SOME ASPECTS OF INVESTMENT MANAGEMENT FOR ENDOwed
COLLEGES AND UNIVERSITIES

A THESIS
SUBMITTED TO THE FACULTY OF THE SCHOOL OF BUSINESS
ADMINISTRATION, ATLANTA UNIVERSITY IN PARTIAL
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OF MASTER OF BUSINESS ADMINISTRATION

BY
AUGUSTUS L. CLAY, JR.

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A.L.C. Jr.
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CHAPTER I
INTRODUCTION

Educational institutions of higher learning have grown tremendously in the past sixty years. We have moved from an era of mostly small colleges to an era of large complex colleges and universities. We have moved from the time when the operation of a college could be carried on by one man to a time when each phase of college and university administration needs the service of a specialist in that particular field of administration. Before 1900 the president of the college was burdened with most of the important administration of the college. He was the chief financial officer, the chief academic officer, the superintendent of grounds and buildings and had the responsibility for all other functions of the college. This arrangement was adequate for many years, but with the increase in the school population, the growth of our nation, and the complexity which normally follows growth, this arrangement was no longer sufficient.

As the institutions increased in size, new offices were established to cope with the ever expanding operations of the college and university. The office of the chief business officer did not come into being until after 1900. With this new office of chief business officer, first being found in colleges in 1906, came a new definition of the financial make-up of educational institutions. Many of the functions that had previously been handled by the president, concerning financial administration, was made the responsibility of this new college officer.
TABLE 1

DATE AND ORDER OF ESTABLISHMENT OF PRINCIPAL ADMINISTRATIVE OFFICES IN THIRTY-TWO INSTITUTIONS OF HIGHER EDUCATION, 1860-1933*

<table>
<thead>
<tr>
<th>Order of Establishment</th>
<th>Office</th>
<th>Median Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>President</td>
<td>1860</td>
</tr>
<tr>
<td>2</td>
<td>Librarian</td>
<td>1860</td>
</tr>
<tr>
<td>3</td>
<td>Secretary of Faculty</td>
<td>1867</td>
</tr>
<tr>
<td>4</td>
<td>Registrar</td>
<td>1887</td>
</tr>
<tr>
<td>5</td>
<td>Vice-President</td>
<td>1889</td>
</tr>
<tr>
<td>6</td>
<td>Dean</td>
<td>1891</td>
</tr>
<tr>
<td>7</td>
<td>Dean of Women</td>
<td>1896</td>
</tr>
<tr>
<td>8</td>
<td>Chief Business Officer</td>
<td>1906</td>
</tr>
<tr>
<td>9</td>
<td>Alumni Secretary</td>
<td>1908</td>
</tr>
<tr>
<td>10</td>
<td>Assistant Dean</td>
<td>1915</td>
</tr>
<tr>
<td>11</td>
<td>Dean of Men</td>
<td>1920</td>
</tr>
</tbody>
</table>


There are other very important areas of administration that must be maintained by the college. The college must maintain administration in three major areas, namely; education administration, public relations and business administration. This thesis is generally in the area of the business administration of colleges and universities. The National Committee on the Preparation of a Manual on College and University Business Administration states that the area of business administration may be subdivided
into at least eight well-defined areas:

- Accounting, auditing, reporting and budgetary control
- Receipt, custody and disbursement of moneys
- Investment of funds
- Procurement
- Management of auxiliary and service enterprises
- Operation and maintenance of the institutional plant
- Selection and promotion of non-academic personnel
- Administration of staff benefit programs.

Here, we are specifically interested in the area pertaining to maintenance of funds which make up the college endowment.

The first three areas as defined by the National Committee will be of major consideration as they pertain to the endowment fund. The endowment fund must be accounted for, moneys of the fund must be received, disbursed, and maintained and the income on the fund must be invested.

The specific aspects which will be investigated concerning the endowment management are: suggested organization within the institution and external organizations which serve in this capacity, a statement of the major objectives and goals of endowment management, principles of investment found in the field of college endowment fund investment and management and accounting principles which are peculiar to endowment funds.

It is the aim of this study to present a guide and reference source on endowment fund management for the use of persons delegated with the responsibility of maintaining endowments for colleges and universities. It is hoped that this study will be helpful to the experienced business officers as well as the inexperienced business officers who are responsible for the endowments.

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There are many ideas concerning the nature of the endowment fund maintained by persons acting in capacities where they have the responsibility for control of endowments. Some think that the fund is open for any use for the betterment of the institution. Mostly, they believe that the endowment can be used for new buildings or better educational facilities. This is not generally true. We can see this from some definitions of endowment by persons who have contributed much in the field of college and university financial administration.

Trevor Arnett has given the standard definition of endowment: "College endowment is a fund, the principal of which is invested and kept inviolate and only the income used for the general support of the college, or for some specific object in connection with it."¹ Arnett is, unquestionably, recognized as having made outstanding contributions in the field of financial administration of colleges and universities. The National Committee carried the above definition further when they stated that, "endowment funds are funds, the principal of which must be maintained inviolate to conform with the restrictions placed thereon by the donor or other outside agency. Generally only the income may be used, but it is recognized that the donor or other outside agency may, by the terms of the instrument of gift, provide for the release from the inviolability of the endowment funds by permitting all or part to be expended at some future date."²

From the above definitions of endowment, there seem to be three essentials worthy of emphasis, namely; (1) the inviolability of the principal, (2) the production of income, and (3) the application of the income to the support of the college or some closely allied object. The National Committee went a step further to bring out the fact that under some conditions the donor or some outside agency may provide for some of the fund to be released from its state of fixation.

The endowment fund has been used mostly by the privately operated college or university, however, changes have been occurring and more publicly operated institutions are acquiring larger endowment funds. Public colleges and universities still receive the larger part of their income dollar from sources other than the endowment fund. Their largest source of income is from appropriations of public funds but if the present trend continues, and it is expected that it will, the need for more consideration of managing the endowments of public institutions will exist.

The privately operated college or university receives a larger portion of its income dollar from the endowment, therefore it is more important to the continuous growth of these institutions. These institutions have endowments of many millions of dollars and the proper use of these funds will determine whether the institution will survive or whether they will be caught in a downward trail resulting from improper use of the important income producer; the endowment fund.

There have been many publications in the field of college and university financial administration which have dealt with every phase of the operation but none have dealt specifically with the endowment and there is a need for some work in this phase of the business officers functions.
Many of the business officers come to their jobs with no previous college administration experience and it is necessary for them to either, call on past business experience, or to become familiar with the peculiarities of college business administration. The need for work in the area of college business administration has been evidenced by the many committees which have been set-up in the past thirty years, for the purpose of making studies and doing research in the general area.

There have been several regional associations of college and university business officers and a national federation of college and university business officers established for the purpose of bringing persons in the field together and for the promotion of a more general understanding of the field. Each regional association has representatives to the national federation who attend the conferences and meetings in an effort to establish uniform principles in the field of college and university business administration. It is usually found, at these meetings and conferences, that a discussion concerning the endowment and its management has been included on the agenda.

Aside from the various committees which have been established to probe into this area of college administration and the books which have been written, there has appeared in the past few years a monthly magazine which deals primarily with college and university business administration and the problems of this phase of administration. In this magazine there is usually some space devoted to the endowment fund and the management of the endowment fund.

With all of this attention being focused on the endowment, it seems as though it is safe to assume that there is still much to be desired in
relation to the general improvement of material available to the persons who are in the field.

It is the aim of the writer that this work will in some way offer some aid in the field of endowment fund management for colleges and universities. Since it has been a long desire of the writer to find out as much as possible about the workings of the fund, he feels that his efforts will not have been wasted if something good is accomplished that will be an aid in the field.
CHAPTER II

ORGANIZATION FOR ENDOWMENT MANAGEMENT

Most endowment funds are actually in the form of trusts. They are gifts from persons or organizations who have the interest of educational institutions at heart. These donors sometime select an outside institution to act as trustee for the fund, however here we are interested in those donors who leave the administration of these gifts to the college itself. In this situation, and this is the most common arrangement, the college must have an organization which is capable and trained in the use and maintenance of these gifts to conform with the wishes of the donor and also administer them to the best interest of the institution.

The controlling board of the institution, the board of trustees, has the responsibility of selecting the type of organization which will be responsible for the endowment of the college. The forms of organizations have been set forth by John Dale Russell as follows:

An analysis of the plans followed in large number of endowed colleges and universities indicates that six different agencies are found to be engaged in the task of managing endowment: (1) the entire board of trustees as a group; (2) a committee of the board, usually known as the endowment committee or the investment committee; (3) some officer of the college, usually the treasurer or business manager, but sometimes the president or other academic officer; (4) a commercial agency employed as corporate trustee; (5) an investment counsel, usually on a part-time basis; (6) some outside, usually superior agency such as is sometimes found in the case of a church-related college whose funds may be managed by an agency representing the entire denomination and not directly the college.¹

We will go into the types of organizations which are used within the college or university first, then we will look into the types of organizations which are hired by the board of trustees who are outside and

independent of the institutions, and compare the advantages and disadvantages of each.

The size of the endowment will be a great determining factor in deciding the type of organization which will be used in managing the fund. An institution with a very small endowment cannot afford the cost of an internal staff delegated to safeguarding and investing funds designated as endowment.

The National Committee in their second volume, stated; "an institution with a fund of less than five million dollars cannot afford the employment of a full-time investment officer, while one with a fund of over ten million can." They based this on the theory that not more than 10 percent of income should be expended for the management of funds in excess of one million dollars. Therefore they reason that a fund of five million dollars or less should be managed by some outside professional agency such as a trust company or an investment counsel. We will explore these types of agencies later in this chapter.

For an institution with an endowment of ten million dollars or more, there are several possibilities for internal endowment management organizations. In many institutions the services of a board member are utilized. Usually this member of the board is a banker, an investment banker or corporation executive who has had wide experience in matters concerning investments and the investment market. This is sometimes very beneficial to the school because these services are used and good results are maintained with a minimum of cost to the institution. This board member usually serves on

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the board in the capacity of treasurer of the institution. He gives freely of his time and efforts to the perpetuation of the fund and the realization of the best possible income rate on the investments. Usually he makes periodic reports to the other members of the board of trustees of the institution.

Although there is little or no cost incurred against the college or university for these services, there are disadvantages in an organization of this type for the management of the investment portfolio. The endowment fund is totally dependent on the wisdom of one man and in any situation this cannot be condoned as acceptable plan of organization for such an important task. Secondly, the possibility exists that the other members of the board will not readily question the wisdom of a fellow member of the board, even if they are not in total agreement with the manner in which he is handling the investment of endowment funds and income. Third, there is the possibility of the fund developing a lack of proper balance while under the domination of a single board member.

Another plan of organization for the management of endowment funds which is used very successfully in many institutions is the financial or investment committee. This committee is usually made up of several members of the board of trustees and they are responsible to the entire board for the management and reporting on the condition of the investments of the institution. This plan is far superior to the plan using only the one member of the board.

The financial committee brings into play the thinking of more than one person on the conditions prevalent in the market at any given time, therefore gives a broader scope to the possibility of sound investment
practices. Along with the committee, there is usually the availability of bookkeeping assistance from the business manager or other employee of the institution.

One definite drawback of an institution depending on this form of organization for endowment management is the difficulty of drawing several members to its board with such outstanding talent along investment lines who have the necessary leisure time to devote to the management of the endowment. This is especially a problem to the smaller colleges and universities. In spite of the before mentioned limitations, this plan of organization for the management of endowment funds is far more popular with endowed colleges and universities.

An internal plan which has been gaining in popularity in the past few years is the plan using an investment officer who reports to the financial committee of the board of trustees. Under this plan an officer is maintained who is capable in the field of investments but is not a member of the board of trustees. This plan necessitates an adequate staff under the direction of this officer. His staff usually consists of one or more security analysts and the necessary clerical, stenographic and accounting assistance to keep accurate and orderly information and records and to handle the routine necessary to keep the portfolio under constant review. With an organization of this type the members of the board or the financial committee of the board only has to devote a minimum of supervisory and advisory energy.

This plan of organization has great potential in the field of endowment management, but as stated by Russell, "No plan of managing invested
funds can be better than the personnel in charge." Assuming that an institution has at its command the competent personnel, then this plan of organization is by far the best form yet mentioned.

To supplement the investment officer type of endowment management, the institution may hire the services of an independent investment counselor for the purpose of making periodical reviews of the portfolio to make suggestions as to any change in holdings or practices followed in view of the prevailing conditions in the market and the economy at different times. The investment officer would also have other sources of information concerning economic and investment matters. Some of these sources would be brokerage houses which are used for depositories or for the buying and selling of securities. These services are usually available to the customers of these firms for very small service charges. The use of this type of service would be much less expensive than it would be to hire the necessary additional personnel to perform these functions and to it would give the institution the benefit of outside advice on the matter of what's best for the institution as far as investment is concerned at any given time.

In accepting and using the information obtained from the afore mentioned sources, the investment officer must be sure that the analyses are as good as could be made by a staff of his own and that if he was hiring additional persons to do the market analyses in his institution he would hire the persons who are making the reports which he is receiving from the brokerage house. Another source of inexpensive information which can be very helpful to the investment officer, is the investment department of a commercial bank.

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The investment officer and his staff have to make reports to the members of the board of trustees at regular intervals, and these reports should outline the status of the fund, showing what changes if any have been made. The board will be more free with criticism in this plan if they think there is necessity for it, than they would be in a plan where the person responsible for the endowment is a fellow of the board. This will make for a more healthy condition for the institution as far as the endowment fund is concerned.

The plan using the investment officer has the advantage of having the endowment managed by persons who are competent and who have no other function or duties except being responsible for the fund and seeing that it is managed so that the best results are obtained for the institution. This plan is by far the best if the institution's endowment is large enough to support the necessary staff to adequately do the job. As mentioned before, the personnel with the necessary competence is difficult to find and when it is obtained, the cost of this type of personnel is very high. Usually it is worth the cost in the improved position of the institution's endowment.

There are some institutions which use the services of a financial officer who also have other functions. The officer most usually used is the business manager, who reports directly to the board of trustees. He manages the fund under the direction of the finance committee of the board and submits to them his recommendations concerning the fund and this committee either accepts these recommendations or rejects them with counter suggestions concerning what should be done in relation to changes in the investments and the use of any income which might have been evidenced.

The chief business officer or business manager may or may not be
competent in investment matters, therefore there is a definite possibility of the fund producing less than maximum possible return on the investments. This type of organization for management of the endowment fund cannot be highly recommended, unless the business officer has the necessary competence in the field of investments. If this plan of management is used in an institution then it is necessary that the portfolio be reviewed regularly by an independent investment counselor. Russell made a very appropriate statement in reference to competence in investment matters when he wrote, "... the college that tries to carry on the management of its investments without competent personnel is courting serious difficulties."\(^1\)

The above mentioned plans of organization for the management of endowment funds are the most frequently used ones. Some institutions use some combination of those mentioned but they are for the most part alike in that they have either the committee type, the member of the board type or the financial officer type of organization for endowment management.

Whether the institution should use an internal form of organization for the management of the fund is a matter which must be decided by the governing board of the institution. There is no general set of rules which will apply to all schools in the country. There are certain factors which must be considered in making the decision. Some of the factors which must be taken into consideration are:

1. the size of the endowment fund
2. the availability of competent personnel on the staff or on the board of trustees
3. the location of the school in relation to the source of reliable financial information and counsel.

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Some institutions find that it is more profitable for them to obtain
the services of an outside independent agency to manage their endowment fund. There are several possible sources for investment management. All outside sources should operate under the direction of some officer or committee of the board so that there will not be unnecessary activity in the fund and so that the conditions and restrictions of the endowment will not be violated.

In some institutions the investment volume is small and the portfolio is managed by a professional investment counsel, a bank, or trust company. The agency which is used serves as a trustee for the institution. An important situation to beware of is employing an agency which does not have the best interest of the school at heart. Russell has this to say concerning the employment of outside investment counsel:

Counsel should not be obtained from a firm which itself is engaged in buying and selling securities, because the advice is likely to be colored by the desire of the firm to buy or sell certain securities for its own interest. This type of prejudice may be avoided by a rule preventing the purchase of securities from the firm from which counsel is received.

When the outside agency is used and there is proper reporting and adequate controls exercised, this method can prove to be the best plan of organization for the small college which lacks the necessary competence of personnel or board members within the institution.

Of the possible plans of organization for managing the endowment funds of colleges and universities, the investment committee type of organization has been found to be used in a larger percentage of institutions. This conclusion has been drawn from a survey made by Hugh W. Long and Company,

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Incorporated of Elizabeth, New Jersey. They surveyed 263 colleges and universities in the United States, both publicly and privately operated. As a result of this survey it was found that of the 195 institutions reporting on the plan of endowment management organization used, the largest number indicated the use of the investment committee.

**TABLE 2**

WHO SUPERVISES ENDOWMENT FUND INVESTMENTS?*  
(195 SCHOOLS REPORTING)

<table>
<thead>
<tr>
<th>Schools With Endowment Funds</th>
<th>Total Schools</th>
<th>Under $2 Million</th>
<th>$2 to $10 Million</th>
<th>Over $10 Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment committee</td>
<td>78</td>
<td>39</td>
<td>16</td>
<td>23</td>
</tr>
<tr>
<td>Board of trustees</td>
<td>42</td>
<td>30</td>
<td>9</td>
<td>3</td>
</tr>
<tr>
<td>Bank trust department</td>
<td>30</td>
<td>18</td>
<td>10</td>
<td>2</td>
</tr>
<tr>
<td>Investment Advisory firm</td>
<td>20</td>
<td>9</td>
<td>7</td>
<td>4</td>
</tr>
<tr>
<td>Controller or treasurer</td>
<td>9</td>
<td>6</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Endowment fund manager</td>
<td>1</td>
<td>-</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>Other</td>
<td>15</td>
<td>8</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>195</strong></td>
<td><strong>110</strong></td>
<td><strong>49</strong></td>
<td><strong>36</strong></td>
</tr>
</tbody>
</table>


Of the total of 195 schools with endowment funds who participated in the above mentioned survey, 50 or 25.6 per cent used the professional investment supervision from investment advisory firms or bank trust departments. The only school using the endowment fund manager had an endowment
of over 10 million dollars. Of all schools with endowments, 78 or 40 per cent used the investment committee form of organization for the management of their endowment fund. The next most popular form of management was the plan where the board of trustees had full responsibility for the investment portfolio. Table 2 shows very explicitly how investments are managed at the present time. This survey is recent enough to draw conclusions concerning the present status of college investment management. It is apparent that the board of trustees is used in a larger proportion of schools which have an endowment fund of less than 2 million dollars. More schools in the survey having an endowment fund of over 10 million dollars used the investment committee type of organization (23 or 64 per cent).

As has been stated, it is a problem of the trustee of each institution to decide what organization is to be used in their institution. Regardless of the type of organization decided upon, the one thing that must be observed is the review and constant supervision by some individual or group closely associated with the institution. Some colleges and universities review their investments continuously and others review their fund at periodic intervals. The survey made by the Hugh W. Long Company found that the largest number of schools had some plan of continuous review of the endowment fund regardless of what plan of management they had chosen to use. They presented the following table to illustrate the results of their study.¹

It is shown in Table 3 that all reporting schools had a plan of reviewing the endowment fund. Some plans are more desirable than others in that

TABLE 3
FREQUENCY OF INVESTMENT REVIEW

<table>
<thead>
<tr>
<th>Interval</th>
<th>Total Schools</th>
<th>Under $2 Million</th>
<th>$2 to $10 Million</th>
<th>Over $10 Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Continuous</td>
<td>61</td>
<td>28</td>
<td>23</td>
<td>10</td>
</tr>
<tr>
<td>Monthly</td>
<td>24</td>
<td>9</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td>Quarterly</td>
<td>50</td>
<td>29</td>
<td>14</td>
<td>7</td>
</tr>
<tr>
<td>Less Frequently</td>
<td>45</td>
<td>30</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>180</strong></td>
<td><strong>96</strong></td>
<td><strong>51</strong></td>
<td><strong>33</strong></td>
</tr>
</tbody>
</table>

they have either a continuous or periodic plan of investigating or reviewing the investment portfolio. It should be pointed out that the survey shows that schools with endowment funds of 2 million dollars or more are more diligent in their supervision of endowments. Of the 45 or 25 per cent who reported a reviewing program which is less frequent than a quarterly review, 30 or 66 per cent of them had endowments of less than 2 million dollars.

In conclusion, it should be emphasized that only a few of the larger institutions would be wise to staff a department for the purpose of management of the endowment fund. Of the several plans of organizations mentioned in this chapter, the writer would say that the best organization for any given institution should be set in the light of what is best for the institution, always keeping in mind the objectives, goals, and restrictions which have been placed on the fund.

Finally the availability of competent personnel should be taken into
consideration. It is necessary that the institution keep abreast of the trends in the field and constantly review the fund so that if a new plan of organization is at any time warranted, the necessary steps can be taken to add or delete phases of the organization to conform with the changes which have taken place in the fund and in the market.
CHAPTER III

OBJECTIVES OF ENDOWMENT MANAGEMENT

The management of the endowment fund is a very important function of the institutions which have accepted these funds from organizations and individual donors. These funds are placed in the hands of the institution to be used according to certain stipulations. For the school to adequately maintain the endowment in a way that will encourage other donors to give to the institution, the objectives must be clearly defined. The rules must be such that these objectives are realizable.

The institution must also be aware of and well informed on trust laws of the state in which the institution is located. There have many cases of violation of trust by colleges and universities which we do not intend to cover in this thesis, but these are necessary to be considered in the setting of individual institution goals which deviate from those general goals that will be discussed in this chapter.

Back in 1922, Trevor Arnett authoritatively enunciated in his general principles as endowment theory these words pertaining to what is expected from the management of endowments:

An endowments are established to provide permanent regular income, it is important that they be invested in such a way that the income be assured and the principal be kept intact. Safety of the principal is the first consideration; otherwise, the permanency of the income may be endangered. The size of the income, though important, is secondary. ...To safeguard the principal of endowment, and at the same time to get a good income, is one of the chief problems of the trustees of an endowed college. 1

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1 Trevor Arnett, College and University Finance (New York: General Education Board, 1922), p. 32.
In 1958 Charles W. Call, Investment counselor, had this to say about the goals or objectives of investment management:

In the operation of an institutional investment portfolio there are several goals. Though clearly defined, they are difficult to achieve because they are to a certain degree inconsistent with one another. The primary goals generally are said to be three: conservation of the principal of the endowment funds, development of the greatest income which can be prudently attained,¹ and the gradual appreciation in the market value of the funds.

The above statements by persons who have both had many years of experience in the field of college and university investments show some points of agreement. The points of agreement seem to be: the preservation of the principal of the fund and the continuous realization of the best possible income. Mr. Call thinks that this is an inconsistent set of goals, however it should be realized that with the proper caliber of management and investment policies, that these goals should be very much in harmony with each other.

The goals and objectives of investments of colleges and universities are quite different from the goals and objectives of an individual investor, an insurance company, a bank, or other persons or groups. There are two main differences between the institution as an investor and other investors which can have a definite effect on the objectives of each; first, institutions are free from taxation on income and capital gains and can therefore afford to buy some of the high-yielding investments which others might have to weigh in terms of the amount of tax the ownership of these securities would incur and in turn would the net income realization be much less than they could possibly attain from some less attractive securities, second,

the institutional endowment is a perpetuity which has an indefinite life. The institutions do not have the worry of facing the possibility of liquidating to meet obligations or the necessity of transferring principal to new owners.

The endowment manager of the college or university has the responsibility of trusteeship of an investment fund for a life tenant who never dies. The permanent existence of the institution in itself gives for different objectives from other investors. The college endowment manager can always think ahead and gear his decisions on what is likely in the distant future as far as the market is concerned. He can invest in securities which might not be at the top of the list of preferred securities, but from the available information, show a great growth potential in the future. A good example would be investing in industries such as electronics, manufacturers of nuclear components, or a firm which is growing in an industry where there has been the existence of monopolistic condition. A very vivid example of an industry which has been dominated by one major firm without any substantial competition is the data processing and automatic controls. I. B. M. has been and is still considered a very rich stock to hold for investment return. But it might be well to consider investing in a company like Sperry-Rand, a company which has demonstrated its ability with the Univac, with guided missiles, and with automatic controls and shows a great growth potential. The chances are very good that the endowment that has some of this stock in its portfolio will have something that will be worth many times the price which it can be attained for at the present time and will also have a stock that will be paying a good return on the investment.

High speculation has no place in the goals of the investment program
of endowed institutions. The goal of income realization is important, but this income must be of a continuous nature and it must be very stable. Of course, it is recognized that there exist some degree of speculation in any investment but the highly speculative investments should be avoided by the college investment manager. There are three important factors, which the portfolio manager must keep in mind as he manages the endowment fund. They are: "first, stability of income is extremely advantageous for the college or university. The institution of higher education must make its commitments for a considerable period in advance, and violent fluctuations in the amount of income increase the difficulties of budget-making; secondly, the college needs an income that is constant in terms of purchasing power rather than in terms of actual dollars, and thirdly, the college cannot afford to take any speculative risks with the resources of its endowment fund."\(^1\)

Theoretically, the endowment principal should remain relatively safe and inviolate and this is considered as one of the main objectives of endowment management. The manager of the investment portfolio must use all available information to reach decisions concerning the advisability of concentration on capital appreciation of the endowment. As has been previously stated, changes in the purchasing power of the dollar plays an important part in making the appreciation of principal a major consideration in endowment management. There must be some compromise between the two: maintenance of the principal and some speculation for capital gains.

The endowment fund of the college or university is an important income producer and this source of income should be handled so that the best

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possible results are obtained from the investments held by the institution. The person or persons responsible for the fund should be very aware of the objectives; namely, protection of the principal, realization of the best possible income, and lastly the gradual appreciation of the principal from investment in companies which show a great growth potential and companies which have a history of continuous growth. If the endowment managers keep these things in mind as they avail themselves of the best counsel on investment matters, then it is certain that the endowment that has been intrusted in their care will serve the purpose for which it was intended.
CHAPTER IV

INVESTMENT OF THE ENDOWMENT FUND AND INCOME

In the earlier chapters of this paper we have been concerned with some background information concerning endowment and the financial make-up of the colleges and universities; we have explored the various organizational structures for the management of the endowment; and we have stated the major objectives which are set forth as goals to be realized from endowment management, now we are interested in the basic principles for the investment of the endowment fund and the use and investment of the income from these investments.

The funds of the endowment are obtained from several sources; namely, fund raising campaigns, gifts and grants from individuals and foundations and from alumni of the institutions. These gifts and grants fall into two principal classes: unrestricted and restricted. The income from the unrestricted gift, sometimes called a general gift to endowment, may be used for any legitimate needs of the college. The income from the restricted endowment, sometimes called special gifts to endowment, may be used only for the express purpose for which the fund was given.

The most acceptable endowment, according to Trevor Arnett, is the unrestricted gift, because its income can be used in accordance with changing conditions, which must arise in the course of long periods of time, and which at present are coming with startling rapidity. Gifts to the endowment which carry restrictions or stipulations which would be difficult for the institution to administer should be accepted very carefully. Every

\[1\]

effort should be made to convince donors of such restricted gifts of the desirability of making only restrictions which may be altered to fit the changing needs of the college or university.

Every means must be employed by the investment manager to safeguard the funds for which he is responsible. One safety factor is using diversification to protect and insure the soundness of the investment portfolio.

The National Committee of the Preparation of a Manual on College and University Business Administration writes:

Diversification of investments is essential for protection against the hazards of: (1) unforeseeable trends in the economy; (2) unwise selection or retention of industries or companies; and (3) participation in enterprises involving greater risk but also potentially greater income.¹

Diversification may be made in several ways in investment management. The investment policy may dictate how some diversification may take place by stating the relative holdings allowed in any given type of security, any given industry, and even what part of the fund may be invested in fixed and variable return securities. Further there may be policies governing the geographical location where these investments may be made.

The various types of investments could be divided into fixed return and variable return. Fixed-return investments include bonds, preferred stocks, mortgages and real estate under long-term lease (twenty-five to ninety-nine years), net leases, or net leases providing for full amortization of capital, all of a quality justifying the term "fixed return". Variable-return investments include common stocks, real estate under short-term leases, and operations of business.² Due to the nature of endowment

²Ibid., p. 109.
funds, fixed-return investments have always been more popular with investment managers. The income is relatively stable and can be expected continuously subject only to violent fluctuations in the economy. The endowment funds, however, do show some investment in the variable-return securities, sometimes called "equities". The income on equities is somewhat higher but less stable than that of fixed-return securities. In the study made by Hugh W. Long and Company, the following table was presented.

**TABLE 4**

HOW SCHOOL AND COLLEGES INVEST THEIR ENDOWMENT DOLLARS*
(186 SCHOOLS REPORTING)**

<table>
<thead>
<tr>
<th>Type</th>
<th>Bonds</th>
<th>Preferred Stocks</th>
<th>Common Stocks Including Mutual Funds</th>
<th>Real Est. and Mortgages</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Private Schools</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Preparatory</td>
<td>37.8</td>
<td>5.8</td>
<td>55.0</td>
<td>0.9</td>
<td>0.5</td>
</tr>
<tr>
<td>Colleges</td>
<td>26.9</td>
<td>5.6</td>
<td>49.2</td>
<td>14.6</td>
<td>3.7</td>
</tr>
<tr>
<td>Universities</td>
<td>36.5</td>
<td>3.3</td>
<td>50.0</td>
<td>7.5</td>
<td>2.7</td>
</tr>
<tr>
<td><strong>Public Schools</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Colleges</td>
<td>41.3</td>
<td>2.2</td>
<td>39.5</td>
<td>16.6</td>
<td>0.4</td>
</tr>
<tr>
<td>Universities</td>
<td>72.8</td>
<td>1.9</td>
<td>19.1</td>
<td>3.6</td>
<td>2.6</td>
</tr>
<tr>
<td><strong>All Schools, Public &amp; Private Endowment up to $2 million</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>26.5</td>
<td>6.3</td>
<td>36.5</td>
<td>21.3</td>
<td>9.4</td>
</tr>
<tr>
<td><strong>Between $2 and $10 million</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>20.3</td>
<td>5.7</td>
<td>46.0</td>
<td>17.4</td>
<td>4.6</td>
</tr>
<tr>
<td><strong>Over $10 million</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>42.9</td>
<td>3.2</td>
<td>45.2</td>
<td>6.2</td>
<td>2.5</td>
</tr>
<tr>
<td><strong>Average of all Schools</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>41.1</td>
<td>3.5</td>
<td>45.1</td>
<td>7.6</td>
<td>2.7</td>
</tr>
</tbody>
</table>

* Averages weighted to reflect the dollar amounts invested.

to show how the schools included in the study invested their endowment dollars. In Table 1, it is clear that equities hold a small share of the endowment dollar. The average invested by all schools in preferred stocks is 3.5 cents of the investment dollar. This might at first seem very low and insignificant but if it is looked at from the point of view that little or no money was invested in variable-return securities thirty years ago, then it will definitely point up a new trend in the investment of the endowment funds of endowed institutions. We might notice that the trend towards common stocks as a part of the investment portfolio has increased in the past few years. There has been a tendency for colleges and universities to rely heavily on bonds as an investment. Mostly the endowment managers have used government bonds as an investment outlet. These are by far the safest investments for the endowment funds, but the return is relatively low and they do not allow for the income increase that is desired by endowment managers of today. There is, however, and there will always be, a place for bonds in investment portfolios of colleges and universities, because of their safety and stability.

Diversification of investments has made a wider degree of speculation in the investing of the endowment. This diversification allows for investing the funds in a variety of different industries. The endowment manager may choose industries such as; utilities and natural gas, variety chains, railroads and railroad equipment, atomic energy, aircraft, air lines, tobacco, road machinery and farm equipment and farm machinery, just to name a few.

Geographical diversification is used to avoid evident area risks. This is especially true of heavy concentration of investment in real estate, mortgages, utility, or industries located in the area which relies heavily
on the endowed institution for most of its income. Unforeseeable future changes which might affect one area should not be allowed to endanger any substantial portion of the investment portfolio. Geographical diversification is also necessary because of peculiar risks of an area such as: natural hazards, military vulnerability, unfavorable local laws concerning taxes and real estate.

Diversification is very important in the management of the endowment portfolio, but the National Committee mentions this warning concerning diversification:

In selection of individual securities, diversification is not a substitute for informed consideration, nor does it alleviate the responsibility for constant review and revision of the portfolio. It frequently is apparent that many investors who exercise great caution in buying securities, have a perverse reluctance to sell; that frequently a security, coming as a gift, which under no circumstances would be purchased at the prevailing price level, is nevertheless retained. This is not to imply that every security which would not be purchased at a given time should be sold immediately. There should be a reasonable area of inertia to avoid a policy of continual switching.

Control plans are used to determine the degree of diversification of some endowment funds. These control plans have provided a desirable method of preserving the investment of the institutions. Usually a control plan is based on a desirable formula that will integrate the investment objectives with the expected swings of the economy. The purpose of such plans is to permit ownership of common stocks during a portion of the business cycle without suffering all of the shrinkage that the exaggerated changes entail. Under the control plan, common stocks are sold at high market levels and purchased at low market levels according to a predetermined criterion for deciding what is high and what is low.

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The National Committee used the following terms to state the functioning of control plans:

A control plan may provide for a constant ratio between fixed income and equity holdings, building up or decreasing the proportion of equities as market fluctuations change the percentages from those determined upon, or for one which varies as the market moves upward or downward from a selected norm. The objective of a control plan is to sell equities at high market levels, investing the proceeds temporarily in less fluctuating media, and to later re-invest at lower levels.

There should be included in any well diversified portfolio some growth stocks. This type of stock is usually confused with highly speculative securities, but this is not necessarily true. Speculation, as is generally known, usually implies a lack of complete knowledge or evidence upon which conjectures of future value are made. W. E. Camp presents a very interesting, and appropriate definition of growth stocks:

Growth stocks can be defined as those stocks that have already established long-term growth prospects. Complete information is available covering their operations for a short or medium length of time showing consistent growth better than the average, either of the industry itself or of corporations generally. Their prospects should offer a more rapid rate of expansion, not only of sales but also of income, with the chance of becoming leaders in their own fields through some research and some diversification.

The idea of a growing company sometimes leads some persons to think that the company is new in the industry or relatively small. A look at several growth stocks will show that mostly they are old established firms who have practiced plowing back a large portion of its income into expansion programs and paying a relatively smaller dividend during this period of expansion. The advantage of investing in this type of security would be the possible future capital gains and a future increased earnings on the

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1 Ibid., p. 111.
original investment. It seems that this type of investment would be very advantageous to the college endowment fund.

The nature of the endowment places certain restrictions on the use of the investment portfolio. There have been evidences of some misuses of the funds in the past. Some misuses which have been committed might not seem like a violation to the layman or the uninformed, but is no less serious. There are certain types of loans which should not be made from endowment funds. Russell makes the following statement concerning undesirable loans:

No loan should be made to a church, fraternal lodge, or other charitable organization. The reason should be obvious. The college itself is an eleemosynary institution, and for it to attempt to enforce collection against another organization of a charitable type would subject it to severe criticism in the community.

There should never be any loans made to trustees, officers, or staff of the institution or any company or firm controlled by any of these persons. If there are no state laws which prohibit this practice then there should be some restriction of this nature in the by-laws or in the form of a resolution of the board.

Another misuse of endowment funds has been the practice of investing in college buildings and land. This is an undesirable practice because endowments are supposed to be income producing and to invest these funds in non-income producing properties is to violate the very purpose of the endowment. Regardless of how badly need such facilities may be, it is never wise to use the endowment as a source of funds for expansion of the physical

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plant. "Campus, laboratories, libraries, recitation buildings are not endowment, and funds so invested simply cease to be endowment, for they produce no money income". 1

It might be argued that an investment in dormitories for an increase in enrollment would warrant the use of funds of the endowment, but if the principles of endowment investment are applied, this investment would not meet the necessary requirements for a good endowment fund investment. First, the income cannot be regarded as regular and second, the return could not be the best possible rate on the funds invested. There is a possibility of showing a reasonable rate of income for a few years while maintenance costs are low but in the long run with depreciation, and increased cost of maintenance and up keep, the return would be much less than necessary for an endowment investment. A further consideration would be the possibility of a decrease in enrollment, making the facility useless to the institution because of the lack of need and the loss of income. This facility could not be sold by the institution because there would be no market for it. Securities can be sold very readily in the market and they would not become the type of asset which would be so fixed that if circumstances should change from the time they were acquired the institution would have to keep them. This would be true of an addition to the physical plant.

Another use of endowment funds which should be avoided is hypothecation. Hypothec has been defined by Webster's New Collegiate Dictionary as, "an obligation, right, or security given to a creditor over property of the debtor without transfer of possession or title to the creditor". In reference to the endowment, hypothecation is the act of using the endowment as

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security or collateral for loans made by the institution. This practice can be detrimental to an endowment fund since a portion of its principal has been pledged as security for a loan and this portion can no longer be considered as endowment since the most basic principle dictates that the principal remain inviolate.

College and university endowments are an important source of income for the current operating expenses of the institution. The return must be steady and must be income that can be depended on for years in advance of the time the investment is made. Colleges have used government and corporate bonds as an investment outlet for assured continuous earnings. Bonds are by far the safest type of investment, however along with this safety goes lower income than some of the more risky investments. Surveys have been conducted to find out the per cent of each type of investment being held by colleges and universities in their investment portfolios. Stillman, Maynard, and Company, of New York, sampled twenty-six institutions of higher education as of June 30, 1954. At market value the average holdings of these institutions were shown to be: ¹

<table>
<thead>
<tr>
<th>Investment Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds - Government</td>
<td>15.7%</td>
</tr>
<tr>
<td>Bonds - Corporate</td>
<td>17.2%</td>
</tr>
<tr>
<td>Total Bonds</td>
<td>32.9%</td>
</tr>
<tr>
<td>Preferred Stocks</td>
<td>7.0%</td>
</tr>
<tr>
<td>Common Stocks</td>
<td>51.2%</td>
</tr>
<tr>
<td>Real Estate (excluding institutional properties)</td>
<td>4.0%</td>
</tr>
<tr>
<td>Mortgages</td>
<td>2.5%</td>
</tr>
<tr>
<td>Uninvested Cash</td>
<td>0.6%</td>
</tr>
<tr>
<td>All Others</td>
<td>1.8%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>

Another survey made by Vance, Sanders, and Company, of Boston, as of June 30, 1951, of thirty-five institutions showed an average percentage of each type of investment as follows: 1

<table>
<thead>
<tr>
<th>Type of Investment</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds</td>
<td>34.8%</td>
</tr>
<tr>
<td>Preferred Stocks</td>
<td>6.5%</td>
</tr>
<tr>
<td>Common Stocks</td>
<td>50.1%</td>
</tr>
<tr>
<td>Real Estate and Mortgages</td>
<td>6.0%</td>
</tr>
<tr>
<td>(excluding physical plant)</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>2.3%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>

From the findings of the two surveys we can see that the popularity of common stocks is very high with the institutions included in the two studies. This shows that the endowment managers of the institutions surveyed are holding a good many stocks which they consider as quality investments. These surveys further show that the common stock held showed only about one-half per cent better yield than government bonds and about the same yield as high grade utility bonds. 2 These stocks were being held, not so much for the current yield, as for the hoped for future income. Of course it is necessary for investment managers to make comprehensive analyses of individual companies to decide what commons are suitable for the endowment fund. It was revealed in the survey by Vance, Sanders and Company that there were ten companies whose commons were especially popular with the endowment managers of the colleges in the survey. The companies whose common stocks were held by most of the eighteen schools responding to this phase of the study were: 3

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1 Ibid., p. 48.
2 Ibid.
3 Ibid.
Although preferred stocks show a low percentage of the total investment holdings of the institutions in the before mentioned surveys, it must be brought out at this time that there is definitely a place for these stocks in the endowment portfolio of the endowed colleges and universities. The institution, however, cannot invest too heavily in preferred stocks because of the degree of speculation which is involved. The return on the preferred stock will be somewhat higher than on corporate and government bonds but the risk is also greater. The investment manager must scrutinize very carefully those stocks which he thinks will be good investments for the investment portfolio. Some preferred stocks will carry a convertible feature whereby they might be exchanged for common stock. This feature will carry a premium over and above the price of the related common stock.

The quality of a preferred stock is improved appreciably by inclusion in its terms of a fixed sinking fund which will retire the stock in from thirty to thirty-five years.

The decisions relative to the purchase of any type of security for the endowment fund should be based on the best possible findings and facts arrived at by professional assistance. The well informed investment counsel can help in many ways to make the best and most profitable decisions for the investment portfolio. The economy plays an important part on the values
of securities and it determines what fluctuations will be experienced at any given time. The investment manager must give careful consideration to the present market value and yield, and especially future prospects for stocks in each industry, as well as the individual companies. All of these things make-up the necessary cautions and steps to be followed in the investing of the endowment fund.

Investment company shares and mutual trust shares offer another investment outlet to the investment manager of the college or university. Shares of this type should not be prevalent in the investment portfolio in too large amounts. They may be held for the sake of further diversification. The returns on these types of investments are not exceptional and it constitutes the delegation of authority for investment of the funds to an outside agency which should be avoided. The investment manager would be wise to check with legal counsel before making investments of this type to determine if trusts are forbidden from using this type of investment outlet in the particular state where the institution is located.

Real estate, not including educational properties, is considered as a good investment source for endowment funds as long as several factors are present. One factor is the necessary staff to properly manage real property holdings, another factor is that there exists an economy of increasing real estate values. The ownership of real property for investment purposes may be justified on two grounds; it may afford protection against declining purchasing power, and it may produce higher income.

Until about thirty years ago, real estate properties were considered as very good endowment investment. Portfolios carried as larger per cent of the total endowment invested in real estate than is the case to-day.
This decline in the interest in real estate as an investment is explained thusly by the National Committee:

The decade of the thirties was a rigorous one for operators of real estate, and it was then that a significant distinction between real property and securities as an investment media, was disclosed; namely, that while the income on securities could decline to the vanishing point, operated real estate actually could produce deficits which became either a charge on other institutional income or an encumbrance on capital invested in the property. Inadequate or no provision had been made for depreciation and obsolescence of buildings with the result that such buildings became liabilities rather than assets.¹

In the use of real estate as an investment the institution may lease vacant land which it has purchased or has received as a gift and lease it under a long-term lease. Under such an arrangement the lessor usually improves the property by building on it and maintaining the property during the term of the lease. In case the lessor defaults or the lease expires without being renewed, then the entire property becomes the property of the institution. This would be a way for the college or university to acquire improvements to properties held as endowment without a heavy financial outlay on the part of the institution. Again the perpetual nature of institutions of higher education serves as a definite advantage over businesses in the economy.

There are many valuable documents of ownership connected with the endowment funds of colleges and universities. The investment manager and his staff or the investment committee has the responsibility of safeguarding and keeping these documents so that no loss can possibly come to them. They must be protected from such loss as theft, fire, misappropriation, and

There is no ironclad rule as to where these valuable evidences should be kept, however, some possibilities are: safe storage space on the premises, or safety deposit boxes at nearby banking institutions. Such documents as securities registered in the name of the institution, real estate title papers, deeds of gifts, wills, etc. do not require frequent handling but should be secured and available when needed.

In the case of marketable securities, a safer and probably less expensive method than custody managed by the institutional investment representative, would be the use of bank or trust company custodianship. These services would include safekeeping, receipt and delivery of securities authorized, collections of coupons and dividends, notification of calls, maturities, and changes requiring institutional action, advices confirming all transactions, and periodic statements summarizing holdings and changes. These services could be performed by the bank as custodian of marketable securities for an amount which would be less expensive than if handled by the institution itself. It would be of great help to the endowment manager in that this function would give him time for which to focus more attention to the matter of purchasing and selling securities, analyzing the market for changes in trends, and generally managing the investment functions of the institution.

Investment of the endowment mostly is concerned with long term investments which are made for income realization over a period of years. Sometimes in investment management the time comes when it is not considered wise to make investments of this type. It is then necessary for the portfolio manager to look to short-term investments for cash which is laying idle in the fund. This is a practice which has been used very advantageously
in business corporations but have not been used to a great extent by endowment managers. Short-term investment of endowment income which will not be needed by the institution for say thirty to ninety days or longer could be placed in investments which would add to current operating funds of the institution. C. John Kuhn, Vice President and Treasurer, C. I. T. Financial Corporation, has this to say about short-term investments for the college or university:

The best known mediums are U. S. Treasury bills and sales finance company financial paper. There are others, such as short issues of government agencies - the Federal Intermediate Credit, Home Loan, and Land Bank Notes... added mediums, such as repurchase agreements. What is not well known, but what happens to be an historical fact, is that the sales finance commercial paper of the top companies is as good as cash. This type of paper has never suffered a default, not even a rumor of one. Its self-liquidating feature, backed by huge capital, makes it virtually impregnable.

The endowment must always be invested safely, whether it be long-term or short-term investing, but the realization of the best possible income is also a prime consideration. Idle funds produce no income and theoretically the institution would be missing out on potential income by having idle cash in the endowment when this cash could be directed to short-term investments. Some other outlets for short term investments would be; certificates of indebtedness, short-term notes, bonds approaching maturity and preferred stocks where notice of call has been formally issued and payment at a set date has become an obligation of the issuer. The additional income which can be realized from these types of investments, along with the little or no risk which is involved, make them well worth consideration by the investment manager of institutional endowments.

As has been stated previously, there are no set of rules which are fast and definite concerning endowment management and investment. The endowment manager must use every available source of information concerning the market, concerning inventions and developments by individual companies, study and analyze the economy and trends in the economy, and forever keep in mind the magnitude of the responsibility which is his in managing the endowment fund. He might be cognizant of statements made by authorities such as the following made by Russell and Reeves:

Purely on theoretical grounds the principle was adopted that not more than fifty per cent of the investment should be in bonds, not more than twenty-five per cent in stocks, not more than fifty per cent in mortgages, and not more than twenty-five per cent in real estate.¹

The investment manager of the present has an advantage over his predecessor, who had to adhere to legal lists of securities which were the only ones that could be used by trust funds without the trustee taking full responsibility for any losses which might occur on investments. Now the prudent man investment rule is in operation in most states which gives more latitude in the investment of trust funds of colleges, universities, and other charitable institutions. The prudent man investment rule was handed down by the Massachusetts Supreme Court and stated:

All that can be required of a trustee to invest is that he shall conduct himself faithfully and exercise a sound discretion. He is to observe how men of prudence, discretion, and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering probable income, as well as the probable safety of the capital invested.²

The endowment manager will have success in his endowment portfolio if he will heed the suggestions which have been mentioned in this chapter. The endowment will realize a good income, will experience an appreciation of capital, and will be safe in an economy which can be highly unstable. If he manages the fund as a "prudent man" manages his personal funds, then only success can be his.

Many of the suggestions noted in this paper may not be practical for endowment funds depending on the size and the location of institution. Perhaps the size of the fund is such that internal management is not practical. If this is true, then some of the other methods should be considered. There must be a policy developed or a program established to continue the growth of the endowment fund and to insure the fund against the ravages of depletion and obsolescence which have taken over so many poorly managed funds in the past.
ACCOUNTING FOR THE ENDOWMENT FUND

One of the primary purposes of an accounting system is to furnish financial information to management and other interested groups, so that it can be determined whether or not the organization is functioning properly and whether there is any area which needs special attention. The accounting system of a college or university should be designed to meet the needs, conditions, and ideals which are prevalent for the institution.

Accounting for the endowment funds of endowed institutions should be based on the established principles of college and university accounting. Endowment accounting is focused upon showing the condition of investments, the income which has been realized from the investments, and the separation of the principal of the individual funds within the endowment.

There is a basic difference between college accounting and commercial accounting; that difference is the non-existence of profit in college accounting. In commercial accounting there is a direct relationship between revenues and expenditures; in colleges and universities, income, for the most part, is obtained independently of expenditures. In commercial accounting emphasis is given to the determination of net profit and net worth; in accounting for non-profit organizations no such objective exists.

In the college endowment fund there are usually several separate funds which have originated due to the many different sources of gifts for the purpose of producing income for the college's operation. These various funds might be too small in size to invest individually and should be pooled together so that all funds may be invested in large blocks and the best income can be realized from each gift to the endowment. When this situation
exists, and it is usually the condition in most college endowments, a different accounting problem is acquired. Accounting for pooled funds of the endowment does not eliminate the necessity of keeping each principal inviolate and separate. There should be only one control account for each class of investments of the pool. Individual accounts should be kept for the principal of each fund in the pool. One control account is maintained for the earnings of all pooled investments, or an account for the earnings of each of the several classes of investments of the pool. From these accounts a distribution of earnings is made periodically to the income accounts of the funds participating in the pool. The usual method of distribution is on the basis of the relation of the average principal of participating funds to the total pool for the period each fund has participated in the pool, disregarding fractional months.

It is the opinion of the National Committee on Standard Reports For Institutions of Higher Education that there exists, with exceptions, a similarity between trust accounting and accounting for endowments. They made this evident when they made the following statement:

The endowment funds of an educational institution partake to some extent, although not wholly, of the nature of trust funds. A commercial trust fund is held and administered by one party, the trustee, for the benefit of a second, the beneficiary. Definite legal restrictions govern the types of investments in which the funds can be placed by the trustees. In educational institutions, however, the trustee and the beneficiary ordinarily are one and the same. The institution represents interests corresponding to both a life-tenant and a remainder-man. These institutions, furthermore, usually are relieved almost entirely of legal restrictions in regard to types of investments. The accounting system for these funds in an educational institution should provide just as strict and accurate a record of the operation of the funds as does the accounting system in a trust company.\(^1\)

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The major difference in the endowment fund and the commercial trust is the non-existence of a distinct trustee for the beneficiary. In commercial trusts there must be at least two parties to each trust fund; the trustee and the beneficiary, but in the endowment fund trust, the trustee and the beneficiary are one in the same.

Investments of endowment should be entered in the books at cost. Gifts of securities should be entered in the books at the market value or appraisal value at the time the gift is received. The investment manager should never make an attempt to adjust the value of securities in the endowment fund to conform with changes of values quoted in the market. The endowment's book value will almost always be less than the aggregate market value of the investments in the portfolio.

Investment managers should follow the above suggestion, however, they should also be interested in and constantly aware of the market value of the funds under their supervision. This awareness of market value will be a by-product of the investment manager's analyses of the market and his obtaining the best advice from professional counsel on investments.

The balance sheet of colleges and universities will contain many different funds; one of which will be the endowment fund. Each fund is accounted for distinct from other funds of the institution. Endowment funds should be accounted for in a balanced group. This is true of all funds of the institutions of higher education. There are usually found six distinct fund groups, namely; current funds, loan funds, endowment and other non-expendable funds, annuity funds, plant funds, and agency funds. In the endowment and other non-expendable funds group, any funds functioning temporarily as endowment and any funds held in trust by others for the benefit
of the institution should be shown separately on the liability side of the balance sheet. The endowment and other non-expendable funds section of the institution's balance sheet should appear as follows:

**BALANCE SHEET**

**ASSETS**

Endowment and Other Non-expendable funds:

<table>
<thead>
<tr>
<th>Cash</th>
<th>$1,000.00*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investments:</td>
<td></td>
</tr>
<tr>
<td>Securities:</td>
<td></td>
</tr>
<tr>
<td>Bonds</td>
<td>10,000.00</td>
</tr>
<tr>
<td>Real Estate Mortgages</td>
<td>1,000.00</td>
</tr>
<tr>
<td>Preferred Stocks</td>
<td>5,000.00</td>
</tr>
<tr>
<td>Common Stocks</td>
<td>10,000.00</td>
</tr>
<tr>
<td>Others</td>
<td>3,000.00</td>
</tr>
<tr>
<td>Real Estate</td>
<td>3,000.00</td>
</tr>
<tr>
<td>Institutional Property</td>
<td>2,000.00</td>
</tr>
<tr>
<td>Funds Held in Trust by Others</td>
<td>5,000.00</td>
</tr>
<tr>
<td>Total Endowment and Other Non-expendable Funds</td>
<td>$10,000.00</td>
</tr>
</tbody>
</table>

**LIABILITIES**

Endowment and Other Non-expendable Funds:

| Principal of Endowment Funds | 20,000.00 |
| Principal of Funds Temporarily Functioning as Endowments | 14,000.00 |
| Reserve for Gains and Losses on Investments | 1,000.00 |
| Funds Held in Trust by Others | 5,000.00 |
| Total Endowment and Other Non-expendable Funds | $40,000.00 |

In accounting for the endowment there should be no inclusion of pledges or subscriptions in the endowment until they are actually paid. A record of pledges and subscriptions should be kept so that the total of pledges

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*Amounts arbitrarily placed by the writer for the sake of illustration.*
and subscriptions is known and the potential donors are known and identified according to the amount of their pledge to the endowment of the institution. Trevor Arnett made the following statement concerning the proper handling of pledges to the endowment:

Endowment is a reality, not a potentiality; pledges and subscriptions are potentialities. The amount reported as endowment should normally increase, but if uncollected pledges were included in endowment, and later those found to be of no value taken out, the opposite might arise.

As payments are made on pledges and subscriptions, they should be recorded in a memorandum account, and the total of receipts from pledges posted to the endowment cash account.

The cash of the endowment fund should be accounted for in a separate ledger account from all other cash of other funds of the institution. This cash should be deposited in a separate bank account and if possible in a separate bank. In cases where several endowment funds are pooled for investment purposes, the cash of the pooled funds should be kept separate from general endowment cash which is not pooled.

In accounting for securities of the endowment it should be kept in mind that they are entered in the books at cost. Bonds and mortgages frequently are bought at premiums or at discounts. Premiums should be amortized out of the income of the investment by applying a portion of the income to the premium account of the funds. Discounts need not be amortized, rather the gains secured at a time of maturity should be added to the principal of the funds involved.

Stocks are entered in the books in the same manner as are other securities. The treatment of stock dividends present different problems. The

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National Committee on the Preparation of a Manual suggests:

The treatment of stock dividends will depend upon the type. If the dividend consists of preferred or common, no income exists. If, however, it is mixed as to classes of stock, there may be income. There also may be income in certain other cases. Each case should be studied and treated according to the circumstances involved.

The accounts for real estate should be the same as those of other types of investments of the endowment fund. In addition there should be operating accounts for income and expenditures which are common to the operation of this type of property. Expenses for repairs, operation, insurance, and taxes should be charged against the income from the property. Appropriate depreciation should be charged to the income from the property regardless of whether the property is used for institutional purpose or for outside investment purposes.

The National Committee on Standard Reports for Institutions of Higher Education presented two methods which may be used in accounting and reporting for replacements and renewal of real estate investment property:

1. The first method is to write down the amount of the original amount to be provided and to deduct this amount from the gross income derived from the property or from any other source. The amount thus deducted is transferred in cash to the assets of the permanent fund and invested along with other assets of the fund.

2. The second method is to set up a separate replacement fund out of the annual charges to income, the assets of which are invested until such time as they are required to make up the reduction of value of the original assets. Either the "straight-line" method, or the "annuity" or "sinking-fund" method of computing amounts, for renewals and replacements may be followed.

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The liabilities of the endowment would include any liabilities outstanding against the assets, the principal of the general endowment funds, principal of funds temporarily functioning as endowment, and the reserve for gains and losses on investments. The principal accounts of the endowment may be classified in two categories according to the use that the income is to be put, namely; (1) endowment for unrestricted purposes and, (2) endowment for restricted purposes. Restricted endowment may be further subdivided to allow for a more accurate accounting of income which is to be used and how much is available for use according to the restrictions.

The balance sheet as shown earlier in this chapter would require at least three supporting statements, namely: Statement of Endowment and Other Non-expendable Funds, Summary Statement of Investments and, Detailed Statement of Investments. The Statement of Endowment and Other Non-Expendable Funds shows the description of and changes in individual funds during any given period. The Summary Statement of Investments shows each type of security and the type of industry in which it is invested. It also carries itemized listings of real estate, real estate mortgages, and institutional property used as endowment investment. The Detailed Statement of Investments shows a detailed listing of each security, the number of shares held, the name of the specific fund to which the securities belong, the maturity dates of bonds and mortgages, par value, and book value of the investment. If the statement is not to be published, the market value may be included for comparative purposes.

Presented on page 49 are the assets and liabilities accounts as they appear on the Balance Sheet which was illustrated earlier in this chapter.

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1 Ibid., p. 28.
Some of the conceivable debit and credit might commonly be entered in the endowment ledger. These transactions are constructed from the past experience of the writer in observing and assisting in endowment accounting over the past five years. The writer realizes that the following presentation is not all inclusive and would have to be modified in terms of any additional transactions which are not included here.

Endowment and Other Non-expendable Funds

Assets

General Endowment Cash

Debited with:

1. donations for endowment purposes
2. receipt of cash from sale of investments
3. borrowed cash from other funds temporarily
4. replacement of loans made to other funds.

Credited with:

1. cost of investments purchased
2. cash loaned to other funds
3. transfer of cash to pooled cash account for endowment funds to be pooled in investment.

Endowment Cash - Pooled Funds

Debited with:

1. transfer of cash from general endowment for pooled investment
2. receipt of cash from the sale of pooled investments.

Credited with:

1. cost of investments purchased
2. cash returned to separate funds when withdrawn from the pool.
Bonds (General Endowment and Pooled Funds)

Debited with:

1. cost of bonds purchased
2. market value of gifts.

Credited with:

1. book value at the time of sale.

Real Estate Mortgages (General Endowment and Pooled Funds)

Debited with:

1. amount paid for mortgage.

Credited with:

1. payments received on principal.

Preferred Stocks and Common Stocks (General Endowment and Pooled Funds)

Debited with:

1. cost of stock
2. market value of stock gift.

Credited with:

1. book value of stock sold
2. book value of stock rights sold.

Real Estate (General Endowment and Pooled Funds)

Debited with:

1. cost of real estate purchased
2. appraised value of real estate gift.

Credited with:

1. book value of real estate sold.

Institutional Property

Debited with:

1. endowment funds invested in institutional property.
Credited with:

1. return of funds invested in institutional property.

Funds Held in Trust by Others

Debited with:

1. amount of funds held in trust by others for the benefit of the institution.

Liabilities

Principal of Endowment Funds and Principal of Funds Temporarily Functioning as Endowment

Debited with:

1. loss on sale of investments
2. transfer from endowment funds to other funds.

Credited with:

1. donations received
2. transfer from other funds to endowment
3. gain on sale of investment.

Reserve for Gains and Losses on Investments

Debited with:

1. losses on the sale of investments.

Credited with:

1. gains on sale of investments.

Funds Held in Trust by Others

Credited with:

1. amount of funds held in trust by others for the benefit of the institution.

The accounts and transactions which have been presented above was an attempt to outline some possible conditions which might take place in an
endowment fund ledger. The accounting system is a vital part of endowment management. Without adequate records, it would be impossible to determine whether the endowment is being successfully managed or whether it is headed for ruin.

I believe that Russell and Reeves stated the consensus of most people who have any dealings with accounting, whether it be for an endowed institution or a commercial enterprise, when they made the following statement:

Satisfactory record-keeping and adequate reporting of factual data are essential to good administration in any institution. The keeping of records and making reports are not ends in themselves, but merely devices to facilitate educational activities. Although records and reports are not themselves directly connected with excellence in educational process, it seems advisable to examine the extent to which the condition of records and the adequacy of reports can be utilized as an index of institutional excellence.¹

CHAPTER VI

SUMMARY AND CONCLUSIONS

The growth of institutions of higher education has been tremendous in the past sixty years. The degree of specialization has been on the increase for the administration of these institutions. Costs of operating colleges and universities have grown to new heights and the need for more income has been a major problem which has plagued those responsible for administering the institutions of higher education. It has been necessary to seek out every possible source of increased revenue without increasing the cost of an education to such a height that it would be impossible for students of limited means to obtain it. In order to face and meet these increasing costs, it has been the problem of administrators to increase income without tremendously increasing tuition.

The endowment fund has been found to be a great income producer, if it is properly managed by competent persons who are well grounded in the principles of investments and investment management. It is conceivable that a well managed endowment could produce the income necessary to be the balancing factor in determining whether the institution will meet its current expenses or will be lacking of the necessary funds to meet the demands of an educational institution.

The writer has attempted to give a brief historical sketch of the development and evolution of financial administration of colleges and universities. The areas of financial administration were defined, and the specific areas which were to be covered in this thesis presented.

The foregoing chapters of this paper have endeavored to examine the
writings in the field of college endowment funds and to consolidate the
best thinking of the authorities with the limited experience of the writer
to develop a paper which could be used by persons desiring information con-
cerning endowment funds and their management.

The endowment fund of an educational institution is a fund, the prin-
cipal of which is to remain intact, and only the income from investing the
fund be used in the operations of the institution. The institution serves
in two capacities in relation to the fund, namely; the trustee and the
beneficiary. The institution has an obligation to the donor to the endow-
ment to invest the funds in the best possible way, not in a reckless way,
but in a way that will produce the maximum income and yet not endanger the
principal of the fund.

Each institution will have to determine its needs in relation to
organization for endowment management. There has been no attempt here to
present an endowment organization which would be best for all institutions
but there is presented in an earlier chapter suggestions of possible types
of organizational structure and some of the criteria for determining which
of these types of organizations are most likely to fit the needs of vary-
ing institutions. A type of organization might be suited for one institu-
tion but entirely unsuited for another. There are desirable and undesirable
features of the various plans presented but the institution can decide upon
a plan according to its circumstances.

The important factor to be observed by the organization responsible
for the endowment, regardless to the type of organization used, is to use
all available information in investing the funds. The best type of organi-
zation is not, in itself, sufficient to protect the institution against
loss of principal or of income from investments. No organization is better
than the personnel in charge. The most qualified persons should be included in any type of organization which is decided on by the institution.

The objectives of endowment management are somewhat the same for all endowed institutions. The two primary objectives of endowment management, safety of principal and the production of income, have been presented throughout this paper. Any discussion concerning the endowment would of necessity hinge on these objectives. Another objective which is prevalent in college endowment funds is the investing for capital gains. To accomplish this objective, the endowment investor must be well informed on the market, on the industries in the economy, and must be aware of the potentialities of various firms within each industry.

The objectives of endowment management have been defined and the next question might be; how will these objectives be realized? They will be realized through the manner by which the funds are invested. The funds may be invested in varying types of securities, real estate mortgages, real estate, and institutional properties. The funds should be invested in a manner which will allow for the maximum amount of safety. One safeguard for investments is diversification. The principle of diversification is based on the premise that the possibility of large losses can be kept at a minimum by proper distribution of the risk.

Diversification may be made from a geographical standpoint, as to type of security, as to type of industry, and as to maturity dates of holdings. The degree of diversification should be governed by plan which has been preset by some body of the institution, preferably the board of trustees. Diversification is merely an additional safeguard above and beyond the care that should ordinarily be exercised in the purchase of individual securities.
There are certain uses of the endowment fund which are in violation of the trust which has been placed in the institution by the donor and are in violation of the principles of good endowment management. Certain types of loans should not be made from endowments, endowment funds should not be invested in institutional properties unless it was given to the fund for this purpose, and endowment should not be used as security for loans made to the institution.

To aid in all of the foregoing functions of endowment management is the accounting records of the fund. Without proper records all of the other efforts would be fruitless. The persons responsible for the endowment can discharge their responsibility only by having accounts showing the holdings in the funds, the purchases and sales of securities, the income realized on the investments, and the distribution of the income realized.

One important principle of accounting for endowments is that investments are carried on the books at the price for which they are acquired or the market value of the gift at the time of receipt. Of course, a full and complete accounting on all features of the endowment is essential.

There can be no question of the need for a magnitude of information on college and university endowment management. It is true that there are institutions of higher education which do not have problems of administering endowment funds, however, it is believed that in the future all institutions will be faced with the problem. This is evident by the increase of endowment funds in publicly-controlled institutions of higher education. It is the hope that this paper on endowment management will be a valuable aid to persons delegated with the responsibility of managing the endowment of a college or university.
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