A Gross Mendelsohn Case Study

How a Mismanaged Endowment Fund Got Turned Around and Grew by 20%

Private Foundation's Investment Approach Overhauled to Produce Stellar Results

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This is the story of a private foundation and its endowment fund that was mismanaged, particularly after its founder passed away. There's a happy ending, though. Read on to learn how this foundation got turned around, and how its endowment grew by 20%.

In the Beginning: Self-Management and Conservative Approach Led to Meager Growth by Design

Robert, the founder of a private foundation, managed the endowment fund on his own. A sophisticated real estate broker, he was hands on and decisive. Robert had a genuine interest in investment management. He had a favorite broker that he used to oversee the fund's investments for the 30 plus years he ran his foundation, which supports the elderly, children and education in Baltimore.

Robert was very conservative and earned the 5% distribution amount required of a private foundation by investing conservatively in just fixed income investments. This approach prevented the opportunity for higher returns available from equity investments, but for Robert, it provided the stability – rather than the growth of principal – that was most important to him.

Early on the foundation had an endowment fund of $2 million. This grew to $7 million with contributions from the founder.

It's important to note that Robert did not pay fees for the management of the fund, nor did he have an investment policy statement for the endowment fund. Two red flags, for sure.

Founder Passes Away, Foundation and Endowment Falter

When Robert passed away, his spouse, Sheila, managed the foundation. Robert's broker continued with the same conservative approach to management of the endowment. Unfortunately, Robert's wife was not interested in the complexities of investment management. She trusted the broker like a son, despite objections from her other advisors.

After the founder's death, the broker began charging for investment management, yet provided almost no service in return. This investment management company did virtually nothing, allowing the fund to become almost 50% cash and not react to the changing markets. The fund incurred losses due to poor asset selection and did not participate in the market rise after 2008.

Sheila's advisors discussed the management of the foundation with the broker. As a result of that intervention, the broker began investing idle cash that had been the subject of investment management fees.

When Sheila passed away, her advisors began managing the foundation. Because the advisors believed the broker took advantage of Sheila's lack of good professional judgment, the new board of the foundation – of which Gross Mendelsohn is a member – took a new path in managing of the foundation.

The board established strong managerial control of the endowment and:

- Asked the family's advisors who had investment experience, such as people from Gross Mendelsohn, to conduct a search for a new investment manager.
- Excluded from consideration conflicts of interest with people related to existing board members.
- Allowed the investment professionals to provide investment proposals, and asked for recommendations for management based upon their experience in managing foundations.
- Reviewed proposals and narrowed down the pool of potential managers to two.
- Interviewed the two finalists and hired the best investment manager for the fund.
- Developed an investment policy statement.
- Provided the goals and objectives for the foundation's endowment to make the normal 5% annual distributions and grow the foundation to at least keep up with inflation.
- Established a finance committee tasked with reviewing performance of the fund and its management.
- Established regular review procedures to monitor the progress of the foundation.

On the Road to Growth

The foundation is now on a good trajectory. Prior to the foundation's overhauled investment approach, the endowment's growth was limited to contributions by the founding family. After the overhaul, the endowment grew by about 20% thanks to a whole new, cutting-edge investment approach.

The foundation and its board now receive from its investment manager the type of regular reporting and analyses needed to ensure the long term stability of the fund, which is critical based upon the desire to receive additional contributions to grow the fund. This level of information gives donors comfort in knowing how their contributions will be managed.

Six Lessons Learned from this True Story

1. Founders of foundations are usually very successful in business and/or investment. They are often very independent in their thinking, and take a hands on approach to all aspects of account management. They need to document any management agreements that they put in place to ensure that their wishes and goals for the foundation are followed long after they are gone.
2. A founder needs to put into place very specific fund management guidelines, both for foundation personnel and any unsophisticated family members who are going to be left with the responsibility to manage both the foundation and their personal lives.
3. An investment policy statement should be developed. The statement should be followed when the founder is not available to guide the investment management.
4. An investment policy statement should provide an allocation plan that prevents endowment funds from being improperly invested.
5. The investment policy statement must state the fees to be paid for investment management. This should be put into place by the founder while he/she is in control of the management of the assets.
6. The investment policy statement should provide guidelines for the management of funds, including the acceptable allocations by asset classes.

For Help or More Information

Gross Mendelsohn's Nonprofit Group helps private foundations with endowment management. Contact us here, or at 410.685.5512 or via email.

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