



Investing for Non-Profits



# *Top 10 Mistakes of the Australian Non-Profit Investor*

*And how to avoid them*

*A guide for Trustees, Directors and Committee Members*

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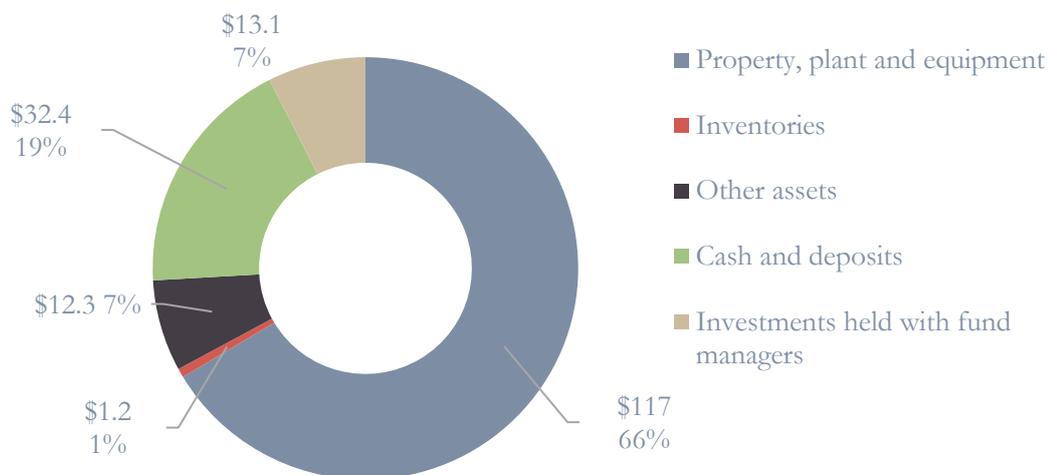
# Introduction

This paper is intended to help people who have taken up the challenge and responsibility of investing money for the benefit of others. This is, for most, unpaid work carried out in an environment where:

1. resources available for support and development are scarce
2. a desire to help achieve important objectives meets a desire to minimise personal and organisational risk
3. long term thinking is challenged by short term issues and concerns
4. very few board or committee members possess relevant investment expertise *and* a deep understanding of their fiduciary duties and responsibilities

Helping non-profit investors avoid common mistakes is important for the sake of all those affected by the way in which non-profit assets are managed. It is significant for another reason as well: Australian non-profit investors hold \$13bn with investment managers – so there is a lot at stake.

## *Australia's Non-Profit Asset Mix (in billions)*



Source: ABS, Koda Capital

# Context

Investing on behalf of a non-profit is a tough job. People who step forward to assume this significant responsibility understand that as a task it is neither easy nor straightforward.

This paper is dedicated to helping investors spot and avoid potential mistakes and common pitfalls. Most of these investors will be carrying out their duties as part of a group. They will sit on a board or investment committee. They may be a member of a risk, audit and finance committee, or they may be a Chief Financial Officer reporting into such a group. In fewer cases, they will be acting alone – entrusted to invest prudently and successfully by others.

This paper is also about recognising danger and dealing with it through a combination of awareness and reflection.

It is said that the second most dangerous person on a non-profit board or investment committee is the person who knows nothing, while the most dangerous person is the person who thinks they know everything.

In the non-profit context, these two individuals are closely followed by the ‘*investment expert*’, who is potentially dangerous for two reasons. Firstly, they are prone to overestimate the relevance of their knowledge, which is typically either too general to be completely relied on, or too specific to qualify them as an all-round expert. Secondly, they are often seen by their fellow board and committee members as ‘*the one who makes the decision*’ and someone everyone else should defer to. Relying on one person, however well qualified on paper, is a potential pitfall for all concerned.

In writing this paper, it is hoped that individual readers will avoid potential pitfalls and otherwise benefit from Koda’s own deep experience of and with the Australian non-profit investment community. Non-profit investment groups regularly ask Koda to help them navigate the challenge of investing by committee and this further adds to our experience.

This experience has helped Koda recognise some of the most common mistakes people commit, in good faith, in the course of their work. By recognising, avoiding and learning from the mistakes of others, we can individually and collectively improve outcomes for Australian charitable, non-profit and philanthropic organisations.

We hope you get something from reading and reflecting on what follows in this paper.

# Top 10 Mistakes

## 1. Wearing the wrong hat

The person who wears the wrong hat fails to recognise that what works for them as an investor in one setting might not work in another. Classic mistakes include believing that all non-profits should invest the same way, assuming that good personal investments equal good non-profit investments and making personal attitudes to risk the basis of decisions taken on behalf of an organisation with a completely different risk profile.

Investing on behalf of a non-profit is often likened to investing on behalf of a superannuation fund. When this leads investors to assume that what is appropriate in the superannuation context is appropriate in the non-profit context, problems arise. While comparisons are often made, superannuation funds operate in a fundamentally different manner to most non-profit funds. For example, superannuation funds operate for a finite period and have a drawdown profile linked to an individual's cost of living and age, while many non-profit funds operate in perpetuity or otherwise operate with an intention to minimize capital drawdowns. The person who fails to take off the superannuation investor hat and put on the non-profit investor hat is making one of the most common mistakes seen around the non-profit table.

The key to avoiding such mistakes is recognising that non-profits operate in an investment environment all of their own and all non-profits have unique needs and circumstances. These facts inevitably require a highly-tailored investment approach.

*“The only source of knowledge is experience.” – Albert Einstein*

### ***Self-reflection***

Do you ever view non-profit investing through the lens of your personal investor profile?

Have you ever made the mistake of assuming investing for a non-profit is just like investing on behalf of a superannuation fund?

If so, what can you do to better understand the differences?

## 2. *Overconfidence*

The overconfident person says “*I know how to invest*” or “*I’ll follow the same approach that made me successful in my business*”. Both these approaches are potentially flawed. There is no one-size-fits-all approach to investing successfully and a little knowledge can be a dangerous thing. It is particularly important not to extrapolate expertise. Great football players do not necessarily make great managers and professionals with business and investing skills may not make great trustees. Likewise, it should not be assumed that investment industry professionals who have spent a career around money have the breadth or depth of experience to manage it on behalf of a non-profit.

*“Most of our assumptions have outlived their usefulness.”*  
– *Marshall McLuhan*

### ***Self-reflection***

Are you guilty of assuming expertise in another role qualifies you as an expert in this one?

Do you assume your business experience translates neatly to your non-profit work?

Can you make time to learn about the unique nature of the non-profit sector?

## 3. *Thinking only about Australia*

Australian investors have traditionally favoured domestic investments. Charitable investors have traditionally valued franking credit income, making them even more focused on Australia. At the same time, the benefits of diversification are well known to the long term investor and it is obvious that investment opportunities available outside the relatively small and concentrated Australian market are many and varied. Why then are non-profit investors so reluctant to invest offshore? The biggest mistake non-profit investors make is to answer this question, without fully exploring it. Being open-minded and taking the time to analyse different options is the key to adopting a prudent, well thought out approach.

*“Nothing is more expensive than a missed opportunity.” – H. Jackson Brown*

***Self-reflection***

How much of your portfolio is invested in one country?

Have you seriously considered investment opportunities outside of Australia?

If not, why not?

***4. Missing the big picture***

Franking credit income represents a valuable source of annual income to many non-profit investors. And who doesn't like receiving a cheque from the Australian Tax Office every year? But does this mean access to franking credits should drive major investment decisions – decisions like asset allocation - that have a significant bearing on investment returns and risk exposure? No. It's very important to take a top-down approach to investment strategy. If you take a top-down approach and find that investments paying fully-franked income fit into your strategy, then it is appropriate to look at making the most of the opportunity. Otherwise, you need to exercise caution. Don't put all your eggs in one basket, just because you like baskets.

*“The tail should not wag the dog.” – Proverb*

***Self-reflection***

Is your approach to investing too focused on one opportunity?

Does the pursuit of one objective compromise your overall investment strategy?

Have you compared the contribution of franking credit income to the opportunity cost and additional risk of investing heavily in Australian equities that pay fully-franked dividends?

## 5. *Being too conservative*

One of the most common statements made by non-profit investment committee members is “*We are very conservative.*” In this context, ‘conservative’ means something along the lines of “*I do not want to risk losing any money*” or “*We cannot lose any money.*”

This is completely understandable and in many cases it is not just appropriate to be conservative, but mandatory. However, many non-profit portfolios are invested in an overly-conservative manner, either because committee members are worried about their own legacy (no-one wants to leave an organisation worse off) or because they fail to fully appreciate the long-term negative effect of overly-conservative investing.

The problem with being overly-conservative is two-fold. Firstly, without a deep understanding of the risks involved in different asset classes, non-profits may actually expose themselves to more risk than is necessary when trying to achieve returns in a ‘*conservative*’ manner.

Secondly, for long-term investors, cost inflation – in the economy or in their sector - is the enemy. Failing to keep pace with rising costs can be disastrous for a non-profit and failure to invest appropriately in growth assets can be disastrous for organisations managing long-term endowment funds.

*“The road to Hell is paved with good intentions.” – Proverb*

### ***Self-reflection***

Do you really understand what risk means for your organisation?

Is an investment in cash and term deposits risk-free?

What can you do to better understand the risk and return profile of different asset classes and the combination of assets in your portfolio?

## 6. *Leaving it to someone else*

It is a rare individual who can honestly say they have never looked across the table while somebody else grappled with a tough decision and left it at that. In a group setting, it is often quite easy to let others carry the conversation, while nodding sagely and occasionally making comments like “*Good point*”, “*That’s true*”, or “*Exactly*”. Opting out of protracted discussions until others make difficult decisions may be tempting, but it is not worth it in the end. Ultimately, the only reason you are there is to make a contribution. And making a contribution means taking responsibility.

*“You cannot escape the responsibility of tomorrow by evading it today.”*  
– Abraham Lincoln

### ***Self-reflection***

Do you ever switch off during discussions that lead up (eventually!) to decisions?

Do you ever take a passive role on the basis you can rely on others to take responsibility?

What can you do differently in your next board or investment committee meeting?

## 7. *Dominating the conversation*

Many non-profit boards and committees have one or two personalities who dominate the agenda and strongly influence decisions. They are usually the big-hitters, the big cheeses or the ones with the most money. People defer to them for a variety of reasons, none of which stand up well to scrutiny. Board and committee work is a team sport and the best teams are the ones where everyone makes a contribution. For some people, this means stepping up. For others, it means stepping back. The best way for someone to dominate a conversation is for them to bring their more reserved colleagues into it.

*“Knowledge speaks, but wisdom listens.”* – Jimi Hendrix

***Self-reflection***

Do you let one or two voices dominate the conversation?

Are you one of those voices?

If so, how can you bring others into the conversation?

**8. *Not showing up***

Another issue regularly reported by non-profit chairs (and CEOs) is a lack of commitment to real work. It is certainly true that accepting an offer to join a non-profit board or committee is easier than contributing to it. What they report, in relation to people not showing up, usually takes two forms. Firstly, some people regularly fail to attend meetings. This can always be explained away, but at the same time, committee meetings are full of people who manage to attend, in spite of competing priorities. Commitment means commitment. Secondly, people who excel in the for-profit world are sometimes accused of dropping down a couple of gears when volunteering their time in the non-profit world. If this sounds familiar, it might be worth reflecting on why you got involved in the first place.

*“Real generosity toward the future lies in giving all to the present.”*  
– *Albert Camus*

***Self-reflection***

Do you have a good record of attendance at investment committee meetings?

Have you ever been guilty of ‘leaving your brain at the door’ (something those from the for-profit world are often accused of when entering the non-profit room)?

If so, can you make the same commitment to your non-profit work as you do to your for-profit work? If not, what does that mean for you and for your non-profit organisation?

## 9. *Steering without a rudder*

Increasingly, non-profits manage their investment responsibilities with the help of a robust governance and policy framework. Some do not.

Organisations that entrust the investment process to a single individual or to a small group who operate according to rules of their own making are a concern. Usually these arrangements are self-justified on the grounds that the individuals involved are “*experts*” or “*know what they are doing*”. In practice, experience suggests the individuals are more likely to be lone rangers, exposed to numerous risks and exempt from the scrutiny of due process.

Regardless of how many people are involved in the investment process, the foundation of successful non-profit investing is a comprehensive investment policy framework complete with a written investment policy statement.

The value of a policy statement depends on how much thought goes into its production, how well it is followed and how often it is reviewed.

*“What’s needed is a sound intellectual framework for making decisions and the ability to keep emotions from corroding that framework.” – Warren Buffett*

### ***Self-reflection***

Do you have a formal written investment policy and do you actually follow it?

When was the last time you reviewed it?

Do you use an independent adviser to help you review your policy objectively?

## *10. Appreciating price more than value*

And finally, we come to what, quite rightly, always matters to the non-profit investor – value for money. Except that value is not always what the non-profit investor actually focuses on. Cost is what they often focus on. And cost is not necessarily the most important consideration when it comes to investing.

In the context of non-profit investing, costs may differ by a fraction of a percent, while investment outcomes may differ by several percent. This is something that the person who largely bases their investing decisions on price can and often does overlook. Which, as the quote below shows, is a shame.

Keeping an eye on the big picture is the key to avoiding this mistake.

*“Price is what you pay. Value is what you get.” – Warren Buffett*

### ***Self-reflection***

Do you make investing decisions based on cost alone?

Do you weigh up all the issues and then base your decisions on price anyway?

If so, are you having the right conversations about value?

# *In conclusion*

Investing successfully on behalf of a non-profit is a challenge that comes with significant responsibility. Making investment decisions on behalf of others, as part of a group, is not straightforward either. It is enormously helpful to start with a clear purpose and a set of well-defined objectives, risk parameters and decision-making processes.

Relevant experience is a priceless commodity. But the most important and valuable commodity of all is really the ability to recognize that experience begins with learning and reflection.

*Key points for trustees, directors and committee members:*

- 1. Self-reflection is valuable and no-one is perfect. Perhaps the biggest trap you can fall into is to stop learning*
- 2. Contributing to a non-profit investment effort requires commitment, self-awareness and a number of softer skills in addition to relevant investment expertise*
- 3. The key to avoiding common mistakes is reflecting on the first two points, while understanding why you are there, what your organisation is trying to achieve and the context within which it is trying to achieve it*

Mastering the non-profit investment process starts by avoiding common mistakes. When individuals, boards and committees devote time and effort to recognising, avoiding and learning from the mistakes of others they reduce personal and organisational risk and make the organisations they serve more attractive to potential funders. This work will improve investment outcomes for Australian charitable, non-profit and philanthropic organisations and, ultimately, increase the capacity of those organisations to do good work for the benefit of our community.

*“An investment in knowledge pays the best interest.” – Benjamin Franklin*

# *How to use this paper*

Please feel free to share this paper with anyone who might benefit from reading it.

- ✘ Circulate it to your board or investment committee contacts
- ✘ Table it at a risk, audit and finance committee meeting
- ✘ Use it when planning your next investment review
- ✘ Invite Koda to discuss it with your board or committee
- ✘ Share it on social media or refer to it in a media release
- ✘ Discuss your investment advice arrangements with Koda

Koda's Philanthropy & Social Capital team is committed to sharing information of value to non-profit leaders. We hope you find this paper insightful and useful in your own work. We would be delighted to hear from you in response to this paper, so please do not hesitate to contact us, via [philanthropy@kodacapital.com](mailto:philanthropy@kodacapital.com).

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## *About the author*



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David heads Koda's specialist Philanthropic & Social Capital team. His primary responsibility is providing strategic advice to charitable, non-profit, and philanthropic investors.

In a 25-year private wealth management career David has worked in fiduciary management roles for Coutts and Merrill Lynch in the UK and held senior advisory and leadership positions in Australia. At Perpetual, David was Head of Philanthropy and Chair of Perpetual's Trust Investment Committee. At JBWere, David was a Managing Director, Head of Philanthropic Services and a member of the JBWere Charitable Endowment Fund Investment Committee. Since 1999 David has been a member of the Society of Trust & Estate Practitioners. He is a member of the Centre for Social Impact's advisory council, Impact Investing Australia's market building working group, the Raise Foundation's Patron's Advisory Committee and a Director of the charity BoardConnect. David also sits on the editorial advisory board of Generosity magazine.

David qualified as a professional trust and estate practitioner in 1998. He has since attended Harvard Business School, where he completed the Governing for NonProfit Excellence executive education course and he has also completed the AICDs Governance Foundations for Non-Profit Directors course.

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We act as an investment adviser to philanthropic, charitable and non-profit organisations. We go beyond the provision of tailored investment services, to provide expert advice on best practice, governance, regulation, investment strategy and relevant trends in the sector.

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1. We will always be independent and free from conflicts of interest that affect our advice.
2. We will always put our clients' best interests first – across the full range of investment, execution and advice services we provide.
3. We will agree, in writing, the services we will provide and deliver those services to the standards we promise. Our clients will have access to the best solutions available - not just a list of products restricted by commercial interests.
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