

# Where next for the charity sector?

Smith & Williamson Charity Report  
in association with Charity Times



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# Introduction



*Nick Murphy,  
Head of Charities,  
Smith & Williamson*

## Where next for the charity sector?

The charity sector is undergoing a dramatic change. And the challenges are many and varied. Brexit, institutional scandals and the question of how to engage millennials have all prompted intense discussions on trustee boards across the country. In what are uncertain times, maintaining funding and holding sufficient reserves has never been more important.

However, this is also a vibrant and exciting time to be involved in the sector. As an investment firm managing capital for a number of charities, Smith & Williamson has seen the journey of ethical and ESG (environmental, social and governance) issues develop from a niche area to a mainstream concern. It's incredible just how entrenched these trends have become, given they were hardly spoken of just a few years ago. And charities' adoption of ESG and ethical investing comes at an opportune time for the sector. Following the scandals of the past year, reputational risk is a hot topic for many trustees and their critics. Scrutiny is intense – investments need to generate a return and be true to a charity's ideals.

With all this in mind, now seems like a good time to take stock. This is why we partnered with Charity Times to survey trustees' views on reserves, risk, benchmarking, and ethical and ESG issues. We wanted to look at charities' investment strategies in the context of the wider issues they are facing – developing a more rounded picture of the sector today. Charity Times' editor Lauren Weymouth chaired an expert panel to discuss some of the survey's most notable results. We hope you find these first-hand insights into the industry's key changes, challenges and opportunities of interest.

### The Panel

Lauren Weymouth (Chair) – Charity Times

Susan Wood – Portfolio Review Services

Grant Wilson – Asset Risk Consultants

Andrew Wimble – Owl Private Office

Malcolm Munro-Faure – The Royal Star & Garter Homes

Noga Confino – The European Nature Trust

Nick Murphy – Smith & Williamson (Investment)

Adrian Wild – Smith & Williamson (Assurance and Business Services)

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# 1

# Reserves

**Lauren Weymouth:** We found in our survey that 30% of charities have fewer than six months' expenditure held in reserves which doesn't seem very much. Is this something we should be concerned about?



Lauren Weymouth – Charity Times ▲

**Nick Murphy:** Six months just doesn't feel sufficient. It must be very hard to make strategic planning decisions if you're living so hand to mouth.

**Malcolm Munro-Faure:** I think it depends on the charity's overall strategy. At The Royal Star & Garter Homes, we designate all of our assets to specific purposes. And then we set aside 12 months for reserves. This is because we provide care for life and that's an expensive thing to do. About half our money comes from fundraising. If that revenue were to collapse, we'd need a reasonable amount of money to restructure our organisation.

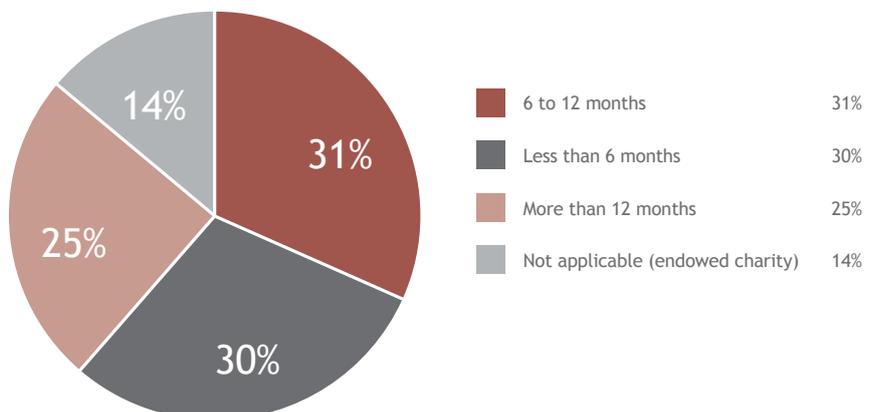
We also need to react to changing circumstances. If we were to find ourselves in a position where the government's approach to social care white paper significantly affects our income, then we would have to make changes to enable us to continue providing high quality care. This has made us a little more cautious when it comes to calculating the amount of reserves we should hold.

**Susan Wood:** I think each charity's reserves policy is different depending on the kind of charity it is. The vast majority of our clients have endowments – reserves aren't so relevant to them, because they don't rely on fundraising.

I wonder how people would have answered this question a couple of years ago. I say that because right now we are dealing with distorted markets. Your return on cash is zero, so there's a cost to holding reserves. And as inflation picks up, that's the part of your portfolio that is going to be most eroded. Of course, you have to be prudent, but you do have to look at the cost.

**Lauren Weymouth:** Do you think the reality is different from the ideal? Do you think a lot of charities, including your own, would like to hold more in reserves?

What proportion of your charity's annual expenditure do you hold as reserves?





We do quite a lot of direct mail and the rules have changed in that area, making it significantly more challenging. This will affect a lot of charities.

Malcolm Munro-Faure, The Royal Star & Garter Homes



**Andrew Wimble:** What is your definition of reserves? In my role as a trustee, we don't have them. We have a certain amount of cash that we can dip into at any one time. But if this income goes down, we'll award fewer grants. I imagine this is the case with a lot of charities.

**Susan Wood:** And that is completely different to Malcolm's challenge. At The Royal Star & Garter Homes and charities like it, they don't award grants, they have long term obligations to provide care or other services.

**Malcolm Munro-Faure:** Yes, we work with long-term commitments – we might be looking after someone who lives for another 10 years and there can be no disruption to their care during that time. There are a lot of different charities and each charity will have its own specific requirements.

**Lauren Weymouth:** Moving on, let's look at what respondents considered the most uncertain sources of income. 29% say annual fundraising activities. Do we think this is surprising?

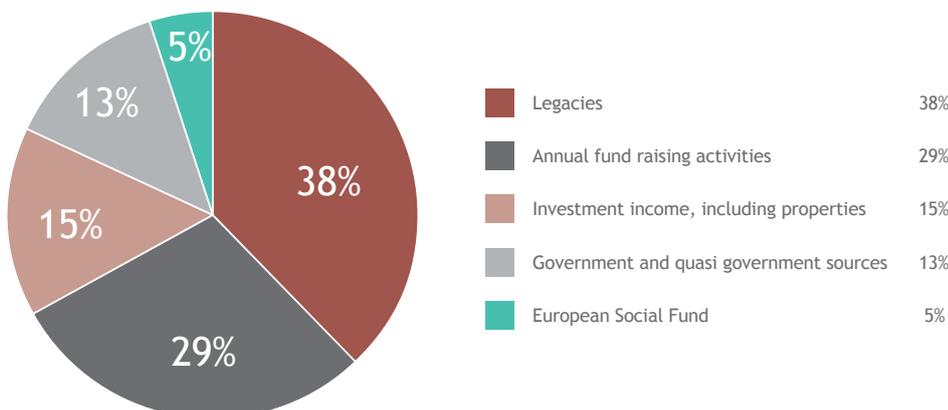
**Noga Confino:** I'm surprised it's not higher. And that's not just because fundraising is naturally unpredictable, but because it depends on the public mood and what's in fashion. As an environmental charity, the fundraising environment for us is very 'moody'. People naturally gravitate toward helping human beings, so we experience highs and troughs on a regular basis.

**Andrew Wimble:** And then there's your reputation. Oxfam's revenues were severely hit because of the recent scandals. But this can create a ripple effect and other charities can find themselves guilty by association.

**Malcolm Munro-Faure:** There's also the fact that fundraising is just very hard work and very hard to maintain. Some things are out of your control. We do quite a lot of direct mail and the rules have changed in that area, making it significantly more challenging. This will affect a lot of charities.

**Grant Wilson:** If we're looking at more secure sources of income, there are professional societies that have big membership dues. And they don't tend to be particularly flexible in economic downturns. The dues will get paid, with the cause and the economic situation of the patrons the main variables. ■

What income sources are the most uncertain?



# 2

# Risk

**Lauren Weymouth:** 42% of charity decision makers think funding is the biggest risk to their organisation. From a charity perspective, are there any new options that you've tried or considered?

**Andrew Wimble:** There's a lot of talk about social bonds, but they are what I would still describe as niche. It will take a while before they become a major funding method.

**Malcolm Munro-Faure:** I think it's all about trying to capture people's attention. Charities are looking at new ways of connecting with people, because it's so much more difficult to initiate a contact with people these days. You have to encourage people to come to you and say, "I'm very interested in what you do." It's about writing your story and promoting it as much as possible in a wide range of media.

**Andrew Wimble:** A good example of that was Help for Heroes. A charity that went from zero to big numbers very quickly. And it was done on the back of the most amazing marketing campaign. For the first time, here was a military charity appealing to young people with a simple strapline and high profile events. It suddenly got a whole new generation involved. Using newspapers and social media outlets was also something other charities hadn't really done before.

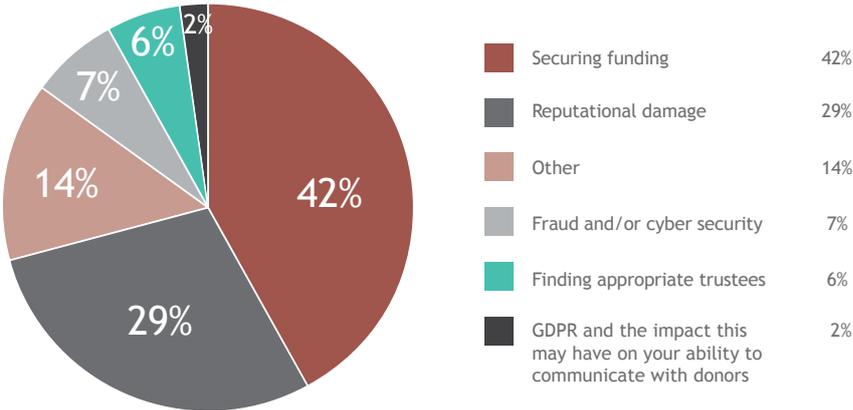
**Nick Murphy:** A phrase from one of the respondents was, "A whole new generation is key for all charities". It's an important message. The average age of donors is getting older and older. And it's vital to get the millennials in and get them interested. That's how new charities will grow.

**Andrew Wimble:** The thing about millennials is that they are green conscious. There are behaviours that young people today would find completely unacceptable.

**Adrian Wild:** What we've been discussing here is a voluntary funding base. But a lot of the sector's funding comes from the government. Aren't changes to government funding a significant risk for a lot of charities?

**Susan Wood:** I'm the trustee of a charity operating out of Tower Hamlets. And it's interesting to note that the grant applications we've received over the past five years have increasingly been from areas where the council would have provided funding. That money just isn't there anymore.

What do you consider the biggest risk to your charity?



**Lauren Weymouth:** Before we move on, I just noticed that no one has mentioned Brexit. Is that a concern? A number of charities said they were worried or quite worried about Brexit. What are your thoughts?

**Malcolm Munro-Faure:** Brexit may well have a significant impact in different areas for different charities. For us, the main issue is staffing, because we require well qualified nurses and health care assistants. We're dipping into the same pool as the NHS in that regard and many potential employees come from the EU. That means there may well be challenges in terms of recruitment and even retaining the staff we already have.

**Nick Murphy:** From an investment point of view, there are things we worry about more. There will be a new equilibrium, it's just that no one knows what that is. Until we know what the deal is, there's very little we can do to prepare except underweight domestically focused business. I think from an operational point of view, there is some European funding that will probably disappear and some charities will be more affected than others. ■



*Susan Wood – Portfolio Review Services and Adrian Wild – Smith & Williamson ▲*



Speaking as a Trustee of a charity myself, I notice that the grant applications we've received over the past five years have increasingly been from areas where the council would have provided funding. That money just isn't there anymore.

**Susan Wood, Portfolio Review Services**



# 3

## Benchmarking

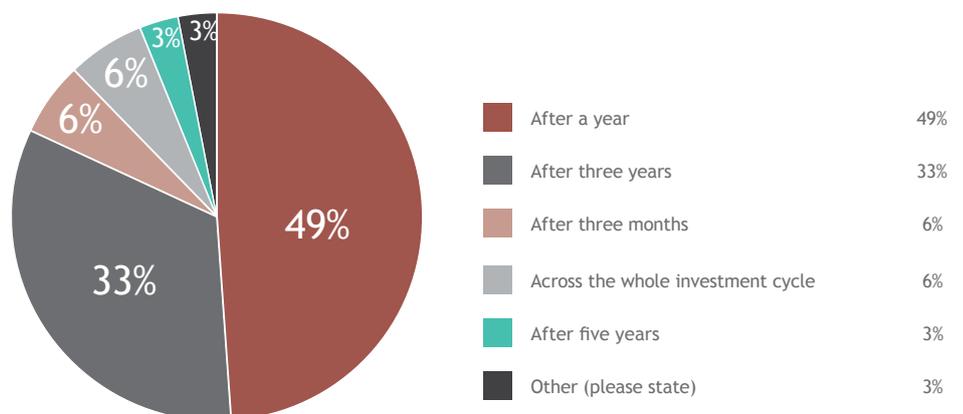
**Lauren Weymouth:** It's a surprise how many charities look at their performance after such a short period of time. Almost half (49%) of the charities in our survey claim that poor performance becomes a concern after only a year.

**Nick Murphy:** This is long-term money. Investment strategies will only meet their objectives over the long term. Some trustees put too much emphasis on comparative benchmarks, when they should be looking at the investment process and seeing whether the investment manager is doing what they said they would do. We want to put together strategies that outperform across a whole cycle, from peak to peak and trough to trough. These cycles can last a long time and there will be periods where an investment manager underperforms. Equally, there will be periods where they outperform.

**Lauren Weymouth:** Does this surprise some of you who are trustees? Do you look at performance over a year? And do you panic if things aren't going well?

**Andrew Wimble:** If you're a trustee, you're receiving quarterly valuations, because regulations dictate that you should. And if you see 1% behind the benchmark one quarter and 1% behind the benchmark again the next, you're going to start getting twitchy. We might be talking about investment cycles, which can last a significant amount of time, but if you're looking at valuations and reports every three months, you're going to become uncomfortable very quickly. So yes, one year makes sense; in fact, every quarter makes sense.

At what stage would poor portfolio performance become a concern?





We need to have our finger on the pulse to ensure we are in accordance with how we need to perform.

**Noga Contino, The European Nature Trust**



**Noga Contino:** We come at this from a different perspective, because 100% of the money raised by The European Nature Trust goes to causes. Money used for operations comes from the investment portfolio – so we have to scale up and down depending on what the investment strategies produce. We need to have our finger on the pulse to ensure we are in accordance with how we need to perform.

**Susan Wood:** We always advise charities that the best long term measure is inflation. If Trustees adopt an inflation plus benchmark it captures the dual objective of aiming to exist in perpetuity while supporting current grant expenditure. Since an inflation plus benchmark has to be looked at over rolling 3 to 5 years, it also discourages Trustees from being too short term about performance.

**Malcolm Munro-Faure:** The key is to know your managers, which can be hard when you use intermediaries. You've got to know you're with the right manager, because the cost of moving can be substantial and it's not a decision to be taken lightly. And the risk is that if you panic, you could always move from one that's performing badly to another that's about to perform badly. This means that you have to consider the issues very carefully as there are serious consequences to taking these decisions at the wrong time.

**Nick Murphy:** You've articulated why it's best not to panic and to actually look at the underlying process. You need to make sure the manager is being candid about what is and isn't working.

From a manager's perspective, what I've been pleased to see from the survey results is so many trustees using all three types of benchmark (target returns, comparative index and peer group). It's good to see from our point of view, because they all measure different things. And you know once you start measuring things, you start distorting behaviour. This I think is the perfect solution to make sure investment managers and trustees all align on a long-term basis. ■



*Grant Wilson – Asset Risk Consultants, Malcolm Munro-Faure – The Royal Star & Garter Homes; and Andrew Wimble – Owl Private Office ▲*

# 4

# Ethical and ESG

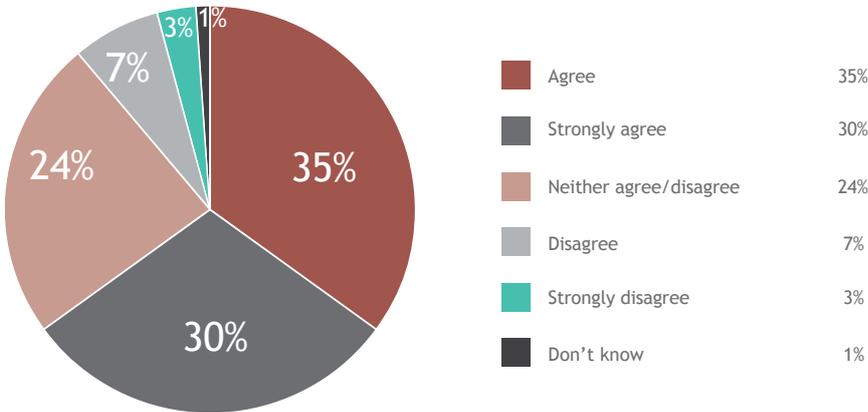
**Lauren Weymouth:** Let's turn to ethical and ESG considerations. It would be good to start by establishing what ethical and ESG are. In fact, there are a lot of different terms contained in those two categories. Is there a difference or are they all essentially the same?

**Grant Wilson:** Well ethical is a moral view and everyone has different moral views. Pro-life and pro-choice are diametrically opposite, but they are still ethically held views. I would suggest that people with money have always put their values and character into their policy. ESG, on the other hand, is a measure. There are about 86 measurable factors and three categories.

**Nick Murphy:** A large number of our clients have an ethical and ESG policy. This is now very mainstream, so at Smith & Williamson we've incorporated those considerations in the fundamental analysis of stocks. Because those things will have an impact on the fundamental value of a share and we need to be aware of that. There's more and more invested in that space and that will have a bigger impact on the fundamentals and what people are prepared to pay. But I am intrigued as to how trustees are interpreting it and what rules they are using to measure it.

**Andrew Wimble:** Most charities I've come across have some kind of policy, but it's always very much their own. I sometimes ask, why do you have no tobacco? If you're a cancer charity there's a very black and white reason why you wouldn't have tobacco. But with other charities, are people more likely to give you money because you have a tobacco exclusionary policy? Probably not. But then maybe it affects your donor base or your beneficiaries. A lot depends on the charity. And then, is exclusion the right way to be ethical? Personally, if you don't like tobacco, and for all the right reasons, go and buy shares in it and then use the vote and actually be active. It can be a positive step and I do know a lot of people who take that stance.

To what extent do you believe that ethical and ESG considerations are essential for your charity?





...reputational risk was listed as one of the biggest risks for charities. And obviously, in today's climate, it's not surprising that charities are worried about their reputations.

Lauren Weymouth, *Charity Times*



**Susan Wood:** When you think about an ethical policy, as a trustee, you have to disregard your personal prejudice and think about the best long-term interests of the charity. And you shouldn't put in ethical restrictions unless they are relevant to your charity. The problem for a lot of trustees is that they think the opposite of ethical is unethical. And therefore, you have to have an ethical policy. You don't! You need to say in your annual report and accounts that you've considered the matter and you don't think it's relevant for your charity and its stakeholders to impose restrictions on the investment portfolio. The Charity Commission's guidance for trustees is very clear on this.

**Malcolm Munro-Faure:** That's absolutely right. It needs to derive from the charity's purpose. I used to be a trustee for one charity and we had very definite views. I'm now working for a military charity and we have quite a different perspective. And it's understandable that charities, because they champion particular causes, will have different views about which types of investment are acceptable. Their purpose will help drive what they choose to invest in.

**Susan Wood:** The Church of England's Wonga scandal was a wakeup call. Even if we're talking about something buried in a pooled private equity fund, the reputational risk can be serious. If an investment contradicts the organisation's purpose, it comes back to reputation.

**Lauren Weymouth:** Absolutely, reputational risk was listed as one of the biggest risks for charities. And obviously, in today's climate, it's not surprising that charities are worried about their reputations. They may not want to exclude everything, but they need to invest in a way that helps achieve their overall goals.

**Susan Wood:** I'm sure I speak for others, but to us the biggest surprise has been the speed with which fossil fuel exclusions have taken hold, from absolutely nothing six to seven years ago. But I think a great deal of that activism has been driven by young people and the student bodies. It's an extremely interesting phenomenon. But then I think, if you exclude fossil fuels and tobacco, where's your ability to make income?

Every decision we take has consequences. This underlines the importance of taking care when developing each charity's investment strategy. ■

#### Important information

Investment does involve risk. The value of investments can go down as well as up. The investor may not receive back in total the original amount invested.

#### Methodology

Smith & Williamson conducted an online survey, which comprised a total of 102 respondents, in 2018 in partnership with Charity Times.

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*Noga Confino – The European Nature Trust and Nick Murphy – Smith & Williamson ▼*



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