

Highlights of Benchmarking Foundation Administrative Expenses: How Operating Characteristics Affect Spending

Policy discussions of foundations often focus on how much they spend on administrative activities relative to their grantmaking and programmatic activities. Foundations themselves seek guidance on this question from their peers and professional associations. Yet often missing in these discussions is the need to consider foundation differences—such as size, operating characteristics, and programmatic activities—when assessing foundations’ administrative and operating expenses. These differences are profound even among the nation’s largest independent foundations.

Benchmarking Foundation Administrative Expenses: How Operating Characteristics Affect Spending explores how variations in foundations’ characteristics, activities, and giving levels influence charitable (program-related) administrative expense levels for a sample of more than 1,000 of the 1,500 largest independent foundations between 2004 and 2006 (see “Sampling Information”).

This study builds on the groundwork laid by a broader study of 2001–2003 foundation expenses¹, but focuses specifically on large independent foundations. Since these foundations account for the bulk of foundation resources and spending, they are of paramount interest to policymakers, watchdog organizations, and to leaders within the foundation world concerned with self-regulation and developing standards.

This study’s goals are to inform policy debates and foundation practices by documenting program-related administrative expenses and assessing the factors that drive these expenditures. By extending the research horizon closer to the present, this study furthers understanding of what drives expenses. It confirms that patterns of expenses for large independent foundations that were clear and consistent in 2001–2003 remained consistent in 2004–2006, despite changes in the economic environment. Such consistency should give foundation managers, policymakers, and the public the confidence to consider a foundation’s operating characteristics when assessing their expenditures.

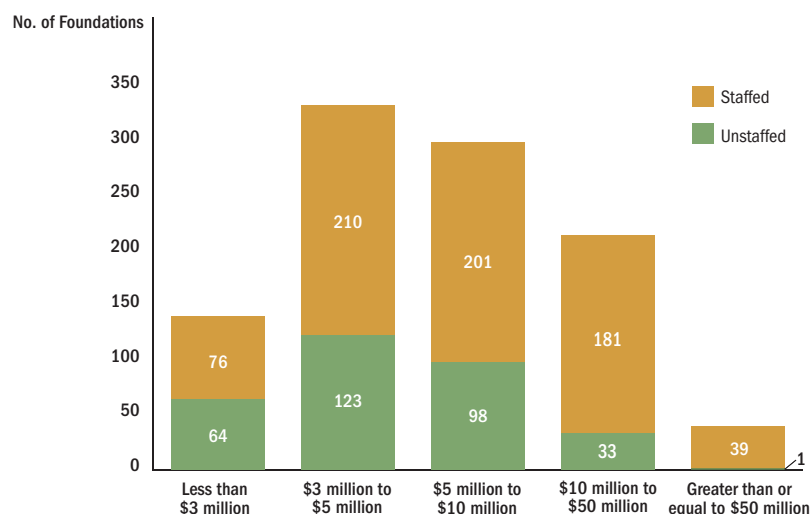
KEY FINDINGS

Operating Characteristics and Expense Patterns

Independent foundations’ characteristics strongly influence their charitable administrative expenses.

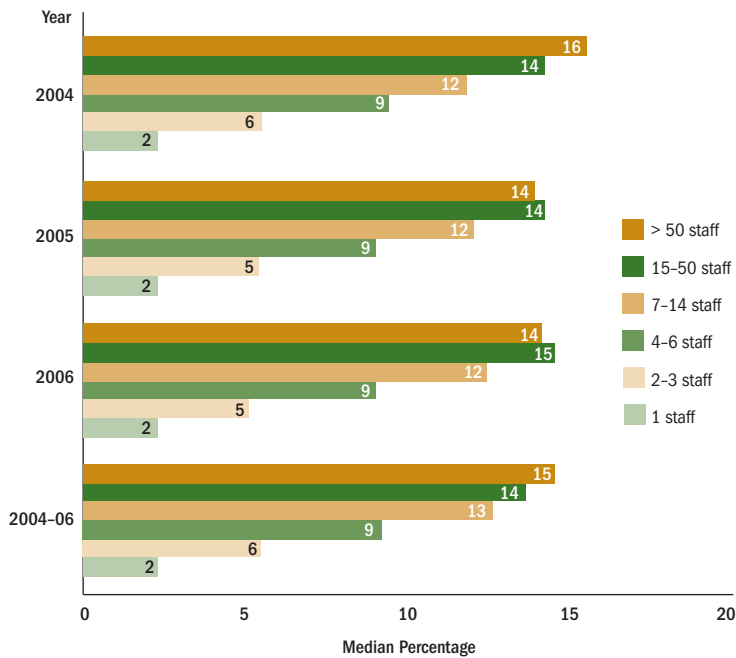
Even among the largest foundations, differences in giving levels, assets, work styles, geographic reach, and programs vary dramatically and produce very different expense patterns. While some foundations in this study reported expenses in the millions in 2004–2006, one out of ten of these large grantmakers reported no expenses as part of their qualifying distributions in that period. Nearly one out of three had no paid staff (Figure 1). Apparently,

FIGURE 1. Staffed Versus Unstaffed Independent Foundations by Giving Range



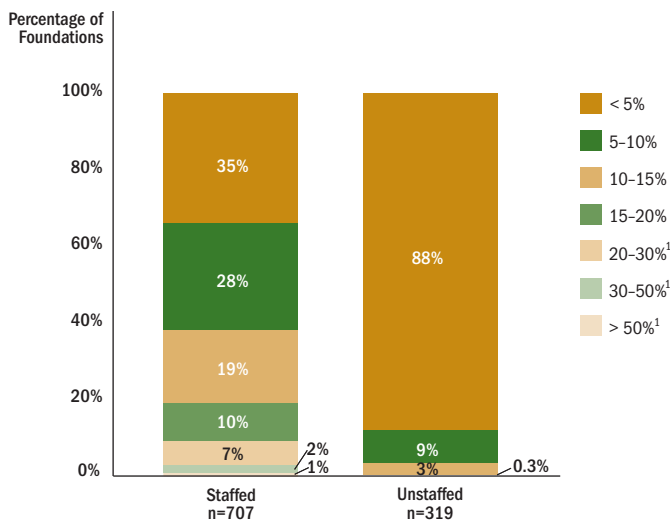
SOURCE: The Foundation Center, 2011; The Foundation Finances Database (2004–2006). Sample includes 1,026 of the approximately top 1,500 independent foundations by giving in 2004, 2005, and 2006 for which data were available for all years; qualifying foundations gave at least \$2.2 million each year.

FIGURE 2. Charitable Administrative Expenses as a Share of Qualifying Distributions, 2004, 2005, 2006: Staff Size (Staffed Independent Foundations)



SOURCE: The Foundation Center, 2011; The Foundation Finances Database (2004-2006). Sample includes 1,026 of the approximately top 1,500 independent foundations by giving in 2004, 2005, and 2006 for which data were available for all years; qualifying foundations gave at least \$2.2 million each year. Of the 1,026 foundations sampled, 707 on average reported having paid staff.

FIGURE 3. Distribution of Charitable Administrative Expenses as a Share of Qualifying Distributions, 2004-2006: Staffed and Unstaffed Independent Foundations



SOURCE: The Foundation Center, 2011; The Foundation Finances Database (2004-2006). Sample includes 1,026 of the approximately top 1,500 independent foundations by giving in 2004, 2005, and 2006 for which data were available for all years; qualifying foundations gave at least \$2.2 million each year.

¹No unstaffed foundations have an average charitable administrative expenses-to-qualifying distribution ratio greater than 20 percent.

SAMPLING INFORMATION

This study focuses only on large independent foundations. The sample includes 1,026 foundations that ranked consistently among the approximately top 1,500 independent and family foundations by giving in 2004, 2005, and 2006 and for which IRS Form 990-PF was available publicly for all years. These foundations each gave at least \$2.2 million in each study year. While foundations in the study represented less than 2 percent of all independent foundations in 2004, they accounted for 64 percent of all independent foundation giving in that year and 70 percent of all independent foundation assets.

these foundations were functioning with volunteer labor while other operating costs were absorbed by the donor or the donor's company.

Employment of staff is the single most important factor affecting expense levels, followed by staff size.

Paying staff significantly raises administrative costs, and expense levels rise consistently with the number of staff (Figure 2). Staff size, which varies greatly even among foundations with similar giving levels, depends on a foundation's mission, roles, and scope of activities. In general, the foundations that tend to give the most have the largest staffs. But smaller foundations with complex programs often have above-average staff size relative to their giving.

Foundations that employed staff had median expense ratios of nearly 8 percent, on average, compared with less than 1 percent for those without staff.

Just 35 percent of staffed foundations had a ratio below 5 percent, while 88 percent of unstaffed foundations were in this range (Figure 3). At the other end of the spectrum, relatively few large independent foundations had ratios greater than 30 percent.

International grantmaking, direct charitable activities, and grants-to-individuals programs are strongly associated with higher expense ratios.

Foundations that engaged regularly in these practices between 2004 and 2006 had median expense-to-qualifying distribution ratios that were roughly twice as high as those that did not. Other practices that substantially boosted a foundation's administrative expense levels were making program-related investments and maintaining a web site (a proxy for a broader communications effort).

Foundations with high charitable administrative expense ratios often mix grantmaking and direct charitable activities.

While making grants is the primary function of most foundations, more than one out of eight of the large independent foundations studied engaged regularly in direct charitable activities (Figure 4), ranging from conducting health policy research to providing technical assistance to nonprofits to operating conference centers or museums.

Operating as a “health conversion” or “new health” foundation tends to raise administrative expense levels, especially for smaller foundations.

This study considered for the first time whether being formed from the sale of a hospital or health organization has an effect on foundation expenses. Higher than average staffing levels and the prevalence of direct charitable activities are among the factors that contribute to the higher expense levels associated with health conversion status.

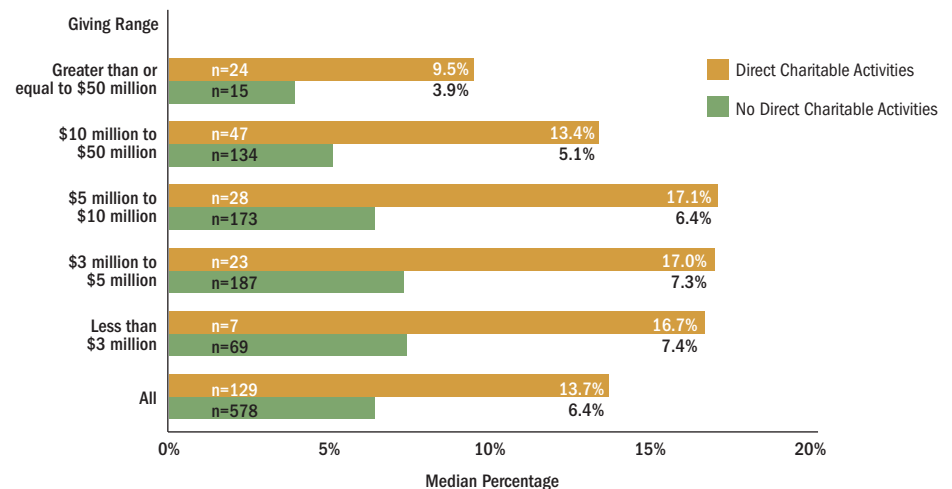
Foundation size influences cost ratios.

Foundations with more resources tend to employ more staff, have more complex infrastructure, and engage in more complex activities. At the same time, the largest foundations also enjoy some economies of scale, so they can achieve lower cost ratios for certain activities.

Donor-family involvement and operating as a “pass-through” foundation usually lower charitable administrative expense ratios in staffed foundations.

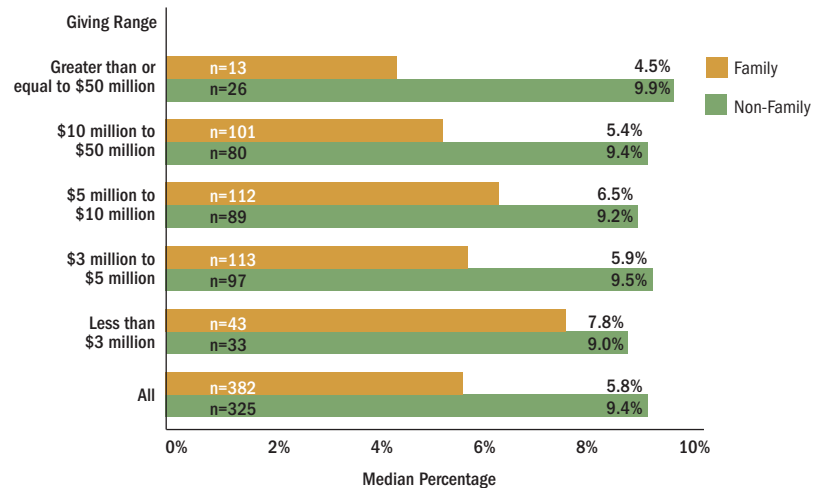
Family members may help hold down staff-related costs by providing program administration and other help (Figure 5). Pass-through foundations, which have no permanent corpus, tend to employ fewer staff than endowed foundations of comparable giving size. Most pass-through foundations also demonstrate family involvement.

FIGURE 4. Charitable Administrative Expenses as a Share of Qualifying Distributions, 2004–06: Direct Charitable Activities (Staffed Independent Foundations)



SOURCE: The Foundation Center, 2011; The Foundation Finances Database (2004–2006). Sample includes 1,026 of the approximately top independent 1,500 foundations by giving in 2004, 2005, and 2006 for which data were available for all years; qualifying foundations gave at least \$2.2 million each year. Of the 1,026 foundations sampled, 707 on average reported having paid staff.

FIGURE 5. Charitable Administrative Expenses as a Share of Qualifying Distributions, 2004–06: Family Versus Non-Family (Staffed Independent Foundations)



SOURCE: The Foundation Center, 2011. Sample includes 1,026 of the approximately top 1,500 foundations by giving in 2004, 2005, and 2006 for which data were available for all years; qualifying foundations gave at least \$2.2 million each year. Of the 1,026 foundations sampled, 707 on average reported having paid staff.

WHAT ARE CHARITABLE ADMINISTRATIVE EXPENSES AND HOW ARE THEY MEASURED?

Charitable administrative expenses are all expenditures related to carrying out a foundation’s charitable mission, including expenses for grants administration, direct charitable activities, and general overhead costs. All operating costs that can be counted as part of the “qualifying distributions” that comprise a private foundation’s annual payout requirement are included. (Investment-related expenses are not included.)

This study measures the relationship between charitable administrative expenses and qualifying distributions for foundations with or without certain operating characteristics to show how different ways that foundations conduct their work raise or lower expenses. It examines the median ratio (middle value) of expenses to qualifying distributions for each characteristic, using a three-year average (2004–2006).

Changes in the economy, particularly the stock market, affect assets and giving levels of independent foundations and thus the relationship of their charitable administrative expenses to qualifying distributions.

Independent foundations are very sensitive to market trends since their mandated payout levels are based on their net assets. Robust stock market growth in 2005 and 2006 helped to boost depleted foundation endowments and contributed to very solid growth of giving (Figure 6). Charitable administrative expenses grew more slowly in this period, perhaps reflecting an adjustment to steep drops in foundation portfolios in 2001–2002. When giving increases faster than expenses, the program-related expense

portion of qualifying distributions decreases. Between 2004 and 2006, the median expense ratio for staffed foundations decreased slightly.

Components of Charitable Administrative Expenses

Compensation was by far the biggest component of expenses.

Compensation accounted for half of all charitable administrative expense dollars of the largest independent foundations between 2004 and 2006 (Figure 7). In addition to employee salaries and remuneration of officers and board members, “charitable” compensation includes pension plans and other benefits.

The other main expense categories were “other expenses” and “other professional fees.”

Between 2004 and 2006, 18 percent of large independent foundations’ expenditures went to “other expenses” while 14 percent went to “other professional fees.” In general, “other professional fees” refers to consulting services associated with grants administration, accounting, evaluation, etc., while “other expenses” is a residual category for expenses that do not fit into one of the major line items on Form 990-PF. However, foundations do not use these categories consistently.

⁴Elizabeth T. Boris, Loren Renz, et al., *What Drives Foundation Expenses and Compensation? Results of a Three-Year Study* (Washington, D.C.: The Urban Institute, the Foundation Center, and Philanthropic Research, Inc., 2006). This study examined 2001–2003 spending and compensation patterns for the largest 10,000 independent, corporate, and community foundations, ranked by amount of grants paid in 2001. The study was the final report of the Foundation Expenses and Compensation Project, a collaboration of the Foundation Center, the Urban Institute’s Center on Nonprofits and Philanthropy, and GuideStar.

FIGURE 6. Change in Aggregate Finances for the Largest Independent Foundations, 2004, 2005, and 2006

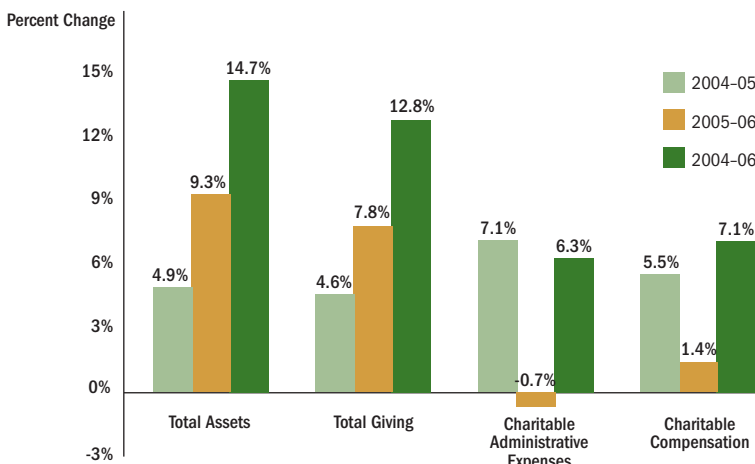
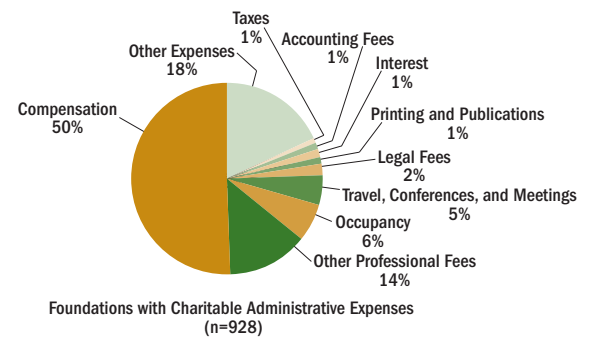


FIGURE 7. Components of Charitable Administrative Expenses for the Largest Independent Foundations, 2004–2006



SOURCE: The Foundation Center, 2011. Includes 928 foundations out of 1,026 of the largest independent foundations sampled that reported charitable administrative expenses. These are costs related to the foundation’s charitable mission and exclude investment-related expenses. The data are based on a three-year average for 2004 through 2006. Ninety-eight foundations did not have any charitable administrative expenses.

SOURCE: The Foundation Center, 2011; The Foundation Finances Database (2004–2006). Sample includes 1,026 of the approximately top 1,500 foundations by giving in 2004, 2005, and 2006 for which data were available for all years; qualifying foundations gave at least \$2.2 million each year. The data are not adjusted for inflation.

⁴Charitable administrative expenses and compensation are costs related to the foundation’s charitable mission and exclude investment-related expenses.

Source for all data: The Foundation Center

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Highlights of *Benchmarking Foundation Administrative Expenses: How Operating Characteristics Affect Spending* is available at foundationcenter.org.



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