

FOUNDING FAMILY CONTROL,
BOARD OF TRUSTEE COMPENSATION,
AND PRIVATE FOUNDATION PERFORMANCE

by

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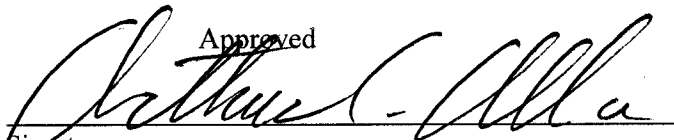
Founding Family Control, Board of Trustee Compensation, and

Private Foundation Performance

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FOUNDING FAMILY CONTROL,
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This dissertation examines the impact of trustee compensation and founding family control on foundation performance for the largest private foundations in the U.S. for the years 2001 and 2002. Competing arguments suggest trustee compensation and founding family control potentially improve or diminish foundation performance. Foundation performance is measured using four different accounting-based measures of performance: endowment performance, grant performance, and two measures of administrative efficiency.

Based on the accounting-based measures of performance, private foundations that pay trustee compensation do not perform significantly better or worse than foundations that do not pay trustee compensation. There is limited evidence that trustee compensation reduces administrative efficiency within private foundations, although this finding is sensitive to model specification. Contrary to the lack of substantial findings for trustee compensation, the results show family foundations perform better than independent foundations. In particular, family foundations distribute a larger percentage

of their assets in grants and are more efficient. These results are especially robust for family foundations with active founder participation.

This study also explores the relation between trustee compensation, founding family control and various foundation governance mechanisms. Trustee compensation policies significantly relate to more time spent on foundation business, shorter trustee tenure, larger boards, higher CEO compensation, and CEO duality. The board of trustees for family foundations is smaller with members spending less time on foundation business and having longer tenures. Family foundations also pay less CEO compensation with higher levels of CEO duality in comparison to independent foundations. Family foundations are also less likely to compensate foundation trustees.

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TABLE OF CONTENTS

	Page
ACKNOWLEDGEMENTS	iii
LIST OF TABLES	viii
CHAPTER	
1 INTRODUCTION	1
1.1 Contribution of the Study	3
1.2 Research Methodology	3
1.3 Results of the Study	4
1.4 Implications of the Study	5
1.5 Organization of the Study	7
2 LITERATURE REVIEW	8
2.1 Importance of the Board of Trustees for Nonprofit Organizations	8
2.2 Comparisons of Governance Structures Between Public Charities and Private Foundations	9
2.3 Measurement of Foundation Performance	11
3 HYPOTHESIS DEVELOPMENT	14
3.1 Potential Effects of Trustee Compensation on Foundation Performance	14
3.1.1 Potential Costs of Trustee Compensation	14
3.1.2 Potential Benefits of Trustee Compensation	15
3.1.3 Hypothesis 1	17
3.2 Potential Effects of Founding Family Control on Foundation Performance	17

	3.2.1	Potential Costs of Founding Family Control	17
	3.2.2	Potential Benefits of Founding Family Control	19
	3.2.3	Hypothesis 2	20
	3.3	Supplementary Analysis	21
4		RESEARCH METHODOLOGY	23
	4.1	Sample Selection and Data Collection Procedures	23
	4.2	Statistical Methodology	25
	4.2.1	Trustee Compensation Variables	25
	4.2.2	Founding Family Variables	26
	4.2.3	Foundation Performance Variables	27
	4.2.4	Control Variables	28
	4.3	Multiple Regression Analysis	30
	4.3.1	Empirical Model: Testable Hypotheses (Primary Analysis)	30
	4.3.2	Empirical Models: Supplementary Analysis	32
5		RESULTS OF THE STUDY	33
	5.1	Characteristics of Sample Private Foundations	33
	5.1.1	Sample Selection	33
	5.1.2	Descriptive Statistics	34
	5.2	Multivariate Analysis	38
	5.2.1	Regression Diagnostics	38
	5.2.2	Trustee Compensation and Foundation Performance	39

5.2.3	Founding Family Control and Foundation Performance	40
5.3	Robustness of Model Specifications	42
5.4	Supplementary Analysis	44
6	SUMMARY AND CONCLUSIONS	48
	REFERENCES	52
	TABLES	56
	APPENDIX A – SURVEY INSTRUMENT MATERIALS	72

LIST OF TABLES

Table		Page
1	Summary of Data Items Available on IRS Form 990-PF	56
2	Definitions and Sources of Variables	57
3	Sample Selection	59
4	Descriptive Statistics	60
5	Determinants of Foundation Performance	64
6	Supplementary Analysis	68

Chapter 1

Introduction

Foundations most often direct their evaluations at the activities of their grantees, only rarely subjecting themselves to the same level of scrutiny, accountability, and discomfort (Easterling and Csuti, 1999)

Private foundations have recently faced increasing criticism regarding their policies for compensating trustee members and the involvement of family members on the board of trustees. A number of news articles have questioned the fairness and legality of trustee compensation (Center for Effective Philanthropy, 2004). For example, the Kimball Art Foundation was heavily criticized in a series of news articles in 2000 for paying its co-founders in excess of \$700,000 each in trustee fees and incurring over \$12 million in administrative expenses, while distributing grants totaling \$291,000 (Fort Worth Star-Telegram, 2000).

Although the Kimball Art Foundation news articles focused on excessive trustee compensation, this anecdotal evidence suggests founding family foundations may be less efficient than independent foundations. The Center of Effective Philanthropy (2004) describes foundations with founding family control as “less actively engaged, more motivated by personal agendas, and less essential to foundation effectiveness.” Private family foundations are distinct from private independent foundations in that family foundations are controlled by the founder or the founding family. The founder and/or the founder’s family are typically members of the board of trustees of a family foundation, while the board of trustees of an independent foundation consists entirely of non-family members (Chorafas, 2002).

Despite the anecdotal evidence, conflicting arguments suggest trustee compensation and founding family control have the potential to either enhance or degrade the financial performance of a private foundation. Trustee compensation potentially reduces foundation performance by creating conflicts of interest between trustee economic self interest and trustee responsibilities, while founding family control has the potential to reduce foundation performance by creating conflicts of interests between family interests and trustee responsibilities. These conflicts of interests can undermine the independent monitoring of foundation managers decisions by the board of trustees and may be incongruous with the best interests of the private foundation.

Although there is substantial anecdotal evidence suggesting trustee compensation and founding family control can lead to poor foundation performance, both characteristics also have the potential of enhancing foundation performance. Trustee compensation may boost foundation performance by enabling private foundations to recruit independent and sophisticated board members and by stimulating trustee interest regarding foundation operations. In addition, private foundations that compensate trustees argue that they are able to attract higher quality trustees with the technical talent and expertise necessary to oversee their foundation's operational and philanthropic goals (Council of Foundations, 2003).

Founding family control also has the potential to enhance foundation performance. The family wealth, name, and reputation are inseparable from the activities of the family foundation; therefore, family members are more likely to support the philanthropic mission of the foundation as originated by the founder.

Also, the long-term presence of founding families in family foundations motivates families to promote strong foundation performance because the family intends to pass control of the family foundation to succeeding generations.

Given that trustee compensation and founding family control have the potential to both improve or hinder foundation performance, this dissertation investigates the association between two variables-of-interest: trustee compensation and founding family control, and three measures of foundation performance: endowment performance, grant performance, and administrative performance.

1.1 Contribution of the Study

This dissertation examines the links between the compensation of the board of trustees of private foundations and foundation performance and the relation between founding family control and foundation performance. The primary research questions focus on 1) whether foundation performance is improved or is reduced as a result of the compensation paid to its board of trustees and 2) whether founding family control improves or reduces foundation performance. Supplementary analysis investigates whether board member compensation and founding family control affects the (a) independence and expertise of the board of trustees, and (b) time and effort of board members to work diligently to promote a foundation's goals.

1.2 Research Methodology

The data used to address the primary research questions is compiled from the annual tax returns (IRS Form 990-PF) of the largest 200 private foundations in the U.S. for the years 2001 and 2002. In addition, supplementary data is collected using a survey methodology to examine the relation between the two variables of interest

and various characteristics of foundation governance. The supplementary analysis will specifically focus on how both trustee compensation and founding family control relate to: 1) board composition; 2) board expertise; 3) board effort, and; 4) CEO influence.

1.3 Results of the Study

Private foundations with trustee compensation policies do not perform significantly better or worse than non-trustee compensating foundations, based on accounting measures of performance. While trustee compensating foundations earn approximately the same level of investment return on their endowment assets and distribute similar percentages of grants to qualified charities as non-trustee compensating foundations, there is limited evidence that trustee compensation reduces administrative efficiencies within private foundations. However, this finding is sensitive to regression model specification. On the other hand, family foundations perform at least as well as independent foundations. Specifically, family foundations earn approximately the same level of investment return on their endowment assets as independent foundations, but they distribute a larger percentage of their assets in grants to qualified charities and maintain higher levels of administrative efficiency. These results for founding family control are especially robust for family foundations with founder involvement. Grant performance and administrative performance levels are significantly higher when founder involvement is still prevalent within a family foundation.

The supplementary analysis provides preliminary evidence showing that trustee compensation and founding family control affect foundation governance

mechanisms. Trustee compensation motivates trustees to spend significantly more time on foundation-related business and promotes shorter trustee tenure, while family foundation trustees spend less time on foundation business and have longer tenures as board members. Independent foundations are also more likely to implement trustee compensation policies, possibly because non-family managers and trustees are not as motivated as founding family members in protecting the foundation's reputation and name. Overall, this is preliminary evidence that independent foundations may require stronger governance structures in comparison to founding family foundations.

Trustee compensation and founding family control are also related to CEO characteristics. Trustee compensating foundations compensate their CEOs at higher levels in comparison to non-trustee compensating foundations, while family foundations also pay lower amounts of CEO compensation compared to independent foundations. Private foundations with trustee compensation and founding family control are also more likely to delegate board chairperson responsibilities to the CEO.

1.4 Implications of the Study

This study has implications for private foundation benefactors, governing bodies, and managers interested in foundation governance and performance. First, private foundations have established trustee compensation policies without knowledge of the consequences of these policies on foundation performance. This study provides initial evidence to foundation trustees and managers on the effects of trustee compensation on foundation performance. Second, CEOs of private foundations perceive family involvement as detrimental to foundation effectiveness (Center for Effective Philanthropy, 2004). Contrary to the perceptions of CEOs, the

results in this study provide evidence that founding family control has a positive influence on foundation performance. As a result, private foundation managers may want to encourage active participation of founding family members in foundation operations. Finally, this study identifies specific accounting performance measures related to endowment management, grant management, and general administrative efficiency for private foundations. The accounting performance measures provide one mechanism for private foundation stakeholders to use in evaluating the efficiency and effectiveness of private foundations.

This study also has tax-related and governance public policy implications. There is substantial anecdotal evidence criticizing the impact of trustee compensation on private foundations. As a result of this negative publicity, Congress considered legislation (H.R. 7; The Charitable Giving Act) that would eliminate the inclusion of trustee compensation in calculating the qualifying distribution amount and the IRS has commissioned an enforcement project to identify and halt perceived abuses by tax-exempt organizations that pay excessive compensation and benefits to the managers and trustees. In addition, state governments are promoting legislation mandating stronger accountability for private foundations. Legislative bodies in Massachusetts, California, and New York have introduced bills similar in nature to the Sarbanes-Oxley Act adopted on the federal level for corporate entities (Strom, 2004). This research study provides empirical evidence to policy makers on the potential effects of trustee compensation on foundation governance and performance. The results of this study suggest that this legislation may be unfounded or should be approached with caution.

1.5 Organization of the Study

The remainder of the study proceeds as follows. Chapter 2 introduces the theoretical basis for nonprofit governance, describes foundation governance structures, and details the importance of foundation-specific accounting performance measures in promoting strong foundation governance. Chapter 3 discusses the potential costs and benefits of trustee compensation and founding family control on private foundation performance and summarizes the research focus for this study. Chapter 4 describes the research methodology, including sample selection and data collection procedures. Chapter 4 also discusses the empirical models used for the testable hypotheses and the supplementary analysis. Chapter 5 presents and discusses the empirical results of the testable hypotheses and supplementary analyses, while Chapter 6 summarizes the findings and conclusions of the study.

Chapter 2

Literature Review

The purpose of this chapter is to provide background information about the importance of foundation governance and review the literature relevant to the following two research questions proposed in this study:

Research Question 1: Does trustee compensation relate to private foundation performance?

Research Question 2: Does founding family control relate to private foundation performance?

Section 2.1 examines the governance literature pertaining to nonprofit organizations and compares the similarities and differences in governance structures between public charities and private foundations. The next section defines four foundation-specific accounting measures of performance and argues the importance of these performance measures for promoting foundation governance.

2.1 Importance of the Board of Trustees for Nonprofit Organizations

Managers of nonprofit organizations have economic incentives to expropriate the contributions received from donors of the organization for their own benefit in the form of excessive compensation and perquisites (Fama and Jensen, 1983). Nonprofit boards help ensure that donations received by a nonprofit organization are used effectively and are not easily expropriated by managers (Fama and Jensen, 1983). Nonprofit organizations are not disciplined by capital market-related forces, such as market-based prices for goods and services, takeover bids, and removal of board members by shareholders (Fama and Jensen, 1983; Williamson, 1983). In the absence of these disciplining mechanisms, nonprofit organizations require external

monitoring by oversight agencies and internal governance mechanisms inherently different from corporations to adequately monitor the actions of managers.

2.1.1 Comparisons of Governance Structures Between Public Charities and Private Foundations

Nonprofit entities organized under Section 501(c)(3) of the Internal Revenue Code are classified either as private foundations or public charities (IRS Publication 578, 1989). For both public charities and private foundations, contributions received from donors are tax deductible and income earned is exempt from federal income tax¹. However, while public charities receive broad public support for directly engaging in charitable activities, private foundations are solely funded by a benefactor, typically a wealthy individual, family or corporation. Private foundations use the income earned from their endowment assets to distribute grants to public charities, rather than directly providing charitable activities.

Public charities and private foundations also have differences in internal governance structures and in oversight by external parties. Public charities are scrutinized by private oversight agencies, such as the Better Business Bureau Wise Giving Alliance and GuideStar. These oversight agencies rate public charities based on established charitable accountability standards (Baber, Daniel, and Roberts, 2002). Public charities also possess specific governance mechanisms that attenuate the potential for malfeasance by nonprofit managers. Public charity boards consist almost entirely of outside members who are not compensated for their board service, thereby providing assurances against collusion with managers and expropriation of

¹ Internal Revenue Code Section 4940 imposes an excise tax of 2% on the net investment income of private foundations (IRS Publication 578, 1989).

donations and reducing the potential for conflicts of interest between board members own agendas and their philanthropic and fiduciary responsibilities (Fama and Jensen, 1983).

Unlike the external oversight and internal governance mechanisms in place for public charities, foundation oversight and governance mechanisms do not appear to be optimally structured to ensure accountability over foundation assets. (Center for Effective Philanthropy, 2002b). Private foundations are not subject to monitoring by external oversight agencies, other than limited oversight by the Internal Revenue Service. Although the IRS is responsible for enforcing regulations aimed at preventing transactions that pertain to self dealing and conflicts of interest for foundation trustees, the IRS provides little oversight over trustee compensation issues (Ahn et al., 2003). The lack of effective external monitoring places greater responsibility on the board of trustees to focus management efforts toward effective foundation operations.

There are three foundation governance characteristics specific to private foundations that potentially limit the effectiveness of foundation trustees. First, the board of trustees for private foundations typically consists of both insider and outsider members, providing the opportunity for insider members to unduly influence outside members and diminishing the independent status of outsider board service. Second, private foundations are allowed, though not required, to compensate outside board of trustee members for services “that meet the exempt purpose of the foundation” as long as the compensation is “reasonable, necessary, and not excessive” (IRS Publication 578, 1989). Third, private family foundations are controlled by the

founder or the founder's family, while private independent foundations are no longer governed by the founding family. Given the substantial influence of founding families on family foundation operations, founding family control has the potential to lead to performance differences between family and independent foundations. This study focuses on the final two characteristics of foundation governance: trustee compensation and founding family control.

2.2 Measurement of Foundation Performance

A private foundation board of trustees is charged with ensuring the effective and efficient use of foundation resources to achieve social objectives. Direct assessment of social benefit is a costly and subjective endeavor, so foundation performance is typically evaluated by using indirect accounting measures of social benefit (Center for Effective Philanthropy, 2002a). Accounting measures of foundation performance fall into three categories: endowment performance, grant management, and general administration (Center for Effective Philanthropy, 2002b).

Endowment performance refers to return on investment assets earned by a private foundation and is calculated by dividing total investment income by average investment assets. Given that private foundation total assets consist of a high proportion of investment assets, the endowment performance measure used in this study is similar to the return on total assets ratio used in previous corporate and charitable nonprofit research (Hallock, 2002; Anderson and Reeb, 2003).

IRS regulations prohibit risky investments that could financially jeopardize the carrying out of a private foundation's exempt purposes (IRS Publication 578,

1989).² Subject to these IRS constraints, stronger investment performance results in larger amounts available for distribution for charitable endeavors. Therefore, higher return on investment assets results in higher foundation performance.

Grant management involves grantee selection based on the stated objectives of the private foundation (Center for Effective Philanthropy, 2002b). While most grant management evaluation involves qualitative processes, accounting metrics are helpful in assessing the dollar amount of grants distributed to public charities. IRS regulations require private foundations to spend at least five percent of the fair market value of their net investment assets. This legally mandated minimum threshold must be paid out in qualifying distributions in the current or following year to avoid severe penalties.³

Qualifying distributions include grants paid to charities, administrative expenses, capital expenditures, and IRS approved amounts set aside (IRS Publication 578, 1989). The grant distribution ratio, used for the first time in this study, only includes grants paid to charities in the numerator and is calculated as the amount of qualifying distributions paid in the form of grants to charities divided by the amount required to be distributed in compliance with IRS regulations. This ratio compares how much a private foundation distributes to charities in comparison with the legally

² Internal Revenue Code Section 4945 discusses definitions and penalties associated with jeopardizing investments. Jeopardizing investment transactions include: 1) trading in securities on margin, 2) trading in commodity futures, 3) investing in working interests in oil and gas wells, 4) buying “puts”, “calls”, and “straddles”, 4) buying warrants, and 5) selling short (IRS Publication 578, 1989). An excise tax of 5% of the transaction amount is imposed on a foundation for making jeopardizing investments.

³ Internal Revenue Code Section 4942 imposes an excise tax on any undistributed income of a private foundation. An excise tax of 15% is imposed on undistributed income that hasn't been distributed before the first day of the second tax year following the year earned; if this undistributed income is not distributed in the second tax year, an additional tax of 100% of the amount remaining undistributed is imposed (IRS Publication 578, 1989).

required minimum distribution. A higher qualifying distribution ratio represents a higher propensity for using grant distributions to public charities in achieving the minimum five percent threshold mandated by IRS regulations.

General administrative performance measures provide information about private foundation operating efficiency. The efficacy of efficiency ratios as a proxy for nonprofit performance has been extensively documented in the public charity research (Weisbrod and Dominguez, 1986; Posnett and Sandler, 1989; Khumawala and Gordon, 1997; Greenlee and Brown, 1999; Tinkelman, 1999; Okten and Weisbrod, 2000). Since administrative costs should increase with the approval of large grants and large numbers of grants, the use of two different efficiency measures provides for better analysis concerning the efficiency of private foundations.

The first measure, the administrative expense ratio, has been used in previous accounting research (Sansing and Yetman, 2002) to measure the efficiency of foundation grant-making. This ratio is calculated by dividing total operating and administrative expenses by total grants paid and can be interpreted as the cost incurred by a private foundation for each grant dollar distributed to a public charity. Lower administrative ratios imply higher efficiency in the administration of foundation operations. The second measure of efficiency, the administrative cost-per-grant ratio, has not been used in prior research studies. This measure combines financial and non-financial information by comparing foundation operating and administrative costs with each grant paid by the foundation. This ratio is calculated by dividing total operating and administrative expenses by the total number of grants paid. Lower administrative cost-per-grant ratios suggest higher levels of efficiency.

Chapter 3

Hypothesis Development

This chapter discusses competing theories of how trustee compensation (Section 3.1) and founding family control (Section 3.2) can either improve or reduce the performance of private foundations. Two testable hypotheses are proposed based on these competing theories. Section 3.3 provides supplementary analyses to be performed on the relation between trustee compensation, founding family control, and various characteristics pertaining to foundation governance structures.

3.1 Potential Effects of Trustee Compensation on Foundation Performance

3.1.1 Potential Costs of Trustee Compensation

Trustee compensation may have detrimental effects on foundation performance in at least three different ways. First, trustees receiving compensation may be beholden to the foundation managers due to the compensation they receive, especially if trustees are excessively compensated for expending little or no effort toward board of trustee responsibilities. Trustee compensation can influence the board of trustees to “rubber-stamp” management plans, instead of dispassionately evaluating the performance and policies of foundation managers (Dalton and Daily, 2001). This may be especially true when foundation CEOs also hold the position of chairperson. CEOs serving as chair of the board of trustees have the power to control the agenda of the board, making it difficult for the board to effectively monitor the actions of managers (Jensen, 1993).

Second, trustees have the potential to collude with foundation managers and expropriate the assets of the foundation for their own economic benefit (Fama and

Jensen, 1983). Despite IRS rules that require compensation to be reasonable, trustee compensation provides a mechanism to extract excessive pecuniary benefits from a private foundation. Specifically, since the IRS does not provide explicit definitions of excessive compensation in its self-dealing regulations⁴, the possibility exists for abusive compensation practices by private foundations (Ahn, et al., 2003). The potentially negative effects resulting from compensating trustee members contradict the spirit of the self-dealing exception for trustee fees while also reducing the level of quality of foundation governance for private foundations.

Finally, the policy of compensating trustees potentially changes the focus of board members from voluntary and charitable objectives of nonprofit service to “protecting an income stream” (Council of Foundations, 2003). Trustee compensation also reduces the amount of money available for distribution to charities and charitable programs. In summary, trustee compensation potentially subverts the philanthropic nature of foundation board service by reducing the altruistic nature of nonprofit board service and the charitable role of private foundations.

3.1.2 Potential Benefits of Trustee Compensation

Foundation trustee compensation has the potential to enhance foundation performance by diversifying the composition of the board of trustees and by attracting highly competent trustees (Cravens and Wallace, 2001). First, trustee compensation

⁴ Internal Revenue Code Section 4941 defines self-dealing transactions between private foundations and disqualified persons. Self-dealing transactions between these parties are prohibited and include property sales and leases, provisions of credit, and compensation payments. However, payment of compensation to disqualified persons for “personal services that are reasonable and necessary to carry out the exempt purpose of the private foundation” are not considered self-dealing as long as the compensation is not considered excessive. The law does not specify the definitions of “reasonable and necessary” services and compensation.

diversifies a board by providing an economic incentive that encourages individuals independent of a private foundation to serve on the board of trustees. Outside representation provides an effective check on the actions of foundation management and helps alleviate any agency conflicts that arise within the private foundation (Fama and Jensen, 1983). Private foundations with more outside trustees are expected to be more effective monitors by providing unbiased oversight over foundation managers.

Second, trustee compensation promotes the recruitment of trustees who are more sophisticated and more committed to their board responsibilities. Siciliano (1993) concludes that public charities with board members from various occupational backgrounds have higher levels of organizational performance. Foundation trustees with a breadth of expertise have the experience and knowledge necessary to monitor the actions of foundation managers, as well as provide valuable direction to foundation management (Zahra and Pearce II, 1989). Since private foundations are in competition with corporations and nonprofit charities for competent board members, trustee compensation enables foundations the opportunity to obtain trustees with a high level of sophistication, especially technical expertise related to investment strategy and charitable nonprofit operations (Council of Foundations, 2003).

Third, board members demonstrating competency in their board responsibilities spend significant amounts of time performing various trustee duties. According to Eugene R. Tempel, director of the Center on Philanthropy at Indiana University: "the larger and more complex the private foundation becomes, the more time that is demanded of trustees, the more likely that directors will be compensated" (Allen, 2001). Trustees are entrusted with the responsibility of ensuring the proper

management of very large endowments and distributing large amounts of grants to public charities on behalf of a private foundation. Trustee compensation may motivate foundation trustees toward more hours of service to a private foundation, potentially resulting in more effective foundation oversight. In a survey of foundation CEOs, trustees receiving compensation spent 33% more time on foundation business outside board meetings than non-compensated board members (Center for Effective Philanthropy, 2004).

3.1.3 Hypothesis 1

The compensation of the board of trustees of a private foundation may have conflicting effects on the performance of a foundation. Trustee compensation has the potential to reduce the operational effectiveness of a private foundation by subordinating the board of trustees' fiduciary and philanthropic responsibilities. Alternatively, trustee compensation enables private foundations to attract higher quality trustee members capable of promoting the operational effectiveness of a private foundation. These competing theories are the central focus of this paper and result in the following non-directional hypothesis:

H1: Private foundations that compensate trustees have higher or lower levels of foundation performance than private foundations that do not compensate trustees.

3.2 Potential Effects of Founding Family Control on Foundation Performance

3.2.1 Potential Costs of Founding Family Control

Founding family control may have detrimental effects on foundation performance in at least three different ways. First, founding family members may

perceive the foundation assets as family money, rather than as money in the public trust for the benefit of philanthropic endeavors (Center for Effective Philanthropy, 2004). As a result, the performance of private foundations controlled by founding family members potentially suffers from sub-optimal choices when compared to independent private foundations. Since founding families have a controlling interest in the private foundation, they have the power to control the agenda of the foundation toward actions that benefit themselves at the expense of foundation performance. In the extreme, families have the potential to expropriate the assets of the foundation for their own economic benefit through excessive compensation, perquisites, and related-party transactions (Fama and Jensen, 1983).

Second, founding families have the capability to recruit foundation managers and trustee members that serve the interests of the family instead of promoting foundation effectiveness. Foundation managers and trustees may be selected to serve the foundation based on cronyism, rather than on the basis of their level of competence (Center for Effective Philanthropy, 2004). Foundation managers may not have the expertise to effectively direct the complex operations of a family foundation. In addition, the board of trustees of a family foundation may have a lower level of independence and competency relative to independent private foundations.

Finally, foundation managers and board members may be beholden to founding family members, especially if the family members influence personnel decisions and trustee recruitment for the private foundation. Involvement in a large family foundation is typically associated with a high level of prestige, and foundation managers and trustees appointed by family members may not have the desire to

contradict the individuals providing them the opportunity to serve the private foundation. Family control may persuade foundation managers and trustees to “rubber stamp” the policies proposed by family members, instead of dispassionately evaluating the performance and policies that serve the best interest of the private foundation (Center for Effective Philanthropy, 2004). In summary, founding family control potentially subordinates the philanthropic goals of a family foundation in favor of the interests of the founding family.

3.2.2 Potential Benefits of Founding Family Control

Although there is anecdotal evidence suggesting that founding family control of a private foundation leads to lower foundation performance, founding family influence also has characteristics that may promote foundation effectiveness. First, founding family members on the foundation board of trustees may be more committed to their board responsibilities since at least a portion of the family wealth is endowed in the family foundation. Fama and Jensen (1983) argue that board members take their board service more seriously when they are substantial contributors to an organization. Since the philanthropic capital used to create the family foundation was contributed by a family relation, founding family trustees are potentially more motivated than non-family trustees at actively monitoring family foundation operations (Fama and Jensen, 1983, Williamson, 1983). In addition, family members may be more likely to direct foundation operations toward the philanthropic objectives as originally established by the founder of the private foundation.

Second, family member trustees have strong incentives to protect the family foundation's reputation and name, especially since the family name (e.g. William and Melinda Gates Foundation, The David and Lucile Packard Foundation) is generally attached to the family foundation name (Anderson and Reeb, 2003). Negative publicity related to the foundation adversely affects the reputation of the founding family. Because they are often affluent and influential individuals, founding family members are motivated to maintain or bolster their reputations. Therefore, founding family trustees are more likely to promote foundation effectiveness to curtail any potential losses to family reputation.

Finally, multiple generations of family members often participate on the board of trustees for a family foundation. Current generation family members want to pass on the control of the foundation to future generation family members, so they have the motivation to leave the family foundation to their descendents in the best condition possible (Nason, 1989). Due to this long-term perspective, founding family members have longer managerial horizons and suffer less managerial myopia relative to non-family trustee members (Anderson and Reeb, 2003). In addition, while non-family trustees on the boards of independent foundations turn over on a continual basis, founding family members are more likely to have long tenures on the board of trustees. This enables founding family members more time to acquire foundation-specific expertise necessary to effectively govern a foundation.

3.2.3 Hypothesis 2

Founding family control in a private foundation may have conflicting effects on the performance of a foundation. Founding family control has the potential to

reduce the operational effectiveness of a private foundation by subordinating the board of trustees' fiduciary and philanthropic responsibilities and elevating family interests. Alternatively, founding family control may enhance the effectiveness of the board of trustees since family members are motivated to monitor the family name, reputation, and wealth attached to the family foundation. These competing theories are the central focus of this paper and result in the following non-directional hypothesis:

H2: Private family foundations have higher or lower levels of foundation performance than private independent foundations.

3.3 Supplementary Analyses

Trustee compensation and founding family control are both hypothesized to impact foundation performance because of their influence on foundation governance structure. However, information about certain foundation governance structures (e.g. number of trustees, tenure of trustees, hours spent in trustee meetings, and trustee expertise) is not available through public sources and may only be obtained directly from private foundations through a survey methodology. As a result, this supplementary analyses is limited by the response rate to the surveys sent and the reliability of the responses received by responding private foundations.

The supplementary analysis examines the effects of trustee compensation on specific features of foundation governance. First, are compensated boards more independent than non-compensated boards? Second, do outside trustees receiving trustee compensation have more financial and nonprofit expertise than outside trustees not receiving compensation? Third, does trustee compensation have an effect

on the number of board meetings, the amount of time spent by board members on foundation-related business, and on trustee tenure? Fourth, does the involvement of the foundation CEO also functioning as the chairperson of the board affect whether a private foundation compensates trustees?

Supplementary analysis also explores the impact of founding family control on specific features of foundation governance. First, are the boards of family foundations more or less independent than the boards of independent foundations? Second, does founding family control have an effect on the number of board meetings and the amount of time spent by board members on foundation-related business? Third, do outside and founding family trustees of a family foundation have more financial and nonprofit expertise than outside and founding family trustees of an independent foundation? Finally, does founding family control have an effect on board of trustee compensation?

Chapter 4

Research Methodology

This chapter explains the sample selection process and the methods used to collect the data required for this study (Section 4.1). The chapter also defines and describes the dependent variables, independent variables of interest, and control variables included in the empirical analyses (Section 4.2). Finally, the chapter provides the primary regression model used for testing H1 and H2 and the statistical methods applied to the supplementary analyses (Section 4.3).

4.1 Sample Selection and Data Collection Procedures

The sample used for this study consists of the 200 largest independent U.S. private foundations by total asset size in 2001. The list of private foundations to be included in the sample was obtained from Foundation Center Statistical Services (FCSS), a nonprofit organization created to collect, organize, and communicate information on U.S. philanthropic resources. FCSS compiles rankings of private foundations by asset size based on information on the IRS Form 990-PF, the informational tax return filed annually by all private foundations.

The data necessary for this study was collected for 2001 and 2002 from two sources: IRS Form 990-PF and an informational survey sent to sample foundations. All information required to test the two primary hypotheses was obtained directly from IRS Form 990-PF, while the survey information is necessary for the supplementary analysis only. Since the data needed for testing the two hypotheses is available from public sources, the primary analyses in this study are not subject to the limitations that result from the proposed survey methodology.

Private foundations are required to file Form 990-PF annually and to disclose the tax return to the general public. Specific to this study, Form 990-PF discloses financial data (income statement and balance sheet), non-financial information about foundation activities and officers, directors, and trustees, and information about compliance with various foundation-related IRS regulations. A summary of data found on Form 990-PF for use in this study is included in Table 1.

The collection of the data available on Form 990-PF involves a three-step process. IRS Form 990-PF is publicly available on searchable websites for The Foundation Center and GuideStar, so the data needed for this study was first collected from tax returns posted on The Foundation Center website. Next, the GuideStar website was used to search for any sample foundation tax returns that are not found on The Foundation Center website. However, since private foundations voluntarily provide Form 990-PF to The Foundation Center and GuideStar for public disclosure, some foundations may choose not to disclose their tax return information. Therefore, tax returns for foundations that do not disclose their Form 990-PF on The Foundation Center or GuideStar websites were requested directly from the private foundation. The final sample selected for testing the proposed hypotheses is provided in greater detail in Chapter 5.

An informational survey was also mailed to the sample of private foundations. The additional information collected from the survey is not available from public sources, but is necessary for the supplementary analysis. The additional information collected by survey methodology includes the following: number of board meetings, expertise of outside trustee members, trustee tenure, and average time spent by trustee

members on foundation-related business. An example of the survey instrument can be found in the Appendix.

Each survey was sent to the attention of each private foundation's CEO or executive director. The foundation manager names and foundation addresses were obtained from foundation websites and from the National Center for Charitable Statistics (NCCS). The private foundations receiving surveys were guaranteed anonymity for all responses by agreeing to allow aggregate results to be published without reference to specific foundations. In addition, a reminder letter was sent to improve the response rate. Survey response rates and statistical procedures pertaining to non-response bias are explained in greater detail in Chapter 5.

4.2 Statistical Methodology

4.2.1 Trustee Compensation Variables

Trustee compensation is defined and tested in two ways. First, a dichotomous variable is coded one if trustee compensation is present in a private foundation. Since IRS Form 990-PF discloses the amounts paid to outside trustee members, determining the presence or absence of trustee compensation is straightforward. Second, the trustee compensation amount paid to each outside trustee is also used to examine the relation between compensation levels and foundation performance. Higher amounts of trustee compensation per outside trustee member may potentially have different effects on individual trustees than lower amounts of compensation per outside trustee member.

The amount of compensation paid to individual trustees is potentially difficult to determine for two reasons. First, the Form 990-PF disclosures include total

compensation paid individually to both inside and outside trustees, so the compensation amounts paid to each inside board member includes both employment-related and trustee compensation. Second, individual outside trustees are sometimes paid different amounts, which leads to uncertainty as to which compensation amount to include in the analysis. This issue will be resolved by using the highest individual amount paid to an outside trustee for computing trustee compensation per outside trustee member.⁵

4.2.2 Founding Family Variables

The private foundation is a family foundation if the founder of the foundation and/or any relative of the founder participate on the board of trustees. Since IRS Form 990-PF discloses the membership of the board of trustees, determining the presence or absence of the founder and the founder's immediate family was straightforward. The identification of distant relatives was more difficult to determine, especially when the last names of the distant relatives were different from the founder's last name. Similar to Anderson and Reeb (2003), the identification of distant relatives was determined by reading and examining the histories for each foundation. These histories were available from the foundations' internet websites.

Founding family control is defined and tested using two measures. First, an indicator variable is coded one if a private foundation is a family foundation, and zero otherwise. The family foundation variable measures participation on the board of trustees by the founder and/or any relative of the founder. Second, founder

⁵ A robustness test is performed using average trustee compensation per outside trustee member. This alternative proxy for trustee compensation does not change the interpretation of the results presented in the tables.

involvement on the board of trustees of a private foundation may have different effects on foundation performance than participation by founding family members from successive generations. Therefore, the family foundation indicator variable described above will be partitioned into two separate components. The first component will be coded one if the founder of the family foundation is present on the board of trustees, and zero otherwise; while the second component will be coded one if founding family members other than the founder participate on the board of trustees, and zero otherwise.

4.2.3 Foundation Performance Variables

Foundation performance is measured using four different performance indicators. Endowment performance is measured using total investment return, calculated as gross investment income (interest, dividends, realized and unrealized gains and losses⁶) divided by average fair market value of investment securities. Grant performance measurement is based on the amount of grants paid to charities divided by the amount required to be distributed in compliance with IRS regulations. General administration performance is calculated using two measures: 1) the administrative expense ratio, measured as total operating and administrative expenses divided by the amount of grants paid to charities, and; 2) the administrative cost-per-

⁶ Unrealized gains and losses on investments are a significant element of foundation investment performance. However, disclosure of unrealized gains and losses on IRS Form 990-PF is voluntary for private foundations. In this study, 78 foundations voluntarily report unrealized gains and losses, while 102 private foundations do not voluntarily disclose unrealized gains and losses. Since all private foundations are required to report both cost and fair value amounts for total investments, unrealized gains and losses can be manually calculated for those private foundations that do not voluntarily report unrealized gains and losses. After controlling for foundation size, there is no statistical difference between voluntarily reported and manually calculated unrealized gains and losses (t -value = 0.27, p -value = 0.7898).

grant ratio, measured as total operating and administrative expenses divided by the total number of grants paid during the year.

4.2.4 Control Variables

Several control variables are introduced into the analyses to control for foundation characteristics. First, Tinkelman (1999) determined that large and well-established public charities have stronger efficiency ratios, so foundation size and foundation age are included as control variables. Foundation size is calculated as the natural log of the fair market value of total assets and foundation age is measured as the natural log of the number of years since the foundation's creation.

Second, corporate and nonprofit governance research detail a relation between specific governance characteristics and performance (See Cravens and Wallace, 2001 and Zahra and Pearce III, 1989 for literature reviews). Board composition and board size are two common governance characteristics examined by the extant literature. Board composition attempts to measure the potential influence outside board members have on board mechanisms (Zahra and Pearce III, 1989). Baysinger and Butler (1985) provide evidence that the presence of outsiders improves firm performance, while Agrawal and Knoeber (1996) and Klein (1998) find that a majority representation by insiders enhances corporate performance. Hermalin and Weisbach (1991) and Bhagat and Black (1999) find no relation between board composition and firm performance. For a sample of Canadian charitable nonprofits, Callen and Falk (1993) determine that board composition is unrelated to efficiency. Corporate research has also found that smaller boards typically result in stronger levels of firm performance (Yermack, 1996; Eisenberg, et al., 1998). However, in a

public charity setting, Callen et al. (2003) finds little evidence that board size is related to program and administrative efficiency ratios.

Corporate and nonprofit research on the direction of the relation between board characteristics (board composition and board size) and performance have yielded mixed results, so these variables are included as control variables in this study. Board composition is calculated as the percentage of outsiders present on a board of directors and board size is measured as the natural log of total number of trustees.

Corporate and nonprofit research also documents relations between CEO characteristics and performance. Baber et al. (2002) document a relation between changes in executive pay and changes in public charity performance as measured by program spending ratios. Although this study examines the level of performance rather than the changes in performance, a CEO compensation measure is incorporated into this study as a control variable based on executive compensation information disclosed on IRS Form 990-PF.⁷ This variable is computed as the natural log of total CEO compensation.

CEO duality has also been found to have both positive and negative relations to organizational performance (Zahra and Pearce II, 1989; Cravens and Wallace, 2001). Daily and Dalton (1997) conclude that specific contextual factors determine whether or not CEO duality has beneficial or detrimental effects on corporate

⁷ The IRS requires the following amounts to be disclosed for current year compensation: salary, fees, bonuses, severance payments, current year payments of deferred compensation from previous years. In addition to current year compensation, the IRS requires separate disclosure for all forms of deferred compensation funded in the current year. For this study, total CEO compensation will be calculated as the sum of current year compensation and deferred compensation funded in the current year.

performance. In order to control for the potential effects of CEO duality on foundation performance, a dichotomous variable indicating CEO/chairperson duality is included in this study as a control variable.

The definitions and sources of all variables used in both the primary and supplementary analysis are summarized in Table 2.

4.3 Multiple Regression Analysis

4.3.1 Empirical Model: Testable Hypotheses (Primary Analysis)

The primary interest of this study is the relation between trustee compensation, founding family control, and foundation performance. The following empirical model using cross-sectional ordinary least squares (OLS) will investigate this relation:

$$(1) \quad \textit{Foundation Performance} = f(\textit{Trustee Compensation}, \textit{Founding Family}, \textit{Control Variables})$$

where:

Foundation Performance = return on investment, qualifying distribution ratio, administrative expense ratio, and administrative cost-per-grant ratio;⁸

Trustee Compensation = binary variable that equals one when the private foundation compensates trustees, and zero otherwise; a second model uses a continuous variable equal to the natural log of the highest amount of compensation paid to an outside trustee;

⁸ Higher levels of foundation performance are indicated by higher return on investment and higher qualifying distribution ratios and by lower administrative expense and administrative cost-per-grant ratios. The administrative ratios are multiplied by -1 for the presentation of the Pearson correlations (Table 4, panel D) and the multivariate analysis (Table 5) to simplify the interpretation of the results presented.

Founding Family = binary variable that equals one when a private foundation is a family foundation, and zero otherwise; a second model uses two binary variables: the first is equal to one when the founder participates as a trustee for a family foundation, and zero otherwise, while the second binary variable is equal to one when founding family members other than the founder are trustees for a family foundation, and zero otherwise;

Control Variables = natural log of total fair market value of foundation assets, natural log of foundation age, fraction of independent trustees serving on the board, natural log of total number of trustees, natural log of total CEO compensation, and a dichotomous variable for CEO duality.

Consistent with Hypothesis 1 and Hypothesis 2, the coefficients for trustee compensation and founding family control are expected to be significantly different from zero after controlling for board governance mechanisms, CEO compensation, and other foundation-specific variables. Pertaining to Hypothesis 1, a significant positive coefficient for trustee compensation provides evidence supporting the argument that trustee compensation improves foundation performance by enabling private foundations to recruit independent and sophisticated board members. On the other hand, a significant negative coefficient for trustee compensation support the argument of trustee compensation reducing foundation performance levels by creating conflicts of interest between trustee economic self interest and trustee responsibilities. With regards to Hypothesis 2, a significant positive coefficient for founding family control provides evidence supporting the argument that founding family control improves foundation performance, while a significant negative

coefficient provides evidence supporting the argument that that founding family control reduces foundation performance levels.

4.3.2 Empirical Models: Supplementary Analysis

The supplementary analysis investigates how trustee compensation and founding family control is affected by specific foundation governance characteristics. The supplementary analysis represents an initial examination of the complex interplay between trustee compensation, founding family control, and additional foundation governance characteristics. Information about certain foundation governance structures (e.g. number of trustees, tenure of trustees, number of trustee meetings, trustee expertise) is not available through public sources and therefore can only be obtained through survey methodology. Given the small number of private foundations responding to the survey used in this study ($n = 65$), the supplementary analysis is limited by this response rate as well as the reliability of the responses received by responding private foundations. As such, univariate statistical analysis is the primary statistical methodology used in the supplementary analysis.

Chapter 5

Results of the Study

This chapter presents the results of the empirical tests conducted. The first section describes the characteristics of the foundations included in the dissertation. The next section (Section 5.2) formally tests the two hypotheses using multivariate analysis. The first hypothesis examines the relation between trustee compensation and foundation performance, while the second hypothesis posits a relation between founding family control and foundation performance. The final two sections report the robustness of various model specifications (Section 5.3) and explore the influence of various foundation governance mechanisms on trustee compensation and founding family control (Section 5.4), respectively.

5.1 Characteristics of Sample Private Foundations

5.1.1 Sample Selection

The sample used in this study starts with the 200 largest independent U.S. private foundations in 2001. Data were manually collected from IRS Form 990-PF and foundation websites for tax years 2001 and 2002 on these 200 private foundations. In determining the final sample, observations were excluded from the final sample for a number of reasons. First, twelve foundation-years (six foundations) were eliminated because these foundations didn't have individuals participating on the board of trustees. Instead, these foundations hire a financial institution to govern foundation operations. Second, two newly founded foundations were excluded in 2001, and one foundation was eliminated in 2002 because it converted from a private foundation to a public charity. Finally, nine foundation-

years were excluded due to missing data requirements. The final sample as presented in Table 3 yields 376 foundation-years or observations across 187 foundations in 2001 and 189 foundations in 2002.

5.1.2 Descriptive Statistics

The descriptive statistics for the raw data used to test H1 and H2 are reported in Table 4, panels A through D. Panel A provides means, medians, standard deviations, and maximum and minimum values for the key variables in the sample. Endowment performance is negative (mean = -6.6%; median = -5.9%), which is expected given the sample period. Over the same 2001-2002 time period, the S&P 500 Index dropped 18.2% (Standard and Poors, 2005). Although the investment portfolios of private foundations declined during 2001 and 2002, foundation portfolio values decreased less in comparison to the S&P 500 Index over the same time period. The mean grant performance measure is very close to one (0.999), showing that on average, private foundations meet the required IRS distributable amount with grant distributions, and not with a combination of grant distributions and general and administrative expenses. The two measures of administration performance demonstrate that relatively high overhead costs are associated with the grant-making process. Private foundations incur general and administrative expenses of \$0.33 for every grant dollar distributed and \$40,824 (median = \$18,992) for each grant distributed⁹. All four performance measures show a high degree of variability, based on the standard deviations and maximum and minimum values for each of the measures.

⁹ Mean (median) grant size is \$351,995 (\$106,716) for private foundations in the sample.

Panel A also provides descriptive statistics for the variables-of-interest (trustee compensation, founding family control) and the control variables. A majority of private foundations compensate trustee members (57.2%) and are governed by founding family members (62.0%). The original founder participates on the board of trustees for 16% of private foundations. Private foundations in the full sample are very large (mean = \$1.022 billion; median = \$391 million) and have been in business for many years (mean = 35.8 years).

Panel B shows the results of difference of means and medians tests between trustee compensating and non-compensating private foundations. With respect to endowment performance, there is no difference in annual investment return or the grant distribution ratio between compensating and non-compensating foundations. Using the two administrative ratios as performance measures, trustee compensation foundations incur higher median administrative expenses in comparison to non-compensation foundations. Compensating foundations experience an addition \$0.05 of median overhead costs for every dollar of grant distributed, or \$15,669 more per grant distributed.¹⁰ Average administrative ratios are not significantly different between trustee compensating and non-trustee compensating foundations. The univariate evidence provides limited evidence that private foundations with trustee compensation policies have lower levels of administrative efficiency.

Private foundations that have trustee compensation policies pay an average of \$30,345 per year in trustee compensation (not shown in Table 4), with the highest

¹⁰ The effect of trustee compensation on the differences in overhead costs is minimal between compensating and non-compensating foundations. Trustee compensation increases overhead costs by approximately \$0.004 per \$1 of grant distributed or \$700 per grant distributed.

paid trustee being compensated on average \$49,061 per year. Private foundations that do not compensate trustees are significantly more likely to have founding family members participating on their boards (76.4% versus 51.2%), which provides preliminary evidence that family control influences the compensation policies of private foundations. Also, foundations with founder involvement are four times less likely to compensate foundation trustees (means: 6.5% versus 28.6%).

Total assets for trustee compensating foundations and non-trustee compensating foundations average \$1.39 billion and \$528 million respectively. Large private foundations may have higher levels of resources available for operations and administration and are therefore more likely to compensate their trustees. Both trustee compensation and no trustee compensation private foundations have been in operations for comparable periods of time (means: 35.1 years versus 36.6 years). Trustee compensation policies do not appear to be antiquated mechanisms used by private foundations established by “old money”. Foundations that compensate trustees tend to have more trustees (means: 9.3 versus 7.5), although the actual percentage of outside trustee members (89.6% versus 90.2%) is not significantly different between compensating and non-compensating foundations. Finally, average and median CEO compensation are significantly higher for trustee compensating foundations (means: \$262,138 versus \$172,679; medians: \$239,082 versus \$187,692).

Table 4, panel C presents tests of differences between family and independent private foundations for the key variables in the study. There is no significant difference for rates of return on endowment assets for family foundations. However,

mean grant performance is higher for family foundations. Family foundations distribute 8.3% (approximately \$4.3 million) more in grants. While there are no significant differences between family and independent foundations for the two mean administrative performance ratios, the differences in medians for both administrative performance ratios are significantly lower for family foundations.

On average, family and non-family foundations have similar total assets (means: \$1.06 billion versus \$958 million) while non-family foundations are significantly older on average than family foundations (means: 38.2 years versus 34.3 years). Family foundations have smaller boards (means: 8.2 trustees versus 9.1 trustees), pay lower amounts of CEO compensation (means: \$202,743 versus \$258,194), and are less likely to compensate trustee members (means: 47.2% versus 73.4%). The univariate evidence suggests that family-run foundations establish stronger foundation governance mechanisms, which leads to more effective constraints over general compensation policies when compared to independent foundations.

Panel D provides Pearson correlations for the variables in the sample. This analysis shows that the two measures for trustee compensation are highly correlated with one another (0.988). However, the two measures are never both included in the same regression model. The family foundation measure shows a high level of correlation with the family foundation, no founder measure (0.723) and moderate level of correlation with the family foundation, founder measure (0.341). The trustee compensation measures show modest levels of correlation with the measures for founding family control (-0.257 and -0.263). Some of the control variables are

significantly associated trustee compensation measures or the founding family measures, but none of the control variables have high correlations levels with either the trustee compensation or founding family measures (highest correlation is 0.334 between trustee compensation, highest and foundation age).

5.2 Multivariate Analysis

5.2.1 Regression Diagnostics

Regression diagnostics are performed to identify and correct data input errors and possible violations of assumptions underlying the multivariate analysis. First, influential observations are explored using both DFFITS and DFBETAS measures (Belsley, Kuh, and Welsch; 1980). All manually collected data items were rechecked for accuracy for any observation identified as highly influential. Second, collinearity diagnostics are undertaken to determine the extent of collinearity between independent variables. Condition indices (highest condition index was 83.8) indicate moderate to high levels of collinearity, while variance inflation factors suggest low levels of collinearity (Belsley, Kuh, and Welsch; 1980). The correlation matrices reported in Table 4, panel D provide further evidence that collinearity is not a problem given the modest pairwise correlations for the independent variables. Finally, the assumption of homoskedasticity is formally tested using White's specification tests (White, 1980). Significance levels for regression coefficients in Table 5 are reported using White's (1980) heteroskedastic-consistent covariance matrix estimation when appropriate.

5.2.2 Trustee Compensation and Foundation Performance

The results of the OLS regressions testing the relation between trustee compensation and the four different measures for foundation performance are presented in Table 5, panels A through D. Panels A and B present results using endowment and grant performance measures, respectively. Contrary to Hypothesis 1, the results show no association between trustee compensation and endowment or grant performance. The coefficients for both the indicator and the continuous measure for trustee compensation are very close to zero and statistically insignificant. In contrast, the results for both the administrative expense ratio and the administrative cost-per-grant ratio provide limited evidence that trustee compensation has an adverse effect on administrative performance. For Model 1 in panels C and D, the coefficients for trustee compensation are negative and significant. The values of the coefficients correspond to a 17% and 19% decrease in administrative performance between compensating and non-compensating foundations, respectively. The signs of the coefficients for trustee compensation remain negative in Model 2 for both panels of data, though the coefficients are no longer statistically significant. For the continuous measure of trustee compensation, the signs of the coefficients for the continuous measure are also negative for both measures of administrative performance. However, only the coefficient in the administrative cost-per-grant ratio analysis is statistically significant.

In conclusion, trustee compensation does not appear to improve or reduce the endowment or grant performance for private foundations. However, there is some evidence that the presence of trustee compensation reduces the administrative

efficiency of foundations. This evidence is consistent with the argument that trustee compensation creates conflicts of interests between trustee responsibilities and foundation efficiency. Overall, the analysis provides weak evidence of a detrimental relation between trustee compensation and foundation performance.

5.2.3 Founding Family Control and Foundation Performance

Table 5 presents results for the founding family control hypothesis (H2) using the four accounting performance measures for private foundations. Similar to the findings for trustee compensation, founding family control does not have a significant association with endowment performance (see Panel A). Neither of the conflicting theories for how family control affects foundation performance is supported using the endowment performance measure.

There is some evidence that the presence of family members in a private foundation appears to improve the grant performance for private foundations. The results reported in panel B show family foundations distribute more in grants to public charities in comparison to independent foundations, although only marginally significant (t-statistics range between 1.53 and 1.63 between models). In Models 2 and 4, the coefficients for non-founders on a family foundation measures are not statistically significant, but the founder participation variables are positive and statistically significant. Family foundations with founder participation distribute approximately 23% (coefficient = 0.231 for Model 2; coefficient = 0.240 for Model 4) more in grants compared to non-founder family foundations and independent foundations. Founding family control, especially founder involvement in the

foundation, appears to promote higher levels of grant performance in private foundations.

Founding family control also improves the administrative efficiency of private foundations measured with the administrative expense ratio. On Table 5, panel C, the coefficients for family foundation are statistically significant and show that independent foundations incur higher administrative expenses per grant distributed compared to family foundations. In particular, family foundations perform better when the founder participates on the board of trustees. Family foundations with founder involvement incur significantly less in administrative expenses for every grant dollar distributed (coefficient = 0.472 for Model 2; coefficient = 0.487 for Model 4) while family foundations without founder participation are not significantly different from independent foundations.

Inconsistent with the results using the administrative expense ratio to measure foundation efficiency, none of the founding family measures are statistically significant using the administrative cost-per-grant ratio to measure foundation efficiency (Table 5, panel D). Family participation of any type does not significantly improve or degrade foundation efficiency when dividing administrative expenses by total number of grants distributed.

In summary, the results in Table 5 provide evidence that family foundations perform better than independent foundations. Family foundations distribute a larger percentage of their assets in grants and maintain a higher level of administrative efficiency based on the administrative expense ratio. In particular, active founder involvement is associated with improved foundation performance. Since founders

contribute the original philanthropic capital to create a family foundation, they may be particularly cognizant in overseeing the efficient use of their wealth toward favored philanthropic objectives.

5.3 Robustness of Model Specifications

Robustness tests are necessary to determine whether the model specifications and proxies used for this dissertation are consistent with the presented results.

Several robustness tests are performed to test this assumption.

First, the primary analysis includes two years of data for the same sample of private foundations. To ensure that foundation-year observations are not driving the results presented, the primary analysis is repeated separately for each foundation year (2001 and 2002). Two differences from the results presented in the tables are identified. First, founder participation significantly improves endowment performance in 2002 for Model 2 (coefficient = 0.054; t -value = 1.68). Mean endowment performance is lower in 2002 compared to 2001 (-0.044 in 2001, -0.089 in 2002). One explanation for this different result is that founders may exert influence toward less risky investment portfolios, which would moderate the effects of a declining stock market. Since founders are the primary contributors of invested philanthropic capital for a private foundation, participating founders may be more risk averse regarding the foundation's endowment. Second, the variables for trustee compensation and founding family control are not statistically significant in Models 1 and 3 for the two administrative performance measures. However, the signs and magnitudes of the coefficients for these two variables are similar to the results presented in the tables and the founder variable remains positive and statistically

significant in Models 2 and 4. All other inferences for the separate years' regressions are consistent with the results presented.

Second, an alternative approach is used to measure foundation financial performance. Hallock (2002) uses return on assets (nonprofit profits/ending net assets) to measure charitable nonprofit financial performance. This alternative approach results in similar results to those presented for endowment performance. Neither trustee compensation nor founding family control is significantly related to return on assets for private foundations.

Third, the Duke Endowment and the Doris Duke Charitable Foundation are eliminated from the primary regressions. These two private foundations have been identified as paying trustee compensation based on financial performance, specifically a fixed percentage of investment income earned (Ahn et al., 2003). The results from this alternative specification are not substantially different from the results presented for the primary analysis.

Fifth, each tail of the distribution for the four performance variables were winsorized at the largest one, two, and five percent levels to test the sensitivity of the primary results to outliers and extreme observations. The results for the winsorized models at each level are not significantly different from the results presented in the tables.

Finally, the pooled results for 2001 and 2002 include four foundations with only one year of available data. Two private foundations were excluded in 2001 because they were founded in 2001 and one foundation was eliminated in 2002 because it converted from a private foundation to a public charity. One foundation

also was missing information for 2002 that was necessary to perform the primary analysis. Once again, eliminating these single-year foundations did not significantly change the results as presented in the tables.

5.4 Supplementary Analysis

The supplementary analysis investigates how trustee compensation and founding family control is affected by specific foundation governance characteristics. The supplementary analysis explores the relation between trustee compensation, founding family control, and additional foundation governance characteristics. All statistics related to the supplementary analysis are reported in Panels A through D of Table 6.

The survey was mailed in November 2004 to the 192 private foundations meeting the selection criteria (see Table 6, panel A). Second requests for information were mailed in February 2005. In total, 65 usable surveys were returned, corresponding to a 33.9% response rate. This response rate is higher than the 26.0% response rate for a survey with similar type questions sent to public charities in 1995 (Callen et. al., 2003), but lower than the 50.0% response rate for a private foundation related survey sponsored by the Center for Effective Philanthropy (Center for Effective Philanthropy, 2004).

Responding and non-responding foundations have average (median) total assets of \$669 million (\$335 million) and \$1.1 billion (\$368 million), respectively. The difference in total assets between responders and non-responders is not statistically significant (t-statistic = 1.60, Wilcoxon Z score = 0.75). The mean and median age for responding foundations (mean = 36 years; median = 41.5 years) and

non-responding foundations (mean = 37 years; median = 38 years) is also not statistically different (t-statistic = 0.36; Wilcoxon Z score = 0.42). The non-responding private foundations appear to be similar to responding private foundations in terms of mean and median size and age, which reduces the probability that the survey methodology suffers from non-response bias. In addition, the mean size and age of early responders are similar to those of late responders within the responding foundation sample.

Table 6, panel B presents summary statistics for the 65 responding private foundations. For this sub-sample of foundations, approximately 52% compensate their trustees and 59% have boards comprised of founding family members. Both percentages are similar to those presented in Table 4 for the full sample. These foundations have boards of trustees with a high proportion of outside members (91%) and trustee members with accounting and investment (74%) or nonprofit management expertise (65%). Annually, foundation trustees spend a mean total of 33 hours per trustee on foundation business and attend five board meetings. The average tenure for a foundation trustee is approximately 14 years.

Table 6, panel C presents the results of difference of means and medians tests between trustee compensating and non-compensating private foundations for the supplementary sample. First, there is no difference in the independence or expertise of the board of trustees between trustee compensating and non-compensating foundations, indicating trustee compensation is not significantly associated with higher levels of board independence or expertise. Second, trustee compensation appears to motivate trustees to spend significantly more time performing trustee

duties. On average, compensated trustees spend twice the amount of time on formal trustee business in comparison to non-compensated trustees (44 hours versus 22 hours). Private foundations with trustee compensation policies also schedule more formal board of trustee meetings (means: 6 meetings versus 4 meetings). Both findings are consistent with compensating foundations using trustee compensation to motivate trustees toward more hours of service to the private foundation. Third, trustee compensation is associated with shorter trustee tenure. Trustees for non-compensating foundations spend an average of four more years (16 years versus 12 years) as a board of trustee member in comparison to trustee compensating foundations. Finally, trustee compensation does not appear to be associated with CEO duality and CEO compensation for this sub-sample of foundations. Only median CEO compensation has significant differences between trustee compensating and non-compensating foundations. However, for the full sample, both CEO attributes are different for the two types of foundations. As shown in Table 4, panel B, trustee compensating foundations are more than twice as likely to have CEOs also functioning as the chairperson of the board of trustees (13% versus 6%) while paying significantly more CEO compensation (means: \$262,138 versus \$172,679).

Table 6, panel D shows difference tests between family foundations and non-independent foundations for the supplementary sample. First, family foundations have boards with similar percentages of outsider trustee members and with similar levels of accounting/investment expertise. Second, trustees of family foundations spend less time in board of trustee meetings (means: 29 hours versus 39 hours) than trustees for independent foundations. Since family members have relationships

outside of the business of the private foundation, there may be less need for formal meeting times to discuss foundation-related business. Third, founding family trustee tenure is significantly longer in comparison to non-founding family trustee tenure (means: 15 years versus 12 years). Family members have the potential to become entrenched as board members within their family foundation, resulting in lower levels of turnover for trustees in family foundations. Finally, founding family participation appears to constrain compensation policies within private foundations. Family foundations are less likely to implement trustee compensation policies (34% versus 78%) and also pay less CEO compensation (means: \$200,649 versus \$266,133). CEO duality is not significantly different for family and non-family foundations for responding foundations. However, for the full sample of foundations (presented in Table 4, panel D), family foundations are more likely to have CEOs dually functioning as chairperson of the board of trustees (15% versus 3%).

Chapter 6

Summary and Conclusions

Competing arguments suggest trustee compensation and founding family control may either improve or reduce foundation performance. Lower levels of foundation performance may result when trustee compensation creates conflicts of interests between trustee responsibilities and self serving goals. In addition, founding family control has the potential to reduce foundation performance by creating conflicts of interests between family interests and trustee responsibilities.

Conversely, both trustee compensation and founding family control may also improve foundation performance. Trustee compensation may enable private foundations to attract independent and highly qualified trustee members who are also motivated to promote private foundation goals. Founding family control has the potential to enhance foundation performance since family members have their family name and reputation to uphold while having a strong interest in the long-term success of the family foundation.

This study examines the impact of trustee compensation and founding family control on foundation performance and explores the relation between trustee compensation, founding family control and various foundation governance mechanisms. The study uses four accounting-based measures of foundation performance: endowment performance, grant performance, and two measures for administrative efficiency. The data used for measuring accounting-based foundation performance, trustee compensation, and founding family control are compiled from

the annual tax returns and foundation websites of the largest 200 private foundations in the U.S. for the years 2001 and 2002.

Based on accounting measures of performance, private foundations with trustee compensation policies do not perform significantly better or worse than non-trustee compensating foundations. While trustee compensating foundations earn approximately the same level of investment return on their endowment assets and distribute similar percentages of grants to qualified charities as non-trustee compensating foundations, there is limited evidence that trustee compensation reduces administrative efficiencies within private foundations. However, this finding is sensitive to regression model specification.

Contrary to the lack of significant findings for trustee compensation, the primary analysis indicates that family foundations perform at least as well as independent foundations. Specifically, family foundations earn approximately the same level of investment return on their endowment assets as independent foundations, but they distribute a larger percentage of their assets in grants to qualified charities and maintain higher levels of administrative efficiency. These results for founding family control are especially robust for family foundations with founder involvement. Grant performance and administrative performance levels are significantly higher when founder involvement is still prevalent within a family foundation.

The supplementary analysis provides preliminary evidence showing that trustee compensation and founding family control affect foundation governance mechanisms. Trustee compensation motivates trustees to spend significantly more

time on foundation-related business and promotes shorter trustee, while family foundation trustees spend less time on foundation business and have longer tenures as board members. Independent foundations are also more likely to implement trustee compensation policies, possibly because non-family managers and trustees are not as motivated as founding family members in protecting the foundation's reputation and name. Overall, this is preliminary evidence that independent foundations may require stronger governance structures in comparison to founding family foundations.

Trustee compensation and founding family control are also related to CEO characteristics. Trustee compensating foundations compensate their CEOs at higher levels in comparison to non-compensating foundations and family foundations pay lower amounts of CEO compensation compared to independent foundations. Private foundations with trustee compensation and founding family control are also more likely to delegate board chairperson responsibilities to the CEO.

There are several limitations in this study. First, the supplementary analysis on board characteristics is based on a survey rather than publicly available data. The information obtained through survey techniques is subject to self-selection and self-promotion biases. Even though the responding and non-responding foundations were statistically compared for similarity, the results from the supplementary analysis exploring the relations between trustee compensation and various foundation governance mechanisms could still be driven by sample-selection bias, rather than by the proposed variables of interest. Also, the data garnered from the survey may suffer from self-promotion bias since foundations self-report information without being subject to audit. Second, the sample used in this study only includes the largest U.S.

private foundations. The results obtained from the study may not be generalized to smaller independent private foundations or corporate and community foundations.¹¹ Third, this study uses a cross-sectional research design including only two years of data. In particular, the endowment performance measure may not be effective in capturing good or poor foundation performance given the time period used in this study (2001-2002). The research methodology employed in this study is limited by the current availability of information on private foundations. However, financial and non-financial disclosures for private foundations are becoming more available. Future studies using longitudinal data could provide information about the long-term effects of trustee compensation on foundation performance and on board of trustee characteristics.

The final limitation pertains to the accounting-based measures of performance used in this study. Although these measures are relatively reliable and objective, they are nonetheless indirect measures of social benefit. The operations of private foundations are driven by philanthropic and social objectives that are extremely difficult to measure and costly to ascertain. Given this caveat, the results provided by this study are limited by the effectiveness and reliability of using accounting metrics for assessing performance for private foundations.

¹¹ On an annual basis, the National Center for Charitable Statistics (NCCS) compiles a database for all tax return filings made by private foundations. In 2001, the NCCS database included tax return filings for 66,861 private foundations with assets totaling \$451 billion. The sample of private foundations examined in this paper for 2001 represents 0.28% of the total number (187) and 45.45% of the total assets (\$205 billion) included in the NCCS database.

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Table 1
Summary of Data Items Available
on IRS Form 990-PF

<u>Description of Data Item</u>	<u>Location of Data Item</u>
<i>Financial Data</i>	
Dividends and interest from securities	Page 1, Part I, Line 4
Net realized gain or loss on sale of securities	Page 1, Part I, Line 6
Total excise taxes paid	Page 1, Part I, Line 18
Total operating and administrative expenses (accrual basis)	Page 1, Part I, Line 24
Gifts and grants paid (cash basis)	Page 1, Part I, Line 25
Gifts and grants expense (accrual basis)	Page 1, Part I, Line 25
Total investments (book value)	Page 2, Part II, Line 2, Line 10, Line 13
Total investments (fair market value)	Page 2, Part II, Line 2, Line 10, Line 13
Total assets (fair market value)	Page 2, Part II, Line 16
Net unrealized gain or loss on securities (when directly available on IRS Form)	Page 2, Part III, Line 2 or Line 5
<i>Non-Financial Data</i>	
Names of officers, directors, and trustees	Page 6, Part VIII, Line 1a
Title of officers, directors, and trustees	Page 6, Part VIII, Line 1b
Compensation of officers, directors, and trustees	Page 6, Part VIII, Line 1c
Total number of grants paid during the year	Page 10, Part XV, Line 3a
<i>Compliance Data</i>	
Current year qualifying distribution	Page 7, Part XII, Line 4
Required current year distributable amount (from prior year return)	Page 8, Part XIII, Line 2a

Table 2
Definitions and Sources of Variables

Variables	Definitions	Sources
<i>Dependent Variables</i>		
Endowment performance	Gross investment income divided by average fair market value of investment securities	IRS Form 990-PF
Grant performance	Total grants paid divided by IRS-required distributable amount	IRS Form 990-PF
Administrative performance 1 (administrative expense ratio)	Natural log of total operating and administrative expenses (less excise taxes paid) divided by total grants paid	IRS Form 990-PF
Administrative performance 2 (administrative cost-per-grant ratio)	Natural log of total operating and administrative expenses (less excise taxes paid) divided by total number of grants paid during the year	IRS Form 990-PF
<i>Experimental Variables</i>		
Trustee compensation	One when a private foundation compensates trustees, and zero otherwise	IRS Form 990-PF
Trustee compensation, highest	Natural log of the highest amount of compensation paid to an individual outside trustee	IRS Form 990-PF
Family foundation	One when a private foundation is a family foundation, and zero otherwise	IRS Form 990-PF and Private Foundation Websites
Family foundation, founder participation	One when a founder participates in a family foundation, and zero otherwise	IRS Form 990-PF and Private Foundation Websites
Family foundation, no founder participation	One when founding family members other than the founder participate in a family foundation, and zero otherwise	IRS Form 990-PF and Private Foundation Websites
<i>Control Variables</i>		
Total assets	Natural log of fair market value of total assets	IRS Form 990-PF
Age	Natural log of foundation age, in years	National Center for Charitable Statistics Database
Percentage outsider trustees	Percentage of outside trustees serving on the board	IRS Form 990-PF
Total trustees	Natural log of total number of trustees on the board	IRS Form 990-PF
CEO compensation	Natural log of total CEO compensation	IRS Form 990-PF
CEO duality	One if the CEO also holds the position of chairman, and zero otherwise	IRS Form 990-PF and Private Foundation Websites

Table 2
Definitions and Sources of Variables (Continued)

Variables	Definitions	Sources
<i>Additional Variables for Supplementary Analysis</i>		
Outside trustee accounting and investment expertise	Percentage of outside trustees with accounting and/or investment expertise	Survey Instrument
Outside trustee nonprofit management expertise	Percentage of outside trustees with nonprofit management expertise	Survey Instrument
Trustee hours	Natural log of total hours spent in board meetings per trustee	Survey Instrument
Trustee tenure	Natural log of the average number of years served by board members	Survey Instrument
Total trustee meetings	Natural log of total number of board meetings	Survey Instrument

Table 3
Sample Selection

	2001	2002	Total
Number of Original Foundations:	200	200	400
Eliminations:			
Bank Trustee Only	6	6	12
No Information Available	1	1	2
Missing Information	4	3	7
First Year Foundation	2	0	2
Conversion to Public Charity	0	1	1
Total Foundations in Final Sample:	<u>187</u>	<u>189</u>	<u>376</u>
# Foundations Paying Trustee Compensation:	109	106	215
# Foundations Not Paying Trustee Compensation:	<u>78</u>	<u>83</u>	<u>161</u>
Total Foundations in Final Sample:	<u>187</u>	<u>189</u>	<u>376</u>
# Foundations With Founding Family Control	115	118	233
# Foundations Without Founding Family Control	<u>72</u>	<u>71</u>	<u>143</u>
Total Foundations in Final Sample:	<u>187</u>	<u>189</u>	<u>376</u>

Table 4
Descriptive Statistics

Panel A: Summary Statistics for the Full Sample (n=376)

Variables	Mean	Median	Standard Deviation	Minimum	Maximum
Endowment performance	-0.066	-0.059	0.131	-1.079	0.728
Grant performance	0.999	0.911	0.491	0.064	4.777
Administrative performance 1	0.332	0.189	1.142	0.002	21.042
Administrative performance 2 (000)	40.824	18.992	82.739	0.227	1,093.142
Trustee compensation	0.572	1.000	0.495	0.000	1.000
Trustee compensation, highest (000)	28.054	9.500	48.238	0.000	450.702
Family foundation	0.620	1.000	0.486	0.000	1.000
Family foundation, no founder participation	0.460	0.000	0.499	0.000	1.000
Family foundation, founder participation	0.160	0.000	0.367	0.000	1.000
Total assets (000,000)	1,022.655	391.230	2,552.655	57.230	32,751.464
Age	35.755	39.000	20.588	1.000	83.000
Percentage outsider trustees	0.899	1.000	0.166	0.000	1.000
Total trustees	8.516	8.000	4.292	1.000	28.000
CEO compensation (000)	233.833	212.804	154.305	0.000	822.000
CEO duality	0.101	0.000	0.302	0.000	1.000

Note: All variables are defined in Table 2

Table 4
Descriptive Statistics (Continued)

Panel B: Difference Tests by Trustee Compensation (n=376)

Discrete Variables	TC Foundations (n=215)	No TC Foundations (n=161)	Fisher's Exact Test (p-value)
Family foundation	0.512	0.764	*0.00
Family foundation, no founder participation	0.447	0.478	0.60
Family foundation, founder participation	0.065	0.286	*0.00
Percentage of outsider trustees	0.896	0.902	0.53
CEO duality	0.130	0.062	**0.04

Continuous Variables - Means	TC Foundations (n=215)	No TC Foundations (n=161)	t-statistic
Endowment performance	-0.065	-0.069	0.29
Grant performance	0.975	1.032	1.09
Administrative performance 1	0.386	0.259	1.22
Administrative performance 2 (000)	45.260	34.900	1.28
Trustee compensation, highest (000)	49.061	0.000	n/a
Total assets (000,000)	1,393.192	527.838	*3.73
Age	35.144	36.571	0.66
Total trustees	9.288	7.484	*4.23
CEO compensation (000)	262.138	172.679	*5.95

Continuous Variables - Medians	TC Foundations (n=215)	No TC Foundations (n=161)	Wilcoxon Test (Z-score)
Endowment performance	-0.061	-0.058	0.25
Grant performance	0.892	0.947	1.51
Administrative performance 1	0.208	0.160	*3.31
Administrative performance 2 (000)	21.654	15.985	*3.39
Trustee compensation, highest (000)	30.000	0.000	n/a
Total assets (000,000)	468.933	284.894	*6.00
Age	38.000	41.000	0.78
Total trustees	9.000	7.000	*4.00
CEO compensation (000)	239.082	187.692	*5.32

*, **, *** Significant at the 1%, 5%, and the 10% levels, respectively. All tests are two-tailed tests.

Note: All variables are defined in Table 2

Table 4
Descriptive Statistics (Continued)

Panel C: Difference Tests by Founding Family Control (n=376)

Discrete Variables	Family Foundations (n=233)	Non-Family Foundations (n=143)	Fisher's Exact Test (p-value)
Trustee compensation	0.472	0.734	*0.00
Family foundation, no founder participation	0.742	0.000	n/a
Family foundation, founder participation	0.258	0.000	n/a
Percentage outsider trustees	0.910	0.880	0.38
CEO duality	0.146	0.028	*0.00

Continuous Variables - Means	Family Foundations (n=233)	Non-Family Foundations (n=143)	t-statistic
Endowment performance	-0.062	-0.073	0.79
Grant performance	1.031	0.948	***1.78
Administrative performance 1	0.354	0.295	0.61
Administrative performance 2 (000)	35.852	48.926	1.29
Trustee compensation, highest (000)	20.326	40.646	*4.05
Total assets (000,000)	1,062.335	958.001	0.44
Age	34.275	38.168	***1.78
Total trustees	8.163	9.091	***1.97
CEO compensation (000)	202.743	258.194	*3.43

Continuous Variables - Medians	Family Foundations (n=233)	Non-Family Foundations (n=143)	Wilcoxon Test (Z-score)
Endowment performance	-0.059	-0.068	0.03
Grant performance	0.932	0.887	1.43
Administrative performance 1	0.167	0.223	*3.79
Administrative performance 2 (000)	17.134	21.537	**2.21
Trustee compensation, highest (000)	0.000	20.000	*4.86
Total assets (000,000)	370.135	414.881	1.16
Age	38.000	40.000	***1.87
Total trustees	8.000	9.000	**1.75
CEO compensation (000)	190.000	235.000	*3.76

*, **, *** Significant at the 1%, 5%, and the 10% levels, respectively. All tests are two-tailed tests.

Note: All variables are defined in Table 2

Table 4
Descriptive Statistics (Continued)

Panel D: Pearson Correlations (N=376)

	EP	GP	API	AP2	TC1	TC2	FF	No Founder
Endowment performance (EP)	1.000							
Grant performance (GP)	**0.131	1.000						
Administrative performance 1 (API)	0.040	*0.399	1.000					
Administrative performance 2 (AP2)	-0.003	0.024	*0.477	1.000				
Trustee compensation (TC1)	0.015	-0.057	*-0.152	*-0.177	1.000			
Trustee compensation, highest (TC2)	0.023	-0.043	**0.123	*-0.173	*0.988	1.000		
Family foundation (FF)	0.043	0.082	**0.013	***0.098	*-0.257	*-0.263	1.000	
Family foundation, no founder participation (No Founder)	-0.021	-0.054	-0.031	0.005	-0.032	-0.045	*0.723	1.000
Family foundation, founder participation (Founder)	***0.086	*0.182	***0.212	0.123	*-0.298	*-0.288	*0.341	*-0.402
Total assets (TA)	**0.092	-0.063	**0.131	*-0.171	*0.299	*0.334	-0.048	0.013
Age	-0.026	**0.130	**0.124	0.016	0.015	0.005	**0.101	*0.168
Percentage outsider trustees (%BOD)	-0.020	0.044	0.042	0.003	-0.016	-0.018	***0.087	0.033
Total trustees (TBOD)	-0.014	***0.090	***0.257	*-0.185	*0.196	*0.167	-0.061	***0.096
CEO compensation (CEO Comp)	-0.079	-0.073	***0.310	*-0.193	*-0.255	*-0.250	*-0.169	0.019
CEO duality (CEO Dual)	0.082	**0.105	**0.119	0.022	**0.112	**0.104	*0.190	*0.239

	Founder	TA	Age	%BOD	TBOD	CEO Comp	CEO Dual
Family foundation, founder participation (Founder)	1.000						
Total assets (TA)	-0.081	1.000					
Age	*-0.363	0.071	1.000				
Percentage outside trustees (%BOD)	0.081	0.028	**0.111	1.000			
Total trustees (TBOD)	*-0.211	*-0.257	*0.143	*0.168	1.000		
CEO compensation (CEO Comp)	*-0.249	*-0.269	***0.099	*-0.201	*-0.282	1.000	
CEO duality (CEO Dual)	-0.074	0.011	***0.093	*-0.266	0.048	*0.135	1.000

*, **, *** Significant at the 1%, 5%, and the 10% levels, respectively. All tests are two-tailed tests.

Note: All variables are defined in Table 2.

Table 5
Determinants of Foundation Performance

Panel A: Dependent Variable is Endowment Performance (N=376)

	Model 1	Model 2	Model 3	Model 4
Intercept	-0.340 (1.75)	-0.344 (2.30)	-0.333 (1.71)	-0.340 (2.25)
Trustee compensation	0.001 (0.04)	0.005 (0.32)		
Trustee compensation, highest (log)			0.000 (0.09)	0.001 (0.36)
Family foundation	0.003 (0.16)		0.003 (0.19)	
Family foundation, no founder participation		-0.003 (0.18)		-0.003 (0.17)
Family foundation, founder participation		0.027 (1.15)		0.027 (1.17)
Ln(total assets)	0.018 (1.70)	0.017 (2.21)	0.017 (1.67)	0.017 (2.15)
Ln(age)	-0.005 (0.46)	-0.001 (0.13)	-0.005 (0.47)	-0.001 (0.12)
Percentage outsider trustees	-0.022 (0.66)	-0.026 (0.57)	-0.026 (0.77)	-0.026 (0.57)
Ln(total trustees)	-0.002 (0.12)	0.001 (0.04)	-0.001 (0.10)	0.001 (0.05)
Ln(CEO compensation)	-0.004 (2.32)	-0.004 (2.02)	-0.004 (2.35)	-0.004 (2.03)
CEO duality	0.040 (2.06)	0.041 (1.69)	0.039 (2.01)	0.041 (1.69)
Adjusted R square	0.011	0.013	0.011	0.013

Note: T-statistics for each coefficient are in parentheses. Bolded items are statistically significant at the 10% level (two-tailed)

Table 5
Determinants of Foundation Performance (Continued)

Panel B: Dependent Variable is Grant Performance (N=376)

	Model 1	Model 2	Model 3	Model 4
Intercept	1.586 (2.86)	1.566 (2.82)	1.656 (2.94)	1.613 (2.91)
Trustee compensation	0.002 (0.03)	0.028 (0.49)		
Trustee compensation, highest (log)			0.002 (0.32)	0.004 (0.84)
Family foundation	0.086 (1.53)		0.092 (1.63)	
Family foundation, no founder participation		0.055 (0.94)		0.059 (1.61)
Family foundation, founder participation		0.231 (2.66)		0.240 (2.29)
Ln(total assets)	-0.018 (0.63)	-0.022 (0.79)	-0.020 (0.70)	-0.025 (0.94)
Ln(age)	-0.054 (1.90)	-0.032 (1.08)	-0.054 (1.90)	-0.031 (1.00)
Percentage outsider trustees	0.025 (0.15)	-0.012 (0.07)	-0.016 (0.09)	-0.014 (0.14)
Ln(total trustees)	-0.051 (0.99)	-0.037 (0.71)	-0.048 (0.95)	-0.036 (0.74)
Ln(CEO compensation)	-0.001 (0.13)	0.001 (0.07)	-0.002 (0.21)	0.000 (0.17)
CEO duality	-0.173 (1.90)	-0.167 (1.84)	-0.182 (2.00)	-0.170 (2.05)
Adjusted R square	0.019	0.028	0.019	0.029

Note: T-statistics for each coefficient are in parentheses. Bolded items are statistically significant at the 10% level (two-tailed)

Table 5
Determinants of Foundation Performance (Continued)

Panel C: Dependent Variable is Natural Log of Administrative Performance 1 (N=376)

	Model 1	Model 2	Model 3	Model 4
Intercept	-3.125 (3.11)	-3.230 (3.17)	-3.128 (2.92)	-3.216 (3.02)
Trustee compensation	-0.192 (1.89)	-0.140 (1.33)		
Trustee compensation, highest (log)			-0.016 (1.49)	-0.010 (0.99)
Family foundation	0.178 (1.76)		0.185 (1.71)	
Family foundation, no founder participation		0.111 (1.08)		0.116 (1.04)
Family foundation, founder participation		0.472 (2.56)		0.487 (2.94)
Ln(total assets)	0.314 (6.08)	0.305 (5.79)	0.314 (5.78)	0.304 (5.60)
Ln(age)	0.112 (1.98)	0.157 (3.01)	0.112 (2.07)	0.159 (2.78)
Percentage outsider trustees	-0.021 (0.09)	-0.018 (0.08)	-0.024 (0.07)	-0.021 (0.06)
Ln(total trustees)	-0.455 (4.92)	-0.432 (4.58)	-0.463 (4.76)	-0.437 (4.50)
Ln(CEO compensation)	-0.074 (4.58)	-0.071 (4.55)	-0.075 (5.51)	-0.071 (5.22)
CEO duality	-0.305 (2.58)	-0.282 (2.36)	-0.313 (1.81)	-0.289 (1.68)
Adjusted R square	0.209	0.219	0.207	0.217

Note: T-statistics for each coefficient are in parentheses. Bolded items are statistically significant at the 10% level (two-tailed).

Table 5
Determinants of Foundation Performance (Continued)

Panel D: Dependent Variable is Natural Log of Administrative Performance 2 (N=376)

	Model 1	Model 2	Model 3	Model 4
Intercept	-7.361 (7.20)	-7.416 (7.23)	-7.429 (7.18)	-7.474 (7.20)
Trustee compensation	-0.215 (1.80)	-0.188 (1.47)		
Trustee compensation, highest (log)			-0.020 (1.66)	-0.017 (1.36)
Family foundation	0.089 (0.77)		0.089 (0.77)	
Family foundation, no founder participation		0.054 (0.45)		0.053 (0.45)
Family foundation, founder participation		0.242 (1.22)		0.245 (1.24)
Ln(total assets)	-0.097 (1.97)	-0.102 (2.06)	-0.093 (1.86)	-0.099 (1.96)
Ln(age)	0.066 (0.99)	0.090 (1.26)	0.066 (0.98)	0.090 (1.25)
Percentage outsider trustees	0.098 (0.27)	0.100 (0.28)	0.098 (0.27)	0.100 (0.28)
Ln(total trustees)	-0.256 (2.19)	-0.244 (2.11)	-0.264 (2.27)	-0.251 (2.18)
Ln(CEO compensation)	-0.033 (1.60)	-0.031 (1.51)	-0.033 (1.61)	-0.031 (1.52)
CEO duality	0.175 (1.00)	0.187 (1.06)	0.173 (0.98)	0.185 (1.07)
Adjusted R square	0.061	0.062	0.061	0.061

Note: T-statistics for each coefficient are in parentheses. Bolded items are statistically significant at the 10% level (two-tailed)

Table 6
Supplementary Analysis

Panel A: Survey Response Rates

Number of Original Foundations:	200	
Eliminations:		
Bank Trustee Only	6	
No Information Available	1	
Conversion to Public Charity	<u>1</u>	
Total Surveys Mailed to Foundations:	192	100.0%
Surveys Not Returned or Refused:	123	64.1%
Surveys Returned With Unusable Responses:	<u>4</u>	2.1%
Surveys Returned with Usable Responses:	<u><u>65</u></u>	33.8%

Table 6
Supplementary Analysis (Continued)

Panel B: Summary Statistics from Surveys Returned (n=65)

Variables	Mean	Median	Standard Deviation	Minimum	Maximum
Trustee compensation	0.523	1.000	0.503	0.000	1.000
Family foundation	0.585	1.000	0.497	0.000	1.000
Percentage outsider trustees	0.908	1.000	0.147	0.333	1.000
Accounting or investment expertise	0.738	1.000	0.443	0.000	1.000
Nonprofit management expertise	0.646	1.000	0.482	0.000	1.000
Trustee hours, total	33.177	24.000	23.508	3.000	96.000
Trustee meetings	5.231	4.000	3.244	2.000	22.000
Trustee tenure	13.788	12.500	8.043	3.000	43.000
CEO compensation (000)	227.850	225.354	131.007	0.000	598.479
CEO duality	0.108	0.000	0.312	0.000	1.000

Note: All variables are defined in Table 2.

Table 6
Supplementary Analysis (Continued)

Panel C: Difference Tests by Trustee Compensation (n=65)

Discrete Variables	Hypothesized Relation	TC Foundations (n=34)	No TC Foundations (n=31)	Fisher's Exact Test (p-value)
Family foundation	Unknown	0.382	0.807	0.00
Percentage outsider trustees	TC > No TC	0.816	0.904	0.67
Accounting or investment expertise	TC > No TC	0.765	0.710	0.41
Nonprofit management expertise	TC > No TC	0.677	0.613	0.39
CEO duality	Unknown	0.118	0.097	1.00

Continuous Variables - Means	Hypothesized Relation	TC Foundations (n=34)	No TC Foundations (n=31)	t-statistic
Trustee hours, total	TC > No TC	43.559	21.790	*4.25
Trustee meetings	TC > No TC	6.000	4.387	**2.12
Trustee tenure	TC > No TC	11.954	15.800	1.92
CEO compensation (000)	TC > No TC	246.563	207.327	1.21

Continuous Variables - Medians	Hypothesized Relation	TC Foundations (n=34)	No TC Foundations (n=31)	Wilcoxon Test (Z-score)
Trustee hours, total	TC > No TC	38.000	16.000	*3.92
Trustee meetings	TC > No TC	5.000	4.000	**2.25
Trustee tenure	TC > No TC	11.244	13.222	1.48
CEO compensation (000)	TC > No TC	251.525	200.000	***1.29

*, **, *** Significant at the 1%, 5%, and the 10% levels, respectively.

Note: All variables are defined in Table 2. TC Foundations are trustee compensation foundations; No TC Foundations are non-trustee compensation foundations.

Table 6
Supplementary Analysis (Continued)

Panel D: Difference Tests by Founding Family Control (n=65)

Discrete Variables	Hypothesized Relation	Family Foundations (n=38)	Non-Family Foundations (n=27)	Fisher's Exact Test (p-value)
Trustee compensation	Unknown	0.342	0.778	0.00
Percentage outsider trustees	Fam > Non-Fam	0.920	0.890	0.68
Accounting or investment expertise	Unknown	0.710	0.778	0.37
Nonprofit management expertise	Unknown	0.605	0.704	0.29
CEO duality	Unknown	0.132	0.074	0.69

Continuous Variables - Means	Hypothesized Relation	Family Foundations (n=38)	Non-Family Foundations (n=27)	t-statistic
Trustee hours, total	Fam < Non-Fam	28.789	39.352	**1.73
Trustee tenure	Fam > Non-Fam	14.815	12.343	***1.32
Trustee meetings	Fam < Non-Fam	4.816	5.815	1.07
CEO compensation (000)	Unknown	200.649	266.133	**2.03

Continuous Variables - Medians	Hypothesized Relation	Family Foundations (n=38)	Non-Family Foundations (n=27)	Wilcoxon Test (Z-score)
Trustee hours, total	Fam < Non-Fam	22.000	30.000	***1.61
Trustee tenure	Fam > Non-Fam	13.000	11.556	0.85
Trustee meetings	Fam < Non-Fam	4.000	4.000	0.30
CEO compensation (000)	Unknown	198.750	247.360	***1.92

*, **, *** Significant at the 1%, 5%, and the 10% levels, respectively.

Note: All variables are defined in Table 2.

Appendix A**Survey Instrument Materials**

	Page
Institutional Review Board Approval	73
Letter to Private Foundation CEOs (Initial Request)	74
Letter to Private Foundation CEOs (Second Request)	76
Survey Instrument	78

November 8, 2004

RESEARCH COMPLIANCE SERVICES
Institutional Review Board

Mr. Brian McAllister
Dr. Arthur Allen
School of Accountancy
CBA 307 0488

IRB#: 2004-10-040 EP

TITLE OF PROPOSAL: **Board of Trustee Compensation and Private Foundation Performance**

Dear Mr. McAllister:

This letter is to officially notify you of the approval of your project by the Institutional Review Board (IRB) for the Protection of Human Subjects. It is the Board's opinion that you have provided adequate safeguards for the rights and welfare of the participants in this study. Your proposal seems to be in compliance with this institution's Federal Wide Assurance 00002258 and the DHHS Regulations for the Protection of Human Subjects (45 CFR 46).

Date of EP Review: **10/14/04**

1. Please include the assigned and approved IRB# on the cover letter to participants. Stamped copies of the approved letter are enclosed for your reference.


You are authorized to implement this study as of the Date of Final Approval: **11/05/04**

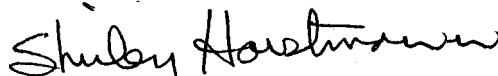
This approval is Valid Until: **11/04/05**

We wish to remind you that the principal investigator is responsible for keeping this Board informed of any changes involved with the procedures or methodology in this study. You should report any unanticipated problems involving risks to the participants or others to the Board. For projects which continue beyond one year from the starting date, the IRB will request continuing review and update of the research project. Your study will be due for continuing review as indicated above. The investigator must also advise the Board when this study is finished or discontinued by completing the enclosed Protocol Final Report form and returning it to the Institutional Review Board.

If you have any questions, please contact Shirley Horstman, IRB Administrator, at 472-9417 or email shorstman1@unl.edu.

Sincerely,


Dan R. Hoyt, Chair
for the IRB


Shirley Horstman
IRB Administrator

cc: Faculty Advisor
Unit Review Committee

October 15, 2004

IRB#2004-10-040 EP
Date Approved: 11/05/04
Valid Until: 11/04/05

John Doe, CEO
Private Foundation Name
1000 Nebraska Avenue
Lincoln, NE 12345

Dear Mr. Doe:

This letter and accompanying questionnaire is a call for your assistance. I am gathering information for academic research related to the effects of board of trustee compensation on private foundation performance. The purpose of the research empirically tests whether board of trustee compensation improves or reduces accounting-based performance measures for private foundations. The results generated from this study will be beneficial by providing a better understanding of the effects of board of trustee compensation on private foundation performance.

Trustee compensation is hypothesized to affect foundation performance because of its influence on foundation governance structures. As a result, I have enclosed an informational questionnaire asking some questions about the characteristics of your private foundation's board of trustees. You have been selected to receive the information questionnaire since you are the CEO or Executive Director of one of the largest 200 private foundations in the United States.

Would you please be kind enough to complete and return this questionnaire? A self-addressed and stamped return envelope is provided for your convenience. I estimate that it will take between 5 to 10 minutes to complete the questionnaire. The information collected from the informational questionnaire, along with publicly available information from your 990-PF annual tax return, will be included in my doctoral dissertation. All data will be presented in summary form only to provide you with confidentiality and anonymity. If you are interested in the summarized results of this informational questionnaire, provide your name and address at the end of the questionnaire.

Please keep in mind that participation in this study is entirely voluntary. There are no known risks involved with participation in this study. You are free to decide not to participate in this study or to withdraw at any time without adversely affecting your relationship with the investigators or the University of Nebraska-Lincoln. Your decision will not result in any loss of benefits to which you are otherwise entitled.

If you have any questions concerning this research project, feel free to contact me at any time by telephone at (402) 472-0526, or by email at bmcallister3@unlnotes.unl.edu. Furthermore, if you have any questions concerning your rights as a research subject that have not been answered by the investigator or to report any concerns about the study, you may contact the University of Nebraska-Lincoln Institutional Review Board, telephone (402) 472-6965.

I wish to thank you in advance for your time and effort.

Best regards,

Brian McAllister

Name and phone number of investigators:

Brian P. McAllister, Doctoral Candidate
College of Business Administration
University of Nebraska-Lincoln
Office: (402) 472-0526

Arthur C. Allen, Ph.D.
College of Business Administration
University of Nebraska-Lincoln
Office: (402) 472-3275

November 15, 2004

IRB#2004-10-040 EP
Date Approved: 11/05/04
Valid Until: 11/04/05

John Doe, CEO
Private Foundation Name
1000 Nebraska Avenue
Lincoln, NE 12345

Dear Mr. Doe:

This letter and accompanying questionnaire is a second call for your assistance. I am gathering information for academic research related to the effects of board of trustee compensation on private foundation performance. The purpose of the research empirically tests whether board of trustee compensation improves or reduces accounting-based performance measures for private foundations. The results generated from this study will be beneficial by providing a better understanding of the effects of board of trustee compensation on private foundation performance.

Trustee compensation is hypothesized to affect foundation performance because of its influence on foundation governance structures. As a result, I have enclosed an informational questionnaire asking some questions about the characteristics of your private foundation's board of trustees. You have been selected to receive the information questionnaire since you are the CEO or Executive Director of one of the largest 200 private foundations in the United States.

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I wish to thank you in advance for your time and effort.

Best regards,

Brian McAllister

Name and phone number of investigators:

Brian P. McAllister, Doctoral Candidate
College of Business Administration
University of Nebraska-Lincoln
Office: (402) 472-0526

Arthur C. Allen, Ph.D.
College of Business Administration
University of Nebraska-Lincoln
Office: (402) 472-3275

Name of Foundation Inserted Here

1. How many board meetings did the Foundation hold last fiscal year: _____

2. How much time (in hours) is spent at a typical board meeting? _____

3. How are trustees selected for membership on the board of trustees? _____

4. If your foundation compensates trustees, how is the compensation paid?

- a. annual flat rate
- b. per board meeting
- c. annual flat rate plus per board meeting
- d. other (please describe) _____

5. The following board of trustee listing was obtained from your IRS Form 990-PF for 2002. Please categorize the following two items: 1) the number of years each individual has served on the board of trustees (insert number of years), and; 2) the primary reason why each individual has been selected to serve on the board of trustees (checkmark all applicable categories):

Board Member	Number of Years Served On Board	Current Foundation Manager	Current Foundation Staff	Founding Family Member	Accounting or Investment Expertise	Nonprofit Management Expertise	Other (please describe)
<i>Board Member Name</i>							
<i>Board Member Name</i>							
<i>Board Member Name</i>							
<i>Board Member Name</i>							
<i>Board Member Name</i>							
<i>Board Member Name</i>							
<i>Board Member Name</i>							