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Administrative Growth and Grant Payouts in Nonprofit Foundations: Fulfilling the Public Good amid Professionalization?

The Tax Reform Act of 1969 remains the core governing policy for the U.S. foundation sector, primarily for its qualifying distributions mandate, which ensures a baseline spending of foundation assets toward charitable purposes. However, implementation of this policy required additional foundation administrative resources and contributed to significant professionalization of the foundation sector. This article focuses on the payout requirement’s potential paradox of accountability, as administrative expenses can be counted toward fulfilling foundations’ qualifying distributions. Using a 14-year panel of grantmaking foundations, the analysis seeks to understand whether professionalization, measured by operating and administrative expenses, contributes to or crowds out grantmaking. Findings indicate that professionalization of the foundation sector has a small yet practically and statistically significant positive association with foundation grantmaking. From a policy perspective, the current structure of the qualifying distributions mandate does not appear to lead to a crowding out of grant allocations as administrative expenses grow.

Over time, a trade-off between foundation professionalization and charitable grant distributions could develop if administrative costs crowd out grants within the fixed percentage of assets spent each year. This analysis seeks to understand whether there is such a trade-off between professionalization and charitable purpose.

Many questions persist concerning what is gained and lost in the nonprofit sector’s professionalization given its civic and mission-driven roots. While professionalized practices may be accompanied by efficiency and accountability gains in the production of tax-exempt public goods, professionalization may also detract from nonprofit organizations’ mission focus (Hall 1992; Smith and Lipsky 1993; Suárez 2011). Previous research on professionalization in the sector has primarily considered service-providing charities. In this article, the focus is instead on a distinct class of nonprofit organizations that have been understudied in this regard: private grantmaking foundations.

For philanthropic foundations, the Tax Reform Act (TRA) of 1969 remains the core governing policy for the foundation sector. The payout policy serves as an accountability tool to ensure that foundation assets do not accumulate uncontrolled or directly benefit individuals related to the foundation. Yet the TRA introduced potential paradoxes of professionalization and accountability for foundations. Part of the legislation requires foundations to distribute a certain percentage of assets each year for charitable purposes (“qualifying distributions”) to ensure that foundations provide substantially public rather than private tax-exempt benefits. However, the resulting tax code allows foundations to include “reasonable and necessary administrative expenses” as part of mandatory qualifying distributions (Internal Revenue Code 4942[g][1][A]). Over time, a trade-off between foundation professionalization and charitable grant distributions could develop if administrative costs crowd out grants within the fixed percentage of assets spent each year. This analysis seeks to understand whether there is such a trade-off between professionalization and charitable purpose.
the public good amid professionalization?

From a principal–agent perspective, private foundations receive greater government scrutiny because foundations lack the informal and formal accountability measures that public charities receive from a broader base of donors.

Enacting the Regulation
Concerned that foundations hoarded assets and generated greater private than public benefits, policy attention was brought to bear during the 1950s and 1960s, culminating with passage of the TRA in 1969. Critics particularly questioned foundations’ distribution rates and the purposes for which they directed resources (Frumkin 1999; Hall 1992; Troyer 2000), and the path of regulation was one of suspicion. Troyer (2000, 54) described the “foreshadowing” that led to the TRA by tracing back two decades the congressional hearings, public statements, and special reports that drew in all levels of government, all the way up to the executive branch. Foundations were targeted for policy regulation because they were viewed as “pockets of great personal wealth” that operated without a “conventional constituency,” which allowed a relative free range of behaviors and a perceived lack of accountability (Simon 1995, 245). The Revenue Act of 1950 included a standard of “unreasonable accumulation” as an attempt to coax the disbursement of foundation resources to the public good (quoted in Edie 1987, 56).

According to Frumkin (1998, 266; 1999), the TRA signified the “first real” regulation of the foundation sector and included measures to define the sector, impose an excise tax, and govern grantmaking by restricting self-dealing and regulating asset disbursement, referred to as a payout requirement (Simon 1995; USHRG 1977). The TRA, therefore, represented a shock to the foundation sector compared to the incremental movement of policy regulation that previously had shaped the nonprofit sector (Young 2010). The payout requirement mandated that “private foundations must distribute all income currently (but not less than 6 percent of investment assets),” and imposed graduated sanctions in the event of failure to distribute (Joint Committee on Internal Revenue Taxation 1970, 36). The rate was eventually lowered to 5 percent in 1981 in order to appease foundations’ concerns about maintaining assets and charitable impact over time (Deep and Frumkin 2001; Troyer 2000; Worthy 1975).

The payout requirement was intended to ensure that foundations fulfill charitable purposes with minimal tax avoidance, but it was also designed to accommodate the operating and administrative work that it would take to fulfill this purpose (Troyer 2000). As the Joint Committee on Internal Revenue Taxation clarified, qualifying distributions under the TRA could include “direct expenditures for charitable purposes,” such as grants, and “expenditures for assets to be used for charitable purposes” (1970, 38). Thus, qualifying distributions calculated for the payout requirement included both the grants distributed to charities and the expenses related to administer those grants.

Evaluating Payout
Existing evaluation of the payout requirement has focused primarily on the payout rate and the impact that it has had on foundations’ ability to manage assets and giving over time (Billitteri 2007; Cambridge Associates 2000; Damon and Verducci 2006; Deep and Frumkin 2001; DeMarche Associates 1999; Frumkin 1998; Konrad, Moyers, and Nichols 1997; Labovitz 1974; Mehrling 1999; Ostrower 2009; Salamon, Voytek, and Council on Foundations 1989; Sansing 2010; Sansing and Yetman 2006). Others target the effect of the variable excise rate within the policy, finding that it discourages foundations from adjusting payments to demand, primarily because a higher tax is risked in future years if payout is increased in the current year (Damon and Verducci 2006; Deep and Frumkin 2001; Sansing 2010). The effect of allowing administrative expenses in the payout requirement has not been adequately assessed, although some have argued that eliminating administrative expenses from the payout calculation would lead to more efficient grantmaking by requiring...
greater grantmaking amounts and forcing foundations to critically evaluate their administrative costs (Frumkin 1998; Irvin 2007).

Evaluations of the payout mandate included in the TRA have been largely framed by two diverging normative expectations of foundations in society: that foundations should exist into perpetuity to address future unforeseen needs versus the perspective that foundations should provide greater public benefits by distributing wealth in current time periods. While each side has made sufficient arguments to either lower or raise the payout percentage, the fundamental disagreement about the appropriate longevity of foundation assets has led to stalemate and prevented significant policy reform. Therefore, further analysis appears unproductive in the absence of a more basic agreement on the underlying normative assumptions concerning the goals of the policy. The current analysis moves beyond examining the mandatory payout rate. Instead, the inclusion of administrative expenses as a part of charitable payout is empirically evaluated, which is especially pertinent given the continued growth and professionalization of the foundation sector.

Understanding Professionalization and Payout
The professionalization that has shaped the nonprofit sector, including foundations, is alternatively viewed as adding value by inserting greater accountability and legitimacy into the internal operations of organizations or as deteriorating the value of the sector by compromising or deemphasizing missions and public purpose in the process of administrative professionalization (Ashley and Van Slyke 2012; Hwang and Powell 2009). Professionalization in the sector has evolved over time and must be viewed in a historical perspective, which describes how the sector has been shaped as well as what has been gained and lost in the process.

Professionalization of the Voluntary Sector
The nonprofit sector’s legitimacy was traditionally rooted in its relations and reputation growing from its altruistic services, but pressures for resources and emphasis on accountability compelled nonprofits to professionalize so that they remained competitive with their professionalized peers in the public and for-profit sectors (Bezjian, Holmstrom, and Kipley 2009; Frumkin and Kim 2001; Hwang and Powell 2009; Salamon 2003). Professionalization has also been self-propelling, as professionals attract other professionals, contributing to the nonprofit sector’s increasingly professionalized and rationalized work behaviors (DiMaggio and Anheier 1990). While professionalization has brought “symbolic assurances of expertise,” it has also shifted the nonprofit sector from its volunteer and community-based roots (Smith and Lipsky 1993, 84).

The literature is divided on the effects of nonprofit professionalization, as it acknowledges both gains and losses as a result of the sector’s evolution. From one perspective, professionalization is credited with helping the nonprofit sector gain legitimacy and performance efficiencies (Frumkin and Kim 2001; Suárez 2011). For example, Frumkin (1999) explains that the rationalized practices that accompanied professionalization for foundations were paired with improved grantmaking strategies, processes, and relationships with grantees. However, others argue that professionalization of the sector has introduced threats to civil society and the social capital provided by voluntary organizations (Skocpol 2003). As Smith and Lipsky describe, nonprofits are “tangible, significant manifestations of community,” and “professionals bring norms and values that often conflict with the orientation of the community” (1993, 22, 84). Conflict may be introduced within the organization as well. For instance, Hwang and Powell (2009) point to possible mission drift as nonprofits evolve to more professionalized and rationalized processes that may divert resources even unintentionally from mission-related activities. With an increase in paid staff, Hall (1992) adds that professionalization signifies a shift of control in a nonprofit from the board of governance toward staff-centered control. Such a shift in control may impel decision making toward administrative perks rather than mission-related outputs.

The TRA and Professionalization
As a subsector of the nonprofit sector, foundations have also been professionalized in part because of the TRA. Despite disagreement on specific features of the policy, there is general consensus that the TRA has led to greater accountability and legitimacy in the foundation sector, which developed amid the general trend of professionalization of the nonprofit sector (Damon and Verducci 2006; Hwang and Powell 2009; Salamon 2003; Suárez 2011). In the context of the TRA, professionalization of the foundation sector was also a necessity in that the policy’s regulations required the oversight of paid professionals (Frumkin 1999; Hall 1992; Smith and Lipsky 1993).

The implementation of the TRA triggered a hiring spree among foundations as they were asked to fulfill new administrative and procedural obligations in grantmaking and foundation management (Frumkin 1998, 1999; Hall 1992; Labovitz 1974; Worthy 1975). Frumkin (1999) explains that previous experience working with a foundation became a prominent qualification for foundation candidates, whereas previous to the TRA, subject matter expertise, such as in health or education, was more highly valued. Several studies (Margo 1992; Worthy 1975) have documented the growth of foundation administrative expenses for the period immediately following payout implementation, and this growth corresponded with a short-term decline in the ratio of grants to total expenses (Margo 1992). In a more recent study of foundation expenses, Ahn, Eisenberg, and Khamvongsa (2003) report that once allowable administrative and other expenses are isolated, grants only constitute between 3.5 percent and 4 percent of assets, implying that there are potentially significant costs of accountability in terms of the overall public benefit produced. Adding to these earlier studies, Boris and colleagues (Boris et al. 2006; Boris et al. 2008) descriptively analyze the administrative expenses of the 10,000 largest U.S. foundations between 2001 and 2003 and find that having paid staff and staff size are the largest contributors to foundations’ reported ratios of qualifying administrative expenses to grant distributions. Taken together, these findings suggest that professionalization could significantly crowd out grant distributions as foundations develop over time, a trade-off that this analysis explores.

Framing the Hypotheses
The intersection of the payout requirement and the professionalization of foundations presents a potential paradox in that accountability to the TRA requires administrative expenses that could detract from foundations’ charitable output. On one hand, having paid professional positions on staff and growing a foundation’s professionalized operations conceivably increase its grantmaking efficiency by developing the organization’s expertise, management practices,
and internal accountability systems. From this perspective, such professionalization could contribute to the charitable purposes of the foundation, justifying the counting of paid staff in the measure of qualifying distributions (Boris et al. 2006; Damon and Verducci 2006; Irvin 2007; Lenkowsky 2002; Silverman 2004; USHRG 1977). Having paid staff also enhances a foundation’s ability to provide charitable services beyond grantmaking. As Silverman (2004) points out, a foundation’s operating and administrative activities not only may further the charitable work of a foundation but also are charitable work themselves. The TRA and resulting tax code recognize this in Treasury regulation 53.4942(a)-2(c)(2), which excludes assets that the foundation uses for direct charitable activities in the payout calculation and includes grantmaking administrative expenses as counting toward the payout requirement. From this perspective, the professionalization of foundations’ grantmaking operations has extended the legitimacy and accountability that the TRA sought as foundations have become equipped with the human resources to fulfill the regulation, both in the spirit and the letter of the law.

On the other hand, much of the debate over the payout rate concerns the ability of foundations to maintain the inflation-adjusted value of assets over time (Steuerle 1977). In alignment with foundations’ general preference for a long-term sustainability strategies, some have argued that the 5 percent payout requirement serves as a cap instead of a floor, with foundations restricting qualifying distributions to internally set percentages to preserve the long-term value of assets (Deep and Frumkin 2001; Irvin 2007; Mehrling 1999; Toepler 2004). Professionalization, therefore, could crowd out charitable activity as expenses accrued from additional administrative costs are accounted for in the qualifying distributions and redirect resources from charitable grantmaking (Lenkowsky 2002).

Other studies have linked staff size and charitable purpose, but they have generally used the more broadly defined qualifying distributions as a measure of charitable purpose and have not isolated the impact of professionalization on grantmaking (Margo 1992; Ostrower 2009). As Boris et al. (2008) indicate, this is an important distinction, as a significant portion of the administrative expenses allocated toward qualifying distributions are in the form of compensation. To assess whether professionalization constrains or contributes to grantmaking, this study isolates grant payments from the total qualifying distributions and uses operating and administrative expenses as a proxy for professionalization. As explained earlier, there are two competing hypotheses derived from the literature. Professionalization could contribute to grant payments and overall public benefit as foundations gain efficiencies and higher levels of mission-related performance with increased staffing and administrative support (hypothesis 1a). Alternatively, increased professionalization may limit grantmaking as foundation agents account for administrative expenses as a “filler” to achieve the mandatory payout rate (hypothesis 1b). Thus, the research question is tested with the following competing hypotheses:

Hypothesis 1a: Increases in the operating and administrative expenses of a private foundation will lead to greater charitable grant distributions.

Hypothesis 1b: Increases in operating and administrative expenses of a private foundation will lead to lower charitable grant distributions.

Data and Methods
Developing the Sample
All U.S. private foundations annually complete and return Internal Revenue Service (IRS) Form 990-PF to maintain their tax exemption. As the foundation’s tax return, this form documents financial reporting, including compliance with the qualifying distribution requirement stipulated in the TRA. The National Center for Charitable Statistics (NCCS) maintains IRS 990 records of 501(c)(3) nonprofit organizations, including foundations.

For the purposes of this analysis, a 14-year panel of private grant-making foundations was developed for the period 1997–2010 based on data from the NCCS to understand the impact of operating and administrative expenses on grantmaking over time. Following Sansing and Yetman (2006) and Sansing (2010) and given the interest of this analysis, the sample of foundations is further narrowed to only include active foundations that report both having assets and making grants over the course of the panel. These restrictions reduce the sample to 689,357 observations across an unbalanced panel of 77,388 foundations. As shown in table 1, the number of foundation observations increases annually, which is consistent with the growth of the foundation sector over this time period (Blackwood, Roeger, and Pettijohn 2012).

Developing the Model
Referring to the research question, foundations’ annual total grant expense is used as the dependent variable, measured according to the dollar amount of contributions, gifts, and grants paid out during the

Table 1 Summary of Foundation Observations across Panel Years

<table>
<thead>
<tr>
<th>Year of Tax Return</th>
<th>Total Foundations</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>35,285</td>
</tr>
<tr>
<td>1998</td>
<td>37,678</td>
</tr>
<tr>
<td>1999</td>
<td>39,058</td>
</tr>
<tr>
<td>2000</td>
<td>42,645</td>
</tr>
<tr>
<td>2001</td>
<td>42,863</td>
</tr>
<tr>
<td>2002</td>
<td>47,405</td>
</tr>
<tr>
<td>2003</td>
<td>49,468</td>
</tr>
<tr>
<td>2004</td>
<td>50,787</td>
</tr>
<tr>
<td>2005</td>
<td>54,054</td>
</tr>
<tr>
<td>2006</td>
<td>52,453</td>
</tr>
<tr>
<td>2007</td>
<td>56,086</td>
</tr>
<tr>
<td>2008</td>
<td>58,318</td>
</tr>
<tr>
<td>2009</td>
<td>61,001</td>
</tr>
<tr>
<td>2010</td>
<td>62,256</td>
</tr>
<tr>
<td>Total</td>
<td>689,357</td>
</tr>
</tbody>
</table>
tax year. This variable represents the total aggregated grant amounts distributed to public charities in each foundation’s tax year. In this study, we use this variable as an objective measure of a foundation’s activities directed toward public benefit. While this is not the only activity foundations undertake, the distribution of assets in the form of grants is, in general, foundations’ primary charitable function. As an objective measure, using grantmaking amounts as the dependent variable allows for comparison of the effect of professionalization on this charitable function across foundations. This variable is not without limitations (e.g., it lacks qualitative indicators of grantmaking quality), but it provides the most direct measure to test this research question. Following previous research, grant expenses and all other financial variables are adjusted for inflation using the consumer price index (U.S. Bureau of Labor Statistics 2012), with 2010 as the base year, and transformed to the natural logarithm to adjust for skewness and to facilitate the interpretation of estimated coefficients as elasticities (Okten and Weisbrod 2000; Tinkelman 2004).

The key independent variable for this analysis is total foundation administrative expenses. This variable is measured as the real dollar amount of operating and administrative expenses paid out during the tax year, as reported on a foundation’s IRS Form 990. It is worth noting that this variable is used as a proxy for professionalization instead of as a true measure of professionalization. A review of the literature shows that various concepts of professionalization exist. Other organizational research focuses on rationalized business policies and practices that, while harder to measure, represent professionalization as a broader concept than simply the retention of paid staff (Hwang and Powell 2009). Yet Hwang and Powell (2009) find a positive correlation between administrative expenditures and rationalized or professionalized management practices for nonprofit organizations, which supports the use of administrative expenditures as a proxy for professionalization. Lacking additional data on management practices, administrative expenses indicate investment in professional, paid staff, which is expected to lead to more professionalized management practices. This operationalization is also consistent with previous literature on foundations that has used administrative expenses, staff, or overhead expenses to represent professionalization (Sansing and Yetman 2006). In the empirical model, the variable for operating and administrative expenses is included as the natural logarithm of the lagged three-year moving average of these expenses.\(^5\) Because foundations plan future grantmaking strategies based on current asset growth and other relevant trends, the operating and administrative expenses variable is lagged one year to account for a related lagged impact from administrative capacity on the next year’s grant payments. Lagging this variable also helps minimize endogeneity between the dependent and independent variables. A three-year moving average is used to smooth random yearly volatility in these expenses and to more adequately serve as a proxy for professionalization trends within foundations.

While the research question is intent on illuminating the relationship between administrative expenses and grant payout, other contributors to grant payout that have been identified by previous research are used as controls. The size of foundation assets has been considered a factor in grant payout, as many foundations manage payout to operate in perpetuity (Cambridge Associates 2000; Guo and Brown 2006; Salamon, Voytek, and Council on Foundations 1989; Sansing 2010; Sansing and Yetman 2006; Seaman and Young 2010; Tuckman 1992). Because noninvestment, charitable-use assets are excluded from the payout calculation, total of assets used in the payout calculation (“investment assets”) is used (Form 990-PF Part X, line 1d).\(^6\) As with administrative expenses, annual investment assets are adjusted to constant 2010 dollars and measured as a lagged log of the three-year moving average of the dollar value of these assets, as rolling averages of prior assets are commonly used in endowment spending formulas (Bowman 2011, 41). Asset growth is also controlled for using the lagged change in investment assets (i.e., the change in investment assets from time period \(t–2\) to \(t–1\)), as the growth of assets affects grant payout as foundations align distribution with annual asset growth (Deep and Frumkin 2001; Labovitz 1974; Salamon, Voytek, and Council on Foundations 1989; Sansing and Yetman 2006; Seaman and Young 2010). Because foundations adjust or maintain grant disbursements in order to qualify for a lower excise tax rate, a lagged dummy variable, excise tax, is included for foundations that qualify for a 1 percent rather than 2 percent excise tax rate (Damon and Verducci 2006; Deep and Frumkin 2001; Sansing 2010; Sansing and Yetman 2006). The excise tax variable is equal to 1 if the foundation qualified for the 1 percent excise tax rate in the previous year and 0 otherwise. Age is also included because younger foundations tend to have higher administrative expenses but are also more likely to be limited-life foundations, indicating a higher payout rate (Boris et al. 2006; Boris et al. 2008; Guo and Brown 2006; Ostrower 2009). Age is calculated as the difference between the filling year and the date of the foundation’s incorporation as indicated on Form 990. Year, operationalized as the year of the tax filing, is also included as a set of dummy variables.\(^7\)

The following regression model is developed:

\[
\text{grants}_it = \beta_0 + \beta_1 \text{opadmin}_{it–1} + \beta_2 \text{assets}_{it–1} + \beta_3 \text{age}_{it} + \delta_i + \epsilon_i + u_{it},
\]

where \(\text{grants}_it\) is the natural logarithm of annual grant distributions; \(\text{opadmin}_it\) is the main variable of interest measuring foundation professionalization expenses; \(\text{assets}_it\) is a vector of foundation investment assets and change in investment assets; \(\text{age}_it\) is foundation age; \(\delta_i\) is a vector of dummy variable controls for year and qualifying for reduced excise taxes in the prior year; \(\epsilon_i\) is the foundation’s time-invariant unobserved effect; and \(u_{it}\) is the idiosyncratic error term. The model is estimated using organization and year fixed effects to control for unobserved foundation-specific variables, such as location and foundation type, which are expected to be associated with other variables in the model and time-specific factors, such as economic and societal conditions that affect foundation management.\(^8\) Standard errors are clustered by foundations’ Employer Identification Number to make the estimates robust to heteroskedasticity and serial correlation.\(^9\)

**Descriptive Statistics**

As shown in the descriptive statistics, administrative expenses accrued from professionalization represent a significant portion of U.S. foundations’ qualifying distributions. At the median, foundations in the sample dedicated 12 percent of total expenses to operating and administrative expenses and 88 percent to charitable grants and contributions. Thus, most expenses are dedicated to grants, but foundation administrative expenses are by no means insubstantial. Relevant to the payout requirement, the median foundation in the sample distributed 5.4 percent of its investment assets as charitable
grants and paid 1.1 percent of investment assets in administrative expenses, but these statistics vary by foundation size. Figure 1 presents box plots of the proportion of investment assets that foundations distributed in the form of charitable grants by foundation size, based on quartiles of the foundations’ reported investment assets, adjusted for inflation. As shown in figure 1, foundations in the smallest quartile with investment assets under $170,809 tended to spend above the mandatory level on grants over the course of the sample, distributing a median of 8 percent of investment assets in the form of grants. Larger foundations spent lower proportions of assets on grants, and foundations in the largest quartile with investment assets over $2,447,833 distributed a median of 4.9 percent of investment assets as grants.

If grant payouts are lower than 5 percent, foundations do not meet the 5 percent payout requirement unless their administrative expenses are factored in to meet this minimum payout threshold. On average across the sample, foundations met the distribution requirement with grants alone around 62 percent of the time. However, between 9 percent and 11 percent of foundations that met the distribution requirement each year (around 17 percent in the largest quartile of foundations) would have failed to meet the mandatory payout rate if administrative costs had not been included. Further, the percentage of total expenses paid as investment assets has steadily increased in the last 10 years, with a median of 8 percent of investment assets, adjusted for inflation. As Deep and Frumkin (2001) describe, the foundation sector is heavily populated by foundations with relatively few assets and less densely populated by foundations with extremely high asset values. Consistent with previous research, this sample includes extreme values, so the full descriptive statistics in table 2 are presented both as averages and as medians. The average annual grant disbursement is $635,705, but it is only $53,165 at the 50th percentile, indicating some extreme amounts. Foundations from the sample report operating and administrative expenses at an average of $204,647, whereas the median is $6,636, which again indicates the skewed distribution of foundation expenses, as well as that many foundations have not yet professionalized by hiring staff. The average value of investment assets held among foundations is $9,898,768, with a median of $709,196. The average age of the foundations is 16.6 years. Select variables from the model are summarized in table 2 according to mean, median, and distribution.

**Results**

In the panel regression analysis in table 3, the effect of administrative expenses on grant payments is both positive and statistically significant ($p < .001$). However, the effect is slight, indicating a relatively inelastic relationship. As administrative expenses increase by 1 percent, grants are expected to increase by only around 0.03 percent. Although the effect is small, it is economically significant. For example, adding an additional full-time staff person, based on an average salary of $70,000 for foundation program officers (Council on Foundations 2005) plus benefits, would increase administrative expenses by around $100,000. For a foundation with the sample median values of administrative and operating expenses, investment assets, and change in investment assets that qualifies for a reduced excise tax, a growth of $100,000 to support an additional program officer would result in a corresponding growth of around $14,000 in grants, which could translate into an additional grant made to a nonprofit. Sensitivity analyses using alternative specifications indicate marginal variation in this effect across foundations. For instance, introducing a quadratic of the operating and administrative expenses variable suggests a slight increasing effect as administrative expenses grow ($b = .002, p < .001$). Interaction terms between administrative expenses and investment assets also suggest marginally greater effects for larger foundations, while an interaction

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**Table 2** Summary Statistics for Foundation Sample

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>Median</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grant payments</td>
<td>$635,705</td>
<td>$53,165</td>
<td>$15,300,000</td>
</tr>
<tr>
<td>Operating and administrative expenses</td>
<td>$204,647</td>
<td>$6,636</td>
<td>$75,500,000</td>
</tr>
<tr>
<td>Investment assets</td>
<td>$9,898,768</td>
<td>$709,196</td>
<td>$441,000,000</td>
</tr>
<tr>
<td>Age (years)</td>
<td>16.6</td>
<td>10.95</td>
<td>15.4</td>
</tr>
<tr>
<td>Qualifies for reduced excise tax</td>
<td>0.45</td>
<td>0</td>
<td>0.65</td>
</tr>
</tbody>
</table>

Note: $N = 689,357.$

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**Table 3** Explaining Foundation Grant Payments

<table>
<thead>
<tr>
<th>Variables FE Model</th>
<th>Coefficient</th>
<th>Standard Error</th>
<th>$p$-value</th>
</tr>
</thead>
</table>
| Operating and administrative expenses, log ($t – 1) | .032*** | (.003) | \(< .001; **
| Assets, log ($t – 1) | .414*** | (.007) | \(< .001; **
| Change in assets ($t – 1) | .124*** | (.007) | \(< .001; **
| Age | .192*** | (.041) | \(< .01; *
| Qualifies for reduced excise tax ($t – 1) | .093*** | (.003) | \(< .001; ***

Notes: The model is estimated using organization and year fixed effects (not reported). Standard errors are clustered at the organization level. All financial variables are adjusted for inflation.

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As Deep and Frumkin (2001) describe, the foundation sector is heavily populated by foundations with relatively few assets and less densely populated by foundations with extremely high asset values. Consistent with previous research, this sample includes extreme values, so the full descriptive statistics in table 2 are presented both as averages and as medians. The average annual grant disbursement is $635,705, but it is only $53,165 at the 50th percentile, indicating some extreme amounts. Foundations from the sample report operating and administrative expenses at an average of $204,647, whereas the median is $6,636, which again indicates the skewed distribution of foundation expenses, as well as that many foundations have not yet professionalized by hiring staff. The average value of investment assets held among foundations is $9,898,768, with a median of $709,196. The average age of the foundations is 16.6 years. Select variables from the model are summarized in table 2 according to mean, median, and distribution.
with age suggests slightly weaker effects for older organizations. Thus, increased professionalization of foundations is not expected to lead to a decline in grantmaking, and there is evidence that professionalization instead contributes to greater overall grants made, even though the average effect is marginal and varies slightly across foundations.

Consistent with expectations under the TRA and previous research findings, foundation size, represented by investment assets, is significantly and positively associated with grant payouts (p < .001). Controlling for other variables in the model, foundations with 1 percent greater investment assets make around 0.4 percent larger grant payments. Also in line with previous research, prior asset growth is positively related to current grant payments, in that a 1 percent increase in asset growth from two years previous will result in about a 0.1 percent growth in grant payments. Having a reduced excise tax rate is expected to positively affect grantmaking (p < .001). Foundations increase grantmaking by about 9 percent if they qualified for the reduced tax rate in the previous year. Foundations are also expected to increase grantmaking as they age.

**Discussion**

With reference to the intent of the TRA, foundations are expected to fulfill public good expectations through the redistribution of assets in the form of charitable grants, and they receive tax benefits to act as taxpayers’ agents in this regard. Because the foundation sector has professionalized, in part as a result of the professionalization of the nonprofit sector in general, but also as a result of the administrative responsibilities of the TRA, the intent of this analysis was to determine whether the professionalization of foundations contributes to or detracts from foundation grant payments. With a relatively inelastic response of total grant payouts to administrative expenses, the overall relationship between foundation professionalization and grantmaking appears marginal. Yet, even if marginal, professionalization is not found to erode grant payments in favor of administrative expenses and instead contributes to slightly positive net grant payments on average, controlling for foundation size, age, growth, and the other relevant factors presented earlier. Thus, the hypothesis (1b) that higher operating and administrative expenses lead to lower grant payout is rejected.

These findings contribute to the broader literature concerning the influence of professionalization on the nonprofit sector over time (Guo 2007; Hwang and Powell 2009; Suárez 2011). Professionalization is generally found to equip organizations, foundations included, to improve accountability and performance efficiencies. Similar to the findings of this analysis, others have found generally positive effects of professionalization on nonprofit performance (Guo 2007; Hwang and Powell 2009; Stone, Hager, and Griffin 2001; Suárez 2011). Given the increasing professionalization of the nonprofit sector over time, the discussion of the net effects of professionalization remains relevant. The findings of this analysis provide support for slight net public benefits of professionalization in terms of foundation grantmaking amounts, but additional research is needed to fully understand the impacts of professionalization on other grantmaking outcomes. For instance, considering the other ways that paid foundation staff may contribute to foundation visibility, grant monitoring, compliance, and evaluation, grantmaking professionalization likely has benefits to charitable and mission-related outcomes that extend beyond an increase in the distribution of charitable dollars.

Increased professionalization of foundations is not expected to lead to a decline in grantmaking, and there is evidence that professionalization instead contributes to greater overall grants made.

Paired with the purpose of the TRA, these results appear to affirm that professionalization supports the public good of foundations. Especially considering that additional foundation staff contributes to public good outcomes in meaningful ways beyond grantmaking, the current policy, which includes administrative and operating expenses as a part of the mandatory payout, does not appear to lead to a shirking of public responsibilities. On the contrary, professionalization may lead to stronger adherence to the public value exchange implicit in private foundations’ tax exemptions.

This finding supports the current payout policy initiated by the TRA, as professionalization appears to contribute to a foundation’s fulfillment of both its internal and its external accountability expectations. Therefore, removing administrative expenses from the qualifying distributions calculation may be unwarranted, as professionalized capacity appears to both support accountability to the regulation and facilitate the mission of the foundation. Yet even such a marginal impact of professionalization begs the question of whether an alternative policy would produce greater grantmaking impacts.

This analysis leads to additional questions that could be addressed in future research. For instance, following on the research of Boris and colleagues (Boris et al. 2006; Boris et al. 2008), who analyze operating expenses and qualifying distributions, more could be done to dissect the components of operating and administrative expenses to learn more about the nuances of these expenses and how they affect grant payments. For example, Sansing and Yetman (2006) found that foundations that were more actively managed had higher payout rates, a finding that warrants further investigation according to a foundation’s salaries and types of positions, such as adding program officers versus investment managers. In addition, while the findings of this analysis point to a positive relationship, the dependent variable of grant payments better indicates the quantity rather than the quality of grant outcomes. Therefore, future research is encouraged to include measures of quality in grantmaking, such as mission targeting and program-related outcomes achieved through grantmaking, in order to further assess the impacts of professionalized foundation administrators.

The findings of this analysis provide support for slight net public benefits of professionalization in terms of foundation grantmaking amounts.

Other findings from this analysis highlight contributors to foundation grant payments and thus directions for future research. Drawing on previous literature, qualifying for a reduced excise tax creates an incentive for foundations to constrain grantmaking, but this finding suggests instead that the reduced excise tax acts as a facilitator of grantmaking. Foundations that achieve reduced excise...
tax are expected to increase grant payments, likely in order to maintain reduced tax payments because the excise rate is based on a calculation of prior grant payments. Additional research to understand the interaction of excise tax rates and grantmaking could inform this motivation for increasing grant payments once the taxes are reduced or, alternatively, to restrain current grantmaking increases in order to facilitate meeting the 1 percent tax threshold in future years. In addition, foundations with a clearer focus of mission have been argued to make greater grant distributions because they have a clear focus for giving and anticipate a return on grant investments toward their mission (Billitteri 2007; Damon and Verducci 2006; Deep and Frumkin 2001; Ostrower 2009; Silverman 2004). The influence of mission clarity was not included in this analysis because the data did not contain a sufficient proxy, but future research could address this shortcoming. Further analysis of these and other effects across additional foundation characteristics from other data sources, such as foundation type, could lead to additional insights. Finally, there remain many potentially fruitful lines of inquiry concerning foundation professionalization. For instance, professionalized foundations may be influenced by staff more than donor board members, so an analysis of trends in grantmaking focus relative to professionalization may provide insights to whether professionalized foundations stray from original donors’ intents (Hall 1992).

Conclusions
The foundation sector was created and vested with tax benefits to provide a public good, implying a broader purpose than fulfilling the qualifying distributions mandate, which has largely defined analysis of the sector’s performance to date. The regulations of the TRA were imposed on the foundation sector because concerns abounded that foundations were failing in this public purpose in a way that was discordant with the tax benefits they enjoyed. Yet the implementation of the TRA’s qualifying distributions afforded foundations flexibility beyond a strict interpretation of grant payments as public purpose. With this implementation flexibility and increasing professionalization of the sector, foundations count operating and administrative expenses as part of qualifying distributions. This analysis found a positive, though limited, effect of foundation professionalization on fulfilling public expectations, at least in terms of the distribution of charitable grants. Referring back to the policy design, this analysis assessed that the inclusion of administrative expenses in the distributions’ calculation has not constrained the philanthropic purpose of foundations and instead supports the philanthropic grantmaking capacity of private foundations.

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Notes
1. According to Sansing and Yetman, the excise tax is a “dual excise tax rate” based on the foundation’s net income. They further describe the role of the tax: “If a foundation’s charitable distributions (as a percentage of investment assets) during the year exceed the average distribution percentage over the past 5 years plus 1% of its net investment income, the foundation pays a 1% tax on its net investment income. If the current year’s charitable distributions are less than the five-year average benchmark plus 1% of its net investment income, the tax rate is doubled to 2% (section 4940(d))” (2006, 364).

2. These data include private independent, family, and corporate grantmaking foundations, but because IRS Form 990-PF lacks identifiers of “family,” “independent,” and “corporate” foundations, we are unable to distinguish among these foundation types in the data. Operating foundations are excluded because they are designed to benefit one organization instead of a broad class of charities, and community foundations are not subject to the same administrative requirements as other foundations in the TRA. Community foundations are also excluded because they are supported by general donations from their communities and formally defined as public charities.

3. Conduit organizations are defined as organizations that have no assets (= 0) (Sansing and Yetman 2006); 59,616 observations were dropped that met this criterion. The sample was cleaned to drop organizations with reporting errors, including 1,133 foundations that reported negative assets and 148 foundations that reported negative grants. The sample was further refined to exclude 3,088 foundations that were deemed “out of scope” by the NCCS.

4. A total of 205,168 observations were excluded, dropping foundations from the sample that had more than one year without grantmaking activity and year observations of foundations that reported zero grants in only one year. Another 8,439 observations were dropped because of missing data.

5. Following Okten and Weisbrod (2000), because the data include observations that report zero administrative expenses, one (1) was added to operating and administrative expenses before logging.

6. The value of total assets was used for 34,114 observations for which “investment assets” was left blank or coded 0.

7. Because of the way the model is constructed with a lagged change of assets, a combined reference group of 1997–98 is used.

8. Organization fixed effects implicitly control for foundation-level variables that we do not observe because of lack of data. Specific foundation-level variables such as foundation type (family, independent, corporate) would be of interest to explicitly include in future research to discern differences in the effect of professionalization by foundation-specific characteristics. While these variables were not available for this study, there is some evidence from a sensitivity analysis to suggest that the effect may not vary drastically across foundation type. Analysis of the variance of the slope coefficient of administrative and operating expenses in a multilevel growth model with repeated measures nested within foundations demonstrated that the effect of administrative expenses on grant payments was statistically significant ($p < .001$) but did not significantly vary across foundations ($t^{2}$ variance component $= 0.038, p > .500$), indicating that the main effect we investigate in this analysis would not be expected to change significantly across foundation type.

9. The results were found to be robust to alternative specifications using both fixed effects and random effects, including models that exclude controls for asset growth and excise tax, models that include state instead of organization fixed effects, models that exclude age, models that substitute total assets for investment assets, and models that control for lagged three-year moving averages of grant payments. The coefficient on the main variable of interest, administrative and operating expenses, is slightly greater in random effects models ($b = 0.74, p < \text{.001}$); however, Hausman’s specification test favored fixed over random effects ($\chi^{2} = 8425.08, p < \text{.001}$).

10. Outlier ratios above 1 are excluded, which are found disproportionately in foundations with very low investment assets below $50,000.

11. As Boris et al. (2008) discuss, some grantmaking programs, such as those that distribute grants internationally or to individuals (such as scholarships), are more costly to administer, which could explain some variation in these expense ratios across foundations, and some administrative expenses may be spent providing direct charitable programs. Foundations also may apply grant expenses exceeding their mandatory payout threshold from the past five years to help them meet their charitable distribution requirement in the current year (Boris et al. 2008, 26–27).
12. This effect was consistent when operationalizing professionalization as compensation of officers within the foundation ($\theta = .032, p < .001$).

References


