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Essential Not Optional: A Strategic Approach to Fund-raising for Endowments

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About Commonfund Institute

Commonfund Institute houses the education and research activities of Commonfund and provides the entire community of long-term investors with investment information and professional development programs. Commonfund Institute is dedicated to the advancement of investment knowledge and the promotion of best practices in financial management. In addition to teaming with NACUBO to produce the NCSE, Commonfund Institute provides a wide variety of resources, including conferences, seminars and roundtables on topics such as endowments and treasury management; proprietary and third-party research and publications, including the Higher Education Price Index (HEPI); and events such as the annual Commonfund Forum and Commonfund Endowment Institute.

Essential Not Optional:
A Strategic Approach to Fund-raising for Endowments

In an era when many believe that returns from financial markets will be lower than in the recent past, endowed nonprofits no longer have the option of treating fund-raising as a tactical resource. Fund-raising has become an essential strategic capability that endowed institutions will have to build or acquire in order to thrive – or, perhaps, to survive.

Introduction

Background

In the aftermath of the global financial crisis of 2008-09, endowed nonprofit institutions are still struggling to regain their financial balance. The strong equity market recovery that began in the spring of 2009 lifted portfolio values through the middle of calendar 2011, but the latter half of that year was marked by a significant retrenchment and the first six months of 2012 have not shown a clear long-term direction. The current market atmosphere thus stands in strong contrast to the quarter-century secular bull market that prevailed – albeit with interruptions – from 1982 through 2007. Further cause for caution comes from academic research demonstrating that the long-term equity risk premium (the historic return from equities above riskless investments) of approximately 6 percent annually[1] is much lower than the returns experienced during the boom years. While the future is unknowable, many investors have expressed doubt that markets will soon resume the double-digit pace that characterized the pre-crisis period, and deep-seated problems such as high levels of sovereign debt among developed economies appear to make a return to the status quo unlikely.

Yet endowments remain more important than ever to the stability and sustainability of the institutions they support, and the loss or permanent impairment of endowment value threatens to harm the long-term missions of these institutions. The financial crisis reminded everyone in the nonprofit sector that many usually reliable sources of revenue are actually unreliable in times of economic stress; gifts, grants, appropriations, fee revenue and investment returns all declined to some degree, and many continue to decline. Many charities have had to use their endowments as "rainy day funds" during the downturn, withdrawing money to support operations as demand for services has increased while these other sources of revenue have declined, notably government support at all levels. Moreover, calls on well-endowed institutions to spend more ignore the fact that endowments are composed largely of separate donor-restricted funds,[2] and that in a world of low investment returns endowment support will increasingly be required to replace other sources of revenue that may reach their limit or even begin to decline. Rating agencies, too, have recognized that a mixture of cost control, diversification of revenue streams and stronger endowment resources is necessary to ensure a robust

1 Dimson, Marsh and Staunton, Triumph of the Optimists (2002), pp. 163-175.

2 See "Viewpoint: Defining Endowment" in 2011 NACUBO-Commonfund Study of Endowments, pp. 43-46.

balance sheet. Increasingly, better-run institutions are making the connection in their financial structure between the management of operating funds, the investment of the endowment and the development or fund-raising function.

In this uncertain environment, it is important for nonprofit fiduciaries and staff to focus on the four factors that contribute most significantly to the financial health of endowed institutions:

- the asset allocation of the portfolio;
- the spending rate from the endowment;
- the smoothing methodology, if any, used to reduce volatility in endowment spending from year to year; and
- the level of new funds coming into the endowment in the form of contributions and other additions

The philanthropic behavior of donors is influenced by many factors, including economic conditions, tax strategies and the dynamics of the donor's relationship with the individual institution. It is, however, possible to arrive at a general view of the current state of giving to endowed institutions and the forces that may influence it in the future.

In previous white papers, we have examined the challenges facing the traditional volunteer-based governance model that is the norm for most endowed nonprofit institutions. Referring to these four factors, we have set forth parameters for an effective investment policy statement and described its function in determining an asset allocation that is appropriate for the institution. We have also examined how the adoption of an appropriate spending rate and spending methodology can be of assistance in maintaining the purchasing power of an endowment over time while minimizing the volatility of outlays.

In this paper, we address endowment giving. The philanthropic behavior of donors is influenced by many factors, including economic conditions, tax strategies and the dynamics of the donor's relationship with the individual institution. It is, however, possible to arrive at a general view of the current state of giving to endowed institutions and the forces that may influence it in the future. Perhaps most important is the structural change that has occurred over the last 20 years in leading institutions' thinking about the development process. Whereas fund-raising was at one time viewed as a tactical function for the organization, taking the form primarily of annual fund drives supplemented by occasional larger-scale but discrete capital campaigns, it has now become the norm for leading endowed nonprofits to staff and manage the fund-raising function as a strategic contributor to the long-term health of the institution, with annual giving, endowment giving, planned giving and bequests each forming a part of the whole.

For this paper, we have reviewed the existing literature and sources of information on giving, and have been fortunate to be able to consult with leading academic researchers and fund-raisers for leading nonprofit institutions. Their contributions form the basis for the conclusions expressed here.

Sources of Endowment Growth

Endowment growth is often assumed to come primarily from investment returns, but in recent years the role of investment returns has diminished as both market appreciation and income from interest and dividends have declined. From January 2000 through December 2011 the S&P 500 Index returned 6.80 percent on a cumulative basis; outside the U.S., the MSCI EAFE Index returned just 6.39 percent cumulatively over the same period. Two recessions occurred during that 12-year time span, but the financial crisis of 2007-2009 was the more damaging by far. According to the 2011 NACUBO-Commonfund Study of Endowments® (NCSE), even after the strong "bounce-back" portfolio returns of 11.9 percent in FY2010 and 19.2 percent in FY2011, the average educational endowment retained just 86 percent of its July 1, 2007, value, assuming no gift inflows and an annual spending rate of 5 percent.[3]

Investment returns are largely outside the control of an institution, but determination of the amount to be spent from the endowment each year lies within the power of the governing board.[4] Spending restraint – a board's decision to reduce spending below the customary policy rate of 4.5 to 5.0 percent – can be a means of increasing endowment assets over time. In the current constricted economic environment, however, spending restraint poses an unusual challenge since the needs of students, grantees, patients and beneficiaries tend to expand during periods of economic stress. This tug-of-war between the two imperatives of supporting the institution's current mission while preserving resources for the future is likely to form the core of the spending policy debate for some time to come.

3 Return data are from the 2011 NACUBO-Commonfund Study of Endowments, Fig. 2.1, p. 9.

4 Private foundations are an exception, being required under Internal Revenue Service regulations to spend at least 5 percent of their assets each year.

With investment returns uncertain and spending restraint a challenge, gift-giving emerges as an important third source of endowment growth. This is not new; in fact, well-endowed institutions are frequently observed to possess active, sophisticated development operations. In periods when investment returns are strong, the importance of donations tends to be masked by the headline news of strong market gains. But at times like the present, when investment returns are uneven, the importance of this third source of endowment growth becomes ever more visible.

Research on Gift-giving

Commonfund Institute White Papers

In the mid-2000s Fred Rogers and Glenn Strehle, professionals with long experience in financial management at leading institutions of higher education, wrote two white papers sponsored by Commonfund Institute that analyzed the dynamics of gift-giving and development practices at colleges and universities. In their first paper, Sources of Endowment Growth at Colleges and Universities (2005)[5], the authors made the case for the importance of gifts in endowment growth, demonstrating that over five- to 10-year periods the incremental effect of annual additions to endowment from gifts, at approximately 1.8 percent of endowment value per year, is frequently a major reason for an institution's relative success in achieving higher long-term endowment growth. They also concluded that smaller endowments were generally adding proportionally more to their value from gifts each year than larger endowments, due to the adverse "denominator effect" of the larger endowments' size.

In their second paper, Strategies for Increasing Endowment Giving at College and Universities (2007)[6], Rogers and Strehle discussed a number of strategies – capital campaigns, planned giving, bequests, gift matching, and others – used by institutions to increase gift-giving. They observed that public institutions' investment returns generally lagged those of private institutions while their gift inflows, as a percentage of endowment assets, were generally much higher – due, again, to their smaller asset size relative to private institutions.

Recent research

Among the leading annual reports measuring and analyzing giving to nonprofits are Voluntary Support of Education[7], Giving USA[8], the NACUBO-Commonfund Study of Endowments[9] and the CASE Fundraising Index[10]. Highlights of relevant data from these studies follow.

Voluntary Support of Education (VSE)

In its annual study of giving to U.S. colleges and universities, VSE reported that contributions rose 8.2 percent to $30.3 billion in 2011, a marked improvement over 2010's increases of 0.5 percent and $28 billion. Giving for capital purposes, such as endowments and buildings, increased 13.6 percent while giving for current operations increased 4.7 percent. Despite the improved level of contributions, giving accounted for only 6.5 percent of college expenditures in 2011, and giving for current operations accounted for 3.8 percent of expenditures. Significantly, giving was heavily weighted toward the largest institutions: Twenty-five percent of the responding institutions raised 86.3 percent of the dollars reported in the VSE survey.

> Despite these increases, budgetary support from giving in FY2011 did not return to its pre-recession level; the average percentage of participating institutions' operating budget funded by gifts was 4.2 percent in FY2011, a notable decline from 5.2 percent in FY2010 and 6.9 percent in FY2009.

Giving USA

The Giving USA Foundation™ reported that total contributions to all charities from American individuals, corporations and foundations grew modestly in 2011, rising to an estimated $298.4 billion from an estimated $290.9 billion in 2010 and $280.3 billion in 2009. The 2011 figure represented growth of 0.9 percent after inflation, following 3.8 percent real growth in 2010 and a combined real decline of 13.0 percent in 2008 and 2009 that was the steepest in more than 40 years. Breaking down 2011 total giving figures by source, individual giving rose 0.8 percent in real terms to $217.8 billion; donations by corporations fell by more than 3.0 percent in real terms to $14.6 billion; foundation grant-making (private, community and operating foundations) fell by 1.3 percent after inflation to $41.7 billion; and bequests, the only source of growth, rose nearly 9.0 percent in real terms to $24.4 billion. Religious institutions, the largest single recipient category, suffered the biggest real decline in donations, of nearly 5.0 percent. Giving

5 http://www.commonfund.org/InvestorResources/Publications/White%20Papers/Sources%20of%20Endowment%20Growth.pdf

6 http://www.commonfund.org/InvestorResources/Publications/White%20Papers/Strategies%20for%20Increasing%20End%20Giving.pdf

7 http://www.cae.org/content/pro_data_trends.htm

8 http://www.givingusareports.org/

9 http://www.nacubo.org/Research/NACUBO-Commonfund_Study_of_Endowments.html

10 http://www.case.org/Samples_Research_and_Tools/Benchmarking_and_Research/Surveys_and_Studies/CASE_Fundraising_Index.html

to educational institutions rose 0.9 percent in real terms, with this category of recipient receiving 13.0 percent of all giving in 2011, unchanged from 2010.

NACUBO-Commonfund Study of Endowments (NCSE)

The 2011 NACUBO-Commonfund Study of Endowments® (NCSE) data showed improved gift flow in fiscal 2011, with 46 percent of participating institutions reporting an increase in gifts compared with 43 percent reporting an increase the previous fiscal year. Similarly, the proportion of the Study universe reporting a decline in gifts fell to 31 percent from 43 percent in FY2010. Twenty-three percent had no answer or were uncertain. The largest institutions reported the highest rate of increases and the lowest rates of decreases, with 52 percent reporting an increase and just 18 percent reporting a decrease.

Despite these increases, budgetary support from giving in FY2011 did not return to its pre-recession level; the average percentage of participating institutions' operating budget funded by gifts was 4.2 percent in FY2011, a notable decline from 5.2 percent in FY2010 and 6.9 percent in FY2009.

As noted by Strehle and Rogers in their work, in general the smaller the institution, the greater the percentage of its operating budget funded by gifts. For FY2011, institutions with assets under $25 million reported that 5.9 percent of the operating budget was supported by annual giving, while it averaged 4.2 percent for institutions with assets over $1 billion at the other end of the size spectrum.

The NCSE reported total additions to the investment pool of $57.1 billion in FY2011. Of this total, almost $5.5 billion came from gifts and bequests from individuals, nearly all of which ($5.03 billion) were donor-restricted. In years when lower investment returns (or losses) have been reported, the relative proportion of growth attributable to gifts and bequests from individuals has been greater. For example, in FY2010 total additions were lower, at $36.9 billion, but gifts and bequests from individuals, at $5.1 billion, were almost as high as in FY2011.

CASE Fundraising Index

CASE is a professional association serving educational institutions and the advancement professionals who work on their behalf in alumni relations, communications, development, marketing and allied areas. This survey, conducted as of June 30 and December 31 each year, estimated in its July 2011 report that FY2011 donations increased by 4.7 percent over the previous year. Fund-raisers predicted further growth of 5.5 percent for the academic year that began July 1, 2011. Fund-raisers at public colleges and universities estimated that giving to their institutions increased by 2.6 percent, while their private counterparts estimated that giving had increased 5.7 percent over the previous year.

It can thus be seen from these highlights that, while giving has recovered somewhat from the steep decline that accompanied the economic crisis, it has not yet returned to pre-crisis levels and the contribution of gifts to the operating budgets of nonprofits is down. Furthermore, as in the past, the bulk of gifts tend to be restricted to a particular purpose, frequently for capital projects. Ongoing programs and maintenance of existing facilities receive a much lower level of gift funding.

Insights from Leading Development Professionals

In preparing this paper, Commonfund Institute sought the views of several leading development professionals on the evolving forces that are influencing the fund-raising field and what the future might hold for institutional development efforts. We are grateful to these dedicated individuals for contributing their time and knowledge to this research:

- Charles Collier, Senior Philanthropic Advisor, Harvard University (retired)
- Mark Dollhopf, Executive Director, Association of Yale Alumni
- Donald M. Fellows, President & Chief Executive Officer, Marts & Lundy
- John Lippincott, President, Council for the Advancement and Support of Education (CASE)
- Fred Rogers, Vice President and Treasurer, Carleton College (formerly Senior Vice President, Cornell University; Chief Financial Officer, Carnegie Mellon University)
- Curtis R. Simic, President Emeritus, Indiana University Foundation
- Roxanne Spillett, former Chief Executive Officer, President and Member of the Board of Governors, Boys & Girls Clubs of America
- Glenn P. Strehle, Treasurer, Massachusetts Institute of Technology (retired)

The perspectives shared by the panel (summarized below) were grounded in each member's individual experiences and viewpoints, and it would be incorrect to conclude that they were unanimous in their views. Taken as a whole, however, their statements about the future coalesced to a surprising degree around the topics discussed in this section. One theme emerged clearly: In the process of rebuilding endowment, donations will, if anything, play a more important role than in the past.

- **"A Golden Age" – for those that can grasp it.** Despite the subdued growth in overall giving that we have seen, many of the professionals with whom we spoke asserted that the current period is one of the most favorable, in historical terms, for endowment fund-raising. Academic research anticipates that a massive wealth transfer of some $41 trillion – including $6 trillion in charitable bequests – is now under way and will continue during the 55-year period from 1998 through 2052.[11] Members of the panel cited unprecedentedly large campaigns concluded successfully (particularly in higher education) and donors willing to make strong commitments to their institutions. But they emphasized that success stories in the development field are invariably the fruit of a building process that takes time, resources and institutional commitment.

One theme emerged clearly: In the process of rebuilding endowment, donations will, if anything, play a more important role than in the past.

- **"The permanent campaign."** Of the major avenues for fund-raising – annual giving, planned giving, bequests and capital campaigns – it is the latter that draw the most attention and consume the most resources. Yet campaigns are a relatively new phenomenon. In the 1970s, a typical institution might undertake a campaign once in a decade. Now, at many large nonprofit institutions there is no real beginning or end; instead, a "permanent campaign" is always running in the background, with continuous cultivation of major gift prospects and a prioritized list of defined projects at the ready for negotiation with donors.

- **The core campaign model.** A significant development has been the transition to a strategic or "core" model, which focuses on providing endowed support for the core mission of the institution and for a specific number of areas that have the potential to make a major difference in the institution's future. Emphasizing the core means that non-endowment donations are no longer used to substitute for already existing budgetary expenditures and that non-critical physical plant or programmatic "accoutrements" are de-emphasized.

- **Coordination and rotation of multi-campus campaigns**. Larger nonprofits—ranging from public university systems to statewide or regional health-care systems—benefit by carefully coordinating their fund-raising initiatives across geographic locations. For example, a multi-campus university system can be raising funds continually but will thoughtfully rotate campaigns from one campus to another, thereby tapping into the local support base and keeping donors carefully segmented.

- **A conversation rather than a request.** Implicit in the idea of the "permanent campaign" is the concept that the relationship between the donor and the institution has also changed and become more strategic. "Asking for money," says one fund-raising professional, "just alienates today's donors. Instead, you need to ask them how they want to change the world." The intersection between donor interests and institutional imperatives may not always be obvious, but the strongest relationships seem to be forged from these conversations – or negotiations – that compel the parties to find common ground.

- **A changing donor base.** Underlying this dynamic relationship is the changing nature of donors themselves. In the past, the image of the large donor was typically that of a person who had inherited wealth and whose giving came from a sense of civic duty rather than from a strong identification with the mission of the institution. Today, more donors tend to be self-made. Relatively skeptical of broad institutional claims, they can be quite specific about their likes and dislikes and will compare the performance of the institution's existing endowment with their own wealth-creation capabilities when deciding to make a gift.
  Here, the connection in the donor's mind between development success and institutional competence in financial management becomes explicit: institutions with strong missions but weak financial management will receive annual gifts, while those with strong missions and strong financial management will be considered for endowed gifts. As one development professional put it, "Trust has to be part of the equation. If prospective donors are inspired but not convinced that the institution can deliver, they probably won't make the gift. There needs to be trust in the leadership and its management capabilities."

- **The rarity of unrestricted gifts.** One corollary of this increased focus on donor interest is a corresponding dearth of unrestricted endowment gifts. While, as noted above, restricted gifts have always outweighed unrestricted, the emphasis on new programs and buildings has tended to overshadow the question of how ongoing expenses are to be met. This has already become a source of anxiety for institutional leaders, particularly at

11 Paul G. Schervish and John J. Havens, "Millionaires and the Millennium: New Estimates of the Forthcoming Wealth Transfer and the Prospects for a Golden Age of Philanthropy". Boston: Boston College Social Welfare Research Institute, October 1999. The authors have confirmed their continuing belief in the validity of this estimate. http://www.bc.edu/research/cwp/about/staff/schervish.html

institutions that lack unrestricted endowment and cannot accumulate free cash flow via operating surpluses or other sources of revenue. Not infrequently, the source of ongoing support becomes the institution's annual campaign – which, as recent years have shown, can be subject to considerable volatility.

- **Greater wealth concentration among donors.** While institutions have always paid lip service to the desire for a broad base of donors, the bulk of donations, in dollar terms, have always come from a minority of individuals. Historically, it was typical for 20 percent of donors to be responsible for 80 percent of the funds raised.
  In recent years, this ratio has tightened markedly. Now, at some leading institutions, just 2 percent of donors contribute 98 percent of funds. This lopsided ratio means that, while a broad base of donors is desirable for many reasons, development efforts are increasingly focused on identifying and grooming those donors who have the capacity to make a significant financial contribution.

...development staff cannot work in a vacuum; alumni, member or donor records must be built or rebuilt in order to give the staff a base on which to work. The initial and ongoing investment required will, it is understood, be eventually repaid through donations.

- **Development staff: "an investment, not an expense."** Until the fairly recent past, permanent professional development departments rarely existed, even at large institutions. As one fund-raising veteran put it, "They would hire a person to run the campaign, who would then recruit some staff. Once the campaign was finished, this staff would be cut back – and the knowledge that we had built of our alumni and donor base would begin to atrophy."
  Now, in contrast, leading institutions have put in place permanent development staffs managed according to highly quantitative goals. In addition to grooming donors for contributions to the "permanent campaign" items mentioned above, development staff also seek to understand the receptivity of donors to planned giving opportunities and to assess the likelihood that they will leave bequests. While a full discussion of planned giving is outside the scope of this paper, it can be said that a mature program of this type will yield an actuarially-predictable flow of funds that can provide a powerful counterbalance to fluctuations in annual gifts and in the market value of the endowment. "In this sense," said one professional, "development staff is an investment, not an expense, for the institution."

- **First steps.** For organizations without substantial resources, it can be difficult to know how to prioritize the task of building an effective development effort. Several of the professionals with whom we spoke said that, for smaller institutions without permanent development staff, "The first step is to screen your list so you know where to go; the main effort should be to build one-on-one relationships with potential donors." Implicit in this recommendation is the concept that development staff cannot work in a vacuum; alumni, member or donor records must be built or rebuilt in order to give the staff a base on which to work. The initial and ongoing investment required will, it is understood, be eventually repaid through donations.
  In this regard, it is worth drawing a distinction between those organizations where a development department's budget is part of a larger overall expense structure and those, like foundations in support of public colleges and universities, where the organization must bear its own expenses apart from the institution it supports. In the former case, fund-raising expenses can be borne within the structure of the general institutional budget, while in the latter a separate charge is frequently levied upon gifts to support the cost of fundraising.

Conclusion

This overview of the state of endowment giving comes at a time of urgent need in the nonprofit sector. With market returns uncertain and spending restraint difficult, the moderate but measurable increase in donations in the last year invites institutions to consider elevating fund-raising to a more strategic position within the organization. For institutions that have historically viewed fund-raising tactically, the tasks can seem daunting: building donor records, prioritizing institutional needs, recruiting staff. But the long-term potential rewards from such efforts are themselves strategic and go beyond the issue of the immediate amounts raised. The formation of strong mutual commitments and ties between the institution and its supporters enhances its ability to articulate institutional goals, promotes honest and deep understanding of donor interests and institutional needs, and ultimately strengthens its ability to fulfill its mission. While the current state of fund-raising may be uncertain, its role is not. No longer optional, an effective fund-raising program, consistently implemented, can become a central pillar of support for the institution.

About the Authors

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John Griswold is Executive Director of Commonfund Institute. In this role, he directs Commonfund's educational, market research and professional development activities. He joined Commonfund in 1992 at head of Client Services. He initiated and supervises the Commonfund Benchmarks Studies®, nationwide research efforts focused on the investment and governance practices and policies of nonprofit institutions. In addition, he supervises and speaks at Commonfund's annual Endowment Institute, Commonfund Forum and Trustee Roundtables. He is a graduate of Yale University.

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