



JBWere

## Special Feature – Banking, Investment and Finance Non-profits have learnt some lessons in the wake of the GFC

In a post-Global Financial Crisis world non-profits are reviewing their approach to endowments and investment more broadly. David Knowles reports from the coal face.

After meeting with executives and directors from 30 leading non-profit organisations to discuss their perspectives on endowments and investment, a number of recurring themes emerged. The meetings were held as part of a 'strategy round', and revealed the key factors and thinking behind how non-profits are changing their approach. The important themes that arose during discussions are highlighted below.

### **The number of recently appointed executives was striking**

It appears the number of newly-minted chief executive officers and chief financial officers is principally a function of internal reviews carried out by organisations in response to the fundraising environment and the broader economic climate of the last two years. The overwhelming impression was one of non-profits reorganising themselves after a testing period, during which the need for experience in key positions became apparent.

If one thing stood out above other observations, it was in relation to the financial officer role. Specifically, it appears numerous organisations have appointed candidates with greater experience and professional qualifications to this role, whilst increasing the scope and seniority of the position, in recognition of the benefits of employing a financial officer who can make both an operational and a strategic contribution.

### **Governance and transparency are high priorities**

There is an element of self-regulation at play here. Organisations are clearly responding to the renewed focus on corporate governance and transparency in the post-global financial crisis world. However, far from being simply a response, many organisations are seeing good governance and transparency as an effective way to communicate their ability to be trusted with the management, investment and application of funder dollars. This is a good investment.

This recognition that governance and transparency need to receive greater attention bodes well for an observation we have made in advising our philanthropic clients over the last couple of years. Major donors, and donors who think of their contribution as an investment, are increasingly looking at an organisation's internal structure and capability before they consider who to support. With over 25,000 deductible gift recipients to choose



from in Australia, organisations that present their ability to achieve their mission, rather than rely on it, are finding governance and transparency valuable sources of competitive advantage.

### **Organisations are realigning policies and activities with mission**

This appears to be more than just a normal part of the operating cycle. When the tide goes out, some programs dry up. Policies that once seemed sound can flounder on the rocks. And a low tide can expose just how far a mission has drifted. This is an opportunity not to be missed, and non-profits seem to have seized it, reviewing their plans and returning to their core activities and strengths, in pursuit of their core mission.

One area discussed at length was the development of a formal investment policy and the many benefits of putting in place a comprehensive framework for investing surplus and endowed funds. Those benefits include using an investment policy to demonstrate to potential supporters that their money will be well managed and the ability of a policy to enable directors and executives to confidently and consistently articulate a course of action to key stakeholders.

### **Short-term concerns continue to influence long-term investment**

When considering investment, not surprisingly, tension still exists between doing what makes sense to build long-term organisational capacity and sustainability and doing what seems to work in the short term. The lack of surprise stems from the obvious nature of immediate considerations: reputational risk to the organisation (related to poor investment returns), reputational risk to individual decision-makers ('not on my watch') and pressure to spend available funds quickly, in the belief that current needs outweigh long-term considerations.

### **Endowments are seen as a way to generate sustainable income**

Many organisations clearly see the value of creating or building upon an endowment. It seems the GFC has only increased awareness of the value of a 'rainy day fund' which generates a passive income stream. In particular, non-profits are attracted to building a pool, or pools, of untied funds that can generate income they can use to offset core operational costs they would otherwise struggle to fund. Creating an endowment around a particular long-term activity also appeals. The key point that came over again and again is that an endowment is a step towards self-sufficiency and sustainability.

### **Non-profits prefer to structure endowments internally**

Faced with the choice of establishing a separate legal entity to hold endowed funds or creating a separate account within the existing non-profit, there is a clear preference. Whilst an external fund is handy for quarantining funds in an accounting



or operating sense, the benefits of an internal fund tend to outweigh them. They are cheap to establish and easy to manage. The parent non-profit retains full legal ownership, and there is no risk of ceding control to an external foundation board that develops its own ideas about how the money should be spent. That said, the need to develop a separate strategy, investment policy and spending policy for an internal fund is widely accepted.

### **The value of franking credits is well known**

Imputation credits on franked income can significantly increase income yields on funds invested by eligible non-profits. Access to franking credit income therefore becomes an important consideration for non-profits looking to maximise their income. This means many rightly make the pursuit of franked income part of their investment decision-making process. However, it's clear in some cases it's not just an important consideration when formulating investment strategy: it is the investment strategy. It's equally clear that those organisations that have considered franking in the context of an appropriate asset allocation are sitting more comfortably than those whose asset allocation was driven by a desire to maximise franking credits.

### **There is a focus on cash yields**

Many of the organisations that participated in the strategy round acknowledged that there is scope to improve their cash returns. Most organisations are looking for ways to increase the yield on cash without disproportionately increasing their risk. They are aware that this is an area where money can be

### **About the Author**

Prior to joining JBWere, David worked for Perpetual Private Clients as Head of Philanthropy, where he also chaired Perpetual's Trust Investment Committee, which oversaw investment of charitable funds managed by Perpetual as trustee. David's 20 year career in financial services also includes 5 years offshore experience working for Merrill Lynch's intergenerational wealth management business and 5 years working for English private bank Coutts & Co, assisting wealthy clients with their banking, investment and estate planning needs.

'lazy' and there seems to be a belief that you can't always rely on your banker to maximise your return. With the right level of active attention and advice, these organisations are looking beyond term deposits to a range of fixed interest securities and hybrids - provided they first understand the characteristics of each investment and provided they trust both the product issuer and their adviser.

### **Social investment is the new black**

Almost without exception, non-profits expressed considerable interest in JBWere's work in social investment. The idea of offering an investment product that delivers social and financial returns is bound to arouse curiosity. In theory, it gives non-profits the ability to take an alternative funding proposition to existing supporters and a compelling investment opportunity to a completely new pool of potential investors, led by superannuation funds and ethical investors. In truth, social investment is an emerging market and potential investors are only beginning to dip their toes into uncharted waters.

To attract funding, non-profits will need to convince investors they can deliver the investment return as well as the social return and that their risk is comparable to similar investment opportunities available to them. Most Australian non-profits are presently unable to meet this test, but there are plenty that can, and if they do crack the code the potential market for this type of capital raising is huge.

Social investment has the ability to change the funding paradigm ... but not for everyone.

### **JBWere Philanthropic Services – Experience where it counts**

Since 2001, we have been helping individuals, families and businesses develop and implement strategic philanthropic goals that meet their particular needs. We work with non-profit clients and provide insights and advice on governance, how to maximise investment outcomes and how to appeal to donors.

We regularly conduct and compile research and best practice in the non-profit space and share these findings with our clients. We also present capacity-building seminars and events, which provide educational opportunities for non-profit staff and board members.

As a team we are committed to contributing to the ongoing development of the philanthropic and the non-profit sectors in Australia and New Zealand.

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To find out more about how our JBWere Philanthropic Services team can help you, please contact:

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