How Charities Can Ensure Financial Longevity

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Charities should create an investment strategy to meet long-term financial liabilities.

Donors typically want to fund charities that will spend most, if not all, of the money they give on the needy.

For charities, many place donation funds in low-yielding bank accounts or government bonds because the idea of investing the funds makes them feel “dirty”.

Their mission, they feel, is to spend funds on worthy causes, rather than making money from investing.

These ideas, while seemingly practical and high-minded in intent, may not deliver the best outcome for charities and those they aid. So both donors and charities should rethink their mindset.

Take orphanages, for example. Like many charities, they often take on long-term projects. As with the prolonged responsibility of raising orphans to adulthood, charities have financial commitments that last for decades. What will they need to do to ensure that they have the means to cover their financial liabilities?

Funding “orphans” for decades

The answer, quite simply, is to have a long-term investment strategy. And the first step towards that is to set up an investment committee. This article is the first in a series based on our new book *Good Practices for Managing Funds for Non-profit Organisations*.

To be sure, large charities such as the Bill & Melinda Gates Foundation have financially sophisticated endowment funds. However, small- and medium-sized charities with funds of up to US$50 million may not be aware that they could do a better job of maximising their funds for the long term.

In the United Kingdom, for instance, just 11 per cent of charities had investments to fund their programmes, according to a survey of the charity sector in 2015 by auditing firm Deloitte.

What stakeholders should consider

In discussing charities’ use of investments, we would like to encourage the founders, board members and workers of charities to think about the financial role of their organisation, and for donors to consider how best to give. We also want to foster discussions on the regulatory environment surrounding the sector.

When donors give to charities, they have the choice of either contributing to the charity’s capital or they can stipulate that the funds should be used immediately. In the former scenario, a charity should think about what responsibility it has to its donors and what it should do with the capital raised to fulfil its fiduciary duty.

For donors, while they want their money to reach those in need, there have long been inadequate discussions on how they should choose which charities to fund. Rather than giving to a charity that spends all its funds each year and has to fundraise afterwards, could donors make better use of their money?

A way to get the maximum bang for their buck is to examine whether charities have a credible investment committee with a strong long-term investment strategy. With such charities, donors’ funds will work in perpetuity for the benefit of those they seek to help.

From the macro perspective, many Southeast Asian countries and China are developing their own regulatory system for the charity sector. They should, however, be mindful of the pitfalls of following those in the West.

For instance, charities in Germany can only invest in capital-protected assets such as government and blue-chip corporate bonds, as well as bank deposits. But such financial instruments erode capital over time because their rates of return fall behind inflation rates.

Charities should instead be allowed to risk their capital by investing in diversified assets such as index funds, which are more likely to beat inflation and safeguard capital in the long run.

The nuts and bolts of an investment committee

In setting up an investment committee, it is normal for a charity’s board of directors to choose board members for the task of managing its capital reserve or endowment fund.

There are two vital steps in forming the committee. First, the body has to set up its charter or terms of reference. It has to outline the roles, responsibilities and authority of the committee, its support staff, the external consultants, the investment managers and the custodian. The charter should regulate its process of amendments and the composition of its membership.

The charter should be viewed as an organic document that changes to meet the needs and complexity of the charity. Ideally, the committee should hold four face-to-face meetings each year. When quick investment decisions are needed, the charter should allow telephonic or video conferencing to avert delays.

Second, the investment committee has to decide on the number of members it needs and who they will be.

A diversified team

As it is not unusual that most board members lack the skills and experience to manage investments, it is common for charities to recruit professionals from the financial services industry. To have sufficiently diverse viewpoints, the investment committee should preferably have between five and seven members of different age and gender.

Academic studies have shown that a diversified team has a higher chance of success.

As committee members are vulnerable to reputational risks and even lawsuits, they should be warned and given appropriate training. In terms of tenure, it is ideal for committee members to serve several years and reduce turnover to a minimum. No more than one person should leave and be replaced each year.

Besides giving committee members proper briefings on the purposes, duties and investment process of the committee, it is advisable for the committee to have a clear succession plan and the continuous addition of younger talents.

Risk management

In investing the charity’s funds, members of the committee should invest as they would their own funds. But they should be required to seek proper advice on the suitability of the investment securities and to diversify investments in order to manage risks.

Indeed, the committee should do its best to seek investments that can yield reasonable returns and meet the investment guidelines and risk appetite of the charity. It is a breach of duty to leave large sums of cash uninvested, a point that is often misunderstood and ignored by charities in their nascent stages of operation.

Lastly, it is important that the investment committee secures competent operational support from its charity and maintains proper records of committee meetings, investment performance reviews, custodian reports, financial accounts and auditor’s reports. That is because of the potential liabilities and risks of claims facing the committee.

It is good practice for the charity to buy liability insurance for its directors and officers in the event that lawsuits are filed against them for alleged wrongdoings in their work.

This post is part of a **series** on good practices in fund management for non-profits.

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About the series

Fund Management for Non-Profits

A series based on the forthcoming book *Good Practices for Managing Funds for Non-Profit Organisations*, by Boris N. Liedtke and Peter Lai.

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