



FURMAN

2007 Best Practices

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Abstract

For many years, Chief Business Officers serving colleges and universities have been responsible for a wide array of activities. Managing the financial areas of the institution, facilities, auxiliary enterprises and administrative services, honed a generation of administrators who were very much "jack of all trades". As these talented individuals have come to appreciate, there are certain functions falling under the traditional "business affairs" umbrella that now demand specialized attention.

Endowment management certainly falls within this category. Years ago, endowments consisted of a large percentage of corporate bonds and stocks. It was a manageable task to oversee investments at the Chief Business Officer level, with perhaps some bookkeeping assistance from the Controller's Office, and good advice from a consultant. However, as endowments have grown and become more diverse in the asset classes they deploy, specialized attention must be afforded to meet institutional endowment goals.

Furman University, a small liberal arts college in Greenville, South Carolina, recognized the need to better manage its endowment, particularly as it realized its low relative endowment per student (\$159,000) was not contributing positively to its ability to compete with other nationally acclaimed liberal arts colleges. The institution embarked on a campaign to improve management of its approximate \$350 million endowment, improve returns, and better identify risks.

National literature and practices at peer and aspirant schools led Furman to implement the following best practices of endowment management:

- ***Adopted a modern asset allocation strategy and a systematic review process***
- ***Implemented a constant growth spending model***
- ***Minimized unnecessary fees associated with endowment management***
- ***Restructured the "money" committees of the Board***
- ***Appointed an Investment Advisory Council***
- ***Staffed the investment function properly.***

*Furman's attention to endowment management is on going. Since embarking on a plan to optimize management of the endowment, Furman's investment returns have improved significantly. **In fact, for the trailing one, three and five year periods, returns were 19.8%, 22.0% and 11.1% respectively.** Most importantly, the Trustee committees, administration and staff are positioned to continue to produce positive results well into the future.*

Introduction of Organization

Furman University is an independent, coeducational, liberal arts university. Founded in 1826, it moved to its current campus on the outskirts of Greenville, South Carolina in 1953. The university is nationally known for its academic excellence, engaged learning program and campus beauty ([Take a Virtual Campus Tour](#)).

Predominantly an undergraduate institution, Furman enrolls 2,623 undergraduate and 473 graduate students. Students come from 46 states and 31 foreign countries. The university employs 200 full-time faculty and 550 full-time staff.

Funded primarily by tuition and fees, Furman relies on spending from its approximate \$350 million endowment to supply 7% of its annual operating budget each year.

Statement of Problem/Initiative

Furman's endowment per student consistently ranked in the lowest decile of endowments associated with its peer schools. The Trustees and administration desperately wanted to improve this situation, as the lack of financial resources prohibited Furman from competing equally with nationally acclaimed liberal arts universities. Fundraising, of course, is and was an on-going strategic initiative aimed at rectifying the situation. However, the Furman trustees and staff believed that value could be added to the endowment through careful management, as well.

As the University began to examine its investment policy and the procedures for managing the endowment, the following conditions, policies and procedures were in place:

1. The University's asset allocation was weighted approximately 60/40 (stocks to bonds), with little diversification.
2. The spending policy from the endowment was much like the policy still employed by approximately 90% of other colleges, and universities. Furman spent 5% of a 3 year rolling average balance of the market balance of its endowment.
3. Returns on the endowment were moderate.
4. The standing committees of Furman's Board of Trustees included three committees dedicated to financial management. They were:

The Finance Committee – Although not generally exercised, the Finance Committee’s responsibilities included general supervision of the financial affairs of the University. The Finance Committee was only secondarily charged with approving investments and investment policies pursuant to recommendations and information provided by the Vice President for Business Affairs. Membership on the committee was granted to any Board member who expressed an interest and the number of committee members was usually ten to twelve.

The Budget Committee – Annually, this committee received and reviewed the President’s proposed budget for the next fiscal year. It was charged with presenting the budget to the Board with any recommendations it determined to be appropriate. The Budget Committee was charged with the responsibility for monitoring the budget and assuring sound accounting principles were being consistently applied. The committee was a large group of fifteen Trustees.

The Audit Committee – The Audit Committee’s responsibilities included appraising the financial control and accounting systems of the University and recommending changes it deemed appropriate. The Committee also chose the independent auditor for the institution. The Audit Committee consisted of three to four Board members.

Design

The Trustees and administration relied on the University's consultant, Cambridge Associates, for recommendations to improve investment returns and management of the endowment. Additionally, Furman's Business Affairs staff surveyed peer and aspirant schools to identify best practices. The staff reviewed professional publications on the subject, including those by NACUBO and AGB.

A set of recommendations was devised and buy-in was achieved with the President. Key trustees reviewed draft recommendations and provided feedback and suggestions. The administration presented its final recommendations to the Board, they were approved, and the institution moved toward implementation.

Implementation

Best Practice #1 – Adopted a modern asset allocation strategy and a systematic review method, allowing for strategic changes to the asset mix and an annual assessment of risk.

Furman’s trustees began dedicating one of their four meetings per year to an in-depth discussion of asset allocation. This discussion generally lasts an entire day, and is led by the University’s staff and outside consultant. Through these thorough reviews, the asset allocation has become more sophisticated. Currently the following targets are in place for various asset classes:

Equity Fund	Long-Term Target
U.S. Equity	20%
Non-U.S. Equity	20%
Emerging Markets Securities	10%
Venture Capital/Private Equity	10%
Marketable Alternative Assets	20%
Real Estate	0%
Commodities	10%
U.S. Bonds	10%
	100%

The process of risk identification, assessment, and control depends on the perspective of the entity. For Furman, it is imperative for investment returns to keep pace with spending and inflation while preserving the real purchasing power of the endowment portfolio. In order to generate sufficient investment returns, systematic assessments of the endowment portfolio’s risk environment are conducted regularly. The fund assets are monitored by the staff and its consultant with the use of a proprietary database. This risk assessment is completed across the manager, asset

class, and total assets levels. Instead of assessing risk based simply on performance measures, Furman utilizes a policy that evaluates how portfolio results are obtained with regard to risk.

Any risk assessment starts with an understanding of systematic and unsystematic risk. Systematic (market) risk is inherent in every security and cannot be avoided. Conversely, unsystematic (manager/company specific) risk is also inherent in every security but can be reduced through diversification. In Furman's case, manager specific risk has been reduced through increased exposure to a broader array of asset classes (emerging market securities, venture capital/private equity, marketable alternative assets, commodities, real estate, etc.). Furman diligently assesses the inherent risks of the endowment portfolio which cannot be diversified away. These include, but are not limited to, the following types of risk:

- Asset Liquidity
- Behavioral
- Credit
- Currency
- Inflationary
- Information
- Market
- Regulatory
- Operational
- Over-Diversification
- Reputation
- Tax

To systematically assess the risk of an investment portfolio, the most commonly used measures are broken up into three categories: absolute measures, relative measures (require a benchmark), and measures based on regression analysis. Absolute measures use analytical tools such as

standard deviation and the Sharpe ratio to systematically assess the risk of a position, manager, or portfolio. Relative measures, on the other hand, utilize the following figures to assess risk with the use of a specific benchmark: excess return, tracking error, downside risk, and relative standard deviation. Finally, a regression analysis uses the alpha, beta, residual risk, and the r-squared statistics to measure risk.

Furman University systematically assesses the risk of its endowment portfolio using a mix of the preceding measures.

Best Practice #2 – Adopted a constant growth spending model.

The University believes the adoption of its constant growth spending policy is one of the most important aspects of its program to improve endowment management. As mentioned previously, the university formerly spent 5% of a rolling 3 year average of its endowment value. This method did little to “smooth” spending and provide stability to the operating budget. Variability of the capital markets caused wide year-to-year fluctuations in the amount available for annual spending.

Additionally, concerns arose about maintaining intergenerational equity, during periods when spending exceeded the endowment’s real return.

In order to address these issues, Furman asked its consultant to model alternative spending policies. After studying the implementation and effects of various models, Furman adopted the following policy.

Furman will spend from the endowment 4.5% of a “spending base” (which is established as the market value of the pool as of June 30, 2000 plus gifts and reclassifications through December 31, 2000). The base amount will be increased at the rate of 4% annually, plus the nominal value of

endowment gifts received through December 31st of the previous year. In no year shall actual spending from the endowment be less than 3% or more than 6% of the actual year ending prior year market value of the endowment.

By adopting a conservative 4.5% rate (as opposed to 5%) Furman believes it has added significantly to the real market value of its endowment over a 5 year time horizon.

Best Practice #3 – Minimized unnecessary fees associated with endowment management.

The administration believed a careful review of the fees associated with the endowment was one of the primary ways it could add value to the process. Vendor relationships (consulting and custodianship) were evaluated by conducting competitive processes to assess services available and associated fees. Fees were reduced and services were improved as a result of these processes. Further, a policy was adopted whereby competitive processes for these critical services are to be conducted regularly.

The administration has begun bringing information on fund of fund and individual money manager fees to the attention of the trustees regularly. Additionally, when changes are made within the asset portfolio, the University's custodian is used for transition services, rather than employ the costly process of having each affected manager sell 100% of portfolio securities.

Costs associated with endowment management are often hidden, because they are "soft" or handled as reduction to income, as opposed

to “hard” costs which require a check to be cut. Furman’s staff strives to convert “soft” costs to “hard” costs where applicable, and regularly reports on those costs that remain a percentage of pay out.

Best Practice #4 – Restructured the “money” committees of the Board.

The investment environment is constantly changing and becoming more complicated. The bull market of 1982-2000, which enabled virtually all endowments to enjoy significant real growth, is gone and may not return anytime soon. In order to counteract the changing environment, colleges and universities (including Furman) have diversified portfolios to include hedge funds, commodities, real estate, natural resources and many other asset classes. Such diversification demands more concentration on the part of the Trustee committee designed to oversee the University’s endowment.

For these reasons, the Furman Trustees and administration took a hard look at the committee structure delineated above. It decided to re-name the Budget Committee “the Financial Management Committee” and expand its charge to include overall financial management of the institution. This includes responsibility for operating and capital budgets; the University’s debt policy; and the financial results of all funds of the institution as evidenced by the annual audited financial statements.

Further, it re-named the Finance Committee the “Investment Committee” and concentrated its responsibilities solely on oversight of the University’s endowment. The size of the newly focused Investment Committee was limited to not fewer than four or more than six members.

Furman believed a small Investment committee, made up of a limited number of knowledgeable members, would be most successful. While members skilled in the investment industry are helpful, some members were chosen who possess experience and skills in a more broad business environment.

Best Practice #5* - Appointed an Investment Advisory Council consisting of ten members with significant experience and/or knowledge of investments. Preference for membership is given to Furman alumni.

The Investment Advisory Council is charged with bringing current industry information to The Investment Committee. The Council is asked to meet quarterly via phone to discuss current issues and recommendations concerning asset allocation; manager selection or performance; and the economic climate. Recommendations from the Investment Advisory Council are made to the Trustee Investment Committee for consideration.

The Investment Advisory Council is made up primarily by alums and will serve to cultivate future members of the Investment Committee. It is hoped this group will bring the more seasoned Investment Committee state of the art ideas for investments and managers. The Council will also bring critical Furman alums closer to the institution, and provide young alums a way to share their expertise with their alma mater.

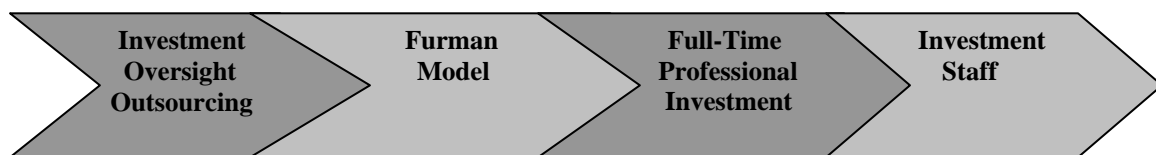
Best Practice #6* - Staffed the investment function properly.

Furman's endowment was managed by the Vice President for Business Affairs; the Controller and Assistant Controller; and an accountant within the Controller's Office. The Vice President and Controller spent

approximately 208 hours collectively on endowment management each year; the Assistant Controller spent approximately 10% of her time; and the accountant dedicated to recordkeeping of endowment funds spent 50% of his time. Collectively, this amounted to \$46,000 annually in salary allocated to endowment management. Additionally, Furman was expending \$164,000 per year for investment consulting, performance management, and custody services. The amount being expended for endowment management totaled \$210,000. Industry standards for endowment management for an endowment the size and complexity of Furman's indicated that an appropriate annual expenditure to allow adequate oversight would be \$400,000 to \$1,000,000. While the administration was not eager to increase expenditures for endowment management, it did not want to fall behind in this important arena.

There are four models of endowment management (and many mutations) in practice at other colleges and universities throughout the country. Before re-engineering, Furman's model (described above) is shown second from the left on the following continuum.

Range of Investment oversight



Some institutions (most but not all, with endowments smaller than Furman's) employ a model for endowment management whereby the entire function is outsourced. A consultant is hired to develop policies;

make recommendations on asset allocation; and evaluate and select individual money managers (or recommend managers to the Investment Committee). The consultant is also responsible for performance monitoring; ongoing and ad hoc reporting; accounting and recordkeeping for the endowment. While it was tempting to outsource Furman's endowment management, there were factors arguing against it. Most importantly, the cost (estimated at more than \$700,000 per year) was prohibitive. Additionally, it was felt that Furman Trustees and staff members, sufficiently sophisticated in endowment management, could assist the institution in avoiding this costly model.

Another model for internal endowment management involves appointing a financial staff member to oversee the endowment as his/her primary area of responsibility. This individual's duties would include conducting due diligence visits with managers; directing manager searches; participating in asset allocation discussions; overseeing performance reporting; and setting agendas for the Investment Committee. It is important to note that the Investment Committee retains full oversight and discretion over the endowment portfolio under this model.

The fourth model is utilized generally by institutions with very large endowments. This model includes a multi-person internal investment staff for managing endowment assets. The staff is charged with many of the decisions currently being made at Furman's Trustee level. Internal staff members specialize in certain asset classes, such as hedge funds, private

equity, venture capital and/or real estate. The staff is charged with rebalancing to asset class targets; monitoring manager performance; and recommending managers and changes in asset allocations to Trustees (or making the decision themselves). Because of the specialization of expertise involved, and the fact that Furman's current allocation to alternative asset classes is only 40% of the total, this model was not felt to be optimum for the University.

Furman's Trustees and staff felt strongly that sufficient, focused attention needed to be concentrated on monitoring the complex asset classes within Furman's endowment. Cambridge Associates facetiously noted that a misguided belief exists the "more complex portfolios can be successfully maintained with no more resources than were required to oversee the equity/bond/cash portfolios of the past. This is like saying no more resources are needed to perform triple bypass surgery than to stitch up a bad cut". In response to the growing size and complexity of the endowment, the administration recommended that an investment officer be hired for Furman.

Concentrating responsibility for endowment management with one staff member should enable more efficient and effective management of the endowment, and afford better support to the Trustee Investment Committee. More comprehensive investment opportunities can be researched and presented for consideration by the Trustees, allowing for better informed financial decisions. The investment officer's salary is to be

charged against endowment earnings, a practice that is consistent with other institutions.

***Furman is still in the process of implementing Best Practices 5&6.**

Benefits

Furman's endowment returns have improved significantly since implementing best practices of endowment management. **In fact, for the trailing one, three and five year periods, returns were 19.8%, 22.0% and 11.1% respectively.** These returns rank Furman at the very top of the universe of similar-sized endowments tracked by Cambridge Associates. Higher returns, of course, increase the value of the endowment and allow more spending on critical student programs and faculty resources. **Asset growth has increased by 75% over the past five years,** and although fueled by a transforming gift, much of the value added is associated with best practices. Most importantly, the Trustee committees, administration and staff are positioned to continue to produce positive results well into Furman's future.

Many of the best practices outlined in this proposal have been discussed by college and university business officers for some time – especially those institutions with large endowments. It is important to note, though, that all institutions – even those with small endowments of \$50 million or less – should continuously assess best practices of endowment management and implement those changes that will add value.