GENERATIONS OF GIVING

Leadership and Continuity in Family Foundations

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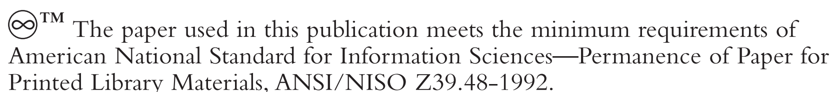

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DEVELOPING THE ORGANIZATIONAL STRUCTURE

Many of the foundations in our sample were created without much thought to their needs as organizations. As often happened in the last century, the work of establishing a foundation was a few days' paperwork for a competent attorney. The designs were boilerplate and minimal; all of the attention was on tax relief and facilitating the donor's personal charitable contributions. The founders were decisive, entrepreneurial people: They faced few legal requirements and needed little organizational support to accomplish their goals.

But the field of philanthropy has matured. Although some advisors still tend to confuse family foundations with family philanthropy, most understand that there are many ways for families and the individuals in them to be philanthropic.[1] Professionals who truly care about nurturing the charitable impulse in families can guide the leaders through an informed discussion of available options. They can help families consider the personal, legal, and financial ramifications of personal giving, and of community and operating foundations. If establishing a private foundation is the appropriate choice, professional advisors can shepherd the process of setting it up from scratch. In the best cases this involves articulating the family's mission and dream within the proper legal format, and creating the organizational structures and processes that will allow the foundation to do its work.

Even though the current legal restrictions place greater requirements on foundations, once the foundation exists the organizational aspects are usually underdeveloped or neglected.[2] The same sort of "pragmatic inattention" often happens in the founding stages of family businesses. Entrepreneurs don't pay much attention to organizational

structure, span of control, project support, information systems, human resources, or even budgets. They want to get the work done with minimum distractions and administrative costs.

However, businesses soon reach the point when they must pay more attention to their infrastructure. Potential employees want contracts and job descriptions. Customers want delivery assurances and to deal with a supplier that demonstrates dependability and professionalism. Most importantly, banks and other creditors want to see management and governance structures that are both adequate and realistic. By the time a business venture has found its niche, when its volume of sales is climbing into the millions of dollars and it is hiring significant numbers of employees, it must meet the basics of organizational design to survive.

Foundations do not often come up against the same constraints. There may not be any nonfamily employees for many years. The "customers" are unlikely to make any demands on the organizational formality of the foundation. And, of course, there are no creditors except for the donors. As policies are being drafted, the preferences of founders, family, and perhaps the grantees may be taken into account, but most often no one speaks for the organization. In fact, those who do raise issues of management, training, performance evaluations, governance designs, leadership criteria and terms, budgetary controls, human resources, and career development, may be accused of distracting the attention of the volunteer trustees and wasting resources. Even the most exemplary foundations are usually noted for their grantmaking, not their administration.

The research suggests that this is a mistake. Good grantmaking cannot occur in a vacuum. A great programmatic idea stands a poor chance in a chaotic, undermanaged meeting. The best talent in any generation is less likely to volunteer if they do not have confidence in the design and management of the system. How many hours are spent in inefficient committee meetings because no one has been trained in basic group facilitation techniques? How long do some foundations keep working with investment managers and attorneys who are performing poorly but are never held accountable?

As we described in chapter 1, the research team evaluated each foundation in the sample on a variety of performance and descriptive variables. The data from this study show a "constellation" of organizational strengths that to some extent differentiated the foundations

Table 8.1. Organizational Performance and Family Dynamics Ratings (Number of foundations in each category)

	Very Low	*Low*	*Moderate*	*High*	*Exemplary*
Clarity of Program	2	5	10	10	4
Grantmaking Vitality	2	5	11	10	3
Successor Development	4	18	4	2	2
Endowment Management	2	4	7	12	5
Quality Control	1	9	7	9	4
Clarity of Mission	2	4	10	8	6
Organizational Structure	1	7	8	9	5
Family Collaboration	1	9	10	8	2
Likelihood of Continuity	1	5	7	14	3
Next Generation Enthusiasm	3	10	9	4	4
Positive Family Dynamics	6	7	11	5	1
Conflict Avoidance*	2	5	10	13	n/a

* Conflict avoidance is scaled in the opposite direction from the others, with very low being the most preferred and high being the most problematic.

rated high on "likelihood of continuity" from those ranked lower. The entire array of scores is presented in table 8.1.

Overall the highest rankings were for endowment management, likelihood of continuity, clarity of mission, clarity of program, organizational structure, and grantmaking vitality (the averages for these characteristics were between moderate and high). The lowest rankings were for successor development and family dynamics (between low and moderate).

When we divided the sample according to their current governance stage, we could compare the Collaborative Family Foundations with the Family-Governed Staff-Managed Foundations. Staff control is, of course, higher in the staff-managed subsample, as is clarity of the mission, while family collaboration is somewhat higher in the Collaborative group.

But staff-managed grantmaking does not provide any observable advantage in grantmaking vitality, successor development and next generation enthusiasm, quality control, mission, or positive family dynamics—the two groups are nearly identical on those variables.

Staff-Managed Foundations were rated somewhat higher on likelihood of continuity and organizational infrastructure, and significantly higher on conflict avoidance. In this case, while there is no way to know from these data, it is likely that the staff-managed form was chosen because of the family's aversion to conflict, rather than

the other way around. (Table D.3 in appendix D presents the mean ratings for all variables for the total sample, and then breaks it down for the twenty-one Collaborative Family Foundations and the nine Family-Governed Staff-Managed Foundations. Table D.4 in appendix D then presents the correlation matrix of all the ratings.)

The number of cases is small for this kind of analysis, but the picture is very clear. Good management is measured in a number of ways that go together: clear programs, clear mission, asset management, quality control, successor development, and organizational structure. All of them, with the exception of the reported quality of asset management, are significantly and positively related to the rated likelihood of continuity.

Less obvious, but even more important, they are also highly correlated with family collaboration, next generation enthusiasm, and positive family dynamics. *In these cases it is strikingly apparent that investing in good organizational infrastructure and good governance pays off in the odds of successful continuity into the future, and in the quality of the experience for the participants today.*

CONSTRAINTS ON ORGANIZATIONAL PERFORMANCE

In chapter 5 we introduced the two primary reasons that trustees voiced for being cautious about professionalization and organizational development: cost and loss of control. We have discussed the issue of the balance of control between family and nonfamily staff in previous chapters. However, the issue of cost deserves further analysis.

Most of these families report some tension or conflict about how much to pay an executive director, or uncertainty about the reasonable cost of meetings, stipends to community board members, and travel expenses. Others worry about sending trustees to conferences. The concerns about money have direct effects on policy, on including non-family directors, and on staff size.[3]

As this foundation's annual giving grew from $500,000 to almost $5 million, they operated with a part-time executive director only. "We wanted to keep operating expenses to a minimum." When a new ex-

ecutive director was hired, he argued strongly that the board needed to also hire a program officer. The board agonized over the additional cost, and eventually agreed to another half-time position.

Many foundations do not feel comfortable with these kinds of expenditures. If they can get individuals to volunteer or accept token salaries, they do it. If they can get by without a computer system, a membership in an association, another telephone line, or a better administrative assistant, they postpone or deny those investments. They are trapped in the same ideology about infrastructure at this professional stage that they remember from the Controlling Trustee stage of the foundation in its earliest years. They treat themselves like bare-bones organizations, and do not consider the possibility that excessive frugality will lead to bare-bones performance.

In this typical scenario, the founder, "Iron Mac" McInerney, did the early grantmaking himself. After a few years, he invited his two children to join him, making recommendations about small grants and occasionally discussing the overall philanthropic agenda of the foundation. As Mac moved through his seventies, he became increasingly collaborative. He also had less time and energy for the details of grantmaking, at the same time as the endowment and scale of the disbursements was growing. When his daughter Margaret, an experienced social service administrator, offered to take over the role of "executive director," everyone was pleased.

Then, after two years as a volunteer, Margaret asked for an "appropriate professional salary." As she spent more time working for the foundation, she had less time for her career, and her income had taken a sharp drop. The board held a special meeting to discuss compensation. Her brother Mike objected to a salary because: (1) the trustees have personal funds and don't need money; (2) all the trustees give their time to the foundation, not just Margaret; (3) it would set a bad precedent for the third generation who might think they should be paid for their work; (4) the foundation should contain administrative costs; and (5) serving on the board should be considered a privilege. Mac's first response was to avoid conflict by paying the salary out of his pocket. But the family stayed with the issue. They researched the legal and practical implications of paying a family member by talking

to other foundations and asking a consultant to spell out the pros and cons. In the end, they agreed to pay the salary from foundation funds.

In general, the staff of the foundations included in this sample were very aware of the consequences of underinvesting in infrastructure, but the boards seemed to accept it as good practice, even if it frustrated their own agendas. Sometimes the severe restrictions on operational spending meant that the board could not implement policies that it had designed for itself. There were many cases where bylaws required due diligence, site visits, and follow-up that were simply impossible given the level of staffing.

When this foundation reached its fiftieth birthday it was being led by its third generation, with annual giving of several million dollars but had only two part-time staff, a researcher and a secretary. The board, aided by a consultant, held its first review of mission and program and designed a system of priorities and strategic program objectives. However, the staff was too small to even make a start on implementing the new model, and the old grantees pressured the trustees into continuing traditional grants. As a result, nothing changed for ten more years, until the board, overwhelmed by the dispersal demands of its rapidly growing endowment, hired its first professional executive director. He was able to use organizational skill to enlarge the staff and formalize the processes. The debates on professionalization and organizational expenditures remain very heated among the trustees.

This foundation asks for reports on the use of its funds, but it has no system for rigorous evaluation of grants because it doesn't have the staff to do them. The trustees have no responsibility for following up on grants that they have stimulated. This group of younger trustees are primarily professionals, geographically dispersed, and not close as a family. The foundation is a peripheral part of their lives.

Are family foundations stingy, appropriate, or self-indulgent in their expenditures? The Council on Foundations has been tracking administrative expenditures for many years. They have consistently found that family foundations spend less on average than independent foundations on administrative activities, averaging about .5 percent of assets and 10 percent of grants.[4]

Table 8.2. Administrative Expenditures as a Percentage of Gifts and Assets

	Admin. Expenditures as % of Gifts	*Admin. Expenditures as % of Assets*	*Gifts as % of Assets*
Lowest Case	0.0	0.0	2.6
Highest Case	32.5	1.4	9.2
Average	11.8	0.56	5.2

That means that a foundation dispersing $1 million per year from an endowment of $20 million will spend about $100,000 on itself—rent, utilities, travel, publications, salaries and benefits, training, and public information. In contrast, among nonprofits in general the most efficient agencies are considered to be doing very well if their administrative expenses fall under 20 percent of their budgets—fully twice the expense level of the average family foundation. (Table 8.2 presents administrative expenses for our sample.)

The percentages for our sample are in line with the council averages.

We gained an additional perspective from the research team's assessment of the level of resources in each of the sample cases. Each foundation was assigned to one of four categories:

- *Underresourced* (inadequate staff to accomplish essential grantmaking tasks, low salaries, inadequate training and professional development, poor or barely adequate facilities and support systems, reluctance to support conference attendance, insufficient funds to engage professional resources).
- *Adequately resourced* (sufficient staff to perform essential tasks, but not intensive or strategic initiatives, competitive salaries, some staff development opportunities, adequate computers, software, phone systems, and so forth, some conference attendance).
- *Fully resourced* (sufficient staff to perform not only management but strategic and program evaluation tasks, attractive salaries, widespread encouragement of development—including participation in multiple conferences and regional associations of grantmakers, use of outside professionals and consultants as needed, active community liaison and education activities, sufficient compensation to eliminate financial hardship on active trustees).
- *Surplus resources* (more staff than necessary to perform functions, excessive salaries, luxurious facilities and infrastructure, generous funding for meetings, including elaborate recreation and very broad family attendance, significant perks for trustees and/or staff).

In the judgment of the research team, one quarter of this sample (7 cases) were allocating too few dollars to organizational support and infrastructure development. An additional third (11 cases) were only adequately resourced. The remaining twelve cases were judged to be "fully resourced," and none was rated "surplus resourced." Taken all together, this data presents a strong argument that these foundations are not only "efficiently" funded, but in fact thinly resourced.

In addition, it is clear that additional resources do pay off in improved performance. When we looked at the impact of the level of resource adequacy on organizational and grantmaking performance, we found that higher levels of resource adequacy are significantly positively correlated with clarity of program, grantmaking vitality, likelihood of continuity, successor development, quality control, clarity of mission, and organizational structure (table D.4, appendix D).

This conclusion stands in stark contrast to the recurrent public concern about foundation expenditures. The specter of self-serving family foundations is periodically raised as a justification for restricting administrative spending more severely. The cases of abuse are undeniable. There have been foundations that have overpaid for services, indulged themselves with facilities and luxuries, and spent more on doing philanthropy than on the actual grants themselves. We have also already made the argument that the public has a legitimate "donor's interest" in any foundation that takes advantage of tax abatement.

But in this sample at least, the story is very different. From these data there is no evidence that foundations are spending inappropriately. In fact, the danger is that many boards will be intimidated by the press attention and the stories of excesses, and be even more reluctant to make necessary investments in organizational upgrades in the future. Based on this study, we would have to suggest that the public has more to lose from understaffed and overwhelmed foundations doing less than exemplary grantmaking because their infrastructure is too thin, than from those that overspend on themselves.

ASSET MANAGEMENT

We found that asset management was the one arena where these foundations have become willing to pay the cost of quality service

and were most likely to use professionals. In the early years, only ten of the foundations used professional investment managers other than family business employees to handle their portfolios, but today nearly all of them do. The total expenditures on endowment management equal the sum of all other expenditures combined. At first it seems as if these foundations place higher priority on the skills required to manage an endowment than on those required to fulfill the philanthropic mission and coordinate the family's dream. More likely this is an area in which many board members and trustees feel there is high risk and where they have few skills. The field has developed a large literature on endowment management and legal and financial issues in asset management, but it is still hard for nonfinancial amateurs to feel confident.[5]

By far the most common structure is an investment committee of the board, usually small and including the few trustees who are most experienced in money management, and a single investment advisory firm. There are some cases where the family does its own investment allocations. These are the families where the family business is directly involved in professional financial services. Even in those cases, some families feel that it is important to turn the foundation's portfolio over to someone else.

The Duttons are sophisticated investors and they know what they are doing as far as managing the portfolio. The nonfamily executive director views the foundation as an investment company: "Our business is to make money so that we can in turn give it out." The Duttons have a very active board committee and a lot of opinions about the way funds should be invested, but they have decided to hire outside professionals to do this work to reduce conflict and conflicts of interests amongst family trustees. "When the professionals don't perform, they are fired, and there are no hard feelings. It would be impossible to do that if a trustee was responsible for the investments or if any of us suggested an investment that later turned sour."

While there have been some important changes in the level of attention that these foundations have given to portfolio management in recent years, it is still an area where the trustees give themselves a critical evaluation. Most of our data was collected before 2001, and reflects

a lower priority on asset management than we would probably find today. We know from our work in the field that the recent dramatic swings in equity markets have had a powerful psychological impact on many foundation boards. They expanded their programs along with the rapid increase in portfolios, and then they had to deal with cutting off longstanding grantees, ending multiyear programs prematurely, and shutting the door completely to new initiatives when the markets turned down.

But even in more placid times, many interviewees expressed anxiety and uncertainty about how to responsibly fulfill their asset oversight responsibilities. Except for discussions about "how much we have to give away this year," the endowment is not part of the general discussion. Most commonly, it is either "in-sourced" (delegated to the member or members of the board who are seen as having financial skills) or "outsourced" (delegated to a professional money management organization). Either way the majority of board members in the sample as a whole do not feel competent in overseeing endowment management, do not have a clear sense of reasonable expectations, and do not want to be responsible for having expertise in this area.

IMPLEMENTING IMPROVEMENT IN ORGANIZATIONAL OPERATIONS

The critical techniques for attending to the organizational health of the foundation are straightforward and no different from any operating system:

Provide adequate staffing
Develop effective financial controls
Define operational policy
Encourage training and development

We have commented on each of these categories for each of the developmental stages of the foundations. There are also two other general lessons that cut across categories.

As we saw in the previous chapter, an effectively managed foundation can actually help heal a dysfunctional family. It is dramatic to

see the cases in this sample where some family dynamic problems were resolved not by directly focusing on the communication, history, or psychodynamics of the family, but rather by formalizing the grantmaking work. Once structures and policies are in place, the momentum of success can be remarkable.

This third-generation sibling group was frustrated and saddened about their inability to work together within the model of philanthropy that their parents had used. They decided to change their operation to rely on outside professionals, and in only a few years they were able to turn the foundation around. "We'll never again have family members as staff. We are just too competitive. Having a nonfamily person saves us from ourselves and allows us as a family to do our best work." The executive director says that she decided to "policy the trustees to death, so there wouldn't be any conflict—and it has worked miracles." The family agrees. "Her strategy was genius. We have clear policies on everything now, it works great, and she is there to remind us in a minute when we forget what we have agreed to."

While policies are a necessary first step in improving the organization's performance, we learned from comparing the foundations' written materials with their actual operations that creating a policy is not the same as implementing one. Most of the cases in this sample, at some point in their history, made great strides in design and policy creation in a "leap." Often stimulated by the intervention of a consultant, there was a flurry of activity in creating a succession plan for trustees, a governance plan about how the meetings will be scheduled and run, and criteria for various aspects of service. It was also common for only some of the new policies to be implemented. Surprisingly, a large number of interviewees were unembarrassed about saying that they were not familiar with their foundation's organizational policies, and did not think the other trustees were either.

This foundation, led by a new second-generation president, spent two years working on a job description for trustees. Over time, it became clear that implementing the new criteria for board service would leave two family branches without any qualifying candidates. Rather than reconsider the policy, they just ignored it. They also resisted spending

anything on infrastructure or professionalization—training, administrative support, stipends for nonfamily trustees. Their operating theory was, "let's not become too professional—a family foundation should be fun work."

Designing policies and then forgetting them can have the same long-term impact as the founder's creating formal organizational structures and ignoring them. It is not just a statement that the current leaders feel entitled to do what they think is right, regardless of the formal rules. It suggests that the rules themselves are silly, or that following rules is unnecessary. That is a confusing message for new members of the organization. It is not possible to respect formal structure and procedure when you agree with it and circumvent it when you do not, without undermining the overall organizational integrity of the foundation. That in itself is a threat to continuity.

A second observation regards the allocation of development and training funds, especially for participation in professional organizations, regional groups, and conferences. Many participants said that in their experience, education and leadership development actually work. There are numerous stories of attendance at conferences or seminars providing a shot in the arm, both in terms of motivation and in pure skill development.

In the late 1980s, some of the second generation began attending meetings of the local regional association. Then all four of the siblings attended the Council on Foundations meeting four years ago. "It was a liberating act and the beginning of our collaboration. We all became excited about the possibilities of running the trust more professionally and continuing it as a family foundation."

The current executive director (a family member) really emphasized the role of the Council on Foundations conferences and networking with others in the region about philanthropy. She emphasized, "We learned so much." Her niece, the newest member of the board, also went to the council conferences so that she could learn about foundations. She said she was very nervous about going, but that it was the "best thing that could have happened. It was amazing to see the great variety of foundations, and that the issues were the same. I

hung close to my aunt, but it was a wonderful introduction and really made me feel confident about my role."

Nevertheless, only ten of the thirty foundations relied on benchmarking or resources from formal philanthropic associations to guide their organization development. Only one-quarter of the sample were regular attendees at conferences and regional grantmaking forums, although all of those participants valued those experiences very highly.

The nonfamily staff were somewhat more likely to mention how much they gained from conferences and conversations with colleagues. However, they worried about confidentiality and protecting the privacy of the family, so they severely constrained their sharing efforts. Some of them stated that they assumed the family expected them to know, or figure out, how to resolve all difficulties and accomplish their tasks without exposing any problems outside the foundation.

This is a case where retreats, discussions, and the input of a trained facilitator or consultant could help many foundations to make better use of the experience of others. The balance could swing a little more toward interfoundation collaboration without risking embarrassment. That would be a benefit for the individual foundations and the field.[6]

In summary, foundations who deal most successfully with the challenge of organizational structure must address several critical tasks:

- Pay as much attention to the organization's needs as to the management of its endowment: provide truly adequate funding for staff, facilities, training, and operations.
- Resolve the dilemma of collaboration versus coexistence: find a balance between collaborative grantmaking and discretionary funds that responds to the diversity in the family without undermining the commitment to improving collaboration skills and evolving a core identity for the foundation.
- Do not accept poor management and ineffective group process, but invest in the training and skill development necessary to handle such mundane tasks as agenda setting, conflict management, decision-making rules, record keeping, and meeting logistics before they become destructive.

- Take their bylaws and policy documents seriously, making sure they reflect the mission, dream, and actual preferences of the group, and then implementing them consistently and fairly.

NOTES

1. The National Center for Family Philanthropy and the Council on Foundations publish many guides to families about their philanthropic options; for example, Born (2001); Foote (2000); Esposito (2002); Edie (2002a); Edie (2002b).

2. Bryson (2002) has written a very popular booklet on the most common pitfalls.

3. These are questions that a family business of comparable size would not entertain in the same way. While cost containment is also an issue in businesses, they are prepared for the "cost of goods sold." The best companies compete for executive talent and pay market-based compensation rates to get it. They invest in support systems, training, networking and trade associations, and technological infrastructure, because that improves their products and their service to customers. When there are problems, they spend the necessary funds to correct them.

4. These figures, taken from 990 forms, make use of the administrative expenditures assigned to the grantmaking functions, which average about half of the total organizational expenditures (the other half is allocated by the foundation to endowment management).

5. For example, National Center for Family Philanthropy (1999) and Esperti et al. (2003).

6. Some leading foundations have become more public about interfoundation collaboration and have invited colleagues to share program ideas, strategic planning, and research on grantees. The Edna McConnell Clark Foundation, for example, is experimenting with a "lead funder" program where they share their "due diligence" data with other foundations interested in common funding areas, and invites collaborators to participate in coordinated funding.