


2015

The Mediating Role of Payout in the Relationship Between Private Foundations and Grantee Organizations' Financial Health

Angie Kim
Walden University

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Walden University

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Walden University
2015

Abstract

The Mediating Role of Payout in the Relationship Between Private Foundations and
Grantee Organizations' Financial Health

by

Angie Kim

MA, University of Southern California

BA, Linfield College

Dissertation Submitted in Partial Fulfillment

of the Requirements for the Degree of

Doctor of Philosophy

Public Policy and Administration

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August 2015

Abstract

Although private foundations are assumed to be beneficial, their impact on grantee organizations is not well understood. This quantitative research explored how private, nonoperating foundations influence grantees' financial capacity to pursue their missions. Principal-agent theory was applied to rationalize foundations' social good purpose, along with subsidy theory of public charities' need for capital accumulation, thus comprising a unique framework for identifying pathways of relationships amongst influencer variables of foundations' operating characteristics; the outcome of grantees' months of unrestricted, liquid net assets (MULNA); and the mediator of foundations' payout rate. Multiple regression and indirect effects analyses of data on 612 cases from NCCS and tax returns revealed that the sector focus and characteristics of certain types of funders (i.e., oldest, largest, smallest, volunteer and professionally staffed, aggressive and average charitable spenders, and arts-focused foundations) affected payout behavior. In addition, large foundations' payout rate influenced MULNA, especially among financially strong grantees. Finally, payout mediated the association between age and MULNA among the largest foundations, and between sector focus and MULNA among the oldest foundations. This research contributes to the discourse on foundations' effectiveness in three ways: (a) associations were significant among segmented data, thus affirming the usefulness of examining specific types of foundations; (b) wealth distribution by the largest and oldest foundations was of tangible importance to their grantees, knowledge of which can be used in grant decision making and in informing policies on payout; and (c) principal-agent theory can be applied to hold foundations accountable to public interests.

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Chapter 1: Introduction to the Study

In the United States, nonprofit organizations comprise a third sector, outside of government or proprietary spheres, for individuals to produce social benefits voluntarily. Salamon (2002) described this sector as “private initiative for the common good” (p. 4). Since the 1980s, the importance of this third sector has increased, as indicated by the concomitant growth in number of degree-conferring studies and research on nonprofit entities (Jackson, Guerrero, & Appe, 2014; Mirabella, 2007; Shier & Handy, 2014).

Despite the growth of this sector, not all types of nonprofit organizations have been subjected equally to in-depth scholarly scrutiny: Grant-seeking public charities have received considerably more attention than grant-funding private foundations. This relative lack of scholarship masks private foundations’ importance to the functioning of the nonprofit sector and influence in society. Foundations powerfully shape and determine social welfare activities in the United States through their support of public charities.

Private foundations’ funding is supposed to help charitable organizations achieve their missions, a point made by the president of the Edna McConnell Clark Foundation: “Foundations, we reasoned, succeed when their grantees grow stronger, achieve more, and gain stature for leadership” (Bailin, 2003, p. 636). Consequently, the performance of foundations is intertwined with that of their grantees. McIlnay (1998) described this relationship between foundations and public charities as one of interdependence: “In a way, then, grantees are not merely recipients of foundations but donors to them because they help them [foundations] achieve their missions” (p. 152). What links the two entities

is foundations' grantmaking: Giving financial support to public charities helps fulfill foundations' own charitable missions, while receiving foundations' financial support supposedly helps public charities pursue their social purposes.

The focus of this dissertation is the nature of this financial relationship between funders and grantees. I explored if private, nonoperating foundation funding, holding other foundation operating characteristics constant, plays a significant role in grantee organizations' financial capacity. I used quantitative-based models to discern the determinants of their yearly rate of charitable distributions and the pathways by which foundations impact their grantee organizations' financial state. One possible route is that certain types of foundations and giving behavior directly impact grantees. Another possible pathway is an indirect one wherein foundations' payout is the mechanism connecting foundations to grantees' financial condition.

Foundations' charitable spending is popularly assumed to help their grantees succeed. The purpose of this study was to press on this assumption by illuminating how and to what extent foundations' payout rates affect public charities. This research tested foundations' payout rates for tangible impacts on grantees' financial health, and explored the role of payouts in mediating the connection between foundations and public charities. Understanding the effectiveness of payout as a mechanism intended to help beneficiaries has policy implications in assessing the social value of foundations' charitable spending against the private benefits these institutions accrue as a tax-subsidized entity.

Chapter 1 begins with background information on private foundations and a rationale for the study. Chapter 2 is a review of the literature and an explication of the

study's theoretical framework. Chapter 3 describes the research design, methodology, study variables, and steps for statistical analyses. Chapter 4 provides the results of the analyses. Chapter 5 concludes with interpretations of the findings and recommendations for future studies.

Background

Although diverse expressions of private philanthropy exist throughout the world, this research focused on private foundations that are officially incorporated in the United States. Private foundations were recognized legally with the passage of the Tax Reform Act of 1969. The Act came about through the leadership of Congressman Wright Patman of Texas who began in 1961 a “personal crusade to make foundations accountable to the public” by questioning their “legitimacy and performance” (Frumkin, 1995, p. 591). Foundation legal expert Troyer (2000) recalled that estate lawyers and financial advisors used to recommend to wealthy clients that they establish endowed nonprofits as a way to avoid taxes and as an instrument to maintain control of their wealth. This form of tax avoidance continued until government stepped in to regulate endowed nonprofits. On signing the Tax Reform Act of 1969 into law, President Richard Nixon (1969) declared, “Tax-free foundations were brought under much closer Federal scrutiny. . . . [as] congressional consideration of this matter reflected a deep and wholly legitimate concern about the role of foundations in our national life” (para. 14). Passage of the Act effectively ended using endowed nonprofits as a tax shelter and established the private foundation entity as a public good.

Private foundations became a new type of nonprofit organization. Both private foundations and public charities are nonprofits, but the former is not publicly reliant for funding (i.e., self-endowed) whereas the latter must demonstrate that a majority of income comes from public, external sources (i.e., passing the *public support test*; Arnsberger, Ludlum, Riley, & Stanton, 2008). In short, both are tax exempt for a charitable purpose, but private foundations are wealth-distributing, whereas public charities are resource-seeking entities.

Beyond delineating and defining private foundations, the Tax Reform Act of 1969 also imposed regulations on private foundations, specifically concerning self-dealing, payout, business income, and lobbying activities (Byrnes, 2004; Troyer, 1999, 2000). Henceforth, private foundations must be used for public, charitable purposes and not for privately benefiting their own institutional owners (i.e., inuring benefits to founders, donors, trustees, and directors); must distribute annually a minimum percentage of their investment assets for charitable purpose; must limit the extent to which businesses may be controlled by foundations; and must not lobby (Bittker & Rahtert, 1976; Byrnes, 2004; Troyer, 2000). Although some components of the rules have been relaxed over the years (most notably lowering the payout requirement to today's 5% annual distribution rate), these regulatory domains remain unchanged (Frumkin, 1995; Troyer, 1999).

History has revealed that the worst-case scenarios about the new federal regulations were unfounded. Critics of the Tax Reform Act of 1969 worried that these rules would either discourage establishing new private foundations or deplete foundations' wealth to the point of termination (Troyer, 1999). Proving these naysayers

wrong, a remarkable number of new foundations have been established since passage of the Act, and great wealth accumulated by foundations since that time. To demonstrate the sector's tremendous growth, in 1975 there were only 21,877 foundations incorporated in the United States with assets totaling \$30 billion (Foundation Center, 2012a). As of 2012, there were 86,192 private foundations with assets totaling \$715 billion (Foundation Center, 2014), which is nearly a 300% increase in the number of foundations and a 2283% increase in aggregate asset size since 1975.

Problem Statement

Each year, private foundations give away more than \$50 billion, which accounts for approximately 15% of all charitable giving in the United States (Indiana University Lilly Family School of Philanthropy, 2014; Foundation Center, 2014). Foundation giving may account for roughly 3% of the nonprofit sector's revenues (Foster & Ditkoff, 2011, p. 143). Although foundation giving may not represent the largest source of nonprofit income, it is substantial enough to merit scrutiny. In particular, there should be knowledge of how and to what extent foundations' charitable spending has a measurable impact on nonprofits' capacity to pursue their missions. Yet, since the time of foundations' establishment nearly 50 years ago with the Tax Reform Act of 1969, there has been no study on the effects of foundations' charitable spending behavior on their beneficiaries. Perhaps this line of inquiry has been overlooked because charitable giving is presumed to be useful; however, the premise of this study is that the very existence of foundations' grantmaking cannot be assumed to help their grantees pursue their missions. The absence of such knowledge has meant that foundations have been largely

unaccountable by this measure with much taken for granted about the social value of their giving. Continuing to overlook this topic is too costly when the ability to address social needs relies on effective deployment of limited financial resources. Pursuing questions about foundations' impact is relevant given that private foundations hold \$715 billion in tax-exempt assets. Moreover, questioning the value of enabling foundations to possess and expend such largess is even more pressing at a time when the federal government has contracted out social welfare responsibilities: Nonprofit organizations have become the primary source for direct service delivery and private foundations are coinvestors with government in underwriting public priorities.

Hence, the purpose of this research was to address a long-neglected question of private foundations' value, which has proven elusive thus far. Private foundations do not pay federal income taxes (although they pay a nominal excise tax to cover federal oversight costs) in return for the promise of benefits to society. Beneficiaries of tax exemptions need to justify how well they serve the needs that government does not meet (Hansmann, 1981, p. 66). Studying foundations' value and impact is too large an enterprise for a single study, but this effort charts new territory in proposing a theoretical framework that holds foundations accountable to public interest and contributes new knowledge on the mechanism and pathways by which foundations impact grantees.

Purpose of the Study

The purpose of this quantitative study was to understand foundations' charitable spending as a percentage of noncharitable-use assets (also referred to as *payout rate*) and its influence on grantee organizations' unrestricted, liquid net assets, which is an

indicator of their financial capacity to pursue their missions. Through this study, I investigated determinants of foundations' payout and how payout acts as a mechanism for redistributing wealth from funders to grantees. I examined two theoretical pathways to explain how foundations affect public charities. Grantees may be affected directly by foundations' operating characteristics of asset size, age, degree of professionalization, and sector focus. Alternatively, foundations' charitable spending, as captured by the payout ratio of spending relative to size, may mediate the relationship between foundation characteristics and grantees' financial condition. In sum, I tested the effectiveness of foundations' charitable spending as a primary mechanism by which foundations realize charitable purpose.

Multiple regressions and testing of indirect effects revealed the various possible pathways of relationships amongst three sets of variables. The mediating variable was the percentage share of annual noncharitable-use assets that a foundation spends charitably (i.e., payout rate). The influencer variables were foundations' structural characteristics of asset size, age, staffing level, and sector focus—key traits that constitute a foundation's character. The outcome variable of grantees' financial health was operationalized by their number of months of unrestricted, liquid net assets (MULNA), which is considered to be an indication of an organization's financial stability (Bowman, 2011a, 2011b).

Significance

This research was conducted at a critical moment. The demand for social services has been growing at a time when responsibility for providing public goods has been shifting from government to those in the private nonprofit and proprietary realms

(Salamon, 2002), and private foundations shoulder increasingly greater responsibility for serving the public good (Quinn, Tompkins-Stange, & Meyerson, 2014). Consequently, public charities have become a societal necessity for producing and delivering social goods and services and, as their financiers, today's private foundations wield great influence. Private foundations are a backbone of the nonprofit infrastructure shaping the functioning of this sector's economy and informing the priorities and direction of public policies. Unbeknownst to the general public by and large, private foundations have become instrumental in influencing this nation's social welfare policies, infrastructure, capacity, and economy (Parmar, 2012).

Although greater expectations have fallen on private foundations for addressing social needs and advancing social issues, there is a lack of evidence that private foundations should be entrusted with such responsibilities. On the contrary, research has shown that the private philanthropic sector and their charitable giving reinforce social class divisions, exacerbate disadvantages stemming from income inequities, and ultimately serve the interests of the wealthy elite (Arno, 1982; Arno & Pinede, 2007; Center on Philanthropy at Indiana University & Google, 2007; Core & Donaldson, 2010; Dasgupta & Kanbur, 2011; Odendahl, 1990; Ostrander, 1984; Ostrower, 1995; Parmar, 2012; Silver, 2007). Enough reasons exist to question not only the value, but also the legitimacy, of the private foundation institution (Prewitt, Dogan, Heydemann, & Toepler, 2006). Despite all the attention paid to questioning foundations' redistributive actions, there has been no research on how their grantmaking contributes to grantee

organizations' capacity to do good work. Too much has been assumed with too little known regarding how and to what extent foundations' grantmaking helps public charities.

The social problem motivating this research was the lack of knowledge about the value of private foundations in supporting the public good efforts of the nonprofit sector: In other words, are foundations effective in supporting grantees' ability to function? In order to address this question of foundations' value, my research inquiry centered on exploring how private foundations influence grantee organizations' financial health, particularly through payout, which is the legislatively-mandated mechanism for foundations to behave for the public good. In order to explore this question, I posited a unique theoretical framework for holding foundations accountable to how well they help grantees achieve financial capacity to perform charitably.

This study cannot definitively answer the degree to which foundations affect social change (for that, much more research is called for). On the other hand, this research addresses a gap in knowledge about the financial relationship between funders and grantees. This findings of this study provide new insight on the pathways by which foundations impact private charities' financial condition and the kinds of foundations that have a measurable impact on grantees' financial capacity.

Contributions to Scholars and Practitioners

The study fills gaps in knowledge about foundations and will be of interest to four key groups: social scientists working in the nonprofit sector, foundation decision-makers, those working in public policy who are seeking information to improve regulations

governing the nonprofit sector (of which private foundations are an integral part), and advocates of public charities' need for adequate levels of investment and capital.

Of interest to nonprofit researchers, I introduce a theoretical framework that makes it possible to scientifically question and test the impact of foundations. I apply principal-agent theory wherein foundations are positioned as agents of government—a proxy for public interest. Perceiving foundations as agent and not as principal enables the questioning of foundations' characteristics, behavior, activities, and performance against an expectation that foundations should have a public benefit. By modeling how principal-agent theory can be applied to understand the phenomena of foundations' impact on grantee organizations through grantmaking, this study contributes to a need in the research field for an accountability framework for understanding and assessing foundations' spending behavior and its impacts.

Also of interest to nonprofit scholars—as well as practitioners in the field and legislators—is the application of principal-agent theory, which contributes to gaps in knowledge about the mechanism and pathways of how foundations affect grantee organizations. Isolated attention has been paid to how much money foundations have distributed to public charities, but little is known about the determinants of foundations' giving and of payouts' importance to grantees. Knowing more about payout has practical importance: The findings may inform public policy debates about how to regulate foundations. Furthermore, the findings may also inform foundation executives' decisions on how to manage foundations' assets and resources to improve their impact on grantees.

This study should also be of interest to nonprofit professionals who have advocated for improvements to philanthropic practices in order to give public charities greater levels of financial support to achieve social objectives (Blackwood & Pollak, 2009; Curtis, 2010; Grantmakers for Effective Organizations, 2011; Gregory & Howard, 2009; Hager, Pollak, Wing, & Rooney, 2004; Miller, 2003, 2010; Moyers, 2011; Nelson, Crump, & Koo, 2009; Nelson & Koo, 2014; Nonprofit Finance Fund [NFF], 2001; Nonprofit Operating Reserves Initiative Workgroup [NORI], 2010; Ryan, 2001; Starr, 2011; Taylor, Harold, & Berger, 2013; Thomas, Christopher, & Sidford, 2011). Incorporating Hansmann's (1981) notion that public charities need to be able to raise and retain profit as a key part of my research framework may mark the first time that the concept of adequate capitalization is used as an outcome indicator for assessing foundation performance. By making grantees' capitalization position the outcome variable, I assign funders responsibility for bringing about or diminishing grantee organizations' financial capacity to achieve a charitable purpose.

Research Questions and Hypotheses

What has remained unclear are the pathways of relationships between private, nonoperating foundations' firm-level characteristics (i.e., size, age, professionalization, and sector focus) and charitable spending behavior and grantee organizations' financial state. In other words, do certain types of foundations directly influence their grantees' financial capacity to pursue mission, and is foundation payout—the legally intended mechanism by which foundations support public charities—effective in redistributing wealth charitably? Despite the centrality of payout in philanthropic strategy, the

determinants of payout and how payout affects grantees have remained unclear. Given foundations' primary purpose as a wealth-distributing charity, I explored determinants of foundations' payout rate and the role charitable spending plays in affecting grantees' financial health.

The research questions and hypotheses are as follows:

Research Question 1: Do private, nonoperating foundations' firm-level traits of asset size, age, professionalization, or sector focus influence their charitable spending behavior?

Hypothesis 1: Private, nonoperating foundations' firm-level traits influence their payout rate.

Null Hypothesis 1: Private, nonoperating foundations' firm-level traits do not predict their payout rate.

Research Question 2: By what pathways do foundations' firm-level traits and payout behavior affect grantee organizations' MULNA?

Hypothesis 2: Foundations' traits and payout behavior directly influence MULNA.

Null Hypothesis 2: Foundations' traits and payout behavior do not influence MULNA.

Hypothesis 3: Foundations' traits influence MULNA through the mediator of payout rate.

Null Hypothesis 3: Foundations' payout rate does not mediate the relationship between foundations' firm-level traits and grantees' MULNA.

Theoretical Framework

I applied a research framework comprised of two separate theories: (a) principal-agent theory, wherein federal government is the principal and private foundations are the agent, and (b) the theory of capital subsidy, which explains that public charities need tax exemption in order to build a level of financial reserves that will afford them the capacity to pursue their missions. Applying principal-agent theory frames private foundations as accountable to the public good via the conditions imposed on them by federal regulations. Capital subsidy theory is also normative in its expectation that financiers of the nonprofit economy should help nonprofits be well capitalized. The combination of these two theories creates a framework for empirically questioning how foundations' grantmaking impacts public charities' financial capacity. I will describe the framework further in Chapter 2.

This approach of applying foundation accountability and financial health theories together has not been tried before. As such, this study will be testing new models for understanding how foundations' payout relates to public charities' financial reserves. Furthermore, the study will extend the concept of principal-agent relationships to the foundation sector as an explanatory theory that holds foundations accountable to public interest. Such an application creates new opportunities for assessing foundations' effectiveness in meeting expectations for the public good.

Nature of the Study

Private, nonoperating foundations are legally required to expend a portion of their wealth charitably. Hence, payout can be understood as the mandated vehicle by which foundations help public charities in order to perform a public good. Despite the importance of payout, little is understood about the determinants of the rate of payout and, more importantly, of how payout affects grantees' financial capacity. I employ quantitative research methodology to understand the pathways of relationships among foundations' traits, giving behavior, and grantees' financial condition.

Foundations' payout rate may be predicted by certain firm-level characteristics. Using ordinary least squares regressions, I tested the relationship between foundations' firm-level characteristics and their payout rate to identify the operating characteristics that are significantly associated with giving behavior. I also used ordinary least squares regressions to identify if grantees' financial condition can be determined by foundation firm-level or spending characteristics. Finally, I used indirect effects analysis to test the significance of foundations' payout rate in explaining the relationship between foundations' traits and the outcome variable of grantees' MULNA. By using this form of mediating path analysis to isolate the role of foundations' payout rate in affecting MULNA, private foundations' primary function as a grantmaker becomes the locus of scientific scrutiny.

Definition of Terms

501(c)(3): Refers to organizations that are tax-exempt under section 501(c)(3) of the Internal Revenue Code. Such organizations operate exclusively for public benefit and

not for private financial gain of its owners (founders, donors, trustees, and anyone overseeing the organization). 501(c)(3) organizations are loosely called *nonprofits*, but that term may also broadly encompass the 29 other types of 501(c) organizations, such as 501(c)(7) country clubs and 501(c)(6) trade unions. The language of this code, U.S.C., Title 26, Subtitle A, Chapter 1, Subchapter F, Part I, §501(c)(3), is as follows:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office. (Tax Reform Act of 1986, 2010)

The Internal Revenue Service (IRS, 2013) synthesized the code as follows:

The exempt purposes set forth in section 501(c)(3) are charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals. The term charitable is used in its generally accepted legal sense and

includes relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erecting or maintaining public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency. (para. 1)

There are two types of 501(c)(3) organizations: public charities and private foundations. To be clear about this distinction, I use the term *public charity* when referring to grant-seeking 501(c)(3) nonprofits and *foundations* or *private foundations* when referring to 501(c)(3) grantmaking nonprofits that are endowed privately.

509(a): This is the U.S. Code that defined private foundations as a new type of nonprofit business entity as a result of the Tax Reform Act of 1969. The following is the language of the code, which can be found in U.S.C., Title 26, Subtitle A, Chapter 1, Subchapter F, Part II, § 509, excerpted to highlight the defining characteristics of this new type of charitable organization:

For purposes of this title, the term “private foundation” means a domestic or foreign organization described in section 501 (c)(3) other than . . . an organization which normally receives more than one-third of its support in each taxable year from any combination of—(i) gifts, grants, contributions, or membership fees, and (ii) gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business[;] . . . and normally receives not more than one-third of its support in

each taxable year from the sum of—(i) gross investment income . . . and (ii) the excess (if any) of the amount of the unrelated business taxable income[; and] . . . is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations; [and] . . . is not controlled directly or indirectly by one or more disqualified persons . . . other than foundation managers and other than one or more organizations . . . [; and] an organization which is organized and operated exclusively for testing for public safety. (Tax Reform Act of 1969, 2010)

This “other than” clause means that all 501(c)(3) organizations are private foundations unless an organization receives more than one-third of its support from external revenue sources (this threshold is termed the *public support test*). An organization that passes this test (i.e., one-third or more of its revenues is generated from grants, gifts, membership) is a public charity. Conversely, an organization that fails the public support test (i.e., less than one-third of its revenues are from external sources and more than one-third comes from a single source or investments) is a private foundation.

Capitalization: This term refers to a nonprofit’s financial ability to achieve its mission by having accumulated enough of financial surplus to weather emergencies or afford new opportunities (Curtis, 2010, p. 2; see also Miller, 2003 for an early explication of an organization’s capital components). An indicator of capitalization is a public charity’s reserve of unrestricted, liquid net assets (Blackwood & Pollak, 2009; Bowman, 2011a, 2011b; Curtis, 2010; Lam & McDougale, 2012; Nelson & Koo, 2014; NFF, 2001; NORI, 2010; Thomas et al., 2011). (See *months of unrestricted, liquid net assets*.)

End of year, fair market value of private foundations: These data can be found on the 2006 Form 990-PF, p. 1, line I (IRS, 2006a). It is the proxy of a foundation's size.

Financial capacity: Researchers have defined this term in various ways, such as Bowman (2011a) who described it as the ability of an organization to “seize opportunities and respond to threats” (p. 174). But, unlike Bowman whose definition alludes to institutional survivability, my use of this term is rooted in the parlance of private foundation professionals who refer to *capacity* as the ability of their grantees to pursue their charitable objectives effectively (Grantmakers for Effective Organizations, 2004). Hence, in using this term herein, I am referring to a public charity's financial ability to pursue and accomplish its charitable mission.

Form 990: Public charities must file tax return Form 990 annually with the IRS, unless they are small enough in budget size or amount of contributions to file simpler, abbreviated 990-N or 990-EZ forms. The purpose of the Form 990 is to enable the regulatory government body—the IRS—to review a public charity's finances and activities, such as assets, donations, and grants received. Completed Form 990 returns are made available for public review (Foundation Center, 2012b).

Form 990-PF: The “PF” is the acronym for *private foundations*, and U. S. tax return Form 990-PF must be filed each year by all private foundations. According to the IRS (2015b), the Form 990-PF is “an annual information return that includes data on excise tax liability, charitable distributions, administrative expenditures, as well as income statement and balance sheet information” (para. 1). Completed Form 990-PFs are also publicly accessible (Foundation Center, 2012b).

Foundation effectiveness: This term is used so casually in the foundation field that it merits an explanation of how it will be used in this study. Foundations do many things—set social change priorities, support public charities, deploy intellectual and financial capital, and manage the balance of asset accumulation and wealth distribution. In all of these domains, each foundation’s leadership has set their own objectives and expectations for what constitutes effectiveness. In this study, the notion of *foundation effectiveness* is tied to the impact that foundations have on their grantees through their primary function as wealth distributors (see also Anheier & Hammack, 2010, p. 6). Hence, for the purposes of this study, effectiveness is the tangible and measurable association between foundations’ charitable spending and their grantees’ financial state.

Limited life foundations: Also called *sunsetting foundations*, these are foundations that expend more charitably than the rate of financial return on investments. Limited life foundations often reflect a deliberate governance decision to give away more now to solve a pressing social problem than over the course of an indefinite future (Atlantic Philanthropies, 2010; Ostrower, 2011). Deciding to be a limited life or perpetual foundation affects the decision on how much to expend charitably or to save. The other option is foundations that are *perpetual* (see *perpetuity*).

Minimum distribution requirement (also referred to as *annual distribution requirement* or *minimum payout requirement*): By U. S. federal law, private, nonoperating foundations must spend some of its assets charitably each year (see *private foundations*). This rule is known as the *minimum distribution requirement*, which is the “minimum amount that private foundations are required to expend for charitable purposes

(including grants and, within certain limits, the administrative cost of making grants)” (Foundation Center, 2015, p. Glossary of Terms). This amount must “meet or exceed an annual payout requirement of five percent of the average market value of its total assets” (Foundation Center, 2015, p. Glossary of Terms). What qualifies toward fulfilling a charitable purpose are considered *qualifying distributions*. *Payout* refers to the actual dollar value of how much a foundation distributed charitably, versus *payout rate* that is the percentage of a foundation’s market value of its noncharitable-use assets (i.e., investment earnings in stocks, bonds, or real estate that are not used in service of mission-related activities) that was spent toward meeting this minimum amount (Boris, Renz, Hager, Elias, & Somashekhar, 2008; Ludlum, 2005; Renz, 2012). A foundation’s minimum distribution amount is calculated based on its prior year’s average market value of noncharitable-use, investment assets, and foundations have a full year to pay out (Cambridge Associates, 2000).

The federal government encourages foundations to meet this payout minimum with a two-tier excise tax structure. Foundations that meet the 5% minimum distribution requirement averaged over a period of five years pay only a nominal 1% excise tax on their net investment income—a cost of paying for government oversight (Council on Foundations, 2006). Any foundation that makes qualifying distributions of more than the 5% minimum can disperse proportionally less in future years but cannot distribute less than the distribution requirement floor over that five-year period (Cambridge Associates, 2000). Those that fail to meet the minimum payout rate of 5% averaged over a five-year period pay a higher excise tax rate of 2% and are penalized financially on the

undistributed amount (Cambridge Associates, 2000; Council on Foundations, 2006; Renz, 2012; Yoder, Addy, & McAllister, 2011). (See also *payout rate* and *qualifying distributions*.)

Months of unrestricted, liquid net assets: This term refers to the study's outcome variable. Also known by its acronym MULNA, it is the financial proxy of a public charity's capitalization position and can be measured by accumulated surplus. The more MULNA there is, the better able a public charity can access readily available cash to use toward both emergencies and opportunities (Blackwood & Pollak, 2009; Curtis, 2010; Lam & McDougale, 2012; Nelson & Koo, 2014; NFF, 2001; NORI, 2010; Thomas, et al., 2011). As such, MULNA is a good measure of a nonprofit's financial stability—a key indicator of financial health (Bowman, 2011a, 2011b).

Nonprofit: This is a broadly encompassing term for tax-exempt charitable organizations, of which the IRS recognizes more than 25 types. A nonprofit can be public serving, such as 501(c)(3) organizations that provide goods or services for public benefit; or it can be member serving, such as 501(c)(6) trade unions that do not benefit from tax-deductible contributions (Salamon, 2012). This term is a bit of a misnomer as any well-functioning organization with expenses and income must retain some degree of profit in order to survive (Miller, 2003). The distinguishing feature of the nonprofit entity is their *nondistribution constraint*—their “prohibition on the distribution of ‘net earnings’ [i.e., ‘pure profits’]. . . . to individuals who exercise control over [the nonprofit],” such as “members, officers, directors, or trustees” (Hansmann, 1980, p. 838). The constraint of benefiting from profit is what makes nonprofits trustworthy, and this trustworthiness is

what allows nonprofits to be a viable enterprise (Hansmann, 1980, p. 847). Hansmann's concept of nondistribution constraint is based on U.S.C. §501(c)(3): "no part of the net earnings [i.e., profit] of which inures to the benefit of any private shareholder or individual" (Tax Reform Act of 1986, 2010).

Payout rate: This amount is the percentage of a foundation's market value of its noncharitable-use assets (i.e., investment earnings in stocks, bonds, or real estate that are not used in service of mission-related activities) that was spent toward meeting the mandatory minimum distribution amount (Boris et al., 2008; Ludlum, 2005; Renz, 2012). (See also *minimum distribution requirement* and *qualifying distributions*).

Perpetuity: Perpetual foundations are ones that manage their assets so that they can exist forever. Perpetual foundations are meant to enable future generations to act charitably as did their founders—a notion termed *intergenerational equity* (Mehrling, 2004)—as well as address unforeseeable problems of the future (Deep & Frumkin, 2001). Operating as a perpetual foundation necessitates managing financial assets so that returns on investments exceed charitable spending and prioritizes keeping foundation payout as low as legally possible. The other option is foundations that are *limited life* or *sunsetting* (see *limited life foundations*).

Private foundations: (See also U.S. Code 509(a) for the federal regulatory definition of a private foundation.) The Tax Reform Act of 1969 established a new class of public charity called *private foundations*. Unlike a public charity that depends on raising income from external sources, private foundations often have a single source of income (Tax Reform Act of 1969, 2010). There are two categories of private foundations:

private, nonoperating foundations and private, operating foundations. The former provides support through grants to public charities and must meet a minimum distribution requirement enforced by the IRS. The latter directly conducts charitable activities to a degree that it does not need to meet the minimum distribution requirement (Ludlum, 2005). The focus of this research is on private, nonoperating foundations, herein referred to as *private foundations* or simply *foundations* or *funders*.

Public charities: 501(c)(3) organizations are divided into two types: *public charities* and *private foundations*. Unlike private foundations, public charities demonstrate to the IRS that a majority of their income is generated from external sources.

Qualifying distributions: This is the amount that a foundation actually expended toward a charitable purpose in order to satisfy the *minimum distribution requirement*. Expenditures that qualify must be for charitable purposes and can include grants and related operational and administrative costs, program-related investments, monies used to acquire assets toward tax-exempt purposes, and amounts for future charitable projects (Boris et al., 2008; Cambridge Associates, 2000; Foundation Center, 2015; Ludlum, 2005; Renz, 2012). The IRS regulates what gets counted toward foundations' annual qualifying distributions, and the majority is in the form of grants to public charities (Boris et al., 2008). The amount of qualifying distributions reported on a foundation's 990-PF is based on the fair market value of cash receipts. (See also *minimum distribution requirement* and *payout rate*.)

Ruling date: This is the year and month when the IRS made its determination of an organization's tax exempt status.

Tax exemption: Nonprofits that are organized as a 501(c)(3) are exempt from federal income tax and are eligible to receive tax-deductible contributions. However, at localized levels of states and municipalities, there may be different rules governing nonprofits' tax exemptions on income, sales, or property.

Assumptions

Three key assumptions underlie this research and each one helps to explain the centrality of money in holding foundations accountable to public interests. The first premise is that private foundations are meant to realize a public good. According to Bowman (2011a), an important basis for foundations' "public acceptance and legitimacy" is the assumption that their "spending policies [will] address human needs and social change" (p. 123). This assumption is the basis for applying principal-agent theory wherein foundations exist to advance the public good and thus should be held accountable to public interest. As evidence of the validity of this assumption, the mandatory minimum distribution requirement ensures that private foundations act philanthropically, "existing strictly to advance their stated missions rather than serving as a tax shelter to perpetuate the accumulation of private wealth or other non-philanthropic purposes" (Astro & Ilkiw, 2003, p. 63). Assuming that foundations exist for a public, not a private, purpose, their distribution of wealth should help public charities and, by extension, the overall viability and capacity of the nonprofit sector. To those who do not agree with this assumption—instead prioritizing foundations' role as fulfilling privately held objectives, such as instilling family values, creating familial bonds

intergenerationally, or honoring the memory of foundation founders (Brody, 1998; Brody, 2010; Brody & Tyler, 2012; Kristol, 1980)—this study may seem problematic.

The second assumption is that of the many priorities that foundations hold (i.e., social mission, operational efficiency, intergenerational transfer of philanthropic opportunities, service to grantees), there should be a way to hold foundations' activities accountable. There are different opinions on the most important aspects of foundations that should be assessed. Some perceive the top foundation priority to be the ambition of their social change objectives (Fleishman, 2009), while others exhort the primacy of effective management in bringing about social change (Frumkin, 2006b). There is also the opinion that foundations must be as or more effective than government in using tax-subsidized assets (see, for example, Toepler, 2004), or the perspective that foundations should strive to be unlike and autonomous from government in using their freedom from democratic accountability to unfetter their potential impact (Anheier & Hammack, 2010). Of all these different perspectives of foundations, this study reflects Porter and Kramer's (1999) view that foundations' value and effectiveness should be measured by the outcomes of their activities. Their perspective influenced my search for a theoretical framework and analytic model that would explain and test the effectiveness of foundations' actual wealth distribution output.

The third premise concerns the centrality of money in the relationship between foundations and public charities. One justifiable concern is that too much emphasis is placed on money in gauging the value that funders have to grantees. Such a focus may be particularly worrisome when applied to the nonprofit sector, which adheres to the

principle that values-based work trumps a desire for money. The nonprofit sector's stance toward money is in stark contrast to the proprietary marketplace, in which accumulation of money signifies winning; hence, raising the most revenue or the biggest endowment are not good metrics for determining the best nonprofits. As such, money has been described as a "poor proxy" for studying nonprofit impact (Palmer & Randall, 2001, p. 135). Yet, money is of central importance in the nonprofit sector as "[money] is an economic means to non-economic ends" (Zuidervaart, n.d., para. 24). Hence, even though money may not be a measure of success, it is important symbolically and practically in affording the existence and activities of the charitable sector.

For public charities, their "survival is as concrete an issue as profits" (Kanter & Summers, 1987, p. 157). Hence, public charities equate "cash with power" (McLaughlin, 2000, para. 1), because having money enables them to realize their social purpose. For foundations, "wealth is an instrument for achieving human ends" (Lindeman, 1988, p. 1), and so the balance between accumulating and distributing money is an expression of a foundation's character—its priorities, values, and ambitions. Consequently, foundations' payout as a ratio of assets is a powerful marker of how they balance self-interested desires to accumulate wealth and outward-facing priorities to meet social needs.

Although the nonprofit sector does not aggrandize money, it is central to reflecting priorities, enabling activities, and conferring power. Hence, the transfer of money between funders and grantees is no small act: Such redistribution of wealth is about transferring the power of resources in service of need. Economic research enables testing the efficiency of foundations' output of distributing wealth (Hughes, 2006). For

these reasons, this study specifically attends to money because of all that it represents practically and symbolically—its role in the functioning of the nonprofit economy, its capacity to afford charitable work, and its transferring of opportunity from funders to grantees.

Scope of Study

This research centers on domestic, private, nonoperating foundations of all asset and giving sizes. These foundations adhere to U. S. regulations regarding minimum distributions of assets and are required to file a U. S. tax return. Grantee organizations are identified by sampled foundations' grants lists and thus public charities reflect grantees and not the overall population of public charities.

Delimitations

There are many contributing factors to a public charity's financial condition, including other sources of funding beyond private foundations, economic conditions, competition for funding, and the level of demands on services. However, this research is restricted to asking how and how much of foundations' mandated wealth distribution can be accounted for in grantees' financial condition. In other words, the research focus is not about understanding the various determinants of public charity's financial health, but rather is concerned with exploring how foundations' charitable spending influences the amount of grantees' financial reserves.

Another delimitation is that the condition of a public charity's financial reserves has much to do with internal management capabilities and governance policies (Herman & Renz, 1999), considerations which I did not include in this study. As an example, this

research cannot account for the many ways that grantees may suppress growing financial reserves. According to Brooks's (2005) research on nonprofit managers' decision making, public charities are more focused on expending charitably than in retaining earnings. Also, board and staff enact internal policies that limit or outright prohibit accumulating reserves and intentionally maintain low reserve levels in order to appear needy enough to qualify for government and philanthropic funding (Calabrese, 2012). Furthermore, employees of public charities prioritize meeting short-term objectives over planning for the long term and therefore generally lack knowledge and management skills to save resources. Hence, no matter how much foundation funding may provide opportunities to build grantees' MULNA, this study did not account for grantees' own fiscal policy and management behaviors.

In addition, the years covered by this study (2006 and 2007 tax years) may not reflect other periods. Since the mid-2000s, public charities have continued to engage in increasingly complicated and innovative methods of raising, spending, and investing in social change efforts. Public charities are developing new resource-generating practices and foundations are experimenting with market-driven spending strategies (for examples of foundation's impact investing methods, see Rockefeller Philanthropy Advisors, 2013). Also, this period precedes the Great Recession that affected foundations' investments beginning in late 2007. Therefore, this study may not adequately reflect more recent conditions or periods of economic contraction.

Conclusion

Through an act of Congress, foundations were established to behave philanthropically by distributing their wealth to benefit charitable organizations acting in service for the public good. Today, there is enough foundation activity to raise expectations that foundations should have some measurable effect on their beneficiaries. This study isolates and tests the significance of private, nonoperating foundations' annual distribution rate on grantee organizations' financial health in order to fill a gap in knowledge about the value of foundations' charitable spending in serving the public good. The next chapter provides an in-depth explication of key concepts, such as foundation effectiveness and nonprofit financial health; an explanation of key theories used to comprise the research framework; and background on the study variables.

Chapter 2: Literature Review

Introduction

This research contributes new knowledge on and a testable theoretical framework for understanding private foundations' financial impact on beneficiaries—a topic that has received no direct scientific attention previously. In this chapter, I establish why relating the financial health of grantee organizations to foundations' charitable spending is important to the larger discourse on the effectiveness and value of private foundations. The literature review has the following main parts. I begin with the rationale for a scientific study of foundations. Then I present a literature review of foundations' effectiveness, thereby providing the context for the research questions on how foundations enable grantees' capacity financially. In tracing efforts to define and capture the concept of foundation effectiveness, I report on the state of research on this topic, explain why its study is important, and describe why foundations' effectiveness has been so problematic to address. The third part of this chapter centers on the study's theoretical framework, which integrates the concept of foundations' public accountability through principal-agent theory and the concept of financial health via capital subsidy theory. In addition, I give an overview of the variables of study: the outcome variable of grantee organizations' MULNA as an indicator of financial health; the influencer variables of foundations' characteristics of asset size, age, professionalization, and sector focus; and the mediator variable of foundations' payout rate.

The Case for Studying Private Foundations

Foundations have been underresearched relative to public charities. Furthermore, the amount of scholarly attention paid to foundations has not kept pace with the sector's rapid growth in numbers and wealth. The lack of scientific research should not be taken to mean that this subject matter lacks scholarly merit; rather, there are many reasons why foundation research is of pressing importance and yet has been overlooked for research.

Growth of Private Foundation Industry

As the voluntary sector has taken on a greater role in shaping civic life and providing social services, private foundations, too, have become a more important part of society. The private foundation entity was formally recognized and codified by the Tax Reform Act of 1969 and, since then, there has been tremendous growth in their numbers, asset size, and giving, especially in the past 3 decades.

To demonstrate the sector's tremendous growth, in 1975, there were 21,877 foundations incorporated in the United States with assets totaling \$30 billion and giving totaling \$1.94 billion (Foundation Center, 2012a). As of 2012, there were 86,192 private foundations with assets totaling \$715 billion that were expending \$52 billion in charitable giving (Foundation Center, 2014). In the span of a little more than a generation, the number of foundations increased nearly 300%, foundation asset sizes increased 2283%, and charitable giving increased by 2580%.

Foundations' Influential Rise

There is no other country that has the kind of wealth and influence that characterize the private foundations of the United States. Relative to charities in other

first-world nations, United States-incorporated foundations are considered the worldwide leaders in philanthropic contributions (Lew & Wójcik, 2010). The blueprint for their uniqueness was set in the early 20th century by philanthropic charitable trusts established by the fortunes of Andrew Carnegie, Henry Ford, Russell Sage, and John D. Rockefeller. The early 20th century was a period of unprecedented meteoric rise of disposable wealth. The newly wealthy were of a new type: They were modern businessmen who used a scientific approach in their decision making and represented a culture of a powerful elite who shared a homogenous worldview shaped by their Protestant upbringing and the same academic connections and social networks (Beer, 2015; Parmar, 2012).

Not only were they wealthy but also they were influential. Philanthropists were able to exert a great deal of influence because the federal government was relatively weak in being able to raise revenue and public will favored allowing private actors, rather than the church or state, to shape the trajectory of the modern reform movement (Karl & Katz, 1981; Parmar, 2012). “Americans had found a way of doing ‘privately’ what governments in other advanced industrial societies were beginning to do” socially and politically (Karl & Katz, 1981, p. 260). In the leadership vacuum left by a weak state, these early philanthropists were credited with “[shaping a] national policy for American society” (Karl & Katz, 1981, p. 247). Although their private wealth was never as great as that of the federal government, philanthropists influenced how and to which causes government spent its resources (Immerwahr, 2012). In short, this “power elite” acted as America’s “shadow government” (Immerwahr, 2012, para. 3), setting priorities and

shaping policies that led to a more progressive government that addressed issues of inequality and poverty (Parmar, 2012).

The characteristics of these modern private charitable trusts became the prototype for today's leading private foundations: They were "top-down" and "elitist," employed a business-minded approach to giving, and prioritized empiricism and scientific knowledge in decision making (Beer, 2015; Parmar, 2012). In this way, they distinguished their approach as *philanthropic*—using science to address the root causes of social problems—and not *charitable*, which is considered emotionally based and makes no distinction between causes or effects of a problem.

In the interim of the mid-twentieth century, the public-good role of philanthropists shifted. Private philanthropists and their institutions continued to be active but were not as influential as the modernist progenitors of foundations. In the 1970s, the federal government greatly expanded, and nonprofit organizations received twice as much public than private charitable support. In other words, when government expanded, private philanthropy exerted less of an influence. This dynamic changed, however, when public sentiment shifted yet again in the 1980s in favor of shrinking the federal government, with more responsibilities for public welfare placed on the private nonprofit sector (Eikenberry & Nickel, 2006; Karl, 1987). Beginning in the 1980s, public support was reduced by 25% in real dollars and did not return to previous levels until the late 1990s, by which time the state had been effectively weakened (Salamon, 2002; see also Abramson & Salamon, 1997; Lipsky & Smith, 1989; Salamon, 1985).

Today, in the wake of an again diminished federal state, private foundations are exerting a degree of influence similar to that of the early twentieth century charitable trusts in their leadership of social reforms and sway in national spending priorities. The conditions that have enabled private foundations to be influential once again are similar to that of a century ago—the proliferation of extraordinary wealth among a relatively few private citizens concurrent with a weakened federal state. Yet the terms of foundations' engagement are different from that of a century ago.

The nature of what distinguishes private foundations' influence today has much to do with the shifting relationship between the private voluntary sector and government. When the state reduced direct public spending on nonprofits beginning in the early 1980s (Grønbjerg, 2001; Liebschutz, 1992), it began to favor contracting for, instead of directly providing or funding, social services (Abramson & Salamon, 1997; Lipsky & Smith, 1989; Ryan, 1999; Salamon, 2002; Smith & Lipsky, 2009). Governmental contracting-out is considered to be a hallmark of privatization, a term that was introduced in the early 1980s (Seidenstat, 1996). The reduction of direct public support reflected not only an antigovernment ideology but also was due to having less money as a result of declining tax bases (Anheier, 2009; Golden, Longhofer, & Winchester, 2009). A succession of economic crises beginning in the 1970s, including the more recent Great Recession that began in 2007, has resulted in less revenue for the federal government. Also, September 11, 2001 not only transformed Americans' psyche, it pitted social welfare spending against new priorities for national security.

Although reductions in public spending rendered nonprofits financially vulnerable, government outsourcing actually expanded the nonprofit sector through a diffusion of public contracting at all levels and sectors of government (Grønbjerg, 2001; Liebschutz, 1992; Lipsky & Smith, 1989; Smith & Lipsky, 2009). In other words, with state responsibilities and functions dispersed to private parties, the nonprofit sector has emerged as more essential and important to the country's social welfare.

Rather than depend as they had on government grants, charities now compete for and manage public contracts procured from various levels and departments of government; they also tap growing sources of private philanthropic support and behave like businesses in generating earned revenues (Grønbjerg, 2001; Liebschutz, 1992; Lipsky & Smith, 1989; Ryan, 1999; Salamon, 1999). Consequently, today's public charities are more complex financially and use a business-like approach to manage varied obligations of diversified funding sources (Ryan, 1999; Salamon, 1999, 2002). Rather than depend on government grants, today's nonprofits greatly depend on the private sector of individuals, corporations, and private foundations for support; compete for government contracts; and generate earned revenues (Salamon, 1999).

According to the literature on *new public management* (McLaughlin, Osborne, & Ferlie, 2002) and Kettl's (2002) influential text on the changing nature of public administration, government can no longer be thought of as a centralized body; instead the state should be understood as a decentralized network of governance dependent on private actors (see also Hall, 2000; Ryan, 1999; Salamon, 1987a). This governance

system relies on lower levels of government and a wide array of nongovernmental actors to enact policies and provide services.

According to this shifting view of governance, foundations, too, can no longer be considered a wholly independent body separate from public responsibilities and public-interest agendas. Consequently, private foundations should be perceived as having an essential and important role in enacting this state of decentralized governance. At first glance, the idea that foundations are so essential to U. S. political and social welfare systems may seem unfounded, as foundations can never expend charitably as much as the federal government spends annually (Barton & Di Mento, 2012; Morino, 2011; Salamon, 2002). Private foundations' \$50 billion in public benefit support (Indiana University Lilly Family School of Philanthropy, 2014; Salamon, 2012) seems negligible compared to federal government's roughly \$2 trillion in social security, health insurance, and safety net spending (Center on Budget and Policy Priorities, 2015). Yet, even the federal government designs programs in ways that rely on private foundations' participation. Today's private foundations are asked to be co-financiers of social welfare infrastructure and its programs. Applicants to the White House Neighborhood Revitalization Initiative, for example, must match federal dollars with private philanthropic support (The White House, n.d.). This public dependence on private philanthropic support is unlike the role that 19th century foundations played in funding activities that the federal government would not have funded (Hammack & Anheier, 2013, p. 41).

Besides contributing financially in public-private partnerships, foundations exert influence in other substantial ways—the ease in which they can deploy financial and

intellectual resources, their elite networks, and the combination of their charitable missions and scientific approach to decision making that garners public trust. In addition, the meritocracy through which philanthropists earned their wealth and privilege has legitimized their leadership in social welfare arenas.

Private foundations are so influential that they are credited as “carriers of modernity in the nonprofit field, rendering a heterogeneous mix of organizations more similar” (Hwang & Powell, 2009, p. 293). Foundations’ unique and powerful combination of financial, social, intellectual, and reputational assets has enabled these institutions to be agents of social change (Quinn et al., 2014) and to shape entire social movements (Bartley, 2007). Foundations are such a powerful platform for activating ideas that they are used deliberately as platforms for influencing public opinions and laws (Teles, 2008).

In the past, the big foundations “sought above all technocratic order: a strong federal government, a class of experts ready to guide it, and a docile public eager to follow” (Immerwahr, 2012, para. 6). Today, private foundations’ wealth, influence, intellectual resources, and even their lack of transparency, make them a powerful part of the governance infrastructure upon which so many rely for everything from arts and cultural experiences to social welfare opportunities. But this change did not happen without foundations’ influence: In other words, foundations have been complicit in the trend to privatize government responsibilities. Something as seemingly benign as a foundation matching grant, which the Ford Foundation introduced in 1957, resulted in decentralizing support of social issues to local levels, thereby transforming wealthy

private citizens into socially active philanthropists with a platform to advance issues of their concern (Kreidler, 1996). Writing in *The Nation*, Amy Schiller (2013) argued: “Philanthropy is an under-recognized player in the trends that led to the [Federal government budgetary] shutdown in the first place: erosion of legitimacy and trust in public institutions, just as mega philanthropy became an ascendant political force. . . . The most visible example is the . . . efforts by [large foundations] in relentlessly pursuing disruptive, top-down corporate education reform” (para. 5). Schiller (2013) questioned foundation owners’ propensity to favor a free market unencumbered by government oversight and criticized their imposition of business-minded, empirical approaches to education reform (see also Bartley, 2007, for how foundations blunted environmental activists’ revolutionary fervor; Parry, Field, & Supiano, 2013, for criticism of Gates Foundation’s private enterprise approach and disproportionate influence in public education reform; Barkan, 2013, for similar critiques of foundation leaders instigating education reform; and Quinn et al., 2014, for a scientific analysis of foundations’ influence in establishing a deregulated charter school management system). There are enough private philanthropists today decrying government as an enemy of the free market and of the privilege of wealthy individual’s freedom of charitable expression that their perspective engendered a national organization, Philanthropy Roundtable (<http://www.philanthropyroundtable.org>). The mission of this association is to defend the freedom of private philanthropy from regulations and public accountability that hamper foundation leaders’ intentions.

Unlike elected officials whose decisions are held accountable by voters, there are no structures or explanatory frameworks for holding private foundations' actions and behavior accountable to a greater good. Foundations are popularly perceived to be of harmless benevolence, but this is a naïve impression that does not reflect the extent to which private foundations are a part of America's decentralized governance infrastructure and the degree to which their influence shapes today's welfare state.

Implications of Tax-Subsidized Status

The most obvious reason for holding private foundations publicly accountable is that these institutions “receive *privileged treatment* [emphasis added] by governments in exchange for an obligation . . . to use those assets for the public good” (Heydemann & Toepler, 2006, p. 4). This privileged treatment is in the form of tax exemptions: “Some of the money that foundations give away belongs, in a sense, to all of us. That is why we look to foundations to achieve. . . . real value for society” (Porter & Kramer, 1999, p. 122; see also Barkan, 2013; Bertelsmann Foundation, 1999; Heydemann & Toepler, 2006; Lammi, Madoff, Smith, & Tyler, 2009; Reich, 2005). Because they are subsidized by taxpayers, foundations should achieve the most public good by giving in ways that effectively help grantee organizations, which, in turn, benefits the greater good.

There is a practical aspect as to why tax-exempt status raises expectations that foundations need to demonstrate a public value: The federal government must forgo approximately \$50 billion in revenues when exempting foundations from income taxation (Reich, 2013a, p. 525). Taxpayers bear this loss of revenue because they trust that foundations' charitable activities provide enough social value to make up for this cost, a

concept called *treasury efficiency* (Toepler, 2004). “The discussion suggests that the primary purpose of regulating foundation spending policies is to ensure that the foregone [*sic*] tax revenues, comprised in the endowments of foundations, will be put to public uses” (Toepler, 2004, p. 736). In short, foundations need to spend their tax-exempt money in ways that are as or more beneficial to society than if government had been able to use those funds.

The crux of the treasury efficiency argument rests on the minimum distribution requirement that requires foundations to pay out 5% or more of their assets each year. Yet research has shown that foundations do not prioritize charitable spending, particularly among large foundations that are not receiving a new infusion of capital; instead, foundations tend to expend as little in charitable distributions and taxes as possible in order to maintain the value of their corpus (Deep & Frumkin, 2001; Ostrower, 2009; Renz, 2012; Sansing, 2010; Sansing & Yetman, 2006; Yoder et al., 2011; Yoder & McAllister, 2012). Given the nature of foundations to save rather than to spend, foundations should be thought of less as “significant agents of redistribution” and more as “devices for holding, investing, and dispensing charitable and religious funds over time” (Anheier & Hammack, 2010, p. 390). In other words, foundations should be understood as protectors of elite wealth rather than as financiers of social change.

Foundations tend to conserve their assets by paying out at a steady rate over time and as close to the minimum payout as possible making the 5% rule seem more like a ceiling than a floor (Deep & Frumkin, 2001; Sansing & Yetman, 2006; Yoder et al., 2011; Yoder & McAllister, 2012). Because foundations get a tax break on the totality of

their assets but society benefits from only the roughly 5% of foundations' corpus that is distributed annually, Porter and Kramer (1999) argued that lost tax revenues are more expensive than the amount of social benefits taxpayers receive from foundations (see also Shakely, 2011; Strom, 2007). Government's loss of taxable revenue and foundations' tendency to accumulate rather than spend wealth lends weight to the argument that foundations should be more accountable to public interest (Bertelsmann Foundation, 1999; Heydemann & Toepler, 2006; Porter & Kramer, 1999; Reich, 2005; Salamon, 2002; Toepler, 2004).

Private Action for Public Good

Foundations are institutions wherein relatively few individuals make decisions on behalf of many. These few foundation owners are not democratically elected and, thus, do not reflect popularly held priorities or values. Furthermore, foundations reflect the demographics and interests of the elite, not the general public, making them undemocratic and plutocratic in nature (Reich, 2013b, para. 5). Given the unchecked power that so few wield in social matters that affect so many people, this imbalance is another reason why foundations' charitable activities merit scrutiny and attention. "The fact . . . that philanthropy is public in its intentions and seeks to enact a private vision of the common good raises accountability issues precisely because the act of giving projects private values and commitments into the public sphere" (Frumkin, 2006a, p. 100). The imposition of values, ideas, and priorities by this tax-subsidized, private entity is why a public accountability framework for foundations is important.

Effectiveness of Charitable Giving Is Unregulated

All private foundations are subject to oversight by the IRS, which is the federal regulatory body overseeing the nonprofit sector; but the scope of what the IRS reviews is limited to financial and governance matters (Simon, 1999). Private foundations are required to complete annually the 990-PF tax return, pay a nominal excise tax to cover federal government's cost of oversight, and distribute at least 5% of its assets each year toward charitable purposes (IRS, 2015a). The IRS reviews tax returns to make sure foundations' owners are not personally benefiting and that foundations are distributing wealth at the minimum distribution rate. Although foundations' tax-exempt status raises expectations for their effectiveness in addressing social problems, foundations' charitable objectives and performance are neither regulated nor reviewed.

Although private foundations must adhere to more fiduciary rules compared to other types of nonprofit entities (Hopkins & Blazek, 2003), their grantmaking is without constraints. Foundation boards are autonomous to decide to whom, to what cause, and how much to give as long as they do not benefit financially (Anheier & Hammack, 2010). Their charitable decisions are not reviewed by government regulators, are unchecked by market forces, and are unaccountable to their nonprofit beneficiaries (Anheier & Hammack, 2010; Frumkin, 1995). As a result, outside the court of public opinion, there are no formal, systematic checks or balances to assess the merits of foundations' grantmaking and if their giving is having any meaningful impact.

Foundations' grantmaking freedom is an advantage that enables them to behave uniquely in addressing social problems (Frumkin, 1995). By being self-endowed,

foundations are liberated from market forces, a freedom that allows them to pursue unpopular and untested ideas (Anheier & Hammack, 2010; Frumkin 1995). They are also free from public input in their decision making, thus giving them greater latitude to take risks that government cannot afford to take with taxpayers' dollars (Anheier & Hammack, 2010).

On the other hand, foundations' decision-making freedom has also been acknowledged to be their characteristic flaw. Federal judge Richard Posner (2006) described foundations' wide latitude to address social problems as problematic given their use of taxpayer-subsidized funds.

A perpetual charitable foundation, however, is a completely irresponsible institution, answerable to nobody. It competes neither in capital markets nor in product markets (in both respects differing from universities), and, unlike a hereditary monarch whom such a foundation otherwise resembles, it is subject to no political controls either. It is not even subject to benchmark competition, that is, evaluation by comparison with similar enterprises, except with regard to the percentage of its expenditures that go to administration (staff salaries and the like) rather than to donees. The puzzle for economics is why these foundations are not total scandals. (para. 1)

In short, foundations' freedom to make charitable spending decisions should be considered a privilege that must have demonstrable benefits to the interests of a greater good. The lack of accountability frameworks and structural mechanisms is a shortcoming not only for taxpayers subsidizing these entities but also for foundations that stand to

benefit from the ability to assess, benchmark, and improve their externally motivated activities.

Foundations Are Assumed To Be Beneficial

Given foundations' influence in social change efforts, the lack of critical scrutiny is a glaring omission. One reason for the lack of public accountability measures is that foundations' charitable spending elicits an unquestioned reverence of their positive role in society (Parmar, 2012). In researching foundations' influence on foreign policies, Parmar (2012) declared: "It is difficult to believe that philanthropy—literally, 'love of all mankind'—could possibly be malignant" (pp. 1–2), but he concluded that foundations are "[anything but] benign, progressive, nonpolitical, and nonbusiness" (p. 5).

The inability to see any downsides in foundation giving is evidenced by the lack of criticism by those best poised to see the failings of private foundations—media and nonprofit organizations. But these two entities are beneficiaries of foundation support and are therefore blinded by foundations' "benevolent fog" (Edmonds, 2002, para. 8; see also Fassenfest, 2007; Feldman, 2007; Parmar, 2012). In actuality, those who directly benefit from foundations' financial largess—media, public charities, academia, and independent research institutions—are apt to overlook foundations' shortcomings (Cunningim, 1972; Jenkins, 2011). Even when scandals of foundation wrongdoing come to light (see for example Healy, Latour, Pfeiffer, Rezendes, & Robinson, 2003), positive impressions of foundations prevail to such a degree that such activities largely escape public notice (Fremont-Smith, 2004; Jenkins, 2011).

Foundation executives have a well-intentioned reason for wanting to deflect attention. Frumkin (1998) explained foundations' "defensive orientation" as a reaction to real and perceived political and public scrutiny (p. 282). The pressure of scrutiny distracts foundation resources away from mission-related work and makes foundations that are worried about needing to justify their grantmaking more conservative in their ambitions (Frumkin, 1995). Foundation leaders deflect attention by commissioning assessments, evaluations, and seemingly critical research that give the impression of self-monitoring. Consequently, they suffer from a blind spot of their own making: By portraying current practices in foundation effectiveness research as the best they can do, they have discouraged opportunities that would develop the sector's critical studies replete with testable theoretical frameworks and scientific scrutiny (Karl, 1987; Salamon, 1987b; Van Til, 1990). Ultimately, assuming that foundations are effective and deflecting critical attention as too distracting actually becomes counterproductive to improving foundations' effectiveness in serving the public good.

Foundations Reinforce Elitist Social Structures

Not wanting to call attention to the foundation sector could be an end unto itself, but there are also self-interested reasons why foundation leaders discourage efforts to assess the industry's effectiveness. Foundation owners have an interest in tempering, controlling, or subverting activities that would potentially upset the existing social order, especially threats to class divisions, wealth-conferring capitalist markets, and institutions that confer power and privilege to wealthy elites (Arnove, 1982; Bartley, 2007; Beer, 2015; Feldman, 2007; Incite, 2007; Parmar, 2012; Research Unit for Political Economy,

2007; Roelofs, 2003). Carl Schramm (2006), president of the Ewing Marian Kauffman Foundation, believed that private foundations' responsibilities were to "strengthen and facilitate . . . a free-market economy," and in no way "work to subvert democratic capitalism" (pp. 357–358). Strengthening a capitalist, free-market system is self-serving in sustaining the very system by which philanthropists benefited.

Evidence exists of how foundation funding is not redistributive of wealth and opportunity. Core and Donaldson (2010) demonstrated that the wealthy give to non-poor causes more than to causes that benefit the poor. Their finding confirmed a collaborative study on giving by the Center on Philanthropy at Indiana University and Google (2007) that showed that charitable giving is not redistributive to the poor. In addition, Dasgupta and Kanbur's (2011) research yielded empirical evidence that philanthropic giving aggravates rather than reduces inequities. By not redistributing wealth to the poor, foundation giving perpetuates unequal access to opportunities and primarily benefits the interests of wealthy elites (Leat, 2009).

Not only are causes of the poor under supported, but there is also evidence that foundations prioritize serving their own elite interests. Ostrower's (2002) qualitative study of nonprofit cultural boards revealed that trustees made decisions in ways that conferred prestige to their own standing within elite networks (see also Odendahl, 1990; Ostrander, 1984; Ostrower, 1995; Silver, 2007). They supported institutions and programs that "create and perpetuate elite networks of academics, think tanks, publicity organizations, emerging mass media, and public officials [which are] powerful in constructing and mobilizing a globalist elite" (Parmar, 2012, p. 7). In the period of the

late 1970s through late 1990s when private giving grew by 90% (adjusted for inflation), a large amount of it funded endowments of elite universities and established new private foundations (Salamon, 2002). In effect, when foundation owners fund and volunteer at museums, universities, and medical centers, which are all closed networks where the poor are but visitors, they reinforce structural inequities in ways that benefit their own socioeconomic class (Odendahl, 1990; Ostrander, 1984; Ostrower, 1995, 2002).

Another way that foundations reinforce elitist social structures is by silencing dissent. During the House Committee on Ways and Means's *Hearing on Tax Reform* in 1969, Ford Foundation President, McGeorge Bundy, testified that foundations can mitigate "disruption, discord, and even violence" by appeasing the discontent with foundation support (as cited in Roelofs, 2003, p. 125). Foundations also silence discord by employing or financing the very intellectuals who could have fought against structural and social inequality by leading civil unrest (Arnove, 1982; Friedman & McGarvie, 2004). As employers and funders of activists, foundations are "prime constructors of hegemony by promoting consent and discouraging dissent against capitalist democracy" (Roelofs, 2007, p. 479). Essentially, foundations "engage in ameliorative practices to maintain social and economic systems that generate the very inequalities and injustices they wish to correct" (Arnove & Pinede, 2007, p. 393; see also Arnove, 1982; Bartley, 2007; Incite, 2009). The precedence for placating opposition was established early: Ford, Carnegie, and Rockefeller foundations and their networks of policy makers, academics, and intellectuals advanced their own elite interests by managing, rather than solving, society's structural problems (Parmar, 2012).

Foundation Grantmaking Practices Can Cause Harm

Foundations can actually undermine grantees by undermining their financial capacity. Many have documented how foundation grantmaking practices are counterproductive to helping grantee organizations (Buechel, Keating, & Miller, 2007; Burd, 2009; Curtis, Nelson, & Engel, 2010; Foster, 2008; Hager et al., 2004; Grantmakers for Effective Organizations & Harder+Company Community Research, 2008; Grantmakers for Effective Organizations & TCC Group, 2011; Gregory & Howard, 2009; Miller, 2003; NORI, 2010; Overholser, 2006; Starr, 2011; Thomas, et al., 2011; Woodwell & Bartczak, 2008). In an article titled “The Nonprofit Starvation Cycle,” Gregory and Howard (2009) described foundations as “perpetuating a vicious cycle [that] is leaving nonprofits so hungry for decent infrastructure that they can barely function as organizations—let alone serve their beneficiaries” (para. 1). They blamed foundations’ “unrealistic expectations” of what grantees need as instigating the cycle (Gregory & Howard, 2009, para. 1; see also Curtis et al., 2010; Miller, 2003).

Foundations can undermine grantees’ capacity to realize their missions in several ways. They can starve financially an organization by not covering the actual costs of a project, most notably overhead expenses—salaries, rent, mortgage, utilities—that are the backbone to every endeavor (Froelich, 1999; Gregory & Howard, 2009; Hager et al., 2004; Woodwell & Bartczak, 2008). Also, foundations place restrictions on grants, disallowing funding to be used toward necessary operating expenses or accumulating as an unrestricted, liquid asset (Hager et al., 2004; Grantmakers for Effective Organizations & Harder+Company Community Research, 2008; Grantmakers for Effective

Organizations & TCC Group, 2011; Miller, 2003). Or, foundations make grants that are too small relative to the ambitions of a project, thereby forcing grantees to expend precious time fundraising (Grantmakers for Effective Organizations & TCC Group, 2011) or to use their own reserves to cover the costs of foundation-supported projects (Froelich, 1999). The average grant size of the 100 largest foundations was \$200,000, but, most were multiyear grants meaning that this amount was spread over more than a single year (Foster, 2008). Moreover, a survey of all foundations—not just the largest—found that the median grant size was only \$20,000 (Grantmakers for Effective Organizations & TCC Group, 2011). Most foundations do not follow grantmaking practices that they themselves acknowledge would be helpful to grantees—multi-year grants, grants of sufficient size, and unrestricted support. In short, “walk trails talk” (Woodwell & Bartczak, 2008, p. 1; see also Grantmakers for Effective Organizations & Harder+Company Community Research, 2008; Grantmakers for Effective Organizations & TCC Group, 2011) with foundations eroding grantee organizations’ capacity to meet their social objectives.

Given the prevalence of literature on the negative impact that foundations’ grantmaking practices can have on grantees’ financial capacity (Buechel et al., 2007; Burd, 2009; Curtis et al., 2010; Foster, 2008; Grantmakers for Effective Organizations & Harder+Company Community Research, 2008; Grantmakers for Effective Organizations & TCC Group, 2011; Gregory & Howard, 2009; Miller, 2003; NORI, 2010; Overholser, 2006; Starr, 2011; Thomas et al., 2011; Woodwell & Bartczak, 2008), and the knowledge that foundations tend to protect rather than to distribute wealth (Anheier & Hammack,

2010; Deep & Frumkin, 2001; Porter & Kramer, 1999; Sansing & Yetman, 2006; Worthy, 1975; Yoder et al., 2011; Yoder & McAllister, 2012), it would be too easy to assume that foundations' charitable spending does not have a role in contributing to grantee organizations' MULNA. But, the answer to this question remains unknown. Many of the harmful effects of foundations' grantmaking practices seem to be inadvertent with grantmakers surely wanting grantees to succeed. Given grantmakers' motivation to make effective grants, it is worth noting that foundations' funding is not the sole contributing reason for grantee organizations' generally precarious financial state. Researchers discerned that organizations with less than a three-month threshold for reserves relied primarily on government grants, which is not surprising because government grants are highly restricted to projects. In other words, organizations that depended on government grants had a higher percentage of lacking operating reserves compared to those that relied on private contributions (Blackwood & Pollak, 2009, p. 4; see also Lam & McDougale, 2012).

Given the conflicting picture this information paints of whether or not foundations harm or help public charities, this study does not hypothesize a direction in the relationship between foundations and grantees' MULNA. Foundation grantmaking may or may not grow public charities' financial stability. The lack of clarity on this issue affirms the importance and timeliness of this study.

State of Literature on Foundation Effectiveness

I conducted an extensive and broad literature search for studies on private foundations' effectiveness (i.e., how their giving has had an impact on society, the well-

being of the nonprofit sector, and grantees' capacity). I used various combinations of keywords—*private foundation*, *grantmaker*, *grantmaking*, *charitable distributions*, and *payout*—along with the terms *effectiveness*, *effect*, *evaluation*, *outcome*, *impact*, *assessment*, *change*, *theory of change*, and *tracking*. I employed a multipronged and layered approach of (a) reviewing the bibliographic references of seminal publications on private foundations; (b) searching the ProQuest Dissertations and Theses database; (c) searching online peer-reviewed, full text collections of academic databases, including EBSCOhost (Academic Search Complete, Business Source Complete, SocINDEX with Full Text, Political Science Complete, eBook Collection EBSCOhost), Expanded Academic ASAP, and ProQuest Central; (d) identifying relevant works cited in journal articles; (e) using keyword searches within the four leading and relevant peer-reviewed periodicals—*The Foundation Review*, *Nonprofit and Voluntary Sector Quarterly*, *Voluntas*, and *Nonprofit Management and Leadership*; and (f) reviewing articles in field-relevant publications, such as *Stanford Social Innovation Review*, *Chronicle of Philanthropy*, and the *Nonprofit Quarterly*, publications of leading industry organizations, such as by Foundation Center, Aspen Institute's Program on Philanthropy and Social Innovation, Grantmakers for Effective Organizations (GEO, www.geofunders.org) Center for Effective Philanthropy (CEP, www.effectivephilanthropy.org), and NFF (www.nonprofitfinancefund.org), and nonserial reports published by private foundations and nonprofit academic centers. The search parameters spanned all years (although most literature on this topic begins in the

1980s) and included both peer-reviewed academic studies as well as practitioner-published literature.

A review of the literature revealed that the infrastructure for generating knowledge regarding nonprofits is robust and expanding (Jackson et al., 2014; Shier & Handy, 2014). At the time of this writing, the Census of Nonprofit Management Programs identified 292 colleges and universities offering courses on nonprofit or philanthropic studies (Mirabella, n.d.; see also Katz, 1999; Mirabella, 2007; Salamon, 2012). This growth has been mirrored by increased numbers of articles in peer-reviewed journals: A search of nonprofit and philanthropic keywords identified 1,500 articles published in 2000 and over 2,500 published in 2011 (Jackson et al., 2014, p. 804). Similarly, there was a substantial increase in the number of nonprofit-related dissertation topics, from approximately 60 published in 2000 to over 100 published in 2011 (Jackson et al., 2014, p. 805). When including both master's degree theses and doctoral dissertations on nonprofits and voluntary sector activities, the number begins at fewer than 50 published in 1986 and jumps to more than 350 published in 2010 (Shier & Handy, 2014, p. 817).

There is also an “overwhelming body of knowledge” (Bekkers & Wiepking, 2011, p. 924) on philanthropy, such as on individual donor behavior and charitable giving motivations. What has remained relatively underresearched given their influence and size, however, is private foundations and their giving behavior. Private foundations cannot be lumped together with research on private donors: Foundation decision makers are privy to more information, such as public charity's audited financials, tax returns,

program assessments, and strategic plans, that result in unique behaviors (Ashley & Faulk, 2010). Moreover, foundation heads must decide on perpetuity versus sunseting policies that influence how they choose to save or spend financial resources.

Of the few studies on private foundations, the literature is mostly devoted to the grant contractual relationship between foundations and grantees, public charities' accountability to foundations, practices in distribution of wealth, balancing financial investment returns with pursuit of charitable mission, capacity-building funding, and support of underserved populations. Of the studies on foundations' grantmaking behavior, they are primarily focused on discerning the foundation characteristics that correlate with various levels of payout rate (Deep & Frumkin, 2001; Ostrower, 2009; Renz, 2012; Sansing, 2010; Sansing & Yetman, 2006; Yoder et al., 2011; Yoder & McAllister, 2012) or with foundations' criteria in determining grant decisions (e.g., Botetzagias & Koutiva, 2014, found that a nonprofit's legitimacy and reputation was a key grantmaking criterion).

Overall, there is a lack of scientific research on the social, redistributive value of foundation grantmaking or foundations' effectiveness in helping grantees realize their social objectives. Such was the case in 1999 when Porter and Kramer were unable to unearth any scientific studies concerning foundation effectiveness and remains so today (see also Daniels, 1996). A library search yielded only a few scholarly studies on foundation effectiveness that appeared to be free of funding or commissioning by private foundations. These tested an instrument to gauge foundations' effectiveness (Whitman, 2009), proposed evaluative frameworks (Ebrahim & Rangan, 2010; Whitman, 2008), and

assessed foundations' evaluation efforts (Carman, 2010). In their focus on developing evaluation instruments for use by individual foundations, none offered a useable theoretical framework with workable variables for studying and testing foundations' aggregate, field-wide impact.

The lack of scientific study about foundations may be because of a lack of critical interest by academics or not knowing where to start when so little has been done: “[A] consequence—or perhaps cause—of the diffidence and invisibility of foundations is the sparseness of empirical literature and analysis on foundations in America” (Fleishman, 2009, p. 225). Unlike public charities that are more open to researchers, private foundations are less accessible, thus making them difficult to research. Although there are now academic degree-conferring programs on philanthropy, a lack of insider knowledge of how foundations operate has resulted in research questions and findings not particularly useful to the field of practice.

An obstacle to researching foundations is that there is “no compelling strategic framework for analyzing the field of philanthropy” (Eilinghoff, 2005, p. 8; see also Flynn & Hodgkinson, 2001). The lack of frameworks may be because of the sheer diversity of the field. A common adage in the field is “if you’ve seen one foundation, you’ve seen one foundation.” Foundations’ different aims, values, intentions, and practices have thwarted attempts to develop uniform, testable theories of their effectiveness (Anheier & Hammack, 2010; DiMaggio, 2001; Harris, Mainelli, Grant, & Harrow, 2006; Orosz, Phillips, & Knowlton, 2003; Prewitt, 2006). Their individuality has also stymied the development of comprehensive, widely acceptable instruments that could measure and

benchmark foundation performance (Carman, 2010; Eilinghoff, 2005; Harris et al., 2006).

Although social scientists have tended to overlook the topic of foundations and their effectiveness, this topic has been popular among private foundation executives and their membership association leaders. Perhaps feeling the need to justify their privileged tax-exempt status, foundations attempt to be transparent by publishing annual reports to demonstrate their accomplishments and social value (Leat, 2009). There is also copious research on the topic of effectiveness commissioned by private foundations, published by their employees or consultants, or produced by foundation-funded research centers (Andrews, Buchanan, & Huang, 2003; Center for Effective Philanthropy, 2002; Buteau & Buchanan, 2011; Cutler, 2009; Eilinghoff, 2005; Harris et al., 2006; Kramer, Parkhurst, & Vaidyanathan, 2009; Lim, 2010; McNelis & Bickel, 1996; Orosz et al., 2003; Ostrower, 2004, 2006; Peterson & Fujii, 2012; Ross, 2009; Walker & Grossman, 1998).

Reports commissioned and produced by the field, however, have been criticized for being more akin to marketing than critical scrutiny. “The use of the term ‘research’ as an umbrella that would cover the various aspects of advocacy without drawing critical attention to the process has been a stroke of genius” (Karl, 1987, para. 7). In addition, self-chronicled accounts provide “a false façade behind which trustees and foundation officers and staff could feel securely proud of their apparently altruistic . . . contributions” (Lagemann, 1999, pp. ix–x). Foundation-commissioned reports can be self-serving by presenting a positive image that distracts critical attention. Even reports that may have been genuinely intended to help inform effectiveness practices are still

problematic as they may reflect client bias, lack scientific rigor, and be absent meaningful theoretical frameworks (Ebrahim & Rangan, 2010; Hall, 2004).

Given that the state of empirical studies on philanthropy is considered such a “patched landscape” (Lew & Wójcik, 2010, p. 153), this literature review of extant knowledge pertaining to this topic includes both scholarly and field-generated resources. The combination of the two allows for a comprehensive background of the kinds of questions, issues, and discourses that concern the topic of foundations’ effects. Of practitioner-produced literature, I prioritized reports by leading research institutions, foundations, and foundations leaders. In addition, I prioritized writings and studies that were published in peer-reviewed journals or demonstrated use of scientific methodology.

In general though, nearly all research on foundations may be inherently problematic. Not only are reports unable to be perceived as free from self-interested motivations, but so too the work of academics who have benefited from funding by and access to elite professional networks of private foundation executives.

It is merely the fact that a fund is within reach which permeates everything and alters everything. . . . [F]oundations do not control, simply because, in the direct and simple sense of the word, there is no need for them to do so. They have only to indicate the immediate direction of their minds for the whole university world to discover that it always meant to gravitate swiftly to that angle of the intellectual compass. (Economist and academic Harold Laski’s 1930 publication as cited in Parmar, 2012, p. 262)

Public policy professor and former editor of the nonprofit sector's leading peer-reviewed journal *Nonprofit and Voluntary Sector Quarterly* Jon Van Til (1990) concluded that research on foundations has inadvertently served as a promotional vehicle “enhancing philanthropy’s public character and obscuring its ties to private interests” (p. 254). In short, there are not many channels for researching and publishing studies on foundations that are outside foundations’ sphere of influence.

Tools for Assessing Foundation Effectiveness

The lack of scientific research on foundations’ effectiveness belies the multitude of efforts underway at private foundations across the country trying to assess the impact of their funding (Mulgan, 2010). One would never know from searching library resources that so many private foundation boards and staff are assessing the impact of their grantmaking efforts. But, caution must be taken to avoid assuming that evaluations undertaken by foundations meet scientific standards of reliability or validity. What counts as evaluation encompasses many different types of efforts and range greatly in quality (McNelis & Bickel, 1996).

Foundation managers’ interest in assessment has spurred a subindustry devoted entirely to foundation assessment and evaluation. In the past decade, a great quantity of tools and guides, some widely available and some proprietary, have emerged to help philanthropists—including foundation managers, individual donors, social impact investors, and micro-finance lenders—establish a baseline for, conduct research on, track, and assess their impact. Using Foundation Center’s Tools and Resources for Assessing Social Impact (TRASI) database (<http://trasi.foundationcenter.org>), I identified more than

150 such resources. A search of the TRASI database for foundation-related assessment yielded the following items, which appear to be the most relevant to private foundation managers seeking ways to improve their management effectiveness and calculate their social change footprint: Abt Associates's Benefit-Cost Analysis; ActKnowledge's Theory of Change Community; Acumen Fund's Pulse; Ashoka's Measuring Effectiveness Questionnaire; AtKisson's Compass Index Sustainability Assessment; Center for Disease Control & Prevention's Framework for Program Evaluation; Coalition for Evidence-Based Policy's Checklist for Reviewing a Randomized Controlled Trial or a Social Program or Project; Cúnamh ICT's Social Impact Tracker; Foundations of Success's Guideline for Effective Evaluation; Global Impact Investing Network's (GIIN) Impact Reporting and Investment Standards (IRIS); Global Reporting Initiative's GRI Reporting Framework; Hunter Consulting's Social Investment Risk Assessment; Innovation Network's Evaluation Plan Builder; Keystone Accountability's Comparative Constituency Feedback; New Profit's Balanced Scorecard; Organizational Research Services's Outcome-Based Evaluation; Rockefeller Foundation and Goldman Sachs Foundation's Social Impact Assessment; Root Capital's Social Value Metrics; Social Evaluator's social e-evaluator; Social Solutions's Efforts to Outcomes (ETO); Venture Philanthropy Partners's Assessment and Improvement Indicators; as well as a number of research and assessment tools promoted by Annie E. Casey's Organizational Research Services, Center for Effective Philanthropy, FSG, W.K. Kellogg Foundation; Wallace Foundation, Women's Funding Network, and the William and Flora Hewlett Foundation; various organizations that help in measuring SROI (social return on investment), and

rating or benchmarking agencies with unique sets of performance indexes such as Better Business Bureau Wise Giving Alliance, Charity Navigator, Charity Watch, GiveWell, GreatNonprofits, Guidestar, Philanthropedia, and Root Cause Social Impact Research. In general, these tools can be grouped into three types of assessment objectives: evaluating internal priorities for operational decision making, understanding social outcomes, and tracking economic impact.

Gauging Effectiveness at the Operational Level

A popular use of evaluations is to gauge a foundation's operational effectiveness, such as investment performance, administrative and staffing costs, and board performance (Buteau & Buchanan, 2011). As an example, the Center for Effective Philanthropy sells private foundations a popularly used tool, the Grantee Perception Report, to collect grantee feedback on how well their funders respond to and serve their needs. Besides using evaluations for customer service considerations, most foundation managers perceive evaluations as a means to learning if grant objectives were fulfilled (Grantmakers for Effective Organizations, 2014; Ostrower, 2004; see also Ridzi, 2012; Thompson & Patrizi, n.d.). Another, albeit less popular, reason (only 54% of foundations) for conducting an evaluation is to improve grantmaking practices (Grantmakers for Effective Organizations, 2014; Ostrower, 2004; see also McNelis & Bickel, 1996; Orosz et al., 2003).

The primary audience for evaluations is the foundation board (82% of foundations), followed by foundation staff (79% of foundations; Ostrower, 2004). Grantmakers for Effective Organizations (2014) and Innovation Network, Inc.'s (2012)

studies of evaluation practices revealed that these patterns have remained consistent over time: Their studies, too, found that approximately 90% of foundations surveyed used evaluation to account to their boards. In short, the primary way that foundations use evaluations is for internal purposes—reporting progress to the board, tracking the efficiency and effectiveness of internal operations, and improving relations with key constituents.

Gauging Effectiveness of Social Change Efforts

If foundations' uniqueness has posed a challenge thus far for creating an evaluative framework for assessing their performance, then trying to discern their social impact has been no easier (Mulgan, 2010). Efforts to assess foundations' social change efforts have not only been thwarted by the sheer diversity of foundations' objectives (Anheier & Hammack, 2010; Carman, 2010; Eilinghoff, 2005; Harris et al., 2006; Orosz et al., 2003) but also foiled by the difficulty in attributing causality to foundations (Center for Effective Philanthropy, 2002; DiMaggio, 2001; Ebrahim, 2010; Fleishman, 2009). "The complexity of social phenomena renders it virtually impossible to prove a causal connection between the foundation's grant and the social outcome" (Center for Effective Philanthropy, 2002, p. 10). To date, there are no approaches or instruments for capturing the foundation sector's causal effects.

Despite the inability to attribute causality to foundations, foundation leaders have a history of turning to scientific approaches for their social change efforts (Tierney & Fleishman, 2011, p. 10). The prototypical modern foundations of John D. Rockefeller, Andrew Carnegie, and Russell Sage distinguished themselves from older models of

charitable trusts by applying a scientific lens to diagnosing and treating the root causes of social ills (Karl & Katz, 1981; O'Connor, 2007; Schambra, 2004; see also Sealander, 2003). The desire to achieve tangible impacts distinguished philanthropy from charitable giving, with the former considered a means to solving social problems and the latter characterized as emotionally based and effective for ameliorating suffering but ineffective in solving problems (for research on donor motivation, see Oppenheimer & Olivola, 2011).

Given the emphasis on solving social ills, foundation managers demanded measurable outcomes of their grantmaking, which led them to scientific methods and practices. The popularity of scientific methodology in private foundation work is attributable not only to demand among foundation heads for practical approaches and evidence of impact but also to the growing supply of social scientific knowledge. When evaluation research “had moved from the margins of applied social science to full institutionalization. . . . [this approach] began to attract the attention of foundation executives” (Hall, 2004, p. 37). Many of today’s largest foundations incorporate scientific approaches throughout all stages of grantmaking: identifying needs in the field, setting mission-related objectives, grant decision making, and impact assessment.

Innovations in the social sciences were being made in all sectors working in social change, and private foundation leaders have borrowed from all. From the scientific community, foundation program officers learned about designing for and tracking measurable results. Influenced by scientific research design and methods, foundation personnel created evaluative frameworks such as theory of change and logic models that

brought together strategy, program design, and evaluation, as well as turned to randomized control trials to inform grantmaking (Banerjee & Duflo, 2011; Carman, 2010; Chen, 1990; Coryn, Noakes, Westine, & Schroter, 2010; Funnell & Rogers, 2011; Rosenberg & Posner, 1979).

Foundation staff also borrowed scientific approaches innovated in the public and proprietary sectors (Hall, 2004; Hatry, 2006; Mulgan, 2010; Orosz et al., 2003). An example of such borrowing is how public managers' performance management practices that used outcomes-based strategies shaped foundations' own evaluation processes (Hatry, 2006). The focus on results shifted funders' attention away from grantmaking outputs (i.e., number of people served) to outcomes (i.e., how people benefited).

From the proprietary sector, foundation managers have been influenced to prioritize quantitative data. An example is foundations' adoption of performance "scorecards" to benchmark performance (Colby, Fishman, & Pickell, 2011; Kaplan & Norton, 2007). Another example is foundations' borrowing of language from the financial industry to describe *grants* as *investments* and *social impact* as a *return on investments*. This linguistic shift reflects grantmakers' emphasis on tangible social change (see, for example, Bean, 2007).

The combination of these influences has led grantmakers to develop an outcomes-focused and evidence-based grant decision-making lens. This scientifically influenced approach to solving social problems has been called "strategic grantmaking" and "outcome-oriented philanthropy" and is the basis of the concept of "effective altruism" (Brest & Harvey, 2008; Porter & Kramer, 1999). This change marks a shift from

charitable giving (i.e., responding to needs) to investing in impact (i.e., effecting a strategically determined social change), with the former entailing a modicum of basic grant reporting and the latter holding foundations accountable for proof of outcomes realized from their investments (Baum, Gluck, Smoot, & Wubbenhorst, 2010).

The popularity of an investment-minded approach among the largest and most prominent funders has fueled a foundation effectiveness industry represented by national service organizations—the Center for Effective Philanthropy (www.effectivephilanthropy.org), which was founded in 2000 and Grantmakers for Effective Organizations (www.geofunders.org), which was founded in 2002—and dozens of strategy and evaluation consultancies (Salamon, 2002). Large foundations depend on external expertise 81% of the time when conducting evaluations (McGill, Henry-Sanchez, Wolcheck, & Reibstein, 2015).

For the most part, foundations' efforts to prove the impact of their grantmaking have fallen largely on their grantees (Walker & Grossman, 1998). When funders move from charitable to strategic giving, foundations outsource the collection of impact data to grantee organizations that are direct providers of goods and services. The problem is that public charities lack the capacity, skills, and funding for involved evaluation work (Baum et al., 2010; Bearman, 2008; Benjamin, 2010; Brock, Buteau, & Herring, 2012; Buteau, 2015; Thompson & Patrizi, n.d.). The quest to demonstrate impact has been frustrating to grantees who must bear this additional burden of proving the value of funders' investments as well as to funders with their high expectations for demonstrating causal proof of impact.

Despite much cost and effort in trying to capture the effectiveness of foundations' grantmaking, there is still no conceptual framework or universally used instrument that helps foundations assess how their grants impact beneficiaries and, by extension, society (Flynn & Hodgkinson, 2001). Moreover, evaluation methods generally do not capture the effects of sophisticated, multi-party, complex social change activities (DiMaggio, 2001; Kania, Kramer, & Russell, 2014; Patrizi & Thompson, 2011; Preskill & Beer, 2012; Thompson & Patrizi, n.d.). As a consequence, there is skepticism of foundations' social impact.

I'm seeing a lot of fuss coming up around effectiveness that has to do with board satisfaction, grantee satisfaction, good decision making [and] strategic alignment.... I think the bottom line is—does anything change? Do things improve? (Patricia Patrizi interviewed in Orosz et al., 2003, p. 8)

All in all, there is generally a lack of evidence that private, nonoperating foundations contribute to improving society (Prewitt, 2006).

Gauging Effectiveness Using Economic Indicators

Another approach to calculating private foundations' impact is by describing their economic footprint. This lens, however, has rarely been applied, with only one research idea suggested and two studies that fit this category. Toepler (2004) suggested comparing how much foundations spent charitably against how much revenue the government, and thereby the public, lost due to foundations' tax exemption. This *treasury efficiency* approach would use economic data to test foundations' effectiveness (Toepler, 2004), but this idea has yet to be taken up by researchers.

Another type of effort is to calculate the economic footprint of foundations' grantmaking by describing the output of foundation spending. As an example, Toepler's (2010) study of foundations' impact in the arts described the amount and type of foundation spending (e.g., project, operating, or fellowship grants), but did not draw any conclusions about the impact of their spending on grantees. On the other hand, the Philanthropic Collaborative (an organization dedicated to promoting foundations' social value) commissioned two research reports that likened foundation spending to having an impact.

The Philanthropic Collaborative's first report totaled private and community foundation sectors' asset values and concluded that foundations' assets are "equal in value to all of the fixed assets of the American agriculture, mining, and utility industries" (Shapiro & Mathur, 2008, p. 2). In other words, the aggregate wealth of foundations is substantial enough to make a difference to American society. To defend this claim, they calculated that for every foundation dollar spent in 2007, it returned \$8.58 in economic welfare benefits, such as direct and indirect employment, improvement in household incomes, and increase in government revenues (Shapiro & Mathur, 2008).

A follow-up report calculated that foundation grantmaking represented \$63.58 billion in GDP, or roughly 0.3% of GDP (Peterson & Fujii, 2012; Steele, 2015). Over the long term and with multiplier effects, this amount will eventually contribute approximately \$570.56 billion in employment, activities, and production of goods and services representing approximately 3.9% of GDP (Peterson & Fujii, 2012, p. 6). (As a comparison, the agricultural industry in the United States is 1.1% of GDP [Central

Intelligence Agency, 2012].) If that calculation holds true, the foundation sector will continue to become even more influential as it becomes a more sizable contributor not only to the charitable sector but also to the overall U. S. economy.

Necessity of an Accountability Framework

There are limitations to all three types of foundation evaluation approaches. Focusing on operations is easiest to accomplish as it attends to internal considerations, yet does not indicate a foundation's impact in the field. Also, the inability to attribute causality is an obstacle to recognizing foundations' social change impact and, this treatment, too, is difficult to apply widely given the uniqueness of each organization's mission. Finally, gauging foundations' economic footprint may be useful for placing a dollar value on the sector, but assuming that all money spent is beneficial is short sighted: Philanthropic spending cannot be equated automatically with bringing about positive social change.

Other related attempts at positing theoretical frameworks have included efforts to explain their grantmaking behavior (Diaz, 1999) or their role relative to government as a complement, supplement, or adversary (Frumkin, 2006a; Sandfort, 2008; Young, 2006). The unsatisfactory result of all these attempts has led leading scholars of private foundations to conclude that there may be no universal way of creating a broadly encompassing theoretical framework as foundations' diversity and complexity preclude generalizations (Anheier & Hammack, 2010, p. 5). To date, then, there does not exist a scientifically appropriate accountability framework that would facilitate understanding foundations' effectiveness in serving the public good or testing their social value.

Assessing foundations' effectiveness hinges on being able to identify to whom private foundations are accountable. Such an accountability framework is what allows for testing foundation's legitimacy and value to society (Frumkin, 2006a). But foundations seem to operate without accountability: "As ownerless organizations, it is unclear to whom the accountability inherent in evaluation is due" (Hall, 2004, p. 28). Although foundations are privately governed, being tax subsidized means they should be held accountable.

A popularly referenced quote by performance management expert H. James Harrington helps to understand why foundations have resisted scrutiny.

Measurement is the first step that leads to control and eventually to improvement.

If you can't measure something, you can't understand it. If you can't understand it, you can't control it. If you can't control it, you can't improve it. (as cited in Phillips, 2014, p. 49)

If being understood leads to being controlled, foundations have good reasons for wanting to be accountable only to internal owners and not to external stakeholders. The former enables boards and staffs to retain control of foundation assets and decision making. The latter is a slippery slope that could allow others external to a foundation to have a claim on how resources should be deployed.

There are, potentially, many parties to whom foundations should be accountable, and any one—the public, grantee organizations, government, foundation founders, foundation trustees—presents a different set of expectations, standards, and performance measures (Anheier & Hammack, 2010; Hall, 2004). Whoever is conferred with the power

of holding foundations accountable has the concomitant right to assess the worthiness of foundations' actions. Hence, the question of to whom foundations should be accountable has been a persistent source of unease as evidenced by the intensity of debates about the sufficiency or insufficiency of the required minimum distribution amount. Are foundations meant to serve a private interest or a public good?

Payout Debate

One of the clearest manifestations of the tension between holding private foundations accountable to private or public interest is the debate about how much a foundation should spend relative to its corpus. Called the *payout debate*, this difference of opinion pits those who believe that foundations should preserve and grow their endowment to ensure charitable spending into perpetuity against those who believe that foundations should spend more now to benefit society.

The Tax Reform Act of 1969 mandated that foundations must participate in wealth redistribution by setting an annual minimum distribution amount relative to asset size (Steuerle, 1976). Originally set at distributions of 6% of net asset value (Steuerle, 1976), this decision was made without "any systematic data about the consequences it would have on the operations of foundations" (Salamon, 1992, p. 119; see also Deep & Frumkin, 2001; Worthy, 1975). Ignoring how the rate of giving would affect the sustainability of private foundations, legislators seemed to favor a rate of distributions that was on par with foundations' yields on investments (Steuerle, 1976). In other words, money gained would be distributed (Steuerle, 1976), thus adding weight to an interpretation that legislators neither intended for private foundations to last into

perpetuity nor wanted private donors to benefit personally from accumulating wealth (Worthy, 1975).

Only in the years following the Tax Reform Act of 1969 did foundation executives argue successfully for lowering the distribution threshold to protect the value of their financial assets (Steuerle, 1976; Worthy, 1975). Their argument was helped by the economic downturn of the early 1970s when yields on investments dropped below the mandated rate (Steuerle, 1976). Foundation leaders claimed “invasion of corpus” (Steuerle, 1976, p. 5; see also Worthy, 1975) and, as a result, the minimum distribution formula was changed to a 5% flat rate in 1981 (Cambridge Associates, 2000).

Given how much money is at stake, the mandatory minimum payout rate continues to be hotly debated. For every 1% increase in foundations’ rate of distributions, this change results in approximately \$4 billion in additional charitable spending (Deep & Frumkin, 2001, p. 3). Some debate the payout threshold on the basis of preserving the charitable sector over the long term: They argue that public good is achieved by protecting the value of corpus so that foundations can spend charitably for years to come (DeMarche Associates & Trotter, 1995). In other words, the importance of the foundation institution is such that their endowments should be preserved. Others argue that foundations should achieve the greatest public good even at the risk of liquidating their assets (Mehrling, 1999). In other words, foundations are only as important as the social impact that they achieve.

Arguments for each side of the debate have been framed in different ways. On the basis of rights and privilege, some argue that foundation owners are entitled to preserve

corpus in order to hand down philanthropic opportunity to descendants, a concept called *intergenerational equity* (Irvin, 2007). Others argue on the basis of effectiveness that foundations that intentionally sunset have greater social impact (Waleson, 2011). The debate has also been framed as an issue of democracy. Some believe that a foundation is a vehicle for free expression by its founders and donors (Kristol, 1980). Others believe that foundations' social intentions should reflect the voices of the public who are being impacted (Mehrling, 1999). In addition, the debate has been framed economically: A dollar that is saved today is worth more tomorrow (Klausner, 2003) versus a dollar spent today is more valuable than a dollar spent tomorrow (Bradley & Jansen, 2002). Even past financial market performance has not provided a clear answer. Some concluded from their own analysis of rates of returns that even the current 5% payout rate is too much and may eventually erode foundation corpus unless asset managers invest in riskier stocks or hybrid assets (Cambridge Associates, 2000; Collie, 2012; DeMarche Associates & Trotter, 1995). Others pointed out that the growth of foundations' endowment values indicate that foundations can afford to give away more (Bradley & Jansen, 2002), even as much as 8% without compromising their sustainability (Mehrling, 1999).

There is also the argument that setting any kind of distribution amount suppresses foundation giving (Deep & Frumkin, 2001). According to Deep and Frumkin (2001), foundations are distracted from spending at levels that would achieve social impact because they are overly fixated on meeting the minimum distribution amount. Deep and Frumkin (2001) argued for striking this bureaucratic requirement altogether in order to unfetter foundations' greater potential. However, their idea was refuted with empirical

evidence that foundations actually spent more when governed by a strong regulatory environment (Desai & Yetman, 2005). This conclusion was substantiated by evidence that showed that foundations paid out less before the mandatory distribution requirement (Worthy, 1975, p. 239).

Accountability to private interest. The payout debate will continue to be waged inconclusively as long as there is no clear direction on answering to whom foundations should be ultimately accountable. On one side of this accountability question are those who believe that foundations enact democracy by reflecting the individualism of their owners (Kristol, 1980). In other words, a foundation is meant to be an outward expression of a donor's personal interests, worldviews, values, beliefs, passions, and practices. Fleishman (2009) opined that this kind of grantmaking, wherein "many foundations are less interested in achieving real impact than in showing the world that their hearts are in the right place," is "hardly to be deprecated" (p. 159): Such philanthropy enacts American values of individualism, charity, and freedom of expression. Although private-interest grantmaking may not "move the needle" in solving social problems, what is accomplished instead is a perpetuation of U. S. charitable culture by the wealthy.

For purposes of academic study, a private, internal accountability framework is not conducive for researching foundations as an industry and their social good impact. There are four components that comprise accountability relationships: Such a relationship is transparent to public scrutiny, allows for questioning and justifying actions, demands compliance, and includes enforcement and punishment when there are shortfalls in

compliance (Ebrahim, 2010). Wanting foundations to be accountable only to their own owners (Brody, 2010; Brody & Tyler, 2012; Fleishman, 2009; Frumkin 2006b; Kristol, 1980; Schramm, 2006) falls outside an accountability framework, because objectives that are privately set and reviewed internally cannot be questioned. Without an accountability framework, private foundations are sovereign from government or public interest in their decision making and answerable only to inside stakeholders (Brody, 1998; Brody, 2010; Brody & Tyler, 2012; Kristol, 1980).

Accountability to public interest. The counter perspective is that foundations' tax-subsidized status and public intentions mean that private foundations exist for public, not private, benefit and so should be accountable to external stakeholders (Porter & Kramer, 1999; Salamon, 2002). However, "public accountability is not discussed widely in the literature on philanthropy" (McIlroy, 1998, p. 80) as evidenced by a lack of theories and testable frameworks (Benjamin, 2010; Prewitt, 2006). There are pertinent reasons why the development of public accountability frameworks has been so challenging. First, attempting to assess foundations based on the concept of their *public good* is of no help because this term is highly contested, without uniform meaning, and can be claimed by both sides as their intention (Mansbridge, 1999). Second, suitable accountability frameworks are underdeveloped because they could undermine foundation owners' freedom. Employing a Foucauldian lens, Ebrahim (2006) portrayed accountability as an issue of power: Answering to whom and for what foundations must be accountable deprives private owners of their independence and autonomous privileges.

The public accountability perspective is part of a larger narrative that enactment of a welfare state is no longer the sole responsibility of government but rather a shared responsibility with those in the private charitable and proprietary sectors (Salamon, 1987a; see also Kettl, 2002). Stanley Surrey, Assistant Secretary of the United States Treasury in the 1960s, described federal tax exemptions as a subsidy for nonprofit activities that government wanted to encourage (Surrey and McDaniel's 1953 treatise on tax expenditure as cited in Lerch, 2004, p. 3). Also, Congress has defended charitable tax exemptions as relieving government of being solely responsible for helping society (Simon, Dale, & Chisolm, 2006). According to this view, the United States is an "allocative welfare state [that] tied government and private enterprise together" (Hall, 2000, p. 17). The country's modern welfare state is "not simply the expansion of the state but also an extensive pattern of government reliance on private nonprofit groups to carry out public purpose" (Salamon, 1987b, p. 99). In short, the modern welfare state depends on foundations to serve the public good, not just to exist for private interests.

Government distributes social welfare responsibility to the private nonprofit sector in two ways. Governments at all levels provide financial support to nonprofits, particularly social service organizations, to a degree that government funding is a substantial part of public charities' income (Salamon, 1987b; Smith & Lipsky, 2009). Additionally, government provides tax subsidies and exemptions to promote complementary social welfare activities, which is how foundations came into existence (Salamon, 1987b). Government relinquishes tax revenues from foundations in return for obligating them to serve the public good. In this light, private foundations are beholden to

government expectations, which is conducive to employing a public accountability framework.

The notion of foundations being publicly accountable surfaces a tension about this entity that is uniquely American. Foundations came of age during a period of progressive intent but wariness about intrusions of the state. They complement government in pursuing social welfare aims, but do so through freedom of individual expression (Hammack & Anheier, 2013). This tension is reflected in what the Tax Reform Act of 1969 does and does not regulate: It strictly prohibits private owners from benefiting financially but left open to interpretation how charitable spending should benefit the public good. Thus, one position is not more correct than the other, but rather, both perspectives have a valid historical basis and may intentionally, as with so many other ambiguously worded legislative compromises (Ellis, 2008), exist in constant tension.

The premise of this dissertation is that private foundations' mandated spending necessitates holding foundations' charitable behavior accountable to public interest. Hence, the paradigmatic lens applied in this study is one of public accountability. What is needed then is a theory of foundations' actions that is accountable to the impact on grantees.

Theoretical Framework

Having provided an overview of efforts to gauge foundations' effectiveness, a rationale for why foundations should be effective, and background on competing interests and ideologies that have stymied efforts to develop knowledge on this topic, this section describes the theoretical framework connecting expectations for foundations' social-

benefit impact using principal-agent theory with public charities' need for financial health as explained by capital subsidy theory. Principal-agent theory positions foundations' primary purpose as financially helping public charities. "The assets held by [foundations] are unusual in that public charities in the aggregate have a claim on the returns on the assets because the tax laws governing nonprofit organizations impose the nondistribution constraint [prohibiting foundation owners from benefiting]" (Sansing, 2010, p. 42; see also Hansmann, 1980). In a sense, foundation assets belong to and should therefore serve public charities.

Capital subsidy theory explains that public charities need charitable largess to the extent that they can realize financial surplus. Being able to accumulate savings is necessary to conducting mission-related activities. Combining the two theories—one on foundations, the other on public charities—enacts a research framework of their financial relationship in which foundation giving is explained as a means by which grantees accumulate surplus.

Principal-Agent Theory

The relationship between the federal government and private foundations can be described using principal-agent theory. Principal-agent theory has been applied to private foundations before, but always cast foundations in the role of principal and grantee organizations as their agents (Benjamin, 2010; Campbell, Lambright, & Bronstein, 2012; Christensen & Ebrahim, 2006; Steinberg, 2010; O'Dwyer & Unerman, 2008; Van Puyvelde, Caers, Du Bois, & Jegers, 2012; Williams & Taylor, 2012). This research departs from previous work by positioning foundations as agents, not as principals.

Arguably, principal-agent theory may offer a promising solution to the research problem of holding foundations accountable to public, versus their own private, interests. The theory relates principals and agents within a testable framework, and the mechanisms of control and resulting behaviors as variables.

A principal relies on an agent to fulfill principal's objectives, but a central tenet of this accountability relationship is that agents are self-interested to the extent that a principal feels compelled to impose rules to bring the agent in line with a principal's objectives (Jensen & Meckling, 1976; see also Caers et al., 2006; Eisenhardt, 1989; Gailmard, 2014; Speckbacher, 2003). This theory has been commonly used to explain corporate behavior as a consequence of a rift between shareholders and managers (Jensen & Meckling, 1976). It has also been popularly applied in political science as a way of holding elected officials accountable to electoral institutions (Gailmard, 2014).

This principal-agent relationship dynamic bears an uncanny resemblance to the interdependent tension between the federal government and private foundations. Government and foundations inherently have different objectives—the former is interested in the public good while the latter has been shown to prioritize private interests in maintaining and increasing wealth (Deep & Frumkin, 2001). However, in today's distributed governance system, the federal government depends on private foundations to realize public good aims.

What government expects of foundations manifests in three ways. First, private, nonoperating foundations are required by law to participate in wealth distribution to charitable causes. This participation is enforced by the minimum distribution

requirement, which is 5% of the previous year's noncharitable-use, investment assets (Yoder et al., 2011). Foundations that expend the minimum amount averaged over the previous five years are rewarded with a nominal 1% excise tax rate on net investment assets (Yoder et al., 2011).

Second, federal penalties for failing to distribute the annual minimum distribution amount are “sufficiently severe” to compel compliance (Cambridge Associates, 2000, p. 8). A foundation that fails to distribute the required amount by the end of a fiscal year is subject to a doubling of its excise tax rate on net investment income from 1% to 2%, a 30% excise tax on the undistributed amount, with a 100% excise tax on that amount if it remains undistributed by the end of the following year (Yoder et al., 2011). In short, government uses a carrot—dual-tiered excise-tax levels on net investment income—and stick—harsh penalties on undistributed income—to compel foundations to distribute wealth in ways that will benefit the public.

Third, government encourages foundations to support public charities by discouraging them to give to anything other than United States-incorporated 501(c)(3) public charities. Private foundations that want to make grants to charitable entities domestically or abroad that do not have 501(c)(3) status are required to go the extra step of using an “expenditure responsibility” process (Wexler, 2010). Although expenditure responsibility is a legitimate mechanism for supporting non-501(c)(3) organizations, it requires additional knowledge and effort. Effectively, the expenditure responsibility process exerts a cooling effect on the funding of non-501(c)(3) organizations (Worthy, 1975, p. 246).

In sum, these impositions on private foundations are mechanisms for controlling foundations' behavior in ways that redistribute private wealth for public-benefit purposes. These measures are meant to bring foundations in line with government's objectives. Yet, despite regulations, incentives, and penalties to induce foundations to act on behalf of the public good, they are imperfect agents of principal's objectives (Gailmard, 2014).

Distrust in the government-foundation relationship. In describing the relationship between corporate managers and shareholders, Jensen and Meckling (1976) characterized the principal-agent relationship as rooted in distrust because of an agent's self-interest (Jensen & Meckling, 1976). In other words, the relationship is top-down and hierarchical; in this case, private foundations are beholden to the public-good interests of the state. There is a body of evidence substantiating that an agency problem between the federal government and private foundations exists.

Deep and Frumkin (2001) discovered that over a 25-year period, while foundations' return on investments was 7.62% annually, foundations only distributed an average of 4.97% over that same period. In other words, foundation asset growth did not result in commensurate levels of charitable spending (Deep & Frumkin, 2001). Although they did not examine smaller foundations that were found to give at a higher rate (see also McGlaughon, 2013; Renz, 2012), multiple studies have confirmed that the largest foundations, which give away the majority of all distributions, conserved spending, especially if they experience a low rate of asset growth and no infusion of new capital (Renz, 2012; Sansing, 2010; Sansing & Yetman, 2006; Yoder & McAllister, 2012).

Researchers found that foundations go as far as to misreport investment expenses as charitable spending in order to qualify for the lower excise tax rate, thereby contributing even less money to public charities (Yoder et al., 2011). In addition, Yoder and McAllister (2012) discovered that foundation managers prioritized preserving the value of their financial corpus by prioritizing stable and not fluctuating distributions no matter economic conditions or opportunities to have a greater social impact (e.g., during times of financial downturns). Furthermore, researchers found that foundation managers are so motivated to avoid incurring a higher excise tax rate, which would occur if their giving was reduced after a year of higher payout, that they smooth charitable spending no matter social needs (Sansing & Yetman, 2006).

Another evidence of foundations' self interest is that very few foundations devote the entirety of their resources to a charitable purpose. An Urban Institute survey of foundations found that only 8% of foundations intend to sunset in service to their missions (Ostrower, 2009). The vast majority of foundation executives avoid spending more than real rates of investment returns in order for their foundations to last into perpetuity (Cambridge Associates, 2000; Collie, 2012; DeMarche Associates & Trotter, 1995). To wit, if charitable spending today can solve social and environmental problems, there would be no need to prolong charitable spending into the future. Hence, retaining wealth reflects founders' or governing board members' privately held interests.

In addition, even though charitable institutions should be trustworthy, research has shown that nonprofit executives behave no differently than proprietary business owners acting in their own interests. Core, Guay, and Verdi (2004) found that nonprofits

with large endowments paid their executives larger salaries while spending less on charitable activities than nonprofits with smaller endowments. Just because a private foundation is a nonprofit, one cannot assume that their behaviors are always altruistic.

These findings paint a problematic picture of the self-interested nature of endowed charitable organizations, particularly ones intent on perpetuity. Despite foundation executives' commissioning of studies and production of annual reports that promote their beneficence, the evidence of their self interest was enough to prompt Hansmann (1990) to conclude: "It is a truism that many donors restrict their gifts for use as endowment, not to advance education and knowledge, but to purchase a bit of personal immortality" (p. 33). Empirical evidence affirms that there is an agency problem in the dynamic between government and foundations: Foundation owners prioritize institutional self-preservation over enacting social change, thereby necessitating outside intervention to compel them to behave for the public good.

Government as an effective principal. Affirming the suitability of applying a principal-agent lens to the relationship between government and foundations, the presence of government oversight has been shown to be effective at curbing endowed institutions' agency problems. Fisman and Hubbard (2005) discovered that in states with poor government oversight, endowed nonprofits have problems of excessive managerial compensation and low charitable spending. The severity of these problems was reduced in states with strong government oversight leading the researchers to conclude that strong government monitoring helps nonprofits behave more charitably (Fisman & Hubbard, 2005).

Desai and Yetman (2005) arrived at a similar conclusion for private foundations. They correlated the amount of foundation charitable spending with the number of state laws that are meant to detect illegal activities, such as spending that benefits foundation insiders (Desai & Yetman, 2005). In those states with a greater number of detection laws, payout increased 8%, foundations paid out more quickly, and employee compensation was less than in states with fewer detection laws (Desai & Yetman, 2005)

These findings demonstrate that government is an effective principal in improving foundations' public-good behavior through regulations and oversight. In particular, government checks self-interested behavior by mandating that foundations spend their wealth on helping public charities. The following section describes why foundations' distribution of wealth serves government's (i.e., the principal) interest, which is a proxy of the public's interest.

Capital Subsidy Theory

Economist Henry Hansmann advanced nonprofit studies with a “remarkable series of papers that sought to delineate a theoretical framework for the tax and regulatory treatment of tax-exempt entities” (Hall, 2000, p. 24). Hansmann's writings continue to be popular for contract and market failure theories explaining the unique functioning and role of nonprofit organizations. Of his many theories though, his explanation of nonprofits' capital subsidy is not as well known but warrants resurrecting here. Hansmann (1981) described nonprofits' special structural need for sufficient financial capital as essential to performing charitable activities.

Nonprofits' tax exemption is meant to encourage the growth of nonprofits and, thereby, underpins the entirety of the nonprofit sector's economy (Hansmann, 1981; see also Simon et al., 2006). The only way that nonprofits can survive and thrive is by allowing for retention of, and not taxation on, nonprofits' earnings (Hansmann, 1981). They uniquely need tax exemption for products and services that cannot be sold profitably in the private commercial marketplace (Hansmann, 1981). Because public charities depend on contributed income, their enterprises are more risky to sustain (Hansmann, 1981). As a consequence, public charities need to retain and accumulate a financial surplus—profit—in order to overcome the volatility of financial markets and fickleness of donors in order to provide goods and services to beneficiaries consistently over time (Hansmann, 1981). This idea that nonprofits need to accumulate financial profit abetted by tax exemption was what Hansmann (1981) implied by the term *capital subsidy*.

Nonprofits have structural issues warranting their unique need for accumulating a financial reserve. First, nonprofits operate in issue areas that reflect a failure of the capitalist marketplace. Hansmann (1981) called this *contract failure* to imply how those in the consumer marketplace are unwilling to pay for goods and services that benefit all, such as clean air and water. Without donative, charitable support, nonprofits would be unable to afford overcoming the tragedy of the commons in which there is not enough spending on services that benefit the masses.

The second reason why nonprofits uniquely need tax-exempt support is that they produce goods and services that beneficiaries cannot pay for. In other words, public

charities' financial model is one in which those with wealth (i.e., donors) pay for the things that direct consumers cannot afford. An example is a soup kitchen whose clients cannot afford to pay the cost of their meal. Another example is a museum that cannot charge visitors the full cost of what it took financially to acquire its collection.

Third, nonprofits do not achieve productivity gains, which weakens their financial ability to realize cost savings (Baumol & Bowen, 1968; Kreidler, 2013). For example, a soup kitchen needs the same number of materials and people to provide a meal no matter if serving five meals a week or seven: Each meal costs the same (Kreidler, 2013). The soup kitchen must raise and spend the same amount of money to provide each and every meal no matter how many meals it serves over time.

These inherent structural problems of sustaining nonprofits are why they need tax exemption. Because they cannot rely on market demand, paying clients, or productivity gains to drive down costs, tax exemption protects their financial resources from being eroded so that they can maximize their spending to help beneficiaries of their services. Furthermore, freedom from taxation enables nonprofits to accumulate savings, which help smooth provisions of goods and services, especially during financial downturns or increased demand. In short, a public charity needs to realize profit and accumulate reserves in order to achieve its mission (Wicker, Longley, & Beuer, 2015). Hence, given the vital role that private foundations play in supporting public charities, it is important to understand with greater specificity how private foundations affect grantees' accumulation of profit.

Evidence of benefits of accumulating surplus. Essentially, Hansmann's (1981) theory of nonprofit capital subsidy is a matter of their financial health, which did not become a subject of empirical study until a decade later in Chang and Tuckman's (1990) research on nonprofit survivability. Credited for their ground-breaking work on financial determinants of public charities' failure, they also innovated studying the concept of profit, which they measured as residual surplus (Tuckman & Chang, 1991). They debunked the perception that the nondistribution constraint (i.e., restriction from distributing profits to owners) prohibited nonprofits from accumulating profits (Tuckman & Chang, 1991). Their review of 1983 tax returns led them to conclude that most public charities retained profit and actually accumulated this resource intentionally, not accidentally (Chang & Tuckman, 1990; see also Tuckman & Chang, 1992).

The notion that nonprofits retain profit raised concerns that charitable entities might save too much money. In 1992, Tuckman and Chang cautioned against excessive accumulation and, nearly two decades later, Ramirez (2011) questioned why public charities were holding \$425 billion in noninterest-bearing cash. Frumkin and Keating (2001) found empirical evidence that excess surplus is related to excessive CEO compensation, which affirms the worry that profitable nonprofits would be self-serving. Indisputably, acquiring profit for profit's sake undermines altruistic purpose, but the self-interested motivations of some do not diminish Hansmann's (1981) main point, which is that financial reserves are necessary to furthering charitable aims.

Researchers and experts in the field have presented substantial evidence that nonprofits benefit from financial surplus. Surplus reduces financial vulnerability

(Calabrese, 2012; Handy & Webb, 2003; Thomas et al., 2011), enables the building of institutional infrastructure and organizational effectiveness (Hager et al., 2004; Taylor et al., 2013; Thomas et al., Christopher, & Sidford, 2011), helps in weathering economic or donor-caused downturns (Thomas et al., Christopher, & Sidford, 2011; Wicker et al., 2015), serves as an investment toward affording future opportunities (Curtis, 2010; Curtis et al., 2010; NORI, 2010; Ramirez, 2011), and contributes to mission-related productivity (Grantmakers for Effective Organizations, 2011; Moyers, 2011; Ryan, 2001). According to one of the most prominent sector experts on nonprofits' financial health, financial surplus is the most essential ingredient for ameliorating structural issues so as to pursue mission-related work effectively (Miller, 2003). Conversely, too little surplus predicts financially and organizationally unstable public charities (Bowman, Keating, & Hager, 2005) and organizational demise among arts organizations (Hager, 2001).

State of public charities' surplus. Despite evidence of the benefits of accumulating surplus, public charities operate with very low levels of financial reserves. A study of the financial condition of Washington, D.C.'s nonprofit sector found that 57% of public charities had fewer than three months of reserves and 28% of them had no reserves whatsoever (Blackwood & Pollak, 2009). In short, more than half of the area's public charities were unstable financially and a full quarter of them were at risk of demise, no matter the size of the organization (Blackwood & Pollak, 2009). In addition, between years 2000 to 2006, organizations that failed (i.e., no longer filed a tax return or filed a tax return indicating an inoperative charity) had a median operating reserve of only 0.7 months, thereby demonstrating the relationship between low reserve levels and

extreme financial vulnerability (Blackwood & Pollak, 2009, p. 9). A more recent study of nonprofits in San Diego County found a similar, troubling pattern of financially unstable organizations: Nearly 62% of them had fewer than one month of operating reserve (Lam & McDougle, 2012).

Unhealthy reserves may be due to a persistent misperception that nonprofit means no profit (NORI, 2010). Board members of public charities impose policies prohibiting the accumulation of profit, and private donors and public funders question an organization's financial need when it shows a reserve (Calabrese, 2012; Curtis et al., 2010). Foundations can undermine grantees' pursuit of financial stability by not only withholding funding from organizations with a healthy reserve but also by restricting funding to a degree that an organization needs to pay for a foundation-supported program by dipping into its own reserve (Froelich, 1999). The mixed feelings about accumulating reserves are reflected in a poll that showed that only 37% of nonprofit employees strive for cash reserves and financial flexibility (Center on Philanthropy at Indiana University, 2011).

Measures of public charities' surplus. Nonprofits do not have a financial 'bottom line' that can be found in their financial statements, which has resulted in various definitions and measures being used to approximate the proprietary sector's concept of profit. Researchers have used end-of-year fund balances (Chang & Tuckman, 1990), savings (Handy & Webb, 2003), and cash position (Ramirez, 2011). The reason for the proliferation of different measures is that a public charity's surplus is more complicated to identify than that of a business (Herman & Renz, 1999). In a for-profit business, any

income that is left over after paying expenses is profit, which is therefore a good indicator of success. In the case of public charities, they adhere to generally accepted accounting principles (GAAP) set by the Financial Accounting Standards Board (FASB, 1993) that divided assets into three categories: permanently restricted, temporarily restricted, and unrestricted. As a consequence, neither the amount of a nonprofit's assets nor its cash balance can be equated with financial surplus as the nature of an asset's restriction must also be taken into account. My comparable measure to commercial profit is public charity's assets that are free from restrictions (i.e., unrestricted assets) and easily converted to cash (i.e., liquid).

Unrestricted assets. Assets, such as cash and investments, can be temporarily restricted, which means that a donor can impose conditions restricting its use for a certain time (e.g., the next fiscal year) and for a specific purpose (e.g., for a scholarship program). Assets can also be permanently restricted, such as an endowment (Miller, 2003). Unlike temporarily or permanently restricted assets, unrestricted assets have no conditions on its use. At any time, it can be saved, used for overhead, tapped for financial emergencies, or used to invest in new opportunities (Miller, 2003; Moyers, 2011). Therefore, an organization with a sizable endowment may look well off, but if it has little unrestricted net assets, it is actually 'cash poor' making it vulnerable to economic downturns and unexpected losses of income (Miller, 2010).

Liquidity of assets. Another type of financial asset that a healthy nonprofit needs is liquid assets that can be converted quickly to cash. Money in savings accounts and short-term investments are liquid whereas real estate that takes time to sell is not (Miller,

2003). If an organization's financial statement shows a sizable unrestricted net asset balance, it may be comprised of properties, plant, or equipment (PPE), which cannot be converted easily to cash. A public charity with a large endowment, a deed to its own building, or an abundance of donor-restricted grants and contracts can still be at risk of not meeting payroll. Hence, an organization can have sizable unrestricted assets, but if they are not easily converted to cash, it has a liquidity problem. The problem of illiquidity is one of the top issues plaguing public charities (Miller, 2010).

Unrestricted, liquid assets "has the greatest relevance to [a public charity's] cash flow and ability to respond to needs and manage its operations well" (Miller, 2003). In sum, unrestricted, liquid net assets may be the single most significant measure of a public charity's ability to realize a charitable purpose. In this study, this type of asset is the most equivalent to commercial profit and serves as a measure of an organization's ability to realize capital subsidy.

Integration of Theories

Applying principal-agent and capital subsidy theories together created a research framework for holding foundations' mandated charitable spending accountable to government's, and thereby the public's, interest in helping grantee organizations realize the financial capacity to pursue their missions. To test the performance of foundations' wealth distribution role, the conceptual framework was centered on the nature of the two entities' financial relationship. The conceptual model tested pathways of relationships between foundations and grantees through the potential mediator of payout rate. Payout was hypothesized to be the primary path of relationship between the two entities as it is a

mechanism of control by a principal (i.e., federal government) to induce public good behavior.

Variables of Study

Outcome Variable: Grantee Organizations' Financial Health

Within the business management field, Bourgeois (1981) was seminal in laying the groundwork for exploring the nature of profit and advised studying surplus as a dependent variable in order to “[discover the methods of its] creation and sustenance” (p. 38). This study applies Bourgeois’s suggestion to the nonprofit sector. The level of unrestricted, liquid net assets serves as the outcome variable operationalizing grantee organizations’ financial health. I borrowed NFF’s financial formula for calculating a public charity’s months of unrestricted, liquid net assets (MULNA) to measure financial capacity (G. Brinkerhoff, personal communication, January 15, 2013). Albeit a rather involved calculation that calculates net assets after taking out equity in fixed, illiquid assets, this formula results in a figure that is a close approximation to commercial profit. Like a proprietary business’s profit, MULNA affords flexibility: It can be used as operating capital to cover such ongoing costs as overhead and personnel, as risk capital for investing in new ventures and innovation, and as a rainy day fund for emergencies.

MULNA also indicates survivability by calculating how much money an organization has on hand to continue paying expenses if all income stopped. Bowman (2011a, 2011b) referred to this concept as *months of spending* and described this type of asset as reflecting an organization’s short-term resiliency. An organization is resilient if it has enough cash to meet obligations and pursue long-term objectives even if no money is

coming in (Bowman, 2011a, 2011b). Short-term resilience enables being able to weather economic bumps in the road without jeopardizing performance and mission. This type of resilience is distinguished from long-term measures of health that would require a larger amount of accumulated resources to not only remain operational but also to ensure that the value of assets do not erode over time from inflation (Bowman, 2011a, p. 94).

A potential threat to validity is the question of MULNA (or any single formula) as a valid and reliable measure of a public charity's financial capacity to fulfill its mission (Herman & Renz, 1999; Prentice 2013). According to Prentice (2013), nonprofit accounting ratios that supposedly measure constructs of liquidity, solvency, profitability, and operating margin have been commonly used by researchers but have remained underdeveloped as a research topic for two decades (p. 134). Ritchie and Kolodinsky (2003) used factor analysis to discover that nonprofits' fundraising efficiency, public support, and fiscal performance can be identified from tax return-derived financial ratios. However, Prentice's (2013) research was the first to test the factorial validity of measures of nonprofits' financial vulnerability. Prentice (2013) found that nearly all of the popularly used accounting ratios were not valid indicators of theoretical constructs of a public charity's financial condition. Regarding MULNA (he called it *months of spending*), this accounting ratio did not satisfactorily load onto the construct of liquidity and, therefore, does not reflect a public charity's short-term resilience (Prentice, 2013).

A research challenge is that formulas used to test the relationships between financial constructs against the larger construct of financial vulnerability fail to appropriately nuance measures of financial vulnerability. In Prentice's (2013) research,

financial vulnerability was operationalized by such simplified measures as the amount of liabilities relative to total assets (insolvency risk), change in net assets from previous fiscal year (asset disruption risk), total revenues (funding disruption risk), and total expenditures (program disruption risk). These measures may not actually reflect how a public charity behaves. Possibly a better measure of financial vulnerability may be actual instances of organizational demise, even though this measure, too, eludes accuracy. According to Hager (2001), even nonprofits thought to be *dead* because of consistent nonfiling of tax returns turned out to have revived and were *alive* rendering all existing measures of financial vulnerability still somewhat unsatisfactory in predicting organizational death. Arguably, Hager's dependent variable for predicting nonprofit failure (i.e., an organization's dead or alive status) is more satisfactory than continuing to use reductive financial formulas of organizational failure that Prentice (2013) relied on to test various measures of financial constructs.

Instead, there is considerable face validity to the MULNA measure of financial health. Although the measure of MULNA—of which Prentice's (2013) research used a close approximation of the more detailed and precise NFF formula—was not found to load factorially onto the concept of liquidity, it is widely used by practitioners. Nonprofit finance professionals and accountants as well as funders use MULNA to gauge financial health (Blackwood & Pollak, 2009; Bowman, 2011a, 2011b; Lam & McDougale, 2012; Miller, 2003; Moyers, 2011). The calculation has also been used as a criterion in grant decision making (Nelson et al., 2009; Nelson & Koo, 2014; NORI, 2010; Ryan, 2001). Guidestar provides the calculation of NFF's formula for MULNA as a service in its

Financial SCAN product to subscribed users of its nonprofit services, and its adoption by this leading nonprofit data industry provider indicates the widespread degree of the calculation acceptance and use. More recently, I saw this measure included as its own section of a public charity's audited financial statement by one of New York City's leading accounting firms. In addition, approximations of NFF's MULNA formula have been used in research on public charities' finances and in studies of factors that contribute to public charity's financial state (Blackwood & Pollak, 2009; Bowman, 2011a, 2011b; Calabrese, 2012; Lam & McDougale, 2012; Nelson et al., 2009; Nelson & Koo, 2014; NORI, 2010).

In short, there are good reasons why MULNA, as well as similarly elusive measures, may not load onto the construct of liquidity but has been accepted by practitioners and used by researchers. As a grantmaker, direct experience reviewing financial statements and working with always financially vulnerable public charities have taught me that public charities' long-term survivability defies the ability of financial vulnerability measures to accurately predict organizational demise. On the other hand, because NFF's calculation of MULNA has been used to influence funders' giving and grantees' management of resources, the MULNA formula is a practical measure of public charities' financial health.

Regarding the threshold level of MULNA that an organization should maintain, this amount depends on many factors, such as an organization's size, expenses, cash flow, obligations, and fixed costs (NORI, 2010). But, nonprofit finance academics and field experts suggest that public charities maintain enough unrestricted, liquid reserves to

afford at least three months of expenses (Blackwood & Pollak, 2009; Bowman, 2011b; Foley, n.d.; Konrad and Novak, 2000; Kurre, 2010; Lam & McDougale, 2012; Nelson & Koo, 2014; NORI, 2010). Hence, I also use three months of MULNA as a benchmark for indicating financial health.

Influencer Variables: Aspects of Foundations' Reach

Prior research discerned that the type of financial stakeholder (individual, foundation, or government) a nonprofit depends on has a significant effect on a nonprofit's behavior and mission-related activities (Moulton & Eckerd, 2012; O'Dwyer & Unerman, 2008). In other words, private foundations exert an influence on grantees. This study examines the mechanism of the relationship between these two nonprofit actors, with a focus on private, nonoperating foundations' primary function as a distributor of wealth.

I focus exclusively on foundations' charitable spending as the primary mechanism mediating the relationship between foundations' firm-level traits and grantee organizations' financial health. But, private foundations' charitable distributions may not be the sole determinant of MULNA. The firm-level measures that may estimate foundations' influence are asset size, age, professionalization, and sector focus. These traits are indicators of the degree to which a foundation is large enough, experienced enough, dedicated enough, and sympathetic enough to be influential. I examined if these firm-level traits directly confer capacity to their grantees: A foundations' size, tenure, skills, and interest areas may influence their grantees' financial condition (see, for example, Olson, 2000). Other seemingly important characteristics such as a foundation's

number of grants, average grant size, and level of compensation paid to trustees have not been shown to be important determinants of charitable spending behavior and are, therefore, excluded from this study (Boris, Renz, Barve, Hager, & Hobor, 2006, p. 28).

Foundations' size. Asset size is considered a better measure of organizational size than annual giving, although the two are highly correlated (Boris et al., 2008, p. 57). Hence, the value of a foundation's assets is often used as a proxy of its size. Given that the largest foundations are responsible for the majority of all foundation giving, most research on grantmaking only include the nation's largest nonoperating foundations (Anheier & Hammack, 2010). For example, a national study of the 10,000 largest foundations represented only 16% of the number of all independent, corporate, and community foundations, but this minority group represented more than three-quarters of all foundation giving and foundation assets (Boris et al., 2008, p. xii).

For purposes of this research, I did not focus solely on large foundations: A foundation does not need to have sizable assets in order to have an influence on grantees. In fact, the larger the foundation, the more it tends to barely satisfy the minimum distribution requirement (Renz, 2012; Sansing, 2010; Sansing & Yetman, 2006). Unlike small foundations, large foundations afford professional tax planning and financial management services that help them avoid higher tax rates resulting in distributions that meet the bare minimum requirement (Yoder & McAllister, 2012). Also, large foundations that are not growing their endowments through infusions of new capital avoid elevating their payout rate, even in times of social crises such as Hurricane Katrina and the Haiti earthquake, so as to avoid having to expend more in the future (Yoder & McAllister,

2012, p. 27; see also Renz, 2012). In short, large foundations are more likely than small foundations to retain assets, even by incurring the higher excise tax rate, in order to preserve the value of their investments in the interest of perpetuity (Yoder & McAllister, 2012).

The spending and savings behavior of large foundations is important because their spending accounts for the majority of the sector's charitable distributions. But, small foundations with assets of less than \$50 million are also important because they are the "supermajority" in number. These foundations are considerably smaller than the largest grantmaking institutions, but small foundations exhibit more generous behavior. Small foundations distributed 11.7% of the share of their net assets (according to 2012 figures, McGlaughon, 2013, p. 15) compared to 6.4% distributed by the largest foundations (according to 2009 figures, Renz, 2012, p. 7). This finding affirmed Renz's (2012) research conclusion that endowment size was the best predictor of payout-to-net asset ratios, with small foundations giving at a higher payout rate than large foundations—11% median payout among foundations with assets of \$10–\$50 million versus 5%–6% median payout among foundations with assets of over \$50 million (p. 9). In sum, small foundations give away a greater proportion of their wealth than large foundations (McGlaughon, 2013; Renz, 2012). (The exception is if they are small and "inert," in which case, they are unlikely to meet the minimum distribution requirement according to Sansing and Yetman, 2006, p. 376.)

Compared to all other size foundations, small foundations are unique in spending at a higher rate. Hence, it is possible that small foundations may be more influential than

larger funders in effecting grantees' financial health, especially if small foundations give to commensurately small charities. With this possibility in mind, I included private, nonoperating foundations of all sizes and made *asset size* a variable of interest. Studying only the largest foundations does not sufficiently capture the variability that is in the sector, particularly when attempting to discern foundations' impact on beneficiary organizations that can occur with foundations of any size.

Foundations' experience. I included foundation's age as a proxy for its experience. Dowie (2001) described the life cycle of a private foundation as occurring in three successive stages: founder, next generations of friends and family members, and nonfamily members. He characterized the giving of the first two stages as internally focused on family members' interests and of the final stage as externally focused on the needs of the community (Dowie, 2001).

The age of a grantmaking institution has not been studied for its effect on grantee organizations, but it has been shown to be a determinant of foundation behavior (Boris et al., 2008; McAllister, 2005). Age was associated with community foundations' charitable administration expenses, and with younger institutions expending more during their early years of start up than when more established (Boris et al., 2008, p. 41). This finding is particularly true of family foundations. "The payout philosophy of a foundation could be a function of whether or not the originating founder is still alive or a function of the influence of the founder's heirs on foundation payouts" (Desai & Yetman, 2005, p. 28). Family foundations that were young and large that had the active participation of their founding members were more likely to payout at a higher rate than foundations that no

longer had the participation of their founders (McAllister, 2005). Recently established family foundations may give away more than the minimum required amount because of founders' active participation, an interest in establishing their importance in the nonprofit sector, and not yet retaining the services of investment managers who are concerned with conserving spending (McAllister, 2005; Yoder & McAllister, 2012).

Conversely, older foundations are more interested in protecting their asset values to the degree that they preferred to pay a higher excise tax rate than increase their charitable distributions, even if their asset values increased (Sansing & Yetman, 2006; Yoder & McAllister, 2012). Already-established foundations tend to focus more on perpetuity than younger foundations that are establishing themselves and incurring costs associated with starting up their enterprises (McAllister, 2005; Yoder & McAllister, 2012; Sansing & Yetman, 2006).

Generational characteristics also affect giving behavior. Most foundations were founded less than a generation ago, with 60% of all foundations established since 1998 (McGlaughon, 2013). It is only now that the philanthropic field is beginning to experience a generational transition as descendents of those founding donors are exerting their more youthful leadership on foundation boards (Schervish, 2005). The differences of these younger generations of philanthropists are likely to be reflected in their unique giving behavior. The research report *#NextGenDonors* concluded that up-and-coming philanthropists prioritize different values, are more strategic than charitable, and are more interested in being directly involved in bringing about impact (Johnson Center for Philanthropy & 21/64, 2013; see also Schervish, 2005). Although there are a number of

studies on generational differences among philanthropists, there has not been a study of how such differences affect beneficiary organizations.

Although it is beyond the scope of this study to discern if a foundation is governed by its original founders or by their descendants, I included the variable *age* based on a foundation's year of incorporation. For the many reasons cited here, age merits inclusion as a potential contributing factor in determining charitable behavior or as a direct influencer of grantees' financial state.

Foundations' professionalization. Charitable administrative expenses are the costs of conducting mission-related, versus investment-related, activities, which includes employment of grantmaking staff, legal and accounting fees, travel, printing and publications, rent, and utilities (Boris et al., 2008). In short, these costs reflect how much a foundation spends to operate charitably. Of these charitable administrative expenses, the largest expense was compensation (Boris et al., 2008). For the purposes of this study, compensation was a proxy of how much a foundation prioritizes professionalizing the conducting of its charitable activities. Compensation expenses include salaries to trustees, officers, or employees, and includes the costs of their benefits and pensions. Although compensation of employees was the largest administrative expense, not all foundations professionalize. In a study of the largest 10,000 foundations, only about 30% reported paying staff, thus indicating that most foundations rely on voluntary labor (Boris et al., 2008, pp. xii, 51).

Compensation expenses were found to have the most effect on the ratio of charitable administrative expenses as a share of payout (Boris et al., 2008, p. xiii). In

other words, as the amount of compensation increased, the portion of administrative expenses as a share of payout rate also increased. Also, foundations that expended beyond the minimum distribution requirement were positively correlated with having professional staffing (Sansing, 2010; Sansing & Yetman, 2006), which raises the possibility that professionalization may influence grantees' financial health.

There are several reasons why paid staffing may be related to the degree to which a foundation meets payout obligations and, thus, may impact grantees. Family foundations that compensated trustees seemed to pay more attention toward meeting charitable obligations than those operating with all-voluntary labor (McAllister, 2005). In other words, compensation suggests a commitment to conducting charitable activities. Hence, professionalization levels may reflect the degree to which a foundation dedicates resources to its charitable function. As such, foundations' staffing may be a contributing factor of how well their grantee organizations are supported.

There is a possibility that foundation's spending on professionalization may be somewhat exaggerated in order to meet the minimum distribution requirement so as to avoid triggering a higher excise tax rate, but compensation amounts have not been shown to be falsified (Yoder et al., 2011). As such, I examined both the presence and levels of paid staffing.

Reliance on arts foundations' support. There were two reasons for why I examined foundations' sector focus, particularly those that are committed to giving to arts and culture causes. First, arts funders behave differently than grantmakers serving other sectors. Chiefly, unlike their counterparts in other sectors, arts funders do not

reduce funding when a public charity receives government support (Kim & Van Ryzin, 2014). In addition, arts grantmakers have been the first to lead a concerted national campaign, spearheaded by their membership association Grantmakers in the Arts, to deliberately improve the financial reserves of public charities (Curtis, 2010; Nelson et al., 2009; Thomas et al., Christopher, & Sidford, 2011).

Second, arts-focused public charities rely more on private philanthropy, of which foundations are a key part, than their counterparts serving other issue areas. “Arts and recreation” public charities receive a little more than one-third of their income from private philanthropy and only about 10% from government sources of support (Salamon, 2012, p. 41). Contrast this with other sectors wherein government funding is dominant, such as “social services” organizations that depend on public support for more than one-third of their budget and only 10% from private philanthropy, and “health care” public charities that generally rely on government for half of their income and only 3% from philanthropy (Salamon, 2012, p. 41). (The other major category of revenues is fees, which is not included in this study.) Because public charities working in the arts have been more dependent on private than on public sources of support, I singled out arts-focused private foundations to explore how grantees that depend inordinately on this source of funding are affected financially.

Mediating Variable: Foundations’ Charitable Spending Behavior

As noted earlier, private foundations’ payout rate has been the subject of much debate. Critics have concluded that foundations’ charitable spending has been too low relative to the cost of not addressing pressing social problems now (Bradley & Jansen,

2002; Mehrling, 1999; Waleson, 2011), while others have countered that payout rates are too high thus risking the potential for future spending (Cambridge Associates, 2000; Collie, 2012; DeMarche Associates & Trotter, 1995; Irvin, 2007; Klausner, 2003).

Financial analyses can retrospectively answer whether distributions were too high or too low relative to rates of return on investment (Cambridge Associates, 2000; Collie, 2012; DeMarche Associates & Trotter, 1995), but there has been no connection made to how payout affects grantees. As far as could be found in reviewing the literature, none has researched the effectiveness of payout in helping public charities accomplish their work. Given that a mandated function of private foundations is wealth redistribution to public charities, payout rate emerged as a meaningful data point for my research inquiry into foundations' effectiveness in impacting their grantees' financial capacity.

Conclusion

There is substantial evidence to suggest that foundations' redistribution of wealth is neither their primary motivation nor their most important contribution to society but rather that they act in ways to guard and accumulate elite wealth. Given that foundation wealth is tax-subsidized with legislative mandates for charitable spending, questions arise: Are foundations trustworthy? Is their spending worth their tax exemption? And, are foundations an effective vehicle for conferring public benefit? Unfortunately, responses to such questions have been laden with competing normative beliefs of what foundations should prioritize and too little on developing theoretical frameworks that would enable researching how payout impacts beneficiaries. Of the frameworks that have been

developed, they either skirted external impacts by focusing on internal operational efficiencies or have been unsatisfactory attempts at gauging social change.

There remains a considerably large gap in knowledge about foundations' value to society as able to be gauged empirically. This study uniquely contributes to the topic of foundations' effectiveness by attributing impact to a primary mechanism for distributing foundation wealth—payout: After all, the primary relationship between private, nonoperating foundations and public charities is the exchange of money. It is possible that as much as foundations are focused on conserving assets than on spending charitably, the amount that is expended may still have a significant effect on grantees.

In order to test the pathways and significance of these relationships between foundations' characteristics and grantee organizations' MULNA, I applied principal-agent theory to position foundations as accountable to government, and thereby public, interests. In applying this theoretical framework of foundation's accountability, I responded to the inevitable question of *to what end* by incorporating Hansmann's (1981) theory of capital subsidy. Hansmann's theory rationalizes public charities' accumulation of financial surplus as essential to affording the costs of pursuing charitable aims. The integration of these two theories comprises the conceptual framework exploring how private, nonoperating foundations' firm-level characteristics and spending behavior may affect public charities' financial health. I elaborate on the research methodology in Chapter 3.

Chapter 3: Research Method

Overview

The intent of this research was to describe how private, nonoperating foundations affect their grantee organizations' financial capacity to achieve social purpose. This exploration was motivated by the larger socially relevant question about impact and value of foundations: Do foundations legitimately help public charities pursue their missions? To that end, I investigated possible pathways by which foundations may affect grantee organizations' financial health. In this chapter, I describe the research design, methodology, conceptual model, operationalization of constructs, hypotheses and corresponding statistical approaches, data sources and frame, as well as address the reliability and validity of my study.

Research Design and Approach

This dissertation is a quantitative study that used the ex post facto research design to explore pathways of relationships among its variables. There was no test or intervention, which would have been more appropriate for identifying causality than for discerning relationships. Because there was a lack of precedent studies on foundations' impact on public charities' financial condition, multiple regressions of associations between variables was an appropriate method for generating knowledge, particularly with a theory-backed hypothesis but a lack of already-tested theories in the field (Grimm & Yarnold, 2010; Hughes, 2006).

To develop a model of relationships, a researcher relies on theory, previous findings, or experience (Jose, 2013, p. 97). In this case, the suitability of applying

foundation-related, principal-agent and nonprofit-related capital subsidy theories was based on field experts and nonprofit researchers who have described various agent problems of foundations and the need for capital by public charities. Furthermore, my direct experience as a foundation grantmaker helped in designing a conceptual approach appropriate to this inquiry.

The design of the study was a series of path analyses in order to identify the foundation characteristics that influence charitable behavior and their grantees' financial capacity as well as to discern the mediating role of payout rate. As this was an exploratory investigation without the benefit of precedent studies, I examined whole and segmented variables. I conducted analyses using ordinary least squares regressions of these proposed relationships amongst the influencer variables (foundations' asset size, age, staffing ratio, and sector focus), the mediator variable (foundations' payout rate), and the outcome variable (MULNA). I used the indirect effects approach to identify how foundations' payout rates may add to the prediction of grantees' financial health after the effects of foundation influencers—size, age, staffing, and sector focus—were eliminated. The combined effort of these approaches tested the importance of payout as a mechanism by which foundations realize their redistributive social purpose. This study was approved (06-04-14-0260254) by the Institutional Review Board of Walden University.

Path Analysis for Mediation

Path analysis is a method for exploring the order, magnitude, and significance of relationships amongst variables; in other words, it enables exploring how or why variables are related (MacKinnon, 2008). Developed by Sewell Wright in 1921, path

modeling was used to predict genetic inheritance (Jose, 2013). By using a path analysis approach, this research moves beyond simply correlating private foundations' characteristics and grantees' financial health to instead identifying the pathways by which foundations' characteristics and behavior impact public charities. Hence, path analysis enabled testing the theoretical proposition that foundations fulfill a public good role through their mandated charitable spending.

There are two main types of path analysis: mediation and moderation. Mediation and moderation are often confused (Hayes, 2013). Mediation is used to understand how the effects of a variable are carried through another variable (“Moderation and Mediation,” n.d.) Mediation was derived from correlation and regression statistical approaches and “is a hypothesis about a causal network” (Kenny, 2014, “Specification Error”). On the other hand, moderation is based on identifying mean group differences and was derived from statistical ANOVA procedures (Jose, 2013, p. 17); it is relevant to understanding the degree to which a variable exerts an interactive influence on another (“Moderation and Mediation,” n.d.).

Given that the relationship between foundations and their grantees' financial condition had not been examined before, mediation analysis was an appropriate initial approach to learning if and how certain foundation traits and behavior affect public charities' MULNA. If payout could be shown to be a statistically significant mediator of the relationship between private foundation characteristics and grantees' MULNA, such a finding would open the door to further research on the moderating degree to which incremental changes in payout affects nonprofits' financial condition—a furtherance of

knowledge that would greatly inform the payout debate but was beyond the scope of this study.

In order to understand the pathways of relationships amongst these variables, I used the indirect effect approach of mediation analyses rather than Baron and Kenny's (1986) steps for identifying mediation. Unlike the indirect effect approach that estimates the size and presence of the mediation pathway, Baron and Kenny's approach relies on the total effect (i.e., the relationship between influencer and outcome variables) to be reduced when the mediator variable is introduced (Jose, 2013, p. 50). Of the two methods, the indirect effect approach has become the preferred method for identifying mediation (Field, 2013; Hayes, 2013).

Conceptual Model

The conceptual model, as illustrated in Figure 1, posits that private, nonoperating foundations' payout rate mediates the relationship between foundations' operating characteristics—size, age, professional staffing, and sector focus—and their grantee organizations' MULNA. In other words, differences in foundation's charitable spending may predict how many months of financial reserves grantee organizations are able to accumulate if foundations' operational traits were held constant.

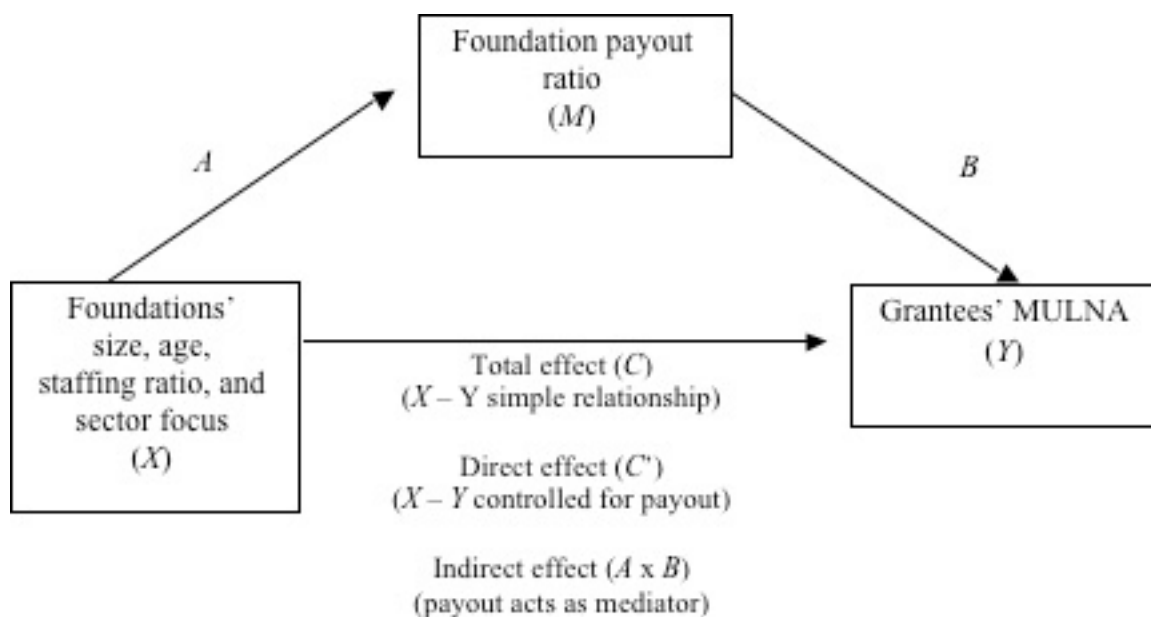


Figure 1. Mediation model of relationship pathways between foundations and grantee organizations' financial health.

This conceptual framework was the basis for statistical analyses. I examined which foundation traits accounted for differences in their payout rate in order to identify the most relevant characteristics for mediation analyses. I also examined which, and to what degree, their firm-level traits directly influenced grantees' financial condition. Any significant relationships have implications for the conceptual model of determinants of MULNA. In addition, given the exploratory nature of this research, I segmented the data into subgroups in order to identify nuances of these three pathways of relationships: firm-level traits on payout (pathway *A*), firm-level traits on MULNA (pathway *C*), and an indirect effect (pathway *A x B*).

Data Collection

The data were from a representative sample of United States-incorporated, private, nonoperating foundations and their 501(c)(3) grantee organizations. The two sources of archived data used herein were the completed tax returns of private foundations (Form 990-PF) and those of public charities (Form 990). I used Urban Institute's (2006b) National Center for Charitable Statistics (NCCS) 2006 Private Foundation Core File to identify the population of private foundations that filed a tax return for that year. NCCS is a program of the Center on Nonprofits and Philanthropy, which conducts research on the role and impact of the nonprofit and philanthropic sectors (www.urban.org/center/cnp/index.cfm). The Core Files are produced annually and combine descriptive information found on foundations' original federal registration forms and a set of financial variables gathered from their tax returns (Urban Institute, 2006a). The Core Files are of all charitable entities that are mandated to file a tax return and are considered population databases of private foundations and public charities (Urban Institute, 2006c).

The 2006 Foundation Core File is a selection of approximately 60 variables, which I used to calculate private foundations' age and to identify their asset size (Urban Institute, 2006b, 2006c). However, the Core File neither provides sufficient data necessary for calculating the ratio of paid professional staffing relative to foundations' asset sizes nor payout rates. To generate these variables as well as grantees' MULNA, I used completed tax returns, which are free and publicly available through Guidestar (www.guidestar.org). Guidestar is an online resource providing comprehensive access to

recent nonprofit tax returns freely and publicly; earlier returns are available without cost to academic researchers.

Although nonprofits' audited financial statements are an ideal source of data because they are prepared professionally, I did not rely on this resource to generate data for this study. First, audited financial statements are not uniformly available and would need to be procured by individual requests to private foundations and public charities. Certain types of foundations, such as family foundations, are likely to be disinclined to agree to such a request as audited statements can contain personal and sensitive information. Second, not all public charities afford professional audits of their finances, particularly small-budget organizations.

Given the limited availability of and access to audited financial statements, all data for calculating study variables were generated from completed IRS tax returns, including the NCCS Core Files that are based on tax return data. Nonprofits' tax returns remain the most comprehensive data source on nonprofit organizations (Grønbjerg & Clerkin, 2005). Tax return data have been used for research on nonprofits' finances, including seminal studies on nonprofits' financial vulnerability (Carroll & Stater, 2009; Greenlee & Trussel, 2000; Hager, 2001; Trussel, 2002; Tuckman & Chang, 1991) and the nature of nonprofits' surplus (Bowman, Tuckman, & Young, 2012; Calabrese, 2012).

Researchers have questioned tax return data as possibly not reflecting nonprofits' finances due to lack of IRS oversight and varying levels of competency in filling out the tax return form (Skelly & Steuerle, 1992). However, studies that compared tax return data to surveyed responses, other nonprofit databases, and audited financial statements have

demonstrated that Form 990 data are generally reliable, particularly for financial and age information (Froelich & Knoepfle, 1996; Froelich, Knoepfle, & Pollak, 2000; Grønbjerg & Clerkin, 2005). The shortcoming of IRS data is that it does not adequately reflect types of nonprofits that do not need to file a tax return, such as religious organizations (Grønbjerg & Clerkin, 2005). However, this weakness was not a concern of this study, because all private foundations are required to file a tax return and are, therefore, well represented by IRS data.

Less is known about the error rates and reliability of 990-PF data, but these returns are probably as, if not more, reliable. Unlike public charities, private foundations can afford competent accounting and financial management services, are pressured by industry organizations Guidestar and Foundation Sector to make their returns transparent publicly, and must adhere to stricter rules on governance and financial abuses as defined under Internal Revenue Code sections 4940–4945. According to private foundation researchers, the 990-PF data are the most comprehensive, complete, and organized of all nonprofit data, and are the baseline against which to assess the accuracy of other private foundation databases (Ludlum, 2004; Renz, 1991).

Regarding ethical treatment of data, the only data set that this concerns is the NCCS 2006 Core File, which was developed and published by the Urban Institute. Core Files are produced for research use, and researchers pay a nominal fee and agree not to share the proprietary records. I purchased the 2006 NCCS Foundation Core File, which I will keep password-protected on a personal computer, will not distribute, and will delete after 5 years. However, the content of the Core File is of publicly accessible IRS filings

and, hence, the data are neither confidential nor anonymous. Data that are accessible via Guidestar do not warrant special treatment for security, which is the case with all of the data used for this study.

Temporal Scope of Study: 2006 and 2007 Tax Years

The unit of analysis was private, nonoperating foundations registered in the United States that filed a tax return. Unlike certain types of nonprofits, such as religious congregations, all private foundations must file a tax return annually. Hence, this study does not reflect non-filers (i.e., foundations that did not submit a tax return), which may indicate no longer operating or being otherwise inactive.

I used private foundations' returns from the 2006 tax year. Figures were not inflation adjusted and reflect constant, not current, dollars. Compared to years affected by the volatility of the Great Recession of 2007–2009, the preceding year 2006 was a strong year economically. In 2006, the Dow Jones Industrial Average hit the 12,000-level for the first time indicating the financial strength of the stock market (Balakrishnan & Seager, 2006). Benefiting from the stock market's success, which is where most foundations' assets are invested, foundation assets grew 12% in 2006 compared to the prior year, from \$455.6 billion to \$509.1 billion (Lawrence & Mukai, 2008).

The increase in asset values contributed to an unprecedented rise in foundation giving compared to prior years. In 2006, the giving rate was close to 6.1% of foundations' assets, which is slightly more than the 6% distributed in 2005. Although this incremental change seems small, it was enough to make 2006 giving “among the highest shares recorded” (Lawrence & Mukai, 2008, p. 5). In other words, foundations gave away

a larger portion of their wealth than before. Another indication of the financial robustness of private foundations was in how much they gave away: Independent foundations spent \$27.5 billion in 2006, 9% over the previous year spending of \$25.2 billion (Lawrence & Mukai, 2008, p. 9). In short, foundations gave away more of their share of wealth and more in real dollars than in previous years.

Returns of the 2006 tax year reflect foundation spending at an all-time high making this moment more appropriate for trying to detect a relationship between foundation spending and public charities' financial state than during an economic downturn when foundations conserve spending. Hence, foundation variables of asset size, age, ratio of professional staffing, sector focus, and payout rate reflect the 2006 tax year.

Although I make no claim for a causal relationship between the two entities—foundations and public charities—I used data on grantee organizations' 2007, not 2006, tax year. Public charities' 2007 tax returns may either reflect already benefiting from a foundation grant or the promise of receiving one. Whether or not a 2006 grant is reflected in a grantee organization's 2007 tax return depends on several factors. A principal consideration is nonprofits' different bases of accounting. Organizations using the recommended accrual basis of accounting will record grants when promised, not when received, unlike cash basis accounting that recognizes a grant only after receipt. As a result, a grant made by a foundation in its 2006 tax year may be reflected in their grantee's 2006 or 2007 tax return, depending on timing and both the foundation's and public charity's choice of accounting methods. I relied on grantee organizations' 2007 tax returns because it may more likely (compared to 2006 tax returns) reflect benefits

conferred from either securing a grant or already using the grant in the prior or 2007 tax year. As with foundations' figures, grantees' financial data were not inflation adjusted.

Sampling Procedure

Population Frame

According to the IRS (2006b), there were 64,468 grantmaking, nonoperating foundations that filed a 2006 tax return. The NCCS 2006 Core File includes many more and other types of foundations—88,223 in total (Urban Institute, 2006b). For private foundations that, for whatever reason, did not file a tax return for that year, the Urban Institute (2009) included the prior year's return, thus making the number of observations in the Core Files a more accurate reflection of the entire population than the number of tax filers in any given year.

Domestic, grantmaking, private foundations that filed a 990-PF tax return for their 2006 tax year (IRS, 2006a) comprised the target population. I excluded foreign entities that adhere to different grantmaking rules. Pass-through foundations wherein assets received are fully distributed were also not included as their payout rates are unusually large as they do not spend from an endowment. Similarly excluded were support organizations that funnel funding to particular charities. Also, I left out nonexempt charitable and split interest trusts that filed a 990-PF but are a different type of entity, as well as operating foundations that primarily fund their own charitable programs in lieu of needing to meet a minimum payout. Last, I excluded foundations that did not complete 990-PF line items necessary in calculating payout rates and foundations that did not list

three or more grantee organizations (e.g., they may have supported only a couple charities or their primary grantmaking was to individuals).

Sampling for the outcome variable. For the outcome variable, I selected the three grantee organizations that received the largest grant amounts as reported in the 2006 990-PF of each sampled foundation. I identified these organizations from foundations' 990-PF grants list section, which lists all grantee organizations and their grant amounts for that tax year. I excluded foreign nongovernmental organizations; nonprofits that are not subject to IRS regulations for filing a 990 tax return, such as churches or unions; entities that are fiscally sponsored or receiving a grant through a foundation's expenditure responsibility process; and organizations with gross receipts of less than \$25,000 as they may not have completed a tax return or may have completed the abbreviated tax return Form 990-EZ that lacks sufficient information for calculating MULNA. Once I selected the top three grantee organizations that received the largest total grant amounts, I calculated their organizational MULNA using their Form 990 from the 2007 tax year.

Sample Size

In describing the process of conducting mediation analysis, Jose (2013) advised using power analysis tools, such as G*Power (Faul, Erdfelder, Buchner, & Lang, 2009) that is readily accessible online. Jose (2013) recommended, based on earlier work established by Cohen (1992), setting the four interrelated power variables: (1) the significance criterion (α) to .05, (2) power level at .80, (3) effect size, and (4) sample size. A study of power in mediation studies (MacKinnon, Lockwood, Hoffman, West, & Sheets, 2002) concluded that, too often, such studies were underpowered. To remedy this

shortcoming, Jose (2013) recommended increasing the sample size in calculating the mediating effect beyond what is suggested by power analysis software (p. 87).

Regarding effect size, I anticipated that it would likely be small considering that so many other factors contribute to a public charity's financial condition (Herman & Renz, 1999). Other variables that fall outside the focus of this study include more dominant sources of financial support: Earned revenues, government support, and individual charitable giving are the largest sources of funding, not private foundations (Salamon, 2012). Private foundations' funding contributed only approximately 16% of all charitable giving in the United States (Foundation Center, 2014) and accounted for only 3% of the nonprofit sector's revenues (Foster & Ditkoff, 2011, p. 143). Furthermore, a public charity's internal factors play an important role in contributing to its financial condition, such as the financial competence of its personnel, management decisions and development of resources, and trustee-imposed policies on accumulating reserves.

I used G*Power version 3.1.9.2 (Faul et al., 2009) to estimate the sample size. I set the significance criterion (α) at .05 (Grimm & Yarnold, 2010). Taking into account that previous mediation studies were underpowered and that so many other factors affect a public charities' financial condition (Jose, 2013; MacKinnon et al., 2002), I set the power level to .95, which increased the sample size. Effect size, which should be small, was set to .1. Using these parameters, G*Power analysis indicated that I needed a sample size of 204 to meet standards for rejecting correctly the null hypothesis while being able to detect actual relationships. In addition, I ran analyses using robust bootstrap methods to calculate the size and significance of the mediating effect.

With 204 observations, the number of cases of the outcome variable was three times that amount (i.e., three grantees per foundation) for a total of 612 cases. The decision to limit the selection of grantees to three was made with a practical consideration for what can be accomplished in a dissertation. Also, because the study was meant to identify pathways of relationships and not causal explanations, three was a sufficiently large enough sample of each foundation's grantees to constitute an average picture of foundations' top grantees' MULNA.

Disproportionate Stratified Random Sampling

I used disproportionate stratified random sampling by small, medium, and large foundation asset sizes. Adapting asset size categories referenced by McGlaughon (2013) and Renz (2012), I categorized small foundations as those holding \$50,000,000 or less; medium foundations as those holding between \$50,000,001 and \$499,999,999; and large foundations as those with \$500,000,000 or more. After stratifying the population of only those foundations relevant for inclusion, I sampled from each stratum using a random number generator in Excel to evenly reflect each asset size category.

Disproportionate stratified sampling was appropriate for this study given the imbalance between the number of foundations of each size and their relative grantmaking footprint (Daniel, 2012). Although 98% of all foundations are small (less than \$50 million in assets), only 1% of the largest foundations gave away roughly half of all grant funds (Foundation Center, 2014). In other words, the vast majority of foundations are small but only the top 1% gives away most of the money. Hence, disproportionate sampling accomplished two things: (a) it allowed for inclusion of small foundations that

are usually excluded from research because their giving impact is relatively small (McGlaughon, 2013), and (b) it counterbalanced overrepresenting large foundations to the exclusion of small foundations if sampling had been based on grantmaking size. Because this research was not about the impact of grantmaking on an issue or geographic area (in which case, the study should attend only to large grantmakers) but rather on the relationship between funders and grantees, it was appropriate to proportion the sample equally. Therefore, each sample stratum was equally represented (i.e., 68 foundations per stratum) so that the characteristics of the smallest or the largest grantmakers neither dominated nor distorted the findings. Disproportionate sampling of asset size categories also allowed for between-strata analyses (Daniel, 2012, p. 136), which was appropriate given that asset size has been shown to be related to payout rate (McGlaugon, 2013; Renz, 2012).

Instrumentation and Operationalization of Constructs

This research was based on a number of constructs that needed to be operationalized for study. The concept of foundation effectiveness was tested by looking for significance of the mediating path of charitable spending linking foundations' influence to grantees' financial well-being. This section provides an explanation of how the variables were operationalized to indicate key concepts of foundations' influence and charitable behavior and grantees' financial capacity to realize social purpose.

Outcome Variable: Grantees' MULNA

The calculation of a public charity's MULNA—months of a public charity's unrestricted, liquid net assets—was developed by NFF. MULNA is a proxy of an

organization's short-term resilience if stress-tested by how long it could operate if all income stopped. The following is a clear and thorough explication of NFF's MULNA formula:

The underlying metric used to calculate MULNA is—unrestricted liquid net assets (ULNA) and is defined as—net assets minus positive equity in property and equipment. Positive equity is calculated by taking the sum of—land, building, and equipment (LBE) and—investment in land, building, and equipment (Invest_LBE) and subtracting property and equipment related debt (e.g., the sum of mortgage, loans, and tax exempt bonds). The result is total property & equipment equity. Property & equipment equity, however, may take on negative values, as the sum of related debt may be greater than the value of land building and equipment. Thus, in calculating unrestricted, liquid net assets, only values greater than zero is [*sic*] considered. Subtracting negative property & equipment equity will result in erroneously overstating unrestricted liquid net assets, thus P&E equity will only take on values of zero or greater. P&E equity is then subtracted from unrestricted net assets to arrive at unrestricted liquid net assets (ULNA). Once ULNA is calculated, determining MULNA is a simple procedure. ULNA is divided by pre-depreciation expenses (functional expenses minus annual depreciation) and multiplied by 12. (Lam & McDougle, 2012, pp. 3–4)

To put it simply, the formula first calculates an organization's unrestricted, liquid net assets and then is divided by 12 months to generate the number of months a public charity can survive without a fresh supply of income. I used the NFF formula (G.

Brinkerhoff of NFF shared their MULNA formula, personal communication, January 15, 2013) for calculating the outcome variable of this study (see Table 1).

Influencer Variable: Foundations' Asset Size

The fair market value of a foundation's total assets is considered a proxy of a foundation's size (Boris et al., 2008). Able to be calculated using data in the 2006 Core File, this information also can be found in two places on the publicly accessible IRS Form 990-PF from tax year 2006 (IRS, 2006a). A foundation's total asset size is found on Part II, line 16c and on the first page of the form, Introduction, line I (see Table 1).

Influencer Variable: Foundations' Age

I used foundation's age to indicate its experience and maturity and to suggest its generational life cycle (i.e., still tied to founders' interests or possibly reflecting a non-family foundation board). I calculated age using the 2006 Core File on private foundations, which provides the ruling date of when the IRS authorized tax-exempt status (Urban Institute, 2006c). This date is not necessarily when a foundation began to operate as a foundation may have begun operating informally before seeking official federal recognition or may have been formally incorporated first at the state level (Urban Institute, 2006a). Although ruling dates may not reflect the actual moment when a nonprofit began operating, ruling dates were found to reflect reliably the age of an organization, with the exception of entities established before 1970 (Urban Institute, n.d.; see also Grønbjerg & Clerkin, 2005). IRS files were computerized during the 1960s and, hence, entities established up to that period may not have accurate or complete ruling date information (Urban Institute, n.d.). According to NCCS's online support for

researchers, a missing ruling date should be filled in by examining the foundation's other tax year returns, by searching on its websites, and, if all else fails, by "bottom coding" missing data with the year 1970 (Urban Institute, n.d., "Two Approaches," para. 3). NCCS researchers examined the 2004 NCCS Core Public Charity File and found that 92% of all public charities had ruling dates of 1970 or later (Urban Institute, n.d., para. 7) indicating that age data are generally complete and reliable. Furthermore, most foundations were established after 1969 when the federal government officially recognized private foundations as a distinct charitable entity, so most foundations' years should not be missing or need bottom coding.

The 2006 Core File provided foundations' year and month of IRS ruling (Urban Institute, 2006b). In order to calculate foundations' age, I converted this number into its age at the time of its studied tax year by dropping the last two digits (month) and subtracting its rule date from the year 2007. This calculation generated the age of a foundation by how old it was in number of years when it completed its 2006 tax return in the year 2007 (see Table 1).

Influencer Variable: Foundations' Staffing Ratio

The presence and level of professional staffing of a foundation may be a contributing factor to how well grantees are supported. A meaningful figure of a foundation's professionalization is not how much was expended on staffing but rather the proportion of staff expenses—compensation and benefits—relative to its size. Hence, I calculated the ratio of payments in wages and benefits to trustees, directors, and staff

relative to the fair market value of a foundation's total assets to generate this study variable.

For this calculation, I relied on data from completed 2006 IRS Form 990-PFs. Paid staff is identified on part I, lines 13–15, columns D. Column D singles out expenses incurred for charitable purposes. Line 14 reflects amounts paid to professional staff. If a foundation does not employ staff, it may choose to compensate board trustees, which is reflected in line 13. A foundation may have senior-level staff also serving as officers or trustees, and so their compensation may be reflected in either line 13 or line 14. Foundations that do not show any staffing expenses—zero expenses in lines 13 and 14 and no employee benefits or pension costs in line 15—are operating with an all-volunteer board, which is not unusual at family foundations (Boris et al., 2008). (See Table 1 for the 990-PF calculation.)

Influencer Variable: Foundations' Sector Focus

To identify arts-focused private foundations, I began by examining how foundations categorized their primary activities for inclusion in the National Taxonomy of Exempt Organizations (NTEE). Unfortunately, this resource was not useful for identifying private foundations' grantmaking focus areas as most foundations selected the category "T-philanthropy, voluntarism & grantmaking foundation," which simply (and unhelpfully) indicates that the foundation focuses on philanthropy. In addition to examining the major subgroup category (NTEEGRP), I also examined the subgroup classification, NTEE-5, which categorizes nonprofit entities by five major subgroups of sector-specific activities—arts, culture, and humanities; education; health; human

services; and other. In this case, most foundations selected “Other,” perhaps because they either wanted to indicate that they are a grantmaking entity and not a direct service provider in their field of interest or because they are a generalist or multi-sector funder (there is no option to select multiple subcategories). A manual examination of these categories revealed that not a single foundation used the NTEE categories to identify which sector they prioritized.

Because the NTEE codes were not useful in identifying arts-specific foundations, I identified arts funders using an alternative two-step process. First, I identified arts foundations based on personal expert knowledge of the field (I was vice-chair of and am a member of the national arts grantmaking membership association Grantmakers in the Arts). Second, I reviewed the list of funders’ top three grantees to identify which foundations supported the arts. If any of the grantees was an arts organization, I then researched that foundation’s giving to see if the arts funding was atypical or indicated a pattern of supporting the arts. For cases that I identified as a potential arts funder using these two methods, I also manually examined these foundations’ tax returns, reviewed their websites, and conducted a general online search to see to what degree they invested in the arts. I coded a foundation as an arts funder if they exhibited a pattern of supporting arts-focused public charities, even if the arts was not their only focus.

Mediator Variable: Foundations’ Payout Rate

There is a mistaken impression that the IRS calculates a foundation’s payout based on its total asset size (Renz, 2012), but doing so would not distinguish between charitable-use and investment-related assets. To account for that distinction, the

calculation for payout rate is based on a foundation's net value of noncharitable-use assets, which are assets held for investment purposes such as endowment as well as investments in real estate, art, and other items that may yield returns of greater value (Ludlum, 2005). This type of asset is different from charitable-use assets that are used to conduct mission-related activities including costs for personnel, meeting expenses, real estate, equipment, and computers (Ludlum, 2005).

The IRS calculates a foundation's payout rate by dividing the amount of qualifying distributions (i.e., expenses incurred in carrying out charitable, not investment, purposes that include grantmaking, operational, and administrative costs)—which is adjusted to account for taxes, allowable deductions, and previous excess distributions—by the net value of its noncharitable-use assets (Renz, 2012, p. 2), as shown in Table 1. I calculated payout rate using data from the 990-PF, because not enough of the data necessary to make this calculation were included in the 2006 Core File. I used the IRS payout rate formula that was published by Renz (2012).

Table 1

Operationalization, Calculation, and Measurement of Study Variables

Variable	Operationalization	Calculation	Measurement
Outcome variable: Grantee organizations' financial health	Months of unrestricted, liquid net assets (MULNA)	All line items are for end-of-year amounts on the 990: MULNA = [(Unrestricted Net Assets line 67B -MAX (0, Land Buildings Equipment line 57cB + Investments in LBE 55c -(Tax Exempt Bond Liability 64aB + Mortgage line 64bB)] / (Total Functional Expenses line 44A – Depreciation line 42A) * 12	Number of months of unrestricted, liquid net assets
Influencer variable: Foundation size	Foundations' fair market value	No calculation necessary	Raw dollar amount
Influencer variable: Foundation age	Year of foundation's IRS tax determination minus 2007	Age = Rule year – 2007	Raw age in years
Influencer variable: Foundation professionalization	Ratio of amount expended on board/staff compensation and benefits to foundations' fair market value of total assets	Ratio of professional staff = (990 PF, Part I, Compensation of Officers Directors Trustees Line 13D + Other Employee Salaries and Wages Line 14D + Pension Plans or Employee Benefits Line 15D) / Fair Market Value of Total Assets at Year End Part II, 16C	Percentage of amount spent on staffing relative to foundation size
Influencer variable: Public charities' dependence on private foundation support (called "sector focus")	Identified which private foundations focus on the arts, which is the nonprofit sector that depends most on their funding	Manual review of foundations' grants lists (990 PF, Part XV, 3a) and online search for information on foundations' giving	Dummy coded for arts and non-arts funders
Mediator variable: Foundation charitable wealth distribution	Payout rate	Payout rate = Qualifying Distributions Part XII, line 4 + Taxes Part XI, line 2c + Deduction from Distributable Amount Part XI, line 6, + Excess Distributions Applied to Current Year Part XIII, line 5, column c) – Recoveries of Amounts Treated as Qualifying Distributions Part XI, line 4 / Net Value of Noncharitable-Use Assets Part X, line 5	Percentage of foundations' net value of noncharitable-use assets that was expended charitably in tax year 2006

Data Analysis

I conducted exploratory data analyses and tested for null and alternative hypotheses using IBM's Statistical Package for the Social Sciences (SPSS) version 21. In addition, I used Hayes's (2014) PROCESS v2.13, which is a SPSS macro, to test for indirect effects of the influence of a mediator. Befitting exploratory research of a little understood phenomenon of the pathways by which foundations affect grantees, I analyzed whole and segmented models of the data.

Preliminary Treatment of Data

I began with univariate analyses to look for missing or nonrepresentational data, to identify outliers, and to assess outliers' influence on the shape of univariate distributions using SPSS frequencies and explore functions (Tabachnick & Fidell, 2013). Based on these results, I treated influential residuals and winsorized data that were nonnormally distributed. I reported the range, mean, median, and standard deviations of both the untreated and then of the winsorized data. I also examined and reported on the bivariate relationships between the outcome (i.e., MULNA) and influencer variables (i.e., foundations' asset size, age, staffing ratio, sector focus, and payout rate) to describe their associations.

In order to meet assumptions for conducting multiple regression analyses, I evaluated linearity and homoscedasticity by generating scatterplots of standardized residuals versus predicted values (Field, 2013; Tabachnick & Fidell, 2013). Histograms of residuals also revealed problems of nonnormal distributions. For independence of errors, I used the Durbin-Watson test (Field, 2013). I also reviewed multicollinearity

statistics to identify potential violations of collinearity. Results of multivariate analyses revealed that the distribution of residuals was not normal; but assumptions of linearity, homoscedasticity, independence of errors, and collinearity were met. Having already treated nonnormally distributed variables through winsorization to mitigate influential outliers, as indicated by Cook's and Mahalanobis Distance statistics, I conducted data analyses using the robust method of bootstrapping. I chose not to further winsorize data, which yielded diminishing returns on improving normality of residuals, and chose not to transform data, which changes the construct being examined from arithmetic means to geometric means and is not preferable when using interpretable, meaningful data (Field, 2013, p. 202).

Hypotheses Testing

I used multiple linear regression to test the first hypothesis that foundations' firm-level traits (i.e., size, age, staffing level, and sector focus) predict their payout rate. I used multiple regression analysis to also test the second hypothesis that foundations' traits and spending behavior influence their grantees' financial condition. To test the third hypothesis that foundation's payout-to-net asset ratios mediates the relationship between their firm-level traits and their grantees' financial health, I used the indirect effects approach for identifying mediation (Field, 2013; Hayes, 2013).

Calculating the Indirect Effect

I used Hayes's PROCESS v2.13, a SPSS add-on macro for statistical mediation analysis. PROCESS uses an ordinary least squares regression-based path analytic approach for estimating the indirect (i.e., mediation) effect (Hayes, 2013). This statistical

tool calculates and reports the unstandardized regression coefficients of the indirect, direct, and total effects using bias-corrected analysis of bootstrapped samples with replacement (Hayes, 2013). As shown in Figure 1, the indirect effect is the mediation pathway ($A \times B$), the direct effect controls for payout (C'), and the total effect (C) is the simple relationship between X and Y . Using PROCESS, I explored the pathways of relationships and looked for an indirect effect, with each model distinguished by examining separately the influencer variables of foundations' size, age, staffing, and sector focus. Because of its use of bootstrapping, PROCESS (Hayes, 2013) applies a robust, nonparametric method that does not depend on meeting assumptions of normality in order to identify mediation (Field, 2013, p. 352; see also Lambert, Negash, Stillman, Olmstead, Fincham, 2012).

I reported the unstandardized regression coefficients and confidence intervals of the direct and indirect effects (Field, 2013) based on 1,000 bootstrapped samples. Significant relationships exist if the confidence intervals do not include zero (Field, 2013). If the presence of a significant indirect effect was detected, I reported the size of the indirect effect using Preacher and Kelley's (2011) kappa-squared value (k^2), which is the maximum possible size of the indirect effect (Field, 2013, p. 413). Although the result of the Sobel z test (1982) continues to be popularly reported (Jose, 2013; Tabachnick & Fidell, 2013), k^2 is a more accurate measure of effect size (Field, 2013; Preacher & Kelley, 2011).

Limitations

There are a few limitations that may affect the interpretation and replicability of this study. Without the benefit of preceding studies on how foundations' characteristics and spending behavior impact beneficiaries of the charitable sector at large, the choice of variables that could help explain how funders influence grantees was based on an educated guess from direct, anecdotal professional experience and on complementary, albeit indirectly associated, research (Boris et al., 2008; Kim & Van Ryzin, 2014; McAllister, 2005; McGlaughon, 2013; Renz, 2012; Sansing, 2010; Sansing & Yetman, 2006; Yoder & McAllister, 2012). To that end, the use of mediating regression was meant to detect only the pathways of relationships between the two entities and, if the mediating path was found to be significant, to account for how much foundation payout rate contributed to grantees' financial condition in a moment of economic strength. If no significant relationships were found, other variables should be explored to explain how and to what extent foundations contribute to their grantees' capacity. In other words, the results of this study should not be interpreted as a conclusion on whether or not foundations affect grantees, but rather as an exploration of the possible ways that foundations might exert an influence.

Another consideration is that the conceptual framework precludes drawing any conclusions on how foundations affect grantee organizations generally. Because data were gathered on only three of however many organizations that received top-dollar grant amounts, the findings reflect only the relationships between funders and their most successful grantees (i.e., success being equated with receiving the largest award

amounts). Hence, the this study is limited to understanding the relationship between funders and their favored beneficiaries and not between foundations and public charities generally.

Threats to Validity

Because of the relatively underdeveloped nature of private foundation research, this study was not able to benefit from already-established and tested theoretical or conceptual frameworks. As such, this study suffers from problems that typically arise from such situations. The validity of adapting a public accountability framework for this subject matter cannot be corroborated or defended by preceding studies from within the field. Moreover, the use of this theoretical premise may be easily dismissed by those who opine that the only valid theoretical framework is foundations' accountability to owners' interests.

Another validity concern is that the error rate and reliability of 990-PF data remain unknown. Froelich and Knoepfle (1996) found that public charities' 990 data were generally reliable, but there have not been similar studies testing if 990-PF data provide an accurate account of foundations' finances and grantmaking activities. In addition, Yoder et al. (2011) suggested that foundations distort their investment expenses as charitable activities in order to spend less, but such uncharitable behavior is mitigated by oversight and regulations (Desai & Yetman, 2005; Fisman & Hubbard, 2005). In general though, private foundations, unlike public charities, afford tax preparation expertise thereby increasing the odds that their tax returns were completely as factually, if

not more so, as public charities. Given that 990 data were found to be generally reliable, 990-PF data may be even more accurate in representing foundations.

Summary

In order to identify pathways of relationships and mediating effects, I used regression and indirect effects analyses. The following chapter describes the results of statistical analyses.

Chapter 4: Results of Analysis

The purpose of this research was to describe the pathways of relationships by which foundations' traits and charitable spending behavior may affect their grantee organizations' financial health. Models were created of whole and segmented variables to test which firm-level traits—size, age, staffing level, or sector focus—influenced their payout behavior; which, if any, of these firm-level traits directly affected grantees' MULNA; and which firm-level traits were associated with MULNA through the mediator of payout rate. This chapter provides an overview of the process for determining the composition of the sampling frame and the sample. I report the results of testing for goodness of fit of the data and for biases, which include exploratory univariate analyses of the variables and multivariate analyses of residuals. I also provide descriptive statistics describing the variables and bivariate relationships of treated data. Finally, I present the findings of hypotheses testing.

Sample Selection

Observations were collected from the NCCS 2006 Core File, which included 88,223 foundations. Based on the sample selection process described in the previous chapter and summarized in Table 2, this number was reduced to 33,621 unique domestically based, private, nonoperating foundations to comprise the sampling frame.

Table 2

Sampling Frame Selection

Description	Number of foundations	Foundation number subtotals
Foundations that filed 990-PF in tax year 2006 as reflected in the 2006 Core File provided by Urban Institute's National Center for Charitable Statistics.	88,223	88,223
Require only private foundations. (LEVEL1: Selected "PF")	<25,668>	62,555
Require only in-scope domestic foundations. (outnccs: Selected "IN")	<212>	62,343
Require only private nonoperating foundations. (P7POFCLM: Selected "N")	<1,479>	60,864
Require only entities with a private nonoperating purpose as stated reason for 501(c)(3) status. (FNDNCD: Selected "4")	<370>	60,494
Eliminate mutual benefit organizations. (ntmaj10 & ntmaj12: Custom Filter "Does not contain 'MU'")	<24>	60,470
Require net investment income greater than or equal to \$10,000 to ensure inclusion of endowed foundations (per Yoder & McAllister, 2012). (P1NETINV: Custom Filter for "greater than or equal to 10000")	<24,182>	36,288
Eliminate "pass-through" foundations with assets of less than \$100,000 (per Boris et al., 2008). (P2TASFMV: Custom Filter for Total Assets that is "greater than or equal to 100000")	<1,365>	34,923
Require charitable spending. (P1TEXMEX: Custom Filter for Total Charitable Spending that is "greater than or equal to \$1,000")	<969>	33,954
Eliminate foundations without ruling date which is necessary in calculating age (per Yoder & McAllister, 2012). (RULEDATE: Greater than 0)	<333>	33,621
Unique foundations included in sampling frame		33,621

Based on this sampling frame, I then stratified the 33,621 foundations by organizational asset size (small, medium, and large foundations). Based on the parameters described in Chapter 3, G*Power (Faul et al., 2009) analysis indicated

needing a sample size of 204 foundations, so I selected randomly 68 foundations from each stratum using Microsoft Excel's random number generator for a total sample size of 612 cases (see Table 3). Looking up each sampled foundation's tax return, I manually data-entered the information necessary for calculating study variables and identified the top three grantees by awarded total dollar amounts. For those foundations that did not list enough public charities as grantees or did not complete their tax returns in such a way as to calculate study variables, I skipped to the next foundation identified through the Excel random number generator.

Table 3

Disproportionate Stratified Random Sampling

Foundation asset size	Population size of sampled frame	% of total in each stratum	Sample size	Sampling fraction
Small (\$50 million or less)	32,527	97	68	1/478.3
Medium (more than \$50 million, less than \$500 million)	999	3	68	1/14.7
Large (\$500 million or more)	95	0.3	68	1/1.4
Total foundations	33,621	100	204	1/164.8
Total grantee organizations			x 3 grantees = 612 cases	

Exploratory Data Analyses

I used SPSS to conduct exploratory, univariate analysis for missing, nonrepresentational, outlier, and normal distribution of data. I also conducted

multivariate analysis of residuals using hierarchical multiple regression to check for potential violations of assumptions.

Nonrepresentational Data

I did not have any missing data. I identified, however, two cases of nonrepresentative data identified by their extremely high standardized values. Both cases had the highest MULNA values with z -scores of 14.3 and 6.8. The unusually high MULNA value was likely due to close relationships between the grantees and their funders. In both cases, the foundations and grantee organizations shared the same names of their founders, which likely explains the unusually large grant amounts distributed to these two grantees. Because the focus of study was on public charities that receive external foundation support and not on insider or pass-through relationships, I replaced these two cases with public charities that received the next-highest award amounts.

Influential Residuals and Univariate Normality

During exploratory analysis, a visual review of the histograms and statistical measures of skewness and kurtosis revealed that the variables of foundations' size, staffing ratio, sector focus, payout rate, and grantees' MULNA were nonnormally distributed with problems of influential cases.

In order to avoid problems of interpretation and avoid deleting cases that legitimately reflected the population, I winsorized outliers until all cases did not exceed standardized values of 3.29 (Field, 2013). I chose winsorizing over trimming: Trimming would have removed extreme cases of large foundations, staffing ratios, payout rate, and MULNA thus losing the variability of the field. In addition, I chose winsorization over

data transformation because each variable's raw values are meaningful and data transforming would have changed the construct being measured (Field, 2013, pp. 198–202).

Improving the shape of univariate distributions through winsorization may not have been necessary, but it was undertaken as a conservative measure to ensure that outliers did not exert too much of an influence. This study used a large enough sample size (greater than 40) that distributions should approximate normal (Ghasemi & Zahediasl, 2012). Furthermore, some statisticians have argued that normality of univariate variable distributions is not required; instead residuals must be normally distributed (Chen, Ender, Mitchell, & Wells, 2014). However, correcting for influential residuals through winsorization should improve the generalizability of statistical findings to the overall population by avoiding having extreme values skew the results. The following describes pre- and post-winsorized treatment of data.

In the case of foundations' asset size, visual examination of the histogram suggested nonnormal distribution, which statistical analysis confirmed. The value of skewness was 4.84, indicating a positive skew and kurtosis was 28.24, indicating the shape was considerably leptokurtic. There were 33 cases with z -score values greater than 3.29, indicating a problem with univariate outliers (Tabachnick & Fidell, 2013, p. 73). I winsorized these extreme cases until none exceeded a z -score of 3.29. As a result, the data became more normally distributed with skewness near normal at 1.81 and a normal kurtosis of 2.33.

Looking at the histogram of foundations' age suggested that the data were normally distributed. Skewness (.58) and kurtosis (-.86) values confirmed normal distribution, and none of the standardized values exceeded a z -score of 3.29. Therefore, the raw values of age were used in statistical analysis.

Foundations' staffing ratio was nonnormally distributed. A visual examination of the histogram indicated nonnormal distribution, which statistical measures confirmed. Skewness was 1.78 and kurtosis was 3.57 indicating that the distribution was somewhat positively skewed and nearly normally peaked. Some z -scores exceeded 3.29, and so a total of 15 cases were winsorized to fall within the z -score threshold of 3.29. As a result of winsorization, skewness slightly improved to 1.28 and kurtosis improved to within normal range of .79.

A visual review of the histogram for foundations' payout rate indicated that the data were right skewed and leptokurtic, which statistical analysis confirmed. Skewness was 4.65 and kurtosis was 23.7, indicating a sharp leptokurtic peak. Standardized values were also extreme, indicating a problem with outliers. A total of 33 cases were winsorized so that none exceeded a standardized value of 3.29. As a result of this treatment, skewness improved to 2.29 and kurtosis was much improved to a value of 4.74, indicating a moderate peak.

The outcome variable of grantee organizations' MULNA was also nonnormally distributed according to the histogram. Nonnormal distribution was confirmed by statistical analysis. Skewness was 3.14 and kurtosis was 12.84 indicating the variable was somewhat right skewed and moderately peaked (i.e., leptokurtic). This shape made sense

upon reviewing standardized values, which were very high. A total of 21 cases of MULNA were winsorized to not exceed a z-score value of 3.29. As a result of winsorization, distribution was nearly normal: Skewness was reduced to 1.94 and kurtosis was greatly reduced to within a near-normal range of 3.89.

Having treated outliers through winsorization, I then examined Cook's and Mahalanobis Distance values to identify residuals that might exert an influence on the data. The largest Cook's Distance value was .07, indicating that none of the cases exerted an inordinate influence (Field, 2013, p. 306). Given that the study had five influencer variables and a sample size greater than 500, any case with a Mahalanobis Distance greater than 25 would have indicated a problem with influencers (Fields, 2013, p. 307). After treating extreme values, the largest Mahalanobis Distance value was 22.47, indicating no problem with residuals. Winsorization greatly improved the Mahalanobis Distance, which was originally 67.14 when using only raw, nonwinsorized values.

Overall, I winsorized 33 foundation size cases, 15 foundation staffing ratio cases, 33 foundation payout cases, and 21 grantee MULNA cases that, in total, accounted for 16.7% of the sample size. I did not winsorize or treat in any other way the variables foundation age or sector. All data, analyses, and findings reported in the narrative and displayed in tables and figures reflect winsorized values of size, staffing, payout, and MULNA, and original values of age and sector, unless otherwise noted. Because none of the variables were transformed, all numerical values reflect arithmetic means, meaning that they are interpretable, meaningful data reflecting dollars, age in years, ratios of staffing and payout, and months of reserves.

Multivariate Analysis of Residuals

Regression tests require that the data must meet assumptions of normality, linearity, homoscedasticity, independence of errors, and collinearity (Field, 2013). Multivariate analyses of residuals were performed using hierarchical linear regression, with winsorized size, age, winsorized staffing, and sector focus entered in the first block and winsorized payout rate entered in the second block regressed onto the outcome variable of winsorized MULNA.

The histogram for residuals showed a nonnormal distribution that was positively skewed and peaked. A visual examination was also used to identify linearity: The plot of standardized residuals versus predicted values revealed a linear relationship without any curvature of the line. A review of the same scatterplot indicated heteroscedasticity with the shape of the scatter resembling a rectangular pattern. In addition, the Durbin-Watson value of 1.92 indicated that the assumption of independence of errors was met. Regarding multicollinearity, the tolerance statistic was .97 and VIF was 1.03, indicating that there was no violation of collinearity.

In conclusion, assumptions of linearity, homoscedasticity, independence of errors, and collinearity were met, while the distribution of residuals was not normal. These results indicated the need to use a robust method that does not require normality (Field, 2013, p. 352). I used the robust method of bootstrapping when conducting multiple regressions and using PROCESS for testing of indirect effects.

Descriptive Statistics

This section describes the sample based on univariate and bivariate statistical analyses.

Univariate Analysis

Table 4 describes the characteristics of the variables in their original, unwinsorized, state. Table 5 displays the characteristics of the sample once winsorized. All analyses, hereafter, reflect winsorized values. As evident in Table 5, foundation characteristics varied greatly based on asset size and age, yet were rather homogenous in terms of their professionalization, support outside of the arts, and payout rate. Regarding foundation size, they ranged from those with less than \$250,000 to very large funders with over \$2 billion. There was also a range of ages, although most have been operating for approximately a generation (i.e., roughly 25 years; see Seppanen & Gualtieri, 2012). Foundations spent little on professional staffing relative to the asset size of the organization, from all volunteer-run operations and up to 1.2% of assets spent on staffing. In addition, most of the foundations in this sample met or exceeded slightly the federally legislated 5% minimum payout requirement.

Sampled grantee organizations' months of unrestricted, liquid net assets varied greatly. The average level of reserves would keep an organization afloat for approximately 1.5 years, but the outsized amount of MULNA by the best-supported organizations skewed this picture. A more accurate measure of the financial health of this pool is most likely reflected by the median of seven months of MULNA. The smallest amount of reserves reflected a deficit amount of 73 months and the largest amount was

nearly 246 months (or 20 ½ years) of liquid, unrestricted assets. The MULNA sizes of this sample were much healthier than the vulnerable MULNA averages in the field (Blackwood & Pollak, 2009; Lam & McDougle, 2012), because what is reflected here were the best-supported grantees of sampled foundations.

Table 4

Descriptive Statistics of Sampled Foundations and Grantees' Characteristics Using Original Values

Variable	Range	Mean	Median	SD
Foundations' total asset size ($n = 612$)	\$214,560–\$12,252,645,528	\$601,535,269	\$84,060,306	\$1,444,662,647
Foundations' age in years as of 2007 ($n = 612$)	1–79	28	22	20
Foundations' ratio of staffing expenses to total assets ($n = 612$)	0%–1.2%	0.16%	0.06%	0.22%
Foundations' ratio of charitable payout to noncharitable-use assets ($n = 612$)	1%–56%	7%	5%	7%
Grantees' MULNA ($n = 612$)	-73–245	19	7	34

Table 5

Descriptive Statistics of Sampled Foundations and Grantees' Characteristics Using Winsorized Values

Variable	Range	Mean	Median	SD
Winsorized foundations' total asset size (<i>n</i> = 612)	\$214,560– \$2,213,867,840	\$415,216,619	\$84,060,306	\$626,086,948
Foundations' age in years as of 2007 (<i>n</i> = 612)	1–79	28	22	20
Winsorized foundations' ratio of staffing expenses to total assets (<i>n</i> = 612)	0%–0.7%	0.16%	0.06%	0.02%
Winsorized foundations' ratio of charitable payout to noncharitable -use assets (<i>n</i> = 612)	0.5%–17%	6%	5%	3%
Winsorized grantees' MULNA (<i>n</i> = 612)	-73–107	18	7	27

Note. Foundations' age was not winsorized because it was normally distributed.

Regarding the dummy variable of foundations' sector focus, I manually identified 28 foundations that supported considerably arts and culture organizations, that described a focus on the arts through conducting online research, or are known in the philanthropic field as an arts funder. Arts-focused foundations were identified in order to operationalize grantee organizations that are more dependent on private foundation than on public sources of support. This variable was tested for its association with payout and MULNA in whole and segmented analyses.

Table 6 provides descriptive statistics for each category of arts and non-arts foundations. Arts foundations were larger, older, and conserved more of their charitable spending than non-arts foundations. In addition, grantee organizations of arts-dedicated foundations fared slightly better financially than grantees supported by non-arts foundations (20 versus 17 months of reserves).

Table 6

Descriptive Statistics of Foundations' and Grantees' Characteristics Varied by Sector Focus

Variable	Arts focused (<i>n</i> = 84)		Non-arts focused (<i>n</i> = 528)	
	<i>M</i>	<i>SD</i>	<i>M</i>	<i>SD</i>
Winsorized foundation size	\$944,992,712	\$836,505,358	\$330,934,059	\$540,745,657
Foundation age	40	21	26	19
Winsorized foundation staffing ratio	0.22%	0.16%	0.14%	0.2%
Winsorized foundation payout ratio	5%	1%	6%	4%
Winsorized grantee MULNA	20	33	17	26

I also segmented data into categories for subgroup analyses. Table 7 displays descriptive information about each variable treated categorically. (The winsorization of variables had no bearing on categorical counts.)

Table 7

Foundation and Grantee Variables Segmented Categorically

Categorical variable	<i>n</i>	%	Categorical variable	<i>n</i>	%
Foundation size			Foundation focus		
Large	204	33.3	Non-arts	528	86.3
Medium	204	33.3	Arts	84	13.7
Small	204	33.3	Foundation payout		
Foundation age in years			Aggressive $\geq 7\%$	102	16.7
≥ 50	111	18.1	Average 4–6.9%	441	72.1
26–49	156	25.5	Conserve $\leq 3.9\%$	69	11.3
≤ 25	345	56.4	Grantees' MULNA		
Foundation staffing			Strong ≥ 24 mo.	137	22.4
No expenses	243	39.7	Stable 3–23.9 mo.	289	47.2
Any expenses	369	60.3	Vulnerable ≤ 2.9 mo.	132	21.6
			Failure risk =deficit	54	8.8

Subgroups for each category were created in the following ways.

- Foundations' size was segmented equally through disproportionate stratified sampling into three main asset size types (large \geq \$500 million, medium = \$499,999,999–\$50,000,001, small \leq \$50 million).
- Foundations' age was divided by 25 years, which roughly spans one generation (see Seppanen & Gualtieri, 2012). Dividing this continuous variable into categories revealed that most foundations in this sample were

young (≤ 25 years of age). Only 18% of them were older than 50 years, which predates federal recognition of private foundations through the Tax Reform Act of 1969. This distribution by age reflects the trend of rapid acceleration in the number of foundations established since the 1980s (Foundation Center, 2012a).

- Foundations' ratio of professional staffing was split into those with staffing costs and those that expended nothing on staffing. This variable was segmented in this way because there is little variation in the proportion of total assets a foundation expends on staffing. Most reported expending some amount on staffing (60%), but even they expended little as evident in Tables 4 and 5. Hence, this segmentation dichotomizes all-voluntary and staffed institutions.
- Foundations' sector was a dummy category (non-arts was coded "0," arts-focused was coded "1") to distinguish between those that focus on giving to arts and culture and those that do not, thus operationalizing grantees of arts funders who depend largely on private foundations' support and those in sectors that depend mostly on other sources of income. Most foundations were categorized as non-arts with only 13.7 % deemed to be arts-specific in focus. However, the proportion of foundations that prioritized the arts was likely an undercount as this number was manually generated based on a review of their grantee list from a single tax year, an online search of foundations' websites, and professional knowledge of the field.

- Foundations' payout rate was categorized into three subgroups—expending at 7% or more of noncharitable-use assets that may result in sunsetting (Cambridge, 2000; Ostrower, 2011), expending between 4–6.9% that is roughly the average payout rate affirmed by other studies (Cambridge, 2000; Renz, 2012), and expending at less than 3.9% in order to conserve assets for future spending (Cambridge, 2000).
- Grantee organizations' MULNA was segmented into four categories. Most studies of MULNA make fewer categorical distinctions, typically only noting weak (fewer than three months) and stable (three or more months) financial conditions (Blackwood & Pollak, 2009; Bowman, 2011b; Foley, n.d.; Konrad and Novak, 2000; Kurre, 2010; Lam & McDougale, 2012; Nelson & Koo, 2014; NORI, 2010). I wanted a more nuanced look at MULNA, and so I categorized MULNA by those that are strong (retaining two or more years), stable (three months to nearly two years), weak (under three months), and failure risk (deficit). Weak and failure risk types of grantees are both vulnerable to closure, but any deficit MULNA position indicates that the organization is at imminent risk of failing to operate and was, therefore, called out separately. This study sampled the most-supported grantees and, unsurprisingly, most grantee organizations were stable or strong ($n = 426$ or 69.6%), while only 30.4% ($n = 186$) were weak or at risk of imminent closure.

Bivariate Analysis

I conducted bivariate analyses using Pearson's correlation coefficients with and without 1,000 bootstrapped samples to examine relationships between foundations' influencer variables and their giving behavior and grantee organizations' MULNA. The relationship of the dichotomous variable, sector focus, was examined using point-biserial correlations (Field, 2013, p. 279). Because bootstrapping made no difference to the output, I only reported the results of the nonbootstrapped analysis so as to include significance levels.

Table 8

Bivariate Correlations of Foundations and Grantees

	Winsorized foundation size	Foundation age	Winsorized foundation staffing ratio	Foundation sector focus (non-arts = 0 arts = 1)	Winsorized foundation payout ratio
Winsorized foundation size					
Foundation age	0.383 (.000)				
Winsorized foundation staffing ratio	0.235 (.000)	0.208 (.000)			
Foundation sector focus	0.338 (.000)	0.233 (.000)	0.139 (.001)		
Winsorized foundation payout ratio	-0.121 (.003)	-0.131 (.001)	-0.087 (.032)	-0.123 (.002)	
Winsorized grantee MULNA	0.040 (.320)	-0.018 (.663)	.0025 (.533)	0.030 (.462)	0.012 (.772)

Note. Significance levels are indicated in parentheses.

As shown in Table 8, there was no significant bivariate association between any of the foundation characteristics and the outcome variable of MULNA. On the other hand, there were significant relationships between foundations' firm-level characteristics—size, age, staffing, and sector focus—and the mediator variable of payout. Foundations' payout rate was significantly and inversely related to all firm-level characteristics. The larger, older, and more professionally staffed a foundation, the less those foundations expended charitably. In addition, sector and payout were negatively correlated, indicating that arts-focused foundations charitably spent less as a ratio of their investment assets than did non-arts funders. The connection between size and staffing with payout rate was in line with prior research that concluded that large, professionally managed foundations expended close to the legal minimum in order to preserve their financial corpus (Yoder & McAllister, 2012).

In addition, there were significant correlations amongst foundations' firm-level characteristics of size, age, staffing, and sector focus. All these relationships were positively related: The greater a foundation's size, the older the foundation, the more it spends on professional staffing, and the more likely it supports the arts. Despite relationships amongst the influencer variables, tolerance and VIF statistics were all within range (Field, 2013, p. 342), indicating that multicollinearity was not an issue.

Results from Multivariate Analyses

Through a series of bootstrapped ordinary least squares linear regressions using SPSS, I explored the determinants of payout rate and the pathways of relationships between foundations' firm-level characteristics and grantees organizations' MULNA. I

used the PROCESS macro to identify indirect effects that would indicate the mediating role of the payout rate in the association between foundations and beneficiaries. I conducted analyses on whole and segmented variables in testing each hypothesis. I reported statistics on the predictive value of the overall model as well as the model parameters according to standards described by Vesey, Vesey, Stroter, and Middleton (2011). In addition, I provided both unstandardized (*b*) and standardized (β) regression coefficients because the former are understandable real-world units of measurement (i.e., dollars and time) and the latter allows for comparisons among the coefficients.

Testing Hypothesis 1: Pathway A

I explored the answer to Research Question 1: Do private, nonoperating foundations' firm-level characteristics of asset size, age, staffing ratio, or sector focus influence their charitable behavior? This question tested the hypothesis that foundations' firm-level traits are determinants of payout rate. This line of inquiry enabled an exploration of the influencers of payout rate in order to isolate the firm-level factors that may comprise a mediation pathway.

Using SPSS, the outcome variable of winsorized payout rate was regressed on influencer variables of winsorized size, age, winsorized staffing ratio, and sector focus. The influencer variables were entered simultaneously. The results of the regression analysis are shown in Table 9. Both unstandardized (*b*) and standardized (β) regression coefficients are reported, and unstandardized coefficients, standard errors, significance levels, and 95% bias corrected and accelerated confidence intervals (reported in parentheses) were generated using 1,000 bootstrapped samples.

Using the enter method, this model was found to be significant, $F(4, 607) = 4.828$, $p = .001$, $R^2 = .031$, $R^2_{adjusted} = .024$. This model did not identify any significant associations between foundations' size and payout rate ($b = 0.000 [0.000, 0.000]$) or between staffing and payout ratios ($b = -0.784 [-2.154, 0.489]$, $p = .288$). In both cases, confidence intervals included zero, indicating that size and staffing did not predict charitable giving behavior (Field, 2013). On the other hand, there were conflicting results regarding the relationship between age and payout. When foundations age by one year, their payout rate decreases slightly ($-0.000138 [-0.000273, -0.000007]$, $p = .051$). The confidence interval did not include zero, but the probability value of .051 was not significant. This result suggests a reason to investigate further the relationship between age and payout, which was also tested in models of indirect effects.

Of the firm-level traits, only foundations' sector was identified as significantly associated with payout. The payout rate of arts foundations was only 0.008% less than that of non-arts foundations ($b = -0.008 [-0.011, -0.004]$, $p = .001$).

Table 9

Linear Model of Predictors of Foundation Payout Rate

Variable	<i>b</i>	SE B	β	<i>p</i>
Constant	0.068 (0.063, 0.074)	0.003	-	.000
Winsorized foundation size	0.000 (0.000, 0.000)	0.000	-.051	.133
Foundation age in 2007	-0.0001 (-0.0003, -6.562E-006)	0.000	-.083	.051
Winsorized foundation staffing	-0.784 (-2.154, 0.489)	0.741	-.046	.288
Foundation sector focus	-0.008 (-0.011, -0.004)	0.002	-.079	.001

Note. Age reported in the ten thousandths in order to show its small regression value. $R^2 = .031$ ($p = .001$)

Subgroup analyses. Age was not significantly associated with payout, but its confidence interval suggested a significant relationship. Hence, I conducted subgroup analyses to identify the types of foundation characteristics that may explain a possible association between age and payout rate. I used SPSS to conduct bootstrapped linear regressions with 1,000 samples, generating 95% bias corrected and accelerated confidence intervals.

Subgroup analyses revealed that age and payout rate were significantly associated only among foundations with certain characteristics.

- Large foundations' age was significantly related to payout rate ($b = -0.000219$ [-0.000387, -0.000065], $p = .024$). As large foundations age by one year, their payout decreases by 0.0002%. This model, with size, age, sector, and staffing

entered simultaneously and filtered by size levels, accounted for 6.5% of their payout rate, $F(4, 199) = 3.45, p = .009, R^2 = .065, R^2_{adjusted} = .046$.

- Average-distributing private foundations' age was a determinant of payout rate ($b = -0.000046 [-0.000073, -0.000015], p = .002$). In other words, among foundations that distributed close to the legal requirement of 5% payout, their payout rate can be predicted by age, but only marginally so. This model, with size, age, sector, and staffing entered simultaneously and filtered by levels of payout rate, only explained 3.6% of average-distributing funders' payout rate, $F(4, 436) = 4.117, p = .003, R^2 = .036, R^2_{adjusted} = .028$.
- Professionally staffed foundations' age impacted payout rate ($b = -0.000231 [-0.000365, -0.000116], p = .001$). As professionally staffed foundations age each year, their payout rate declines by 0.00023%. This model, with size, age, staffing, and sector entered simultaneously and filtered by staffing status, accounted for 6% of professionally staffed foundations' payout rate, $F(4, 364) = 5.829, p = .000, R^2 = .06, R^2_{adjusted} = .05$.
- Arts-focused foundations' age significantly predicted payout ($b = -0.000099 [-0.000178, -0.000016], p = .018$). As arts-focused institutions age, their payout rate declines by 0.0001%. The model, with size, age, and staffing held constant and filtered by sector, explained 15% of arts foundations' payout rate, $F(3, 80) = 4.701, p = .004, R^2 = .15, R^2_{adjusted} = .118$.

In sum, foundations' age influenced payout rate in cases of large, professionally managed, arts-focused foundations that conserved charitable distributions to the legal minimum.

Further subgroup analysis of age, with foundations' size, age, staffing, and sector entered simultaneously and filtered by age levels, revealed that oldest foundations' size and staffing characteristics were significantly associated with payout rate, $F(4, 106) = 8.567, p = .000, R^2 = .244, R^2_{adjusted} = .216$. This result is shown in Table 10, which displays unstandardized coefficients (*b*), standard errors, significance levels, and 95% bias corrected and accelerated confidence intervals (reported in parentheses) based on 1,000 bootstrapped samples. As the asset sizes of the sector's oldest foundations increased by \$1 billion, their payout rate declined by 0.013%. Also, for every unit increase in staffing, mature foundations reduced payout by 5.6%. This model of the most mature foundations' size and staffing accounted for 24% of their payout rate.

Table 10

Linear Model of Oldest Foundations' Characteristics that Influenced Payout Rate

Variable	<i>b</i>	SE B	β	<i>p</i>
Constant	0.115 (0.072, 0.167)	0.024	-	.001
Winsorized foundation size	-1.309E-011 (-2.179E-011, -6.376E-012)	0.000	-.275	.008
Foundation age in 2007	-0.001 (-0.001, 0.000)	0.000	-.112	.143
Winsorized foundation staffing	-5.600 (-8.474, -2.860)	1.440	-.338	.006
Foundation sector focus	-0.005 (-0.013, 0.004)	0.004	-.061	.173

$R^2 = .244$ ($p = .000$)

Overall, the findings of subgroup analyses by age revealed that the association between age and payout was significant only among the largest and oldest foundations, foundations dedicated to the arts, professionally staffed institutions, and those that distributed close to the minimum payout requirement. Their regression coefficients were negative values, indicating that wealth, maturity, dedication to the arts, and professionalization have a cooling effect on the proportion of wealth distributed charitably.

Beyond testing subgroups by age, additional models were tested by subgroups of foundations' winsorized size, winsorized staffing, and sector focus on winsorized payout rate. I used SPSS to run bootstrapped multiple linear regressions with 1,000 samples generating 95% bias corrected and accelerated confidence intervals.

When analyzed by the subgroup of size, large foundations' ($F(4, 199) = 3.45, p = .009, R^2 = .065, R^2_{adjusted} = .046$) and small foundations' ($F(4, 199) = 2.456, p = .047, R^2 = .047, R^2_{adjusted} = .028$) models were able to significantly predict the relationship between asset size and payout. Large foundations' size was significantly associated with payout rate ($b = 4.363E-012 [1.211E-012, 8.308E-012], p = .017$). For every \$1 billion increase in a large foundation's asset size, payout rate increased by 0.004%. Conversely, for every \$1 billion increase in a small foundation's asset size, payout rate decreased by 1.216% ($b = -1.216E-009$, with 998 samples generating 95% bias corrected and accelerated confidence intervals of $-1.735E-009, -8.189E-010$). This finding suggests that already-large foundations with holdings of over \$500 million can afford a modicum increase in payout without risking perpetuity. On the other hand, small foundations of \$214,000 to \$50 million seemed to conserve spending as they grew larger in order to afford long-term or perpetual existence.

This finding may seem to conflict with Renz's (2012) conclusion that small foundations distributed at a higher rate than any other size foundation—11% median payout ratio versus around 5% for all other size foundations—but a direct comparison cannot be made. Whereas this study referred to small foundations as those with asset sizes under \$50 million, Renz (2012) defined small as having between \$10 million and \$50 million, which was more selective. Hence, the findings of this research cannot be compared with that of Renz, except that both Renz's and my efforts revealed that foundation size, under certain conditions, predicted payout rates.

In addition, using the same models of foundations' size, large and small foundations' sector focus was also a predictor of payout. Large foundations with a specific focus on the arts distributed 0.005% less than large foundations outside of the arts ($b = -.005$ [-0.009, -0.002], $p = .021$). Similarly, small foundations with a dedicated arts focus distributed 0.02% less than small, non-arts foundations ($b = -.024$ [-0.036, -0.014, $p = .001$], with the p -value and lower confidence interval based on 998 samples and the upper confidence interval based on 998 jackknife samples computed by the percentile, versus BCa, method). In short, large and small arts-focused foundations were less generous in giving away a portion of their wealth charitably. (This finding complements the other finding that as arts-focused foundations age, they also tend to decrease spending over time.)

When analyzed by the presence ($F(4, 364) = 5.829, p = .000, R^2 = .06, R^2_{adjusted} = .05$) or lack of presence ($F(3, 239) = 2.685, p = .047, R^2 = .033, R^2_{adjusted} = .02$) of paid staffing, both models were significant predictors of payout rate. Among staffed foundations, their sector focus ($b = -0.007$ [-0.011, -0.005], $p = .001$) was significantly associated with payout rate. Age was already shown to influence payout rate among professionally staffed foundations, $b = -0.000232$ [-0.000365, -0.000116], $p = .001$, with staffed foundations decreasing spending as a portion of assets as they aged. Hence, in sum, professionally staffed arts foundations' payout rate was 0.007% less than that of staffed non-arts funders, and staffed foundations' payout decreases at a rate of 0.0002% for every year of operation. Among foundations without any staffing expenses, only size was a predictor of payout rate ($b = -5.201E-011$ [-8.223E-011, -2.584E-011], $p = .002$):

As volunteer-based funders' total assets increased by \$1 billion, their payout ratio decreased by 0.052%.

When analyzed by differences in sector focus, only arts-focused foundations' professionalization was a significant predictor of payout rate ($b = -1.302$ [-2.557, -0.223], $p = .05$). As arts foundations spent 1% more of their assets on staffing, they expended 1.3% less of their noncharitable-use assets on charitable giving. In other words, arts funders' direct provision of charitable programmatic and operational activities competed against their charitable spending. This model, in which size, age, and staffing were entered simultaneously and filtered by sector focus, was significant, $F(3, 80) = 4.701$, $p = .004$, $R^2 = .15$, $R^2_{adjusted} = .118$.

Subgroup analysis by the dependent variable of payout rate revealed that aggressive spenders who distributed at or more than 7%, ($F(4, 97) = 4.533$, $p = .002$, $R^2 = .157$, $R^2_{adjusted} = .123$), and average spenders who paid out at 4–6.9%, ($F(4, 436) = 4.117$, $p = .003$, $R^2 = .036$, $R^2_{adjusted} = .028$) had characteristics associated with payout rate. Those relationships that were found to be significant are shown in Table 11, which displays unstandardized coefficients (b), standard errors, significance levels, and 95% bias corrected and accelerated confidence intervals (reported in parentheses) based on 1,000 bootstrapped samples unless otherwise noted. Foundations that distributed less than 4% did not have any characteristics that were significantly associated with payout rate.

Table 11

Linear Models of Significant Predictors of Payout Rate Segmented by Types of Charitable Spenders

Segmented type	Variables	<i>b</i>	SE B	β	<i>p</i>
Aggressive $\geq 7\%$ payout rate ($R^2 = .157, p = .002$)	Winsorized staffing	-4.333 (-9.471 ^a , -0.182 ^a)	2.389*	-.217	.064
	Sector focus	-0.051 (-0.060 ^{a,b} , -0.042 ^a)	0.004 ^a	-.210	.001 ^a
Average 4–6.9% payout rate ($R^2 = .036, p = .003$)	Winsorized size	1.484E-012 (7.001E-013, 2.253E-012)	4.998E- 013	.144	.001
	Age	-0.000046 (-0.000073, -0.000015)	0.000014	-.157	.002
	Winsorized staffing	-0.292 (-0.568, -0.035)	0.141	-.095	.037

^a Based on 955 samples

^b Confidence interval computed by percentile method rather than BCa method

Among foundations that were charitably spending aggressively at rates at or above 7% of noncharitable-use asset values, sector focus made a difference: Arts-focused, aggressive spenders conserved more of their wealth. Foundations with average payout rates increased their payout rate when their asset sizes grew: For every \$1 billion in corpus gain, there was a 0.0015% increase in payout rate. On the other hand, as these average-expendng foundations' aged and became more professionalized, their payout rate decreased: For every year in operation, payout rate was reduced by 0.00005%, and for every percentage increase in staffing expenses, payout rate decreased by 0.29%.

In conclusion, my hypothesis that foundations' firm-level traits influence payout rate was only partly confirmed. Whole group regression models showed that payout rate can be predicted only by sector focus. Size and staffing were not significantly associated with payout rate, and age had conflicting results. Subgroup analyses provided more

detailed explanations of the kinds of foundation characteristics that influenced payout rate. In particular, the largest and smallest, oldest, volunteer-run and professionally staffed, aggressive and average spenders, and arts-focused foundations had firm-level characteristics that were significantly associated with payout rate.

Testing Hypothesis 2: Total Effect Pathway

With SPSS, I conducted linear multiple regression analysis with 1,000 bootstrapped samples that generated 95% bias-corrected and accelerated confidence intervals. Using this statistical method, I explored the research question: By what pathway do foundations' firm-level traits and charitable spending behavior affect grantee organizations' MULNA? I began exploring the answer to this question by testing the hypothesis that foundations' traits and payout behavior directly affect MULNA. This is the unmediated model (C), referred to as the "total effect" (Kenny, 2014, para. 1), which does not control for the mediator and reflects a simple relationship between independent and dependent variables (Field, 2013).

Using the enter method, there was no significant relationship between any influencer variable—winsorized size, age, winsorized staffing, sector focus, or winsorized payout rate—and the outcome variable of winsorized MULNA, $F(5, 606) = 0.491, p = .783, R^2 = .004, R^2_{adjusted} = -.004$. Statistical results are shown in Table 12, which displays unstandardized coefficients (b), standard errors, significance levels, and 95% bias corrected and accelerated confidence intervals (reported in parentheses) of 1,000 bootstrapped samples. Moreover, the model was a poor predictor ($R^2 = .004, p = .783$). Despite the lack of association between foundation traits and behavior and

grantees' MULNA, mediation may still exist through the pathway of payout rate (Field, 2013; Hayes, 2013), which was tested by the third hypothesis.

Table 12

Linear Model of Predictors of Grantee Organizations' Financial Health

Variable	<i>b</i>	SE B	β	<i>p</i>
Constant	16.864 (10.849, 22.364)	2.943		.001
Winsorized foundation size	0.000 (0.000, 0.000)	0.000	.046	.335
Foundation age	-0.057 (-0.179, 0.068)	0.062	-.043	.360
Winsorized foundation staffing ratio	294.058 (-785.327, 1422.907)	593.640	.022	.613
Foundation sector focus	1.833 (-5.439, 9.373)	3.809	.023	.661
Winsorized foundation payout ratio	13.156 (-45.485, 77.074)	33.537	.016	.688

$R^2 = .004$ ($p = .783$)

Subgroup analyses. Although no relationship was detected between whole group foundation variables and grantees' MULNA, I conducted further analyses of segmented variables using bootstrapped linear regressions in SPSS to identify the types of foundations that may determine differences in MULNA. Bootstrapped linear regressions of 1,000 samples with replacement generated 95% bias corrected and accelerated confidence intervals. Analyses segmented by age, staffing ratio, and payout rate continued to yield no significant results, but subgroup analysis by size yielded a significant relationship between foundations' payout rate and grantees' MULNA. Subgroup analyses by foundation size with foundation traits and behavior influencers

entered simultaneously revealed that the payout rate of large foundations ($n = 68$) had a small, but significant, influence on grantees' financial condition, $F(5, 198) = 2.421$, $p = .037$, $R^2 = .058$, $R^2_{adjusted} = .034$. A 1% increase in large funders' payout rate, which would be an unusually and considerably large jump in spending, would result in grantees having 246 more months (or nearly more 20 years) of reserves ($b = 246.048$ [27.682, 551.536]).

Further exploration of large foundations revealed that the relationship between their payout rate and MULNA was strengthened when further segmented by financially well-off grantees, $F(5, 39) = 3.402$, $p = .012$, $R^2 = .304$, $R^2_{adjusted} = .214$. Large foundations that increased their payout rate by 1% more annually would boost already financially strong grantees' reserves by over 48 years ($b = 584.767$ [228.507, 1946.422]). This model, with all other variables held constant, was a significant predictor of the outcome with large foundations' payout rate accounting for 30% of financially strong grantees' months of reserves.

Additional sets of models by subgroups yielded only two more noteworthy results, but in both cases, the regression coefficients were significant but the models were not. I share them here to suggest possible directions for further research. Subgroup analysis by sector focus (with predictors of size, age, staffing, and payout entered simultaneously) indicated that arts foundations' size may predict grantees' MULNA ($b = 1.036E-008$ [4.579E-010, 2.044E-008]), with the confidence interval not passing through zero. In other words, for every \$1 billion increase in an arts foundations' asset size, grantees' MULNA would increase by 10.36 months. However, the model was not

significant in predicting the outcome, $F(4, 79) = 1.379, p = .249, R^2 = .065, R^2_{adjusted} = .018$. Despite the lack of generalizability of this model, the significant regression coefficient should be considered alongside arts grantmakers' advocacy within the field to deliberately improve the financial reserves of public charities (Curtis, 2010; Nelson et al., 2009; Thomas et al., 2011). Moreover, researchers have discerned that arts grantmakers behave differently than their counterparts in other sectors by not reducing funding when a public charity successfully receives government support (Kim & Van Ryzin, 2014). Hence, this finding is shared to encourage further exploration of arts funders' impact on grantees' MULNA, particularly as the tenuous statistical connection reported herein may have some basis in the capitalization practices of arts and culture grantmakers.

Also, subgroup analysis by grantees' reserves indicated that staffed foundations may help grantees suffering from deficit MULNA balances ($b = 1393.399 [214.458, 2824.121]$). The model, with influencers size, age, staffing, sector, and payout held constant, showed that when foundations increased their staffing expenses by 1%—which would be a tremendous jump given that all foundations sampled in this study expended an average of 0.16% of total assets on professional services (see Tables 4 and 5)—the financial reserves of the most financially unstable charities would increase by over 100 years. Another way to understand this result is that grantees that are most at-risk of closing may be most helped by foundations with professional staffing. Such a finding makes intuitive sense given how much foundation program staff connect grantees to other funders; support capacity building; award grants that afford financial, operational, and development consultants; and provide technical assistance. But this result, too, only

suggests a direction for more exploration as this model was not a significant predictor of the outcome, $F(5, 48) = 1.919, p = .109, R^2 = .167, R^2_{adjusted} = .08$.

Testing Hypothesis 3: Indirect Effect Pathway

In exploring the research question about pathways of relationships between foundations and their grantees, I tested the third hypothesis that posited that payout rate mediates the relationship between foundations' firm-level traits and grantee organizations' MULNA. Payout rate is a federally mandated mechanism by which foundations must perform a public good, and conducting path analysis enables isolating and identifying any influence that payout rate may have on public charities.

I used PROCESS to conduct bias-corrected analysis of 1,000 bootstrapped samples with replacement. Bootstrapped unstandardized (*b*) regression coefficients and confidence intervals are reported. Due to the small sizes of the values, results are reported in the ten thousandths where appropriate. The indirect effect regression coefficient represents the change in MULNA when holding the firm-level trait constant but changing the payout rate by one unit (Pearl, 2001). The regression coefficient only reflects a genuine, indirect effect if its confidence interval does not include zero, in which case, I reported the k^2 value of the effect size.

For mediation to be present, the relationship between the influencer and outcome variables must go through another variable. This pathway is the indirect effect ($A \times B$). If any part of the mediation pathway (A or B) is significant, then this finding suggests the possibility of an indirect effect (Hayes, n.d., #25; Jose, 2013). In answering Research Question 1, only foundations' age and sector focus appeared to be associated with payout

rate, so I subjected these two influencer variables to mediation analyses, the results of which are reported here. I also tested models of the other two influencer variables—size and staffing ratio—for an indirect effect, but these were not found to be significant.

I ran two separate models of foundations' age and foundations' sector focus. Although the assumption of collinearity was met, these two influencer variables were significantly correlated; therefore, bootstrapped regressions were run for each influencer variable separately rather than simultaneously (Hayes, 2013, p. 195). I used the original values of age and sector focus, and the winsorized values of payout rate and MULNA.

As shown in Figure 2, the model of foundations' age did not detect the presence of mediation ($b = -0.002$, 95% BCa CI [-0.021, 0.012], and its indirect effect size ($k^2 = .001$, 95% BCa CI [.000, .004]) was small. Confidence intervals included zero, thereby indicating a nonsignificant result.

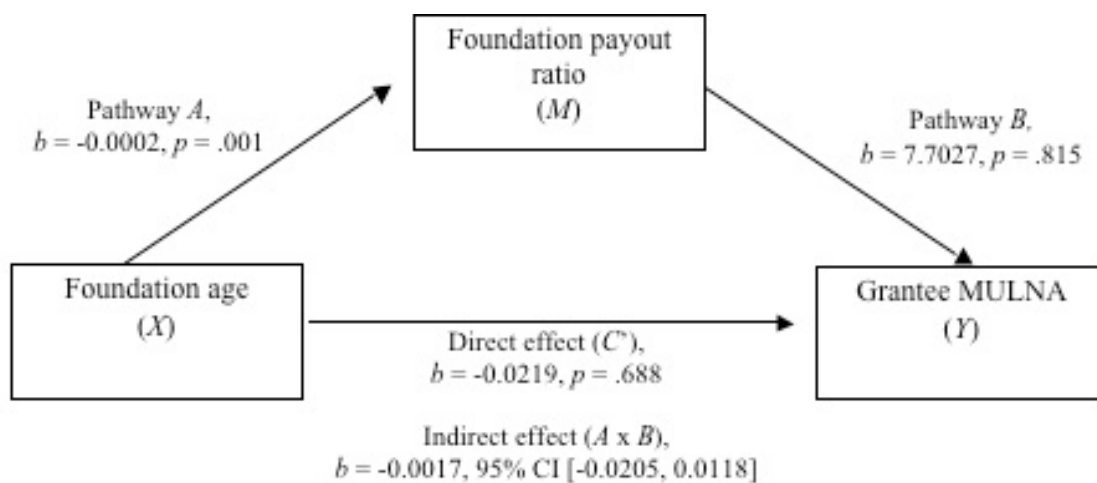


Figure 2. Model of foundations' age as a predictor of MULNA not mediated by payout.

Likewise, as shown in Figure 3, the model of foundations' sector focus did not detect the presence of mediation ($b = -0.150$, 95% BCa CI [-0.993, 0.660], and the

indirect effect size was small ($k^2 = .002$, 95% BCa CI [.000, .007]). Both confidence intervals included zero, indicating there was no significant result.

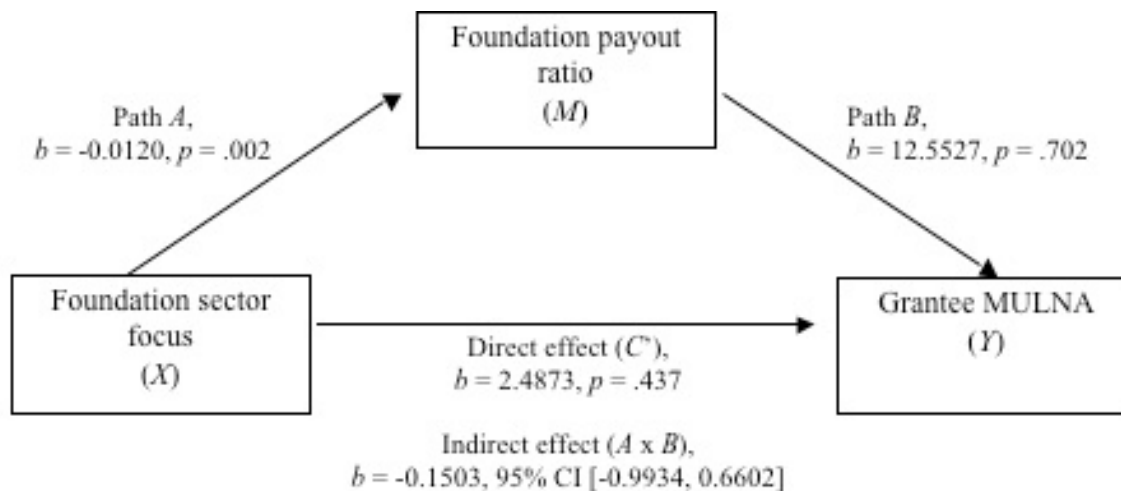


Figure 3. Model of foundations' sector focus as a predictor of MULNA not mediated by payout.

In both models of foundations' age and sector focus, statistical analyses displayed in the form of a path diagram (as shown in Figures 2 and 3) and table of statistical indices (see Tables 13 and 14) revealed that there was no significant indirect effect whereby payout rate acted as a mediator of age or sector focus in predicting grantees' MULNA. Regarding the predictive value of pathway *A* of both age and sector models, both were significant but revealed that age was but a small factor in determining payout rate ($F(1, 610) = 10.634, p = .001, R^2 = .017$), and that sector focus similarly exerted a minor influence in effecting payout rate ($F(1, 610) = 9.316, p = .002, R^2 = .015$). Pathway *B* of age and sector focus models was not generalizable to the population.

Table 13

Mediation Model Coefficients for Foundations' Age

		Outcomes						
		<i>M</i> (payout rate)			<i>Y</i> (MULNA)			
Influencer	Path	<i>b</i>	<i>SE</i>	<i>p</i>	Path	<i>b</i>	<i>SE</i>	<i>p</i>
Age	<i>A</i>	-0.0002	0.0001	.001	<i>C'</i>	-0.0219	0.0545	.6882
					<i>B</i>	7.7027	32.8342	.8146
		$R^2 = .017$ $F(1, 610) = 10.634, p = .001$			$R^2 = .0004$ $F(2, 609) = 0.123, p = .885$			

Table 14

Mediation Model Coefficients for Foundations' Sector

		Outcomes						
		<i>M</i> (payout rate)			<i>Y</i> (MULNA)			
Influencer	Path	<i>b</i>	<i>SE</i>	<i>p</i>	Path	<i>b</i>	<i>SE</i>	<i>p</i>
Sector	<i>A</i>	-0.0120	0.0039	.002	<i>C'</i>	2.4873	3.2011	.437
					<i>B</i>	12.5527	32.7874	.702
		$R^2 = .0150$ $F(1, 610) = 9.316, p = .002$			$R^2 = .0011$ $F(2, 609) = 0.344, p = .709$			

Subgroup mediation analyses. Results of subgroup analyses from testing the first two hypotheses suggested the possibility of an indirect effect among certain types of foundations and grantees—foundations that are large or small, the most mature, professionally staffed or volunteer-run, arts-focused, and aggressive or average charitable

expenders, as well as financially strong grantee organizations. Hence, additional sets of models were tested of categorical differences by size, maturity level, staffing status, sector focus, payout rate, and grantees' level of reserves (see Table 7). I used PROCESS to conduct bias-corrected analyses of 1,000 bootstrapped samples with replacement to detect the presence of mediation. Ultimately, only size and age subcategories influenced MULNA through the indirect path of payout rate. No other subgroup analyses yielded significant results.

Only among large foundations with assets over \$500 million did payout rate mediate the association between foundations' age and MULNA (see Figure 4). The confidence interval for the indirect effect was 95% BCa CI based on 1,000 bootstrapped samples of 204 cases. First, regarding pathway *A*, large foundations' age was negatively related to payout, $b = -0.0002$, $t(202) = -3.107$, $p = .002$, and this model was significant ($F(1, 202) = 9.65$, $p = .002$, $R^2 = .046$). Second, regarding pathway *B*, payout rate was positively related to grantees' MULNA, $b = 239.43$, $t(201) = 2.745$, $p = .007$, and this model, too, was significant ($F(2, 201) = 3.77$, $p = .025$, $R^2 = .036$). Finally, there was an indirect effect of large foundations' age on MULNA through payout rate ($b = -0.052$, 95% BCa CI [-0.148, -0.006]), which represents a relatively small, but significant, effect size ($k^2 = .041$, 95% BCa CI [.005, .112]). Regarding the direct effect pathway whereby large foundations' age affects MULNA when controlled for payout rate, results indicated that this *C*' pathway was not significant, $b = 0.045$, $t(202) = .512$, $p = .61$, although the model had predictive value ($F(2, 201) = 3.77$, $p = .025$, $R^2 = .036$). These findings

suggest that the payout rate of the largest foundations mediates the relationship between their age and grantee organizations' financial health.

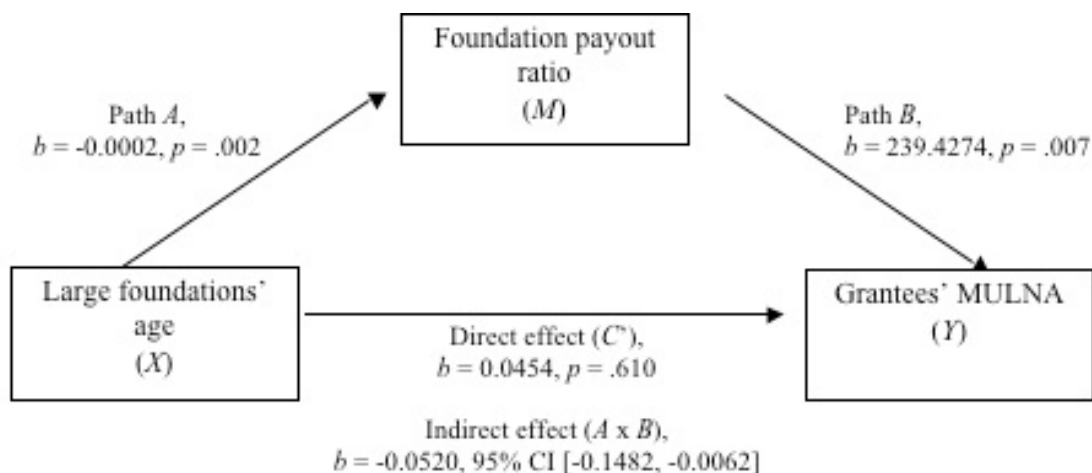


Figure 4. Model of large foundations' age as a predictor of MULNA significantly mediated by payout.

Besides a foundations' size, there was also a significant indirect effect when segmented by age. Among the oldest foundations that were established 50 or more years ago as of 2007, their sector focus was significantly associated with grantees' MULNA through the mediator of payout rate (see Figure 5). The confidence interval for the indirect effect was 95% BCa CI based on 1,000 bootstrapped samples of 111 cases. Pathway *A* was significant: The sector focus of the oldest foundations was negatively related to payout rate ($b = -0.016, t(109) = -2.203, p = .03$) indicating that mature, non-arts funders paid out at a greater rate than their counterparts funding the arts. The model of pathway *A* was significant ($F(1, 109) = 4.854, p = .03, R^2 = .043$). On the other hand, pathway *B* was not significant: Oldest foundations' payout rate was not significantly associated with grantees' MULNA ($b = -116.703, t(108) = -1.491, p = .139$), and the

model was not predictive ($F(2, 108) = 1.206, p = .304, R^2 = .023$). Although pathway B was not significant, individual pathways of the $A \times B$ route do not need to be significant in order for mediation to be present (Hayes, n.d., #25), which departs from the now-outdated mediation approach described by Baron and Kenny in 1986 (Field, 2013; Hayes, 2013). Such was the case here: The indirect effect was significant ($b = 1.889, 95\% \text{ BCa CI } [0.080, 4.640]$), with a small, but significant, effect size ($k^2 = .03, 95\% \text{ BCa CI } [.004, .075]$). The direct effect path (C') of foundations' sector focus on MULNA when controlling for payout rate was not significant, $b = 0.709, t(109) = .116, p = .908$, and the model was not a significant predictor as well ($F(2, 108) = 1.206, p = .304, R^2 = .023$). This combination of statistical results suggests that the relationship between sector focus and grantees' MULNA was mediated by payout rate among the longest established foundations.

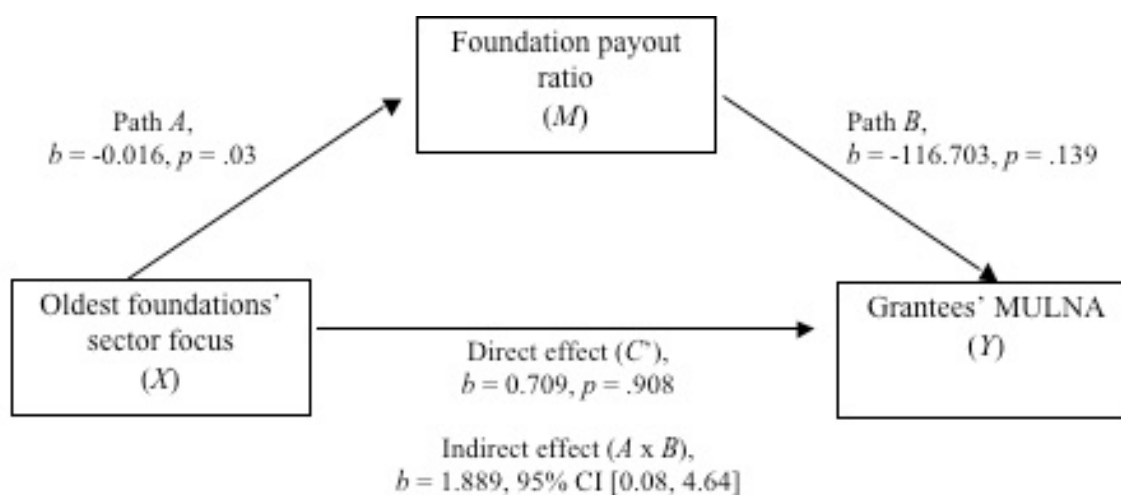


Figure 5. Model of the oldest foundations' sector focus as a predictor of MULNA significantly mediated by foundations' payout.

To summarize, the hypothesis that foundations' payout rate mediates the relationship between their firm-level characteristics and grantees' financial health was not supported by whole group variables. Instead, there was an indirect effect with small effect sizes in models segmented by asset size and age. Payout rate mediated the association between age and MULNA among the largest foundations ($b = -0.052$, 95% BCa CI [-0.148, -0.006]) and between sector focus and MULNA among the oldest foundations ($b = 1.889$, 95% BCa CI [0.080, 4.640]).

Conclusion

The first hypothesis that foundations' firm-level traits influence payout rate was only partially supported. Only the whole group variable of sector focus was found to play a small, but significant, role in contributing to payout rate. Foundations' firm-level traits were more influential in determining payout behavior when examined by subgroups of foundations' characteristics than by whole group variables. In summary, payout rate was influenced by (organized from largest to smallest effect sizes):

- oldest foundations' size (for every \$1 billion gain, payout decreases by 0.013%, $R^2 = .244$, $p = .000$),
- oldest foundations' staffing ratio (as they increase staffing, payout decreases by 5.6%, $R^2 = .244$, $p = .000$),
- aggressive-expending foundations' sector focus (these arts funders paid out at a 0.051% rate less than non-arts funders, $R^2 = .157$, $p = .002$),
- arts-focused foundations' age (as they age each year, payout decreases by 0.0001%, $R^2 = .15$, $p = .004$),

- arts-focused staffing ratio (as they increase staffing, payout decreases by 1.302%, $R^2 = .15, p = .004$),
- large foundations' asset size (for every \$1 billion gain, payout increases by 0.004%, $R^2 = .065, p = .009$),
- large foundations' age (as they age, payout decreases by 0.00022%, $R^2 = .065, p = .009$),
- large foundations' sector focus (large arts funders paid out at a 0.005% rate less than non-arts funders, $R^2 = .065, p = .009$),
- professionally staffed foundations' age (as they age each year, payout decreases by 0.00023%, $R^2 = .06, p = .000$),
- professionally staffed foundations' sector focus (staffed arts funders paid out at a 0.007% rate less than non-arts funders, $R^2 = .06, p = .000$),
- small foundations' asset size (for every \$1 billion gain, payout decreases by 1.216%, $R^2 = .047, p = .047$),
- small foundations' sector focus (small arts funders paid out at a 0.024% rate less than non-arts funders, $R^2 = .047, p = .047$),
- average-expending foundations' asset size (for every \$1 billion gain, payout increases by 0.0015%, $R^2 = .036, p = .003$),
- average-expending foundations' age (as they age each year, payout decreases by 0.000046%, $R^2 = .036, p = .003$), and
- average-expending foundations' staffing ratio (as they increase staffing, payout decreases by 0.29%, $R^2 = .036, p = .003$),

- nonprofessionally staffed foundations' asset size (for every \$1 billion gain, payout decreases by 0.052%, $R^2 = .033$, $p = .047$).

These findings indicate that payout rate can be better understood when examining specific types of foundations.

Regarding the second hypothesis regarding the simple relationship between foundations' characteristics or behavior and grantees' MULNA, the null hypothesis was supported when examined by whole group variables: No foundation variable—size, age, staffing level, sector focus, or payout rate—directly affected grantee organizations' MULNA. However, there was a significant relationship between payout rate and MULNA when segmented by large foundations, particularly among large foundations that supported already financially strong grantees. Hence, a total effect path relationship existed only among the largest foundations.

Finally, the findings from testing the third hypothesis indicate that an indirect effect pathway existed only among certain types of foundations. First, foundations' age related to grantees' MULNA through payout rate only among the largest foundations. Second, foundations' sector focus related to grantees' MULNA through payout rate only among the oldest foundations. The final chapter will discuss the implications of these findings for researchers and nonprofit practitioners, as well as suggest areas for further exploration.

Chapter 5: Discussion, Recommendations, Conclusion

In the absence of empirical evidence of the effect that private, nonoperating foundations' payout rate has on grantees' financial capacity, I conducted exploratory regressions of whole and segmented variables to understand the pathways of relationships amongst foundations' firm-level traits, charitable behavior, and grantee organizations' financial condition. Foundations' firm-level traits were examined for how they contribute to differences in payout rates. In addition, foundations' asset size, age, staffing ratio, sector focus, and payout-to-net asset ratio were examined to understand how these variables influence the amount of grantees' MULNA via total effect and indirect effect pathways. Statistical analyses using the indirect effect approach enabled me to isolate the mediating role of payout in contributing to public charities' financial capacity.

This investigation yielded several findings. Foundations' sector focus and the traits of certain types of foundations (i.e., oldest, largest, smallest, volunteer-based and professionally staffed, aggressive and average charitable spenders, and arts-focused foundations) affected funders' payout rate. In addition, only among large foundations was there a total effect, with a larger effect size when large foundations support already financially strong grantees. Finally, payout rate acted as a mediator between foundations' age and MULNA among the largest foundations, and between sector and MULNA among the oldest foundations.

Interpretation of the Findings

Pathway *A*

Regarding pathway *A* analysis, only foundations' sector focus played a small part ($R^2 = .031, p = .001$) in influencing payout rate, with arts-focused foundations expending slightly less charitably as a ratio of investment assets (.008%) than other types of foundations. However, when segmented by differences in foundation characteristics, there were numerous associations between foundations' subgroup types and payout rate, with oldest foundations' size and staffing accounting for as much as 24% of their payout rate. Firm-level traits among certain types of foundations (i.e., oldest, largest, smallest, volunteer-run, professionally staffed, aggressive spenders, average spenders, and arts-focused foundations) were determinants of payout rate.

The finding that certain foundation traits influenced charitable spending behavior is consistent with earlier research. Renz (2012) discerned that endowment size was the best predictor of payout ratios. Boris et al. (2008) identified foundation firm-level traits that were drivers of charitable administrative expenses, which count toward payout calculations. Boris et al. (2008) examined a broader range of foundations' characteristics and expenses, such as staff size, geographic focus, operating activities, programs for individual giving, maintaining a website, and program-related investment activities, and identified paid staffing as the most important factor influencing independent foundations' charitable administrative expenses, with asset size having a small effect on how foundations allocate charitable administrative expenses (pp. 18 & 24). My research

complements their findings in identifying asset size and staffing status as characteristics that make a difference in charitable spending as a proportion of noncharitable-use assets.

Total Effect

After an extensive scan of extant literature on foundations' effects, little research surfaced on the simple relationship between foundations' charitable spending and their grantees' capacity to afford mission-related work. To address that deficit, I conducted exploratory regression analyses of both whole and segmented data to better understand the connection between foundations' traits and charitable behavior and grantees' MULNA. I found that there was no direct relationship between any whole group foundation variables and MULNA, but there was a significant association between payout rate and MULNA among the sector's largest foundations. This finding was particularly true for large foundations that support already financially strong public charities, with the model accounting for 30% of the differences in these grantees' financial capacity.

Without the benefit of an already existing theory about the unique impact that large foundations have on public charities, this result cannot be interpreted without an applicable framework and more knowledge. To that end, finding a significant relationship between large funders and grantees is grounds for more investigation about the unique impact that the nation's largest private foundations have on grantees' financial capacity. For example, perhaps this relationship can be explained by potential differences in the size of large funders' grant amounts compared to mid-size and small foundations. There is also the possibility that large foundations exert an influence on MULNA due to

nonfinancial reasons, such as their influence as an imprimatur helping grantees secure more income.

Also, the sizable impact of large foundations' payout on already financially strong grantees merits further attention. Lines of inquiry include whether or not large foundations reward already financially well-off public charities, if financially strong charities share unique qualities that resulted in this level of large foundations' support, or the possibility that these well-off public charities may be operational entities of foundation-initiated efforts. This finding may have some bearing on a body of research that has discerned that revenue concentration (versus revenue diversification) improves the financial health of nonprofits (Chikoto & Neely, 2014; Foster & Fine, 2007). Foster and Fine (2007) demonstrated that nearly all (90%) of the large-asset nonprofits in their study with over \$50 million in annual revenues attained financial growth by relying on a single source of income rather than by diversifying funding sources. As such, my findings could point to deeper possibilities in illuminating the nature of relationships amongst large private foundations, financially strong nonprofits, and revenue concentration.

Indirect Effect

Tests for an indirect effect among whole variables did not yield significant results. However, exploratory analyses of subgroups identified an indirect effect, albeit with small effect sizes, in models segmented by asset size and age. Payout rate mediated the association between age and MULNA among the largest foundations ($b = -0.052$, 95%

BCa CI [-0.148, -0.006]), and between sector focus and MULNA among the oldest foundations ($b = 1.889$, 95% BCa CI [0.080, 4.640]).

These findings indicate that the hypothesized relationship, that a foundations' payout rate is an effective vehicle in supporting public charities, does not hold for whole-group foundation characteristics of asset size, age, staffing status, and sector focus. To account for payout rate's lack of a mediating role among whole-group variables, I return to a commonly used refrain in the foundation field: "If you've seen one foundation, you've seen one foundation." The sheer diversity of foundations not only has thwarted the development of conceptual frameworks explaining their role, behavior, and impact, but also the ability to identify patterns of whole-group behavior that can be captured statistically. "Even among foundations of the same type, differences in assets, giving levels, work styles, geographic reach, and program type vary dramatically and produce very different . . . patterns" (Boris et al., 2008, p. xii). My findings affirm that patterns of significant associations are better revealed when studying certain types of foundations. To that end, this research makes a contribution by revealing the specific types of foundations' characteristics to explore.

Findings of segmented mediation analyses revealed that payout rate affected grantees' financial capacity, but only among the largest and oldest foundations. These results suggest that payout rate is limited to being a measure of the largest and oldest foundations' performance in fulfilling government's expectations for their public good. Given that the largest 1,000 foundations give away roughly half of all grant funds (Foundation Center, 2014), the applicability of this finding is no small matter. This

research underscores the importance of the largest and most established foundations' charitable spending on their grantees, and by extension, on the financial capacity of the nonprofit sector.

Limitations of the Study

Although the reliability of 990-PFs has not been tested scientifically, these documents seemed to be a generally reliable source of information about the state of private foundations' finances and operations. Anecdotally, having completed a manual review of all sampled foundations' 990-PFs, and drawing from personal experience in which I reviewed professionally many 990-PFs, it was clear that 990-PFs had the advantage of being completed with expert tax preparation. However, until 990-PFs are tested for reliability, the trustworthiness of these data has not been proven to accurately depict foundations. Moreover, the least reliable data point may be foundations' sector as it was surely an undercount of the number of foundations that are dedicated to arts and culture funding.

Additionally, I was concerned that small public charities, which were not legally required to file a tax return due having gross receipts under \$25,000, would be overlooked in this study. In actuality, small public charities were not present in this study because they were not among the grantees that received foundations' three largest grant amounts. Hence, the study had sampling validity in examining the relationship between foundations and their top-three grantees, but the findings of this research does not reflect the financial state of public charities generally.

Another limitation of this study is that I used only one measure of grantee organizations' financial health capturing data from only one moment in time. I made the case for why I chose MULNA, as it has been most popularly used in the nonprofit industry having been promoted by NFF and adopted by funders in their grant decision making (Nelson et al., 2009; Nelson & Koo, 2014; NORI, 2010; Ryan, 2001); however, Prentice (2013) demonstrated that accounting ratios may not be good measures of theoretical constructs of financial conditions used in research studies. In theory, I agree with his conclusion, which is why I used an indicator of financial capacity that is widely used among practitioners in the field. Hopefully, this research will encourage further exploration using more and different types of dependent variables to reflect grantees' capacity to pursue mission, including using time-series data to more accurately capture the financial condition of grantees over time (as suggested by Kingma, 1993, p.112).

Another concern is the threat to validity due to segmented analyses. One potential concern is that significance was more often found in subgroup analyses with reduced sample sizes than in whole-variable analyses. For example, the significant relationship between large foundations' payout and MULNA was based on a bootstrap of 68 foundations, and the relationship found between the oldest foundations' size and staffing with MULNA was based on a bootstrapped sample size of 111 foundations. However, because I used the robust method of bootstrapping, I did not incur a Type II error. On the other hand, by testing the sample multiple times, the possibility of having incurred a familywise error rate, which is a Type I error, was raised (Vesey et al., 2011, p. 17). The familywise error rate may become inflated each time a test is run on a set of data (Vesey

et al., 2011). A more conservative approach to avoiding Type I error would be to replicate this study and apply the Bonferroni correction to avoid the problem of repeated testing effects (Mundfrom, Perrett, Schaffer, Piccone, & Roozeboom, 2006; Vesey et al., 2011).

Another limitation of the interpretability of my findings was the small effect sizes. I anticipated that if foundations' payout rate had any effect on MULNA, the effect would be small. Too many other factors should determine differences in sizes of MULNA, such as public charities' management skills and their support by other sources of, particularly government, funding. Consequently, any significant total or indirect effect was interesting in establishing preliminary knowledge of the kinds of foundations and giving behavior that may affect grantees' financial condition. On the other hand, some of the effect sizes were small enough to question the impact that changing foundations' behavior may have on a grantee organization. Ideally, the next step of these findings would be to identify other complementary foundation factors that contribute more greatly to mediating (or moderating) the impact on grantees' financial reserves.

Implications and Recommendations

As this research was exploratory in nature, it would be premature to draw any conclusions without further studies to replicate these findings in more robust ways. Yet there are three contributions that this research makes to extant knowledge and the still nascent state of scientific study on private foundations: (1) The findings provide new information on how foundations' mandated charitable spending behavior relates to grantees' financial capacity, (2) the conceptual model demonstrates the viability and

value of measuring the effects on beneficiaries of regulated foundation activities, and (3) my adaptation of principal-agent theory introduces a novel approach to holding foundations' behaviors accountable to the public good.

Nuancing the Payout Debate

Up to this point, opposing sides of the still-contentious payout debate have advocated for changes to foundations' charitable distributions generally; however, my findings demonstrate the value of parsing different types of foundations and their payout rates in a more nuanced way. The results of this research show that certain types of foundations and their payout make more of a difference on grantees than other types of funders. This kind of information can help policymakers consider potential changes in payout regulations based on types of underperforming foundations rather than make sweeping changes as occurred with the tax reform acts in 1969 and 1981.

Along these lines, the findings suggest specific directions for further study, namely the relationship between charitable spending and MULNA among the sector's largest and oldest foundations. The results of total and indirect effect analyses indicated that the payout of these foundations makes a difference to grantees and has a particularly sizable effect on financially strong public charities. Such knowledge has practical implications in informing these foundations' decision making about the types of public charities to support and how much to provide. This knowledge also has implications for researchers interested in identifying the unique characteristics that financially successful public charities share that seem to attract (or are caused by) large foundations' investments.

Research Value of Variables of Regulated Activities

This research demonstrates that, despite the individuality of foundations, the variable payout rate was conducive to research. One of the more commonly cited reasons why foundations have not received academic scrutiny is that the sheer diversity of foundations hinders understanding them as a field (Anheier & Hammack, 2010; Harris et al., 2006; Orosz et al., 2003; Prewitt, 2006). Yet the payout variable is among a handful of quantitative variables universally applicable to all nonoperating foundations uniformly reported on publicly accessible tax returns. Other researchers have recognized the value of such variables by examining foundations' distributions, excise tax responses, amount of undistributed income, and set-aside amounts (Sansing & Yetman, 2006; Yoder et al., 2011; Yoder & McAllister, 2012). This study extends their research, which focused on industry-wide foundation responses to regulations, by examining the external impacts of regulated foundation behavior on beneficiaries. By using universally applicable variables governed by federal regulations, there are many more possibilities for understanding the relationships amongst foundations' characteristics, behaviors, and effects using the conceptual model introduced in this study.

Accountability Framework of Foundations' Activities

Principal-agent theory is an accountability framework for testing an agent's responsiveness to a principal's goals (Gailmard, 2014, abstract). This theory offers a flexible framework for modeling countless relationship variations (Gailmard, 2014). As such, applying this theoretical framework to foundations enabled holding foundations' activities accountable to grantees' financial capacity to pursue their charitable missions.

The implication is that philanthropic accountability can become a more robust line of research inquiry, which benefits the public who subsidize foundations' tax-exempt status. For example, this research complements efforts to develop private foundation-specific corporate governance accountability theories that are in service to foundations' social purpose (Coule, 2015). The opportunities for testing foundations' social impacts using this theoretical lens is exciting and limited only by the challenge of finding suitable indicators of social change.

Conclusion

I was motivated to undertake this research by several ambitions. I have been interested in exploring a social problem that questions how and if foundations contribute to the public good in measurable ways. In addition, I wanted to understand the effectiveness of mandated charitable spending on grantee organizations' financial capacity. And, ultimately, I wanted to contribute in ways that would catalyze more research on private foundations.

To those ends, this research contributes in several ways. My findings generated new and practical knowledge that the payout rates of the sector's large and oldest foundations have a mediating role in helping grantees afford their charitable endeavors. Consequently, this new information should shift the prevailing discourse from a fixation on a formulaic payout rate to a more strategic consideration of the kinds of measurable impacts that certain types of foundations have on grantees. In addition, I introduced an accountability framework for understanding and assessing foundations' performance in serving the public good, and a conceptual model for isolating the impact of their payout

on beneficiaries. The development of these theoretical and conceptual models should encourage more accountability-based research on private foundations, the proliferation of which has the power to shift foundations' actions to effect greater positive social change over time. As with any exploratory endeavor, this effort should be improved by the contributions of others, which I hope will be the case. There is much more work to be done to understand foundations' social, political, and economic impacts.

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