
	0.044	0.026
Constant	0.249**	0.069
	0.103	0.046
Observations	412	412
R-squared	0.291	0.028

Standard errors are displayed below the coefficients;

\*omitted dummy self-appointed

#: estimated p-value from corrected likelihood test proposed by Moreira (2009).

Table 5: Focus Group Interview- OLS Estimates

VARIABLES	1	2
	International	Local
<b>N. of Staff</b>	0.023 0.037	0.007 0.02
<b>Kampala</b>	0.129 0.112	-0.088** 0.042
<b>Indigenous</b>	0.03 0.131	0.031 0.053
<b>Registered to pay taxes</b>	0.226** 0.094	-0.045 -0.045
<b>Education- Degree</b>	0.106 0.074	0.028 0.048
<b>Community Needs-Own Staff</b>	-0.174** 0.081	0.047 0.051
<b>Community Needs-Loc.Opinion Leaders</b>	0.01 0.079	0.024 0.052
<b>Community Needs-Ind.Surveys</b>	0.17 0.117	-0.051 0.088
<b>Beans- Efficiency</b>	0.181* 0.098	-0.167* 0.086
<b>Targets the Poor</b>	-0.263** 0.131	0.032 0.043
<b>Constant</b>	0.238 0.257	0.141 0.144
<b>Observations</b>	118	118
<b>R-squared</b>	0.228	0.097

Standard errors are displayed below the coefficients.

Table 6: IV Estimates

	1	2	3	4
	IV For Appointment	IV For Audit	IV For Appointment	IV For Audit
VARIABLES	First Stage	2SLS	First Stage	2SLS
<b>N. of Staff</b>	0.033 1.36	0.003 0.12	0.017 0.63	0.001 0.07
<b>Kampala</b>	0.008 0.15	0.036 0.82	-0.018 0.36	0.069 1.65**
<b>Indigenous</b>	0.089 1.11	-0.231 3.02***	-0.145 1.76**	-0.240 2.76***
<b>Registered to pay taxes</b>	0.160 2.21***	0.162 2.29***	0.218 3.03***	0.180 2.14***
<b>Education- Degree</b>	0.280 5.67***	-0.001 0.01		
<b>Services by business</b>	-0.139 2.53***			
<b>Services by other NGOs</b>	-0.081 1.61**			
<b>Membership System</b>	-0.201 3.95***			
<b>Appointment - Interview</b>		0.590 3.26***		
<b>Community Needs-Own Staff</b>			-0.041 0.86	-0.119 2.95***
<b>Community Needs-Loc.Opinion Leaders</b>			0.146 3.01***	0.004 0.09
<b>Community Needs-Ind.Surveys</b>			0.082 1.17	0.114 1.87**
<b>NGO owns land</b>			0.176 3.62***	
<b>Manager has another occupation</b>			-0.090 1.83**	
<b>Manager has traveled abroad</b>			0.138 2.94***	
<b>Audit</b>				0.512 3.27***
<b>Constant</b>	0.498 4.16***	0.223 1.89**	0.400 2.99***	0.180 1.26
<b>Observations</b>	412	412	412	412
<b>R-squared</b>	0.183	0.076	0.142	0.146

Standard errors are displayed below the coefficients.