

# Philanthropie Aktuell

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## EDITORIAL

Dear readers,



There is a trend towards NPO having to comply with the same legal regulations as companies, examples are the revision law or the recently introduced financial reporting rules. It is, however, often overlooked that NPO follow a different logic to companies. In the case of financial management for instance, the second financial goal besides economic efficiency is not profitability, due to NPO not pursuing the goal of making returns. Instead, the central financial goal is liquidity. NPO largely lack access to borrowed capital due to barely being able to provide securities. For this reason, NPO need sufficient reserves to allow for planning security. In addition, NPO need to record all revenues as income – this also applies to donations towards the capital – that can lead to considerable fluctuations between the individual years.

The evaluation of the financial health of an NPO therefore needs specific indicators that correspond with the characteristics of NPO instead of a one-to-one mapping of profit-oriented financial management rules commonly used for companies.

The contributions in this edition illustrate the directions that research on NPO is currently taking regarding this topic.

Your Georg von Schnurbein

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## Can nonprofits have too much money?

**The financial situation of NPO is barely discussed in research compared to the same topic in the research on corporations. In practice, it is the lack of financial knowledge within an NPO that often leads to wrong management decisions. So far, there is no common understanding of what financial health of NPO actually means.**

**A contribution from Georg von Schnurbein.**

A certain abundance is needed for donations, particularly if they are large amounts of money. Yet, there are not enough financial means available to solve the current social problems. This is why donations, as soon as they are recorded by NPO, become scarce resources. In times of national austerity programs and stagnant donations the question arises at what point NPO attain stable financial health.

### The financial ignorance of nonprofits

Nonprofit organizations are defined by several core criteria such as volunteering, a charitable purpose or their independence from the state. Among the most important criteria for differentiation is the non-distribution constraint. Nonprofits are allowed to make profits, but if they do so, they cannot distribute their gains; instead, they have to reinvest them towards the organization's purpose. From a theoretical point of view, the non-distribution constraint is a decisive factor for the existence of nonprofits. Where market-driven companies take advantage of clients due to information asymmetries, nonprofit organizations offer alternatives. Many clients, for example, trust a care home of a charitable legal form more than a profit-oriented institution, where an owner may be looking to distribute individual gains. The absence of ownership and individual profit seeking however also has a downside. As a consequence, nonpro-

fits tend to have insufficient knowledge of financial issues. These matters are often neglected because, in contrast to businesses, earnings are not a primary aim. Even in academic literature it is surprising how few contributions are found on the topic of nonprofit financial management (excluding fundraising literature, which is largely dominated by marketing aspects). In practice, it is this ignorance regarding finance that is more often than not the origin of wrong management decisions and organizational inefficiency in both directions: financial insufficiency and overfunding.

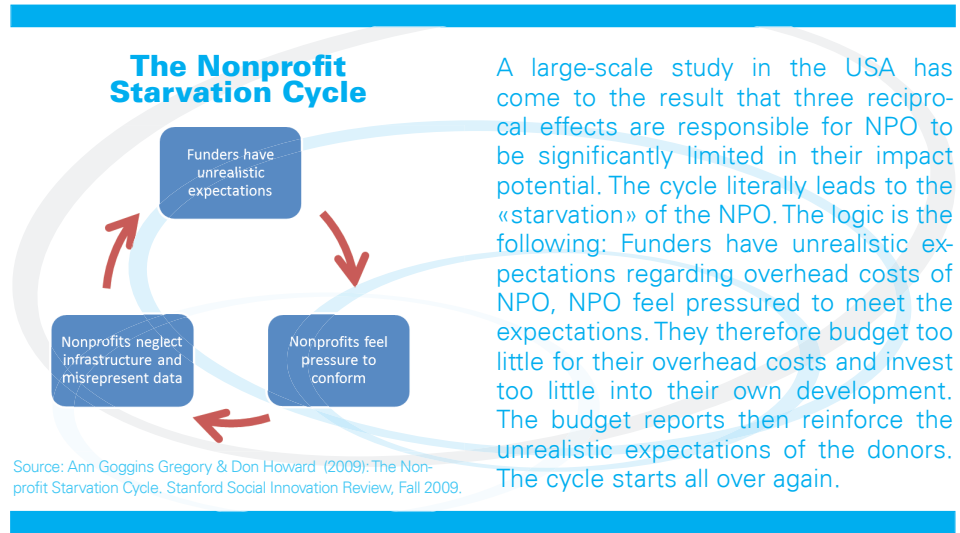
### The accountability paradigm

The current answer to these developments is the accountability paradigm. The improvement of reporting and performance measurement is seen as the best way to control the allocation of resources in nonprofits. Two basic forms of accountability can be differentiated: legal and moral accountability. Legal accountability is based on formally and officially defined contracts that both parties accept. Moral accountability exists when reporting is not legally required but parties believe that there is an obligation for one to be accountable towards the other. Following the assumptions of the underlying agency theory – self-interest and information asymmetry – accountability is mostly about organizing oversight and measuring past activities. Hence, the final aim

of strengthening accountability is to enable nonprofits to provide more effective services in more efficient ways.

**The investment and growth argument**

Notwithstanding the importance of accountability and performance measurement, a new movement of rethinking the functioning of nonprofits is emerging. By adapting strategies and techniques from venture capital to the financing of social purpose organizations, the notion of investing and re-investing was introduced to philanthropy. The concept of donating is shifted more towards a type of investment. Nonprofits are turning into hybrid organizations combining social and economic goals with economic approaches. The basic idea of hybrid organizations is to use economic value creation strategies to solve social problems and by this, to increase the utility of the donated money. The magic word is Social Business. At the forefront of this movement are people like Dan Pallotta who call for a new framework of nonprofit actions, pushing them to be more business-like. They criticize that nonprofits are measured too much on the basis of their inputs (especially cost efficiency) instead of their social impact. While start-ups can be unprofitable over a number of years, reinvesting their capital into their organizational development, nonprofits are expected to prove effectiveness and to not spend on administrative costs right from the beginning. Conse-



A large-scale study in the USA has come to the result that three reciprocal effects are responsible for NPO to be significantly limited in their impact potential. The cycle literally leads to the «starvation» of the NPO. The logic is the following: Funders have unrealistic expectations regarding overhead costs of NPO, NPO feel pressured to meet the expectations. They therefore budget too little for their overhead costs and invest too little into their own development. The budget reports then reinforce the unrealistic expectations of the donors. The cycle starts all over again.

quently, the new thinking requires nonprofit to focus - just as businesses - on investment and growth in order to increase their social impact in the long-term.

**Rethinking financial health of nonprofits**

Although the growth argument is fascinating and compelling, the fiscal and legal advantages that nonprofits have should not be forgotten. If nonprofits are made even more business-like, there is a danger of losing privileges such as tax exemptions or tax deductions for donors. For this reason, nonprofits need to develop a new understanding of financial health. As much as constant austerity negatively affects goal attainment, resources as well as capacities, excess funds increase the risk

of nonprofits losing their mission focus, potentially leading to risking their reputation and donor support. To this day, the majority of nonprofits are still insufficiently informed on finances. There is a lack of knowhow on evaluating risk, suitable and adequate asset management, and the different possibilities of investments of capital towards the purpose. Especially the last aspect is crucial for nonprofits. Without this knowledge more than their reputation is put at risk, should clients, donors and the wider public settle with the idea that nonprofits are actually in the position of having too much money.

Georg von Schnurbein  
Source: Pallotta, D. M. (2008): Uncharitable. Medford, Mass.: Tufts University Press.

**Reserves as a sign for financial health?**

**Fundraising organizations are also in need of financial reserves; despite of this, charities that accumulate excessive assets will run the risk of losing credibility. Transparent communication is necessary.**

There are many good reasons why NPO should build up sufficient reserves for themselves. Examples include the cushioning against donation fluctuations or the coverage against operational risks. Resources are also needed for any future investment into the NPO infrastructure. It is assumed that NPO are better able to implement their purpose if they do not lead a hand-to-mouth existence where they are having to direct most of their energy towards the acquisition of funds. But this isn't easy. Many donors want their money to be used in the short-term, rather than it being accumulated to form organizational capital and this is justifiably so. However, more progres-

sive foundations are starting to accept a certain surplus amount and no longer exclusively focus on the pure project costs.

**Reserves for life time**

A study by PPCmetrics on Swiss Charities has shown that a typical Swiss NPO can subsist on its assets for ten months. This means that if all income sources were to dry up, the charity can run on its own resources for almost one whole year. As a guide value the ZEWO states 3-12 months. But the study also features organizations where the duration is 5 years and longer. In these cases, the question whether the NPO are actually able to effectively use

their financial means to reach their charitable goal needs to be asked. However, there can also be a valid reason for these high reserves. The most important criterion of an NPO is its impact orientation. High reserves make it possible to kick-off courageous projects, take risks and allow for a failure once in a while. Nevertheless, the NGO also needs to explain this to its donors. If there isn't a good reason for the accumulation of organizational capital, then donors and the foundation should think about alternatives for a better use of the funds.

Steffen Bethmann  
Source: PPCmetrics (2015): Jahrbuch der Hilfswerke 2015. Analyse der Jahresrechnungen von spendensammelnden Schweizer Nonprofit-Organisationen.

## Continuity and growth

SwissFoundations celebrated its 15th anniversary on the occasion of the Swiss Foundation Symposium in Biel. On the same day, Lukas von Orelli, Managing Director of the VELUX STIFTUNG, took over the presidency of SwissFoundations. He succeeds Antonia Jann, who chaired the association's board for four years. The CEPS talks to the new president.

**CEPS:** What goals have you set yourself for your presidency?

**L.v.O.:** SwissFoundations is very well-positioned. My predecessor Antonia Jann and the board members up to now, together with our extremely professional office, have done an excellent job. The dynamism, as well as the atmosphere and engagement of the members of SwissFoundations we experience today are unique. First and foremost, these aspects need to be preserved and continued. We need to develop our strengths further in order to prepare for future challenges. We are observing first signs of possible threats to the Swiss foundation sector potentially affecting its reputation on the basis of its legal framework. Such developments will be tackled by us in taking an active and creative stand in the debate.



**Lukas von Orelli**

Since 2004 Lukas von Orelli is the CEO of the VELUX STIFTUNG. He is a lawyer and economist by training. He was elected as board member of SwissFoundations in 2010.

To this end, we will also need to strengthen our legitimization as a national association. There are Swiss regions that are not yet sufficiently represented by us. The focus on Eastern Switzerland in the current Foundation Report is a first step in that direction. Last but not least, the question of the direct use of a membership of SwissFoundations will be something to work on. Over the next 15 years, our goal continues to be the hands-on support of foundations and their work, while offering them a successful platform for exchanging information.

**CEPS:** The activities of foundations are often referred to as undemocratic. How do you deal with this reproach?

**L.v.O.:** The question is why undemocratic as such is a bad thing. Being initiated by private individuals, foundations are important players in Swiss civil society. One aspect of this means a large proportion

of our society engages in voluntary work – in Switzerland, the amount of voluntary work totals more than 650 million hours per year – this way, privately established charitable foundations are contributing to our solidarity and the common good. Our country is, on the one hand, living by individual initiative, through entrepreneurs, on the other hand, it also needs the civil society engagement of the innumerable militia deployments, associations and foundations. In total, this is an extremely democratic process because many social needs are covered; often including those that would otherwise not be taken care of. These private initiatives are able to react to social needs much faster, more efficiently and ultimately, more effectively. They can try new and exceptional paths that sometimes lead to solutions that would not have been possible without them. Besides, the consequence of the claim that individual initiatives are to be dismissed on the basis of being undemocratic would have to be that one supports the planned economy.

**CEPS:** Does Switzerland need more foundations?

**L.v.O.:** There can never be enough foundations as long as there are problems that remain unresolved on this planet.

**CEPS:** How can foundations contribute to the solution of current social problems other than giving grants?

**L.v.O.:** It is through their activities that foundations develop an expertise in special topic areas. They thereby work in areas that are neither economically nor politically supported. They are thus able to use their expertise to initiate and find solutions for social topics in an innovative way. In addition, foundations can mobilize people to get engaged in their topic area; simply by creating awareness and even by showing ways of how anybody can contribute to a certain topic. Foundations are able to trigger movements and can ultimately change a lot.

**CEPS:** Are the foundations in Switzerland thinking too conservatively?

**L.v.O.:** In principle, there is nothing to say against conservatism in the sense of acting in a solid, prudent, balanced and

discrete way. In the end, foundations are committed to the founder's will. If in a specific case, there is reason to believe that the founder wished for work done in a «conservative» manner, this wish must be respected. Though generally speaking, founders want to change something. Considering this premise, foundations should be acting more courageously and openly. When implementing a founder's will, the question that always needs to be kept in mind is whether we are doing everything possible to realize the intended purpose. Especially because foundations are equipped with strengths that other institutions lack, like long-term orientation, independence and expertise in very specialized areas, they should strive for innovative action.

**CEPS:** What is the most exciting thing about working for a foundation?

**L.v.O.:** To be faced with the challenge of turning limited means into a maximum benefit for society, thereby pursuing the intention of the founder and doing so on a daily basis – what could be more exciting than that?

**CEPS:** Thank you very much.

### CEPS INSIGHT

#### Dissertation successfully completed

Tizian Fritz has successfully defended his dissertation entitled «Mission Investing. Four Essays on Mission-based Investment Strategies in the Context of Nonprofit Organizations». Tizian Fritz is leaving the CEPS to take up a new challenge with the Swiss Science and Innovation Council (SSIC). The entire CEPS team wishes him success and all the best for the future!

#### New staff members

Sophie Langloh joined the CEPS team as a research assistant on 1 April. She is working on a PhD thesis on the topic of competition and cooperation between NPO. Starting in June, Leonore Wenzel will be supporting the management team in administrative tasks. Since March, student assistant Thomas Starzynski is working on setting up a database.



## Swiss Foundation Report 2016

It has so far been difficult to make any well-founded statements on the assets and administrative costs of foundations. For the first time, empirical data from three cantons is presented in the new Swiss Foundation Report.



Both the public as well as foundation representatives expect that foundations use as much money as possible for the implementation of the foundation purpose and as little money as possible for administrative tasks. Not much has been known about the exact proportions. An analysis of 1,138 foundations in St. Gallen, Thurgau and Ticino is providing first evidence. Results show that foundations with assets of less than CHF 250,000 only spend an average of CHF 2,557 on their administration; whereas foundations owning assets of more than CHF 15 million spend almost CHF 150,000. When looking at the percentage rate, small foundations are the less efficient. They spend 2.6% of their assets on administration while the large foundations spend a rate of 0.3%. The analysis of foundations with assets between CHF 1-3 million and CHF 10-15 million yielded interesting results. Rather than being in line with the trend of decreasing costs, an increase in absolute numbers and percentage rate of administrative costs is observed in relation to the adjacent asset class. Foundations with assets below

CHF 1 million are mostly managed on a voluntary basis. Above this amount, a paid staff member is often required. In the case of foundations between CHF 10-15 million similar disadvantages regarding expenditures apply. In addition to higher personnel costs, they are not yet in the position to benefit from lower tariffs in asset management. The Foundation Report, which provides further figures, facts and exciting topics, is available in English as a download on the CEPS website.

<https://ceps.unibas.ch/en/publications/ceps-forschung-praxis/>

### Did you know?

**2.3%**

Half of the foundations monitored by the supervisory authority of Eastern Switzerland own just 2.3% of the foundation assets amounting to a total of CHF 3.2 billion. 19.4% of the total assets of the 1,278 foundations are owned by only 1%. These numbers show a very uneven distribution of assets as well as a high number of very small foundations in the total population.

Source: Swiss Foundation Report 2016

## Swiss Foundation Code

The new edition of the most comprehensive governance code for grant-making foundations is available in English.



In 2015, a fully revised version of the Swiss Foundation Code (SFC) has been published. The SFC is based on three main principles «Effective realisation of the Foundation's purpose», «Checks and balances» and «Transparency». The principles are further explained in 29 recommendations and refer to the following topics: creation of Foundations, organisational structure, management, grant-making, finance and investment policies. Every recommendation is commented on in detail and illustrated with case studies that show different options of how to act in specific situations, questions to be asked and the possible problems faced. Features that round off the Code are a comprehensive glossary, multiple sample texts, detailed references and a short introduction to the three management levels of grant-making Foundations. All important phases in the life cycle of a Foundation are thematically represented in the SFC. A particular emphasis is put on economic and legal aspects. The code is meant to guide foundations in creating their own governance structure.

<https://ceps.unibas.ch/en/publications/>

## CALENDAR

### CEPS ADVANCED STUDIES

[Enroll now! \(courses in German\)](#)

### CAS Kommunikation & Wirkungsmessung

Modul 1: 22 - 25 August 2016, Oberhofen  
Modul 2: 12 - 14 September 2016, Basel  
Modul 3: 17 - 20 October 2016, Basel

### CAS Global Social Entrepreneurship

(in English)

Modul 1: 25 - 28 October 2016, Basel  
Modul 2: 7 December 2016, online  
Modul 3: 16 - 18 January 2017, Basel  
Modul 4: 5 - 12 March 2017, Sri Lanka (Creation of Social Business)  
Modul 5: 4 - 5 May 2017, Basel

### Intensiv-Lehrgang

#### Finanzmanagement in NPO

7 - 11 November 2016, Gunten

### FURTHER DATES

#### Stavros Niarchos Foundation International Conference on Philanthropy

21 June - 22 June, Thessaloniki, Greece

#### International Society for Third-Sector Research

#### The Third Sector in Transition: Accountability, Transparency, and Social Inclusion

28 June - 1 July 2016, Stockholm, Sweden

#### The Philanthropy Programme Cross-Border Giving: A Practitioners' Global Guide to Giving

28 June, London, UK

## LEGAL NOTICE

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