THE BUSINESS OF GIVING: Governance and Asset Management in Foundations Formed from Health Care Conversions

Since the formation of the first foundation in the wake of the conversion of a nonprofit health organization in 1973, grantmakers, regulators, and others have watched the conversion phenomenon with great interest. Grantmakers In Health (GIH) identified 174 foundations formed from health care conversions, which hold assets totaling $18.3 billion (Figure 1).

> GIH defines the term "foundations formed from health care conversions" to include foundations created when nonprofit health care organizations convert to for-profit status, foundations created when nonprofit health care organizations are sold to a for-profit company or another nonprofit organization, and existing foundations that receive additional assets from the sale or conversion of a nonprofit health care organization.

For nearly 10 years, GIH has been monitoring the development and operations of these foundations. Our latest survey, conducted in mid-2004 and soon to be released in a report, *The Business of Giving: Governance and Asset Management in Foundations Formed from Health Care Conversions*, documents the continued growth of this sector of philanthropy and focuses particularly on how these organizations are managing their investments, the conduct and composition of their boards, and other structural issues.

With policymakers and the press focused on nonprofit management, compensation, and accountability, it is clear that more information is needed about how foundations operate and how they make decisions about their grantmaking, their investments, and other matters. As this preview of GIH's report shows, foundations formed from health care conversions have strong structures in place to guide both decisionmaking about their work and prudent management of their assets.

COMPENSATION OF BOARD MEMBERS

While compensation of directors for board service is relatively common in the for-profit sector, it is much less common in the nonprofit sector. GIH's survey found that only 18 percent of foundations formed from health care conversions provide compensation to board members for their service on the board. More than half the foundations do not provide any type of compensation to board members for their service, although 25 percent provide reimbursement for travel to board meetings and 37 percent reimburse board members for other foundation-related trips.

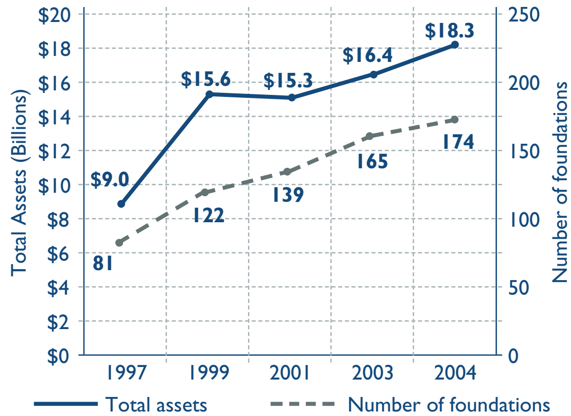
USE OF BOARD COMMITTEES

GIH asked about the use of committees to oversee foundation finances, audits, investments, and compensation. Nearly all foundations responding to the survey have a finance committee (94 percent) and an investment committee (91 percent). Of the foundations with a finance committee, about two-thirds (65 percent) give that committee decisionmaking authority on budget matters, while the remainder use the finance committee to advise the full board. Among foundations with investment committees, decisionmaking authority is most commonly given for decisions on rebalancing investment portfolios (66 percent) and switching investments among funds (52 percent). More than three out of every four foundations (76 percent) report having a committee to oversee foundation audits, and 65 percent report having a committee to review compensation policies and practices.

BOARD COMPOSITION

As the nation's population becomes more diverse, many foundations are working to increase the diversity of their boards.

Figure 1. Growth in Total Assets and Number of Foundations Formed from Health Care Conversions, 2004 (billions of dollars and number of foundations)



Source: Grantmakers In Health, *Survey of Foundation's Formed from Health Care Conversions*, 2004.

GIH's 2004 survey shows that foundations formed from health care conversions have increased – albeit modestly – the number of board members from racial and ethnic minority groups. From 2001 to 2004, the percentage of foundation boards that included no minority members decreased from 34 percent to 24 percent, while the percentage that included at least two minority members increased from 12 percent to 22 percent. By 2004, over one-third of boards (38 percent) had three or more members from racial and ethnic minority groups, up from 33 percent in 2001. Gender diversity, however, did not improve substantially from 2001 to 2004. The percentage of boards with no female members remained at 5 percent, while the percentage of boards with two or fewer women decreased by only 2 percentage points, from 31 percent in 2001 to 29 percent in 2004.

INVESTMENT OF FOUNDATION ASSETS

The ups and downs of the stock market make many foundation boards and executives concerned about how to maintain or increase the value of their portfolios. Like all investors, foundations must balance the potential benefits of investing conservatively to sustain the value of their assets against the potential benefits of investing more aggressively to increase their assets. GIH asked foundations for a wide range of information on their investments.

- ***Asset allocation*** – Among the foundations responding to GIH's survey, over half (60 percent) of the average foundation's financial portfolio was in equity investments (stocks and stock funds) and nearly one-third (31 percent) was in fixed income investments, such as bonds or annuities. A much smaller amount (6 percent) was placed in alternative investments or cash (3 percent). There is considerable variation around these averages, however. For example, although about half of the foundations maintain equity investments at between 58 percent and 69 percent of their investment portfolios, equity investments may represent as little as zero or as much as 92 percent of a foundation's portfolio.

- ***Management of foundation investments*** – Nearly all foundations responding to GIH's survey review their portfolio performance more often than once a year (96 percent), and most also include explicit allocation targets and criteria for rebalancing their portfolios in their investment policies (81 percent). About 60 percent of foundations indicated that they have guidelines or rules of thumb that trigger a decision to eliminate a particular investment from their portfolio.

  Foundation investment policies are not static, with about 74 percent of foundations reporting that they have revised their policies within the last two years. Those that revised their investment policies were most likely to change allocation targets for different types of investments or to add new types of investments. The reason most often cited for such changes was to achieve further diversification (63 percent of those making revisions) or to take advantage of new opportunities (37 percent).

- ***Target rate of return on investments*** – Foundations reported a median target rate of return of 8.0 percent (the average was 7.6 percent), with half the responding foundations falling between 7.0 percent and 8.7 percent. The highest target rate reported was 12.0 percent. Actual rates of return for the most recently completed fiscal year averaged 16.4 percent (the median was 17.9 percent), with a range between 7.8 percent and 25.1 percent return on investments.

- ***Use of social responsibility screens*** – About 37 percent of foundations reported applying social responsibility screens to their investments. Social responsibility screening describes the inclusion or exclusion of corporate securities in investment portfolios based on social or environmental criteria, such as employee relations records, levels of community involvement, environmental impact policies and practices, human rights policies, and the safety of products. The screens most commonly used by survey respondents were avoidance of investments in companies connected to tobacco products (23 percent) and alcohol (11 percent). Other screens that were cited included firearms, environmental concerns, gambling, production of pornographic publications and products, production of indiscriminant weapons of mass destruction, and process-oriented criteria such as companies with gross violations of consumer fraud or occupational safety standards.

CONCLUSION

The trend toward conversion of nonprofit health care organizations to for-profit status is continuing. The current pattern of conversions may be slightly altered from the 1990s – health plan conversions, for example, are facing more opposition in many localities and have therefore become less common – but the country is likely to continue to see the formation of new foundations.

At the same time that new foundations are being created from conversion transactions, many foundations formed from health care conversions have now been operating for a decade or more. The maturation of this sector of health philanthropy is evident from the strong governance and investment policies they have put in place, as well as the modest improvement in the diversity of their boards. As with other foundations, the leadership and staff of foundations formed from health care conversions seek to be good stewards of the resources entrusted to them. The early years of this decade were challenging ones financially for these foundations, as they were for all foundations. Generally, however, this group of foundations weathered the storm well, protecting their assets and their ability to make grants. Going forward, they will continue to make an important difference in the health and well-being of the communities they serve.

The Business of Giving: Governance and Asset Management in Foundations Formed from Health Care Conversions **will be released on February 23, 2005. A downloadable version of the report will be available on GIH's Web site at www.gih.org.**