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A Study of the Investment Policies and Practices of California Social Service and Advocacy Organizations

Alexis Whitney Olian
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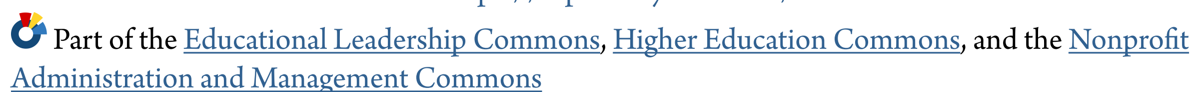
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A Study of the Investment Policies and Practices of California Social Service and Advocacy Organizations

A Thesis Submitted

by

Alexis Whitney Olian

In Partial Fulfillment of the Requirements

for the degree of

Master of

Nonprofit Administration

The University of San Francisco

March 27, 1995

A Study of the Investment
Policies and Practices of
California Social Service
and Advocacy Organizations

This Thesis written by

Alexis Whitney Olian

This Thesis written under the guidelines of the Faculty Advisor Committee, and approved by all its members, has been accepted in partial fulfillment of the requirements for the degree of:

Master of Nonprofit Administration

at the

University of San Francisco

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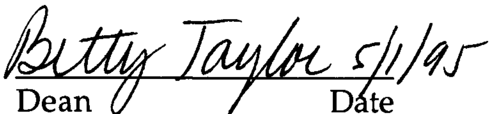

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ABSTRACT

This research examines the investment policies and practices of California social service and advocacy organizations by investigating the level of complexity of their investment activities and whether the mission of their organization is taken under consideration, as a social investment screen, when making investment decisions.

The nonprofit sector is an essential and influential part of our society as well as our economy. The management of this sector's growing assets is of key importance to its long-term financial stability. With the growing popularity of social investment and the increasing diversity of social investment strategies, it is also a valuable time to examine whether the organization's own social purpose is being incorporated into its investment strategy.

The study concludes that among California advocacy and social service organizations, the majority are seeking a return on their investments and a large portion have fairly complex investment portfolios. The research also concludes that approximately half of California social service agencies and approximately 63 percent of advocacy organizations considered the organization's social mission when making investment decisions. However, the majority of these organizations were investing their funds in money market accounts, certificates of deposits and checking accounts. Only 28.5 percent of California social service agencies and only 40 percent of advocacy organizations which indicated that they considered the organization's social mission when making investment decisions were using more complex vehicles of investment, such as mutual funds, individual stocks or bonds.

The study also identified an area of deficiency in the financial

management of investments for these organizations. Written investment policies were infrequent among advocacy organizations and social service organizations, even among those organizations which reported having very sophisticated investment strategies. An appendix to this study includes sample policies from several organizations which did have investment policies, and is offered here as a source of information and inspiration for financial managers.

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Antonio & Lorena
Mom & Dad
Kiri & Stephanie
Grandma Syl & Uncle Moe

THANK YOU!

This work is dedicated to two courageous women

Marita Jane Olian
and
Pamela Rose Gerk

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CHAPTER ONE: INTRODUCTION

Background of the Issue

The nonprofit sector is a valuable and powerful part of our society. It has fostered the growth of social movements which have been the vanguard of change in our society. It has served as a vehicle for the promotion of social welfare. It has provided a haven for a multitude of diverse religions and has offered a forum for the expression of new ideas and creative thinking. Through the nonprofit sector we reach out to provide aid and assistance to other nations and we reach inward and serve our own community needs. The nonprofit sector is where we most often turn to address our social concerns.

In addition to playing a valuable social role in our society, the nonprofit sector plays a significant role in our economy. Over the last three decades, it has experienced a steady growth rate rivaling that of the business and government sectors (Hodgkinson, Weitzman, Toppe & Noga, 1992, p. 17). Contrary to its title, the nonprofit sector can make a profit, and charitable organizations have increased their assets by more than 71 percent over the last two decades (Hodgkinson et al., 1992, p. 136). Revenue and spending have also increased at a rapid rate. This growing financial power has made the nonprofit sector a more influential economic participant in our society.

The combination of financial power and social influence raises many interesting questions and makes the nonprofit sector a fascinating and worthwhile area of study. This study will examine how two specific types of nonprofit organizations invest their assets and whether their investment decisions are influenced by the organization's mission or purpose.

The nonprofit sector is large and vastly diverse. This study will narrow

its focus to two classifications within the nonprofit sector: social service and advocacy organizations. These two sectors were selected because they focus on meeting social needs or addressing social issues.

Social service organizations primarily focus on providing some personal or social service. The social service subsector houses nonprofit organizations with purposes which can vary widely. Education, health, religion, and family service organizations fall within the confines of this subsector, as do many multi-purpose organizations which accomplish several of these tasks simultaneously. This multi-faceted subsector is often the first which comes to mind when referring to the nonprofit sector.

> If opera companies and Ivy League universities represent the establishment side of the nonprofit sector, social agencies represent its street-smart, sometimes heroic, often heartrending side. Drug addiction, alcoholism, child abuse, schizophrenia, homelessness, immigration problems, wife battering, and teenage pregnancy are only a few of the problems that nonprofit social agencies deal with every day. Millions of Americans are directly affected by their work, and millions of others are indirectly affected: Every drug addict cured means fewer people mugged, every marriage problem solved means fewer children emotionally scarred or physically abused (O'Neill, 1989, p. 97).

While social service organizations are in the front-line trenches facing our greatest immediate social needs, financial management is often given only cursory attention. As we grow increasingly more dependent on these agencies to cure our social ills, we should be more concerned with the financial health and survival of these organizations. The social service subsector holds assets of approximately $20 billion dollars, with mean assets of $1.1 million and median assets of $130,000 per organization (Hodgkinson et

al., 1992, p. 227). A few agencies hold a large portion of assets, and the balance are working miracles on shoestring budgets.

Advocacy organizations provide a slightly different perspective on investment behavior in the nonprofit sector. Although their financial power is limited, their social influence is indisputably large. Advocacy organizations address social issues and encourage social change. It may be said that they are the social conscience of the nonprofit sector. Most advocacy organizations are formed to address very specific concerns, such as civil rights, environmental protection, anti-war efforts, and public safety. They have employed many techniques to raise public awareness and achieve their missions. This study will examine whether some advocacy organizations have considered investment as an additional tool for social change.

Advocacy organizations offer another characteristic which lends to this research. Advocacy organizations represent the most impoverished segment of the nonprofit sector. While a small percentage have become established and institutionalized, the median assets of this group range around $100,000 (Hodgkinson et al., 1992, p. 212-228). This subgroup of the nonprofit sector may be representative of the conditions which many nonprofit financial managers face when they have accumulated enough assets to begin considering an investment policy for the first time. An examination of the investment behavior of advocacy organizations may help determine how organizations are investing their funds when their assets are more limited.

The intent of this study is to generate information regarding investment policy and behavior which will be useful to nonprofit financial managers. Currently, very little information is available which addresses the unique needs of the nonprofit sector. Indeed, even the regulations and standards of financial management in the nonprofit sector are sparse and ambiguous.

This may be due, in part, to the only recent emergence and growth of the nonprofit sector. However, as the nonprofit sector plays a larger and more influential role in society, the concern for financial accountability is growing. As the public turns a more critical eye on the financial activities of charitable organizations, the financial managers are being called upon to demonstrate financial prudence and policies which are consistent with the goals of the organization. This study will begin to provide these financial managers with information which may serve them as they develop investment policies for their own nonprofit organizations.

Statement of the Problem

The nonprofit sector is a large and growing part of our economy. It also plays a significant role in the formation of our society, providing a vehicle for volunteerism and philanthropy, as well as a forum to express new ideas and advocate social change. The nonprofit sector often plays the role of setting the social standards for our society.

The nonprofit sector is growing and becoming a more powerful and influential part of society. For the same reason, it is drawing more attention and must meet an increasing expectation of professionalism and financial accountability. Unlike the business sector, the nonprofit sector is tax-exempt, primarily due to its commitment to promote social welfare. Thus, a nonprofit organization is held to a higher standard of social accountability. Also unlike the business sector, most nonprofits rely on contributions, making public image of key importance to the success of the organization. The public outcry which results from the exposure of questionable financial activities of a nonprofit can result in huge losses in revenue and often destroy an organization.

Although, nonprofits are under increasing scrutiny with regard to the expenditure of their funds, they do not suffer the same pressure as the business sector with regard to the management of investments. Stockholders in the business sector carefully monitor investment returns, yet nonprofit board members and donors are often under the impression that seeking a profit on investments is somehow counter to the nonprofit status of the organization. Hence, this area of nonprofit financial management is a source of concern as this sector continues to accumulate investable assets.

Financial managers of nonprofit organizations in California are confronted with several unique factors when making investment decisions. They must first contend with the vague and ambiguous California Nonprofit Corporation Law of 1980 (California Corporations Code 1980, §5231(a)). The law stipulates that directors of nonprofits must satisfy a standard of care while performing their duties. This stipulation is often referred to as the "prudent man rule" because the standard of care is based on what a "prudent person" may do under similar circumstance. The law also states that directors must satisfy the additional standards imposed by the articles, bylaws or express terms of the donor (Silk et al., 1990). Because the articles of incorporation of a nonprofit organization contain the organization's statement of purpose, this stipulation may be interpreted to mean that nonprofit financial managers should be considering the organization's mission when making investment decisions.

Until recently, developing an investment policy which satisfies the standard of care was not a complex issue. Social investment has existed for some time, but there were very few viable options for small institutional investors. Social investing was practically unknown and certainly unexpected. Even today, many claim that socially-screened funds yield low

returns, barring them as a viable option. However, as the number of socially invested dollars increases, so do expectations that the returns should be competitive in the market. As more and more claims are made that social-screening is a viable investment option, financial managers of nonprofit organizations are now presented with a new alternative.

The main purpose of this study is to provide financial managers of nonprofit organizations with useful information which will assist them in making investment decisions for their own organization. This study will examine how social service and advocacy organizations in California are investing their funds and whether their decisions have been influenced by organizational mission or purpose. This study also explores factors which may influence the investment practices of social service and advocacy organizations. In addition, this study investigates whether there is a relationship between investment practices and the presence of a written investment policy. Sample investment policies collected from survey respondents are included in Appendix E.

Social service agencies were selected for this study due to the multifaceted quality of the services they provide. A study of the broad variety of organizations within the social services category yields useful information for financial managers seeking a better understanding of financial management within the nonprofit sector. Because advocacy organizations as a subsector have more limited assets when compared with the nonprofit sector as a whole, these organizations can present more information regarding how smaller, less financially sophisticated organizations are investing their funds. In addition, advocacy organizations are an interesting group to observe because of their stance on social issues and because they often advocate corporate responsibility and divestment as tools for social

change. It is interesting to learn whether these tools for social change have been integrated into their own investment activity.

Normative Definitions of Relative Variables

Investment practice, the dependent variable, is defined as "putting money to use, by purchase or expenditure, in something offering a profitable return" (Lowry, 1991, p. 21). (The present study excludes investments in fixed assets.)

Investment activity is defined as the degree of complexity of investment practice, ranging from simple interest-bearing checking accounts to diversified stock portfolios.

Investment policy is defined as a procedure or guidelines approved or enacted by a board of directors or by staff regarding investment of an organization's funds.

Social investment is generally defined as an investment practice which actively supports and promotes a higher quality of life, welfare, and social relations in society (Lowry, 1991, p. 21). For the purposes of this study, social investment will be defined as investment practices that are related to or influenced by a nonprofit organization's mission or values.

Social impact is the potential effect an investment may have on society in general or on the specific areas related to the stated purpose of the nonprofit organization.

Mission statement is also referred to as statement of purpose. It is a formal written statement adopted by a nonprofit organization which describes the unique strategy by which it will support or promote a higher quality of life, welfare, and/or social relations in society.

The independent sector consists of those nonprofit organizations which are defined as 501(c)(3) and 501(c)(4) organizations under the federal tax code for

tax-exempt organizations. These organizations include educational, scientific, religious, other charitable organizations, and civic and social welfare organizations. These organizations represent a major proportion of all nonprofit organizations (Hodgkinson et al., 1992, p. 16).

Advocacy organizations are groups that primarily focus on broad issues of fundamental rights or some form of action to bring about social change or reform (Hodgkinson et al., 1992, p.229). In this study, advocacy organizations are defined as organizations which to seek to influence public opinion regarding social issues and to promote social change.

Social service organizations serve particular individual or social needs that may include: individual and family services; job training and related services; child day care services; residential care; housing and/or shelter; food services and nutrition; and information and referral services.

Financial manager is defined as a person involved in making financial decisions for a nonprofit organization.

Investable assets are total assets of an organization, excluding the following fixed assets: real-estate, inventory, and accounts receivable (please refer to Chapter Three, page 66, and Appendix D for detail). This variable represents the estimated amount of funds that financial managers may consider available to invest.

Fund balance is the net worth of an organization as reported to the Internal Revenue Service in the organization's annual tax return.

Outside expert is defined as legal counsel, accountants, or other professional experts in the area of finance.

Board-designated reserve fund represents funds raised and set aside by the board of directors to be used for a specific purpose. Some possible functions may be to provide interest-income to the organization for grant-making or

other tax-exempt purposes. Other functions may be to continue building the fund until there is enough to purchase a building or open a clinic. The principal of these funds is usually not spent except for the purposes specified by the board of directors.

Endowment fund represents funds whereby a donor has stipulated that the principal remain intact, with only the income generated by the principal utilized for operational expenses. Endowment funds are usually established to provide a long-term source of funding to support an organization.

Risk is defined in The Random House College Dictionary (1975) as the "exposure to the chance of injury or loss" (p. 1139).

Speculation is defined in The Random House College Dictionary (1975) as "engagement in business transactions involving considerable risk for the chance of large gains" (p. 1262).

Research Questions

This research addresses the following questions:

1. Do California social service and advocacy organizations invest their investable assets? The research will look at overall investment practices of the two different classifications and make some comparisons in their activity.

2. To what degree of complexity do California social service and advocacy organizations invest their assets? The various types of investments will be grouped into various categories of complexity ranging from interest-bearing checking accounts in group one, to securities and stock portfolios in group three. The answer to this question will provide a more in-depth view of the kind of investment activities that occur in each nonprofit classification. It will also provide more data with which to analyze what possible factors may influence investment behavior.

3. Do California social service or advocacy organizations consider the social impact of their investments when making decisions about how to invest?

These three research questions are the first steps toward addressing the overall question of whether the financial managers of nonprofit organizations are prudently managing their assets while taking into consideration the best interests, as well as the stated purpose, of their organization.

Limitations

The following are limitations of this research:

1. The size and diversity of the nonprofit sector necessitates that the focus be on two smaller subsectors. Therefore, the study is limited to the geographic area of California and to advocacy organizations and social service agencies with total assets greater than $100,000. These qualifications may limit the degree of validity with which the results may be generalized to other nonprofit organizations or other regions.
2. This study assumes but cannot demonstrate that responses to questions posed in the survey were truthful and therefore constitute a reliable basis for the conclusions of this study.
3. This study relies on data drawn from the most recently available federal tax returns which represent the financial status of the organizations queried at a specific moment in time in the past. This may limit the degree of validity with which the results may be generalized to present investment activities.
4. The study relies on data obtained from a mailed survey. In order to overcome the reticence which financial managers may have in providing information regarding financial issues and their investment practices, the survey was designed to appear less intrusive. The respondents were assured

confidentiality and specific financial information was not solicited. Such information was drawn instead from a supplemental survey of the annual federal returns of each responding organization.

5. Social investing has been a source of controversy since its inception. The terms "social responsibility" or "ethical investing" which are often used when referring to social investing can be interpreted as judgmental. The respondent may feel pressured to appear "socially responsible." Others may feel compelled by this terminology to debate whether or not social investing is responsible or ethical. This may deter them from completing the survey. This research avoids using the word "responsible" or "ethical" in an attempt to avoid influencing the survey responses.

6. Social investing is a difficult standard to measure and there is no official definition. An investment may be considered good for society by one person's standards, and bad for society by another's. Therefore, the definition of social investing has been broadened to include investment policy or practice which is influenced by the organization's mission or stated purpose. In other words, the organization's mission would be considered a social screen. This may limit the degree to which the results can be generalized to other definitions of social investing.

Importance of Study

The information gathered from this research is intended to serve as a useful tool for financial managers who are in the stages of developing, or reconsidering, the investment policies of their nonprofit organizations. Although nonprofit financial managers are expected to make prudent investment decisions consistent with the best interest of their organizations, there is surprisingly little literature available regarding the investment

practices of nonprofit organizations, and actual research is almost nonexistent. In addition to providing practical information, this study is intended to serve as a valuable resource for scholars and other researchers interested in further analyzing the investment policies and practices of nonprofit organizations.

The dearth of information is especially apparent with regard to social investing in the nonprofit sector. With the exception of the activities of the multimillion-dollar pension plans and the divestment activities of a few universities, there is little that financial managers of small nonprofit organizations can use to compare to their own situation. This research study begins to address this growing need for such information.

The nonprofit sector is growing rapidly both in numbers of organizations and in assets, the public is beginning to pay more attention to how their contributions are being managed. The enactment of the California Nonprofit Corporation Law (1980) and more stringent accounting standards being issued by the Financial Accounting Standards Board underscore a growing realization that nonprofit organizations should be held more accountable. One way to evaluate whether the minimum standard of care is being met is to determine whether advocacy organizations and social service agencies are holding their investable assets in interest-bearing accounts.

Another objective of this study is to address the issue of social investing. Social investing and its history have significant parallels with the nonprofit sector. Social investing and advocacy organizations have their roots in the same movements, and have often worked in conjunction toward the same goals. Social investing is a tool which nonprofit organizations can employ to achieve their goals, although some may question how effective a tool it really is. This study will attempt to determine whether social investing has been

adopted by nonprofit financial managers. It will be very interesting to examine whether the most "socially oriented" sector of the economy is embracing social investment. Often, it is members of the nonprofit sector who point to the business sector and demand social responsibility. This study turns the spotlight in the other direction.

CHAPTER TWO: LITERATURE REVIEW

This chapter reviews literature related to the topic of study and is divided into two sections. The first section begins with a review of literature regarding the role of the nonprofit sector as a forum for new ideas and a vehicle for social change. This is followed by a review of literature related to the growing financial power of the nonprofit sector and, thus, the increasing need for financial accountability.

A third topic of review concerns statutes and literature related to the fiduciary obligations of nonprofit financial management. When managing funds, directors are obligated to meet a standard of care. Exceptions to this standard of care may arise when funds are applied toward the tax-exempt purposes of an organization. This exception to the rule may present nonprofit financial managers with opportunities to explore social investments.

The second part of this literature review summarizes literature related to social investing, beginning with an overview of social investing, followed by a review of the definitions and various forms of social investing. Next a brief history of social investing is presented, highlighting significant factors which have increased its popularity. No discussion of social investing can be complete without mentioning the impact of multibillion dollar pension plans, which are discussed in the section concluding this chapter.

The Role of the Nonprofit Sector

Dedicated to promoting the general welfare, the nonprofit sector often provides a forum for the expression of ideas and the fulfillment of basic needs which the public and private sector do not always provide. Michael O'Neill

(1989), director of the Institute of Nonprofit Organization Management, expounds on the impact of the nonprofit sector in his book, The Third America:

> Free from the constant demands of profit margins and elections, the independent sector can experiment with new strategies of social action, respond quickly to new social needs, and generally provide "social risk capital." The problem of child abuse has been a dark secret throughout history; recent efforts to do something about it were pioneered by the nonprofit sector. Family planning and population control efforts began in the nonprofit sector when these issues were politically too hot to handle. All the major social movements in the nation's history have started in the nonprofit sector — child labor legislation, abolition, mental health care, women's suffrage, prohibition, the civil rights movement, consumer protection, environmentalism, the anti-Vietnam War movement, the women's movement, the nuclear arms control movement (pp. 16-17).

The nonprofit sector plays a critical role in society. It has been a vehicle for trying out new ideas, for meeting personal needs, for serving others, and for testing social limits. It has been a means through which social needs are met and critical social issues are addressed.

In addition to serving as the social vanguard, the nonprofit sector is steadily becoming a stronger economic force in society. In 1992, a national nonprofit coalition of corporate, foundation and voluntary organizations, called Independent Sector, completed a study of what the group designates as "the independent sector," meaning 501(c)(3) and 501(c)(4) tax-exempt organizations and published the results in Nonprofit Almanac 1992 - 1993: Dimensions of the Independent Sector (Hodgkinson et al., 1992). The study,

which examines the years 1977 through 1990, highlights the increasingly significant role of the independent sector in the United States national economy.

According to the profile developed in the almanac, over the last three decades the independent sector has experienced a steady growth rate rivaling that of the business and government sectors (Hodgkinson et al., 1992, p. 17). The independent sector has acquired a larger proportion of the national income, rising from 4.9 percent in 1977 to 6.2 percent in 1990 (Hodgkinson et al., 1992, p. 17). The sector's share of national employment rose from 8.5 percent to 10.4 percent during the same period (Hodgkinson et al., 1992, p. 28). Nonprofit organizations are also spending more money. Based on 1982 constant dollars, the independent sector spent $278 billion dollars in 1990, up from $171 billion dollars in 1977 (Hodgkinson et al., 1992, p. 32).

The independent sector has also grown in numbers of organizations. During the 10 years prior to 1965, the Internal Revenue Service received only 5,000 to 7,000 applications each year for tax-exempt status. In 1965, the number jumped to 13,000 and has continued to climb steadily. The number of completed applications in 1985 was more than 45,000 (Weisbrod, 1988, p. 170). In 1990, the estimated number of 501(c)(3) and 501(c)(4) organizations was 983,000, almost 250,000 more than in 1977 (Hodgkinson et al., 1992, pp. 23, 24). Hodgkinson et al., (1992) found that "for every charitable organization that closes, three new ones open. From 1987 to 1989 more than 110,000 charitable organizations were added to the Internal Revenue Service master file while 41,000 were removed" (p. 12).

The independent sector is also increasing in net worth. Total assets of charitable organizations have increased at a dramatic rate. Total assets rose from $279.6 billion in 1982 to $707.7 billion in 1990. This represents an

increase of 153 percent in current dollars and a real growth of 71 percent after inflation (Hodgkinson et al., 1992, p. 136).

It is clear that the independent sector is large and growing. And yet, these figures only partially represent the true size and breadth of the sector. Many nonprofit organizations remain uncounted because they are not required to register for tax-exempt status.

> In general, nonprofits must file for exemption and submit yearly reports to the IRS and state agencies; but religious institutions, nonprofits with less than $25,000 in annual revenue, and operating subunits of large national organizations such as the Boy Scouts do not have to file. These exceptions mean that at least 500,000 and possibly a few million nonprofit entities are not regularly counted (O'Neill, 1989, pp. 5-6).

The independent sector draws heavily upon the voluntary and philanthropic spirit of this nation. Reports for 1990 show that national income for the independent sector totaled $178 billion. In 1990, volunteers added to that income by contributing more than 10 billion hours of their time to the independent sector. This represented an additional income valued at $110 billion increasing the total national income of the independent sector to $288 billion dollars (Hodgkinson et al., 1992, pp. 27, 37, 71).

Although individuals cannot make a profit from nonprofit organizations, profits can be generated for the benefit of the organization. In fact, according to Robert Fallon (1991), a management consultant for the health care industry, "Contrary to common understanding, not-for-profit organizations must earn a profit in order to maintain fiscal solvency" (p. 47).

Accumulating assets can be beneficial to a nonprofit organization in several important ways . Accumulated assets serve as a safety net during dry funding periods. They can also be used toward funding pilot programs which

have little support. A healthy balance in the bank serves as a hedge against risk or uncertainty and affords a manager a margin of flexibility and freedom in making decisions about an organization's future (Chang & Tuckman, 1990, pp. 123-124).

Financial Management Accountability

The increasingly significant financial power of the nonprofit sector raises some interesting questions regarding financial management and accountability. Managers of nonprofit organizations are not beholden to a board room of stockholders clamoring for dividends, as in the private business sector, but they are nonetheless burdened with the fiduciary responsibility to prudently manage an agency's funds. However, many nonprofit managers do not have the skills or background to meet this obligation.

> The average corporate board of directors has 13 members. The average nonprofit board has about three times that number, most of them serving without pay and many possessing little knowledge of fiduciary issues, including investments. . . . Board members tend to think that since they are serving an institution that doesn't seek profits, they have to bend over backward not to appear aggressive in their investment policy, lest someone misconstrue their goals and withhold their funding (Mattlin, 1993, p. 213).

Internal Revenue Service regulations and generally accepted accounting procedures provide strict guidelines regarding the expenditures of nonprofit organizations. Foundations, government grantors, and individual contributors often require audits, financial reports and program reports to determine whether their contributed funds have been spent appropriately

and effectively. However, there are few inquiries or stipulations made with regard to how the assets of an organization are invested. Are these managers seeking the best return on their investments, or taking unnecessary risks? Are they investing their assets at all? Are they investing in activities which contradict the missions of their organizations? This study focuses on these questions.

The California Nonprofit Corporation Law (1980) addresses some of the fiduciary obligations of nonprofit fund managers. This law has, among other things, helped to reduce confusion regarding how prior corporate laws apply to the nonprofit sector (Silk et al., 1990). The California Nonprofit Corporation Law (1980, §5231(a)), describes the standard of care required of directors of public benefit organizations. The standard is fairly similar to that required of the directors of business corporations.

> A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, in good faith, in a manner such director believes to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances (California Nonprofit Corporation Law, 1980, p. 150).

The terms used in this section, such as "good faith" and "believes", are somewhat ambiguous. However, according to Thomas Silk of the law corporation, Silk, Adler and Colvin, the law corporation, the Nonprofit Corporation Law (1980) defines the steps directors should take to insure that they are serving the best interests of an organization (Silk et al., p. 2-4b, 1990).

> . . . ordinarily, the director will be regarded as having satisfied that standard of care and will be protected from liability if the director acts, in

> good faith, in reliance on qualified advice; that is, on "information, opinions, reports or statements" prepared or presented by (1) an officer or employee whom the director believes to be reliable and competent; (2) counsel, accountants, or other professional or experts if the director believes the matter is within their area of expertise; or (3) a committee acting within its authority if the director does not serve on it and believes that it merits confidence (Silk et al., 1990, p. 2-4b).

The case of Lynch versus John M. Redfield Foundation (1970) provides an illustration of how this standard has been used to evaluate the investment practices of foundation directors. The directors of the Redfield Foundation had a disagreement which evolved into a feud. As a result of this feud, the directors neglected to invest dividend payments which were automatically being deposited into a non-interest bearing account. The California Appellate Court concluded that the directors had breached the standard of care by "ignoring their obligations to carry on its charitable purposes and to manage its assets with the degree of care and diligence which a prudent man would exercise in the management of his own affairs" (Lynch v. John M Redfield Foundation, 9 C.A. 3d 293; 88 Cal.Rptr.86, 1970). Due to their failure to invest the funds in an interest-bearing account, the court held the trustees liable for the interest lost to the foundation.

Although the law appears to encourage directors of nonprofit organizations to invest the corporation's assets, it also warns against speculation (Silk et al., p. 2-5, 1990).

> Except with respect to assets used for the exempt purpose of the organization, assets are not to be invested in a speculative manner. Rather, the directors are directed to look to the permanent disposition of the funds, considering the probable income as well as the probable safety

of the corporation's capital. These restrictions are not applicable if the investments conform to written directions of a donor made at the time of the contribution (Silk et al., p. 2-5, 1990).

The Nonprofit Corporation Law (1980) also stipulates that directors should comply "with additional standards, if any, imposed by the articles, bylaws or express terms of an instrument or agreement pursuant to which the assets were contributed to the corporation" (California Nonprofit Corporation Law, 1980, §5240).

Financial managers of nonprofit organizations are legally required to manage finances in the best interest of the organization. However, unlike the private sector, they should also consider the added purpose of serving the public good as stated in the organization's articles of incorporation. This makes investment a more complex issue and creates more room for debate.

According to Silk's interpretation of this section of the Nonprofit Corporation Law (1980), exceptions regarding investment practice are made "with respect to assets used for the exempt purpose of the organization" (Silk et al., p. 2-5, 1990). Furthermore, "[investment] restrictions are not applicable if the investments conform to written directions of a donor made at the time of the contribution" (Silk et al., p. 2-5, 1980). The law points out that directors should also comply with their organization's articles of incorporation and bylaws, which, among other things, identify the tax-exempt purpose of the organization.

These two exceptions — that contributors may stipulate how funds are invested, and that the organization's purpose may be taken into consideration — afford financial managers some room to consider the option of social investing, especially when requested that they do so by the donor. These considerations along with the recent proliferation of social investment

alternatives and increased awareness has brought the issue of social investing to the forefront of the nonprofit sector.

Social Investing in the Nonprofit Sector

Most nonprofit organizations which are not religious and which generate more than $25,000 in expenditures are required to file an application for nonprofit, tax-exempt status with the Internal Revenue Service. The application includes a request for statement of purpose, or organizational mission statement, which describes the organization's purpose and how its objectives will be achieved. This statement defines how the nonprofit organization will serve the public good. If an organization chooses to adopt a social investment policy, financial managers can rely on the organization's statement of purpose to determine how the organization's assets can be put to work in a manner consistent with the organization's mission. For example, the mission statement of an environmental protection organization might be to promote environmental protection through education, advocacy, and lobbying. When creating an investment policy, this organization may target companies which are known to promote recycling, and avoid companies known to pollute the environment.

It is important to recognize that there are widely differing viewpoints within the nonprofit sector regarding how to benefit the public interest. Every nonprofit organization has a unique approach to serving the public, and should have a unique approach to social investing. Janet Prindle, a partner of Neuberger & Berman, a New York investment firm, relates that ". . . some investors shun Philip Morris, which stacks up well in financial analysis, because they dislike its beer and tobacco products. Others love it because it has a strong record of employing women and minorities" (Rosen,

1992, p. 41).

As a further example, there are clearly opposing viewpoints between the National Rifle Association and advocates of gun control so it would be surprising to learn that gun control advocates were invested in weapons production. On the other hand, it would not be surprising if the National Rifle Association held stocks in corporations which manufacture weapons.

This study will not attempt to make a determination regarding what may be socially responsible, or what is an appropriate social-screen for investments. Instead, this study will attempt to determine whether financial managers consider their organizations' unique missions when making their investment decisions.

Popularity of Social Investing

Although the seeds of social investing were planted in the last century, the concept only began to take root a few decades ago, nourished by the social movements of the sixties. Today, social investing is burgeoning into a new industry with assets of more than $650 billion dollars (Klinger, 1994, p. 68). As the popularity explodes, so has the debate and controversy which surrounds it.

The proliferation of social investment alternatives in the last decade has introduced a new element to investment decision-making. Some argue that social investing is a sound investment alternative yielding competitive returns which serve the public good as well. Others dismiss such investments as too risky and volatile and, therefore, fiscally irresponsible and unethical.

Social investing first gained popularity during the Vietnam War, when investors began to acknowledge the links between money and morality

(Lowry, 1991, p. 20). Social investing has become increasingly popular in the last decade.

> Social investing is today's fastest-growing money management style. Money management professionals are managing $625 billion in socially-invested dollars, up from $500 billion in 1990 and a mere $100 billion in 1985 (Conover, 1991, p. 169).

The increasing popularity of social investing may be due to increasing evidence that it can be as profitable as any conventional investment. A comparison over the last five years of the Standard and Poor's 500 Index (S&P) with the Domini Social Index (DSI), an index comprised of 400 common stocks of companies which pass multiple ethical screens, shows an almost identical performance (Kinder, 1993, p. 12).

> The DSI 400 was backtested against the S&P 500 from January 1, 1986 to May 1, 1990 and live comparisons have continued since. Through early 1992, the financial performance of the DSI has mirrored the S&P 500 closely with the DSI 400 exhibiting a little more volatility and higher overall financial return (Progressive Asset Management/Progressive Portfolio Services, 1992, p. 13).

Other accounts regarding the success of social investing differ widely. As one writer for Barron's puts it, "sometimes it costs money to be a 'socially responsible investor'" (Zipser, 1993). Some opponents point to low rates of return, high risk, and opportunity costs of social investing, and argue that social investing has its costs and might even be financially irresponsible. (Teper, 1991, p. 34). There may still be some hesitancy on the part of financial managers to consider social investing due to the fear that the returns on social investing may be too low, or the risk too high.

Definition of Social Investing

Social investing has been referred to in the industry as ethical investing, socially responsible investing, alternative investing, socially conscious investing, and simply as social investing. Although each of these terms may connote minor differences, they may all be considered to share a broader concept which will be referred to in this study as social investing.

Lowry (1991, p. 21) defines social investing as "putting money to use in something that offers profitable returns and that actively supports and promotes a higher quality of life, welfare, and social relations in society." Marlene Share (1990, p. 134) provides a useful description of social investing which successfully encompasses a broad range of viewpoints:

> In the broadest sense, it means investing our dollars in those companies that we believe make a positive contribution to the society in which we live. It means looking beyond just earnings, into the activities that bring those earnings, and the impact those activities have upon the world.

While most may agree with this statement, many disagree over what constitutes a positive contribution. Marlene Share goes on to explain that every investor has his or her own criteria for what corporate social responsibility means. "Among the many concerns are: the environment, employee relations, weapons, energy, health care, international policy, education, and community participation/citizenship" (Share, 1990, p. 135).

For the purposes of this study, each nonprofit is expected to have its own unique criteria, as defined by its statement of purpose. For the purposes of this study, social investing is defined as investment policy or practice which is responsive to or influenced by the organization's statement of purpose.

Forms of Social Investing

There are many different forms of social investment practice. Social investing can range from a somewhat passive avoidance of "sin stocks" to more proactive shareholder activism.

At the more passive end of the spectrum, an investor may elect to use a combination of divestment and target investing. Divestment can also be described as "avoidance investing."

> Most of the better known "social" mutual funds operate in this fashion, avoiding specific areas deemed offensive to their shareholders. . . .The more offensive the activities of a corporation, the more likely it is that investors will sell the stock because they do not want to associate themselves with those activities. . . Disinvestment strategies often are used in conjunction with boycotts of a company's products. The best current example of this is consumer reaction to the Exxon Valdez oil spill when angry consumers cut their Exxon credit cards in half and sold Exxon stock (Gay, 1989, p. 60).

Target investing or reinvestment involves the selection of investment alternatives in the pursuit of positive social or economic impact (Harrington, 1992, p. 3). For example, an investor might select companies with strong affirmative action programs, or invest in the redevelopment of a disadvantaged community. Another example might be to reinvest in South Africa, as suggested by Mr. Nelson Mandela, president of the African National Congress (Rosen, 1992, p. 41).

Another recommended targeting strategy is what Lowry (1991) calls "alternative investing." This form of social investing concentrates upon support for unusual forms of investment and business practices such as land trusts and community-based revolving loan funds (Lowry, 1991, p. 31).

More active forms of investment practice involve direct shareholder action to change corporate practices. Such activism may entail filing shareholder resolutions or negotiating with company management (Owens, 1989, p. 10). This form of social investing is more prevalent among institutional investors who have greater invested assets and therefore have a more powerful voice to be reckoned with.

> In the 1980s public pension funds emerged at the forefront of the shareholder rights movement. It is not hard to understand why. Pension funds cannot leave the market; they have huge dollars to invest and reinvest annually; in effect, they are the market (O'Cleireacain, 1991, p. 12).

Much of the growth of social investing activity can be attributed to the participation of public and private pension funds. These institutional investors are a powerful force in the market.

> American workers have more than two trillion dollars in their pension funds. They own about one-quarter of all the corporate shares on the New York exchange and account for almost half of daily trading activity. Having tripled in size in the 1980s, these funds are bigger now, in dollars and power, than even those of us close to them imagined ten years ago (O'Cleireacain, 1991, p. 12).

The participation of these financial giants in social investment has sharpened the debate. As trustees for the funds of millions of employees, these institutions are watched carefully and are held to high standards of fiduciary responsibility. However, as nonprofit organizations and public institutions in a powerful financial position, they are easy targets for public pressure. By moving into new territory, these institutions are setting precedents which clear the path for other investors, nonprofit financial

managers among them.

History of Social Investing

The best way to understand social investing is to examine its short history. The origins of social investing can be traced to the heart of the nonprofit sector when the assets of the religious sector were combined with the activism of the advocacy sector. This combination brought about the first divestment and shareholder activism. Temperance, pacifism, environmentalism, and other organized movements have inspired and promoted social investing.

The growing concern over corporate responsibility and societal needs in the last two decades has prodded more and more investors to consider social investing as a viable alternative. In the 1980s, public outrage over the racist South African government pressured nonprofit pension plans to venture into the complexities of social investing. The participation of these pension funds has lent credence to social investing. The question that now remains is whether the rest of the nonprofit sector which initiated social investing has embraced it as an investment alternative.

According to John Harrington (1992), social investing was born in the nonprofit sector in the nineteenth century:

> The birthplace of socially responsible investing was the American church. In the 1800s many churches found investing in alcohol and tobacco morally repugnant and prohibited church funds from being invested in such businesses. (Harrington, 1992, pp. 5-6).

Avoidance of undesirable corporate activities apparently was the first form of social investing and continues to be the most passive form. Although social investing may have had even earlier origins, it was the wholesale divestment of sin stocks by churches that made the practice a great

deal more conspicuous.

Churches remained the leading exponents of social investing until the 1960s, when the advent of the black civil rights movement brought on a new wave of interest in social reform. "The idealism of the civil rights movement and the charismatic leadership and then martyrdom of Martin Luther King, Jr., created one of the most powerful social movements in American history" (O'Neill, 1989, p. 118).

The more active forms of social investing began to surface during the temperance movement, about the same time as the emergence of advocacy organizations. "Like the rest of the nonprofit sector, advocacy organizations had their real birth in the nineteenth century. The first major issue was temperance" (O'Neill, 1989, p. 115).

It is no coincidence that social investing originated during a period when the United States witnessed a sizable growth in the nonprofit sector, and in particular the emergence of advocacy organizations. The same awareness which inspired people to organize for social change also induced them to consider the social impact of their own actions.

Investor activism surfaced as churches began to unite in powerful coalitions to promote integrated housing, jobs for minorities, and sanctions against South Africa (Harrington, 1992, p. 6).

> In 1966, a coalition of black activists calling their organization FIGHT (Freedom-Integration-God-Honor-Today) began pressuring Eastman Kodak to provide 600 jobs to minorities in Rochester, New York. A confrontation ensued when the company reneged on a pledge, and FIGHT took it to the 1967 shareholders' meeting (Harrington, 1992, p. 6).

Adding to the momentum was the growing concern over the Vietnam War. In the 1970s, the impact of napalm and other antipersonnel weapons in

Southeast Asia was reaching American living rooms through television. Many Americans were repulsed by the images and recoiled at the thought of financially supporting corporations which profited from such violent destruction. "Investors who were opposed to the Vietnam War began to see the linkage between their investment dollars, their dividend checks, and the senseless carnage abroad" (Harrington, 1992, p. 44).

> The small investor learned what the large institutional investor had known all along: Money is power. Thousands of small investors banding together with a cause could significantly reduce the flow of investment capital into corporations producing the death machinery of the Vietnam War. People felt that they made a political and moral statement by removing their money from war-related corporations (Harrington, 1992, p. 7).

The Vietnam War drew the attention of many investors to other questionable activities of increasingly powerful corporations throughout the world. Corporate presence in South Africa, Northern Ireland and numerous developing countries raised questions in many peoples' minds about corporate culpability. Increased interest in corporate social responsibility generated pressure on firms to respond to social demands. These demands became organized in various movements including the civil rights movement, the antiwar movement, the women's movement, the consumers' movement, the environmental movement and the anti-apartheid movement (Wokutch, 1990, p. 58).

Corporate Catastrophes

The growing concern over corporate social responsibility in the 1970s evolved into blatant mistrust and suspicion in the 1980s. A decade of

takeovers and leveraged buyouts created a fallout of social costs. Takeovers and leveraged buyouts had a profound effect on the fabric and psyche of American economic life.

> The undeniable reality is that the people who experienced most of the suffering — those who lost their jobs, those who kept their jobs but lost their sense of loyalty and security, those whose communities were turned upside down — played no role in creating the original problems (Taylor, 1992, p. 44).

According to Jay Hopkins of Capital Values, Inc., stunned and disillusioned shareholders began seeking safe haven in social investing (Hopkins, 1992, p. 10).

> Shareholders — disillusioned by insider trading, the savings and loan bailout and environmental catastrophes such as the Exxon Valdez oil spill — are no longer content to assume that corporations are trustworthy. Instead, they are increasingly interested in the ethical dimensions of the companies in which they invest (Hopkins, 1992, p. 10).

Among many tragic corporate catastrophes of the 1980s was the Union Carbide chemical accident in Bhopal, India, a result of poor safety standards (Ramanan, 1992, p. 62). This tragic event claimed thousands of lives and provoked outrage from the international community.

Another corporate blunder was Nestle's "commerciogenic malnutrition" campaign (Smith, 1989, p. 14). Nestle, the world market leader in powdered baby formula, was accused in the early 1970s of inappropriately marketing its product to people who could not use it properly or had little need of it, with the result that thousands of infants in developing countries suffered debilitating malnutrition and death. Nestle refused to alter their marketing practice for more than a decade.

Closer to home, when the Exxon-Valdez ran aground and spilled 11 million gallons of oil into Prince William Sound on March 24, 1989, 40,000 angry consumers were motivated to return their credit cards (Rogers, 1994, p. 13). In September 1994, a federal jury assessed $5 billion dollars in punitive damages against Exxon Corporation, the largest punitive damage award in history. "Some analysts believe a $5 billion award could have a chilling long-term effect on the company's stock price" (Camp, 1994, pp. A-1, A-6) That ordeal has motivated shareholders to push for greater management accountability. "When social and public policy issues become intertwined with and affect a corporation's profit, shareholders begin to assert their ownership rights" (Minow & Deal, 1991, p. 35).

Increasingly companies are sensing public pressure and are committing to the environmental principles set forth by the Coalition for Environmentally Responsible Economies (CERES). The CERES principles are a 10-point code for corporate environmental performance and public accountability ("Endorsing Environmental Responsibility," 1994, p. 8).

Anti-Apartheid Movement

Concern about racist policies in South Africa dates back to 1912 when the NAACP provided assistance to what later became the African National Congress of South Africa. "It was not until the mid-1960s, however, that college students, civil rights leaders and church groups began to devise strategies in response to the evil of apartheid" (Williams & Worthley, 1991, p. 20). Divestment and shareholder activism became key weapons in a successful fight against apartheid and through their use, social investing was introduced into the minds of thousands of concerned citizens.

In 1971, the first shareholder resolution on South Africa calling for the

termination of General Motors operations in South Africa was presented by the Episcopal Church. Church officials stated that their goal was not to force General Motors to leave South Africa, but rather to pressure General Motors to use its power to help change South African government policy (Williams & Worthley, 1991, p. 20).

In 1977, the Reverend Leon H. Sullivan, a black pastor from Philadelphia and a member of the board of directors of General Motors, responded to the Epsicopal Church resolution by drawing up a code of conduct governing business conduct in South Africa emphasizing equal opportunity, nonsegregation and training programs for nonwhites. These standards have come to be known as the Sullivan Principles (Ring, 1989, p. 42). At the urging of Sullivan and other interested parties, 135 companies had signed the statement of principles by 1980 (Patten, 1990, p. 577).

U.S. companies have found themselves in the middle of controversy about how to "do the right thing." While some called for economic sanctions, the Episcopal Church and supporters of the Sullivan principles pointed out that active participation and support of the black cause was dismantling apartheid, however slowly. Writing in 1991, Williams and Worthley observed that:

> Although U.S. corporations employ only about 90,000 of the 9 million workers in South Africa, the efforts to dismantle apartheid by American firms have served as a beacon and a catalyst in generating reform throughout business and industry. If the non-U.S. companies who have recently adopted a code similar to the Sullivan principles are counted, almost one million blacks in South Africa enjoy the protection of the code (Williams & Worthley, 1991, p. 21).

Many opponents of apartheid felt that the dismantling of the apartheid

government could not happen fast enough. Their view was that any involvement with the racist government was tantamount to complicity with injustice.

> The criticism of corporate involvement in South Africa goes beyond an objection to companies remaining in a country which so clearly flouts the democratic principles cherished in their home countries. The economic function of apartheid and the role of business in apparently maintaining and benefiting from it suggests that those multinationals operating in South Africa bear some responsibility for apartheid (Smith, 1989, p. 11).

Clifton R. Wharton Jr., chief executive of the $70 billion Teachers' Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF) maintained that the impact of U.S. business was doing little to alleviate the plight of blacks in South Africa.

> For the small minority of blacks employed by progressive U.S. corporations, there have been some changes for the better. But these gains are overwhelmed by the clear evidence that for the vast majority, things have gotten steadily worse, not better, during the last decade (Williams & Worthley, 1991, p. 25).

It was difficult for individual investors to sift through the complex web of political, economic and social factors which might enhance or diminish justice in South Africa. Many investors preferred the "clean hands" approach to the problem because it eliminated any possibility of complicity with the apartheid government. This eventually became the most popular approach. In October 1986, Congress passed the Comprehensive Anti-Apartheid Act, overriding President Reagan's veto (Williams & Worthley, 1991, p. 26).

The stated purpose of this Act was "to bring about reforms in that system

of government that will lead to the establishment of a non-racial democracy." Thus, the basic goals of the Act were to bring an end to apartheid and to encourage South Africa to create a government founded upon the principle of equal rights for citizens of all races (Lansing, 1991, p. 90).

Major institutional investors joined the movement, with giants such as TIAA-CREF at the helm. In 1990, under Wharton's direction, TIAA-CREF opened a Social Choice Account which among other things excluded firms doing business in South Africa ("Not so silent," 1990, p. 42). Alan Seidner (1989), head of The Alan G. Seidner Company, an investment management and consulting firm, claimed at the time that the divestiture from South African businesses by institutional investors was an important factor in the move toward ending apartheid in South Africa. At the height of the divestment movement, Seidner wrote:

> Specifically, over the past two years more than 100 American corporations have sold their subsidiaries in South Africa. . . . Had it not been for the concerted action of institutional investors in the United States, many of the American corporations would have been slower to respond (Seidner, 1989, p. 24).

Concerns over apartheid created a tidal wave of interest in social investing and shareholder activism. In 1984, socially invested dollars amounted to $40 billion. By 1991, socially invested assets had climbed to $625 billion (Conover, 1991, p. 170). In 1987 alone, over 100 shareholder resolutions called for withdrawal from South Africa.

The economic sanctions appear to have been successful. "Financial sanctions were key to the South African government eventually reacting to and compromising its policy of apartheid" (Thuermer, 1992, p. 33). On May

10, 1994, millions celebrated when Nelson Mandela became the first black president of South Africa.

> The world that gave social investing its birth is rapidly changing. Nelson Mandela, president of the African National Congress, recently pronounced South Africa irreversibly on the road to democracy and called for an end to economic sanctions (Klinger, 1994, p. 68.).

Now that reforms appear to be underway in South Africa, there is some concern that institutional investors may have lost their incentive to engage in social investing. Eric Becker of Franklin Research and Development, a Boston-based portfolio manager specializing in socially responsible issues predicts, "A large amount of money that was South Africa-free will now be moving out of socially responsible funds" (Zipser, 1993, p. 20). But, other financial managers and analysts counter that despite the lifting of sanctions in South Africa, the demand for social investment is growing.

> The Social Investment Forum, a trade association representing organizations and financial professionals active in the field, has more than doubled its membership in the past two years to 450. The number of social mutual funds also has grown. There are at least 24 mutual funds with social screens with combined assets of $2.7 billion, up 15 percent over last year. Of these funds, nine were launched in the last two years (Klinger, 1994, p. 69).

For the target investor, reinvestment in South Africa poses new challenges in social investing, and mutual funds are quickly being developed to address them. One of the first to tap into the South African stock market is a new mutual fund called New Africa Advisors. "Not only is it the first African-American investment firm plugged into South Africa, it is the only post-Apartheid, pan-African fund" (Warren, 1994, p. 38).

Scott Klinger, CFA, a social research analyst, suggests that social investing has moved beyond definition by any single issue or strategy.

> With new information resources, a deeper understanding of evolving issues and broadening social-change strategies, social investors hope to bring a host of new issues from the periphery into the center of discussion within the business community. Such awareness and discussion will prove vital as the world continues to change (Klinger, 1994, p. 70).

Pension Plans

For the institutional investor, the financial manager, or the trustees of a large pension fund, the social investment debate is complex. It is not simply an issue of profits versus principles. Institutional investors must resolve whether they may wield their financial power for social change when they derive that power from other people's money. Strict regulations have been written to maintain the accountability of these powerful money managers. Nevertheless, public pressure to consider the nonfinancial benefits of investments has forced pension funds into social investing and into the center arena of the debate.

The participation of institutional investors has helped social investing break out of being a simple fad and has made it an institution in its own right.

> The concept itself has become vastly more sophisticated. And the persistence, thoroughness and moral resonance of its practitioners increasingly has captured the respect — if not the endorsement — of the mainstream investing community. No less a personage than Labor Secretary Robert Reich recently urged the nation's biggest pension-fund managers to examine nonfinancial criteria when buying stocks,

contending such measures are as useful as balance-sheet analysis in predicting corporate performance. (Zipser, 1993, p. 20).

For the nonprofit financial manager, pension funds have marked the path through a potential minefield. Pension funds confront the strictest of fiduciary regulations, and not surprisingly, they have come under heavy fire and several court cases have ensued. These court cases have served to set valuable precedents regarding the amount of wiggle room a financial manager has with regard to social investing. For this reason, this chapter will conclude with a review of literature regarding institutional investors and social investing.

Profit-sharing plans, such as 401(k) plans and public and private pension plans, currently represent the majority of shareholders in the United States. The U.S. Department of Labor estimates that there are currently more than 100,000 pension, profit-sharing and savings plans covering 19 million participants and holding assets of more than $335 billion (Hershey, 1992, p. 2). Others estimate that the public and private pension pool amounts to more than three trillion dollars ("Ethical Investing," 1991, p. 32).

More than half of the stocks in the Standard & Poor's 500 (an index of the five hundred largest corporations in the U.S.) are owned by pension funds, and some 70 percent are owned by one or another type of institutional investor (Dobson & Sabino, 1991, p. 22). "They [pension funds] have become the dominant owners and lenders in our financial system and now hold 40 percent of the medium- and long-term debt of the country's bigger companies" (Burke, 1992, p. 18). On the New York Exchange some 80 percent of the value of all outstanding shares are held by institutional investors, primarily pension funds (Dobson, 1992, p. 26).

These immense institutional investors have been recognized not only

for their economic power, but for the potential social impact of their investments.

> Now, with almost everyone aware that private and public pension funds comprise the single largest source of U.S. capital, pressures are increasing to divert assets to other functions. Politicians seek to revitalize local economies by making in-state investment geared toward home creation, venture capital, small business or shoring up ailing companies. . . . While most of the pressure has been on public and Taft-Hartley funds, corporate funds are not immune. The growing pressure by chief executive officers on fund executives not to invest in leveraged buyouts and to take a `longer-term view' in plan investments is seen by some experts as a smoke screen for 'corporate social investing' (Chernoff, 1989, p. 3).

This power and influence has drawn pressure from the public. After reviewing the tremendous growth of pension fund assets, the Task Force on Pension Fund Investment created by New York Governor Mario Cuomo issued a report entitled, "Our Money's Worth" urging the guardians of pension funds (trustees and executives) and the sponsors of pension funds (corporations, unions and governments) to recognize the immense financial power and the broad economic effects of pension fund decisions (Burke, 1992, p. 18).

Institutional investors are not free moral agents; they are held to strict fiduciary restrictions with regard to the management of funds as well as referendum activities. Pressure from the public to consider the social impact of their investments on one side, and strict regulations from the U.S. Department of Labor on the other, has forced financial managers to meet the debate head-on and resolve the most critical question of whether social

investing and fiduciary responsibility are, or are not, mutually exclusive.

Qualified Defined Benefit Pension Plans, usually referred to simply as public or private pension plans, are essentially retirement benefit plans offered by businesses to their employees. Typically, the employer commits to providing a predetermined amount of money to the employee after retirement. The employer is then obligated to set aside these funds and hold them until the employee retires. This is where the controversy begins. While these funds are being held for the employee, they should be managed so as to ensure that the funds retain their real value and increase in value at a rate relative to the market. Stringent regulations regarding how this is to be accomplished have been set by the federal government in order to protect the interests of the employees and to provide guidelines for plan managers.

S.Q. Dellagrotta (1990), vice president of Meyer Real Estate Advisors, describes the basic objectives and functions of pension plans.

> The private pension funds are held to the most stringent regulations. The primary objective of the pension plan is to provide benefits to its participants and their beneficiaries. To attain these goals, it is essential that plan assets are invested prudently in order to maintain plan solvency while meeting the reasonable cost of administration and benefits. The Internal Revenue Code specifies that in order to qualify for a tax-exempt status a plan must be maintained for the exclusive benefit of employees or their beneficiaries. Further, the IRS position is that the costs of investments do not exceed fair market value; that a fair rate is required commensurate with the prevailing rate; that sufficient liquidity to pay benefits is maintained; and, the investments are prudent and diversified (p. 31).

According to Joel Chernoff, pension plan assets historically were being

used in violation of these regulations (Chernoff, 1989, p. 3).

> For decades, pension assets have been invested to fill needs other than those related to their primary function of providing retirement benefits for participants and beneficiaries. For example, the United Mine Workers of America Pension Fund purchased shares of utility companies in the mid-1950s to pressure them to buy union-mined coal. . . . The Employee Retirement Income Security Act of 1974 was supposed to stop many of those practices for private plans (Chernoff, 1989, p. 3).

"The enactment of ERISA (Employment Retirement Income Security Act of 1974) was the response of the Congress to the abuse of fiduciary authority and indiscreet investment practices affecting the solvency of many plans," explains Dellagrotta (1990, p. 31).

> Under ERISA, a fiduciary is required to discharge his/her duties in respect to a plan for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan. Further, the fiduciary must carry out duties with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in like capacity and familiar with such matters would use in the conduct of a like character and with like aims (Dellagrotta, 1990, p. 32).

Financial experts have found room for debate with ERISA regulators regarding social investing. The most successful argument for social investing has been that 'good returns can be achieved while also accomplishing a social good.' Another argument is that the definition of the participants and beneficiaries can be expanded to include a greater community (Chernoff, 1989, p. 3).

In 1980, Ian Lanoff, the U.S. pension administrator, issued a statement

that pension funds may consider "incidental" benefits as long as competing investments remained economically equal. Ian Lanoff later expressed regret at issuing the U.S. Department of Labor announcement, saying that it "created a loophole bigger than the rule" (Chernoff, 1989, p. 3).

It was a loophole that many private pension funds began to jump through. In 1988, the U.S. Department of Labor yielded even further by allowing that ERISA funds be invested in a pooled fund which invests in property mortgages involving union-only labor, stating that the creation of jobs is an incidental benefit (Chernoff, 1989, p 46).

Even more recently the U.S. Department of Labor took a more progressive position when current Labor Secretary Robert Reich actually "urged the nation's biggest pension-fund managers to examine nonfinancial criteria when buying stocks" (Zipser, 1993, p. 20).

The ERISA Regulations apply also to Qualified Money Purchased Defined-Contribution Profit-Sharing Plans, usually referred to simply as profit-sharing plans, such as the 401(k) salary-reduction plan. There has been a significant growth in the use of 401(k) salary-reduction plans as a less expensive alternative to the traditional employer-funded pension plans. Over the last decade, participation has increased by nearly 45 percent (Limbacher, 1994, p. 16). More than 95 percent of the Fortune 1000 have salary reduction 401(K) plans (Rafter, 1992, p. 28). In a profit-sharing plan, an employee has the option of saving for retirement by having a portion of his gross wages deducted before taxes are withheld. "Although many companies make profit-sharing or partial-matching contributions, 401(k) plans are funded primarily with employee money" (Rafter, 1992, p. 28).

Significant changes will soon take place with regard to the management of the 401(k) retirement plans. Since the bulk of the funds in the 401(k) plans

come primarily from employees, "it seemed natural for employers to give employees the right to choose how to invest their accounts" (Rafter, 1992, p. 28). Typically, the employer would provide a number of investment options from which an employee could choose. However, throughout the 1980s, the fiduciary responsibility for plan management has always remained the burden of the employer. The employer remained subject to ERISA standards and faced liability if the employees lost money due to a bad investment decision (Rowland, 1992, p. 17).

In an attempt to avoid potential legal battles, many employers refrained from offering socially-screened investment options (Hopkins, 1992, p. 10).

> An increasingly common application of social investing is the defined contribution [profit-sharing] plan, which typically offers participants several investment options. Although a number of such plans include socially screened options, the large majority do not. The absence of socially screened investments may be due in large part to a perception that social investing violates ERISA's standard of prudence (Hopkins, 1992, p. 10).

A new regulation may loosen the ERISA restrictions enough to allow employers to offer social investment options. On October 8, 1992, the U.S. Department of Labor issued new regulations which will provide pension fund and profit-sharing managers with an opportunity to find exception from the ERISA standards (Hershey, 1992, p. 2). Beginning January 1, 1994, Section 404(c) of the U.S. Department of Labor rules gave employers the option of passing fiduciary responsibility of 401(k) plans to their employees. Employers who choose to comply with the 404(c) regulations will continue to be responsible for the prudent selection of the initial investment options but they will gain some protection from lawsuits by employees who are

disappointed with the return on their investment (Hershey, 1992, p. 2).

The new 404(c) offers employees more control over their pension and profit-sharing plans. Assistant Secretary of Labor David George Ball explained, "This regulation will afford millions of American workers the opportunity to exercise independent, meaningful control over the investment of their pension dollars" (Hershey, 1992, p. 2). Although the employers still retain the weighty responsibility of selecting the investment options, they will be able to offer socially-screened options with less trepidation of legal fallout.

> Market watchers predict a surge in the number of 401(k) plans offering "green" investment options, with the timing dependent on when the larger mutual fund families begin to offer social and environmental funds within bundled service approaches (Philip, 1994, p. 8).

For public pension plans, the door to social investment has already been forced open. Dellagrotta points out that ERISA does not apply to public pension plans, thereby allowing public plans to be much more active in social investing (Dellagrotta, 1990, p. 32). Probably the most significant milestone for social investing was the impact of the anti-apartheid movement on public pension plans.

> ERISA, which is a federal law, preempts state law, but does not apply to public plans. . . . Public plans operate under, and are administered according to, state statutes and enabling legislation. . . . There are numerous examples of social investing by public funds. The most significant and visible one, of course, has been the divestiture of investments in United States corporations and their subsidiaries doing business in, or with, South Africa (Dellagrotta, 1990, p. 31-33).

Hence, local, state and federal ordinances have forced public pension

plans to adopt social investing strategies alarming those who feel that social investing violates ERISA's standard of prudence.

> The prudent man rule (a phrase with an unfortunate gender bias) has been used as an argument against social investing for many years. Naysayers contend that plan sponsors who allow ethical criteria into the investment decision-making process are violating this rule and are, therefore, breaching their fiduciary responsibility (Hopkins, 1992, p. 10).

As many public pension plans were forced to divest from companies in South Africa, a number of precedent-setting court cases ensued and a change in pension policy has evolved. One of the most significant rulings was issued from Baltimore's appellate courts and later upheld by the Supreme Court (Chernoff, 1989, p. 46). The case, Board of Trustees of Employees' Retirement System vs. Mayor and City Council of Baltimore (1987), involved the divestiture of South Africa-related stocks by Baltimore's city pension funds. The court rejected the view that trustees must maximize returns and ruled that trustees can accept a "de minimus" loss (Chernoff, 1989, p. 46). The judge went even further to say, "Even if the impairment were more significant, it would be insubstantial when compared to the salutary moral principles which generated the ordinance" (Hopkins, 1992, p. 10).

Of the many pension funds which have divested their holdings in companies with operations in South Africa, among the largest is the California Public Employees Retirement System (CalPERS) with assets estimated at $58 billion ("CalPERS Outlines Investment Policy," 1991, p. 40). According to Richard Koppes, general counsel for CalPERS, "The plan trustees initially opposed the legislative action. . . but to no avail, and they chose not to sue to block the mandate" ("CalPERS," 1991, p. 40). CalPERS completed its divestiture in 1990. In the same year, The Teachers Insurance

Annuity Association-College Retirement Equity Fund, the largest pension fund in the United States, with $84 billion in assets, elected to provide its members with a social choice account ("CalPERS," 1991, p. 41).

Pension funds and 401(k) plans are continuing to apply social investment criteria to their portfolios. Their participation in the debate over social investing has helped to clarify the fiduciary obligations of financial managers. The precedents set by the pension funds in their court battles benefit financial managers of small nonprofit organizations which can't afford lengthy litigation. The outcome of these cases and the comments made by the U.S. Department of Labor suggest that a small sacrifice in returns may be tolerated when the results are strongly beneficial to society. Therefore, in the case of nonprofit organizations, whose funds must be spent on activities which serve the public benefit, a strong case can be made for investing unexpended funds in a manner which serves the public benefit.

Summary of Literature Review

This review of literature describes the growth of the nonprofit sector and the consequential need to monitor how the growing assets of this sector are being managed. A review of the California Nonprofit Corporation Law (1980) helps to clarify the necessary standard of care to which nonprofit directors must adhere. In addition, the law offers an exception to the standard of care in the event that the financial activity supports the tax-exempt purpose of the organization. This exception may create a legally safe space for nonprofit managers to consider social investment as it is defined in this study: investment practices which are related or influenced by a nonprofit organization's mission or purpose.

The literature review also offered an historical context for understanding

the origins of social investing and the controversy it has sparked. It is a relevant observation that social investing has its origins in the nonprofit sector and that many social screens have purposes which run parallel to the missions of many nonprofit organizations. These shared goals make social investing appear to be a compatible financial management tool for nonprofit financial managers.

However, the concern regarding fiduciary responsibility is a valid one. Questions still remain regarding the potential risk and low returns from socially-screened investments. While financial advisors from both camps hotly debate the issue, many financial managers may prefer to wait and let the test of time give the final verdict.

In the meantime, the public has found the potential power of the multibillion dollar pension funds difficult to ignore. Public policy has forced many pension funds into the relatively new territory of social investing and into the crossfire of the debate. Meanwhile, employees whose funds are held in profit-sharing plans are also requesting more control over how their funds are invested. The resulting lawsuits have forced regulatory agencies to reexamine and redefine the concept of fiduciary responsibility, possibly to allow for "incidental benefits" in the public interest and to accept a "de minimus" in the name of "salutary moral principals" (Hopkins, 1992, p. 10).

The literature reviewed illustrates that social investing has become more popular, more established and more accepted. Simultaneously, the nonprofit sector has become larger and wealthier. Those nonprofit financial managers who are adhering to a standard of care should be developing investment strategies to manage the sector's growing assets. They may also be considering their organization's mission and they may now be including social investing as one of their investment policies.

CHAPTER THREE: METHODOLOGY

Overview

The purpose of this study is to determine how nonprofit social service and advocacy organizations in California are investing their assets and whether their investment policies or practices are influenced by organizational mission or purpose.

This study examines two classifications of the nonprofit sector: social service and advocacy organizations. These two classifications serve as a basis of comparison to identify whether variations in investment practice exist between the two different types of nonprofit organization.

The research subject population was limited to 501(c)(3) and 501(c)(4) social service and advocacy organizations operating in the State of California. It was also limited to organizations with total assets greater than $100,000. From this population a sample of 50 organizations was drawn for each classification. A survey was directed to the financial manager of each organization. An additional survey was made of the responding organizations' annual federal returns, Internal Revenue Service Form 990 (please refer to Appendix D for a sample copy of this form).

Social Service and Advocacy Organizations

Due to the breadth and extent of the independent sector, it was necessary to narrow the focus of this study. The area of study was limited social service agencies and advocacy organizations in the State of California

Social service agencies is a broad category including organizations which provide a variety of human or social services. The following types of organizations are included under the Standard Industrial Classification Code

for Social Services: Individual and family services; job training and related services; child day care services; residential care; housing/shelter, food services and nutrition; and information and referral services (please refer to Appendix A for a complete listing). This subsector is widely diverse with organizations ranging from international refugee assistance groups to teenage guidance centers. Social service organizations are typically among the first to identify and address problems often ignored or denied by the rest of society. Recent examples of heroism in the nonprofit sector have been for causes such as the fight against Auto-Immune Deficiency Syndrome (AIDS), homelessness, and domestic violence.

> Historically, nonprofit social service organizations have often played a vanguard role in responding to social needs. Child abuse is a recent example. Although the sexual and physical abuse of children is centuries old, it was one of America's darkest and most closely kept secrets until the 1960s, when medical evidence made it unavoidably clear that child abuse was a serious problem. Nonprofit agencies took the lead in caring for the victims and getting the public and the government to face the problem (O'Neill, 1989, p. 97).

While this subsector is often lauded for its heroic deeds, it is often criticized for its management. The dedicated staff of these organizations are often perceived to be too burned out or too busy saving others to save their organizations from financial ruin. However, with total assets of $20.4 billion dollars and mean assets of $1.1 million, social services organizations manage to play an influential role in our economy in as well as our society (Hodgkinson et al., 1992, p. 227). Social service organizations can provide an interesting and valuable perspective regarding investment policy and practice.

Advocacy organizations are usually smaller, less conventional agencies formed to respond to current social issues and promote social change. The sampling frame used in this study for advocacy organizations included organizations identified with civil rights, social action, legal defense, environmental quality, beautification and protection, international or foreign affairs and national security, and advocacy organizations according to the Standard Industrial Classification Code (see Appendix A for complete listing). These organizations are often at the vanguard of social change, addressing the same issues as the social investment industry.

Among advocacy organizations there is a wide diversity of financial conditions. Data published in the Nonprofit Almanac 1992-1993 describe civil rights, social action, and advocacy organizations as having median assets of $65,000 and mean assets of $379,000 (Hodgkinson et al., 1992, p. 229). There is a significant gap between the mean assets and the median assets, suggesting that the wealth of this subsector is concentrated in the holdings of relatively few advocacy organizations. This study examined those advocacy organizations with more than $100,000 in assets to determine how they are managing these funds. It was thought that many of the advocacy organizations with more than $100,000 would have enough cash assets available to begin developing an investment strategy. However, very few of them were expected to have a substantial amount of assets with which to develop a more complex investment portfolio.

There were several benefits to examining the investment practices of advocacy and social service organizations. Primarily, financial managers of smaller nonprofits may find information about the activities of these organizations to be useful when evaluating their own investment strategy. These smaller advocacy organizations may represent more closely the

financial conditions of nonprofit organizations which are starting to develop investment policies. The broad range of organizations may also provide information which will help to identify the approximate amount of cash-on-hand an organization holds when it begins to consider investing.

These organizations also provide an interesting population for research with regard to social investment activity. Social service agencies are, by nature, dedicated to meeting certain social needs. The advocacy subsector tends to be quite outspoken and strongly promotes activities which may bring about social change or reform. Social investing has often been promoted by advocacy organizations as a tool to bring about social change. It is interesting to note whether those advocacy organizations with investable assets have embraced social investing as an additional tool to promote their respective causes.

Research Design

Fifty organizations were randomly selected from each of two separate sampling frames drawn from the California Nonprofit Database compiled by the Institute of Nonprofit Organization Management (INOM) at the University of San Francisco. The two separate sampling frames were based on the classifications "social service" and "advocacy organizations." The sampling frames included only 501(c)(3) and 501(c)(4) organizations, and were limited by zip code to the State of California, and excluded all organizations with total assets of less than $100,000.

The sampling frame for social service organizations was selected from the Institute for Nonprofit Organization Management (INOM) Database based on the Standard Industrial Classification Codes (SICC). The selection of advocacy classification was based on Standard Industrial Classification Codes

8540 (civil rights, social action, advocacy); 8111 (legal services, 8550 - environmental quality, protection and beautification); and 8560 (international/foreign affairs and national security). Within legal services is the subgroup of public interest law agencies which seek social change through the legal process. Environmental quality, protection and beautification includes organizations which seek to change social behavior which affects the preservation and protection of the environment. The international/foreign affairs and national security includes organizations which promote international human rights and international understanding.

For the purposes of this study, advocacy organizations were defined as organizations which seek to influence public opinion regarding social issues or to promote social change. A listing was created combining the four SICC classification codes. To create a sampling frame, the listing was filtered based on the titles of the organizations and organizations which clearly did not match this study's definition of an advocacy organization and were excluded from the sampling frame.

The selection for the social service organization classification is based on Standard Industrial Classification Codes 8332 (individual and family services); 8331 (job training and related services); 8351 (child day care services); 8361 (residential care); 8391 (housing and shelter); 8392 (food services and nutrition); 8394 (information and referral services); and 8399 (social services).

It is possible that some social service organizations which are often multipurpose may also be classified as advocacy organizations under the Standard Industrial Classification Code. To avoid duplication, the advocacy sample was selected first. Then, social service organizations which appear in the advocacy sample were excluded from the sampling frame used to draw the social service organization sample.

The California Nonprofit Database compiles data from a variety of sources, but primarily from the Registry of Charitable Trusts, the California Attorney General's Office, and the Internal Revenue Service. Occasionally, the forms submitted to these agencies did not reflect the nonprofit organization's location of operations. Therefore, when the samples were created, the addresses were cross-checked with the Taft Directory of Nonprofit Organizations (1994) to identify any possible inaccuracies.

Confidential mail surveys were sent to the financial manager of each of the 100 selected organizations. The same survey was sent to both social service and advocacy organizations. After 10 days, nonrespondents received a follow-up call to verify the mailing address and identify the name of the proper respondent. An additional survey was sent with a personalized letter encouraging a response. Financial managers who did not respond to the first two mailings were sent an additional survey, with a personalized letter and a five-dollar redeemable coupon as token of appreciation for their time to complete the survey. A follow-up phone call was made to the organizations with written investment policies to ask them if they would be willing to include a copy of it in the study.

Past research using the survey method to obtain financial information reveals that nonprofit organizations are wary of disclosing financial information (Marx, 1992-1993, p. 39). To reduce the nonresponse rate, specific financial data which managers might be reluctant to disclose in a mail survey were obtained through a survey of each organization's federal returns. To improve the response rate, the mail survey was limited to 20 questions and the time required to complete it was limited to less than 10 minutes. The sample was limited in size to ensure effective follow-up, which may have helped to boost the response rate.

In addition to the mail survey, a supplemental survey was made of the organizations' federal returns (IRS Form 990) to obtain additional financial data. Data were also available through the California Nonprofit Database at the University of San Francisco's Institute for Nonprofit Organization Management.

Due to the nature of filing requirements, federal returns were not always available for the prior year's financial activity. This study accessed the most recently available federal returns. There was a 2- to 30-month time difference between the survey (which measures current-year activities) and the closing date of the available federal return. A question in the survey addressed this issue by inquiring about any significant changes in financial conditions during the prior two years which may have affected the investment strategy of the organization.

Instrumentation

A survey was mailed to the financial managers of the selected organizations (see mail survey instrument Appendix C). The survey was designed to cover three topic areas: investment practice and policy; information about the organization; and information about the respondent. The survey of the annual federal return gathered data regarding the assets, retained earnings, and expenditures of the nonprofit organization.

Operational Definitions of Variables

Many of the operational definitions of the variables in the study were based on financial managers' responses to questions included in the survey. When applicable, the operational definition of the variable will include a reference to the survey and the specific questions related to the variable.

(Please refer to the mail survey instrument in Appendix C for the specific wording and format of the question).

Investment activity

This dependent variable measures the degree of complexity of an organization's investment activity. Investment practices were grouped into three levels of complexity. The first group of investments (G1) includes interest-bearing checking accounts and savings accounts. All are low-risk and very low-return accounts which represent a minimum of investment activity. The second group of investments (G2) includes certificates of deposit, treasury bills, notes or bonds, and other accounts which also tend to have fairly similar low rates of return and risk. They usually don't require much background research or oversight. The third group of investments (G3) are the higher-risk, higher-return investments which include mutual funds, corporate stocks, and other bonds. These investments represent a higher risk and usually require more knowledge of investments, more research, and often more involvement of higher management in monitoring the investments.

This variable of investment activity was used to evaluate how investment behavior is influenced by other factors. The data, which were collected in an ordinal form, helped determine each organization's level of investment activity. The data will be drawn from respondents' answers to survey question 2.

Total invested

This dependent variable represented the amount of money which the organization invested. This variable did not include assets invested in land, buildings, equipment, or inventory. It also excluded cash assets in

noninterest-bearing accounts. These data were gathered from the IRS Form 990.

Equation: Total Invested = Line 46 + 54 + 56 (Form 990)

Social investment practice:

This dependent variable was measured as any investment practices that are related to or influenced by a nonprofit organization's mission or values. The data for this variable were drawn from respondents' answers to survey question 13a.

Investment policy

This is a dependent variable and measures whether an organization has an investment policy. The data were collected from respondents' answers to survey question 11.

Type of organization

This is an independent variable. There were two categories: social service, and advocacy. These data were drawn from the Standard Industrial Classification Codes provided through the Institute for Nonprofit Organization Management. Supplemental data were drawn from respondents' answers to survey question 1.

Total assets

This independent variable was used to determine whether the total assets of an organization had any correlation to an organization's investment activity or social investment practice. The data were drawn from line 59 of the IRS Form 990.

Investable cash assets

This independent variable was used to measure the relationship of available cash-on-hand which an organization has when it begins to consider investing. This figure represents total assets after excluding receivables,

investments in land, buildings, equipment or inventory. The data were drawn from financial information which has been reported on IRS Form 990. It was derived by subtracting land, buildings, equipment, and inventory assets as well as receivable assets from the total assets as reported on IRS Form 990. Equation: Investable Cash Assets = Lines 59 - (47c+48c+49+50+51c+52+53+55c +57c+58) [IRS From 990]

Total operating budget

This independent variable was measured as the total annual expenses of an organization as reported on IRS Form 990, line 17.

Fund balance

This independent variable was used to determine how the net worth of an organization may affect the organization's investment activity or social investment practice. These data were drawn from line 74 (or the sum of lines 67-79) of IRS Form 990.

Changes in net worth

This independent variable was measured as the respondent's perception of the change in the organization's net worth over the last five years to determine whether perceived change in net worth influences investment activity or social investing practice. These data were gathered from respondents' answers to survey question 4.

Changes in financial condition

This independent variable helped to determine whether the financial data from IRS Form 990 reflect a substantially different financial situation than the current conditions of the same organization. This was determined based on respondents' answer to question 5.

Fluctuations in cash flow

This independent variable was measured to determine whether the

organization undergoes dramatic changes in cash flow. These data were collected from respondents' answers to survey question 6.

Outside expert

This independent variable was measured to determine whether the presence of an outside consultant had any correlation to the investment activity or social investing practice of organizations. These data were collected from respondents' answers to survey question 8.

Endowment or board-designated reserve fund

This independent variable was measured to determine whether the presence of an endowment fund had any correlation to investment behavior. This variable was measured by the respondents' answers to survey question 3.

Number of financial managers

This independent variable measured the number of people involved in the financial management of the organization. This information was drawn from the respondents' answers to survey questions 7.

Investment knowledge

This independent variable is based on how the respondent rated his or her own knowledge of investment practice. These data were drawn from each respondent's answer to survey question 14, on a scale ranging from "no knowledge" to "area of expertise."

Social investment knowledge

This independent variable is based on how the respondent rated his or her knowledge of social investing. These data were drawn from each respondent's answer to survey question 15, which asked the respondent to rate himself on a scale ranging from no knowledge to area of expertise.

Financial management training

This independent variable measured the amount of education and

training the financial manager has received. These ordinal data were drawn from respondents' answers to survey question 19.

Perception of risk

This independent variable measured a financial manager's perception of the risk associated with each kind of investment. The data were drawn from the respondent's answer to survey question 9.

Perception of what might be speculative

This independent variable measured a financial manager's perception of what investments would be too speculative for the organization. These data were drawn from the respondents' answers to survey question 10.

Perception of social investing

The different possible perceptions of social investing were measured by asking respondents to compare their perception of social investing to perceptions of standard (not social) investing. These data were gathered from the respondents' answers to survey questions 9 and 16.

Treatment of Data

The data were analyzed to determine whether there was any correlation between the dependent variables of investment behavior and social investment activity, and the various independent variables.

Investment activity

Data regarding investment behavior were gathered in several forms. It was first collected in nominal form by separating those organizations which do invest from those which do not. Investment is considered to be cash assets held in anything other than a noninterest bearing account.

Second, those organizations which do invest were categorized into ordinal rankings of investment activity from the most basic to the most

complex.

Third, ratio data were obtained from each organization's federal returns. This data were summarized in the form of dollars invested, as well as in percentage of investable assets.

The dependent variables were compared in various forms to independent variables, or combinations of independent variables, to determine whether there was any correlation with the variation in investment behavior.

Social investment practice

Data regarding social investment practice were gathered in nominal form according to those which do, and those which do not, engage in social investment practice. An unusual characteristic of social investing is that the avoidance of a particular investment may be considered a form of social investment practice. It is difficult to create a measure for investments which were avoided due to social considerations.

Social investment practice was also treated as a dependent variable and was compared with other independent variables or combinations of independent variables to determine whether there was a correlation.

Investment policy

For those organizations which do invest, it is of interest to know whether they have developed an investment policy. This may provide some insight into the complexity of investment behavior or social investment practice. These data are nominal.

Types of investment

When provided, information regarding specific types of investments was compiled in nominal form from the survey completed by the financial manager and in ratio form from the schedules attached to IRS Form 990. If

possible, this information was summarized to better illustrate investment behavior.

Type of organizations

Each respondent's organization was classified first as either a social service or an advocacy organization. Then, to gain a better understanding of the scope and variety within each classification, organizations were classified according to the information provided by the mail survey responses and supplemental information obtained from the organization's tax-exemption application.

The purpose of drawing samples from two different classifications of organizations was to determine whether investment behavior varied significantly between different classifications of nonprofit organizations. Independent variables were tested against each sample separately and the results were compared to determine whether the correlation is consistent in both classifications.

Total assets

Total assets may be a significant factor with relation to investment behavior and social investment practice. The data are compared to investment activities to determine whether a correlation exists. This was done by ranking the total assets of the organization on an ordinal scale to compare with the ordinal data gathered on investment activities.

The assets of the organization can be an indicator of the size of an organization. As an organization becomes larger, several circumstances are likely to arise. There is the possibility that an organization with greater total assets will have more cash assets available to invest. There are instances, however, when this may not be the case. For example, when an organization's assets may be held entirely in real estate and the organization

may have very little cash on hand with which to develop a complex investment portfolio. Therefore, total assets were compared to investable cash assets. This was accomplished with ratio data.

Another consideration is whether an organization can afford the cost of an outside financial consultant to provide qualified advice and recommendations with regard to an investment portfolio. A director may wish to do so in order to satisfy the standard of care stipulated in the California Nonprofit Corporation Law (1980). Reliance on an outside expert was compared to total assets to determine whether there is a correlation.

Investable cash assets

This variable was derived from an equation using data from IRS Form 990 which estimates the actual cash-on-hand available for a financial manager to invest. This ratio was compared to investment behavior and to social investment practice to determine if there was a correlation.

This data were also analyzed in ordinal form as a percentage of each organization's total operating budget. An organization should maintain enough cash in easy-access accounts to cover projected short-term expenditures. Long-term investments are generally made with the excess amount. Therefore, the amount of investable assets may be a function of an organization's total operating budget.

Fund balance

The fund balance is another indicator of the financial size of the organization. These ratio data were drawn directly from the financial information reported on IRS Form 990. This figure represents the total assets and liabilities or net worth of the organization. It is not a very good indicator of the assets available to invest, but it is an indicator of the overall financial strength of an organization. Fund balance may play some role in financial

decision-making, especially if the fund-balance has been decreasing or increasing over time.

Changes in net worth

Changes in net worth were measured as either increasing, decreasing, or remaining about the same. Ordinal data obtained from responses to the mailed survey were compared to investment behavior to determine whether a correlation exists.

Fluctuations in cash-flow

The financial information reported on IRS Form 990 reports a specific moment in time. Unfortunately, if an organization experiences large fluctuations in cash-flow, information collected from IRS Forms may show investable assets greater or less than is actually the case. Organizations with large fluctuations in cash-flow are less likely to invest in long-term activities, and might have less complex investment behaviors.

Outside expert

The more complex and diverse the investment needs of an organization, the more knowledge and expertise are necessary to successfully invest organizational funds. Higher-risk investments may draw higher returns, but they may also increase the risk of liability for the directors of an organization. Reliance on a qualified outside expert to maintain a standard of care may help to reduce potential liability. The "outside expert" variable was measured as nominal data and was compared to investment behavior.

Endowment or board-designated reserve fund

The presence of an endowment or board-designated fund identified organizations which had assets set aside to serve a specific purpose. These funds are usually invested. The presence of endowments was measured nominally and compared to investment activity and social investing.

Number of financial managers

This variable, which represents the number of staff and board members involved in the financial management of an organization, was collected as descriptive information. It may be of interest to other financial managers to know how other organizations invest their staff resources in financial management. Financial managers may also be interested in the prevalence of board committees on finance.

Investment knowledge

It was very difficult to determine in this study whether a financial manager's greater knowledge of investment increases investment activity, or whether greater investment activity by an organization induces the hiring of managers who are more knowledgeable in investing. Regardless of which is cause and which is effect, there is an expectation that the two will correlate. This ordinal variable of managerial investment knowledge was compared to investment activity.

Social investment knowledge

This variable, which yields ordinal data, was compared to the variable of social investment practice. It was also intended to be compared to financial managers' perceptions regarding social investment.

Financial management training

This variable offers an additional method of evaluating the knowledge of the financial manager. The responses, gathered in ordinal form, were compared to the investment activity of the organization.

Perception of risk

This variable attempted to identify the level of risk associated with various investments. Risk is one possible deterrent to investing funds. Perception of risk was compared to investment activity.

Perception of what constitutes speculative

The California Nonprofit Law (1980) warns against speculation (Silk et al., p. 205, 1990) and yet there are differing viewpoints on what constitutes speculation. Respondents were asked to identify which types of investments they believed to be speculative. These ordinal data are compared to the investment behavior of the organizations.

Respondent were also asked to indicate whether they perceived social investing to be too speculative for their organization. These data were compared with social investment activity.

Perception of social investing

The data regarding perception of social investment are ordinal and are compared to the variable of social investment practice to identify a correlation between various factors which may compel or deter an organization from engaging in social investment practice.

CHAPTER FOUR: RESULTS

This chapter summarizes results of the data drawn from surveys collected and from each respondent's corresponding Internal Revenue Service Form 990. The chapter begins with a discussion of the survey response rate, the lack of a nonresponse bias, and a brief illustration of the diversity of the organizations which responded to the survey. This is followed by a review of the results of the data, addressing the research questions as stated in Chapter One:

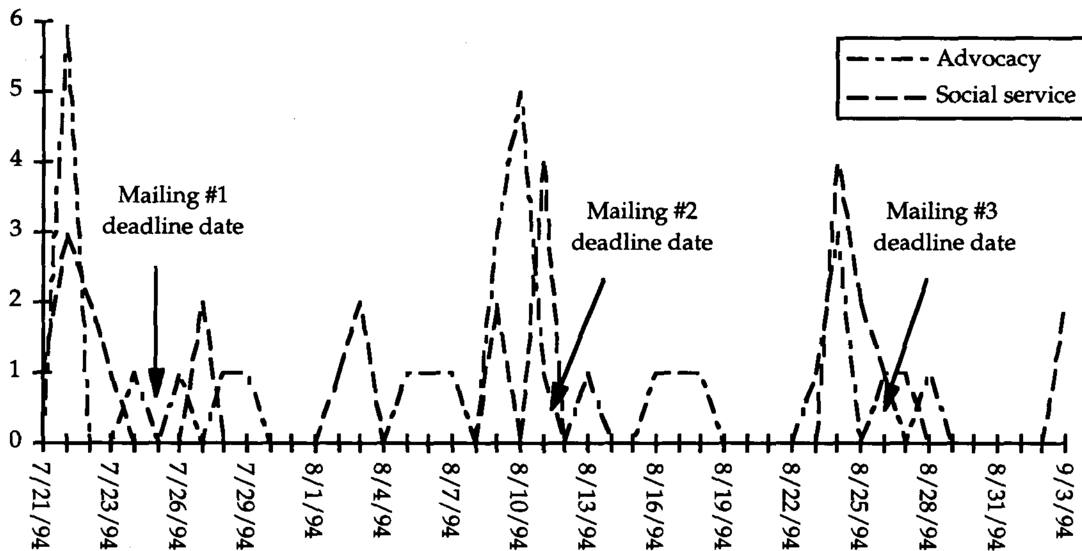
1. Do social service and advocacy organizations invest their assets?
2. To what degree do social service and advocacy organizations invest their assets?
3. Do social service or advocacy organizations consider the social impact of their investments when making decisions about how to invest?

The results of additional findings regarding existence of written investment policies will also be reviewed in this section. Finally, this chapter will review the results of data gathered on some of the independent variables thought to have some bearing on organizations' level of investment activity, the presence of an investment policy, or the practice of social investing.

Survey Response

The surveys were mailed according to the methodology described in Chapter Three. Sixty surveys were completed and returned between July 18 and August 31, 1994 resulting in an overall response rate of 60 percent. Thirty-two advocacy organizations (64 percent), and 28 social service organizations (56 percent) returned completed questionnaires. Figure 1 illustrates the response patterns of the two subsectors.

Figure 1
Survey Response Patterns



Of the advocacy organizations which responded, 34 percent responded to the first mailing of surveys, 47 percent to the second, and 19 percent to the third mailing. Of the social service organizations, 43 percent responded to the first mailing, 21 percent to the second mailing and 36 percent to the third mailing.

Before the first mailing, addresses provided by the California Nonprofit Database of the Institute of Nonprofit Organization Management (INOM) were compared to the addresses listed in the 1994 edition of the Taft Directory of Nonprofit Organizations. After the responses to the first mailing began to taper off, the researcher attempted to call all the nonrespondents to obtain the name of the person responsible for financial management. While doing this, the researcher discovered that 10 percent of the organizations which could be reached by telephone had relocated their offices or were receiving mail at a different address than was provided by both the nonprofit database and the nonprofit directory. Several other organizations (8 percent) were unlisted and could not be reached by telephone. This may have reduced the number of potential respondents to the survey.

Nonresponse bias

Although surveys are a useful tool for gaining information, one of the greatest drawbacks of using mail surveys as a research instrument is the low response rate. Earl Babbie (1989), in his book, The Practice of Social Research, discusses this issue.

> It should be pointed out here that the body of inferential statistics used in connection with survey analysis assumes that all members of the initial sample complete and return their questionnaires. Since this almost never happens, response bias becomes a concern, with the researcher testing (and hoping for) the possibility that the respondents look essentially like a random sample of the initial sample . . . and thus a somewhat smaller random sample of the total population (pp. 241 -242).

Babbie (1989) goes on to offer some guidance to the social researcher with regard to response rates.

> Even so, it's possible to state some rules of thumb about return rates. I feel that a response rate of at least 50 percent is adequate for analysis and reporting. A response of at least 60 percent is good. And a response of 70 percent is very good. You should bear in mind, however, that these are only rough guides; they have no statistical basis, and a demonstrated lack of response bias is far more important than a high response rate (p. 242).

The researcher felt that a number of factors may have limited the number of survey responses. A primary factor was the subject matter of the survey. Many financial managers are reticent to discuss the financial activities of their organizations. Another factor was difficulty in locating some of the organizations selected for the sample. Finally, the timing of the mailing during July and August may have been a factor. It appeared that many financial managers were out of the office at this time.

In order to demonstrate a lack of response bias, the researcher compared responses from the first eight surveys and the last eight surveys received. This is based on the assumption that the organizations which responded last may closely represent the nonrespondents. A lack of significant difference between the responses of these two subsamples would suggest that there probably isn't a significant difference between the organizations which responded and those which did not, at least with regard to the research question. A lack of significant difference would indicate a lack of nonresponse bias.

Nominal and ordinal data were drawn from the questionnaires and ratio data were drawn from the IRS 990 forms. The ratio data collected from the 990 forms of the advocacy and social service organizations were found to be skewed and platykurtic in distribution. Therefore, all ratio data were converted into ordinal data and only nonparametric tests such as the Spearman r and chi-square tests were used to identify significant differences.

Responses from the first group and last group were compared and tested at a confidence level of $P<.05$. The researcher did not find any statistically significant differences between the responses provided by the first and last group. Nor were any significant differences found between the data collected from the federal tax forms of each sample.

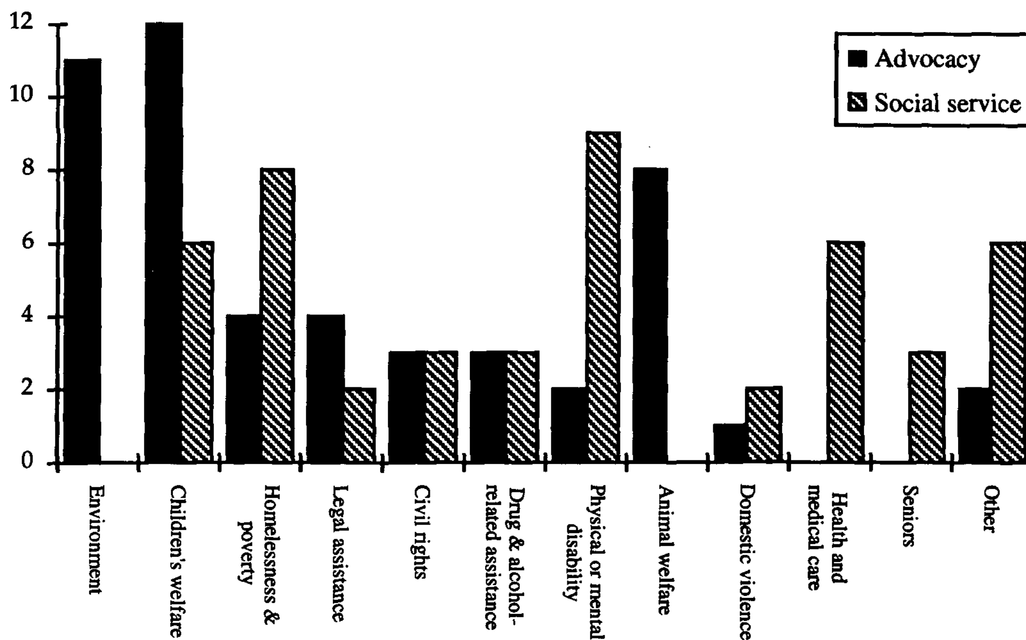
While it is likely that some differences may exist between the organizations which responded and the organizations which did not respond, the researcher is confident that those differences did not have any significant bearing on the data collected with regard to the research questions.

Review of Results

Diversity of organizational purposes

To gain a sense of the type of organizations responding to the survey, several possible organizational purposes were listed. Respondents were asked to check one or more choices which best described the primary purpose of their organization, or to describe the purpose of their organization in the "other" category. The figure below illustrates the diversity of purposes indicated by the respondents.

Figure 2
Diversity of Organizational Purposes

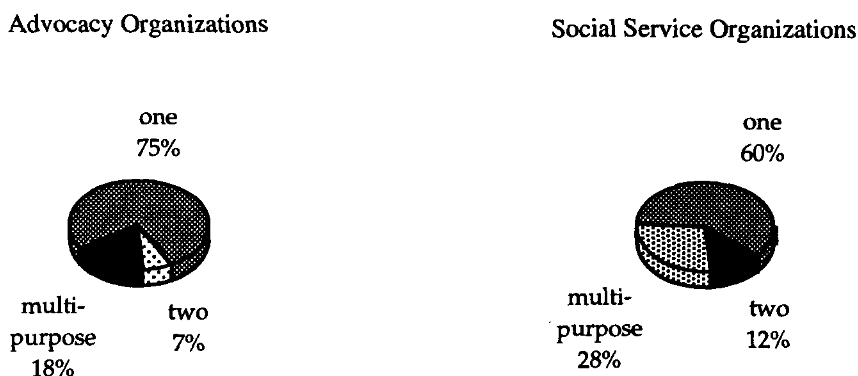


Among the advocacy organizations, 75 percent identified only one primary purpose and 18 percent acknowledged having three or more purposes. Among the most common purposes identified by advocacy organizations were: child welfare and youth advocacy (37 percent); environmental conservation, protection and beautification or promotion of a clean environment (34 percent); animal welfare and wildlife preservation (25

percent); and advocacy and/or legal services for the homeless or low-income community (25 percent). All the organizations which listed multiple (three or more) services listed services for the homeless and low-income community as one of their primary purposes. This is understandable because it is difficult to approach the issues of homelessness and poverty without addressing several related problems such as alcohol abuse and mental health.

Not surprisingly, even more of the social service respondents listed multiple purposes. Only 60 percent reported having only one purpose and 28 percent reported three or more purposes. Among the most common purposes identified by social service organizations were: services for the physically or mentally disabled (32 percent); homelessness (29 percent); children's welfare and youth advocacy (21 percent); and health services (17 percent). All are complex issues which often demand that an organization address several needs simultaneously.

Figure 3
Number of Primary Purposes Identified by
Advocacy Organizations and Social Service Organizations



<u>Variations between advocacy and social service organizations</u>

The survey responses from the two samples were compared to identify variations between advocacy and social service organizations. Using the chi-square test at a confidence level of $P<.05$, each response was tested and no

significant correlation was found between the type of organization and any of the responses on the survey. Both types of organizations responded to the surveys in very similar ways.

The ratio data collected from the IRS 990 forms were collected and for both samples the data were positively skewed and very platykurtic. Therefore, these data were not useful for parametric statistical tests.

The range of total assets for advocacy organizations was $37,021 to $11,154,016. The median was $305,120 and the mean was $1,544,302. The range for social service organizations was $98,522 to $7,524,046. The median was $587,747 and the mean was $1,063,236. Both samples were skewed by a small number of very large organizations. According to Richard Sprinthall (1990), author of Basis Statistical Analysis (3rd ed.), this is a common occurrence for financial data because the low end is fixed around zero (few nonprofit organizations which have negative assets survive for long), "while the sky is the limit at the high end" (p. 32).

The data regarding total assets of both samples were unexpected because the original sample provided by the INOM California nonprofit database should have excluded organizations with total assets of less than $100,000 on their most recent IRS forms, as requested. Instead, only organizations which never had total assets of greater than $100,000 were excluded. This error was only discovered after the IRS 990 forms of the responding organizations were requested and the total assets of some of the organizations were found to be less than $100,000.

Organizations with less than $100,000 were excluded based on the researcher's belief that a correlation might exist between total assets and the complexity of investment activity. The researcher wanted to draw a sample from a population above the threshold of $100,000 because of the concern that

very little investment activity would take place below this threshold. Interestingly, two of the five organizations with total assets less than $100,000 were investing in mutual funds and were among the organizations with the most complex level of investment activity. Only one of the organizations was in the group one level of investment activity. This finding contradicts the researcher's expectation of a correlation between total assets and complexity of investment activity. It supports the statistical finding of no correlation between total assets and the complexity of investment activity for either sample.

The range of investable assets for advocacy organizations was $13,963 to $7,861,386. The median was $170,629 and the mean was $843,277. The range for social services organizations was $1,590 to $871,204. The median was $145,780 and the mean was $218,637.

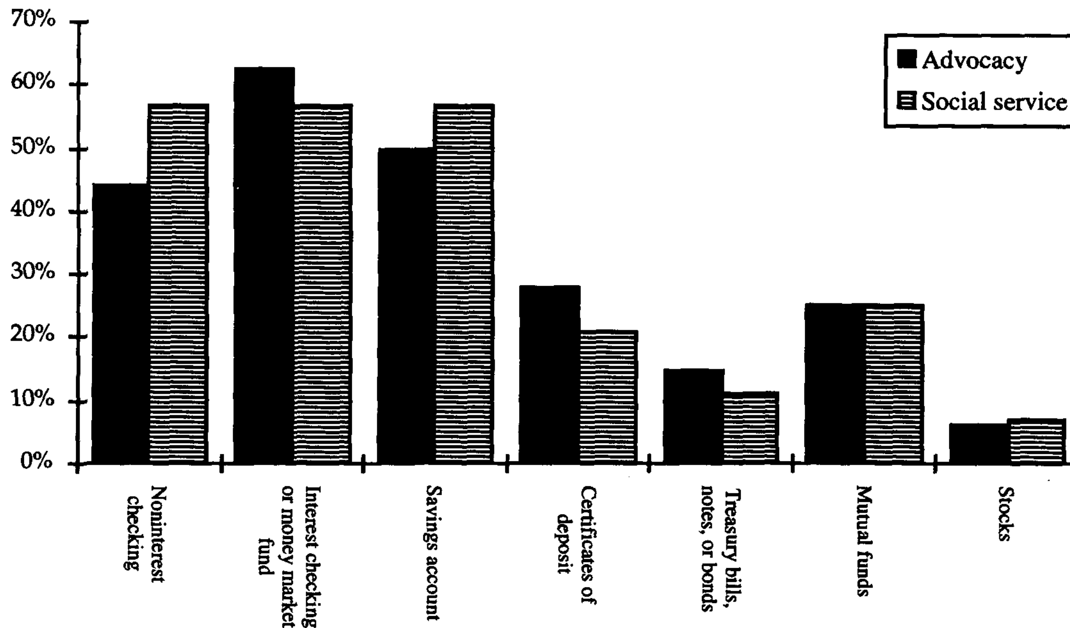
Investment activity

The primary research question, "Do California social service and advocacy organizations invest their assets?" was addressed by question number two of the questionnaire, "Please indicate each type of account where your organization has assets." Of the organizations which responded, all but 9 percent of advocacy organizations and 3.5 percent of social service organizations hold their assets in interest-bearing accounts. Based on the definition of investment practice, "putting money to use, by purchase or expenditure, in something offering a profitable return" these organizations are earning a return on their assets, albeit quite small in some cases.

Forty-four percent of the sampled advocacy organizations held some of their assets in noninterest-bearing checking accounts, 50 percent indicated holding assets in savings accounts, 62.5 percent used interest-bearing checking accounts and/or money market funds, 28 percent held certificates of deposit,

15 percent held treasury bills notes or bonds, 25 percent had invested in mutual funds and only 6 percent in individual stocks.

Figure 4
Investment Vehicles



The respondents from the social service organizations reported that 57 percent held assets in non-interest bearing checking accounts; 57 percent held assets in savings accounts; 57 percent used interest-bearing checking accounts and/or money market funds; 21 percent held certificates of deposit; 11 percent held treasury bills notes or bonds; 25 percent invested in mutual funds, and only 7 percent held stocks.

Investment behavior

The second research question, "To what degree of complexity do California social service and advocacy organizations invest their assets?" was addressed by grouping various forms of investment according to complexity and then using the responses to question number two of the survey to identify the levels of investment activity for each organization.

Table 1
Investment Activity Groups According to Complexity

	Types of accounts	Advocacy organizations	Social service organizations
Group one:	Noninterest-bearing accounts Savings accounts	7	7
Group two:	Interest-bearing checking Certificates of deposit Money market accounts	13	13
Group three:	Treasury bills, notes or bonds Mutual funds Corporate stocks and bonds	12	8

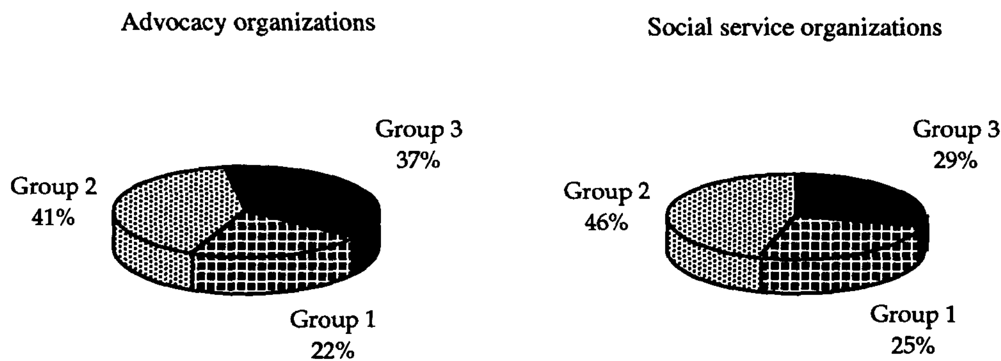
Among advocacy organizations, three organizations limited themselves to noninterest-bearing accounts. Among social service organizations, only one organization limited itself to noninterest-bearing accounts. The organizations included in group one were organizations which limited themselves to a very simple level of financial management by holding their funds in noninterest-bearing checking accounts and low interest-bearing savings accounts. To implement such a strategy involves very little research, and risk is insubstantial as long as account balances remain below a bank's federally-insured account limit.

Group two represents the second level of investment activity and includes organizations which invest their funds in interest-bearing accounts such as checking accounts, money-market funds, and certificates of deposit. These accounts represent almost no risk, and yield relatively low returns. Forty-one percent of the advocacy organizations which responded invested their funds at this level and 46 percent of social service organizations also fell within group two.

Group three includes investments which represent a larger degree or risk and require some research or knowledge of investing. When managed

successfully, they may also yield higher returns. Included in group three are treasury bills, notes or bonds, mutual funds, and stocks. Thirty-seven percent of advocacy organizations and 28 percent of social service organizations invest their funds at this level.

Figure 5
Distribution of the Complexity of Investment Activity of Advocacy Organizations and Social Service Organizations



Written investment policies

The researcher was curious to know whether, as the investment activities of the organization become more complex, organizations would be more likely to develop investment policies. Of the advocacy organizations which responded to the questionnaire, 19 percent reported having a written investment policy and of the social service organizations, 18 percent reported having written investment policies.

In the case of social service organizations, a chi-square test showed a correlation at a confidence level of $P<.05$ that there is a relationship between complexity of investment strategy and the possession of an investment policy. In the case of advocacy organizations no correlation was found at $P<.05$.

In both cases, the researcher was surprised to note the scarcity of written

investment policies. As demonstrated in Tables 1 and 2 below, only one-half of the social service agencies investing at the complex group three level had an investment policy as did only one third of advocacy agencies investing at the same level.

Table 2
Relationship Between the Level of Investment Activity and the Possession of a Written Investment Policy

Advocacy Organizations	Group one	Group two	Group three
Written investment policy	1	1	4
No written investment policy	6	12	8

Table 3
Relationship Between the Level of Investment Activity and the Possession of a Written Investment Policy

Social service organizations	Group one	Group two	Group three
Written investment policy	0	1	4
No written investment policy	7	12	4

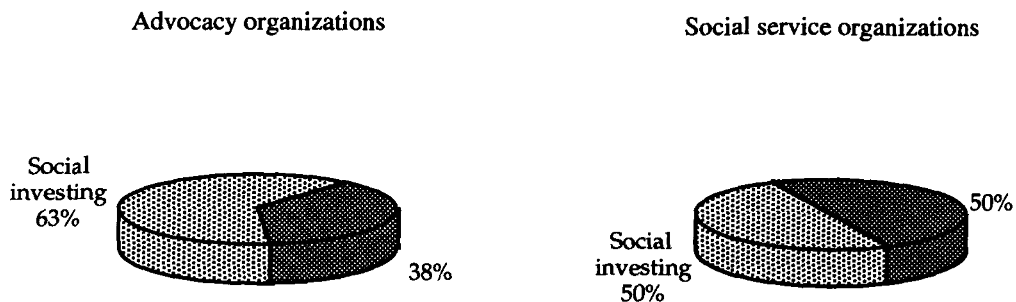
Drafting a written investment policy takes time, and occasionally sparks controversy in an organization. However, a written policy is a valuable tool for organizations whose investments are long-term and that may outlive the staff which initiated the portfolio. The organizations with written policies were contacted and invited to submit their policies for inclusion with this work. All the policies provided have been included in Appendix E. The names of the organizations have been omitted to guarantee anonymity.

Social investing

The third research question, "Do California social service or advocacy organizations consider the social impact of their investments when making decisions about how to invest?" is addressed by survey questions 13a and 13b.

This study has defined social investment as investment practices that are related to or influenced by a nonprofit organization's mission or values. It is measured by respondents' answers to the question, "Is it the policy or practice of your organization to take into consideration the organization's social purpose when making investment decisions?" In response to this question, 50 percent of the social service organizations and 62.5 percent of the advocacy organizations indicated that they do take the organization's social purpose into account when making investment decisions. Fourteen percent of social service organizations and 25 percent of advocacy organizations indicated that they also take other social issues under consideration.

Figure 6
Distribution of Social Investment Activity Among
Social Service Organizations and Advocacy Organizations



These findings seem peculiar considering that only 37 percent of advocacy organizations and 29 percent of social service organizations are investing at the group three level where proactive social investing can take place. In fact, of the 20 advocacy organizations which indicate social investing practice or policy, only eight (40 percent) reported using an investment

strategy which falls within the group three level of investing. Of the 14 social service organizations, only four (28.5 percent) reported investing at the group three level.

The responses provided in the surveys may not be contradictory. As explained in chapter 2, social investing often takes the form of avoidance. It is not necessary for an organization to invest in complex, higher-risk investment vehicles in order to practice or maintain a policy of social investing through avoidance. It is possible that those nonprofit organizations which claim to be practicing social investing are doing so by avoiding investments which may contradict the mission of their organizations. Rather than developing a socially-screened investment strategy, they may be screening out altogether all stocks, bonds, mutual funds and other forms of complex investment. At the group one and group two levels, organizations can practice avoidance simply by divesting their holdings from financial institutions associated with undesirable activities, such as investment in South Africa for example.

One of the limitations of this study is the assumption that responses to the questions posed in the survey constitute a reliable basis for deriving conclusions. Under these circumstances, the researcher concludes that the majority of organizations which practice social investing do so in the form of passive avoidance rather than in a more complex, proactive form.

When the same financial managers were asked, "Aside from the organization's mission, are other social issues considered when making investment decisions?" eight (25 percent) of the advocacy and four (14 percent) of the social service agencies responded affirmatively.

Social investing and written investment policies

Unfortunately, it is difficult to verify the responses of financial managers

whose organizations are practicing an avoidance social investment strategy. In the case of proactive social investing, responses may be verified by observing the investment activities of the organization. In the case of avoidance, however, there isn't any investment activity to observe. A possible secondary source of data might have been an organization's written investment policy. Unfortunately, as observed in this study, the majority of organizations do not have written investment policies, even in the case of organizations which are investing at a more complex, high-risk level. Of the 20 advocacy organizations which indicated having a practice or policy of social investing, only three had a written investment policy. Of the 14 social service organizations indicating a practice or policy of social investing, only one had a written investment policy.

Independent Variables

The survey results show that the respondent social service and advocacy organizations do invest their money and do so at varying levels of complexity. They show that they often lack written investment policies. They also show that 50 percent or more of them make it a policy or practice to consider the social mission of the organization when making investment decisions. By compiling data from IRS Form 990 and the questionnaire, the researcher attempted to gain some insight into what factors influenced organizations' investment behavior. The rest of the chapter reviews the relationships that these independent variables have to investment activities, investment policy, and social investing.

Endowment or board-designated reserve fund

Endowments and board-designated funds are often comprised of assets which are set aside for the purposes of generating income to support

operating funds, to provide a safety net for the organization against risk or low cash-flow periods, or as a nest egg to develop new programs or enhance the organization in other ways. These funds are generally held for several years or even into perpetuity. The establishment of such funds normally requires action by a board of directors as well as on-going oversight and management. The existence of these types of funds may offer incentive to adopt a more complex investment strategy and to develop an investment policy. More than half (53 percent) of the social service organizations which responded had a board-designated reserve fund or an endowment fund, as did more than a third (37 percent) of advocacy organizations.

Tables 4 and 5 illustrate the relationship between the existence of a board-designated or endowment fund and the complexity of the investment activity organizations engage in.

Table 4
Relationship of Board-Designated Funds or Endowments to the Complexity of Investment Activity of Advocacy Organizations

Advocacy organizations	Group one	Group two	Group three
With board-designated fund or endowment fund	1	4	7
No board-designated fund or endowment fund	6	9	5

Table 5
Relationship of Board-Designated Funds or Endowments to the Complexity of Investment Activity of Social Service Organizations

Social service organizations	Group one	Group two	Group three
With board-designated fund or endowment fund	2	5	8
No board-designated fund or endowment fund	5	7	0

The distribution in Table 4 illustrates that although advocacy organizations with endowment funds are likely to be investing at a more complex, higher-risk and higher-return level, the existence of an endowment fund does not necessarily compel financial managers to adopt a more complex investment strategy. Several advocacy organizations without board-designated funds or endowment funds were also investing at a more complex, higher-risk and higher-return level. A chi-square test at $P<.05$ confirms that there is no correlation. However, in the case of social service organizations, a correlation was found at $P<.05$ between the complexity of investment activity and board-designated or endowment funds. Table 5 shows that all the social service organizations with a complex investment strategy also had a board-designated fund or an endowment fund. However, almost half of the social service organizations with these funds did not adopt a complex investment strategy. So, it cannot be assumed that the presence of these funds inspires complex investing. Instead, it appears that the adoption of a more complex investment strategy may also inspire the board to create these funds, since every organization which has a complex investment strategy has also created a long-term fund.

Interestingly, five of six advocacy organizations and four of five social service organizations which had written investment policies also indicated having an endowment or a board-designated fund. Surprisingly, in both categories, more than half of the organizations which held these funds had no written investment policy to offer guidance regarding how these funds should be managed. Tables 6 and 7 below show the correlation of written investment policies and board-designated or endowment funds among the respondent organizations.

Table 6
Relationship of Board-Designated Funds or Endowments to the Possession of a Written Investment Policy Among Advocacy Organizations

Advocacy organizations	With written investment policy	Without written investment policy
With board-designated fund or endowment fund	5	7
No board-designated fund or endowment fund	1	19

Table 7
Relationship of Board-Designated Funds or Endowments to the Possession of a Written Investment Policy Among Social Service Organizations

Social service organizations	With written investment policy	Without written investment policy
With board-designated fund or endowment fund	4	11
No board-designated fund or endowment fund	1	12

A chi-square test at a confidence level of P<.05 showed that among the responding advocacy organizations there is a correlation between a written investment policy and existence of board-designated or endowment funds. A chi-square test of responding social service organizations did not show a correlation between a written investment policy and existence of board-designated or endowment funds.

In terms of social investing behavior, no correlation was found using the chi-square test at P<.05. The existence of an endowment or board-designated fund seemed to have no bearing on social investment activities.

Total assets and investable assets

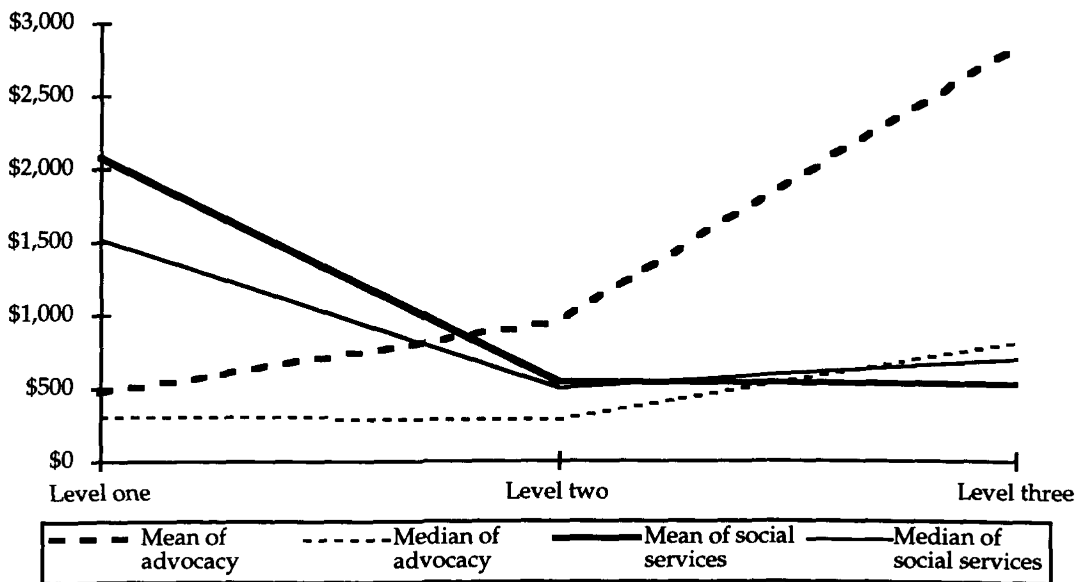
Often people believe that a successful investment strategy requires a large sum of money. To be sure, investments do tend to yield higher returns on investments held over longer time periods and this does require having sufficient excess funds in order to set aside funds. The researcher decided to

gather data regarding the assets of the responding organizations and determine whether any relationship exists between organizational assets and investment behavior. The total assets of all responding organizations were drawn from their most recently-filed federal tax returns (IRS Form 990). The distribution of this data were found to be skewed for both the advocacy and social service samples. Therefore, the ratio data were converted to ordinal data and the Spearman *r* test was used to identify a correlation between total assets and the complexity of organizational investment activity. No correlation was found for either sample at a .05 level of confidence.

The mean and median total assets at each level of investment activity are graphed in Figure 7 to illustrate the relationship of total assets to investment activity.

Figure 7

Relationship of Total Assets to Investment Activity (in Thousands)

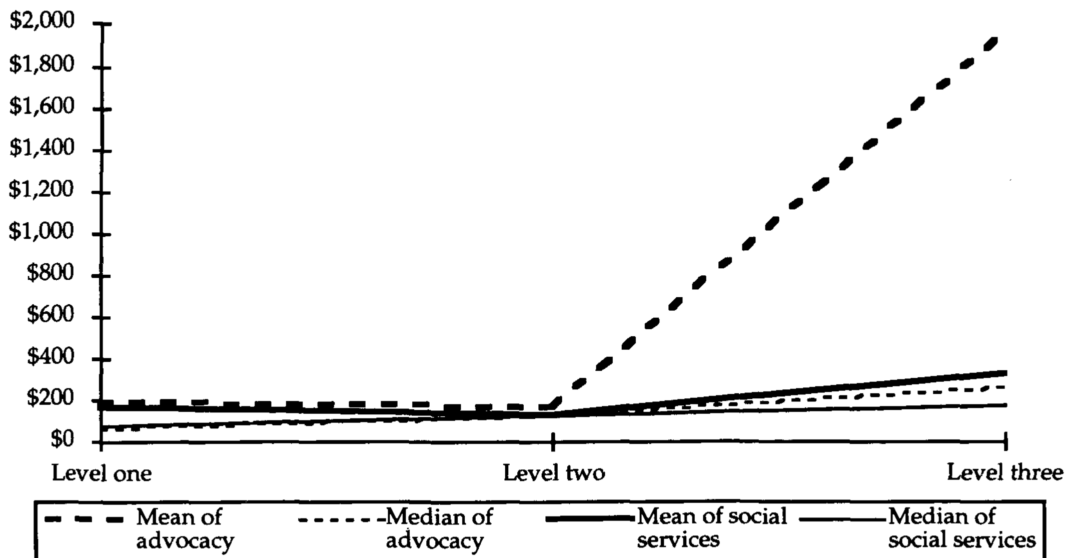


The researcher suspected that the total assets of an organization may not be as much of a factor in making an investment decision as are the actual amount of funds which an organization has available to invest. To estimate the amount of cash-on-hand available, land, buildings, equipment, inventory

assets and accounts receivables were excluded from total assets as reported on IRS Form 990. The Spearman *r* test was applied and a correlation was identified at a confidence level of $P<.05$ for advocacy organizations; but at the same level of confidence there was no correlation identified for social service organizations.

The mean and median investable assets at each level of investment activity are graphed in Figure 8 to illustrate the relationship of investable assets to investment activity.

Figure 8
Relationship of Investable Assets to Investment Activity (in Thousands)



The level of investment activity for both types of organization increases with the mean and median investable assets available. It appears that the amount of available funds to invest may have some influence on the complexity of investment activity among nonprofit organizations. The Spearman *r* test supported this assertion for advocacy organizations but not for social service organizations.

Using the chi-square test a correlation was found at $P<.05$ confidence among advocacy organizations between the amount of assets available to

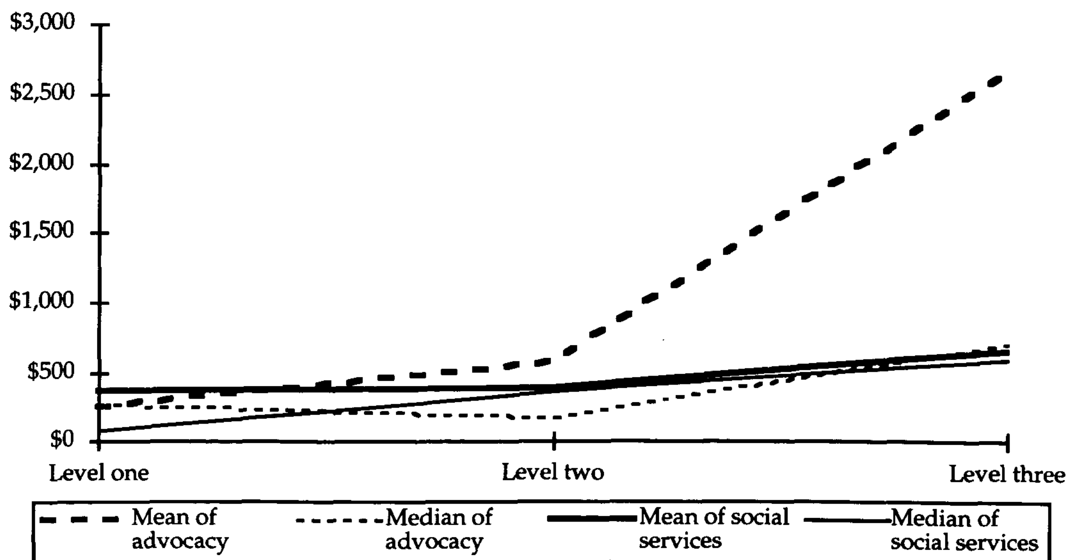
invest and the existence of a written investment policy. The existence of a written policy is less likely among organizations which do not have investable assets greater than $50,000. However, even among organizations with investable assets greater than $150,000, only 50 percent of the advocacy organizations had written investment policies.

The variables of total assets and investable assets did not show any correlation to the social investment behavior of the social service organizations or of the advocacy organizations.

<u>Fund balance</u>

Fund balance data were drawn from the IRS Form 990. The fund balance data were compared with the investment activities of both sample groups using the Spearman *r* test. Due to the nonnormal distribution of the data, a correlation was found for both social service organizations and advocacy organizations at P<.05. Figure 9 illustrates the relationship of fund balance to investment activity.

Figure 9
Relationship of Fund Balance to Investment Activity (in Thousands)



No correlation was found between fund balance and existence of a written investment policy for either sample group. Nor was a correlation found between social investing and written investment policy.

<u>Organizational resources</u>

The number of staff dedicated to financial management, staff knowledge, and staff training were measured and evaluated as variables which might correlate with investment strategy, written investment policies, and social investing.

A mean average of 2.66 staff members and 3.3 board members were found to be involved in the financial management of the advocacy organizations which responded to the survey. A mean average of 2.18 staff and 5.6 board members were involved in the financial management of social service organizations. No correlation was found between investment strategy, social investing or investment policies, and the number of staff or board involved in financial management. Nor was a correlation found between the existence of a finance committee on the board of directors and any investment strategy or investment policy of the respondent organizations.

Financial managers were asked to describe their level of knowledge regarding investments and social investments. They were provided a scale ranging from "no knowledge" to "area of expertise." No correlations were found for either type of organization between organizational investment strategy and investment knowledge on the part of the financial managers, nor was a correlation found between organizational social investing and investment knowledge of the financial managers. However, in the case of the advocacy organizations a correlation was found which indicated that organizations having financial managers possessing limited or no knowledge

of investments, also did not have a written investment policy. Among the social service organizations, only one had both a written investment policy and a financial manager who claimed limited knowledge of investing; however a chi-square test did not indicate a correlation.

Table 8
Relationship Between Staff Knowledge of Social Investing and Social Investment Practice Among Social Service Organizations

Social service organizations	Limited or no knowledge of social investing	Some knowledge of social investing	Extensive knowledge of social investing or area of expertise
Practice social investing	12	5	3
No social investing	5	7	0

Table 9
Relationship Between Staff Knowledge of Social Investing and Social Investment Practice Among Advocacy Organizations

Advocacy organizations	Limited or no knowledge of social investing	Some knowledge of social investing	Extensive knowledge of social investing or area of expertise
Practice social investing	7	6	1
No social investing	10	4	0

Financial managers were also asked to describe their knowledge of social investing on a scale from "no knowledge" to "area of expertise." Surprisingly, social investing was most prevalent in agencies with financial managers who claimed limited or no investment knowledge.

This may suggest an alternative explanation of the data regarding the number of respondents who claimed to be social investing despite the fact that their organizations were not investing at a complex level. There is a possibility that some financial managers may have erroneously indicated in that their organization practiced social investing due to lack of understanding

of social investing. However, a definition of social investing was included in the text of the survey and survey questions 13a and 13b were carefully worded to avoid possible misunderstandings regarding the meaning of social investing. The term social investing was omitted and substituted with the definition of social investing "to take into consideration the organization's social purpose when making investment decisions" (Please refer to the mail survey instrument in Appendix C for the specific wording and format of the question). Although the researcher worded the questions to reduce the possibility of misinterpretation, this study is limited because of its reliance on the responses to the questions as a reliable basis for the conclusions of this study.

The financial managers were also asked to indicate the amount of training they had received in the area of financial management. No noteworthy relationships were found between the training of the financial managers and the existence of organizational investment policies, social investing practices or the complexity of investment strategies.

A noteworthy correlation which the researcher identified using a chi-square test at a confidence level of $P<.05$ was a relationship between the level of investment activity and the reliance on outside experts for advice. Advocacy and social service organizations both relied more heavily on outside advice as the complexity of their investment strategies increased. However, this was not the case with regard to social investment strategies.

Perception of risk, risk aversion, and perception of social investing

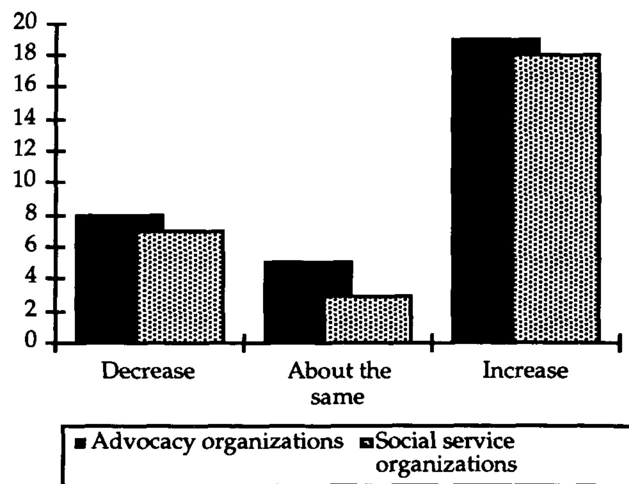
Questions 9, 10 and 16 of the mail survey instrument addressed the potential influence that risk aversion may have on organizational investment behavior (please refer to the sample mail survey instrument in Appendix C). These questions were framed so that respondents would have

to indicate on a scale how risky they perceived certain types of investments to be. Unfortunately, the questions proved to be too broad or generalized and the respondents had difficulty answering them. For this reason, the data gathered from these questions were inconclusive.

Change in fund balance

When financial managers were asked to what degree the organization's net worth had changed over five years, the majority of respondents from both samples reported increases in net worth.

Figure 10
Change in Net Worth of Advocacy and Social Service Organizations Over Five Years

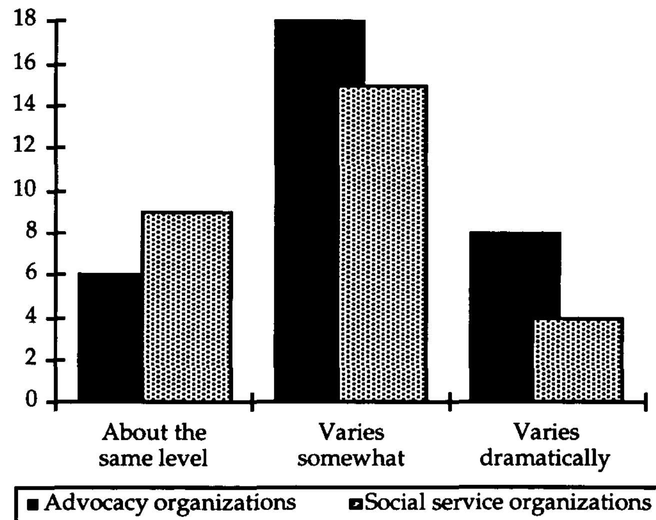


No correlation was found between the change in net worth and the investment behavior of the organization for either sample.

Fluctuations in cash flow

The survey asked financial managers to indicate to what degree their organizations' cash assets fluctuated during the year. Most organizations did not experience fluctuations in cash flow greater than a quarter of their annual operating budget.

Figure 11
Fluctuations in Cash Assets of Advocacy and
Social Service Organizations During a Fiscal Year



No correlation was found between the fluctuations in cash flow and organizational investment behavior.

<u>Outside expert</u>

One indicator of prudence in financial management is reliance on outside experts to monitor or offer advice regarding financial management. The responses to survey questions regarding outside experts was reassuring. Ninety percent of the advocacy organizations and 96 percent of the social service agencies indicated that they had relied on an outside expert to audit their organizational finances. In addition, 56 percent of the advocacy organizations and 46 percent of the social service organizations sought advice from attorneys, accountants, or other financial experts regarding investment matters. Nineteen percent of the advocacy organizations and 21 percent of the social service organizations hired outside experts to manage their investments.

For both sample groups a chi-square test at a confidence level of $P<.05$ identified a correlation between the level of complexity of investment activity

and the reliance on the advice of outside experts. Tables 10 and 11 illustrate the relationship between these two variables. A noteworthy observation is that almost all the organizations investing at the most complex level have sought advice from outside experts.

Table 10
Relationship Between Reliance on Advice from Outside Experts to the Complexity of Investment Activity for Advocacy Organizations

Advocacy organizations	Group one	Group two	Group three
Reliance on advice from outside experts	1	7	10
No reliance on advice from outside experts	6	6	2

Table 11
Reliance on advice from outside experts as compared to the complexity of investment activity

Social service organizations	Group one	Group two	Group three
Reliance on advice from outside experts	2	4	7
No reliance on advice from outside experts	5	9	1

Unfortunately, it does not appear that the outside experts advised these organizations to develop an investment policy. Of the 18 advocacy organizations which sought advice, only five had a written investment policy. Of the 13 social service organizations, only four had developed a written investment policy. No correlation was found between these variables using the chi-square test.

CHAPTER FIVE: CONCLUSIONS

Review of the Problem

The nonprofit sector is an essential part of our economy and our culture. It has increased in spending power as well as in people power. It has grown in the amount of funding it receives and in the amount of services it offers. The nonprofit sector has also grown in total net worth and if it continues to grow at the same rate, it will easily surpass one trillion dollars in total assets by the start of the next century.

The importance of this sector's role in the economy is only exceeded by the importance of its role in our society. The nonprofit sector has served as our safety net. It has heroically met needs of the global community that the business sector and government sector either cannot or will not address. The nonprofit sector permits the formation of private organizations that offer services as diverse as protecting endangered species and providing antiviolence programs for youth. The nonprofit sector houses the institutions which educate people, care for the sick and nurture creativity. It also provides an environment where people can pursue their personal beliefs or work for their individual causes. The nonprofit sector serves as a social conscience and offers a forum for social change.

Because the nonprofit sector is such a large and influential part of our society, it is an important subject of study, especially with regard to its financial management practices. The nonprofit sector is highly reliant on volunteerism and philanthropy. Nonprofit organizations have benefited a great deal from the volunteered time and money entrusted to them in support of their activities. It is therefore important that these organizations manage their finances with prudence and in accordance with the missions of

their organization.

It is also becoming more important that the nonprofit sector be financially healthy. In recent years government funding for welfare, education, health, and many other services has diminished. Society is becoming more and more dependent on the nonprofit sector to cast the safety net to aid the less fortunate. It is critical that those working in the nonprofit sector take a more careful and self-critical view of nonprofit operations and work to ensure the financial staying power of nonprofit agencies.

Unfortunately, financial management in the nonprofit sector has not previously received as much oversight as have other sectors in the economy. Regulations which address financial management in the nonprofit sector are somewhat vague and are rarely enforced. When nonprofit financial management is scrutinized, the focus is primarily on organizational income and expenditures. It is rare that inquiry is made into the investment of accumulated organizational assets. This laxity may be due in part to the myth that nonprofit organizations should not make a profit. It may not be foremost in people's minds that nonprofit organizations have assets to invest. However, based on the growing net worth of the sector as a whole, it is safe to assume that many nonprofits are indeed accumulating assets. In fact, they should be, if only to guarantee the long-term staying power of their organizations. Unfortunately, very little attention has been directed toward this very important aspect of financial management.

Because so little attention has been given to the management of assets in the nonprofit sector, very little information is available on the subject. The main intention of this study was to gather information which may prove useful to the financial managers of nonprofit organizations who are making investment decisions. The entire nonprofit sector is too large and diverse for

an introductory study, so this study focuses on social service organizations and advocacy organizations. The first for its commitment to serving social needs and the later for its role as a vanguard in promoting social change. Both subsectors represent the more impoverished end of the sector's financial spectrum. The information gathered may be more useful to financial managers of smaller organizations that are just beginning to develop an investment strategy.

This research study attempted to answer three basic questions: Are nonprofit organizations investing their assets? If so, to what degree, and is the mission of the organization taken into account when making investment decisions? An inquiry was also made regarding the possession of a written investment policy. The answers to these questions are of interest to many financial managers in the nonprofit sector and offer other scholars a basis for pursuing further research.

Discussion of Findings

This study was designed to collect data from two separate samples of advocacy and social service organizations in the State of California. Due to their similar characteristics and often overlapping purposes, it was not surprising that the results from both samples were quite similar in most respects. When the survey responses from each sample were compared, there was very little difference, and no statistical significance was found to indicate that the type of organization (advocacy versus social service) had any significant correlation to the variations in responses.

The samples were limited by type of organization and were geographically confined to the area of the State of California. Therefore, results can be generalized only to social service or advocacy organizations within California.

Research questions

Based on the data compiled, the researcher was very encouraged to find that only a small percentage of organizations held their assets solely in non-interest-bearing accounts. Even more encouraging was the discovery that 29 percent of social service organizations and 37 percent of advocacy organizations were using relatively complex investment strategies.

On the other hand, it was disappointing to discover how few organizations had actually developed written investment policies. It may be hoped that as the assets of these organizations increase, or as their investment strategies become more complex, they will develop investment management guidelines. The data in Table 2 suggest that organizations with less complex investment strategies are unlikely to have a written investment policy. However, the data do not demonstrate that organizations with more complex strategies are necessarily more likely to have a written investment policy. In fact, 50 percent of the surveyed social service organizations that are investing at the most complex investment level have actually developed a written policy to manage those investments. Among advocacy organizations in this study, only 33 percent of those which are investing at the group three level have written investment policies.

In response to the research question, "Do social service or advocacy organizations consider the social impact of their investments when making decisions about how to invest?" the researcher found that 50 percent of the social service organizations and 60 percent of the advocacy organizations are using their organizational missions as social screens. Interestingly, social investing had little to do with the organization's propensity to invest at a complex level. No correlation was found between the complexity of investment activity and social investing for either advocacy or social service

agencies. In fact, fewer than half of the organizations that indicated having social investment strategies were investing at the more complex level. A plausible assumption is that most of these organizations may be practicing an avoidance strategy of social investing.

Type of organization

Further study was made into whether organizational type of was a factor in determining level of investment activity. Although a slightly larger percentage of advocacy organizations were found to be investing at the group three level of investment activity than were social service organizations (see Figure 5), there was not a significant difference between the two. The researcher did not find that type of organization was a variable influencing the level of investment activity to any major degree.

Total assets and investable assets

Another variable hypothesized to have a potential influence on organizational investment activity was the amount of surplus cash available to invest. But this variable of total assets could not be directly correlated with the complexity of investment activity. This noncorrelation may be explained by the observation that total assets is not a very good indicator of the amount of money a manager actually has available to invest. A better method for estimating investable assets is to exclude receivable accounts, inventory, and real estate. Whatever remains is more likely to reflect actual surplus cash on hand. Using this indicator produced different results. The researcher found that among advocacy organizations there was a significant correlation between this variable of investable assets and the complexity of the investment activity adopted by the organization. No such correlation was found for social service organizations.

The researcher also found a correlation between investable assets and

written investment policies. Advocacy organizations with greater assets appeared to be more likely to have written investment policies. A correlation was not found for social service agencies.

No correlation was found between social investment practice and the total assets or investable assets of advocacy organizations or of social service organizations.

Fund balance

The fund balance, or net worth, of both sample groups was found to correlate with the level of organizational investment activity. The net worth of an organization is one indicator of the overall strength of the organization. Net worth represents an organization's total assets minus the organization's total liability. Over the past five years a majority of the responding organizations have experienced an increase in their fund balance. The research data indicate that a larger fund balance may be a factor influencing both types of organizations to adopt a more complex investment strategy.

Endowments or board-designated reserve funds

One of the variables thought to have a potential influence on investment behavior was the existence of board-designated reserve funds or endowment funds. Such funds are usually set aside and held for longer periods of time. The purposes of these funds vary, but they are usually maintained for the long-term stability of an organization. It was encouraging to find that many of the respondent organizations held such funds because they are reliable indicators of financial strength. However, it was surprising that three organizations held their board-designated reserve funds or endowment funds in standard savings accounts or in noninterest-bearing checking accounts, rather than in higher-yielding investments.

A correlation was found among social service organizations between the

existence of board-designated reserve funds or endowment funds and the level of investment activity. However, this correlation was not demonstrated for advocacy organizations (see Tables 4 and 5). For both samples, organizations with endowment or reserve funds were only slightly more likely to invest at the most complex level rather than at the two lower levels. Many advocacy organizations investing at the group three level did not have endowment funds. However, all of the social service agencies investing at the group three level did have endowment or reserve funds.

These results appear to tell us, at first glance, that for social service agencies, the existence of reserve funds induces financial managers to adopt more complex investment strategies. However, since chi-square tests demonstrating correlation do not explain the causality of the relationship, there may be other possible explanations. For example, it is possible that in the process of developing more complex investment portfolio, these social service organizations decided it would be beneficial to establish reserve funds.

Organizational resources

The number of staff and board members dedicated to financial management was thought to be another factor potentially influencing the investment behavior of organizations. It was also hypothesized that the training of financial managers or their knowledge of investing or social investing might be very significant factors. The study examined the number of board and staff members involved in financial management and whether board finance committees were established. No correlations were found between these variables and any of the investment behaviors under examination.

Similarly, there was no correlation demonstrated regarding knowledge and training of the financial manager, with one notable exception. Social

investment was more prevalent among financial managers who indicated having little or no investment knowledge or knowledge of social investing. This suggests the possibility that financial managers may have indicated in error that their organization was engaged in social investing without really understanding the nature of social investing. This is unlikely, however, due to the manner in which the survey questions were worded. In order to avoid any possible misinterpretation, the term "social investing" was omitted from Questions 13a and 13b (Please refer to the mail survey instrument in Appendix C for the specific wording and format of the question)

Outside experts

One key method of exercising prudence and satisfying the standard of care set forth by the California Nonprofit Law (1980, §5231(a)) is to seek expert advice.

> . . . ordinarily, the director will be regarded as having satisfied that standard of care and will be protected from liability if the director acts, in good faith, in reliance on qualified advice; that is, on "information, opinions, reports or statements" prepared or presented by (1) an officer or employee whom the director believes to be reliable and competent; (2) counsel, accountants, or other professional or experts if the director believes the matter is within their area of expertise; or (3) a committee acting within its authority if the director does not serve on it and believes that it merits confidence (Silk et al., 1990, p. 2-4b).

A majority of the organizations using a more complex strategy of investment reporting having sought qualified advice. However, more than half of the social service agencies and 40 percent of the advocacy organizations did not seek expert advice — and among them are three advocacy organizations and five social service agencies each with more than one

million dollars in assets. Five of these million-dollar organizations are holding their funds either in savings or in noninterest-bearing checking accounts. The board members of these organizations are not necessarily in compliance with the standard of care simply because they have avoided high risk investments. In fact, they could be found liable for failing to seek sufficient returns on their investment, as in the case of Lynch vs. John M. Redfield Foundation (1970).

Conclusions

The primary objective of this research was to generate information regarding investment policy and behavior. The results of this survey suggest that a substantial number of California advocacy and social service organizations hold their assets in complex investment portfolios which may include treasury bills, notes or bonds, mutual funds and corporate stocks and bonds. An even more encouraging finding is that only a very small percentage of California advocacy and social services are neglecting to earn interest on their assets.

Another encouraging inference which may be drawn based on the survey responses is that social investing is common among California advocacy and social service organizations — more common, in fact, among the advocacy organizations. This seems very appropriate considering the role of advocacy organizations in promoting social change. While 25 percent of the surveyed advocacy organizations and 14 percent of the social service organizations were investing at a complex level, the majority of respondent organizations which claimed to practice social investing were only investing at the group one and group two levels. This raises some questions regarding the form of social investment these organizations have undertaken and is a

recommended topic for further study.

The findings regarding written investment policies were quite dismal. The results of this research indicate that possibly fewer than one out of every five advocacy and social service agencies in California have written investment policies. Such guidelines were noticeably absent among the kinds of organizations for which the need seems greatest. In every organization in which a financial manager had held that position for fewer than three years (indicating a high turnover rate for financial managers) the organization had no investment policy to offer guidelines or to ensure continuity in financial management. Furthermore, nearly half of the organizations that held long-term funds (which require long-term management) did not have written investment policies to guarantee their safekeeping.

Even more surprising is that eight of 10 advocacy organizations with more than one million dollars in total assets did not have written investment policies, although three of them were investing at the most complex level, and four also had endowment or board-designated reserve funds. Of seven social service organizations with total assets greater than one million dollars, four of them had not sought the assistance of any outside expert other than for annual year-end audits and three of them did not have investment policies although all three held endowment or board-designated reserve funds.

Another area where written investment policies are noticeably absent is in the area of social investing. Although an organization may have an unwritten policy to respect specific social principals, that policy may not be understood by the entire staff and board. Without a written policy there is no guarantee that the policy will be put into practice or that old controversies won't need to be rehashed every time a change is made in the investment

portfolio.

One may conclude from these findings that there is a great need among California advocacy and social service organizations to formalize their investment policies. That this research may serve as a step in that direction, the appendix provides examples of investment policies from some of the surveyed organizations which participated in this study. It is important to note that most of the financial managers who volunteered their policies as examples cautioned that they consider them "work-in-progress," and by no means are they recommending that they be adopted verbatim by other organizations. But, they do give financial managers an opportunity to consider their diversity of structure and approach, and may serve as a source of useful information and inspiration.

Organizational fund balance appeared to be an influential factor in investment behavior of both advocacy and social service organizations. A strong correlation was found, both for advocacy organizations and for social service organizations, between investment activity level and fund balance. It seems safe to conclude that the complexity level investment activity does increase as the financial strength of the organization increases. This conclusion is supported by the correlation found between the variable of investable assets and complex investment activity among advocacy organizations.

An important qualification to this assumption is that the correlation between the variables measured from data drawn from IRS 990 forms and the variables measured from survey responses were measured at different points in time. The investment activity was measured in the summer of 1994 while the data regarding the financial condition of each respondent organizations may have been reported as much as 30 months prior to the research study.

Recommendations for Action and Further Research

The intention of this study was to gather information regarding investment activity in the nonprofit sector and help to shed light on this neglected subject. It is clear even from this introductory study that a great deal of investment activity is taking place among advocacy and social service agencies in California. This study also identified relationships among some of the significant variables affecting the investment decision-making and highlighted some areas where social service and advocacy organizations may be deficient in their financial management practices. The findings of this research raise some new and compelling questions which invite further research, and also call attention to gnawing concerns that require remedial action.

After observing the data and speaking with several of the financial managers who participated in the study, the researcher now suspects that attitudes of decision-makers toward investing are key variables in the decision-making process. Although fund balance, an indicator of an organization's financial strength, was found to play an influential role in the decision-making, there are clearly other significant variables. For example, there were several cases where organizations with very limited assets had quite complex investment strategies as well as a sophisticated approach to financial management, while at the same time, some of the wealthiest organizations were holding their endowment funds in noninterest-bearing or low-yield checking accounts. In these cases, the researcher suspects that the financial managers' or board members' attitudes toward investing were significant factors influencing the organizations' investment behavior. It is regrettable that many managers did not respond to the survey questions 9, 10, and 16 which asked for their perspectives on investment activity. They may

have provided some guidance for further inquiry. Perhaps focus groups would provide a better forum for this kind of research.

Another very important follow-up to this research would be to decipher the investment decision-making process. Few organizations have written investment policies, and yet many of these organizations have endowment and reserve funds, complex portfolios, social investment policies and sometimes very large amounts of assets to manage. It would be very interesting to learn how many people are involved in making these decisions and what processes they are employing to arrive at decisions.

This study found that at least half of the social service agencies and advocacy organizations surveyed take their organizational mission into consideration when making investment decisions. Unfortunately, very few of these organizations have articulated these considerations in writing. Among the advocacy and social service organizations investing proactively, it would be interesting to know exactly what their social investment screens are. It would also be interesting to learn what processes were followed in formulating their social investment policies, and what key social concerns were taken into account.

Another conclusion of this study was that social investing is commonly practiced among advocacy and social service organizations. Twenty-five percent of the surveyed advocacy organizations and 14 percent of the social service organizations were investing at a complex level. Another 38 percent of surveyed advocacy organizations and 36 percent of social service organizations indicated they were socially investing although they were not investing their funds at a complex level. Unfortunately, no data was gathered regarding the form of the social investing activity. Further research in this area would be valuable.

Finally, based on the fact that so much investment activity is taking place, it would be of great value to many financial managers to see more research of all kinds regarding the investment activities of the nonprofit sector. It is obviously an important part of financial management and critical to the long-term financial health of any organization.

It is the hope of this researcher that this study will inspire others to give deeper consideration to how nonprofit organizations are managing their assets. The majority of these funds represent the goodwill of individuals who have supported these organizations through foundations, through taxes, or through direct gifts. These gifts were made with the intent that they be used in good faith fulfilling the stated missions of the organizations. When these funds accumulate, as they should in a well managed organization, it is the researcher's opinion that they should be put to work earning additional income for the organization until they are put to work for the community. This should be done in a responsible and nonspeculative manner, and it should be done without contradicting the social mission of the organization.

While the findings of this study show that in many cases this is taking place, they also show that there is a great deal of room for improvement. It is the hope of this researcher that this study will inspire other financial managers of nonprofit organizations to recognize the growing financial power of the nonprofit sector and its potential as an additional tool to serve the community.

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Appendix A

Standard Industrial Classification Codes

Code

Agriculture
0100 Agricultural production, crops
0711 Soil preparation services
0721 Crop planting
0751 Livestock services
0780 Landscape and horticultural services

Printing and Publishing
2700 Printing and publishing

Transportation and Public Utilities
4111 Local and suburban transit
4119 Local passenger transportation, nec
4813 Telephone communications, exc radio
4822 Telegraph & other communications
4830 Radio and television broadcasting
4832 Radio broadcasting stations
4900 Electric, gas and sanitary services

Wholesale Trade
5153 Grain and field beans - wholesale

Retail Trade
5399 Misc. general merchandise stores
5812 Eating places
5942 Book stores

Finance, Insurance, and Real Estate
6060 Credit Unions
6159 Misc. business credit institutions
6351 Surety insurance
6371 Pension, health and welfare funds
6399 Insurance carriers, nec
6541 Title abstract offices
6553 Cemetery subdividers and developers
6732 Educational religious, etc. trusts
6733 Trusts

Services
7021 Rooming and boarding houses
7032 Sporting and recreational camps
7041 Membership-basis organization hotels
7311 Advertising agencies
7323 Credit reporting services
7410 Fundraising and/or fund distribution
7812 Motion picture & video production

Amusement & Recreation Services
7922 Theatrical producers and services
7929 Entertainers & entertainment groups
7941 Sports clubs, managers, & promoters

Health Services
8011 Offices and clinics of medical doctors
8021 offices and clinics of dentists
8031 offices of osteopathic physicians
8041 Offices and clinics of chiropractors
8042 Offices and clinics of optometrists
8043 Offices and clinics of podiatrists
8049 Offices of health practitioners, nec
8051 Skilled nursing care facilities
8052 Intermediate care facilities
8059 Nursing and personal care, nec
8062 General medical & surgical hospitals
8063 Psychiatric hospitals
8069 Specialty hospitals, exc. psychiatric
8082 Home health care services

8092 Kidney dialysis centers
8093 Specialty outpatient clinics, nec
8099 Health and allied services, nec
8111 Legal services

Educational Services
8200 Schools, undifferentiated
8211 Elementary and secondary schools
8221 Colleges and universities
8222 Junior colleges
8231 Libraries
8243 Data processing schools
8244 Business and secretarial schools
8249 Vocational schools, nec
8299 Schools & educational services, nec

Social Services
8322 Individual and family services
8331 Job training and related services
8351 Child day care services
8361 Residential care
8391 Housing/shelter
8392 Food services and nutrition
8394 Information and referral services
8399 Social services, nec

Museums, Botanical, Zoological Gardens
8412 Museums and art galleries
8422 Botanical and zoological gardens
8499 Arts, culture, humanities, nec

Advocacy Services
8510 Fund raising and/or fund distribution
8520 Philanthropy and voluntarism promotion
8530 Community improvement/capacity building
8540 Civil rights, social action, advocacy
8550 Environmental quality, protection & beautification
8560 international/foreign affairs & national security

Membership Services
8611 Business associations
8621 Professional organizations
8631 Labor organizations
8641 Civic and social associations
8651 Political organizations
8661 Religious organizations
8671 Mutual benefit
8699 Membership organizations, nec
8733 Non commercial research organizations

Management Services
8741 Management services
8742 Management consulting services
8743 Public relations services
8744 Facilities support services
8748 Business consulting, nec

Services, nec
8999 Services, nec

Public Administration
9199 General government, nec
9224 Fire protection
9229 Public order and safety, nec

Non classifiable establishments
9999 Non classifiable establishments

Appendix B

Letter of Introduction

(please note that the format has been modified to meet the margin requirement of this publication)

Alexis Olian
3474 Twenty-First Street
San Francisco, CA 94110

June 17, 1994

Dear Colleague,

I am writing to request your assistance with research I am conducting regarding investment policy and practice of California nonprofit organizations. I hope that you will be willing to participate in this research by taking a few minutes to fill out and return the enclosed questionnaire.

As a financial manager, it is my hope that the results of this research will be useful to other nonprofit organizations as they begin to formulate investment policies or develop an investment plan.

I am surveying the financial managers of nonprofit organizations who have the most in-depth knowledge of their organization's financial management. It is not necessary for your organization to be actively investing to make a valuable contribution to this research. Neither you, nor the name of your organization will be identified in the results of this survey and all information will be held in strictest confidence.

The questionnaire should take no more than 15 minutes to complete. I have enclosed a stamped, self-addressed envelope to make it easy for you to respond. At your request, I would be delighted to send you the results of this research.

This research is being conducted as part of the Master's degree program in Nonprofit Administration of the University of San Francisco. If you have any questions, please do not hesitate to call me during office hours at (415) 725-1803 or in the evenings at (415) 695-9438. Thank you in advance for your help.

Sincerely,

Alexis Olian

Appendix C

Mail Survey Instrument

No.______

This questionnaire takes most people less than 10 minutes to complete. Please answer all the questions to the best of your ability. A space is provided at the end for additional comments. Thank you for taking part in this research.

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1. Please check the box(es) which best describe the primary purpose of your organization strives to meet.
(you may check more than one)

- ❑ promotion of a clean environment
- ❑ alcohol/drug-related assistance
- ❑ children's welfare/youth advocacy
- ❑ services for the physically or mentally disabled
- ❑ health services
- ❑ animal welfare and wildlife preservation
- ❑ homelessness or poverty
- ❑ equal opportunity and civil rights
- ❑ legal access/assistance
- ❑ international peace and/or arms control
- ❑ protection of civil liberties
- ❑ environmental conservation, protection or beautification
- ❑ other *(please describe)* ______________________________

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2. Please indicate each type of account where your organization has assets.

- ❑ non-interest checking
- ❑ savings account
- ❑ treasury bills, notes or bonds
- o interest bearing checking
- o certificate of deposit (CD)
- o mutual funds
- ❑ other bonds (please specify) ______________________________
- ❑ other type of account (please list) ____________________________

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3. Does your organization have an endowment or board-designated reserve fund?

❑ yes ❑ no

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4. How would you describe the net worth (or fund balance) of your organization compared to 5 years ago.

- ❑ a dramatic decrease
- ❑ a small decrease
- ❑ remained about the same
- ❑ a small increase
- ❑ a dramatic increase

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5. Have any significant changes in the financial condition of your organization occurred in the past two years which may have affected the investment strategy of your organization?

❑ yes ❑ no

If yes, please explain ________________________________

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6. Please indicate the statement which best describes the degree of fluctuation of your organization's cash assets during a fiscal year.

❑ The amount of cash assets remains at about the same level throughout the year.

❑ The amount of cash assets may increase and decrease somewhat during the year but by less than a quarter of our annual operating budget.

❑ The amount of cash assets may increase and decrease dramatically during the year by more than a quarter of our annual operating budget.

7(a) How many staff members participate in your organization's financial management?
____ *(enter a number)*

7(b) How many board members participate in your organization's financial management?
___*(enter a number)*

7(c) Does your organization have an active finance committee, budget committee or similar committee?

❑ yes ❑ no

8(a) Does the organization hire outside experts to audit the organization's finances?

❑ yes ❑ no

8(b) Have staff members or members of the board of directors sought advice from attorneys, accountants or other financial experts regarding investment matters?

❑ yes ❑ no

8(c) Does the organization hire outside experts to manage investments?

❑ yes ❑ no

For the purposes of this questionnaire, the term *investment* refers to all of the organization's investments other than investments in fixed assets such as land, building, equipment and inventory. The term "*social investment*" will refer to any investment decisions made after considering the potential social impact of the investment, especially with regard to the stated mission of the organization.

9. What degree of risk do you associate with each type of investment? *(indicate by circling one number for each type of investment)*

		No Risk	Small Risk	Some Risk	Large Risk	Very Risky
a.	Stocks	1	2	3	4	5
b.	Treasury Bonds	1	2	3	4	5
c.	Certificate Of Deposit	1	2	3	4	5
d.	Mutual Funds	1	2	3	4	5
e.	Interest-Bearing Checking Account	1	2	3	4	5
f.	Social Investment Fund	1	2	3	4	5
g.	Corporate Bonds	1	2	3	4	5

10. Which of the investments listed above do you consider to be too speculative for your organization? *(you may circle more than one)*

a. b. c. d. e. f. g.

11. Does your organization have a written investment policy?

❑ yes ❑ no

12. Please briefly describe the primary social purpose or mission of your organization *(or attach a copy).*

____

13(a) Is it the policy or practice of your organization to take into consideration the organization's social purpose when making investment decisions?

❑ yes ❑ no

13(b) Aside from the organization's mission, are other social issues considered when making investment decisions?

❑ yes ❑ no

If yes, please describe briefly

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14. How would you describe your level of knowledge regarding investing in general?

- ❑ no knowledge
- ❑ limited knowledge
- ❑ some knowledge
- ❑ extensive knowledge
- ❑ area of expertise

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15. How would you describe your knowledge regarding social investing?

- ❑ no knowledge
- ❑ limited knowledge
- ❑ some knowledge
- ❑ extensive knowledge
- ❑ area of expertise

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16. Please circle the word which best describes how you view social investments as compared to investments which do not factor in social constraints.

a. Social investments are _____ than investments which do not factor in social constraints.

More Risky   Same   Less Risky

b. Social investments are _____ than investments which do not factor in social constraints.

More Profitable   Same   Less Profitable

c. Social investments are _____ than investments which do not factor in social constraints.

More Volatile   Same   Less Volatile

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17. What is your position or title? ____________________

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18. Please indicate the range which reflects the total amount of time you have held a position with financial management responsibilities.

- ❑ less than one year
- ❑ 1-3 years
- ❑ 3-5 years
- ❑ 6-10 years
- ❑ ten years or more

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19. Please indicate below, the total amount of training you have received in financial management. Please include on-the-job training, undergraduate course-work, graduate course-work, professional education, etc.

- ❑ none, self-taught
- ❑ six months to two years
- ❑ less than six months
- ❑ more than two years

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20. The space below is provided for your comments regarding this survey. Please also use this space to note any questions which were confusing or difficult to answer.

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Thank you for completing this questionnaire. Your valuable input is much appreciated. To mail, simply fold the questionnaire in half and seal with the stickers provided. Please mail the completed survey by July 25, 1994.

Alexis Olian
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Appendix D

Sample Internal Revenue Service Form 990

Part I Statement of Revenue, Expenses, & Changes in Net Assets or Fund Balance

Revenue

Line 1	Contributions, gifts, grants and similar amount received:
Line 1a	Direct Public support
Line 1c	Government grants
Line 1d	Total (1a through 1c)
Line 2	Program service revenue (from 93)
Line 3	Membership dues and assessments
Line 4	Interest on savings & temporary cash investments
Line 5	Dividends and interest from securities
Line 6a	Gross Rents
Line 6c	Net rental income (loss)
Line 7	Other investment income
Line 8aA	Gross amount from sale of securities
Line 8aB	Gross amount from sale of other non-inventory assets
Line 8cA	Net gain (loss), securities
Line 8cB	Net gain (loss), other
Line 8d	Gain (loss) from sale of assets other than inventory
Line 9	Special fundraising events and activities
Line 9a	Gross revenue
Line 9c	Net income (loss)
Line 10a	Gross sales less returns and allowances
Line 10a	Gross sales less returns and allowances
Line 10c	Gross profit (loss)
Line 11	Other revenue (from 103)
Line 12	Total revenue

Expense

Line 13	Program services (from 44B)
Line 14	Management and general (from 44c)
Line 15	Fundraising (from 44d)
Line 16	Payments to affiliates
Line 17	Total expenses

Net Assets of Fund Balances

Line 18	Excess (deficit) for the year (12 less 17)
Line 19	At beginning of year (from 74A)
Line 20	Other changes in net assets or fund balances
Line 21	Net assets or fund balances at end of year

Part II.Statement of Functional Expenses

Line 22A	Grants and allocations
Line 23A	Specific assistance to individuals
Line 24A	Benefits paid to or for members
Line 25A	Compensation of officers, directors, etc.
Line 26A	Other salaries and wages
Line 27A	Pension plan contributions
Line 28A	Other employee benefits
Line 29A	Payroll taxes
Line 30A	Professional fundraising fees
Line 31A	Accounting fees
Line 32A	Legal Fees
Line 33A	Supplies
Line 34A	Telephone
Line 35A	Postage and shipping
Line 36A	Occupancy
Line 37A	Equipment rental and maintenance
Line 38A	Printing and publications
Line 39A	Travel
Line 40A	Conferences, conventions & meetings
Line 41A	Interest
Line 42A	Depreciation, depletion, etc.
Line 43A	Other expenses
Line 44A	Total, all functional expenses (B to D)
Line 44B	Total, program services
Line 44C	Total, management and general
Line 44D	Total, fundraising

Part IV Balance Sheets - End of Year

Assets

Line 45	Cash - on interest-bearing
Line 46	Savings and temporary cash investments
Line 47c	Accounts receivable
Line 48c	Pledges receivable
Line 49	Grants receivable
Line 50	Receivable due from officers, directors, etc.
Line 51c	Other notes and loans receivable
Line 52	Inventories for sale or use
Line 53	Prepaid expenses and deferred charges
Line 54	Investments - Securities
Line 55c	Investments - land, buildings, equipment
Line 56	Investments - other
Line 57c	Land, buildings, equipment
Line 58	Other assets
Line 59	Total assets

Liabilities

Line 60	Accounts payable and accrued expenses
Line 61	Grants payable
Line 62	Support and revenue designated for future periods
Line 63	Loans from officers, directors, etc.
Line 64	Mortgages and other notes payable
Line 65	Other liabilities
Line 66	Total liabilities

Fund Balances or Net Assets

Line 67a	Current unrestricted fund
Line 67b	Current restricted fund
Line 68	Land, buildings, and equipment fund
Line 69	Endowment fund
Line 70	Other funds
Line 71	Capital stock or trust principal
Line 72	Paid-in or capital surplus
Line 73	Retained earnings or accumulated income
Line 74	Total fund balances or net assets
Line 75	Total liabilities & fund balances/net assets

Appendix E

Sample Investment Policies

(please note that these policies are not intended to be used verbatim for any organization)

Sample Investment Policy #1

I. Policy Statement

It is the policy of the name of organization to manage its investments in adherence to the "prudent man rule" It is the strategy to evaluate investment opportunities on a regular basis to maximize profits for working capital and maintain principal to ensure financial stability.

The Board of Directors shall establish guidelines and review annually. They shall appoint an Investment Committee to carry out their policy and guidelines.

II. Definitions

A. Management

1. Investment Committee - a group of knowledgeable people appointed by the name of organization Board of Directors and reporting to the Finance Committee to evaluate and recommend investment strategies. this group should meet at least quarterly or as directed by the Finance committee. Membership should include, at a minimum, a member of the Finance Committee, a Board member, two persons from the financial community (banks, brokerage house, insurance company, financial planning) and the Executive Director.

2. Prudent Man Rule - This standard shall be followed in all investment decisions (see page 2, #10 for definition).

B. Sources of Funds

1. Bequests - cash, stock or other funds left to the name of organization at death which may be donor-designated for specific use or general use.

2. Annual Fund Campaign - funds generated through the Fund Development Committee in its yearly campaign.

3. Capital Campaign - funds generated for specific capital improvements and which may come in stock or cash form and which may need to be invested on a short - term basis.

4. Insurance Policies - individual policies in which the name of organization is disunited as the beneficiary.

5. Deferred Gifts - investments which the name of organization receives from individuals and pays dividends to the donors during their lifetime.

6. Surplus Funds - those from the operating account that were received as general contributions and which may be Board designated for future use.

7. Endowments - funds given to the name of organization in which the principal

must be held intact and only the interest and/or capital gains may be spent.

C. Glossary of Investing

1. Asset - On a balance sheet, that which is owned or receivable.

2. Blue Chip - A company known nationally for the quality and wide acceptance of its products or services, and for its ability to make money and pay dividends.

3. Bond - Basically an IOU or promissory note of a corporation, usually issued in multiples of $1,000. A bond is evidence of a debt on which the issuing company usually promises to pay the bondholders a specified amount of interest for a specified length of time, and to repay the loan on the expiration date. In every case, a bond represents debt -- its holder is a creditor of the corporation and not a part owner, as is the shareholder.

4. Diversification - Spreading investments among different companies in different fields. Another type of diversification is also offered by the securities of many individual companies because of the wide range of their activities.

5. Government Bonds - Obligations of the US government, regarded as the highest grade issued in existence.

6. Growth Fund - A fund whose rate of growth over a period of time is considerably greater than that of business generally. An average rate of 10 percent per year issued by some analysts as definitive.

7. Income Fund - A mutual fund with a primary objective of current income.

8. Interest - Payments made by a borrower to a lender for the use of his money. A corporation pays interest on its bonds to its bondholders.

9. Mutual Fund - An open-end investment company that continuously offers new shares to the public in addition to redeeming shares on demand as required by law. While in common use, the term mutual fund has not meaning in law.

10. Prudent Mans Rule - An investment standard. Generally, the law requires that a fiduciary, such as a trustee, may invest in a security if it is one that a prudent man of discretion and intelligence, who is seeking a reasonable income and preservation of capital, would buy.

11. Stock - Shares that represent ownership interest in a corporation.

12. Treasury Bill - Short-term US government paper with no stated interest rate. It is sold at a discount in competitive bidding and reaches maturity in ninety days or less.

III. Process and criteria for investment strategy

A. The process for evaluating investment opportunities should include the following. It must be recognized that not every investment will pass all these screens. It is therefore the responsibility of the Investment Committee to evaluate and recommend the most appropriate opportunity.

1. Ensure that the investment includes an element of liquidity.

2. Evaluate direct professional management of investment.

3. Assess ability to establish or terminate a position within one day without having to worry about an extended buying or selling program.

4. Ensure that total portfolio is managed to include diversification.

5. Study to ensure knowledge of potential investment vehicles, i.e. pooled life income funds, unitrusts, specialized savings plans, etc.

6. Assess commission, redemption fees, management fee structure and any possible "hidden" fees.

7. Review total expense ratios of fund or stock.

8. Profile the average record of annual returns as compared to similar funds and either Standard and Poor's 500 stock index or a more suitable market index.

9. Ensure through periodic reviews that the investment philosophy of the fund does not include primary or direct investment in liquor, tobacco, South Africa or nuclear weapons.

B. Criteria

1. An above average record of returns over previous 5 years, preferable 10 years.

2. A clear and consistent investment philosophy as defined below:

   - Growth - emphasizes stocks of companies with rapid earnings growth. Willing to pay high multiples of earnings, dividends, and book values.

   - Value - the reverse image of growth stock investing. Focuses on low -rise-to-earnings ratios (usually in relation to the overall market, but at least in relation to corporate growth rates or return on equity), low price-to-book multiples, high yields, and depressed price relative to previous highs.

   - Opportunistic - Primary emphasis on shifts within the stock market. No strong identification with particular market sectors, however defined.

   - Diverse - Securities from all or most market sectors, but not an index fund.

   - Small Company - Specialist in small companies (not necessarily growth companies).

   - Bond Target Funds - Funds that permit the investor to buy and hold particular bond maturity series.

3. Individual or team management that has been with the fund at least three years, and is likely to stay aboard.

4. A reasonable asset size, neither too small to be economic nor so large as to

impair the particular philosophy being used.

5. The fund advisory business is either the company's only business or one of its most important businesses.

IV. Long Term Strategy Recommendations

A. The name of organization recognizes the need for increased income into the operating account in order to produce program meeting accelerating community needs. We salute Board, volunteer, and member effort to support operating expense through the Annual Fund Drive, special events, and membership fees. We recognize the need to supplement these efforts through the increased return from our investments.

Recommendation: To provide $20,000 each year to the operating account.

B. The name of organization recognizes that the building is one of our most valuable assets. We pledge ourselves to maintain this asset at top quality through its full life into the 21st century.

Recommendation: To commit $10,000 per year in building improvement funds.

C. The name of organization recognizes the need to build a reserve fund for support of the operating budget in times of emergency. The name of organization encourages this and the instability of the economy mandates it.

Recommendation: To designate the XXX fund as the reserve fund, and to increase this fund by $3,000 each year.

Part of this fund will also serve as ready cash to stabilize cash flow needs caused by government grants.

D. The name of organization recognizes that endowment funds are key to the continued life of the name of organization in this community.

Recommendations:

a. The name of organization funds currently designated by the Board as "funds functioning as endowment" will be invested to yield high income to the operating account while preserving capital.

b. The name of organization funds will be invested to produce a steady stream of income in support of the XXX fellowship, capital preservation, diversification for safety, and with an element of liquidity and growth.

c. The name of organization Fund will be invested to produce income into the operating account, to serve as the reserve fund, and for capital growth.

Sample Investment Policy #2

I. Policy

One of the most important responsibilities of the Board of Trustees in the management of [organization] assets. Those assets held as part of [organization] invested portfolios are managed pursuant to the following purposes.

1. to preserve the value of the invested asset;
2. to produce the maximum return prudently possible.

II. Practice

A. Objectives:

The assets managed and invested by the Board of Trustees are classified as current funds, endowments, and trust. They vary in size and in their need for liquidity and yield. [Organization] recognizes and addresses these different needs by creating different investment portfolios.

Current funds are managed to achieve maximum current income and minimum market volatility.

The endowments are managed for long-term total return (i.e. growth plus earnings) and building a hedge against inflation. These funds may be subject to short-term fluctuations.

The charitable trusts, for which [organization] has residual inters in, are managed to the individual needs of the trust.

B. Diversification:

The trustees seek to preserve the value of the invested assets through diversification. [organization] diversifies its investment by the selection of different managers, types of investment securities, types of industries and companies, maturities and durations. The multi-asset, multi-manager approach seeks to maximize investment return to reduce the risk of offsetting asset classes. in the case of some of [organization] portfolios, diversified through investment in mutual funds, these investments are limited to a share of a pool rather than having a direct interest in any single company.

C. Performance

The performance of each portfolio is measured in terms of its total return rather than earnings alone. Each portfolio is measured against a comparable market index, its performance, as well as overall market conditions. Performance and asset allocations are reviewed each quarter by [organization] Investment Committee.

III. Environmental Considerations

Advancing the cause of environmental protection within the investment community is of high interest to [organization] and presents unique opportunities and challenges. Through mutual fund diversification, participation in any individual company is very small and several times removed, thereby limiting its influence in those companies. However, [organization] has reached agreements with its investment manages to jointly seek ways to promote the cause of environmental protection.

[Organization's] investment strategy is based on the broad allocation of investments among various asset, classifications, which is inclusive; that is, the investments reflect a relatively small investment in a large number of entities rather than relatively large sum in a few companies. As such, its selection of individual investments, a process several steps removed from the decision of itself, is not to be construed as comment either favorable or unfavorable on the environment or social practices of that company or entity.

Sample Investment Policy #3

Endowment Fund Investment Policy

1. Preserve the purchasing power of the corpus as measured by the Cost of Living Index for our area. This requires use of equity securities which have historically out-paced inflation.

2. Produce the maximum income safely and consistent with the above objective.

Initially this led us to a mix of 50% high quality fixed income securities and 50% equities with a relatively good yield.

Periodically the assets are reviewed to see if we are meeting out two original objectives.

Sample Investment Policy #4

Board-designated Reserve Fund Policy

The purpose of this document is to establish the policy of the Board of Directors of name of organization regarding its recently established board-designated reserve fund. Name of organization has had no such board-designated reserve fund until resettle; however, it expects the fund to last in perpetuity and to increase substantially over time. Therefore, it is in the best interest of name of organization and its potential contributors to make clear that the following guidelines apply to said board-designated reserve fund until this policy statement is revised, in writing, by name of organization's Board of Directors. The board-designated reserve fund policy guidelines are as follows:

1. The board-designated reserve fund shall be segregated both in terms of its investment an din terms of name of organization's internal auditing and bookkeeping records.

2. The board-designated reserve funds may be used for any of name of organization's charitable purposes; however, it is the recommendation of the Board of Directors that the board-designated reserve fund be reserved for funding of special projects, funding or purchase of special equipment or assets, and to exist primarily to finance the general activities of name of organization at any time when name of organization other sources of income (including charitable contributions) fall short of on-going expenses.

3. Name of organization's Board of Directors may amend this policy by vote of a majority of its members.

4. Income of the fund may be distributed for name of organization's charitable

purposes or may be accumulated in whole or in part in the discretion of name of organization's staff management.

5. Name of organization's management shall employ or make use of a qualified investment advisor regarding how the funds shall be invested from time to time.