Managing in uncertain times:
Are you adapting to new challenges and opportunities?

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Pesh joined Crowe in 2008 from Deloitte, where he was Head of Non Profits. He is now Global Head of Non Profits at Crowe. Pesh has been involved in the non profit sector, both professionally and as a volunteer, for over 30 years.

Pesh writes and lectures internationally on matters facing non profits. He has extensive experience of assurance, governance, structures, trading, tax matters, risk management, strategy, performance measurement and knowledge management in the sector.

He has been appointed by the Charity Commission to act as sole Trustee and interim manager of five charities and undertaken special work for the Charity Commission both in the UK and overseas. He has also been Finance Director of two charities and is Special Advisor to the Charity Finance Group.

He was a member of the Accounting Standards Board's Committee on Accounting for Public Benefit Entities for five years and is also a charity Trustee. He has been a member of the Charity SORP Committee for over 20 years and is now technical advisor to the SORP Committee.
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Key messages

- Strategy in uncertain times needs to take account of different factors.
- The status quo is rarely the right option.
- Strategies have to become more dynamic and focused on the short term.
- Monitoring and measurement of progress against the strategy is more frequent.
- Strategies and tactics have to be developed on the premise that several different outcomes are possible.
- Scenario planning is valuable in helping cope with the uncertain environment and can help identify the drivers of change.
- There is a need to put values and analysis on different scenarios and this requires out of the box thinking from different perspectives. Horizon scanning is important.
- Scenarios are often wrongly treated as forecasts and the range of scenarios is too simplistic.
- The focus on new scenarios should not mask important long term trends or undervalue relevant existing strategies.
- Charities should develop action plans for different scenarios by setting and monitoring trigger points along with trend analyses.
- Look beyond the obvious - consider both direct and indirect drivers and short and long term implications.
- It is important to consider whether the fundamental operating model can be improved.
- Be aware of the importance of remote events that together can have a significant impact.
- Probability has less value for risks that occur outside the norm and the past is not the best indicator of the future.
- If a risk that is both relevant and has extremely high impact, it should be addressed, regardless of ‘remote’ likelihood.
- Lower significance risks can escalate to a very high impact risk because of risk interactions.
- It is important to understand the core processes and sub processes and their role in achieving strategy.
- Governance structures, board and management competencies and frameworks for decision making may need to be revisited.
- The reserves policy should link with the risk management and forecasting process.
- Understand what the reserves represent and look at the ease with which they can be made available in times of need.
- The continued uncertainty and volatility of income has dramatically increased the exposure to liquidity risk.
Charities and other non profit organisations are facing much uncertainty. This comes in many shapes and forms and goes beyond the question of Brexit. There are new laws and regulations on fundraising, new expectations from different stakeholders, new demands for services, a changing funding landscape, foreign exchange volatility, cost escalation and much more.

There is too much conjecture and crystal ball gazing on all the downside risks but the reality is that we do not know what the reality will be. However, it is important to be prepared and think carefully of the implications. Most non profit organisations have recognised that it is not business as usual and there are new challenges that require specific attention. It is widely acknowledged that there is likely to be much change in the future and that this will continue to impact on charities in a number of ways.

The task of setting priorities remains as difficult as ever; matching the demands to satisfy short-term needs against pressure for the resources required to achieve long-term solutions. The operating environment is becoming even more demanding and plans for future strategic development will have to take into account a number of new factors. It is a world in which priorities need to be constantly reassessed and organisations need to be nimble and flexible. Knowledge has to be not only accurate and relevant but attuned to analysis from different perspectives.

But all this need not be as difficult as it seems as many charities have learned how to adapt and manage turbulent times during the downturn in 2008 to 2009.

In my discussions with the organisations I work with it is apparent that there is a need to revisit and rethink many of the accepted assumptions in:

1. strategy and scenario planning
2. governance and decision making
3. risk management
4. structures, operations and business models
5. reserves and treasury management.
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**Strategy and scenario planning**

During periods of uncertainty more rigorous out of box thinking is needed. Care needs to be taken to examine some of the projects and programmes that have been planned. This examination and approval process for new projects and expenditure needs to be rigorous with a focus on both short and longer term timeframes.

It is important to recognise that rigour in decision making is not the same as ponderous and charities need to be nimble and agile in their decision making.

This may require changes to delegations and to reporting and decision making procedures. Governance may need to be revisited.

As strategies become more dynamic, focused on the short term, and contain more analysis the organisation has to be ready to react to outcomes that are different to earlier predictions and events that require strategic adjustment. This means regular monitoring and measurement of progress against the strategy – many organisations are now doing this monthly. This is more than preparing management accounts and variances from budgets. Whilst the short term is important it is equally important to consider the longer term and to think hard about indirect as well as direct implications of unfolding events such as Brexit, new funding landscapes, changes to laws and regulations and the wider implications of new and changing stakeholder expectations. There is need to take into account events beyond the typical planning horizon.

The strategy must be able to deal with uncertainty and at a time when predicting the probable is difficult to say the least, strategies and tactics have to be developed on the premise that several different outcomes are possible.

During the uncertainty that accompanied the last downturn, scenario planning was seen as one of the most valuable elements in helping organisations cope with the uncertain environment and non profits have been horizon scanning and using scenario planning, factoring in a range of possible outcomes. The exercise requires the need to put values and analysis on different scenarios and this does require some out of the box thinking.

Scenarios often expose the flaws in a single forecast and if done well allow organisations to factor in the outcomes of uncertainty. Common problems are that scenarios are wrongly treated as forecasts and the
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The range of scenarios is too simplistic – for example optimistic and pessimistic. I continue to be surprised that some charities are modelling plans on optimistic and pessimistic scenarios when they believe that neither of these are likely. However this doesn’t mean that scenarios should be discarded on because they are deemed to be not likely. Such scenarios need to be considered while acknowledging their low probability and bearing in mind that a low-probability event can still be significant if its impact is large enough.

The aim of a successful scenario planning process is not an accurate prediction of the future but to deliver a means by which an organisation can learn, adapt and take effective and timely action by preparing it for what might happen in the future.

Another reason why scenario planning is not done in an effective way is the lack of out of the box thinking. We tend to unconsciously bias our thinking to what we know and wrongly think that the future will resemble the past or to extrapolate on the basis of what is happening now. Good scenario planning requires many perspectives and this involves engaging with a diverse team across functions in the organisation. It should also include external perspectives to identify threats and opportunities that may have been overlooked. However, the focus on new scenarios and the immediate issues should not mask important long term trends or undervalue relevant existing strategies.

The identification of potential scenarios needs to involve people across the organisation and this requires breaking down silos. There is a need to monitor and track the key indicators that give early warning of the imminence of a particular scenario. These indicators should be seen as signs of potentially significant change and need to be selected and monitored with great care. Each organisation may well have very different choices of indicators - for example average gift size may be critical to one and foreign exchange rates may be critical to another.

A number of charities have developed action plans for different scenarios by setting and monitoring trigger points along with trend analyses. These make it possible for the charity to decide when plan A or plan B needs to be implemented. For example, ‘if income looks like it is going to drop by X we will do Y...’
Risk management needs a rethink

Unprecedented events require a new awareness of the importance of remote events that can have a significant impact; this casts some question marks over the way organisations have traditionally identified and scored risks and adopted procedures to manage them. Traditional risk management methodology focuses on considering both impact and likelihood or probability of a risk and giving them equal importance. The thinking has moved on and there is greater recognition that probability has less value for risks that occur outside the norm. This means that approaches will have to be incorporated to deal with a new financial climate and new challenges.

Risk management needs an overhaul in turbulent times especially when:

- events are rare or unprecedented
- where the rules are unknown or rapidly changing or
- where causes are driven by external factors beyond the organisation’s control.

In such instances, the concept of vulnerability and risk interaction should assume prominence in both the risk assessment and risk management processes.

If an organisation is vulnerable to a risk that is both relevant and has extremely high impact, it should be addressed, regardless of ‘remote’ likelihood. However, ‘addressed,’ in this context, is not necessarily the same as ‘mitigated.’ A balance needs to be attained and vulnerability should be weighed alongside probability. Non profits are invariably resource constrained and risks and rewards will need to be considered. Furthermore, the board will need to establish their risk appetite and the risk tolerance that they are ready to accept. However it is important to recognise that sometimes improbable events do occur with devastating effect, while other times probable events fail to materialise.

A focus on high impact risk is important, but one should not forget how a lower significance risk can escalate to very high impact risk because of risk interdependencies. An isolated concentration on value at risk can sometimes result in finance directors not spotting ‘risk contagion’ – in other words where one low impact risk leads to another and another so that the cumulative impact is catastrophic.

Many studies have shown that most business failures are the result of a series of small, linked events rather than a single large event. If organisations only look at the big risks they can often end up lethally ill-prepared to face the interaction of separate adverse events.
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Fear or even doubt of the uncertain can lead to missed opportunities and organisations need to consider the risks they need to take to create value, as well as the risks they need to take to protect assets.

Understanding risk appetite and the risk resilience of the organisation in terms of reserves, competencies, and other resources is important. The aim is not to avoid risk but to manage it knowing the risks that can and should be taken and the ones that need to be avoided. See my article on value protection and value creation on our online resource library.
Are the ways of doing things fit for purpose?

Many non-profit organisations have restructured during the last few years as they acknowledged that there was often scope to review the way things are done with the aim of increasing productivity and/or reducing costs.

The thinking now may be that all this has been done and there is little surplus fat but it is surprising how easily necessary complexities begin to flourish in organisational processes and structures, ways of working and governance.

There is always benefit in taking a good hard look at how efficiently activities are carried out and services are delivered.

Sometimes, peripheral and non-core activities have quietly taken seed and diverted resources from core activities. Organisations have found that activity value analysis is a good way of deciding which activities add value and which do not. As activities develop, errors and waste often creep in so that reworking and correction time is accepted as part of the normal routine. To understand how to save costs on activities it is important to understand the core processes and sub processes and their role in achieving the expected deliverables and the overall organisation strategy. This requires a good understanding of activities and related cost and income streams. See also my article on cost optimisation.

Following the last downturn management that previously found it very difficult to implement unpopular operational changes and cuts now have more leverage with colleagues, the board and staff. The downturn meant that individuals were more receptive to the need for change and the need for some tough choices. They saw that this put the organisation in a better position to take advantage of opportunities when they came. This means that there is often the cultural acceptance of the need for change.

Governance structures need to be well balanced and allow proper and swift decision making. Boards must have the right information that gives them knowledge to be able to add value.

Different skill sets may be required and ensuring that there are the right competencies within boards and management is really important.
Are the leaders acting as catalysts for change when it is needed?

Non profit organisations often do all these things but seem to be averse to looking at the fundamental business model and considering how fit for purpose it is. As funding streams change and cost structures evolve it is important to consider whether the fundamental operating model can be improved. Strategic alliances, collaborative working and mergers need to be on the agenda. There are no stereotype answers but try and avoid dismissing things based on previous and sometimes biased analyses. New times require new responses.
Reserves and liquidity

As income levels are threatened, cash flow and reserves management inevitably demand more attention. Charities should reassess their reserves policy and ensure it meets operational needs. Unfortunately many reserves polices are often created to justify the existing level of reserves rather than what is realistic and operationally necessary.

The reserves policy should link with the risk management and forecasting process. This may require a rethink on why the organisation needs reserves and what the appropriate level is.

To do this properly a full understanding of any problems forcing the organisation to dip into its reserves is required, and operating realities must be considered. Analysis of the options open to the organisation when dealing with the actual problem in hand should follow. Key to this is an understanding of income and expenditure flows and the nature of the reserves.

This means asking what the reserves represent and looking at the ease with which they can be made available in times of need. For example, if the reserves are represented by tangible fixed assets then their availability for use will be different from stock market investments. Many charities have recognised that they are going to have to dip into reserves to manage cash requirements. The issue is how is the reduction in reserves is going to be managed. Are funds going to be obtained by borrowing, selling investments or drawing down on cash balances?

The continued uncertainty and volatility of income has dramatically increased the exposure to liquidity risk; underlining how vital it is to have robust assumptions behind forecasts. Non profit organisations need to ensure that there are processes in place to ensure that appropriate procedures and controls have been applied to the use of models to generate cash flow and income information, including the choice and consistent use of key assumptions. See also my article on reserves management.
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Other guidance

The Charity Commission has published guidance for Trustees on the issues they need to be considering. Big Board Talk is in the form of 15 questions organised into four broad areas - strategy: opportunities and risks, financial health, governance and making best use of resources.

Working it through

Charities need to avoid knee jerk reactions whilst recognising that change is inevitable.

There are a number of steps before launching into responses to matters such as Brexit, new fundraising requirements or any of the many drivers of change that the sector will be facing. Simplistically this can be broken into three key areas

**Early thinking stage** – This requires identifying the right people to think about the key uncertainties that can impact the organisation. Remember to consider direct and indirect drivers and short and long term implications.

Avoid group think and be ready to look beyond the obvious identifying both risks and opportunities.

**Consider the strategic choices** – This requires revisiting the SWOT and PEST analysis that may have driven earlier strategic plans and tactics. Consider the different scenarios and the strategic choices and options for action. Are the right structures, resources and procedures in place to first make the right choices and then to capitalise on them. There need to be triggers for actions as scenarios become reality and ways of identifying warning signs and alerts. This stage requires much analyses and interpretation of the choices that are available and the resources needed to make them.

**Taking Action** – As the organisation implements its plan and tactics there will be need to have in place a strong change enablement framework that considers both the organisational and people transitions that may be necessary. There is a need to remain nimble and flexible and recognise that the first two stages may not have come up with the right answers and that the options and actions may need to change accordingly.

The key is to think carefully about the future and be ready to face challenges and grab the opportunities as they arise.
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Notes
Start the conversation

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About us

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We are trusted by thousands of clients for our specialist advice, our ability to make smart decisions and our readiness to provide lasting value. Our broad technical expertise and deep market knowledge means we are well placed to offer insight and pragmatic advice to all the organisations and individuals with whom we work. Close working relationships are at the heart of our effective service delivery.