

Strengthening Community Foundations:
Redefining the Opportunities

Prepared by

The Foundation Strategy Group

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I. Executive Summary

The Foundation Strategy Group conducted three studies during 2003 to better understand the factors that affect the long-term sustainability of community foundations:

- Detailed cost and revenue analyses of nine foundations,
- A survey and conjoint analysis of donors and financial advisors in six regions to weigh their preferences regarding price and selected features of donor advised funds (DAFs)
- A scan of trends in the national market for philanthropic advising.

Our research revealed the following findings and conclusions:

A. Findings

- 1. The allocation of a community foundation's internal resources is often misaligned with both economic and mission-driven priorities.** Community foundations rightly put their mission first and do not expect to break even on all funds that they administer. However, an examination of costs often determined that the foundation's resources were being spent in ways that neither contributed to sustainability nor served the foundation's highest mission-driven priorities.
- 2. Most foundations in our sample heavily cross-subsidize certain products.** Although the same fee structure is often used for different types and sizes of funds, the costs of administering them can vary dramatically as a percent of assets, from a sample average of 1.7% for scholarship funds and 1.3% for DAFs to 0.57% for unrestricted funds and 0.18% for designated funds. Although foundation leaders had been aware of differences in cost, none had realized the full extent of the subsidy certain products required, and once they have accurate data, many foundations in our sample have taken action to adjust their pricing, internal processes, or marketing emphasis.
- 3. Costs vary tremendously within the sample set.** Costs to conduct similar activities and administer similar types of funds varied tremendously among different foundations in our sample, often by a factor of more than ten to one.
- 4. None of the core community foundation products are inherently unsustainable.** For each type of fund there is at least one foundation in our sample that is able to cover its costs by the revenues generated by that product.
- 5. The products with the most rapid growth are often the most costly.** In some cases, the most costly products are the area of greatest asset growth, suggesting that the foundation may become less sustainable over time. Even in cases where the foundation is covering its costs, the positive contribution from more rapid growth products is often narrower than the historical contribution from unrestricted and designated funds.

6. **Some product costs exceed any reasonable projection of near-term revenues.** In some cases, the costs of providing service for a particular type of fund are so high that no realistic change in market values, fees or minimum balances would enable the foundation to cover its costs from the revenues generated by that type of fund.
7. **Donors are highly price sensitive.** DAF donors weigh the importance of price twice as heavily as any other factor in prioritizing which DAF offering from a community foundation is most attractive. In order of descending importance, other factors considered important are advice and research, donor events, investment flexibility, and grant processing speed.
8. **DAF donors who have more personal contact with the foundation are more likely to leave bequests.** A majority of DAF donors plan to leave a bequest to the foundation, whether to their DAF or another type of fund, and the likelihood increases with the frequency of personal interactions between the foundation and the donor. However, nearly 40% of donors report no personal interactions with the foundation over the course of a year.
9. **A small but highly important segment of donors consider philanthropic advice worth paying for.** Most donors will not pay for philanthropic advice, but a significant share of younger donors or those with funds over \$250,000 are willing to do so.
10. **Community foundations have an inconsistent competitive positioning in the evolving DAF marketplace.** Within the competitive market for DAFs, community foundations tend to have a different positioning than either mass-market commercial funds or high-end philanthropic advisors. Unlike these competitors, many community foundations have chosen to pair high-cost product offerings with low-cost pricing.
11. **The national market for philanthropic advisors shows weak demand and little growth, but there are alternative opportunities for community foundations to generate revenue.** Most firms that offer philanthropic advice derive their primary revenue from other sources, and there is no evidence of a growing donor demand to pay for such advice. There is, however, a growing and profitable market in the administrative support of small family foundations, which may offer an opportunity for community foundations. Additionally, community foundations can learn from the example of private banking by offering tiered levels of services at different levels of pricing or for accounts of different asset sizes.

B. Conclusions

1. **There is tremendous potential for foundations to learn from each other about ways to reduce costs and increase revenue for all products.** The variation in cost for similar activities is not due to differences in average compensation levels of foundation staff, but is instead due to differences in the way similar activities are handled, as well as the degree of standardization and automation of services. There is a significant opportunity for the field to improve its overall performance by studying comparable cost data and adopting the best practices of the lower cost foundations.
2. **A similar set of factors influence the long-term sustainability of community foundations, and these factors can be controlled by the foundation's staff and board.** The wide variations in economic performance that we discovered are largely attributable to six key factors, all of which can be controlled by foundation management. Foundations therefore are well-positioned to improve their sustainability. These key drivers of sustainability are the following:
 - Concentrating assets in fewer products
 - Limiting customization and enhanced services
 - Achieving efficiencies in high volume transaction processing
 - Shifting toward larger average fund sizes
 - Offering minimal pricing discounts
 - Capturing alternative sources of revenue beyond a 1% asset-based fee
3. **The price sensitivity of most DAF donors constrains community foundations from offering a higher level of service at higher prices.** Although community foundations may be able to tailor higher service offerings for particular segments of younger or wealthier donors, our market research revealed that they are unlikely to be able to compete more broadly with commercial gift funds by charging higher fees in return for a higher levels of service and advice. This suggests that community foundations must bring their cost of service for DAFs down to break-even levels if they are to continue growing through the acquisition of DAFs without undermining their long-term sustainability.
4. **Community foundations must examine their strategy and operations on a product-by-product basis, taking into account their mission-driven priorities, internal costs, customer preferences and the competing donor alternatives for each type of product or service they offer.** Given this knowledge, foundation leaders can determine how best to improve their sustainability through changes in costs, pricing, and marketing emphasis. The right choices will be different for each product at each foundation, and there is no single formula that provides the optimum results for all. The information and approach needed for making the right choices is, however, largely the same.

**Assets at Community Foundations Grew Rapidly from 1988 to 1999
In 2001, They Declined for the First Time in Recent Memory**

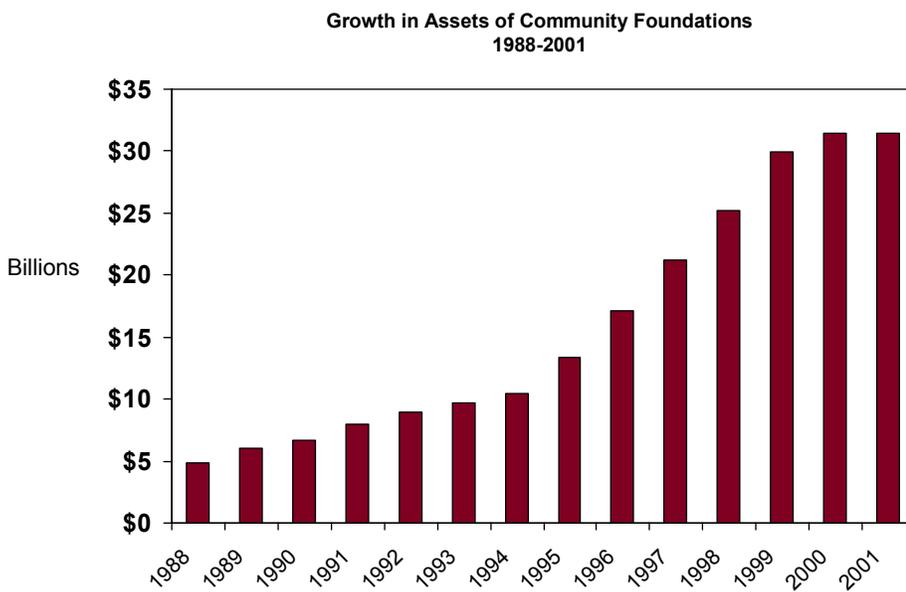


Figure 1

II. Introduction

Community foundations have enjoyed a renaissance over the past 20 years in the United States and, increasingly, around the world. By every measure – new foundations, new donors, contributions, assets, grants, and community engagement – the field has expanded dramatically since the 1980’s. Much of this growth is due to changes in the strategy and operations of community foundations – such as the shift by some to a more donor-focused model. Growth has also been fueled by funding from private foundations, such as the Lilly Endowment that helped establish nearly a hundred new community foundations, and by the booming stock market of the late 1990’s – the “dot.com bubble” – that created so many new millionaires and inflated investment portfolios.

With the sudden and unexpected end of the stock market boom, however, the climate for community foundations has shifted dramatically. Contributions have leveled off and assets have dropped for the first time in recent memory. (*See figure 1*) Many community foundations have seen their assets shrink by as much as one-third, with a resulting reduction in operating budgets and the need to lay off staff or reduce services. Intense competition from commercial gift funds and donor advised funds at other nonprofits continues to increase and is felt more acutely in times of scarcity. Strategies and operating practices that seemed highly effective during the heyday of rapid growth no longer seem viable today. The result has been a degree of confusion and consternation, as each community foundation struggles to balance its budget through short-term compromises and stop-gap measures.

The dilemmas that community foundations face, however, are not short-term in nature. The environment in which they operate has changed profoundly over the past decade on many dimensions, including competition, donor behavior, operating costs, asset mix, pricing models, and community expectations. Many of these changes are unlikely to be reversed soon. The rapid expansion of the 1990’s concealed many of these problems, just as the painful contraction of the last three years has exaggerated them. Some changes have positive implications for the future of the community foundation field, and others are more challenging, but all of them require a shift in the way community foundations approach their strategy and operations.

The solution for each foundation may be different, but the variables are the same. This study is our attempt to identify the key factors that community foundation leaders must understand – and the choices they must make – to position their foundations for long-term sustainability and success. Our analysis calls into question many of the assumptions prevalent today, and it requires a new way of thinking about the foundation’s products and activities. In particular, our research suggests that community foundations must begin to develop more sophisticated strategies, based on deliberate and carefully researched choices, in a way they have never done before. The new market realities make it extremely difficult for any foundation to sustain itself indefinitely while continuing to “do everything for everyone” at competitive prices.

Instead, foundations must understand the costs of each of the many services they provide, the features and services donors want and will pay for, the positioning of the many competitors they face, and the ways in which they can allocate their own resources to create the greatest value for their communities.

Accurate cost and market data are essential to making the right choices, but do not alone provide the answers. Community foundations are dedicated first and foremost to their missions. The ‘right’ choice for any community foundation depends not merely on its costs or competitors, but on whether that choice best serves its donors, its grantees, and its communities. We do not suggest that every product or service of a community foundation should pay its own way or that foundations should put donor preferences above community needs. We suggest only that foundations must understand the economic and competitive consequences of their choices in order to create strategies that will succeed.

This report focuses exclusively on the economic and donor considerations in operating a community foundation, although we fully recognize that equally important questions arise about the ways community foundations can create strategies to achieve the greatest social impact through their grantmaking and community leadership. Any analysis of those activities, however, falls outside the scope of this report.

One of the most important results of this study is a recognition of how much community foundations can learn from each other, once they have accurate and comparable data. For any problem our study turned up, at least one foundation has already found a solution. We believe that the field can make dramatic improvements in performance merely by working more closely together and sharing information more fully.

Some may find grounds for pessimism in this study. Certainly, the data suggests some reasons for concern about the long-term sustainability of foundations that ignore today’s realities. But we see far greater cause for optimism. The unique role of community foundations has not been – and will not be – supplanted by any of its competitors. Each foundation can find within its own strengths a wide range of opportunities for growth, financial sustainability, and social impact. The evidence suggests only that no foundation can continue business as usual. Instead, each foundation must redefine its opportunities in light of external and internal realities, and make a set of disciplined strategic choices about its priorities. Given the right information and the right set of choices, however, our research concludes that community foundations can continue to thrive, now and in the future.

III. Study Background and Methodology

The idea for this study grew out of FSG's intensive consulting work with community foundations over the last three years, in particular, The Chicago Community Trust, The Community Foundation for Greater New Haven, and The Pittsburgh Foundation.

As we worked closely with staff, we realized that the role of community foundations has shifted dramatically over the past decade, but the way they generate income has not. Historically, the early community foundations were established by bank trust departments and, naturally, adopted their fee structure: an annual fee based on a percentage of assets. The problem is that community foundations today are expected to perform a range of philanthropic services in their communities that bank trust departments never contemplated.

For example, community foundations have increasingly taken on the role of providing advice and continuing education to estate and tax professionals, helping local nonprofits raise funds or develop their own endowments, convening funders to organize solutions to community problems, and advising and educating donors to be more knowledgeable about their giving, and a long list of other efforts that provide value to their communities. In most cases, community foundations merely absorbed the cost of these additional services within their operating budgets, relying on self-administered grants or counting on the growth of their investment portfolios to cover these additional costs.

At the same time, much of the growth in community foundation assets has shifted from unrestricted funds into donor directed accounts, such as donor advised funds (DAFs), scholarship funds, or supporting organizations, all of which require more extensive administrative support. In addition, commercial gift funds, such as the Fidelity Charitable Gift Fund, have emerged as a major market force, competing with community foundations on both price and service. Foundations have responded by trying to outshine the commercial funds through the personal service they provide and the good works they perform. As a result, it costs the foundations more to handle DAFs, yet they remain constrained by the same pricing as the commercial funds. Obviously, this is a difficult competitive model to sustain for the long-term.

Simultaneously, a national set of professional philanthropic advisors has emerged, charging clients a fee for counsel similar to that provided by community foundations for free. This market appears to be fragmented and ill-defined, however, and it is unclear whether this trend poses a competitive obstacle or a new revenue opportunity for community foundations.

FSG brought these thoughts to the Council on Foundations Community Foundation Leadership Team, which agreed that a study was in order to answer three questions:

1. What are the costs of the different kinds of funds and activities that community foundations handle?

FSG's Community Foundation Sample Included a Wide Range of Asset Values and Mixes

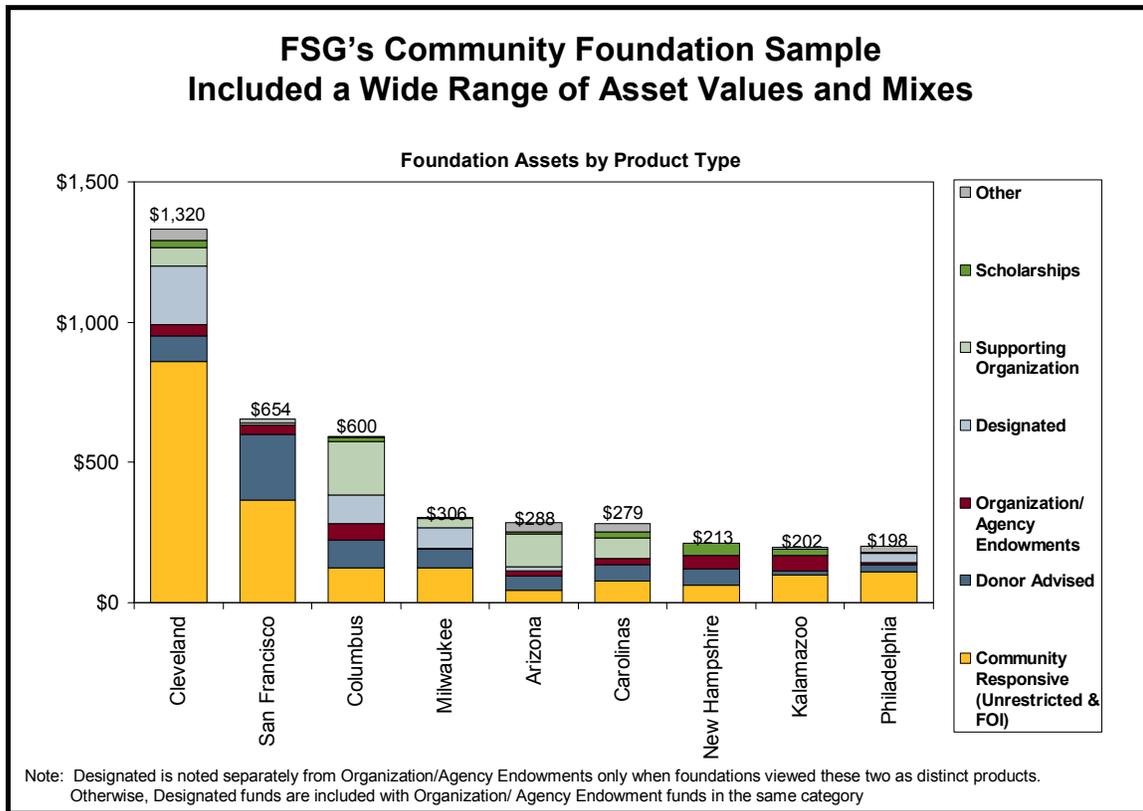


Figure 2

2. What features or services do community foundation donors value, and how much are they willing to pay for them?
3. What national trends exist among professional philanthropic advisors, and what opportunities do these trends present to community foundations?

Each question required a different methodology to answer, so FSG undertook three separate studies.

1. Cost & Revenue Study. Answering the first question required an in-depth analysis of the costs and revenues associated with every activity, service and product that a community foundation handles. Nine community foundations agreed to fund and participate in this cost accounting analysis:

- Arizona Community Foundation
- The Cleveland Foundation
- The Columbus Foundation
- Foundation for the Carolinas
- Greater Milwaukee Foundation
- Kalamazoo Community Foundation
- New Hampshire Charitable Foundation
- The Philadelphia Foundation
- The San Francisco Foundation

FSG used an activity based costing model which provides a high degree of specificity in cost allocations.¹ Every staff member was asked to fill out a time sheet allocating his or her time to each activity and each product or service. Other costs were attributed directly to products or services where they could be matched (*e.g.*, postage for DAF statements could be allocated directly to DAF products) or were allocated based on the underlying drivers of each activity, such as the distribution of staff time (*e.g.*, if 30% of total staff time was devoted to supporting organizations, then 30% of rent and other non-allocable charges were attributed to supporting organizations). Preliminary results were reviewed carefully with foundation staff to ensure accuracy, and allocation rules were adjusted as necessary.² Finally, FSG analyzed public information to determine the comparable costs of commercial and alternative gift funds.

It is important to note that the participating foundations were selected on the basis of their willingness to fund and participate in the study, not as a result of any disciplined sampling technique. The set of participants covered a wide range — asset sizes varied from \$200 million to \$1.3 billion, and each foundation had a very different asset mix among different types of funds. (*See figure 2*) However, we cannot say that the range of

¹ Note that the Boston Consulting Group conducted cost studies for several community foundations, including Atlanta, Boston and Chicago, using a less detailed methodology. As a result, the allocation rules developed by FSG differ from those used by BCG, and the data from these two different methodologies is not comparable.

² A more detailed description of the methodology, along with a template and instructions for foundations that may wish to undertake a cost analysis on their own, will be available from FSG's website at www.foundationstrategy.com.

costs in our sample is a reliable description of the field as a whole. Most notably, the sample did not include any smaller foundations or those whose assets are primarily composed of DAFs.

2. Donor Conjoint Analysis. To answer the question about what donors want, we focused specifically on DAFs and conducted quantitative market research on donor and financial advisor preferences, utilizing a conjoint analysis methodology.

Conjoint analysis is regularly used to assess the tradeoffs that purchasers make between price and product or service features. Rather than directly asking respondents what they will pay, or how they rate the importance of one feature against another, conjoint analysis forces purchasers to make tradeoffs among a set of price and product features by conducting choice simulations, which can then be statistically analyzed to identify the importance of pricing and of each component feature separately. Donors and advisors in each participating community foundation region were asked to rank the desirability of 15 different donor advised fund product offerings from community foundations, with varied pricing and levels of service (*e.g.*, philanthropic advice, donor events, investment flexibility and grant processing speed). Six community foundations participated in this study:

- Arizona Community Foundation
- The Columbus Foundation
- The Community Foundation of Louisville
- Foundation for the Carolinas
- Kalamazoo Community Foundation
- The Philadelphia Foundation

Altogether, we analyzed the responses of 445 donors and 184 financial advisors, representing a statistically reliable sample, allowing us to compare responses with a 95% statistical confidence level. In addition, we distributed a survey with specific questions about pricing alternatives and donor characteristics, which enabled us to draw conclusions about different segments of the donor population.

3. Scan of Philanthropic Advisors. The third and final component of our study was to obtain a qualitative description of trends in the market for philanthropic advisors. FSG conducted approximately 35 telephone interviews with philanthropic advisors across the country, supplemented by a literature review, in-depth conversations with a few leading providers, and an analysis of the economic models of several advisors.

This report represents a synthesis of our findings from all three perspectives: costs, customers, and competitors. Together with the foundation's values and mission, these are among the key variables necessary to understand the economic challenges and opportunities that lie ahead for the field.

IV. Thinking about Products and Activities

Succeeding in the complex philanthropic marketplace today requires that community foundation leaders begin to think about strategy in a new and fundamentally different way. They must begin to make deliberate choices about how to allocate their resources, deliver their services, and price their offerings in a way that makes competitive sense, economic sense, and best serves their mission. The key difference, however, between what worked in the past and what is necessary to capture the opportunities of the future is to begin thinking about discrete “products” and to develop a strategy with separate plans of action for each one.

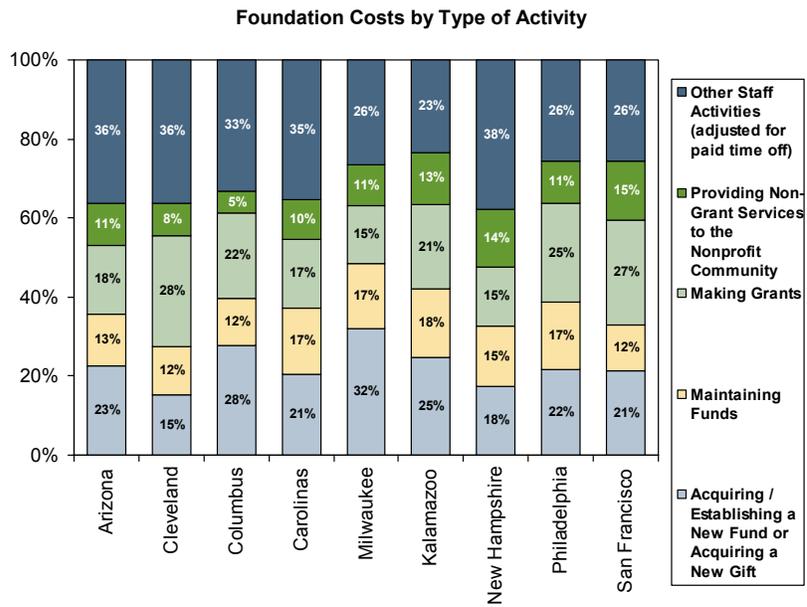
Many community foundations today view themselves holistically — a single indivisible entity that provides a complicated array of services to the community at large. In this model, the foundation might be thought of as a “black box,” with contributions coming in and grants or community building activities going out. Viewed this way, every foundation is unique, because no two foundations have the same combinations of inputs and outputs — it is impossible to compare them.

The “black box” model is simple to understand, but extremely difficult to manage. There is no way to identify or re-allocate either costs or revenues within the box. Every fund and activity seems just as important as any other, all donors are treated equally, and the same fee is charged on all products. The mix of different activities and products within the box is often as much a result of history as of any deliberate set of strategic choices. One year, there may be an overall operating surplus, or another year a deficit, but it is impossible to re-allocate resources without a clearer understanding of what happens inside.

In fact, foundation leaders already know that different fund types have very different costs to administer and different degrees of importance to the foundation’s mission. Inevitably, some funds subsidize others. Different segments of donors desire different kinds of services and bring different propensities to pay for them. Some products “compete” with inexpensive alternatives offered by other organizations, such as DAFs offered by commercial gift funds, while other products, such as scholarship funds, may not have any competing alternatives. In order to make effective and sustainable choices in today’s complex environment, community foundations must look inside the box and begin to make decisions about each component separately.

Looking inside, one finds a complicated collection of activities that begin to seem more similar across different foundations. Every community foundation, for example, acquires new funds, maintains them, makes grants, and provides other services to the community. Within these general categories, specific activities are even more alike. Acquiring a fund involves donor meetings, drafting and executing agreements, processing the contribution, entering an account in the computer system, etc.

Each Foundation Has a Slightly Different Mix of Costs Across Activities



Note: *Other Staff Activities* includes IT, Human Resources, management and supervision, staff meetings, professional development, governance, planning, reception, office management, reporting, etc. Where applicable, *Paid Time Off* is subtracted from "Other Staff Activities" and allocated across the full range of each Foundation's activities

Figure 3

In fact, we determined that all of the community foundations in our sample perform 87 different activities, and although they may do them in different ways and call them by different names, each activity is fundamentally the same across all foundations, and each one is vital to the operation of a community foundation. The mix of activities varies between foundations, (*See figure 3*), but all of the activities can be grouped together under five broader headings:

- Acquiring or establishing a new fund or gift
- Maintaining funds
- Making grants
- Providing non-grant services to the community
- Other staff activities, such as internal meetings

Examining individual activities enables best practices to be identified and shared. For example, our data shows that one foundation can process grant requests for its DAFs at a cost of \$16 per grant or 0.4% of the average grant size, while a different foundation spends \$260 per grant, or 3.0%. Clearly, there is a good chance that the higher cost foundation can learn to be more efficient by studying the specific activities of the lower cost foundation.

Understanding activities is even more useful, however, when they are grouped together around products. As we use the term, a product is merely a set of related activities that serve a particular goal. It can be a fee-based product that generates revenue, such as a scholarship fund, or it can be a different kind of product altogether, such as “promoting philanthropy in the community,” which may not have any revenue associated with it. While this may seem like an odd sort of product, it is a discrete set of activities on which the foundation has chosen to spend its staff time and other resources – in other words, it has a cost. In this sense, community leadership activities can be considered products too.

Every foundation has some products that are unique, and each has a slightly different terminology, but we found seven basic products common across almost all foundations in the sample:

- **Unrestricted/Community Responsive/Field of Interest Funds** – Funds in which the foundation has wide discretion over all investment and grantmaking decisions.
- **Donor advised Funds (DAFs)** -- Funds in which the donor retains the privilege of directing grantmaking and, sometimes, investment decisions as well.
- **Supporting Organizations** – Quasi-independent organizations, often private foundations, that are affiliated with and administered by the community foundation. The Trustees or governing body of the supporting organization generally makes all grantmaking and investment decisions.
- **Agency Endowment Funds** – Funds in which the community foundation holds and invests an endowment for a local nonprofit organization.
- **Designated Funds** -- Funds in which a donor specifies one or more organizations to receive the annual income from a fund at the foundation.

Five Common Myths

Our research calls into question some of the assumptions that have been taken for granted by many community foundations, for example:

Myth # 1: If the economy were better, we'd be fine. In many cases, a return to historic stock market highs would bring money-losing products to breakeven. However, every community foundation in our sample has at least one product – sometimes several – where the gap between the cost of service and the revenues is so great that even a 50% or 100% increase in investment values would not be enough to cover their costs through existing fee structures.

Myth # 2: Any new fund is a good fund. No product of any community foundation in our sample had a break-even fund size below \$80,000, yet 56% of the DAF funds in our sample had assets of less than \$50,000. In some cases, we found that every million dollars contributed to DAFs generated \$10,000 in new annual revenue, but as much as \$25,000 in annual costs to the foundation. In cases like this, where most of the foundation's growth is concentrated in products that require a subsidy, taking on new funds can be detrimental to the foundation's long-term sustainability.

Myth # 3: Community foundations are so different that they can never be compared to each other. The community foundations in our sample differ in many ways. Each has some unique activities and products. However, they also have a great deal in common. All of the foundations perform 87 basic activities and provide at least five common products or services. They may perform the activities in different ways and call them by different names, but each of these activities and products is essentially the same across all foundations.

Myth # 4: Community foundations can differentiate themselves from commercial gift funds primarily by offering philanthropic advice to donors. Our study found that, at present, most community foundations in our sample provided minimal – and most donors did not seek – program advice. On average, only 2% of the cost of donor advised funds is attributable to the time spent by program staff advising donors. Our analysis of donor preferences revealed that donors are price sensitive, and a full 77% are not willing to pay extra for philanthropic advice. Similarly, we found a weak national market for independent philanthropic advisors, with much of the apparent growth actually arising from back-office services for small foundations or investment management, rather than any strong demand for philanthropic advice by individual donors.

Myth # 5: All community foundations must adopt a strategy of prioritizing donor advised funds. Our analysis clearly showed that each foundation has a different set of strengths based on its asset mix, internal capabilities, and positioning in the community. Generally, costs are lowest for whichever type of product represents the largest share of a foundation's assets. There does not appear to be a single product emphasis that would best suit all foundations.

- **Scholarship Funds** – Funds established at the foundation to provide annual scholarships to students from the region.
- **Community Leadership Activities** – The non-grantmaking activities that the community foundation undertakes in its communities to address social problems, educate donors or encourage philanthropy.

Not every foundation has every product, and some combine two products together because they are handled the same way, but all foundations in our sample had at least five of these seven products.

By looking at products separately, one can ask many more useful questions, such as:

- How much does it cost us to offer this product?
- How much revenue does it bring in?
- What is the minimum account size to break even?
- Are there competitors who offer the same product? If so, what pricing and features must we offer to be competitive?
- If the product provides a positive contribution, are we using those funds to advance our highest priorities?
- If the product is losing money, is it important enough to our mission or marketing to continue subsidizing it?

Once the foundation has the information to analyze its products separately, it can determine if every product makes sense – both to donors and to the foundation. One can also begin to benchmark performance against other foundations or competitors to see if there are demonstrated ways to reduce cost or increase revenue. By thinking in “product” terms, community foundations can learn from each other far more effectively.

It would be simple to say that every product should make money or break even, but community foundations are mission-driven nonprofits and, unlike commercial gift funds, their goal is not to make money. Community foundations are committed to the long-term, however, and that means they must find a sustainable economic model that does not gradually drain away resources. It also means they must make strategic choices about which products and activities are worth of subsidizing and which are not, in order to optimize the benefits they provide to their communities.

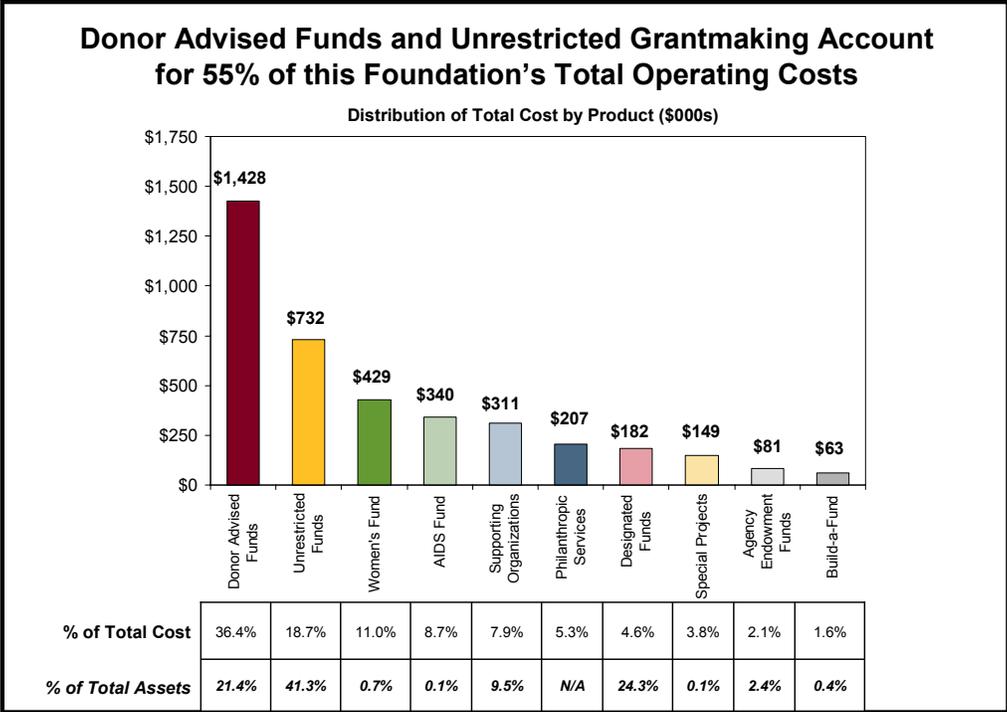


Figure 4

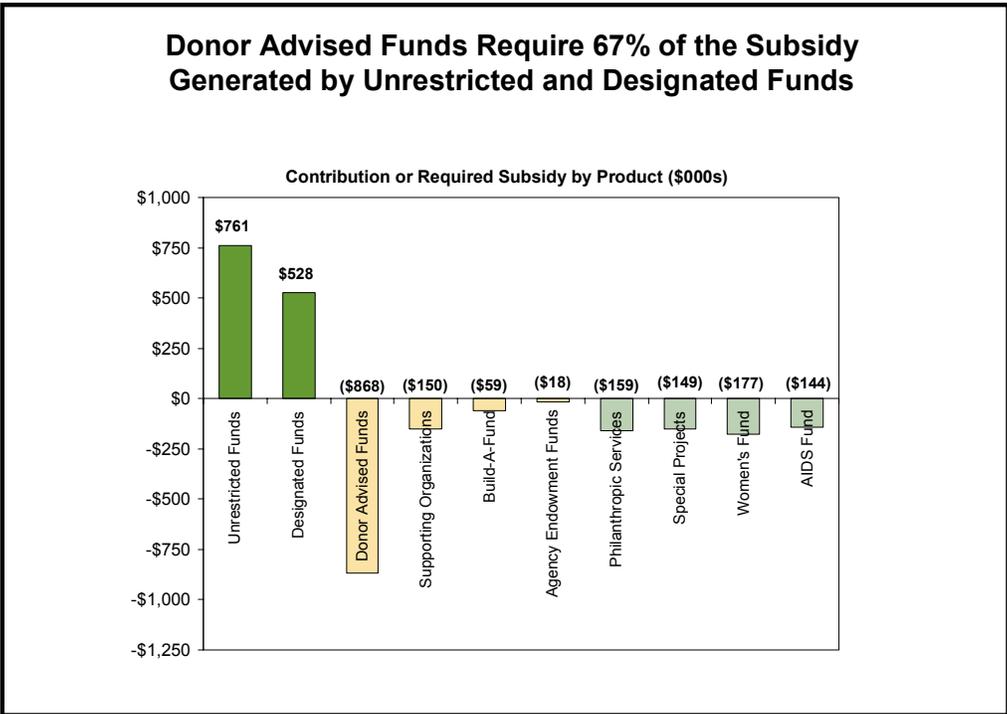


Figure 5

V. Understanding Costs

Costs vary widely among community foundations, even for the same products and activities. The differences are not due to disparities in the average wages per FTE at the different foundations, but correlate with a set of sustainability drivers identified later in this section. Every foundation in the sample had products that broke-even below the traditional 1% fee, but none had all products break even below that level.

Among the foundations in our sample, total operating costs ran between 0.6% and 1.6% of total assets. Among the 3 largest, the average was 0.8%, well below the 1.4% average among the three smallest, clearly reflecting the advantages of scale. Even higher cost foundations had better overall economic performance if they had a much larger asset base. Although we did not examine smaller community foundations, it seems likely that several hundred small community foundations across the United States face an even more difficult economic challenge to reach long-term sustainability without the considerable benefits of scale that our analysis so clearly revealed.

No foundation had all of its fee-based products generate positive contributions, and for seven of the nine foundations in our sample, standard fees at 1% of assets would not provide a sustainable level of income at current market values.

The cost analysis for each foundation is, of course, unique to its circumstances. Yet there were some commonalities that seemed to be typical. The costs and net contribution or subsidy by product for one foundation (*See figures 4 & 5*) fairly represents the tendency among most foundations to have from one to three products that generate a substantial contribution to their operations, and a larger number of products that require subsidy.

Often, in our discussions with management, there had long been awareness that some products were more labor-intensive than others, but the true extent of the subsidy for various products had not previously been known and was often very surprising. In several cases, this led management to consider whether the funds could be applied more effectively elsewhere by changing internal processes or de-emphasizing the future sale of certain product types.

To understand the cost and revenue data, it is useful to look at each individual product, as well as the key factors that influence sustainability and the steps that can be taken to improve performance, as discussed in the following three sections.

A. Product Cost Analysis

Looking at the costs associated with each product, it is striking to see how wide the variances can be – often separated by a factor of more than 10 to 1 – for foundations conducting fundamentally similar activities. In some cases there may be sound strategic reasons why costs are high – investing to promote a new product, for example, or including extra value added services. In many cases, however, our analysis suggests that

All Foundations in the Sample Had One or Several Products with Costs Greater than the Typical 1.0% Fee

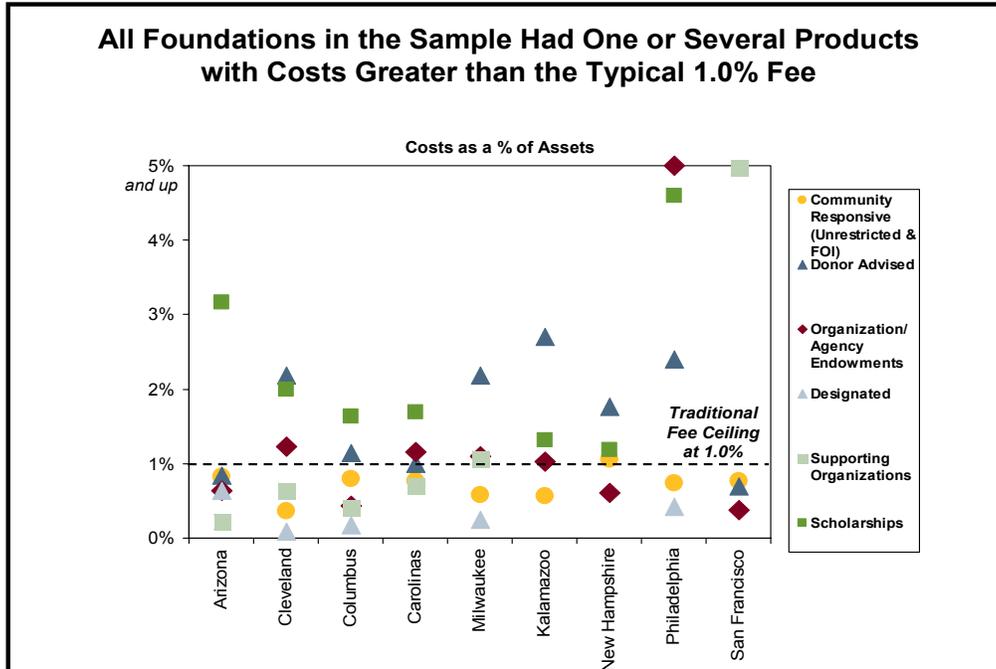


Figure 6

Average Annual Cost per Thousand Dollars of Assets By Type of Product

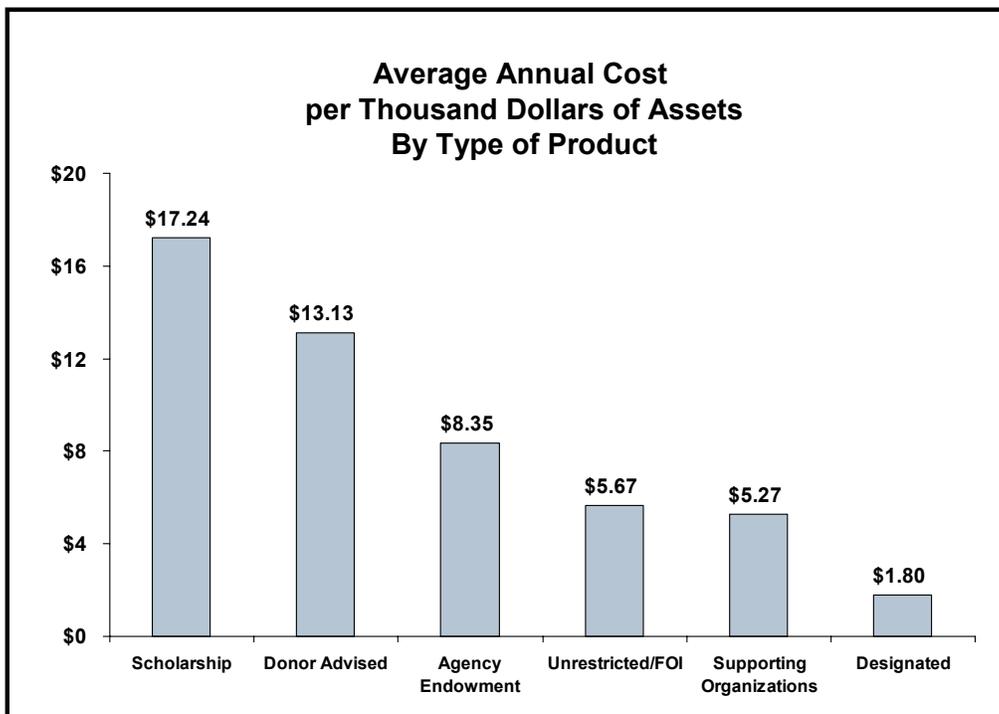


Figure 7

one foundation has found a way to handle a product with dramatically greater efficiency than the others – often this is because the foundation had an unusually large concentration of assets in that type of product, and so devoted the attention necessary to develop streamlined processes. We see this variation as evidence of tremendous potential for community foundations to identify cost-effective practices and learn from each other to improve their collective economic prospects.

Although no foundation in our sample was able to cover the costs of all fee-based products within a standard 1% fee (see figure 6), there was at least one foundation in the sample that managed to cover its costs for each type of fee-based product – whether through lower costs, higher fees, or scale of assets – suggesting that all of the community foundations’ basic products have the potential to be economically viable. At the same time, at least one foundation managed to lose money on each type of product, except for designated funds.

Despite the variation in costs among the foundations, certain trends were clear. Different types of fee-based products, for example, have very different average costs across the sample. (See figure 7) Equally important, in looking at individual foundations, there is tremendous variation in the fund size needed to break-even. One foundation can cover its DAF costs with an average fund size of \$80,000, while another would require an average DAF fund size of \$1,344,000 to cover its costs at a 1% fee. (See figure 8)

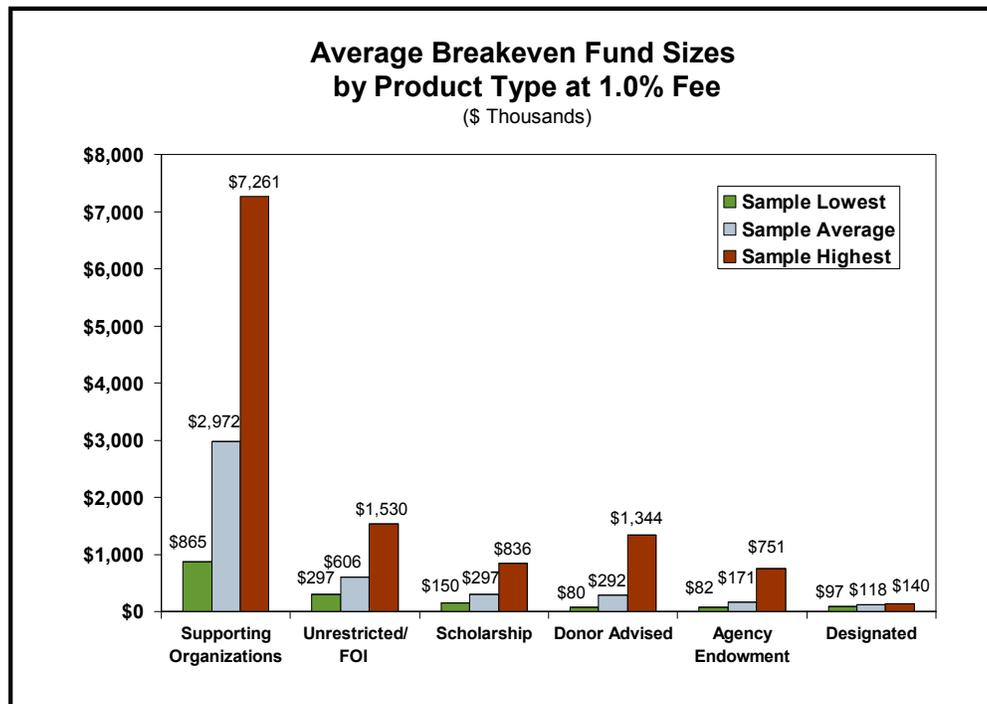


Figure 8

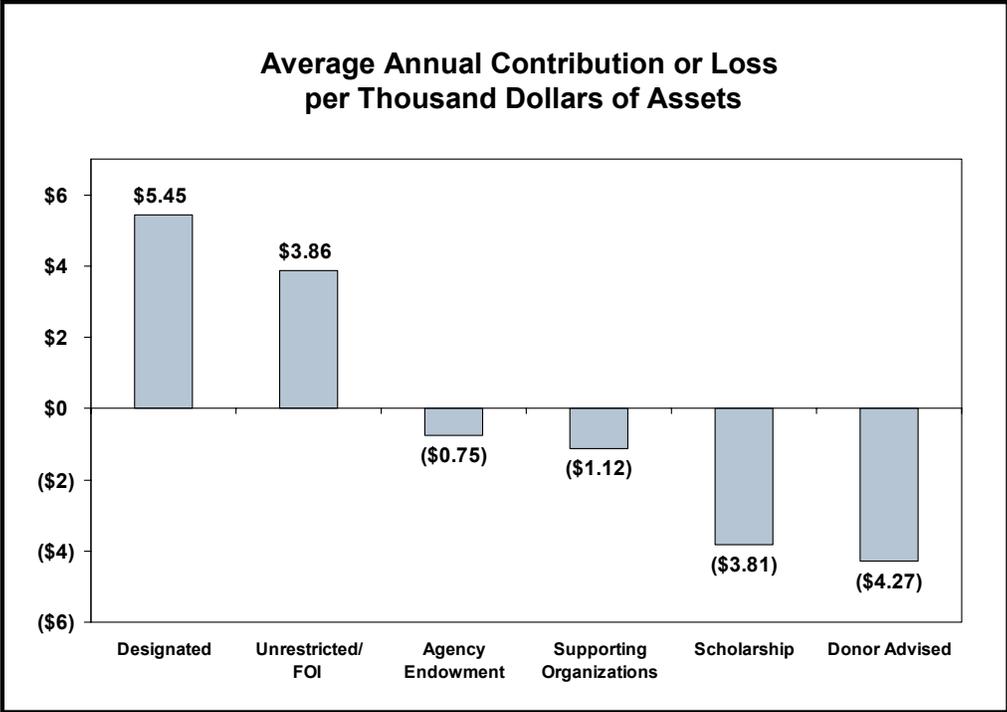


Figure 9

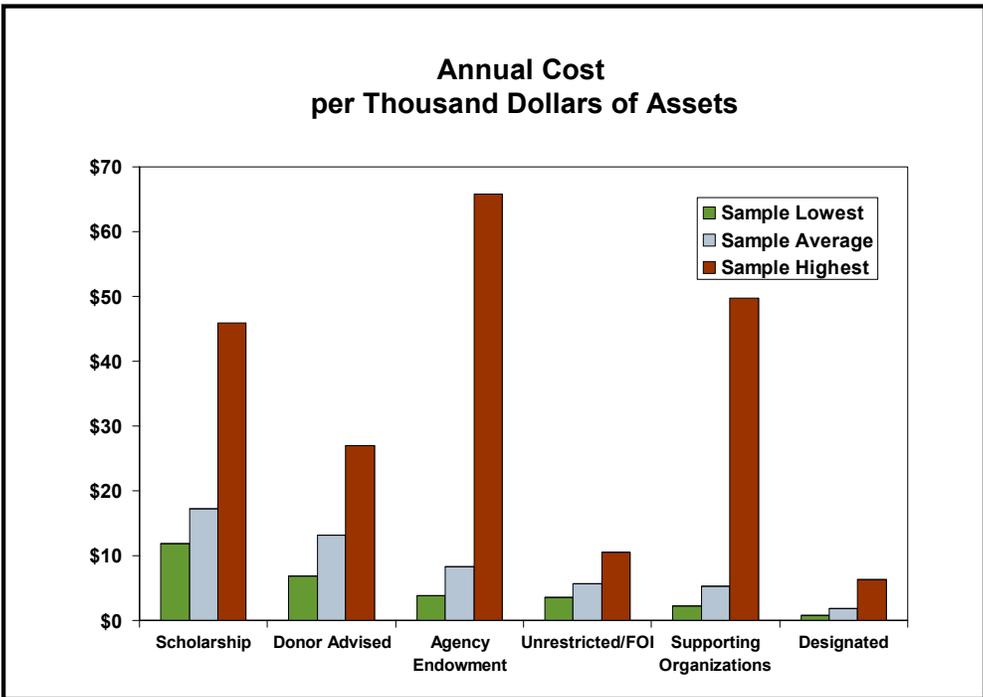


Figure 10

The result of these different fund costs and average account sizes is a dramatically different picture of the contribution or subsidy by product. (See figures 9 & 10) In addition, several broad conclusions can be drawn:

- **Scholarships tend to be the most costly category.** Even here, however, there was an exception: The New Hampshire Charitable Foundation, which has the highest concentration of scholarship funds in our sample, was able to manage them at a cost of \$1,500 per fund, half the average sample cost of \$3,000, and less than 20% of the highest cost foundation.
- **DAFs rarely made a significant positive contribution, and often require substantial subsidies.** In general, DAFs were the next most costly to administer after scholarships. In the most extreme case, DAFs represented less than 7% of assets and 23% of total operating costs.
 - Within our sample, the Foundation for the Carolinas provides services at the lowest cost per fund, with an emphasis on web-based processes. It manages to have a cost per fund of \$800, one-quarter the \$3,200 average cost for the other 8 foundations.
 - Excluding the costs of acquiring new funds or gifts, the amount necessary to maintain a DAF annually averaged 1.2% of assets for the six foundations that did not cover costs, and 0.5% for the three that did.
 - Most community foundations in the sample had substantially higher DAF costs than commercial gift funds. (See figure 11) Only two foundations in our sample managed to hold costs down to similar levels, largely through standardization of accounts and automation of processes.³

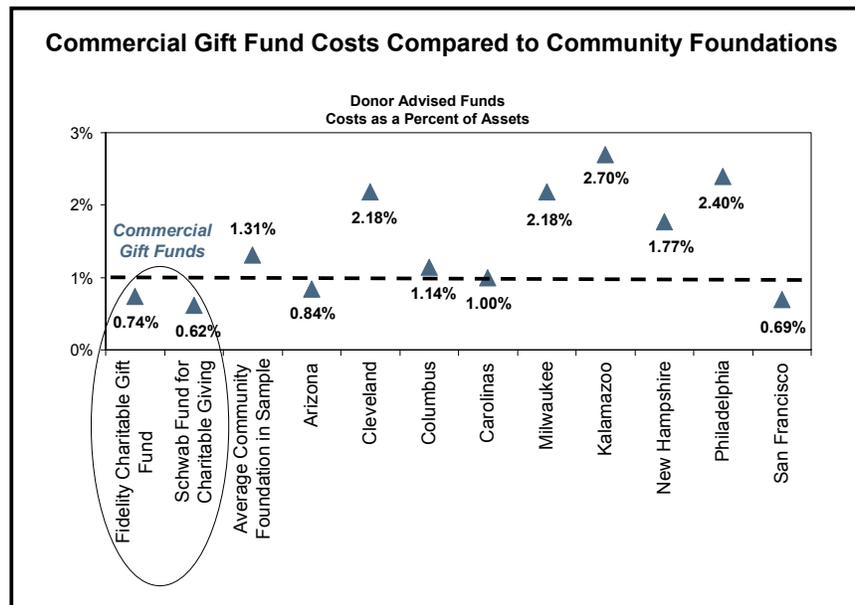


Figure 11

³ The asset value for commercial gift funds is reported on a June 2002 fiscal year-end, while the community foundation data is from December 2002. Given a decline in the stock market values of approximately 15% during this 6 month interval, commercial funds costs may be slightly higher as a percent of assets.

The Economics of Supporting Organizations Are Highly Variable – For Some, an Area of Strength

Sample Foundation Losing Money on Supporting Organizations
\$7.2M in Assets per Fund
Effective Fees @ 0.42% of Assets

Sample Foundation Generating a Contribution from Supporting Organizations
\$3.9M in Assets Per Fund
Effective Fees @ 0.48% of Assets

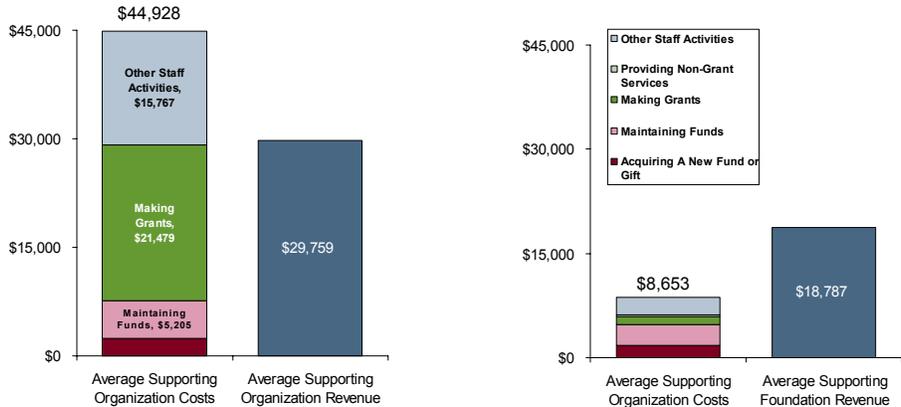


Figure 12

For All Foundations, Large Funds Subsidize Smaller Funds

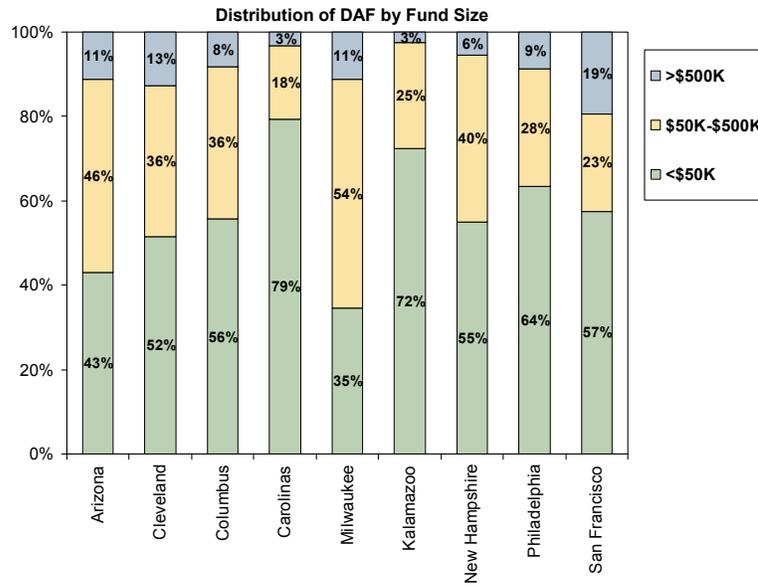


Figure 13

- **Supporting Organizations and Agency Endowments have highly variable performance.**
 - Few foundations generate a positive contribution from Agency Endowments, despite the fact that costs are relatively low, because they generally charge lower fees, averaging 0.8%.
 - Supporting organizations can be strong contributors, although these fees are even more heavily discounted, averaging 0.4%.
 - Differences in performance on Supporting Organizations are not exclusively due to differences in scale, but also to variations in services provided, fees charged, and the underlying cost structure of each foundation. The foundation that generates a substantial contribution averages a cost per fund of \$8,653 and an average fund size of \$3.9 million, while the foundations that require subsidies average a cost per fund of \$40,677 and fund size of \$6.5 million. *(See figure 12)*

- **Unrestricted Funds and Designated Funds tend to make a positive contribution.**
 - In sharp contrast to scholarships and DAFs, unrestricted funds generally made a positive contribution to the overall operation of the foundations in our sample, ranging from a contribution of \$100,000 at smaller foundations to as much as \$2.2 million at the larger foundations, with an average contribution of \$1.0 million.
 - Because unrestricted funds generate so much more contribution than DAFs, even the foundations that cover the direct cost of administering their DAFs may find their margins narrowing because the growth in DAFs may not create the same degree of subsidy for community leadership or donor development activities as they are used to enjoying from the growth of unrestricted funds.
 - Designated funds are the simplest product to administer, making regular payments of income to the same organizations every year, and as a result they tended to make the greatest financial contribution in proportion to their share of the assets. The positive contributions in our sample ranged from \$100,000 to \$1.2 million, with an average contribution of \$350,000.

- **A few large funds subsidize many small ones.**
 - Across all fee-based products, the foundations that broke even tended to do so because they had very large funds that subsidized the many smaller ones. The percent of DAFs greater than \$500,000 in assets varies from a low of 3% to a high of 19% within our sample. *(See figure 13)* Foundations with a higher percent of large DAF funds tended to have better economic performance.

**Community Foundations in the Sample
Spend from 5% to 15% of their Total Operating Budget
in Providing Non-Grant Services to the Community**

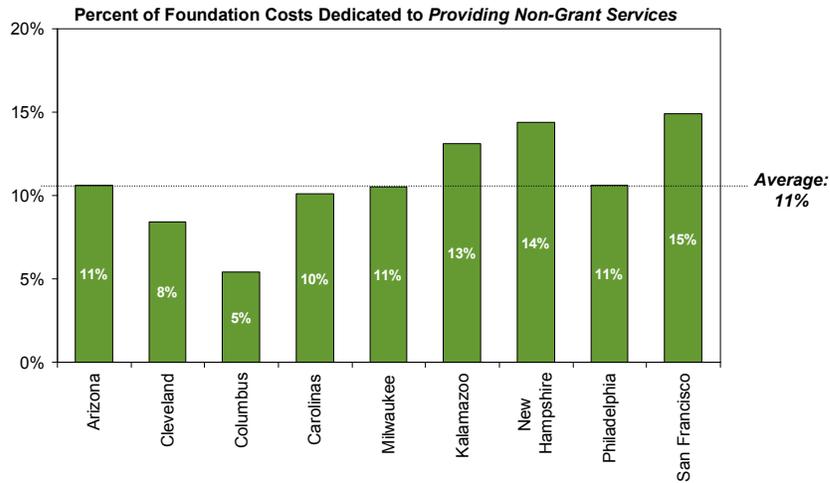


Figure 14

**Products with a Larger Concentration of a Foundation's Assets
Generally Require Lower Fees to Breakeven**

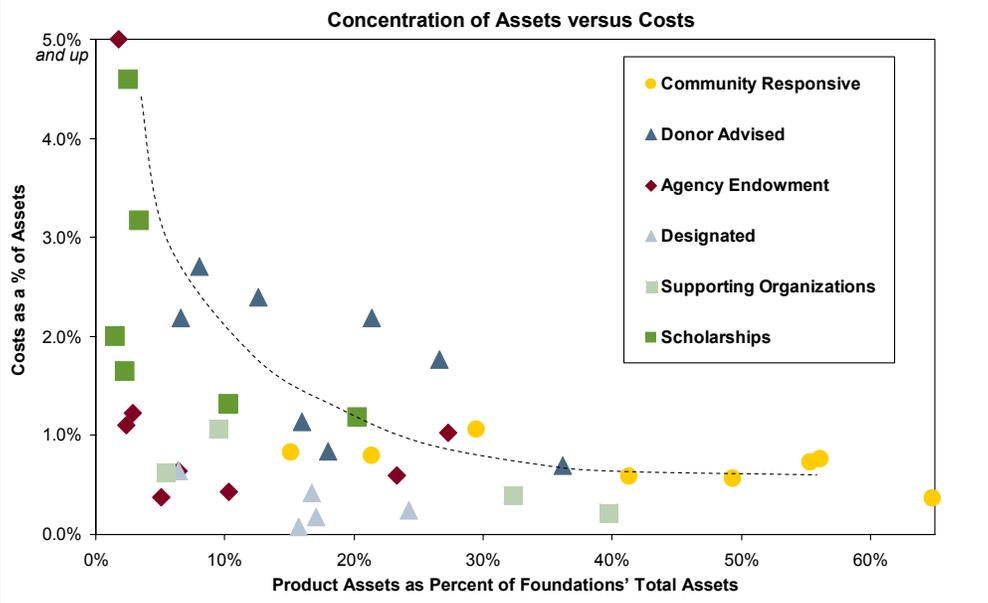


Figure 15

- **Foundations devote a significant share of their budget to non-grantmaking services in their communities.** Expenditures for community leadership products ranged widely, ranging from 5% to 15% of total costs, with an average of 11%. *(See figure 14)*
 - In dollar terms, spending on community leadership products ranged from \$280,000 to \$965,000, averaging \$434,000.
 - Often the smaller foundations spent more on community leadership, both as a percentage of total budget and in absolute dollars.
 - Only one foundation in the sample, which raised a significant part of its budget from annual board and community contributions, had any external sources of revenue to offset the cost of community leadership activities. In all other cases, these activities depended on subsidy from the products that made a positive contribution, or on self-administered grants approved by the foundation's board.
- **Affiliate structures can be extremely expensive.** Some foundations rely on affiliate or regional structures to cover a broader geographical area or to address regional differences among donors and grantees. Our limited sample suggests that these affiliate or state-wide structures can create a considerable burden.
 - The Arizona Community Foundation affiliates constitute only 3.2% of assets but 19.5% of total costs, costing the foundation \$465,000 per year above the income they generate.
 - The New Hampshire Charitable Foundation has a regional Board structure, and its governance costs are twice the average of other foundations in the sample.

B. Key Drivers of Sustainability

Several factors appear to be the primary influences on a foundation's ability to cover its costs and avoid significant subsidy of its various products. All of these factors are within the control of the staff and board, and can be used for guidance in improving the long-term financial performance of the foundation. In fact, our analysis disclosed six key drivers of foundation sustainability:

1. **Number of products and asset concentration.** Foundations with fewer products tend to operate more efficiently. In general, foundations had lower costs in whichever type of fund had the greatest concentration of assets. The New Hampshire Charitable Foundation, for example, has an unusually high concentration of scholarship funds, and its scholarship costs were substantially lower than any of the other foundations. Scale helps – having more assets spreads costs more thinly – but even more than the total amount of dollars in a product, it is the percent of a foundation's assets in that product that seems to make the most difference. *(See figure 15)* In other words, foundations have developed more efficient processes for the products they handle most often.

**Community Foundations' DAF Pricing Varies Widely --
All but Two Are Lower than the Sample Set Breakeven Fee of 1.31%**

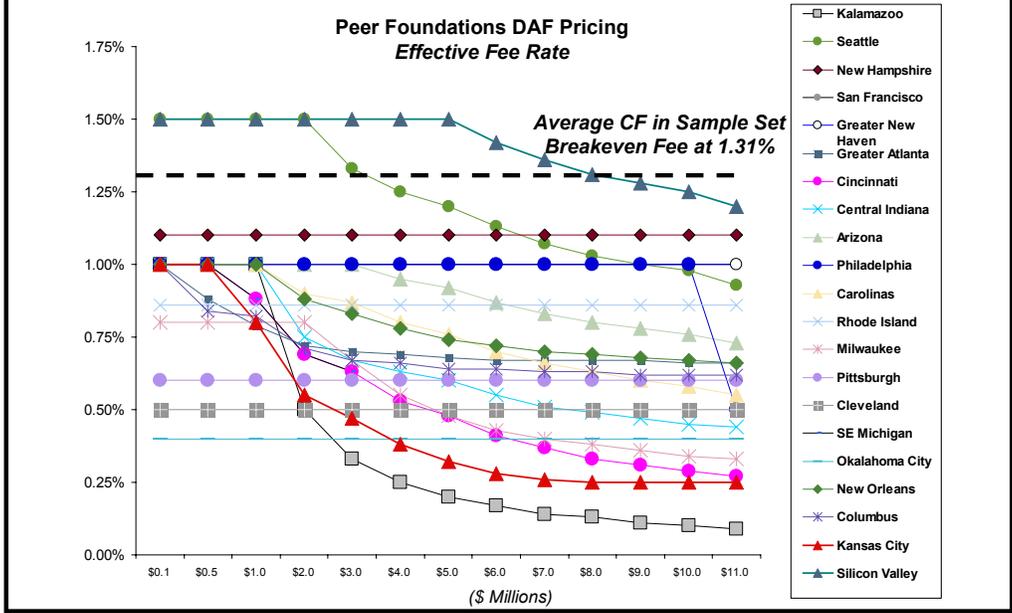


Figure 16

Pricing of Alternative Gift Funds

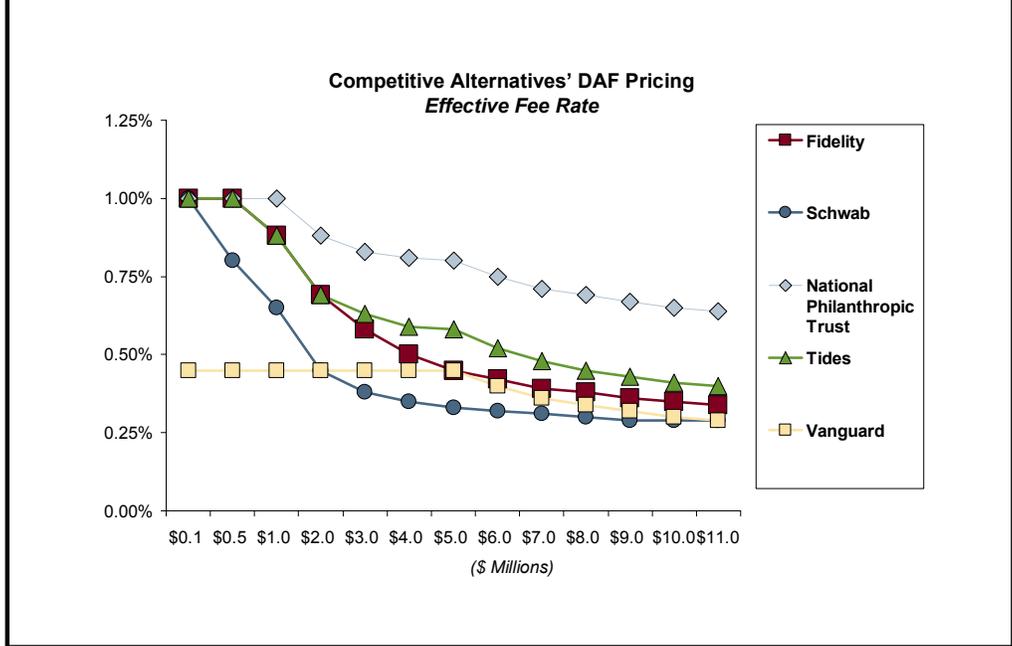


Figure 17

2. **Customized or enhanced services.** Foundations in our sample often created variations on their standard products to satisfy the requests of one or a few donors. One foundation, for example, discovered that they administer over 100 distinct types of funds, each with slightly different terms. Similarly, foundations regularly offer extra services to donors, such as grantmaking advice, processing scholarship applications, preparing grant dockets for committee-advised DAFs and supporting organizations, or offering a variety of investment options, generally without extra charges or restrictions on account size. These extra services and unique processes prove to be extremely costly, and the lower-cost foundations have made substantial efforts to standardize their fund terms and processes. The San Francisco Foundation, for example, has focused on standardizing its DAFs, and – combined with the advantages of scale – is able to handle them at the same cost as the commercial funds, earning a positive contribution. Alternatively, foundations might recover more of their costs if they were to charge for a standardized set of enhanced services – either *a la carte*, or by limiting them to accounts over a certain size or fee level.
3. **Volume of transactions.** The more transactions, the more costly to administer, unless the products are standardized and the use of technology has created streamlined and efficient processes. In some cases the foundations with a high volume of transactions were lower cost providers because of the efficiencies they had created, in other cases, more transactions drove higher costs.
4. **Average fund size.** In every case, a small number of large funds subsidize many small ones. No account of any product type at any foundation in our sample broke even below \$80,000, and the overall breakeven size across our entire sample was \$358,000. By contrast, more than 54% of all funds of any type – and 56% of DAFs – in our sample were below \$50,000 in assets.

Many foundations have committed to a minimum DAF fund size of \$10,000 in order to participate in national partnerships with brokerage firms, and a number take even smaller “build-a-fund” or “acorn” funds with a commitment to build up over time. In general, the 1% fee on these funds of \$100 per year does not begin to cover the average annual cost of \$3,000 per fund, or even the \$800 annual cost at the most efficient foundation in our sample. Our data suggests that community foundations should think carefully about the implications of taking funds of any type below \$100,000. Minimum fees or charges per grant transaction may be useful in discouraging donors from opening small accounts, but are unlikely to make up the shortfall in revenue. For example, a minimum DAF fee of \$250 and a charge of \$25 per grant would only bring in an average of \$375 per year, still far short of the foundations’ true costs.

5. **Pricing discounts.** In general, the foundations in our sample discount their fees for larger accounts, whether by individually negotiated agreements or by a published sliding scale. (*See figures 16 & 17*) Given that the few large accounts almost always subsidize the many small ones, this practice can seriously impact

Few Foundations Create Significant Revenue from Sources Other than Direct Fees

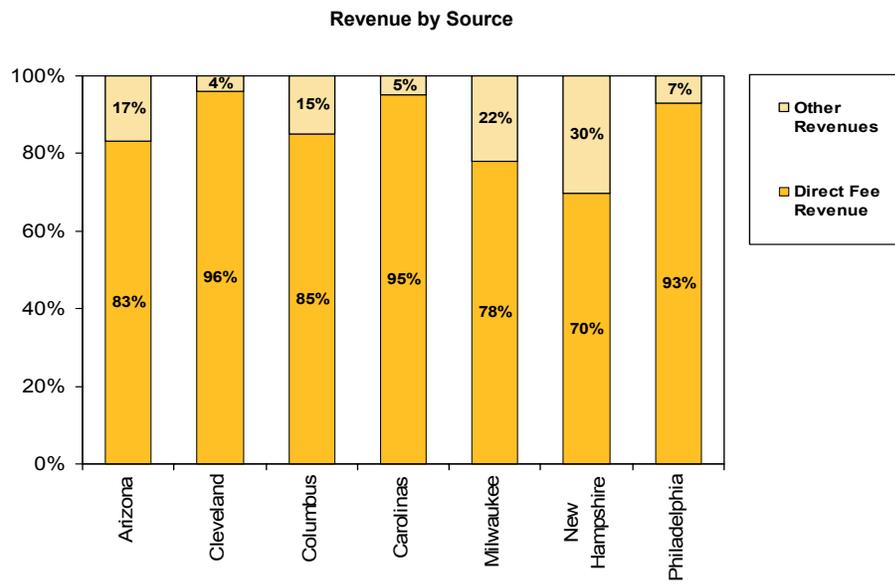


Figure 18

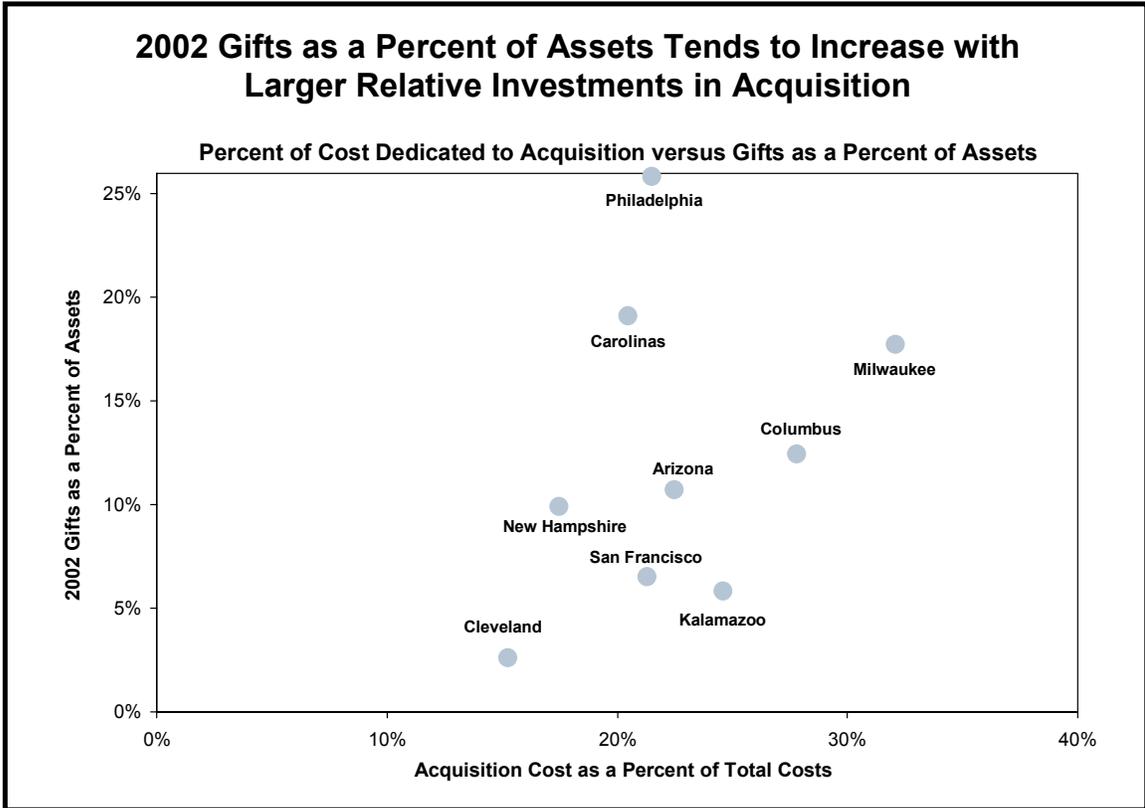
the foundation's long-term sustainability. Our sensitivity analysis suggests that where the break-point for fee discounts is set on large funds has a much greater impact on the foundation's total revenues than minimum fees or other kinds of pricing adjustments. Most of the community foundations we surveyed currently set their DAF fees above the commercial funds, with higher break-points and lesser discounts, and a few offer no breakpoints at all.

It seems likely that foundations with lower prices and break-points will have more success in acquiring DAF funds than foundations with higher fees, however so many other factors are involved, that this conclusion cannot yet be made on the basis of the available data. Commercial gift funds tend to have lower pricing than foundations and have indeed grown faster, although there are many differences in marketing, sales support and the scale of their existing customer base that might be much more important variables. The Kansas City Community Foundation, one of the most successful in attracting DAF funds, has one of the lowest price structures, yet the Silicon Valley Community Foundation has also grown rapidly with one of the highest price structures.

Our donor conjoint analysis, discussed in the next section, indicates that donors weigh pricing heavily in choosing among community foundation options, but other factors may be at work in their choice between a community foundation and a commercial gift fund. Therefore, it seems advantageous but not yet certain that community foundations must match commercial fund pricing for DAFs. Even if they do, foundations should be wary of discounting fees for other kinds of products where commercial competition is less intense.

- 6. Alternative pricing or sources of revenue.** Given that most foundations in our sample are unable to cover their full costs at traditional fee levels, it is important to find other sources of revenue, although few have done so. Three foundations in our sample have avoided the standard 1% fee structure. One has retained all investment returns on DAFs, instead of charging a fee, resulting in the equivalent of a 1.5% fee during 2002, although they have recently decided to change to the more standard 1% fee. Two others deduct their operating costs from unrestricted payout before calculating the amount available for grants, in one case amounting to an effective fee of 1.4% on all non-DAF funds. Obviously, these foundations have relatively better overall economic results.

Some foundations have found other sources of income through contributions and fees. (See figure 18) In 2002, the New Hampshire Charitable Foundation raised 7% of its budget from board and advisory committee member contributions, and 14% of its budget from gifts and grants to the operating fund. They also receive a variety of fees for handling scholarships, which represent a significant portion of their assets. The Columbus Foundation and the Foundation for the Carolinas house their offices in donated buildings, virtually eliminating occupancy costs that run 5-13% of the annual operating budget for other foundations. Each year, the Kalamazoo Community Foundation develops a separate budget for



Source: FSG Analysis

Figure 19

community leadership initiatives – and the board set aside discretionary funds to cover these expenses. Other foundations outside this study have been able to raise grant dollars from national foundations to administer grant programs locally, with an accompanying contribution toward their administrative expenses.

The Community Foundation for Greater New Haven, for example, received 44% of its 2002 contributions in the form of grants from larger national foundations.

In summary, each foundation's cost and revenue structures will be different, but our research suggests that these six factors have a substantial impact on the sustainability of a community foundation. A foundation with many different products, customized accounts and extra services, very few large funds, low fees, and no sources of alternative revenue may not be able to cover its costs consistently. Conversely, a foundation that is able to adjust these elements may be able to significantly improve its sustainability.

Community foundations are charitable organizations, after all – unlike commercial gift funds – and they have an opportunity to take advantage of this distinction by raising revenue in ways that for-profit organizations cannot.

The objective, of course, is not to “make a profit” on every fund. The foundation's role is to create value for its community, and to fulfill its mission. But every fund that requires subsidy drains a portion of the foundation's limited income. The question that management must ask is whether subsidizing these funds is the best possible use of the foundation's resources to further its mission.

Perhaps the most perplexing question is around the subsidy of small donor advised funds for the sake of building relationships with donors. As the donor analysis in the next section of this report suggests, a majority of DAF donors do intend to leave funds to the foundation, validating the assumptions behind this approach. Not all donors have the capacity for a major gift, however, and the cost of managing a small DAF can be substantial. Research for one FSG client determined that the average time lag between the commitment to make a bequest and the receipt of funds was 15 years. In a worst case scenario, given the cost data above, a foundation might spend nearly \$3,000 per year for 15 years to subsidize a \$10,000 DAF and ultimately receive a final bequest that is considerably less than the \$45,000 it cost the foundation to maintain the DAF during the donor's lifetime.

The question is whether subsidizing small funds is the best way to achieve impact in the community and build donor relationships, or whether the same funds could be more effectively applied in other ways. Donor survey data suggests that many donors have little personal contact with the foundation, so that the foundation's willingness to subsidize their DAF does not alone develop a strong relationship. Some foundations we have worked with outside this study have been successful in building close donor relationships through their leadership and activism in the community, others do so through advertising and public relations, or donor events and site visits. Investing in marketing and acquisition activities also has a positive impact on contributions, and might be a more effective place to direct the available subsidy. *(See figure 19)*

A decade ago, community foundations were the only place where a small donor could create a long-term charitable fund. Today, donors are awash in options, many of which operate at substantially lower costs, ultimately imposing less administrative overhead on their charitable dollars. Community foundations should consider carefully whether the willingness to subsidize small funds continues to an important priority for the future.

C. Improving Sustainability

As noted earlier, foundations must begin to look inside the “black box” and develop separate plans of action for each one of their many products. Once they have gathered accurate cost data and determined which products are being subsidized, and to what degree, they are in a position to improve their sustainability by considering three types of action for each product.

1. **Reduce costs** by managing some of the sustainability drivers listed above, such as streamlining the administrative processes associated with the product. The Cleveland Foundation, for example, immediately observed that the costs for committee-advised funds could be reduced by simplifying internal grant-making processes. Everyone knew the existing process was cumbersome, but the true costs had never been known, and there had been no compelling reason to make changes.

Given the clear evidence that at least one foundation – even in our extremely limited sample – is able to generate a positive contribution from each fee-based product, and that the difference between the highest cost and lowest cost foundation is more than 10:1, even at similar average salary levels, there should be ample opportunity for foundations to study each other’s best practices and find ways to reduce costs, redirecting resources to more important uses.

2. **Emphasize products that make a positive contribution and de-emphasize subsidized products that are not important to the foundation’s strategy or mission.** Every foundation felt that certain subsidized products were important to their mission and must be continued. However, once foundations in our study understood the extent of the subsidy for each product, most foundations were able to identify some products or donor segments – such as, in one case, handling corporate contributions – that were not of sufficient strategic importance to warrant such extensive subsidies. Often the asset mix was a result of historical legacy or arose from a policy of taking whatever type of fund a donor was willing to open. Development and donor relations staff have often been judged on overall dollars raised, not on the types of funds acquired, and they may have been given little direction about which fund types were considered desirable and which were not.

While foundations have an obligation to maintain the assets already under their management, they also have the option of deciding which products to promote for future growth. If a product is costly to administer but unimportant to the strategy or mission of the foundation, the development staff might de-emphasize the product in donor discussions, or the foundation might raise its pricing to premium levels to discourage donors from making that selection.

3. **Modify pricing.** Finally, foundations should consider whether pricing could be increased, given donor preferences and the competitive environment. Here too, the answer is very different for different products. Some products face competing alternatives that may impose a price ceiling, others do not. But it is clear from our study that setting the same level of fees for all of a foundation's products, without acknowledging differences in the level of cost involved, the competitive context or the strategic importance of the product, can lead to unintentional cross-subsidies and a draining of resources that may not be sustainable for the long-term.

Foundations that want to strengthen their financial sustainability will need to consider a combination of all three options, on a product-by-product basis, to maximize the contributions or narrow the subsidy in a manner consistent with their operational strengths as well as their mission and strategy. The final section of this report offers a hypothetical example to illustrate the way these choices might be made by a given foundation.

In considering each of these factors, the foundation must also take into account the donors' preferences and the competitive context, as discussed in the next two sections.

Donors Who Have Personal Interactions With Their CF Were More Willing To Increase Giving To the CF From Their Estate

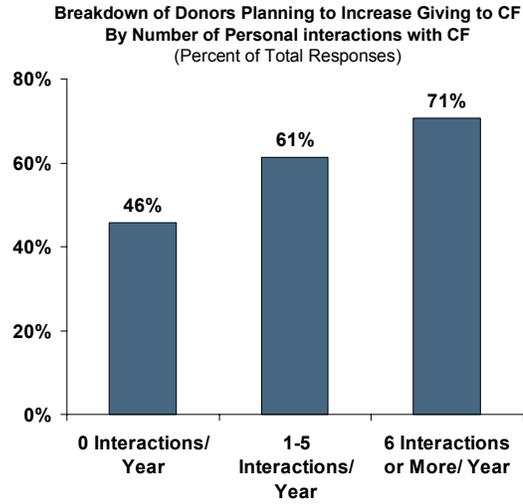


Figure 20

Most Donors Have Limited Personal Contact With Their Community Foundation With 37% Of Donors Having No Contact

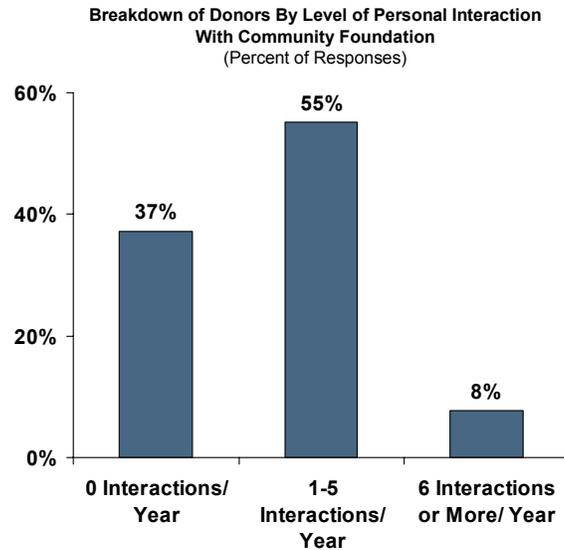


Figure 21

VI. Understanding Donors

Given the challenges of understanding donor priorities across many different products, we restricted our analysis of donor preferences to DAF pricing and features because this is the fastest growing product and faces the most competition. In order to understand which preferences drive DAF donor decisions, we distributed surveys and conjoint instruments to approximately 2,000 donors and 1,800 financial advisors across six regions. We received 445 responses from donors (23% response rate) and 184 responses from advisors (10% response rate). These response rates are at the high end of the normal range for surveys of this type and are considered to be statistically reliable at a 95% confidence level or better.

Respondents included both men and women, although a majority were older men with an average age over 60. They had funds ranging in size from below \$50,000 to above \$250,000.⁴ In general, the distribution of responses mirrored the demographic profile of the foundation's entire DAF donor base. The regions surveyed were again chosen on the basis of which foundations were willing to participate, and are not entirely representative of the nation — for example, no West Coast donors participated. Nevertheless, the sample includes a very diverse set of regions in terms of cultural diversity, population density, average income level, and other demographic characteristics.

Importantly, our analysis disclosed no statistically significant variation in DAF donor preferences between regions. Donors exhibit the same set of preferences, whether on the East Coast (Philadelphia), in the South (Louisville, Carolinas), Southwest (Arizona) or Midwest (Columbus, Kalamazoo). While not conclusive, the data strongly imply that there is a single national market for DAFs, and that the most desirable combination of price and features will appeal equally to the donors of any community foundation.

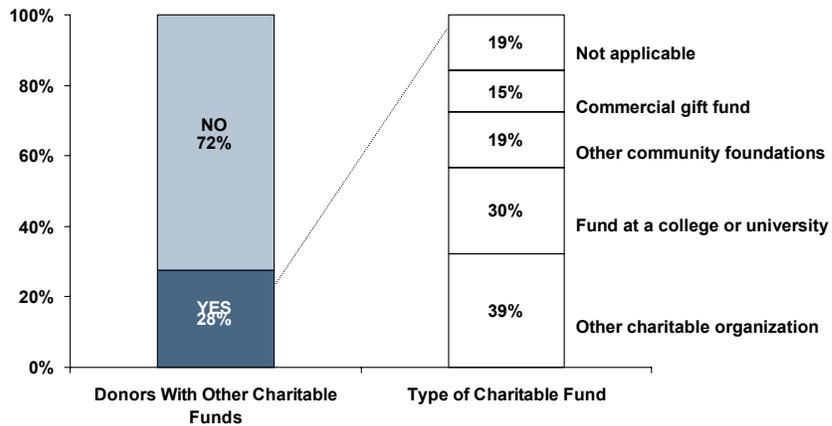
A. Survey findings

- 57% of donors plan to leave additional funds to the community foundation from their estates, although it is not known whether this would be in the form of a DAF directed by their heirs, or an unrestricted bequest. The more personal contact a donor has with the community foundation in a year, the greater the likelihood of a bequest. Seventy-one percent of donors with 6 or more interactions intend to leave a bequest, compared to only 46% of those reporting no interactions. (*See figure 20*) Unfortunately, less than 8% of donors have such frequent interactions, while a full 37% report no personal contact at all over a full year. (*See figure 21*)

⁴ Additional data about the profile of the respondents and more detailed results for the conjoint analysis are available from FSG's website at www.foundationstrategy.com

Most Donors Did Not Have Other Charitable Funds Outside of Their Donor Advised Fund

Breakdown of Donors with Other Charitable Funds
(Percent of Responses)



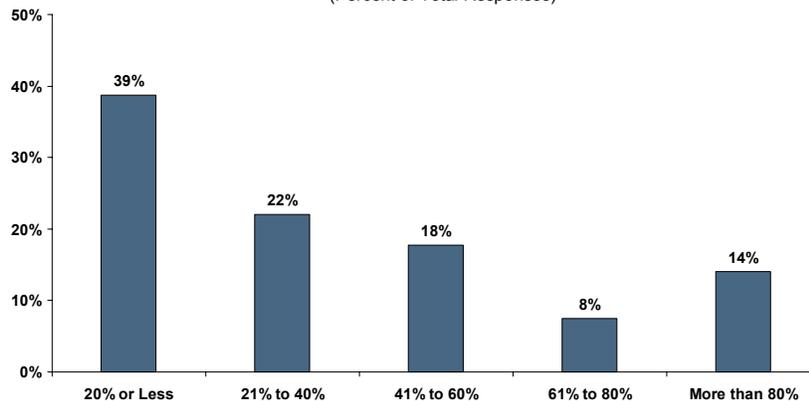
For those that did, non-profits and institutions of higher education were the most popular alternatives

Note: Charitable funds represent over 100% of "Yes" responses due to donors choosing multiple types of charitable options

Figure 22

When Advising Clients on Charitable Giving, Advisors Recommended Donor Advised Funds To a Minority Of Their Clients

When You Do Discuss Charitable Giving, How Often Do You Recommend Donor Advised Funds to Clients?
(Percent of Total Responses)



Note: Relevant clients are those clients receiving advice on charitable giving

Figure 23

- The source of funds for most contributions to DAFs is income or asset appreciation, although for large accounts a frequent source is either the sale of a business or receipt of an inheritance.
- 72% of donors have only one DAF. Of those that report more than one DAF, the overwhelming majority are at other nonprofit organizations, universities or community foundations. Only 4% of community foundation donors surveyed have another DAF at a commercial gift fund. *(See figure 22)* This may suggest that donors to community foundations are drawn from a segment of customers that prefer to work with nonprofits. It also suggests that foundations must be attentive to competition from the many nonprofit DAF alternatives, in addition to the commercial gift funds.
- Financial advisors rarely give charitable advice to their clients. Almost 40% of advisors report that they give charitable advice to less than 20% of their clients. Even when they do give advice, they do not recommend DAFs in a majority of cases. *(See figure 23)*

B. Conjoint Findings

Each donor was given a choice of 15 DAF offerings with different combinations of features, and asked to rank them in order of preference. This forces donors to make tradeoffs, for example, between paying a lower price while receiving a low level of services or paying a higher price for a higher level of services. The features we tested were:

- Price
 - 1%, 1.5%, or 2% of assets
- Information and research on local nonprofits
 - None, limited or extensive
- Donor events
 - None, 3 or 6 per year
- Investment flexibility
 - Available or unavailable
- Grant processing speed
 - 3 days, 2 weeks, 4 weeks

Our analysis yielded indications about the relative importance of each of these factors in the donors' choices. Certain preliminary conclusions can be drawn from this analysis, however, the limited range of choices provided to donors in this study suggests that additional research is needed to more fully understand the factors that influence donors' decisions. In particular, note that donors were asked to choose among several offerings from a community foundation, rather than between the offerings of a community foundation and offerings from other commercial or nonprofit organizations.

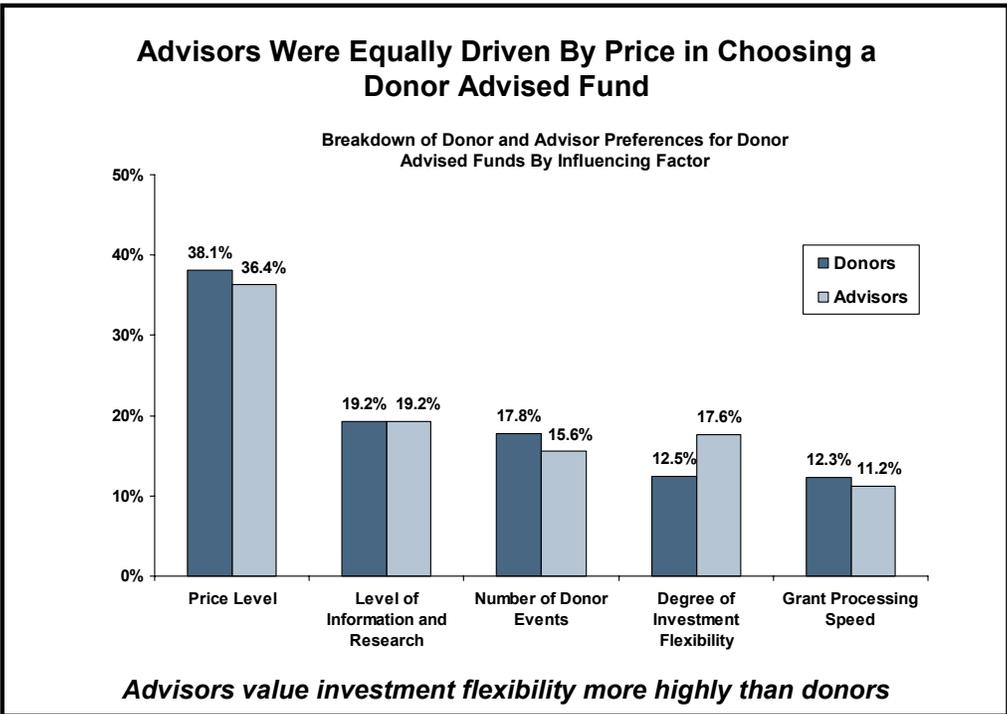


Figure 24

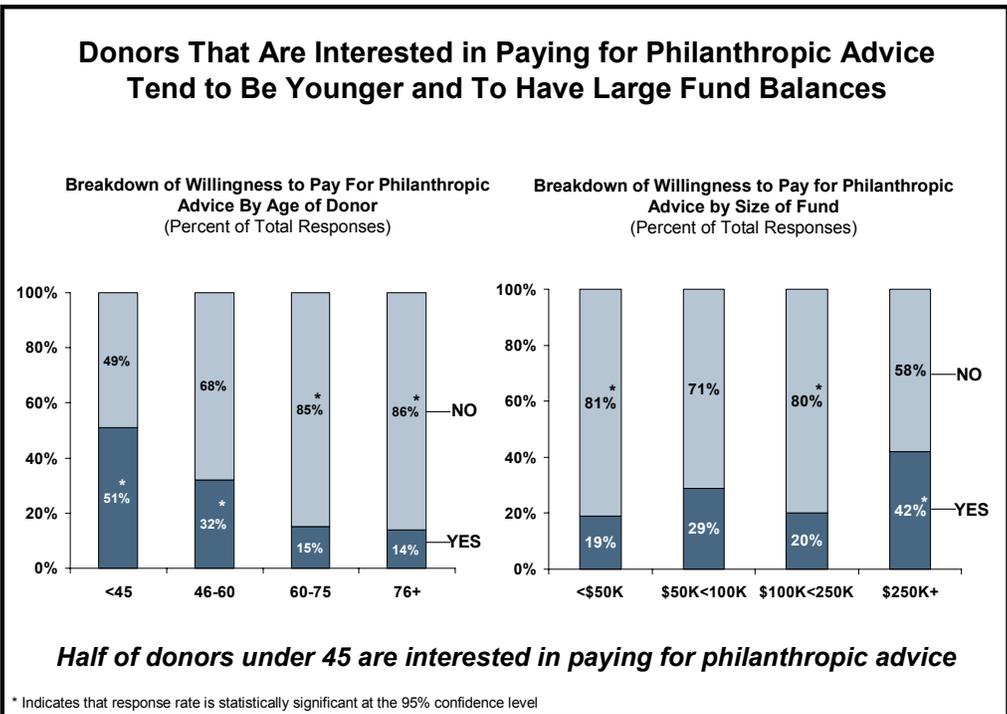


Figure 25

Pricing

- Price is the single most important determinant of choice, weighted nearly twice as heavily as the next most important factor. (See figure 24) Pricing alone explained 38% of the donor's choices and 36% of the advisors choices. Among the fee choices, 1% was preferred nearly 3 to 1 over 1.5%, and no combination of features could make a 2% fee attractive.

Information and Advice on Local Nonprofits

- Information and research on local nonprofits was the second most important driver of choice, accounting for 19.2% of both donor and advisor preferences. Surprisingly, however, more advice was not necessarily better, even if it didn't cost any more. Instead, the preferred option was *limited* information and research.
- Roughly one-quarter (23%) of donors were willing to pay an hourly fee for philanthropic advice, although the overwhelming majority was not. One important finding is that younger donors and those with larger fund balances are significantly more willing to pay for advice.
 - 51% of donors under age 45 and 32% under age 60 were willing to pay for philanthropic advice, compared to 15% of those over 60.
 - 42% of those with fund balances over \$250k were willing to pay for philanthropic advice, compared to 19-29% of those with smaller funds.
 - Donors that have more frequent interactions with the community foundations were also more willing to pay for advice.

Taken together, these findings are encouraging, suggesting that younger and wealthier donors value – and may pay for – philanthropic advice from their community foundation. The data also makes clear, however, that this strategy will not appeal to the majority of community foundation donors.⁵ Competing broadly with commercial gift funds by offering philanthropic advice, therefore, may not be an effective strategy to attract a large number of donors, nor can a higher cost structure associated with DAFs be subsidized by charging for advice or higher levels of service. On the other hand, limiting philanthropic advice to a highly targeted offering for a particular segment of donors might be extremely attractive and create a modest incremental revenue stream for the community foundation that simultaneously furthers its mission. (See figure 25)

⁵ Note, however, that this limited study did not examine the quality or range of advice that might be offered in the future – donors responded on the basis of their experience with the advice given by participating foundations. As the cost data shows, often very little staff time is actually spent on donor advice.

Donor Events

- Donor events are the next most important driver of choice, accounting for 17.8% of the preference among donors. This option was a lesser factor for advisors, however, at 15.6%.
- Here too, donors did not believe that more was necessarily better, even if they didn't have to pay for it. Three events per year was the preferred choice, although having no events was almost equally attractive. Six events per year was the least preferred choice.
- Interestingly, we found preferences for different types of events among different donor groups.
 - Donors over age 60 are most interested in educational forums
 - Donors that are willing to pay for philanthropic advice also tend to be interested in lectures
 - Donors under age 45 are most interested in site visits and donor networking events.
 - Receptions were the least popular type of donor event

This data reinforces the idea that there are different market segments for DAFs, with different preferences. For example, a foundation that wanted to reach younger donors or those interested in paying for philanthropic advice could tailor its donor events to attract them by emphasizing site visits, lectures and networking events.

Investment Flexibility

- Advisors rank investment flexibility higher than donors, at 17.6% versus 12.5% for donors, and this is the only factor on which a statistically significant variation in response between donors and advisors was observed. We were surprised to find that donors considered investment flexibility a significantly less important factor than donor events or philanthropic advice. Given the choice, however, donors would prefer to have investment flexibility by a margin of more than three to one. However, this would not necessarily be an important factor in their decision to open a fund, nor would it seem to justify higher fees.

Grant Processing Speed

- Donors have a clear preference for faster grant processing speed, and the faster the better. Three days is preferred by 2 to 1 over two weeks, and the four week option was not considered attractive at all.
- Donors seemed to weight this factor as least important, however, accounting for 12.3% of their choices, similar to investment flexibility. Advisors considered this even less important a factor, accounting for 11.2% of their preferences.

C. Putting the Preferences Together: Optimizing DAF Features

Based on an analysis of these results, the “preferred option” – which would have been the first choice for 41% of donors – would have been a DAF with the following features:

- 1% fee as a percent of assets
- Limited information and philanthropic advice
- 3 donor events per year
- Investment flexibility
- 3 day grant processing speed

Interestingly, this differed from the typical features offered in our six foundation conjoint sample only in that grant processing speeds were normally two weeks. This research strongly supports much of the work that community foundations have done over the last 5 years to reduce grant processing time, increase investment flexibility and promote philanthropic advice. It suggests, however, that some of these features may be considerably less important than had been assumed, and that managing costs may ultimately be the most important step community foundations can take.

In addition, we constructed two hypothetical alternatives to measure the appeal of lower fees versus higher service.

- **Low Fee Scenario.** Price is such an important variable that reducing the fee to 0.5%, would be almost equally as attractive as the “preferred option,” even if community foundations provided no advice, no events, no investment flexibility, and 4 week grant processing. In fact, this low cost option would be the first choice for 40% of donors compared to 41% for the preferred option above.
- **High Service Scenario.** Raising fees to 1.5% in order to support an increased level of donor services through more donor events and more philanthropic advice would actually be less attractive, and would be favored by only 9% of donors.

The analysis suggests that community foundations will not be able to compete broadly for DAFs in the long run by charging higher fees for higher levels of service. If community foundations want to attract DAFs without undermining their economic strength, they will need to increase efficiency and bring their costs down to break-even levels. Given a competitive cost and fee structure, the most effective strategies for competing with commercial gift funds would be through lower prices, faster processing, and a moderate level of services. The research also suggests that community foundations could appeal to small segment of younger and wealthier donors through a more specialized offering of site visits, networking and philanthropic advice, combined with additional charges to subsidize these services.

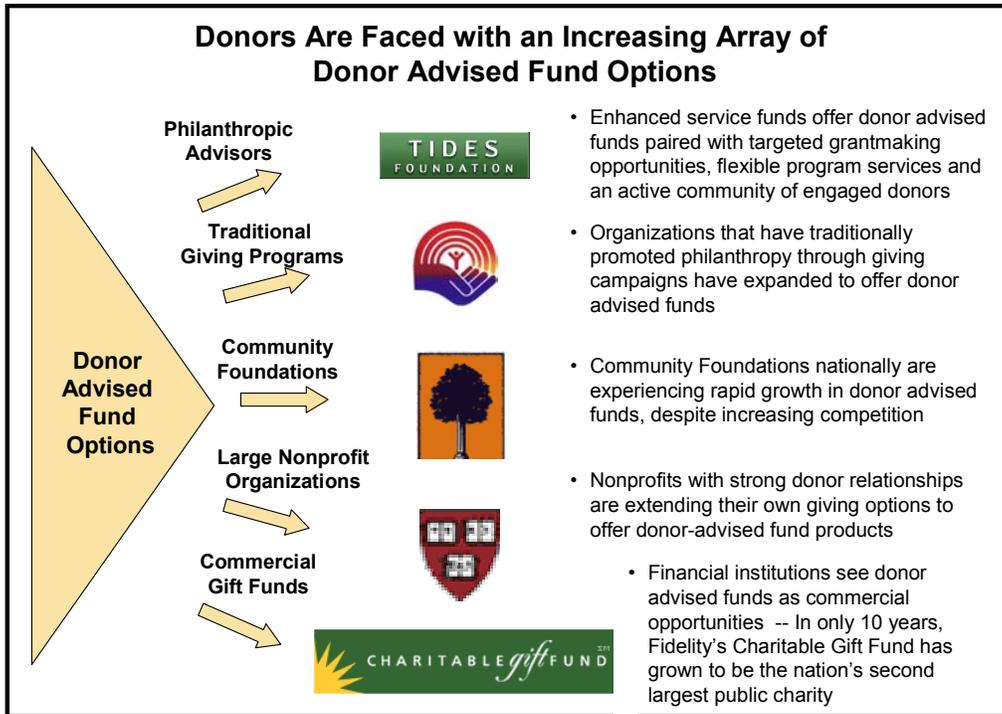


Figure 26

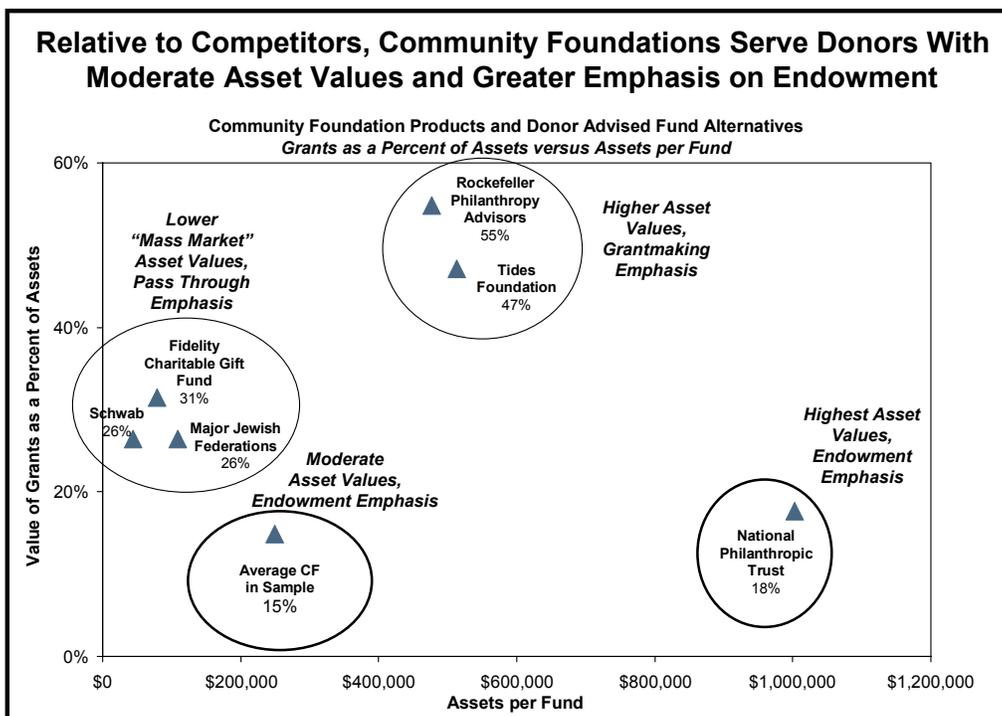


Figure 27

VII. Understanding Competitive Context

Donors have alternative options for many products and services that community foundations provide. The nature of the alternatives varies with the type of product, the size of the market (rural town, major city, national market), and the donor's level of affluence. Some products may have no comparable alternatives, such as small scholarship funds tied to a region rather than to a specific college. In other cases, such as DAFs, there may be dozens of nearly identical choices in a fiercely competitive national market, supported by extensive advertising and leveraging pre-existing client relationships. *(See figure 26)*

Community foundations may, of course, choose to offer whatever combination of price and features they wish, with or without regard to what other alternatives exist. The way potential donors respond to the offering, however, may depend on how it compares to their other choices. Consequently, community foundations must understand both the national and local alternatives donors face on a product-by-product basis in order to understand the likely results of the choices they make. They may be offering the same features to the same set of customers at the same price, or they may have chosen a different “positioning” by offering a different combination of features that appeal to a different segment of customers.

As part of our study, FSG examined two key donor alternatives that have emerged in recent years: commercial DAFs and professional philanthropic advisors. In both cases, it is helpful to see how community foundations generally are positioned relative to these alternatives.

A. DAF Market Segments

Our analysis suggests that the market for donor advised funds is actually segmented into several distinct sub-markets. *(See figure 27)* Commercial gift funds are characterized by lower average fund sizes, in the vicinity of \$100,000, and a higher pass-through rate, granting out roughly 25-33% of assets each year. They operate with low cost and efficient transactional processes, and without offering philanthropic advice.

High service philanthropic advisors such as Rockefeller Philanthropy Advisors and the Tides Foundation work with much larger average accounts, averaging roughly \$500,000 in assets, and much faster pass-through rates of 50% per year. Their emphasis is clearly on providing intensive assistance to help substantial donors develop customized funding initiatives. They also operate on a very different economic model charging not only the standard fees that commercial funds charge, but also fees for each transaction and, for any additional services, a percentage of grants paid out or hourly consulting fees. Tides, for example, charges a fee comparable to the commercial funds, but also charges \$25 per grant, additional fees of 5% to 12% of grants paid for program support and design, and hourly rates for even more customized services.

Commercial Gift Fund Costs Differ from Those of Community Foundations or High-End Providers Like the Tides Foundations

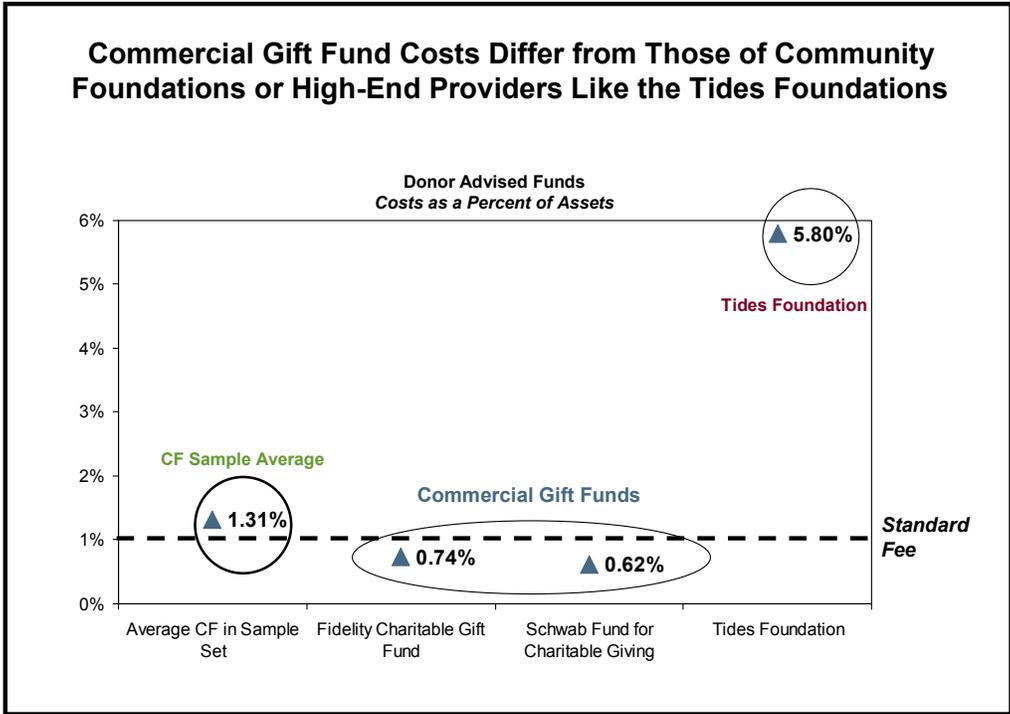


Figure 28

Many Community Foundations Match Higher Cost Options with Lower Pricing

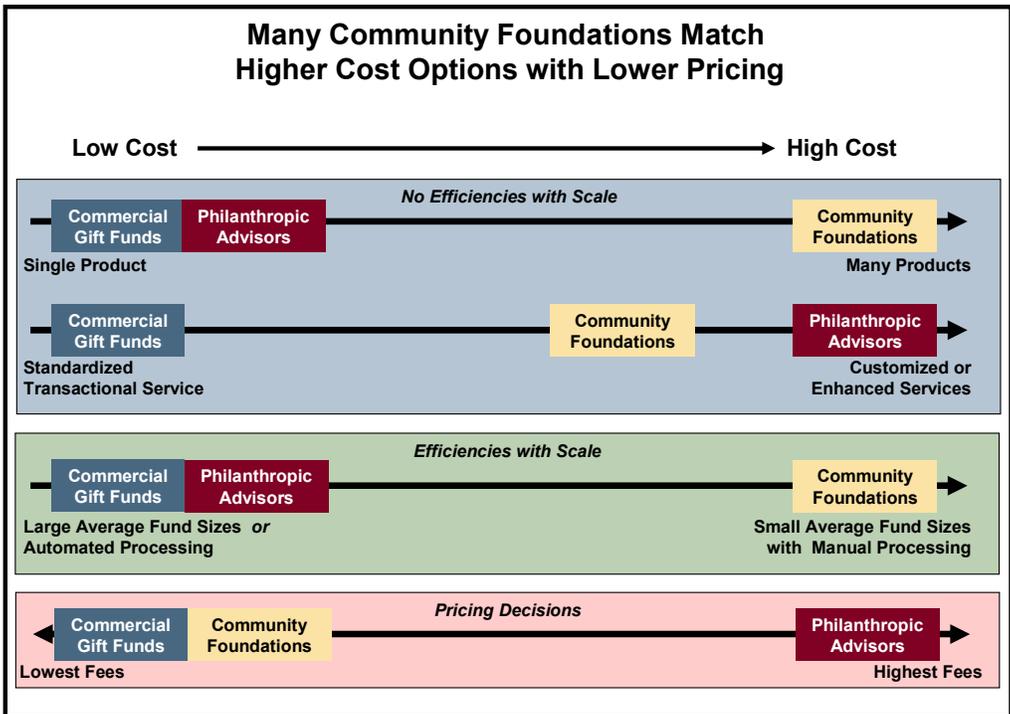


Figure 29

Yet a third position is occupied by the National Philanthropic Trust, with low fees, higher transaction costs, no philanthropic advice, but extremely large average fund sizes of \$1,000,000 which enables them to cover their costs. Through working with the trust departments of major banks, National Philanthropic Trust has unique access to high net work customers.

Different community foundations will fall different places on this chart. The sample average, however, falls in between these three camps, with mid-level asset size funds and a stronger endowment focus, granting out only 15% per year. Community foundations offer limited philanthropic advice and a higher level of personal service than the commercial funds, but charge the same low fees. On the other hand, they offer significantly less expert advice and substantially lower fees than the high-end advisors. This in-between positioning raises the question of whether there might be a distinct segment of donors to whom this mid-level of service and pricing appeals or, if not, whether community foundation might improve their performance by shifting toward one of the other three market positions.

One consequence of different market positions is a difference in the accompanying costs of service. The high-end advisors, for example, have a cost structure more than four times that of the community foundations, while community foundations themselves average twice the costs of commercial gift funds. *(See figure 28)*

The difference in costs can be explained by the decisions each segment has made about the different drivers of sustainability discussed earlier. Commercial gifts funds have chosen all low cost options, using technology to handle many small accounts and transactions efficiently, and they have matched these choices with low pricing. Philanthropic advisors have chosen a much higher level of service. They generally do not have the cost savings from high volume technologies, but they limit their transaction costs by taking a limited number of large accounts, and they charge a much higher level of fees. Community foundations have sometimes chosen more costly options without cost-saving technologies, yet they have also chosen a low price point that is comparable to the commercial funds, resulting in a less consistent set of choices than their competitors. *(See figure 29)*

B. Philanthropic Advisors

High end philanthropic advisors such as Tides Foundation and Rockefeller Philanthropic Advisors represent only one segment of a much larger and more diffuse national market for philanthropic consulting and advice. We hypothesized that these advisors were meeting a strong donor demand, charging substantial fees to offer advice similar to that provided by community foundation program staff, and we speculated that there might be an opportunity for community foundations to take on this role more formally, charging fees for expert program advice to individual donors. In fact, our research disclosed a more complicated situation, and a different kind of opportunity.

We discovered that the broad heading of philanthropic advisors actually encompasses three very different kinds of enterprises:

- Investment management and professional services
- Philanthropic guidance for individuals
- Administrative support for small family foundations

Many community foundations, of course, provide all three of these services to some degree, such as planned giving advice, investment of DAF funds, programmatic advice, and the administration of supporting organizations. Yet the growth in demand and the economic model differ significantly among these three different enterprises listed above. The differences are not always easy to observe because so many providers offer various combinations of these services to an overlapping set of clients.

1. Investment Management and Professional Services

Many banks, brokerage and financial services firms fall into this category, along with financial planners, insurance agents, and law firms. The range of philanthropic advisory services they provide varies considerably, and pricing is often rolled into the overall private banking or professional services relationship, rather than billed separately. As one advisor described:

- *“It is clear that the big private banks in New York have an internal captive market where philanthropic advice is considered a value added service. I was approached by a private bank in Boston to do a study on this . . . but they pulled back after the market declined. There’s a lot of chatter in the system – New York City seems to have a market to support this – but I’m not sure about Boston or other cities.”*

Similarly, individual financial planners, insurance agents, and small wealth management consulting firms such as the Legacy Group, IFF Advisors, and Renaissance also provide philanthropic counsel, including assistance in establishing a foundation. Like the banks, these advisors offer a moderate level of philanthropic services as a means of distinguishing themselves from their competition.

A similar category of philanthropic advice is offered by law or accounting firms, generally billed at their usual rates, and this may even, at times, move into a stand-alone service. For example, Goulston & Storrs, a law firm in Boston, has developed a philanthropic advisory practice separate from its legal practice, staffed in part by non-lawyers, and serving a constituency that goes beyond their own legal clients.

Inevitably, the advice that these providers offer emphasizes the legal, financial, and estate planning issues around the establishment or management of a foundation, DAF or other giving vehicle. Yet many also offer programmatic advice about where to direct grant dollars, and counsel regarding intergenerational or familial issues. The key distinction is

that these firms are primarily in a different line of business and, in most cases, they do not expect the revenues from philanthropic advice – if any – to cover their costs.

These markets have grown steadily, but their growth has been driven more by demand for the underlying financial and legal services than by the demand for philanthropic advice. In many cases, the sense of urgency to offer these services has diminished with the stock market decline. Investment management and professional service firms will likely continue to offer a low level of philanthropic advice only to the extent that their clients' value it and they can afford to absorb it as a part of their overall fee structures.

Since these firms often do not charge separately and are interested in providing reliable advice at the possible lowest cost, there may be opportunities for community foundations to establish partnerships with them, especially those firms or advisors that do not themselves hold assets under management. On the other hand, alliances with one firm may undercut the neutrality community foundations need to work with competing firms.

2. Philanthropic Guidance for Individuals

Excluding the investment management and professional services firms, the market shrinks dramatically, with less than ten philanthropic advisory firms ranging in size from 2 to 20 employees, and – according to the database at the National Center for Family Philanthropy -- more than 8,000 individual consultants. These firms and individuals generally charge hourly rates ranging from \$100 to \$600, but typically \$150-200/hour or \$1,000-2,000 per day.

Despite the large number of consultants, the market for these services appears to be very weak, and many are no longer active or are primarily engaged in other activities. The Philanthropic Initiative (TPI), an early pioneer and the national leader in this field, has experienced only modest growth over its 15 year history, and supplements its donor consulting with corporate clients and foundation-funded research studies.

Even the brief spurt of growth in this segment during the late 1990's has since evaporated, as our interviews revealed:

- *“There is a market, where there wasn't one in 1990, but it's pretty small.”*
- *“My consulting to independent and family foundations has decreased . . . when people have fewer dollars to spend, they use consultants less.”*
- *“I used to get several calls a week from individuals and fledgling firms interested in getting in to this field; now I get perhaps one a month. There's been a terrific fall off in the level of interest in what we do.”*
- *“There are pockets of people -- TPI, and a few individual consultants -- trying to reinvent themselves in this arena, but they are few and far between. . .”*
- *“When I started in 1991, nobody else was doing what I'm doing. Since then, several firms and individuals have tried to start, but a number of them have failed.”*

- *“Giving Capital, a venture backed start up in the late 1990’s, is going out of business . . . they couldn’t sustain it.”*
- *“Most of our clients are giving less, and our fees are dropping like flies.”*

One reason for the gap between the perception of a growing market and the reality is the difference between the “need” and the “demand.” Over and over again, we heard from those knowledgeable about philanthropy that there was a great “need” for philanthropic advice to individual donors, and that donors would be much more effective if they had the research and expertise to make better informed giving decisions. On the other hand, this need was not generally perceived by the donors themselves, nor were they willing to pay for research and advice.

- *“There’s greater appreciation now for using philanthropy to achieve things that are important, but it hasn’t translated into seeking out and paying for services.”*
- *“The need for these services is obvious, but the demand is problematic. Gaining clients requires a lot of relationship and trust building . . . Getting into this business has been tough for me financially . . . there’s just not a great deal of demand.”*
- *“This is truly a cottage industry: The work has been done historically by consultants, who have over time, narrowed their focus to working with families around issues relating to family dynamics and succession more than philanthropic advice.”*
- *“We receive one or two new inquiries a year from potential clients -- there’s not a huge demand, but we’ve had a little growth over time.”*
- *“I am constantly surprised by how much price sensitivity I find. People expect to get philanthropic advice for non profit rates”*
- *“Those that are successful have anchor clients. I don’t know anyone, other than TPI, who is any good and has enough business.”*

Our conclusion, therefore, is that the market for philanthropic advice to individuals as a stand-alone business is weak, driven more by the dedication and persistence of those offering advice than by any sense of strong or growing demand on the part of donors.

Community foundations may be able to offer higher quality advice at a lower cost than solo consultants, primarily because their staff can provide advice on an occasional basis without having to depend on consulting fees to cover their full salaries. As the conjoint data suggests, a segment of donors may be willing to pay for this advice. However, charging fees for philanthropic advice is not likely to drive tremendous growth in a community foundation’s revenues.

In addition, two other barriers limit the revenue potential for community foundations. First, concerns were repeatedly expressed about a perceived “conflict of interest” that community foundations might have in providing paid philanthropic advice. Because of their own fundraising activities and, to a lesser degree, their proactive initiatives, community foundations were sometimes perceived as “having an agenda” to promote their own products rather than acting as neutral advisors. Second, the skill set of expert

program officers may differ from the customer-service orientation needed to successfully cultivate high net worth donors. These issues of credibility and customer service orientation may need to be addressed by individual foundations that seek incremental revenue through charging for philanthropic advice.

3. Administrative Support for Small Foundations

The most promising area of substantial growth and opportunity for community foundations appears to be in this third segment, providing back-office and grant support for small family foundations.

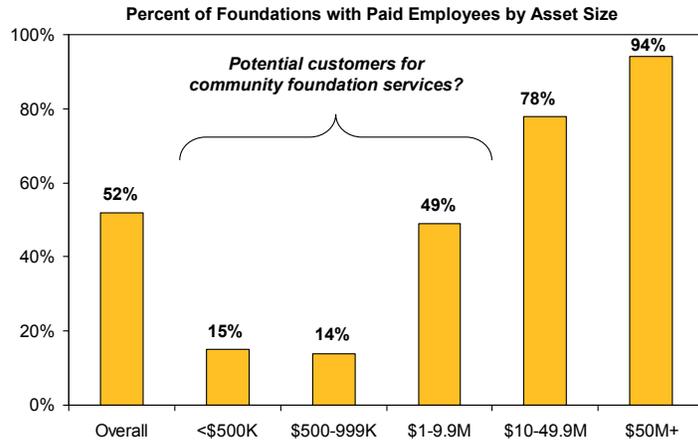
Unlike providing advice to individual donors, the market for administrative support to small foundations appears to be profitable and growing. The number of small foundations has been growing rapidly, more than doubling over the past decade. In many cases, opening a DAF might have been the most efficient alternative, but donors often do not make that choice, whether because of inadequate information or because of a preference for the independence and prestige of a foundation. Once established, small foundations require a significant number of new activities: Grant requests must be reviewed and answered, meetings must be held with grant dockets prepared in advance and minutes recorded afterwards, tax returns must be prepared, checks distributed, and various legal requirements met. For the vast number of small foundations, an estimated 40,000 under \$10 million in assets, there are few cost effective ways to handle these requirements.

Many major cities now have one or a few firms that serve foundations like these, essentially providing outsourced staff support, and offering philanthropic advice and grant program design upon request. A typical example is Grants Management Associates, which began 15 years ago in Boston, and now handles administrative support for 27 local family foundations. In general, our interviews disclosed considerable optimism among philanthropic advisors about the growth in private foundation support services.

- *“Smaller foundations really want some help in operations; that’s where the demand is.”*
- *“We’re beginning to see clear indications that demand is growing for foundation management services. 15% of what we do for donors is the front end strategic advising stuff; 85% is on-going foundation management stuff. It’s this latter work that keeps us afloat . . .”*
- *“There is a very high renewal rate We’re not re-inventing our revenue stream every year. Once we start working with a foundation, we’ve never lost a client.”*
- *“We do consulting, but we’re predominantly foundation management staff.”*

A newer provider of foundation support services is Foundation Source, offering a web-based solution for all aspects of private foundation management, in partnership with asset

Less Than Half of Small Foundations Do Not Have Paid Staff – a Potential Market Opportunity for Community Foundations

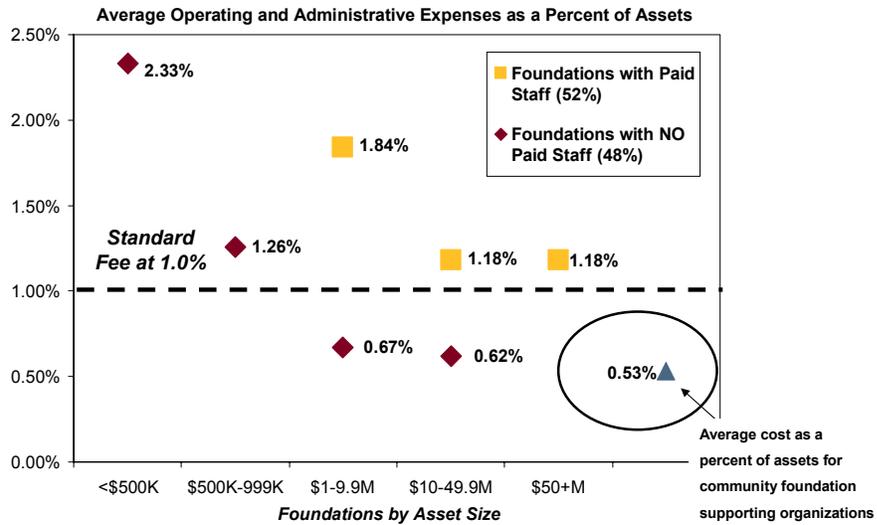


Most supporting organizations at community foundations have assets of less than \$10M and no paid staff

Source: Association of Small Foundations 2002 Membership Survey Report. 2/3 of ASF members have foundation assets of less than \$10M

Figure 30

Community Foundations Have the Potential To Offer Cost Advantages to Smaller Foundations



Note: Operating and Administrative Expenses exclude investment management fees, which average 0.58% of assets for all foundations.
Source: Association of Small Foundations 2002 Membership Survey Report. 2/3 of ASF members have foundation assets of less than \$10M.

Figure 31

managers. Now with a staff of 30, Foundation Source works in partnership with asset managers, philanthropic advisors and community foundations to provide everything necessary to set up a foundation, create a “philanthropic agenda,” and manage whatever needs to be done from grant processing to tax returns. As the founder, Doug Mellinger, described:

- *“A new market has developed which is completely integrated, supporting all back office needs and engaging specialists when necessary. It’s a full service operation. The market is huge – My belief is that this is a \$5-10 billion asset management business.”*

Other organizations also are discovering the field of small foundation management. Fidelity recently announced an initiative to provide web-based support for private foundations. Baldwin Family Office and the Family Office Exchange have also begun to provide support for small foundations as an ancillary service to family investment offices.

It appears that community foundations are well situated to offer these services through the vehicle of supporting organizations, or merely through annual management agreements. The Association of Small Foundations reports that more than half of foundations with assets of less than \$10 million have no staff, *(See figure 30)* and the average cost of supporting organizations in our sample, at roughly 0.5% of assets, was significantly below the administrative costs reported by these foundations, whether staffed or not. *(See figure 31)*

Community foundations may also learn from the private banking model, in which specialized services are available only to a particular segment of customers with assets under management above a certain level. By offering tiered levels of service for different size accounts, or pricing different levels of service differently, community foundations might be able to cover their costs without charging separately, particularly for supporting organizations and small foundations.

In conclusion, there seems to be a strong economic argument for community foundations to offer administrative and grantmaking support to small foundations, where donors perceive a genuine need that community foundations can meet cost effectively. Some foundations in our sample were already adept at assisting small foundations in their administrative needs, but for others this strategy might require a shift in external positioning and internal processes in order to be successful. Even this market, however, may not be sufficient to change the fundamental economics of community foundations. In all but the very largest cities, the number of foundations in the \$5-25 million range is limited, although the community foundation may be able to capture a surprisingly large share of this market: The Columbus Foundation, which focuses on supporting organizations, estimates that 52% of all private foundation assets in its region reside at the Foundation.

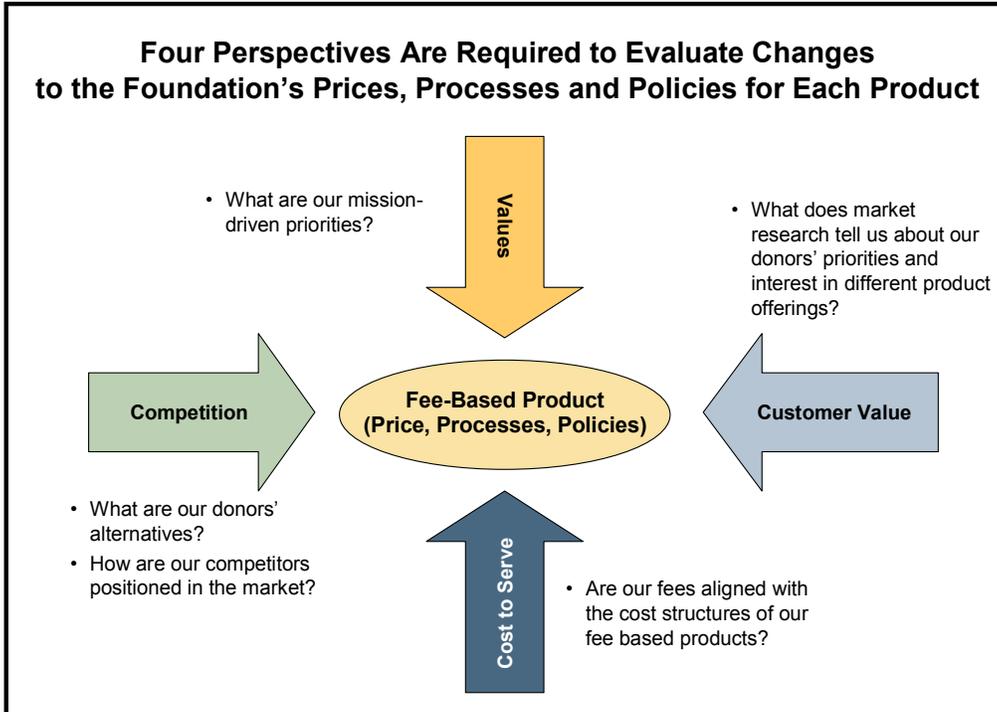


Figure 32

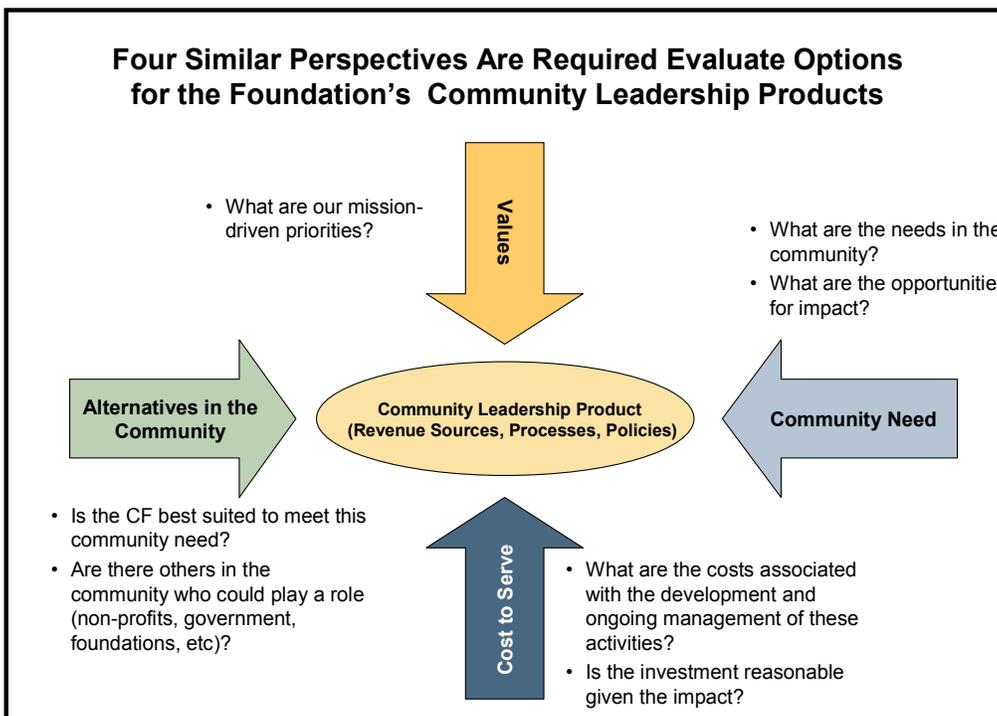


Figure 33

VIII. Making the Right Choices

Our research suggests that community foundations must adopt a much more precise and analytical approach to management decisions in order to succeed in the complex competitive environment of today and the foreseeable future. The current pricing model that is the same for all products does not fit the reality of dramatically different levels of service required for different products, nor does it address the different competing donor alternatives, and differences in donor preferences among product features.

The limited resources of community foundations are too precious to continue being allocated by historical precedent rather than by a clearly determined and soundly researched strategy. This means that community foundation must examine their values and operations on a product-by-product basis, taking into account their mission-driven priorities, internal costs, customer preferences and competing donor alternatives. *(See figure 32)* A similar analysis can be applied to community leadership products. *(See figure 33)*

Given this knowledge, foundation leaders can determine how best to improve their sustainability through changes in costs, pricing, and emphasis. The best answer will be different for each foundation, and there is no single formula that provides the optimum results for all. The wide variance in costs to serve within our sample suggests, however, that there is ample opportunity for foundations to improve their long-term performance by studying and learning from lower-cost providers of each product they offer. We note, however, that the foundations in our limited sample do not yet represent an adequate database to identify the best practices of low cost providers nationally – a much more comprehensive body of cost data would need to be assembled and periodically updated.

Foundations must also become more strategic about the trade-offs inherent in their spending decisions. A dollar spent to subsidize the cost of maintaining a small DAF is a dollar that is not available for leadership activities in the community, reinvestment in the endowment, donor development or grantmaking. If foundations are to optimize their performance, they must make these spending decisions deliberately, not as a result of history or incomplete information. And some foundations in our sample, whose growth is primarily in products on which they lose money, may find that their resources are becoming more and more strained over time if they maintain the status quo.

Not every product needs to make a positive contribution, but foundations must carefully weigh their purpose in promoting products as loss leaders. In particular, they must consider whether subsidizing the cost of smaller funds, especially those below \$100,000, is the best way to cultivate donor relationships, compared to devoting the same resources to leadership activities in the community or investments in development and promotion.

In general, community foundations will need to bring their costs for administering DAFs below the 1% fee they charge – as two foundations in our sample have already done—if they are to grow those products without shrinking their operating margins. Donors are

**Community Foundation Strategy Requires a Set of Choices
Driven by the Foundation's Mission and
Informed by a Thorough Analysis of Each Product**



Figure 36

price-sensitive and may not respond well to the 1.5% fees that would be necessary to cover the current costs of most DAFs in our sample.

The choices that face any given community foundation are not simple, but taken together they can substantially change its operating model and positioning in the community. (*See figure 36*) Making choices such as those described in the case example, serve to align the foundation's activities and economics with its ultimate mission and goals. Taken together, these choices form the essential strategic plan that each community foundation must develop. In today's challenging environment, foundation leaders can no longer settle for weekend retreat to produce a "strategic plan" that is no more than a redrafted mission statement. Without a solidly researched fact base and a clear delineation of organizational priorities, boards will have great difficulty guiding their foundation to effective and sustainable performance.

Ultimately, we draw positive conclusions from our research. First, even in our small sample, community foundations have demonstrated that they can cover their costs at reasonable fee levels for every one of the basic fee-based products that community foundations offer. Second, there are few donor alternatives to many of the other products they offer, suggesting that their role cannot and will not be overtaken by commercial funds. Third, there are clear opportunities to enhance revenues by adjusting fees for less competitive products, raising additional contributions to support community leadership initiatives, offering philanthropic advice to a segment of donors and administrative support to small foundations. If community foundations take the initiative to understand their costs, donors, and competitors, and to learn from each other, they can move the entire field to a higher level of performance and sustainability, ultimately delivering greater value to their communities and the nonprofits that depend on them.

Case Example

Consider, for example, a hypothetical set of decisions that a community foundation might make, based on the costs analysis shown as an example in figure 5 earlier, and repeated below.

Before making any decisions, the foundation gathered additional cost data about the products that require the greatest subsidy – understanding how far each product is from break-even – and more detail about the composition of its DAF costs. (See figures 34 & 35)

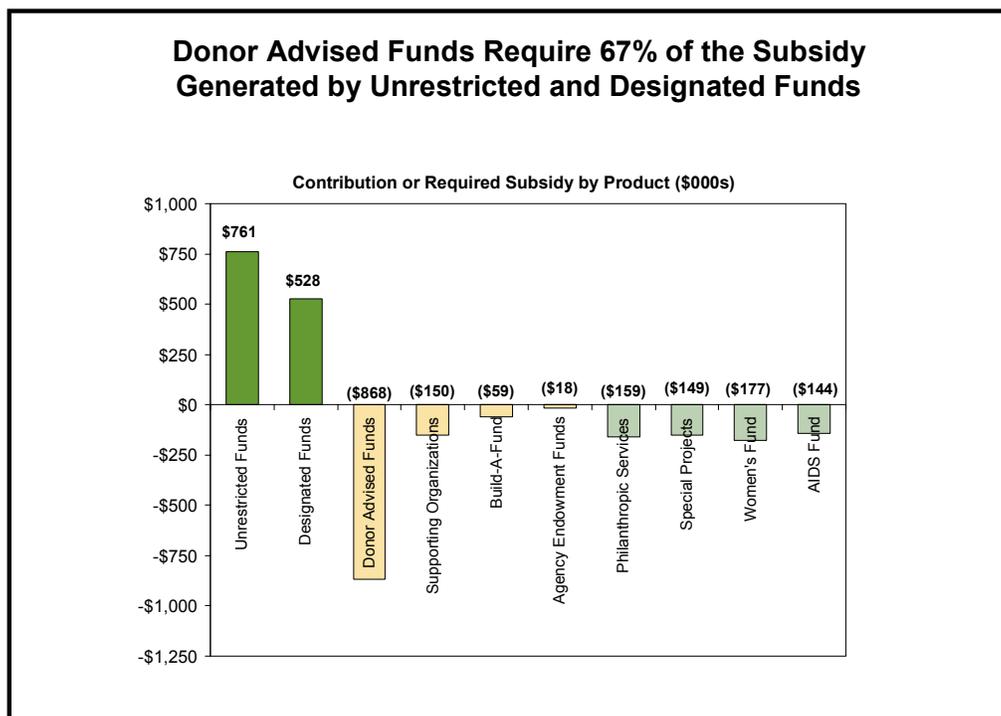


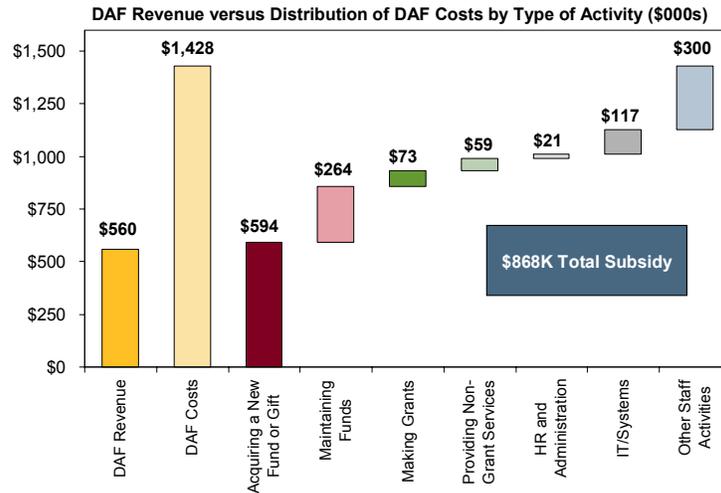
Figure 5

Breakeven Analysis for Select Products

Breakeven Analysis	Donor Advised Funds	Supporting Organizations	Build-A-Fund	Agency Endowments
Assets	\$65.4 M	\$28.9 M	\$1.2M	\$7.3M
Assets per Fund	\$258,668	\$3,616,545	\$6,103	\$101,460
Revenue per Fund	\$2,214	\$20,079	\$0	\$874
Cost per Fund	\$5,645	\$38,816	\$320	\$1,121
Post-Acquisition Cost per Fund	\$3,297	\$30,412	\$180	\$842
Published Fees	<ul style="list-style-type: none"> • 0.8% for 1st \$2M • 0.4% for \$2-3M • 0.2% for all over \$3M 	<ul style="list-style-type: none"> • 1.0% for 1st \$2M • 0.5% for \$2-3M • 0.25% for all over \$3M 	<ul style="list-style-type: none"> • No fees for funds under \$10,000 	<ul style="list-style-type: none"> • 0.8% for 1st \$2M • 0.4% for \$2-3M • 0.2% for all over \$3M
Costs as a % of Assets or Breakeven Point	2.18%	1.07%	5.24%	1.10%
Breakeven Size of Fund (at published fees)	\$705,648	\$8,526,511	N/A	\$140,068

Figure 34

Detailed Breakdown of DAF Costs



Even excluding acquisition costs for new funds and gifts, DAF fees cover only 67% of the product's annual costs

Note: Other Staff Activities include management and supervision, staff meetings, Board meetings, planning, reception, office management, reporting, and Paid Time Off

Figure 35

The foundation might, under these circumstances, make the following choices:

Donor Advised Funds

- Donor advised funds require the greatest subsidy, using 2/3 of the foundation's available surplus. Costs, at more than 2% of assets, are extremely high and the competitive environment suggests that fees could not be raised enough to cover them. Examining costs in more detail, the foundation discovers that the greatest costs are in acquisition, fund maintenance, and other staff activities. Based on an analysis of one lower cost foundation with a similar average DAF size and staffing levels, the foundation determines that, although it cannot meet their post-acquisition cost of 0.6% of assets, it should be able to reduce the post-acquisition costs to 1.0%, a reduction of \$506 in annual cost per fund, or \$128,000 total savings. An internal committee is formed to study and recommend cost savings to reach this goal by 2005, largely through automation and standardization of accounts.
- Simultaneously, the foundation decides to raise its DAF fees from 0.8% to 1.0% to cover its annual maintenance costs while remaining competitive with commercial funds, an average increase of \$554 per fund, or \$140,000. A minimum fee of \$250 is also established for DAF accounts below \$25,000, an additional increase in revenue of \$6,000.
- Annual acquisition costs are not reduced because the Board has endorsed this level of investment in building philanthropic resources for the community. However, the foundation's acquisition priorities are shifted – the development staff is requested to spend more time promoting other kinds of products – redirecting one-third of the marketing costs away from DAFs, a reduction of \$851 in costs per DAF, or \$215,000 in total.
- The net result is a reduction in cost per fund from \$5,645 to \$4,288. Together with the increased revenue, the subsidy required for the foundation's DAFs is reduced from \$868,000 to \$379,000. While DAFs continue to lose money, the board has agreed that they are sufficiently important to subsidize to this extent.

Supporting Organizations

- Supporting Organizations' costs are more in line at just over 1%, however the fees have been heavily discounted due to a rapidly sliding scale and a flexible negotiating posture. The foundation decides to shift the break point from \$2 million up to \$3 million and to take a firmer line on fee discounts with a goal of bringing the product to break even.
- In addition, the foundation decides to promote a new supporting organization product for small foundations which includes administrative and program support for a fee of 2%, based on the average cost of staffed foundations under \$10 million in assets. The foundation sets a minimum fee of \$60,000 to ensure a

strong positive contribution. One hundred thousand dollars from the annual acquisitions budget is shifted to attracting these small foundations with a targeted campaign to bring on board one new foundation every year. In the short run, the acquisition costs will not be covered, but if the plan is achieved, the net contribution will be positive after three years.

Agency Endowments

- Agency endowments break even at 1.1% of assets, somewhat above the 0.86% average fee, resulting in a net subsidy of \$19,000. The Board discussed the possibility of raising its fees, but feedback from the community indicated that the agencies were extremely price sensitive, especially in the current economy. The staff also felt that agency endowments, while directly relevant to the foundation's mission, were a secondary priority. The final decision was not to change pricing, but to discontinue any aggressive acquisition efforts for new agency endowments.

Other Products

- Build-a-funds, with balances of less than \$10,000, are the product with the highest cost as a percent of assets – more than 5% -- and the foundation charges no fee for these accounts. The foundation staff reviews the list of donors and discovers that none of them have the potential to make a major gift, but that they represent an important segment of the community that would otherwise not be involved with the foundation. The board notes that all commercial DAF offerings have a \$10,000 minimum, so there is no competitive pressure on the pricing of these small funds. Ultimately, the board decides that these accounts should be continued, but subject to the new minimum annual fee of \$250, which covers more than 80% of the foundation's costs.
- The Women's Fund requires an annual subsidy of \$175,000, and the development staff reports that it has not created much donor interest. After polling a number of donors, the foundation decides to discontinue the fund, offering donors the opportunity to shift their balance to a field of interest fund within the unrestricted grantmaking. The money that had been spent to subsidize the fund will be re-invested in sponsoring an annual conference on women's issues in the region. The conference will provide a substantial benefit to the community and attract considerable visibility to the foundation, potentially achieving a greater impact in cultivating new women donors than merely subsidizing the fund.

Admittedly, these steps are easier said than done, but they provide a hypothetical example of how a foundation might go about adjusting costs, pricing, and activities to create greater value for its community and a more sustainable and competitive operating model for itself. The answers will differ from foundation to foundation, and there is no magic cure, but each foundation can begin a similar transition to a stronger future.

About Foundation Strategy Group:

The Foundation Strategy Group was founded in 1999 by Professor Michael E. Porter and Mark R. Kramer with the vision of increasing philanthropy's potential to improve society. With offices in Boston, San Francisco and Geneva, our international team of consultants is drawn from the world's top strategy consulting firms and dedicated exclusively to assisting private, corporate and community foundations in developing and implementing strategies and in measuring their results. Our exclusive dedication to foundation strategy and performance keeps us at the forefront of the field, learning from our clients, providing thought leadership through regular seminars and publications, and bringing our clients the latest research and insights that can enable them to do good, better.

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