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Linking Payout and Mission

A National Dialogue with Foundation Leaders

By Thomas J. Billitteri

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THE ASPEN INSTITUTE

Nonprofit Sector Research Fund

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Linking Payout and Mission

*A National Dialogue with
Foundation Leaders*

By Thomas J. Billitteri

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THE ASPEN INSTITUTE

A little more than a year ago, the Aspen Institute’s Nonprofit Sector and Philanthropy Program began an important dialogue on foundation spending with leaders from organized philanthropy throughout the United States. The subject of the dialogue was simple but compelling: How can foundations be more strategic in their grant-making, and how might they do better at matching their payout practices to their philanthropic missions? The dialogue consisted of five meetings that included leaders of some of the nation’s biggest private foundations, founders and trustees of small but intensely active family foundations, officials from regional grant-making associations, corporate philanthropists, and others with stakes in the future of foundation giving.*

The meetings underscored an important fact: Among the challenges facing those engaged in grant-making, none is more daunting than that of aligning a foundation’s charitable work with its financial resources. Matching payout to mission requires a commitment at a foundation’s highest levels, from presidents and other key staff officials to boards of directors and their investment and program committees. In the case of family philanthropies, the donors—aided by their financial advisers and estate-planning attorneys—can play a crucial role in helping new foundations adopt a mission-driven spending strategy right from the start.

A foundation might contemplate payout and mission in various ways. The institution’s particular nature—its charitable work, the size of its endowment, its planned life span—will typically play a strong role in shaping spending and program decisions.

* See the end of this document for a list of the meetings and their locations.

The involvement of donors—or the absence thereof—can play a role as well. And examples set by other foundations can have a big influence on the way a board designs its payout policy.

In the Aspen Institute’s meetings, held in New York, Chicago, and northern and southern California, participants expressed a desire for more examples and new tools to help shape payout practices. Case studies of specific grant-makers, “how-to” manuals, and other resources would help, they said. A first step in developing such tools is learning how to think strategically about payout. That is what this document is about. Below, we offer a summary of some of the most important questions and words of reflection that arose in the Aspen Institute meetings. We hope this material helps inspire fruitful contemplation and positive action on payout and mission.

*** How can a foundation balance its duty to protect or increase its assets with its desire to advance its mission—and how can the foundation do both without compromising either?**

It can be easy for a foundation’s staff members, engaged as they are in the day-to-day work of an institution, to view endowment management differently from the way trustees and their investment committees see it. As participants in the Aspen discussions noted, staff members may see reason to spend additional money on starting or strengthening programs, while trustees may be motivated by their fiduciary duty to protect—and perhaps increase—the institution’s wealth.

That is why a written payout strategy, reviewed by key staff members and formally endorsed by trustees, is important. The strategy should speak to the varying needs and concerns of the foundation’s trustees, staff, and investment personnel, and it

should be both firm and dynamic: firm so that it is taken seriously and followed rigorously, and dynamic so that it is reviewed periodically and altered as conditions change.

In structuring a payout plan, it is important to consider two overarching questions: What is the foundation in business to do? And how can the foundation deploy its assets to accomplish that mission in the most efficient and effective ways? If those questions form the basis for the foundation's internal deliberations, then all other matters will fall into place.

Such a scenario need not undermine a foundation's ability to both protect its endowment and advance its mission. Three basic steps can accomplish both:

- ✓ Have a written spending policy that details how assets will be allocated for grants, administration, and other costs, and review it regularly. Shape the policy so that it can remain in place whether the financial markets are strong, weak or not moving much at all. Evaluate the policy at least once a year to take account of changing circumstances. And avoid the biggest mistake: putting the spending policy on "autopilot," never going back to review or adjust it.
- ✓ Include people on the board who speak for the program side of the foundation's work, and make sure the investment committee hears those voices. If no such voices are present on the board, consider inviting a program officer, community representative, or grantee to join. For all the benefits of having lawyers, bankers, and other

pillars of the professional world serve as trustees, some potential limitations exist. A lawyer, for example, may see the trustee's duty primarily as one of ensuring legal compliance; a banker or investment professional may see it as one of promoting asset protection or growth. The board must place those perspectives in the larger context of the foundation's overall philanthropic mission, and input from the program side can be invaluable in carrying out that responsibility.

- ✓ Engage donors or their heirs in key discussions about balancing financial and philanthropic goals. It is not uncommon for wealthy benefactors to establish foundations with good intentions, but without a roadmap for maximizing philanthropic effectiveness. One way to start this discussion is to educate financial advisers working with donors on the purpose and ideals of private and family foundations and ask them to broach these topics with their clients.

*** How can a foundation create a pattern of grant-making that balances today's needs with tomorrow's?**

In weighing a payout strategy, a key question may arise: Should current social or cultural needs take precedence, or should the foundation conserve its money so that funds are available for future programs?

Answering this question can be tricky, as participants in the Aspen discussions noted. If the foundation's mission is to eradicate a disease that is taking a heavy toll today, spending more now could well make sense. If the mission is to support a museum for decades to come, a conservative approach might be in order.

Trustees and staff also must consider whether money from other sources will be available in the future for the kind of work the foundation is doing. Perhaps new donors with similar interests are coming forward, allowing the foundation to step up spending now in anticipation that other benefactors will be making grants in the future. On the other hand, the foundation may judge that new money is unlikely to be available in the future and decide to adopt a conservative payout strategy in response.

Foundations must also shape their grant-making practices around their internal beliefs, values and instincts. To help guide them through this complex territory, more and better research is needed—research on current and future donors, on program areas, and on the relative merits of delaying or accelerating spending.

Here in more detail are approaches, culled from the Aspen discussions, that a foundation might use to balance current and future spending.

- ✓ Craft a giving strategy before deciding whether to give away more money today than tomorrow, or to conserve today and spend more tomorrow. Much of that strategy should depend on the foundation's mission, beliefs and values. For example, if the mission is to protect the environment, spending more now may be the best approach.. After all, if the foundation waits, it could be too late to reverse environmental damage. If, on the other hand, the

mission is to fight race or sex discrimination, the foundation might go either way—plenty of discrimination exists today, but one can also reasonably expect it to be a problem years or decades from now. If a chief goal is to treat victims of a future bird-flu pandemic, the foundation might argue that it's best to conserve as much money as possible for the day when a pandemic hits.

Contrary arguments can be made in all such cases, however. That is why foundations must rely on their own values, coupled with all available research, to arrive at reasoned spending decisions.

- ✓ Consider the issue of generational equity. By spending more now than later on a philanthropic goal, a foundation may be benefiting the current generation at the expense of later ones. Or, in the alternative, by delaying spending until later, future generations might benefit in ways the current one does not. Either scenario may or may not be appropriate. The question for foundation leaders is whether they have carefully considered generational equity issues and made a sound decision about how to proceed.
- ✓ Remember that new foundations and new donors are likely to come along in the future. Some foundations are cautious about spending more than the federally required minimum because they fear not having enough money to meet future needs. But many of today's biggest grant-making institutions have sprung up in only the past decade or so, and new money is constantly flowing into

philanthropy. Don't assume future generations will be less generous than former ones.

- ✓ Consider spending down assets and even letting the foundation go out of business. Most private foundations are set up to operate in perpetuity, even though relatively few of them are required by trust agreements or other legal stipulations to do so. While good reasons may exist to disburse grant money conservatively so that an endowment lasts indefinitely, it might be wise to limit the life of the foundation and spend the endowment over a defined period to achieve a specific goal. In any event, participants in the Aspen discussions cautioned against being too hasty in implementing a spend-down strategy. Better to go slowly at first, they said, because the spend-down process requires a steep learning curve. The advice: Learn as much about the program area and grantee needs as possible, and build the foundation's capacity to manage grant-making before doling out big portions of an endowment.

* **How should family foundations think about balancing the duties of trustees with the intent and desires of donors and family members?**

The participation of an original donor, family members or heirs in a foundation's management can pose special challenges for staff and trustees—a point that several foundation leaders made in the Aspen discussions. Key questions to ask: What is the donor's (or family's) intent? Why was the foundation formed, and what does the family want it to be doing?

Donors may have multiple objectives when starting a foundation: to do good generally, but also perhaps to have the family name live on in the future, to encourage heirs to work toward a common goal, or to advance a particular cause, whether it is curing a disease, promoting the arts or fighting a social injustice. In some cases, a wealthy parent might form a foundation in the hope that it will keep siblings together and communicating with each other after the parent's death.

In crafting a payout strategy, staff and trustees must be careful to account for the wishes of donors and family members. At the same time, those philanthropic values must be balanced with the fiduciary duties inherent in foundation governance and the broader needs of society.

Some specific issues, as articulated by participants in the Aspen discussions:

- ✓ In shaping a payout strategy, trustees must assess their duty to honor the wishes of a donor or a donor's heirs. To what extent are trustees the guardians of a donor's intent? Where does the trustees' legal obligation to follow the donor's wishes begin and end? Are those obligations the same when the donor is alive as when the donor has died? Are they the same when heirs are involved in the foundation as when they are not? How can trustees learn to be both good watchdogs over a foundation's money and wise stewards of its societal obligations?
- ✓ Before donors establish a foundation, they should be encouraged to learn about the theory and practice of payout policies. Financial advisers, trust and estate lawyers, and others who have close

relationships with donors should be encouraged to counsel clients on spending policies. The foundation world should be more forceful in educating financial advisers, lawyers and others about the philosophical issues surrounding payout.

- ✓ Even after a family foundation is in operation, trustees should engage the founding donor—or surviving family members—in periodic discussions about mission and payout. A particular point to consider in those discussions is the foundation’s time horizon. Would it make sense to speed up payout? Would it make sense to distribute most or all assets in a set period? If the foundation ceased to exist, would family members feel the donor’s legacy had been honored because pressing needs had been met? Or would they feel the legacy had been damaged because future needs would be left to others to support or because the family name would recede in prominence?

*** How can foundations think about their mission and duty to society amid growing regulatory oversight and public scrutiny?**

Nonprofit groups are under increasing pressure to show results and justify the favorable tax treatment they receive. Private foundations are no exception. Congress, the Internal Revenue Service, and other official bodies, as well as the news media, have looked closely—and often skeptically—at the performance and management of foundations. At the same time, critics have pushed for higher payout rates—either with

proposals to raise the mandated minimum or to prevent foundations from counting certain administrative expenses toward the minimum payout rate.

While no one can predict the future of government oversight, the Aspen discussion yielded valuable suggestions to help foundations examine their payout strategies.

- ✓ Be sure the mission and spending plan are clear, and communicate them in a compelling way both inside and outside the organization. Avoid jargon and generalities. When the board deems it necessary to alter the mission or payout plan, make that known in a timely way and explain why the change is necessary.
- ✓ Improve the quality of annual reports and CEO statements so they do a better job of explaining the role of foundations in a democratic society and the way that role is promoted through a careful payout strategy. As some participants in the Aspen discussions noted, foundations sometimes have no clear rationale for their spending patterns, or they fail to communicate a coherent payout strategy to stakeholders and regulators.
- ✓ Communicate regularly with interested groups outside the foundation, be it the media, the local community, or those in government. Tell the story of the foundation's work and show, through specific examples, how the payout policy has led to desired outcomes and how it relates to the strategic vision.

The Aspen Institute and its Nonprofit Sector and Philanthropy Program are committed to supporting further research on foundation governance and spending. Aspen studies are underway, for example, on “spend-down” foundations that distribute their assets at an accelerated pace and on new philanthropic vehicles that straddle the line between conventional philanthropy and for-profit business. In addition, a soon-to-be-released study assesses the contributions that private foundations have made to society.

This document is based on the following Aspen Institute forums on foundation payout:

** November 21, 2005, hosted by The Atlantic Philanthropies, New York.*

** June 20, 2006, hosted by New York Regional Association of Grantmakers, New York.*

** October 9, 2006, co-hosted by the William and Flora Hewlett Foundation and Northern California Grantmakers, Menlo Park, California.*

** October 10, 2006, co-hosted by the Pacific Life Foundation and Southern California Grantmakers, Newport Beach, California.*

** November 30, 2006, hosted by the Donors Forum of Chicago.*

The forums grew out of a working paper on foundation payout that the Aspen Institute’s Nonprofit Sector and Philanthropy Program sponsored in 2005. To download “Money, Mission, and the Payout Rule: In Search of a Strategic Approach to Foundation Spending,” by Thomas J. Billitteri, please go to the following Web link:

http://www.nonprofitresearch.org/usr_doc/Full_Report.pdf

The Aspen Institute’s Nonprofit Sector and Philanthropy Program welcomes additional ideas and comments on this subject. Please send them to: NSPP/Payout, The

Aspen Institute, Nonprofit Sector and Philanthropy Program, One Dupont Circle, Suite 700, Washington, DC 20036-1133; or e-mail them to: tom.billitteri@aspeninstitute.org.

The Nonprofit Sector and Philanthropy Program seeks to improve the operation of the nonprofit sector and philanthropy through research and dialogue focused on public policy, management, and other important issues affecting the sector. The Aspen Institute, founded in 1950, is an international nonprofit organization with headquarters in Washington, D.C., that is dedicated to fostering enlightened leadership and open-minded dialogue.



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