What Drives Foundation Expenses & Compensation?

Results of a Three-Year Study—Highlights

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This brief presents key findings from the latest report of the Foundation Expenses and Compensation Project—the first large-scale, long-term, systematic study of independent, corporate, and community foundations' expense and compensation patterns and the factors behind them. Documenting the varying characteristics of the 10,000 largest U.S. grantmaking foundations, the study finds these differences—including foundation type, size, and operating activities—essential for understanding foundation finances. Not surprisingly, hiring staff and taking on staff-intensive activities raise charitable administrative expenditures relative to charitable distributions, while relying on unpaid board and family members and engaging in less-staff-intensive activities lower them. Most foundation operations, however, are somewhere between these poles.

The study focuses on 2001, 2002, and 2003, the latest years for which data were available when the research was initiated. Despite the economic downturn and the volatility of the stock market during these years, the patterns of foundation expenses and compensation are clear and consistent over time. A longer time frame would have been preferable, of course, but this three-year study is the most robust analysis to date of nonprofit finances, and it confirms and extends the findings based on 2001 data, as reported in *Foundation Expenses and Compensation: How Operating Characteristics Influence Spending (2006).*

The study's goals are to inform public policy debates and foundation practices by documenting administrative expenses reported by foundations for their grants and other charitable activities, examining compensation levels of their executive staff and board members, and assessing the factors that drive both types of expenditures. The focus is specifically on *charitable administrative expenses*, those expenses that relate exclusively to programs and count as qualifying distributions toward the 5 percent payout requirement for private foundations. Expenditures for investment-related activities are not part of this study, except insofar as compensation levels of individual staff and trustees are based on total compensation, and are not broken down by functions.

For years, discussions of appropriate levels of foundation expenses and compensation have been hampered by insufficient empirical data. This study is large and rigorous enough to answer basic questions about existing practices. The hope is that this report will inform government oversight, sector self-regulation, and individual foundation administration. In particular, foundation managers and board members can use the data to compare their expense levels over several years with those of similar foundations.

The Foundation Expenses and Compensation Project is a collaboration of the Urban Institute's Center on Nonprofits and Philanthropy, the Foundation Center, and GuideStar. All three partners provided financial and programmatic data from IRS Forms 990 and 990-PF, and the Foundation Center collected additional survey data. To examine executive and board member compensation, the study used individual-level compensation data reported on the IRS forms for officers, trustees, and key paid staff. The Center on Nonprofits and Philanthropy and the Foundation Center analyzed the data and prepared this report. The full report is available on the collaborators' web sites (see page 6).

The grantmaking foundations profiled and analyzed here are tax exempt—in recognition of their purposes. The Internal Revenue Service requires them to complete annually one of two public information documents: Form 990 for community foundations and Form 990-PF for independent and corporate foundations. These public reports supply much of the data in this study.

The study focuses on the 10,000 largest foundations—roughly 16 percent of all independent, corporate, and community foundations in the United States that reported activity in 2001. Together, they were responsible for 78 percent of all foundation giving in that year and 77 percent of all foundation assets. Independent foundations including family foundations represent nearly 90 percent of these foundations and 80 percent of their giving. Corporate foundations make up 8 percent of the study sample and 13 percent of giving, followed by community foundations at 3 percent of foundations and 9 percent of giving.

About 70 percent of the foundations studied do not employ staff. Instead, donors and their families or other individuals or institutions are entrusted with their operations. About 38 percent report compensating staff or board members, and 76 percent of foundations report incurring program-related (charitable) expenses. In other words, about a quarter of the largest foundations report no expenses as part of their required distributions.

Overall Key Findings

The study examines what factors contribute to foundation expenditure and compensation patterns and whether these patterns change over time or across different types and sizes of foundations. Although the answers to these questions are complex, five key points stand out:

1. **Foundations exhibit enormous diversity in their structures, resources, and operating characteristics, which significantly affect their expense levels.** Besides important legal distinctions between foundations and other types of charitable organizations, sharp contrasts also exist among types of grantmaking foundations.[1] Independent, corporate, and community foundations have different auspices, governance structures, and operational characteristics. Even among foundations of the same type, differences in assets, giving levels, work styles, geographic reach, and program type vary dramatically and produce very different expense and compensation patterns.
2. **The size of the foundation, number of staff, and staff-intensive activities all tend to increase cost ratios.** Surprisingly, even among the largest 10,000 foundations, just 29 percent employ staff. The minority with staff incur significantly higher charitable administrative expense–to–qualifying distribution ratios than the majority without staff. Besides compensation and benefits, more staff means more infrastructure, which raises costs. And engaging in complex activities, such as direct charitable activities (programs conducted mainly by staff), international grantmaking, and program-related investments, also tends to increase cost ratios.
3. **Most foundations do not compensate board members, although compensation is influenced by the type and size of the foundation and the complexity of its programs.** Being staffed and independent are the two characteristics most closely associated with foundations that compensate board members. And, not surprisingly, larger foundations tend to compensate individual board members at higher levels than smaller- or medium-sized foundations.
4. **There is relatively little year-to-year change in the factors that drive expense ratios or in how foundations allocate their charitable administrative expenses during the study period.** The three-year average smoothes some annual fluctuations, but the underlying patterns remain consistent. The characteristics that influence expenses in 2001 continue to do so in 2002 and 2003. In terms of expense allocations, independent and corporate foundations report modest changes between 2001 and 2003. For community foundations, the percentage of administrative expenses spent on compensation increased.
5. **The status of the economy, particularly the stock market, affects assets and giving levels and thus the relationship of foundations' charitable administrative expenses to qualifying distributions.** Independent foundations are particularly sensitive to economic trends because their mandated charitable distribution levels (payout) are based on their net assets. The burst of the dot.com bubble and sharp declines in the stock market after the September 11, 2001, terrorist attacks reduced foundations' assets and grantmaking activities and led to several years of uncertainty. Foundations were slower to adjust their program-related expenses. Institutional infrastructure—especially staff size and multiyear program commitments—cannot easily be changed as assets fluctuate from year to year.

Other Findings

Foundation scale influences cost ratios. Foundations with more resources tend to employ more people, engage in complex activities, pay their chief executives more, and compensate board members. At the same time, the largest foundations also enjoy some economies of scale, so they can achieve lower cost ratios for certain activities.

It is difficult to accurately measure corporate foundation expenses because the parent corporation often absorbs some of the costs. As a result, most corporate foundations have lower charitable expense–to–qualifying distribution levels than independent and community foundations of the same size. This makes comparisons between corporate foundations and independent or community foundations difficult.

Compensation of employees and board members is related to operating characteristics and program activities. Almost half the foundations studied compensate staff or board members for work in charitable and investment activities. An important contribution of this study is to separate compensated board members who engage

in the day-to-day work of the foundation from board members (paid and unpaid) who are mainly involved in governance.

Components of Foundation Expenses

For all foundations, compensation and the residual "other expenses" category are the two types of charitable administrative expenses most commonly reported. "Other professional fees," such as consulting services and information technology, modestly increase the total, especially for independent and corporate foundations. "Other expenses" is a residual category for expenses, such as evaluation, new technology, and so on, that do not fit into one of the major line items on the Forms 990 and 990-PF. The extensive use of this line item category suggests the need to revisit and revise the structure of the annual IRS reporting forms.

The distribution of these major expense categories varies by foundation type. For independent foundations, compensation is the biggest component of administrative expenses (47 percent). For corporate and community foundations, "other" expenses is the dominant category.

The size of a foundation's assets and the foundation type have a small but often unclear effect on how a foundation allocates its charitable administrative expenses. For example, small independent foundations tend to allocate a lesser share of their administrative costs on compensation and more on "other expenses" than foundations of other sizes. Large independents spend a higher percentage on consultants ("other professional fees") than do independents of smaller sizes. Small corporate foundations report a higher share of their charitable administrative expenditures on "other professional fees" and less on compensation than corporate foundations of other sizes. Small community foundations spend relatively less on compensation than their larger counterparts, while larger community foundations report smaller shares of "other expenses" than do smaller community foundations.

Operating Characteristics and Expense Patterns by Foundation Type

Independent Foundations

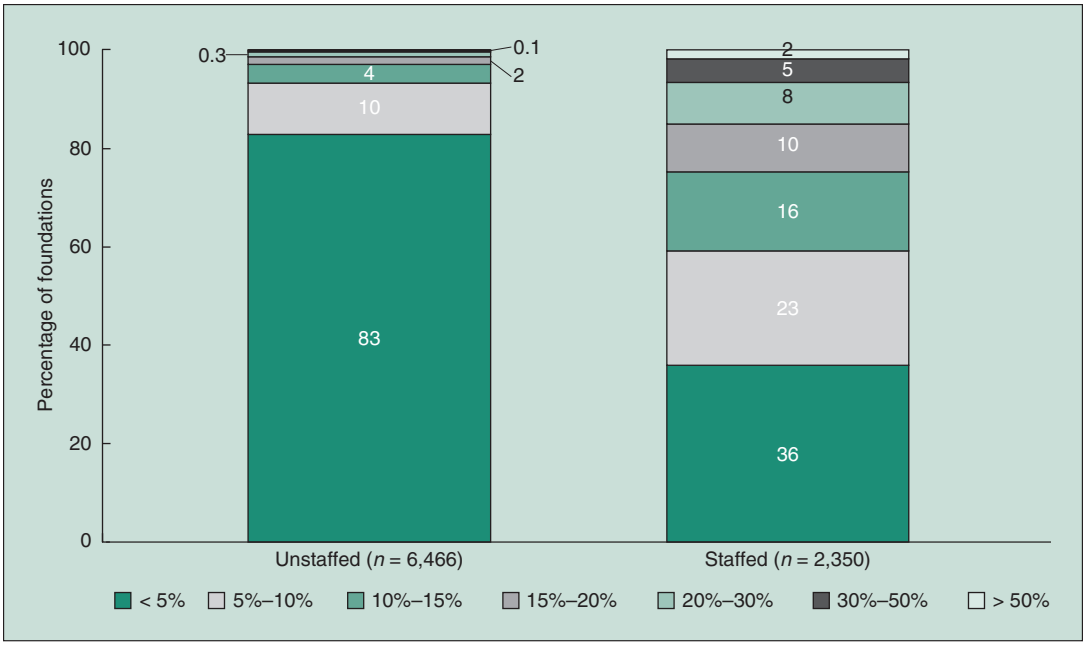
Employment of staff is the single most important factor affecting expense levels, followed by staff size. Paying staff significantly raises administrative costs, and expense levels rise consistently with the number of staff. Staff size, which varies greatly even among foundations with similar giving levels, depends on a foundation's mission, roles, and scope of activities.

Staffed independent foundations tend to have higher charitable administrative expense–to–qualifying distribution ratios than unstaffed foundations. While 36 percent of staffed independents had a ratio below 5 percent, 83 percent of unstaffed foundations were in this range. On the other hand, relatively few independent foundations had ratios greater than 30 percent—7 percent of staffed foundations and less than 1 percent of unstaffed (figure 1).

International giving, direct charitable activities, and programs that make grants to individuals are strongly associated with higher expense ratios. Besides these staff- and resource-intensive activities, other complex activities that can substantially boost a foundation's charitable administrative expense levels are making program-related loans and investments (which require special financial expertise) and maintaining a web site.

Donor-family involvement and operating as a nonendowed, or "pass-through," foundation usually lower charitable administrative expenditure ratios in staffed independent foundations. Most likely, family members help hold staff-related costs down by providing free program administration and other help. Pass-through foundations, which have no permanent corpus and are mostly small compared with endowed foundations, may have lower expenses because they employ fewer staff and lack long-term administrative infrastructure.

FIGURE 1. Distribution of Charitable Administrative Expenses as a Share of Qualifying Distributions, 2001–03: Staffed and Unstaffed (Independent Foundations)



Source: NCCS-Foundation Center-GuideStar, Foundation Expenses Data Set, 2001–03.

For staffed foundations, foundation size is an important factor in determining expense patterns. Larger givers report lower charitable administrative expense–to–qualifying distribution levels for each staff size group, suggesting greater efficiency with size. Larger givers that give internationally, conduct direct charitable activities, maintain endowments, or maintain web sites also have notably lower expense ratios than smaller foundations with the same activities.

The factors that drive expense ratios change little from year to year. All the characteristics that influenced expenses in 2001 were the same in 2002 and 2003. Still, median expense ratios increased slightly from 2001 to 2003, most notably for staffed foundations that give internationally and those with direct charitable activities.

Corporate Foundations

Compared with other foundation types, corporate foundations have lower expense-to–qualifying distribution ratios and fewer operating characteristics that relate clearly to expenses. Charitable administrative expenses as a percentage of qualifying distributions from 2001 to 2003 are less than 2 percent for 63 percent of staffed foundations and less than 10 percent for 82 percent of corporate foundations. Only a handful of corporate foundations spend more than 30 percent on charitable administrative expenses. The median expense ratio for staffed corporate foundations during this period is less than 1 percent, compared with almost 8 percent for independent foundations and 6 percent for community foundations. Determining actual expenses and staff costs for corporate foundations is difficult since companies often absorb foundation expenses.

Exceptions aside, staff size, geographic scope of grantmaking, and presence or absence of direct charitable activities all influence expense levels. Median charitable expense levels increase along with staff size for large and small corporate foundations. Corporate foundations that give nationally or internationally tend to have higher expense ratios than strictly local givers. Engaging in direct charitable activities raises charitable administrative expense levels of corporate foundations more than any other characteristic, and median expense ratios of corporate foundations with such activities are far higher than for independent and community foundations. In fact, direct charitable activities make up a bigger share of the charitable disbursements of some large corporate foundations than does grantmaking itself.

The influence of characteristics that increase corporate foundation expense ratios changed little over three years.

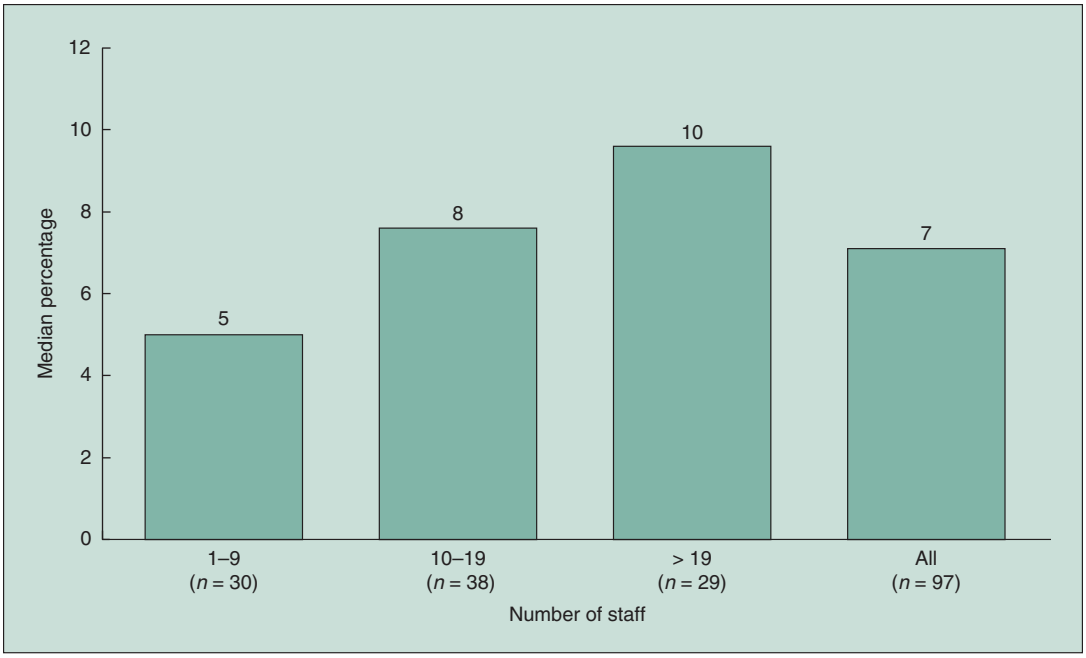
Community Foundations

Expense levels are fairly consistent across community foundations, nearly all of which are staffed; in addition, large givers typically benefit less from economies of scale. Charitable administrative expenses as a proportion of qualifying distributions (total program services expenses including giving) range from under 5 percent for 45 percent of community foundations (compared with 36 percent of staffed independent foundations) to over 30 percent for 9 percent of the foundations; the median is 6 percent. Larger foundations reported slightly higher median expense ratios than smaller foundations (7 percent compared with 5 percent).

Larger staff size affects community foundations' expense levels more than any other factor, followed by direct charitable activities. Charitable administrative expense levels increase sharply with staff size for both large and small community foundations (figure 2). Community foundations operating their own charitable programs report higher median expense ratios, though their expense levels are much lower than those of independent and corporate foundations. Also, the difference between community foundations with and without direct charitable activities is less pronounced than for the two other types of foundations.

The youngest community foundations have the highest expense levels relative to

FIGURE 2. Charitable Administrative Expenses as a Share of Qualifying Distributions, 2001–03: Staff Size (Community Foundations Giving $3M or More)



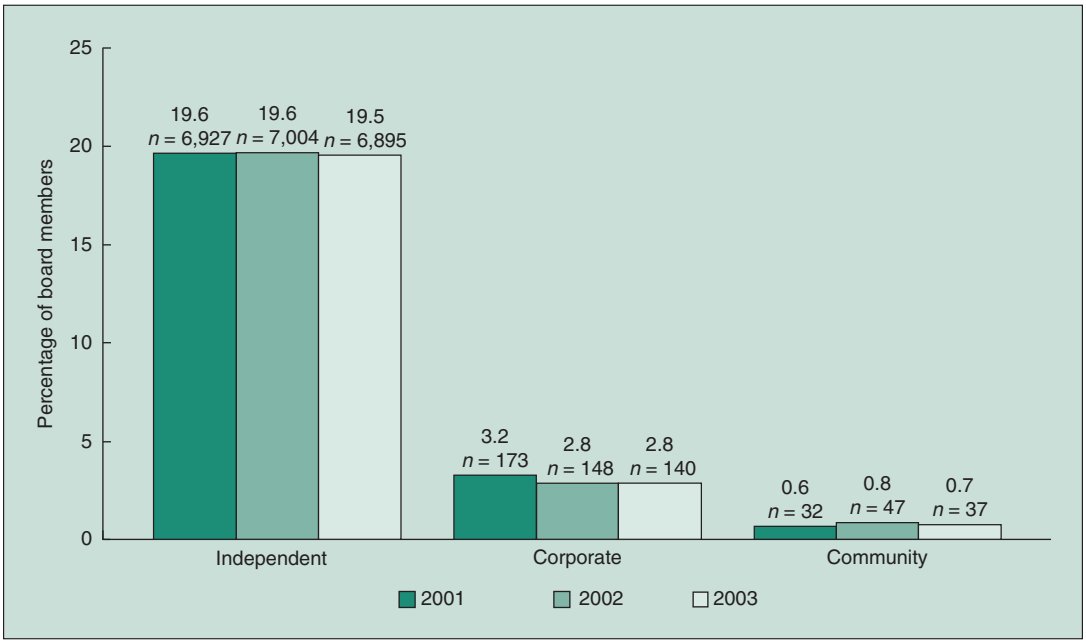
Source: NCCS-Foundation Center-GuideStar, Foundation Expenses Data Set, 2001–03.

qualifying distributions. Possibly, high start-up costs and a focus in their early years on fundraising and endowment building explain why. As grantmaking programs ramp up, administrative expense ratios decrease.

Community foundations with web sites have greater expense-to–qualifying distribution ratios than those without. While web sites alone probably do not drive up expense levels significantly, the foundations that invest in them may be spending more on communications in general.

Characteristics associated with higher expense ratios for community foundations held steady throughout the study period. Median expense levels for each characteristic fluctuate only slightly from 2001 to 2003.

FIGURE 3. Percentage of Individual Board Members Who Receive Compensation, by Foundation Type, 2001, 2002, and 2003



Source: NCCS-Foundation Center-GuideStar, Foundation Compensation Data Sets, 2001–03.

Compensation

Most foundations do not compensate any staff or board members. Even among the 10,000 largest U.S. foundations, more than half (52 percent) report no compensation, benefits, or payroll tax expenses over the three-year study period.

Of the 10,000 foundations studied, 2,938 have paid staff. Top executive staff members earn median compensation of over $100,000. Executive staff members earn more in larger foundations, with the largest independent foundations typically compensating top executive staff members over $500,000 in 2003.

Most board members do not receive compensation. Of the 10,000 foundations, 2,571 compensated individual nonstaff board members (figure 3). Corporate and community foundations rarely compensate board members, but nearly one in five board members in independent foundations receives compensation—a median of roughly $8,000—in each of the three study years.

About one in eight foundations studied name a bank or other institution to represent the foundation. In many small foundations (annual giving less than $500,000), these institutional trustees are often the foundation's sole representative, and they earn a median compensation of nearly $30,000. But the largest foundations, in which institutional trustees are comparatively rare, pay institutional trustees the most. The approximately 60 foundations with at least $50 million in annual giving pay their institutional trustees a median compensation of roughly $250,000.

Implications of the Study

This study's most salient finding is that identifiable factors consistently affect foundation expenses and compensation and change little over time. In addition, influences on foundation finances vary by foundation type—independent, corporate, and community. Further, this study documents the tremendous effect that employing staff has on the charitable expense portion of qualifying distributions. Key related factors are program priorities and strategies. Scale also matters: larger foundations generally have higher absolute expense levels, but complex grantmaking or operating programs can cost smaller foundations more than larger ones in terms of higher expense ratios.

Note

1. Because the study focuses on grantmaking foundations, operating foundations are not included. While they may engage in some grantmaking, operating foundations use the bulk of their resources to provide charitable services or programs rather than to distribute grants.

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