



Effective Foundation Boards

A GUIDE FOR MEMBERS
OF INSTITUTIONALLY RELATED
FOUNDATION BOARDS



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FOUNDATION BOARDS

AGB ASSOCIATION OF
GOVERNING BOARDS
OF UNIVERSITIES AND COLLEGES

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Effective Foundation Boards: A Guide for Members of Institutionally Related Foundation Boards

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FOREWORD

Effective Foundation Boards

Institutionally related foundations are an important partner to all institutions of public higher education. As public colleges, universities, and systems respond to a shifting landscape, related foundations have become increasingly important to their financial sustainability, commitment to academic access and educational excellence, and institutional integrity. They provide support through endowments and entrepreneurial ventures, facilitate and expand fundraising capacity, and engage community leaders in outreach and advocacy on behalf of their host institutions.

While institutionally related foundations are a diverse and eclectic group, they share a common cause of supporting public education and a common governance structure that includes a volunteer board. *Effective Foundation Boards* provides an overview of the important responsibilities of serving on the board of a foundation that is related to a college, university, or system. It is intended to clarify the fiduciary responsibilities for which foundation boards are held accountable. It reminds board members that the foundation's core purpose is inextricably intertwined with the host institution, that the formal authority of a foundation board lies within the corporate body, and that how individual members comport themselves contributes to the board's overall effectiveness.

Governance of institutions of higher education remains in the public spotlight because of growing concerns about academic excellence and access, as well as heightened demands for accountability. A number of new standards and regulations for board governance have been enacted, and state and federal policymakers continue to focus their attention on colleges, universities, and systems. Therefore, all higher education boards must continue to perform well and demonstrate the highest ethical standards. Successful board performance is vital to protecting the integrity of foundations, institutional autonomy, and the traditions of public colleges and universities.

Effective Foundation Boards is designed to meet a new standard of board engagement. As a complement to *Effective Governing Boards* (a central resource for institutional governing bodies), it offers a set of governance standards that speaks to the unique role that institutionally related foundations play in public institutions. AGB's goal is to offer a volume that recognizes the nuances associated with board service in an environment that mandates all of higher education to focus on the nation's education priorities. It is especially important for foundation boards to support strong and effective relationships with their host

institutions. Productive foundation-institution partnerships require clarity about respective roles and responsibilities, coordinated planning and business processes, open and transparent communication, flexibility and nimbleness, and a shared commitment to the mission and goals of the college, university, or system.

This guide updates AGB's list of board responsibilities, emphasizing board accountability and board-member conduct. I encourage you to consider the board responsibilities outlined in the following pages. Not everyone will concur with all the ideas and recommendations. I do hope, however, that *Effective Foundation Boards* will provoke important discussions about these responsibilities and how they fit the culture and history of board members' particular foundations and institutions. It can serve an especially useful purpose in the recruitment and orientation of new board members and help all board members grasp what is at stake when they commit to serving on a foundation board.

Ultimately, *Effective Foundation Boards* is about leadership in institutions of higher education. This publication has been informed by the wisdom of many colleagues whose commitment to the study of foundation boards broadens our understanding of this complex subject. I appreciate the leadership provided by David Bass, AGB's director of foundation programs and research, for his work in developing this significant contribution to foundation governance; and by Marla Bobowick, director of AGB Press, whose skills as an editor are unparalleled. We are grateful to Mark Yusko, chief executive and chief investment officer of Morgan Creek Capital Management, for his willingness to provide generous support for this volume.

We live in a time of urgency for American higher education. Foundations working in concert with public colleges and universities—and boards working in concert with institution leaders—have a challenging role to fill in ensuring success.

Richard D. Legon
AGB President
December 2011

SECTION ONE

Institutionally Related Foundations in a New Era

Almost all public colleges, universities, and university systems are supported by one or more foundations that fulfill a variety of functions. Foundations serve as gift repositories, manage endowments and other assets, and provide stewardship to donors. The majority of foundations support or oversee development programs, and many also develop real property or undertake entrepreneurial ventures.

When AGB began working with foundation boards in the early 1990s, the most pressing public policy issues included increasing competition for public funds, concerns about student access and costs, and demands for heightened institutional accountability. Institutionally related foundations provided a means of addressing all three challenges. Rapidly growing fundraising programs and endowments created a margin of excellence over and above state support and provided scholarships to offset rising tuition. By providing enhanced financial oversight, independent foundation boards helped secure the trust of donors and the public at large. During the remainder of the decade, college and university endowments enjoyed double-digit returns, and public-institution revenues per student reached new highs.

Today, public colleges and universities operate in a very different and difficult fiscal environment that is likely to persist well into the next decade. State revenues are unlikely to return to 2008 levels until 2014. Many investment professionals are skeptical about the sustainability of the traditional target of a 5 percent endowment payout. Tuition rates are reaching levels beyond the means of many students and beyond the pale for many policy makers. More fundamentally, the long-standing compact between state governments and public institutions may be undergoing a permanent change, leading to increasing privatization for some institutions and changes in mission for others. Despite providing diminishing public resources for education, state and federal policy makers are demanding greater transparency and evidence of institutional efficiency and effectiveness in accordance with a proliferating array of performance metrics. In this context, foundations will play a more-important role than ever.

In the coming years, the following factors will shape the mission of institutionally related foundations and the work of their boards:

- *Increasing need for private support:* Private support will never be able to fully replace state appropriations as a revenue source for public colleges and universities. But, as fundraising programs mature, gifts and endowments will provide an increasingly important source of support for student financial aid, faculty positions, and academic programs. Where institutions once looked to foundations to provide a margin of excellence, they are now more likely to turn to foundations to support core academic functions and ensure access for students unable to pay undiscounted tuition rates.
- *Centralization of fundraising:* In recent years, academic institutions and systems have increasingly relied on foundations to provide centralized oversight of development programs. In some cases, this is driven by a desire to improve prospect management and stewardship across the institution. In other cases, transferring responsibility for fundraising functions to a foundation separates development budgets from general operating and instructional funds. It also enables institutions to manage development staff more flexibly and competitively. As gift flows and endowments grow, foundations may increasingly serve as a funding source for development.
- *Demand for entrepreneurial support:* Foundations have long helped host institutions acquire and develop real estate and supported other entrepreneurial ventures. A dearth of state funding for capital projects has, however, increased the need for such support. Institutions are increasingly turning to foundations to support construction of dormitories, labs, classrooms, and offices, as well as more ambitious public-private partnerships, such as the development of mixed-use town centers. Foundations afford greater flexibility, and their boards often contribute business expertise and experience beyond the scope of institution staff.
- *Complexity of asset management:* Endowment management has grown increasingly complex in the past two decades. On average, foundations allocate 40 percent of their portfolios to alternative assets, employ 15 asset management firms, and yet have less than one full-time-equivalent staff position devoted to investment functions. Foundation boards are now asking whether volunteer committees with minimal staff support can effectively manage complex portfolios in a volatile market. Outsourcing investment management functions, which allows the investment committees to focus on important policy and oversight responsibilities but does not supplant the board's fundamental fiduciary responsibility to exercise care and prudence, is increasingly common.
- *Foundation leadership transitions:* A generation of long-serving foundation chief executives is retiring, accompanied by a turnover of institution presidents that may accelerate the rate of foundation-leadership changes. Identifying and recruiting new chief executives with the requisite skills in leadership, board building, and staff development, in addition to fundraising experience and investment expertise, poses serious challenges for institution administrators and foundation boards. In many cases, foundation boards are called upon to provide interim leadership. As their work becomes more complex, foundations—which often employ chief executives jointly with the institution—may be forced to rethink institution-foundation operations and staffing models.

What's in a Name?

Institutionally related foundations provide support to a college, university, or university system. They may also be referred to as “affiliated foundations” or “college and university foundations.” The term “foundation” can be a source of confusion. Under Section 501(c)(3) of the Internal Revenue Code, college and university foundations are classified as “public charities” rather than “private foundations” and subject to different regulations than the latter. Most private foundations are funded by a single donor, family, or corporation, and have broad discretion in their grant making. Assets held by college and university foundations have been contributed by hundreds or thousands of donors and are typically restricted for particular purposes, such as departmental scholarships, specialized programs, or faculty chairs.

Institutionally related foundations are a heterogeneous lot, ranging from organizations with a few million dollars in assets and no full-time staff to those with more than one billion dollars in assets and hundreds of employees. Some foundations function almost exclusively as gift repositories and asset managers, while others oversee and operate comprehensive development programs, support or operate alumni associations and other affiliates, and undertake complex entrepreneurial ventures. Some institutions have multiple foundations dedicated to separate colleges or purposes.

Foundations may be independently staffed, self-financed, and operate with a high degree of autonomy or be wholly dependent on institutional funding and personnel. The majority of foundations, however, are interdependent with their institutions. The foundation chief executive often also serves as chief advancement officer for the institution, and development functions may be distributed across the foundation, institution units, and other affiliated organizations. Campus culture and tradition, state law, and institution or university-system policy all inform the specific role of foundations, the structure of their relationship with the host institution, and, to some extent, the scope of functions for which the foundation board has oversight responsibility.

In size and composition, foundation boards resemble the governing boards of independent colleges and universities, averaging 28 voting members and six non-voting members (typically ex-officio positions designated for university or foundation administrators). In addition to the foundation's fiduciary board, some foundations also have larger volunteer leadership groups that support fundraising and advocacy efforts. Members of these larger bodies, sometimes called “governors” or “trustees,” often include former board members, prospective board members, and other supporters of the foundation and/or the institution. The responsibilities outlined in this volume, however, pertain only to the board that has fiduciary responsibility for the foundation.

Benefits of Institutionally Related Foundations

Regardless of the scale of their operations and the way in which the foundation-institution relationship is structured, all foundations provide their host institutions with four broad advantages.

1. Meaningful opportunities to engage influential board leaders

Governing boards of public institutions are typically smaller than those of independent institutions. Their members are appointed by the governor or publicly elected, and philanthropic commitment and the ability to help raise private support may not be among the top criteria for board service. Because they are self-perpetuating, meaning that current board members elect their successors, foundation boards provide colleges, universities, and systems with an opportunity to engage donors, alumni, and friends in a prestigious and meaningful role. For example, foundation board members often serve as campaign chairs or on special advisory boards or task forces for the host institution. Foundations supporting universities or campuses that do not have a separate campus governing board may fill the void by serving as advisors to the campus president or chancellor and as advocates on behalf of the campus. Foundation board members are typically recruited for their philanthropic commitment, professional expertise and affiliations, and stature and connections in the community. A foundation board helps the institution expand its network of fundraisers, advisors, and advocates.

2. A vehicle to secure and fulfill the trust of donors

Foundations enable public institutions to clearly separate privately contributed resources from public money. A foundation, whose board often includes major donors and business leaders, fosters greater donor confidence because it can focus its full attention on asset management and gift stewardship. Institution administrators and governing board members face a host of issues demanding their attention and may be subject to short-term budgetary pressures at odds with the long-term perspective essential to major gift cultivation and management of permanently restricted funds. In some cases, foundations may also be better able than the host institution to safeguard the privacy of donors who wish to remain anonymous, although the degree to which they are subject to state open records laws varies. (*For more information, see Foundation Transparency and the Law on page 18.*)

3. Flexibility in expenditure and management of funds

For very good reasons, state entities are subject to a wide range of restrictions and requirements regarding the investment, use, and sale of state funds and other assets. Public colleges and universities are often subject to restrictive bidding procedures; limitations on salaries and other expenditures; rules regarding the acquisition, management, and sale of property; and other cumbersome administrative and regulatory processes. Foundations can be more nimble. For example, foundations affiliated with Georgia Institute of Technology, Virginia Polytechnic Institute, and West Virginia University have used debt financing to acquire and develop real property and to contract for

services more efficiently and advantageously than their universities could. Institutions concerned with recruiting or retaining key leaders may ask the foundation to provide private funds so they can offer more competitive compensation and benefits to presidents, athletic directors, or other key institution staff than would be possible given state salary limitations. *(For more information, see Whose Money Is It Anyway? on page 6.)*

4. Ability to seize opportunities

Institutions are often confronted with opportunities that could enhance educational resources or otherwise advance priorities but for which they lack the immediate means. For example, a foundation may enable an institution to acquire a special library collection that suddenly appears on the market. A bid procedure in such a case might be impossible because institutional funds would not have been budgeted and special state appropriations might not be available. A foundation could use donated funds or tap a line of credit to purchase the collection. Today, many larger foundations play a leading role in public-private partnerships designed to revitalize neighborhoods, foster economic development, commercialize intellectual property, and create opportunities for institutional growth.

SECTION THREE

Characteristics of Effective Foundation-Institution Partnerships

At their best, foundation-institution relationships are marked by trust, candor, and collaboration. This special collaborative relationship allows the host institution to focus on its core educational purpose and still have access to expanded capacity and flexibility through an affiliated foundation. It allows the foundation to support the institution by concentrating on other functions, such as asset management, fundraising, and entrepreneurial ventures. The foundation chief executive, institution president, foundation board, and institution or system governing board all play roles in defining, maintaining, and strengthening this relationship. While the formal structure is often defined by working agreements and tradition, effective foundation-institution partnerships are defined by the following five characteristics:

1. Clarity and consensus about the role of the foundation

In effective foundation-institution partnerships, administrators, staff, and board members of the foundation and of the institution share a clear understanding about the specific functions of the foundation. Institution and/or system boards have ultimate responsibility for determining the role of the foundation and the structure of the foundation-institution relationship. Foundation boards, however, should be actively engaged in the ongoing process of determining how the foundation can best support the institution and how the partnership should be designed.

A memorandum of understanding (MOU) or operating agreement serves as a contract between the institution and the foundation, memorializing agreed-upon roles and responsibilities. More importantly, the collaborative process of developing the agreement and periodically updating it ensures that the foundation's efforts are accurately aligned with institutional needs and provides boards and administrators an opportunity to consider how the foundation could better serve the institution. Orientations of institution and foundation boards should educate all volunteer leaders about the foundation-institution partnership and the respective roles of each board.

2. Integrated planning and alignment of strategic priorities

Institution and system boards appropriately focus on different issues and work with different time horizons than do their foundation counterparts. For example, while the institution board might be struggling to address mid-year cuts in state funding, the foundation board might be concerned about the sustainability of endowment spending. Thoughtful, collaborative planning can help resolve sometimes-competing claims in ways that benefit the institution, its students, and the larger community over time. While institution administrators might see rapid endowment growth as a green light for spending, moderation of endowment payouts during flush times can offset future market shocks. Similarly, sustained investment in planned giving and major gift programs may require current sacrifices but yield significant future returns in the form of endowed faculty positions and financial-aid resources.

Planning processes for the institution and the foundation need to be coordinated and integrated. Including foundation board members in the institution's strategic-planning process gives them a deeper understanding of institutional priorities and generates stronger support for fundraising priorities. It not only allows the institution to tap into the foundation board members' professional expertise and experience, but it also helps to ensure that institutional plans leverage foundation resources. In turn, the foundation's annual and long-term plans should identify specific objectives tied to institutional priorities, and appropriate institution administrators should be included in foundation-planning processes.

3. Trust, candor, and regular communication

Effective foundation-institution partnerships are based on candor and trust, which are supported by frequent formal and informal communication. While institution presidents report to the campus or system governing board, they also spend a significant portion of their time working on fundraising plans in conjunction with foundation leaders. Foundation chief executives often report to both the institution president and foundation board. Disagreements about the use of foundation resources, funding priorities, and institutional politics are inevitable. When leaders—professional and board, institution and foundation—can frankly share their questions and concerns as issues arise, they can often resolve them before they become divisive. Institution and foundation leaders need to abide by a “no surprises” rule because surprises corrode trust and undermine the ability to work through differences productively.

Regular reciprocal reporting between institution and foundation boards provides a baseline of shared information. Informal meetings among board chairs and chief executives provide opportunities to privately explore issues and ideas outside the sometimes politically charged context of open governing board meetings. Overlapping memberships between the governing and foundation boards, occasional joint meetings, and social events not only provide formal conduits for communication but also foster stronger social connections and greater trust.

4. Formal and transparent business processes

The host institution and the foundation need to maintain formal processes and procedures, especially related to their interaction, to protect the integrity of both organizations. A close working relationship between organizations (institutions and foundations) and individuals (professionals and board leaders) is needed on a day-to-day basis. At times, however, collegiality can lead to informal business practices that pose risks for the institution and the foundation and can create liabilities for chief executives and board members. Public colleges, universities, and systems are subject to complex but different regulatory regimes than private nonprofit organizations. State entities may be prohibited from undertaking actions that are appropriate for a publicly supported charity.

To prevent misunderstandings—not just between the institution and the foundation but also from the public perspective—agreements and transactions between the two organizations should be documented and freely disclosed. Full transparency of their interactions can help dispel any impression that the foundation serves as a means of concealing expenditures made on behalf of the institution from public scrutiny. In addition, outlining the respective authority of the foundation and institution boards, as well as documenting decisions (and decision-making processes) can help shield institution and foundation chief executives from political pressures and public reprisals.

5. Flexibility

Foundations support their host institutions in a wide variety of ways, and a given foundation's functions evolve as institutional needs and circumstances change. Effective foundation-institution partnerships depend on clearly defined roles and shared strategic objectives, but they also allow for flexibility. Strategic decisions concerning institutional operations, campaign plans, unexpected opportunities, leadership transitions, and changes in public policy or funding may require foundations to assume new or different functions on a temporary or permanent basis. The creation of a state matching-funds program might prompt a foundation to defer capital projects in favor of a special-purpose campaign designed to take advantage of the new incentive, or an unexpected gift of commercial property might lead to the creation of a real estate subsidiary.

While such flexibility is an important ingredient in the foundation-institution partnership, it needs to be carefully managed and monitored. A foray into real estate development could distract the foundation board and professional staff from fundamental governance responsibilities or sound campaign planning that, over time, could undermine fundraising efforts. Thoughtfully undertaken, such projects can build the long-term capacity of a foundation and increase the volume and variety of support it provides to the host institution.

Effective Foundation Boards: A Guide for Members of Institutionally Related Foundation Boards is available through AGB's Web site at <http://agb.org/publications/institutionally-related-foundations>.

Other AGB publications and resources for college and university foundations include:

- *Foundations for the Future: The Fundraising Role of Foundation Boards at Public Colleges and Universities* by Michael Worth
- *Margin of Excellence: The New Work of Higher Education Foundations* by Rick Legon
- AGB's Foundation Leadership Forum, taking place January 26-28, 2014 in Los Angeles, California
- Regional workshops and Webinars
- Foundation consulting service

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