



# Rebuilding endowment

Endowments have been hit hard by the sharp decline in the value of financial assets and by a reduction in grants, gifts, donations and planned giving resulting from a weak economy. In what may be a protracted low investment return environment, what can nonprofits do to help their endowments grow again?

*Mission Matters recently convened a roundtable of experts to discuss the challenges and opportunities associated with rebuilding nonprofit endowments beyond managing the investment portfolio. Those participating in the roundtable were: **John Lippincott**, President of the Council for Advancement and Support of Education (CASE), Washington, D.C.; **Paul Schervish**, Director, the Center on Wealth and Philanthropy (CWP) at Boston College; **John Havens**, Senior Associate Director of the CWP; and **Fred Rogers**, Vice President and Treasurer, Carleton College, Northfield, Minnesota. Commonfund was represented by **John Griswold**, Executive Director of Commonfund Institute, and **Bill Jarvis**, Managing Director of Commonfund Institute. The roundtable took place in Boston in mid-October.*



**John Griswold:** *The genesis of this meeting traces back to research promulgated by Commonfund — which Fred Rogers authored along with Glenn Strehle — that demonstrated that while investment returns and the asset growth they generate are very important, gift-giving, contributed revenue, and lower costs and spending can be equally important sources of growth.*

Today's conversation starts with the recognition that nonprofits have been through a very tough period. Most endowments are substantially smaller than they were three years ago, the recent rebound notwithstanding. Historically, endowments have grown when investment returns exceed spending, costs and inflation. Beyond this, endowments usually grow in three ways: 1) through major gifts, such as endowing a faculty chair, which are usually restricted; 2) through bequests, which are often unrestricted; and 3) through operating surpluses that, while infrequent, have been effective when institutions are able to consistently transfer small increments to their endowment.

Even with last year's double-digit returns nonprofits are nowhere near back to even. Moreover, there is the possibility—subscribed to by several experts—that we may not see a robust return environment going forward. That makes the search for alternative tools and strategies to grow endowment all the more urgent. So, our goal is helping boards and administrators think about ways to get their endowments growing again.

**Lippincott:** A year ago, fund-raising dropped 12 percent at colleges and universities—something we had not seen as long as the Voluntary Support for Education (VSE) report has been in existence, which is over 50 years. But we are seeing some signs of recovery. At the end of each calendar year and academic year, we at CASE do a quick pulse-taking with fund-raisers to get their best estimate of how they did for the 12 months just ended and how they think they're going to do for the next 12 months. For the academic year that ended June 30, 2010, the sense that we got was that giving had turned up 4 percent. And for the academic year ending June 30, 2011, fund-raisers say they're expecting to be up 6 percent. Granted, those increases are off a really poor prior year, but are welcome nonetheless.



**Schervish:** If you play out that scenario, it will take roughly three years from now for the downturn to shake out and get us back to pre-recession levels. So, getting back to even with 2007 is probably not far off, but not back to trend.



**Lippincott:** Yes—back to even, but not back to trend. Trend was 7 percent growth annually for 20 years. But it would be such a mistake to focus only on that 12 percent drop and somehow think that we should, therefore, cut back on fund-raising efforts. There's reason to be optimistic that, going forward, giving will be a significant contributor to growing endowments. It's easy to forget that in higher education we are still raising money at the same level, in dollar terms, that we were raising four years ago.

**Jarvis:** Inside that 12 percent drop are two things: One is a reduction in the number of individuals who feel able to give and the other is a general drop in the value of assets; for example, 1,000 shares of IBM lost a lot of value. Do you know which has had more impact?



**Lippincott:** Generally speaking, I would say that what we have seen is not a drop in the number of donors. It is much more a drop in the size of the gifts. So, indeed, that is part of the good news and one of the reasons to continue to focus on building the donor base, because there's a great deal of loyalty even if the gift is smaller.

**FRED ROGERS** *via teleconference*

Four of the five participants in the rebuilding endowment roundtable were present in Boston for the discussion and were photographed as they engaged in the exchange. The fifth member of the roundtable, Fred Rogers (pictured here), participated by teleconference from his office at Carleton College in Minnesota.





**Griswold:** *Do you sense that because of the economic malaise we've been through, there is a different mood out there now or has anything changed in the way nonprofits should view fund-raising?*

**Lippincott:** I think the single greatest impact of the economic downturn was this creation of uncertainty, a mood of uncertainty. People are very skittish about making commitments, and long-term commitments particularly. They're very worried about their own financial security. One of the things that has been interesting, just anecdotally talking to university fund-raisers, is their view of the classic pyramid of giving with the base of annual gifts up to the ultimate gift at the top. I've heard some say it's now becoming a giving hourglass—that the people who are really squeezed are the people in the middle. The truly wealthy had sufficient discretionary funds to continue to meet their philanthropic commitments. The people making modest annual gifts, as long as they were still employed, continued to make their gifts. It's the people in the middle who were reaching that point in their lives where they could make a significant gift, but they also were counting on their wealth for their own personal security and retirement. Of course, as they saw their retirement funds get significantly reduced, this group of donors felt squeezed.

**Jarvis:** Implicit, too, in the question is the danger of confusing liquidity with solvency. If you become insolvent, you don't live to fight another day. We've seen that happen to companies, but it can also happen to individuals and families. I think many have looked at their situation and concluded, "It can happen to me and to my family, so I'm going to take care of that first before I donate, even though I'd very much like to give."

**Schervish:** We shouldn't think of giving as having an on/off switch. Money is still being donated—\$595 million is given every day, or about \$217 billion in individual donations in 2009. Some campaigns are now reporting greater giving. So, some money is coming in. The bottom line is that enormous amounts are still being donated by individuals—but a drop in individual giving of 10 percent over the past two years, as we have measured it, has meant \$25 billion less for charities.

**Rogers:** Can you follow that through to see if people gave to, say, a donor-advised fund and ultimately the money went into a similar pattern of distribution as it might have if it had been given directly? Or is the money ending up in different places?

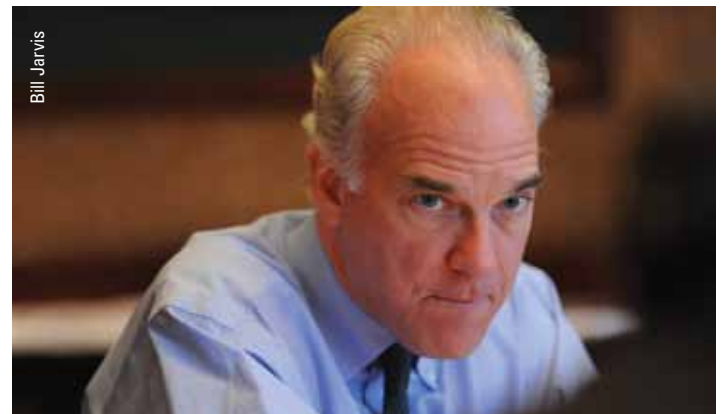
**Schervish:** Some information on this could be gathered, at least for broad categories of charities.

**Rogers:** A question might be, then, whether the donor-advised fund is—let me use this term—"efficient" in the sense that because it's a better manager of estate wealth it actually adds value? That could be one theory. Or it could be inefficient in that it charges a lot of fees and doesn't really add much, so it nets out to be a loss of total resources.

**Lippincott:** Here's a corollary to that. We've been seeing for the last five or six years now, if not more, a decline in alumni participation rates. For several years, my sense was a lot of it was the result of alumni making gifts through a donor-advised fund or through a family foundation, which gets counted as a foundation gift, not as an alumni gift.

**Rogers:** Our largest gifts often come through a family foundation, and that is not new.

**Jarvis:** When I hear someone say something like "alumni participation rates are down," I immediately think of a shift in generational attitudes. If you're raising the same amount of money and more is coming from foundations—which typically would be established by older people, if not an estate planning thing, a permanent thing—are we not setting the stage for an end game where the current generation or those currently under 40 give at lower rates?



**Lippincott:** Let me throw another factor in here, and that is that the alumni participation rate has a numerator and a denominator. The denominator, of course, is the number of alumni of record. As institutions graduate more students and as they get better at populating their databases with alumni, that automatically depresses the participation rate if the number of those giving remains constant.

So, if you account for the donor-advised fund factor and the family foundation factor along with this denominator issue, there are a couple of things going on that could point to a lower alumni participation rate but that do not actually indicate that alumni are becoming less generous. I have seen some research that suggests for the same stage in life, current generations of graduates are as generous as previous generations.

**Rogers:** In fact, I think our data would say that current alumni are probably participating at higher levels than alumni did, say, 30 or 35 years ago.

**Griswold:** Having been a fund-raiser in roughly the same period, I would observe that there was a cohort in the 1970s that was just about missing entirely from the donor bases of schools. It just stopped. And these people didn't do anything until about the 25th reunion when they suddenly all got love.

**Havens:** Long term, generations are about the same. There has been some increase in giving overall. The real issue has to deal with foundations. That is, we're looking at very high wealth people—people with \$10 million to \$25 million or more in net worth. The age distribution at the time of giving goes all the way down to relatively



young ages. But, if you've made the wealth in your own lifetime, which many have, and you're starting, therefore, a new foundation, the age will skew a little older. In addition to serving as a vehicle for charitable giving, one of the reasons people want to establish a foundation is to involve their children in philanthropy. So, more than one objective is served. People generally give more to their family foundation than they give directly to charities of any kind, including higher education. Foundations, on the other hand, give out a good deal more than they get in. So, it does look like there's a leveraging effect—a net positive—with foundations when viewed from the nonprofit client's standpoint.

**Griswold:** To summarize a little bit, we're seeing a shift in the methodology of giving in that it's being channeled—if that's the right word—more and more through private foundations, family foundations and donor-advised funds. Why is that happening? Is it anxiety or donors wanting to hold onto control of it?

**Schervish:** They want to invest it themselves. The attitude is, "I don't do endowments because I can do better by providing you the fruit of investments that I make and/or manage." If you take that back a step, what you're talking about is the actual donors saying, "I can manage this better. Let me do that and then I'll give you the big gift at the end, either in the form of a grant from my family foundation or perhaps even a bequest."



**Lippincott:** Actually, some people have more wealth today than they had three years ago. But, the landscape has become a lot more complicated. I'll come back to the point about uncertainty. It means that getting the donor to make the kind of commitment he or she might have made more readily a few years ago will take more work today. As we were suggesting earlier, it's not that the number of donors has declined, but the size of the gifts has declined, meaning that it's going to take more gifts to get the same end result.

What worries me is that some institutions in that circumstance may look at ways to cut expenses and they start to think about cutting back on their development effort. My view is that when you're flying into a headwind it's the worst time to pull back on the throttle. Now is the time to invest in your fund-raising effort because it's going to take more work and because the simple fact remains that the number of gifts you get is a function of the number of times you ask.

**Rogers:** That's generally the pattern that we're seeing as well. It means you have to work harder to get the same results, which means you have to have more frontline fund-raisers, not fewer.

**Lippincott:** I think the real challenge facing American higher education is affordability. And I think we're going to see more and more backlash against tuition levels not only from those who have to pay, but politically as well.

**The single greatest impact of the economic downturn was the creation of a mood of uncertainty.**



**Griswold:** *That goes to the issue of communication.*

*Do you believe institutions have communicated effectively enough about endowments?*

**Lippincott:** I don't believe people generally understand endowments, and that is reflected in the debate in Congress led by Senator Grassley. We could have done a better job of helping people understand the reason that institutions have endowments, what they're intended to do, how they're used and the fact that 90-plus percent of money in endowment funds is restricted and that it's not, therefore, a fungible asset for the institution.

Popular anger is being stirred up at what is perceived as elite institutions sitting on large amounts of money. But, we're talking about a handful of institutions that are used as the poster children for this issue, and that's highly unfortunate. It remains, though, that we have not done a good job of explaining to people what endowments are; so, in the absence of understanding, the assumption is that there is something wrong with institutions allegedly hoarding this money.

**Griswold:** And people aren't aware that during the downturn it was unrestricted endowment that got used up first. There's also the issue of "engaged philanthropy," or donors wanting to become involved in the programmatic uses of their gift or the income from the gift. There is very much a sense of restriction there.

**Schervish:** Institutions can ask and ask a donor, and eventually they may succeed—but with a sense of resentment. On the other hand, a donor can make a contribution to something that is really not needed. But, if you find that collaborative place

between the donor and the institution, that is gold. I fear losing this as we attempt to rebuild our endowments.

**Jarvis:** Is there something going on out there that is really innovative in all these areas that we're talking about? Are nonprofits trying new things?

**Lippincott:** I have begun to see a good thing in the educational environment, and it's the breaking down of silos. So, the alumni officer is now playing much more of a role in fund-raising, and the planned giving officer is playing a role in securing current gifts and the major gifts officer is thinking about gifts at all stages. There's more multitasking, a lot more crossing of lines, a lot more serving as a kind of concierge for the donor. It's a matter of better aligning the goals of the institution with the mission of the institution and, at the end of the day, ensuring that institutions don't have to wrestle with the gift that keeps on taking.

**Schervish:** In all of this we encounter what I call "hyperagents." These are willful, strong, successful and often, but not always, wealth holders. Think of it this way: What it takes a social movement of agents to achieve, a hyperagent can achieve relatively single-handedly. Instead of being finders of the best place to contribute money, they're founders. In the financial world, they will have founded their own businesses and hired just the right people to run their investments. Both outside and inside philanthropy, these are the founders, the institution builders, the world builders. And to the extent that an institution can ally itself with one or more of these hyperagents, it becomes easier to get other things done, not least because people will have more confidence in the institution.

**Rogers:** Getting back to the question of what's different about endowments now, the recent disruption was so big that many nonprofits had to reset their endowment draw. If they were supposed to be within a range of 4 to 6 percent, but some suddenly found themselves drawing 7.5 or 8 percent, it was not because spending increased but because the asset base went down.

**Griswold:** Commonfund has long advocated spending more in difficult times and less in good times. You want to be flexible, depending on the percentage of your operating budget that's supported by endowment. Some institutions made special appropriations and did not change their policy.

Institutions should take a world view that includes future revenue streams to the endowment. It's useful to step back and ask, "What's our total liability stream going to look like over the next 5 to 10 years, and what's our revenue stream going to look like over the same period?" The answer should include projected investment returns, gifts, government revenue, grants, earned revenue and all other sources of revenue.

**Rogers:** It cuts both ways. If spending goes too low, say 3 percent, donors are reluctant to give. They want to see a higher level of spending before committing.

**Jarvis:** In discussing spending rates, we shouldn't lose sight of current and prospective donors, who will want to understand this. This goes to stewardship. Donors need to be educated. The days are gone when you could spend 6 percent and be able to "spend income only and under no condition invade principal." Once again, the issue is one of communication and education.



**Griswold:** *Paul, are you seeing any changes in the motivations of donors, anything that would worry you or make you more optimistic about giving to support the core, long-term mission of the institution that they're giving to?*

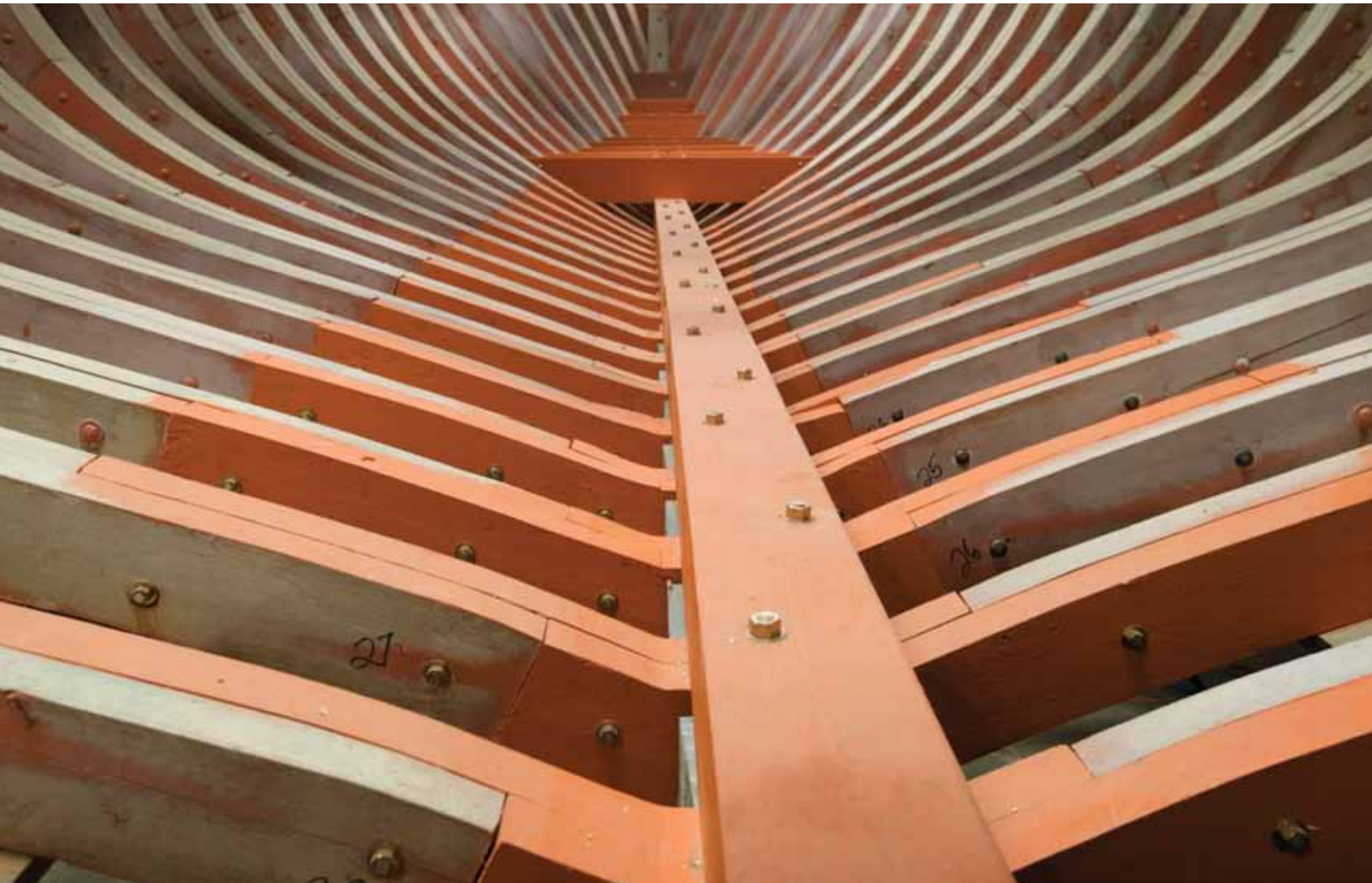
**Schervish:** I think that the younger generation is going to be mixing and matching their types of giving vehicles. Earlier, we agreed that getting rid of silos is important. The Cleveland Clinic, for example, will not make their patients visit a string of specialists. Instead, the specialists gather around a table with the patients, and address each other and the patient at the same time. This way they come up with



Paul Schervish

the most curative diagnosis and treatment. The primary unit of concern is not a specialty or a specialist, but the patient in need of integrated care. In fund-raising, we have made the charity's organizational chart of giving vehicles and giving purposes the basis for approaching donors. We segment donors into cells of a two-way table, with one axis being the size of a gift and the other being the fund-raising department to which the charity has assigned their donors. This should be reversed with the donor free to cross segments.

**Lippincott:** That prompts me to think about another dimension of donor motivation that it's probably important to keep on the table as we talk about endowments. I often get asked why donors give to the likes of a Harvard when it already has a huge endowment. Perhaps they should give to a small nonprofit where the money will have more of an impact. The answer, of course, is because they believe Harvard is in a position to do wonderful things with that money and they want to give to winners. So, I think we want to encourage nonprofits not to issue a plea of, "We're hanging on by our fingernails here as an organization, and we need your gift to endowment because otherwise we're in big trouble." Bailing out the institution will not motivate a donor. That's a losing argument in the long run. A far better argument is to say, "There are some very important things we need to do right now, and student financial aid jumps right



to the top of that list for our college or university. And your gift can be extremely important to us right now, given the challenge of affordability and the growing need, in this environment, for students to have sufficient financial aid, which can be funded by your gift.”

**Schervish:** You also want to avoid the notion that somehow the investment side of the charity has gone through a crisis without scrutiny and reform. It’s the business side of a nonprofit and donors quickly understand when it is sub-par.

Mentioning Harvard, there’s another reason that an institution receives gifts that keep on giving. If there’s one thing that Harvard graduates do, it is that they stay in touch and help each other with contacts and opportunities. I’ve heard this again and again. Even if you went there for a certificate program, there’s a network that connects you to a community that traces its valuable fruits back to Harvard. Other schools should bear that in mind and do all they can to promote and maintain that sense of a network that keeps giving. This is a vital way that higher education can continue to provide the added value that fosters the identification and gratitude that generate generosity.

**Lippincott:** I think your other point, Paul—that the donor wants to feel that the institution is well managed—is a very important part of this. And, Fred, you were suggesting this as well—the message is about taking the necessary steps to ensure that the institution is operating as efficiently and as effectively as possible and that it holds fast to its mission and vision. The real challenge in communication with repeat donors right now is responding to the question, “Why do I want to give another gift to an endowment that has dropped in value by 20 percent?”

**Griswold:** Here, it’s the job of management, the administration or the development people to articulate the underlying reason why the original endowment funds were given. They need to help the donor look beyond the short term at the long-term horizon and how rebuilding financial resources is the way to support vision and mission or individual programs within the institution.

Let’s go back to a question that we haven’t touched on, and that is earned income. Opportunities to make money are there if an institution wants to. Higher ed does all kinds of things, while most other nonprofits don’t do as much in this area.

**Lippincott:** As you rightly suggest, John, in higher ed circles there’s already significant amounts of earned income in the form, primarily, of athletics and tuition. Actually, athletic revenues make the point I want to make, which is don’t look at the income, look at the net. That’s the problem with athletics, and that’s the problem with a lot of other things that people try to merchandise. They go through a lot of effort, but if you step back and look at the net income, it may not have been worth the effort.

**Griswold:** Not to mention the danger of UBIT, or unrelated business income tax.

**Lippincott:** On the UBIT issue, the IRS is studying information it solicited from universities. And what I understand is that the IRS is not focused so much on endowment issues but on compensation and UBIT. So, institutions have to be careful as they study these other sources of revenue. Sure, look at them, but don’t chase the revenue without really thinking about where it’s going to take you and how much it is going to take your eye off the ball.

**Havens:** How do joint ventures with businesses fit into all of this? Shared intellectual rights, licensing and such are interesting areas. I don’t know whether it has really contributed much to endowment over the years.



**Lippincott:** I do think that scenario has potential. Universities have been doing technology transfer with corporations for a long time. There was an instance recently of a university moving into this area but in a little different way by setting up a research center that would feed ideas into the university as well as take ideas out of the university.

**Schervish:** We may see a new model of the university emerge. Corporations have long been vertically integrated. I believe we’ll see more vertically integrated universities and hospital centers: from basic research all the way to product development and product sales. These institutions will seek recompense at as many rungs of the

vertical ladder as possible. This business model permeating the vertically integrated university or hospital will presage a turning point in fund-raising. Will this mean that upper-tier donors will be able to invest money, say, in the form of a loan that will be eligible for an established rate of return as with an annuity? Will we find more universities being able to run ancillary for-profit enterprises that deal directly with the purpose and product of the university, such as with genetic discoveries?

Back to the endowment: Notice how we come to think of the donor to the endowment as a tool that enables the charity to do good. But once we trace the chain of effects that flow from the donor's dollars, through the charity to the improvement of humanity, we realize that the donor is not primarily a tool for the charity to do good, but that the charity is a tool for the donor to do good.

**Rogers:** I don't have a lot of experience receiving a patent, for example, as a gift. But I think my point would be that when you make a decision about investment in a venture capital fund or an energy fund, if it's done through a diligent, disciplined process it's an investment. When you come to investments that are motivated more by donor relations or by motivations of wanting to remain close to a certain person and his or her company, they fall outside normal investment guidelines.

**Griswold:** *Any thoughts before we wrap up?*



**Lippincott:** We touched on this, but I would like to come back to one of the key messages, and that is now is the time to reinvest in your fund-raising operation. It has always been a great investment, and lots of different studies support that. Generally speaking, the return is something like \$7 for every dollar spent on fund-raising. So, I think institutions have to look very seriously about how they can perhaps benefit from the current environment. It's the "a crisis is a terrible thing to waste" syndrome.

**Schervish:** I would follow up on that and say the answer may not be a quantitative increase in "the ask." Let it be known that you have a need, but don't be demanding. Release fund-raisers from just having quotas for contacts, requests or dollars. Also have a quota for biographical conversations that treat donors to the gift of one or more extended conversations. When this is done for the care of your donors, you may find yourself naturally asking, Is there anything that you would like to do to improve the well-being of humanity through this charity? And is there anything we can do to help you become more connected, more effective and happier? One adage is to thank your donors seven times. Also be sure to show them their connection seven times.

**Havens:** I may not match the eloquence of my colleagues here, but I would point out that the top 10 percent of donors generally gives more than 50 percent of the dollars. Many of these donors are business owners, and businesses are struggling. This is a drag on what they have available to give to charity. From their point of view, the first priority should be to try to maintain the livelihood and well-being of their employees. As the recovery proceeds and as businesses start to be less stressed, I think you're going to see a gradual or even sudden increase that will appear on the graph as a major turn, a real rebound.

**Schervish:** I would add one thing, which is sort of a comment on reactions to crises like this. I believe a lot of us think about the "don't waste a crisis" theory by taking care of those things we've always wanted to do. That's an okay place to start but I don't think it's an okay place to finish, because the real question is, Where do you want to be positioned in the next 5 to 10 years? It may not simply be a matter of getting back to where you were. The hard thing here, while resources are tight and institutions are feeling constrained, is not to invest in your old ideas but to really develop a strategy for what will position the institution 5 to 10 years hence. If done successfully, the institution won't be where it was, it will be stronger. |