

Starting a Financial Endowment by a Nonprofit Organization in Higher Education

Lyubov Semenovna Morozova, Vladimir Yuryevich Morozov, Natalia Vladimirovna Khavanova, Elena Vladimirovna Bokareva* and Elena Vladimirovna Litvinova

Russian State University of Tourism and Service, Moscow, Russia; morozovals@yandex.ru, kaf_gmu_2010@mail.ru, khavanova.nv@mail.ru, id311@yandex.ru, litvinova.alena@mail.ru

Abstract

Objectives: The article presents the findings of the study that analyze the functioning and development of the financial endowment of nonprofit organizations and a review of the legislative framework, regulating the endowment formation, the parties involved in this process and its procedure. **Methods:** The methodological basis was formed by the principles of system analysis and synthesis when studying the system of higher education and its segments, as well as subjects and components of nonprofit organizations financial endowment in higher education. **Findings:** An organization should create an endowment fund for its successful operation as it can provide a stable and growing source of funding for infrastructure, social projects, etc. Compared to other financing systems, endowments are the most stable; their legislative framework ensures transparency of the fund activities and control over the investments spending. **Application/Improvements:** Endowment funds improve strategic planning, providing financial support to nonprofit organizations. The largest endowments in the world are estimated at tens of billions dollars, and their official history spans several centuries.

Keywords: Beneficiary, Competition, Endowment, Endowment Fund, Fiduciary Management, Fund, Fundraising, Nonprofit Organizations

1. Introduction

The development of the nonprofit sector has a great positive impact on the implementation of social, cultural and educational functions of the state, especially in the current Russian context, when the state financing of social goods is limited. In today's society there is a certain range of problems which only nonprofit organizations can solve.

Nonprofit organizations represent a fairly significant sector of the Russian economy. At the same time, financial instability of a nonprofit organization leads to a situation when it cannot meet social challenges facing it.

In Russia, one can establish a financial endowment since 2007, when the Federal Law of December 30, 2006 No 275-FZ "On the Procedure of Formation and Use of the Endowment of Nonprofit Organizations" came into force¹.

According to Federal Law No 275, an endowment is "a share of property of a nonprofit organization, formed

by donations and transferred to a management company for fiduciary management to generate income to be used to finance statutory activities of nonprofit organizations".

Thus, the endowment is a share of an on profit organization's property formed by donations made by an endower (endowers) in the form of monetary funds, transferred to a management company for fiduciary management to generate income to be used to finance statutory activities of nonprofit organizations. The owner of the endowment, i.e. the organization that makes decisions concerning the income, can be a nonprofit organization with a legal organizational form of a fund, an autonomous nonprofit organization, a nonprofit organization without membership, established by individuals and (or) legal entities on the basis of voluntary asset contributions and which *pursues social, charitable, cultural, educational or other socially useful objectives*. Or, it may be a nonprofit organization without membership created to provide services in education, health, culture, science, law,

*Author for correspondence

a nonprofit organization, a non-governmental foundation, or a religious organization. Currently, all other legal organizational forms are not entitled to form a financial endowment².

2. Concept Headings

The mentioned Federal Law states two options for creating endowments. Firstly, a nonprofit organization itself can setup the capital and be the recipient of the income from its use (Figure 1). This is the “internal” option of endowment.

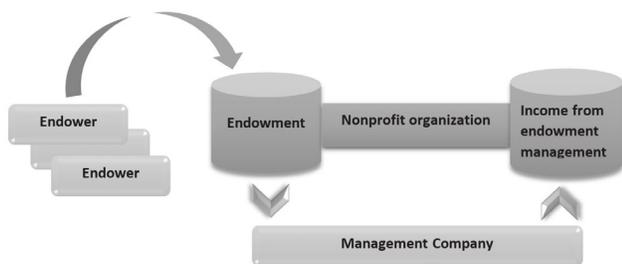


Figure 1. Independent creation of the endowment inside a nonprofit organization³.

The “internal” option can be applied only by organizations with an organizational and legal form of a fund, an autonomous nonprofit organization, a non-governmental organization, a non-governmental foundation, or a religious organization.

If the endowment is established after the first option, the collection of donations and all actions related to the management, with the exception of investment activities, are carried out “inside” an on profit organization.

In this case the endowment fund is just a special way of accepting donations. When forming an endowment, there is a certain sum to be used for a specific purpose; replenishing an existing endowment, when besides money, donations can be taken in the form of securities, real estate, there are specifically accepted donations made with an obligation to transfer them for fiduciary management with special accounting, auditing, reporting schemes, etc.

The second option is quite different and it arises when an on profit organization does not have any of the above mentioned legal and organizational forms.

In this case, a separate entity is created – a special organization, i.e. a fund that manages the operation of

a financial endowment (Figure 2). This may be called an “external” option.

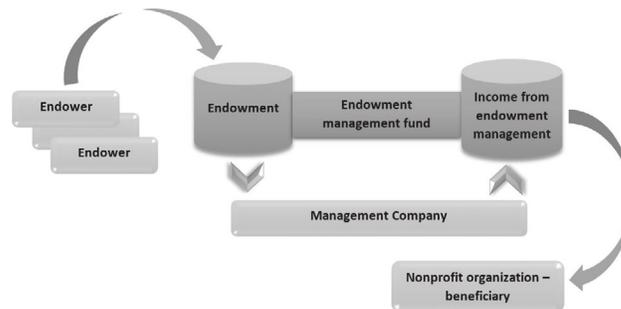


Figure 2. The establishment of an endowment through a specialized organization³.

It is also necessary to consider the process of endowment management (Figure 3), with the reference point as “the decision on the formation of an endowment”. The control point is the stage of “official registration of all required constituent documents”. The next one is the point of “fundraising start”. We will call the period of time between the set points as “preparatory”.

The stage of “the endowment formation” begins with the collection of funds for an endowment. A separate bank account is set up to carry out the calculations associated with obtaining funds for the formation and replenishment of the endowment, its transfer for fiduciary management, the use of income, distribution of the income among other recipients.

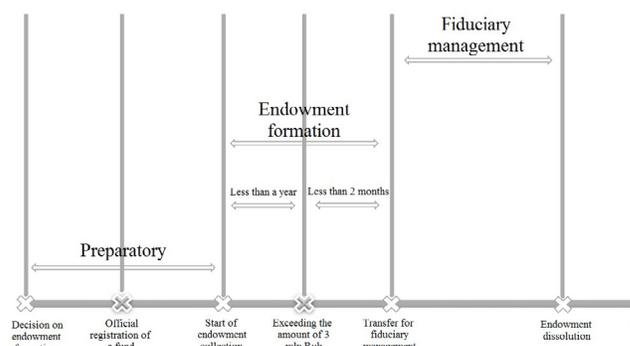


Figure 3. Endowment management³.

A nonprofit organization is obliged to transfer the funds to a management company within two months from the date when the amount of monetary assets obtained to form the endowment reaches the amount of 3 million

rubles. The endowment shall be considered established starting from the date of funds transfer for fiduciary management. Therefore, the next reference point is “Exceeding the amount of Rub 3 mln”, and, respectively, the one after that is “Endowment transfer for fiduciary management”. The endowment must be given a name identifying it. The interval “Fiduciary management” is set from the point of “Transfer for fiduciary management” to the point “Endowment dissolution”^{3,4}.

3. Results and Discussion

In accordance with the legislation, the initial amount for the endowment formation must be collected no later than one year from the date of receiving first donations. If this requirement is not met, the endowment is not formed, and the donation should be returned to the endower. At the formation stage, the donations received can be placed on deposit accounts of credit institutions⁵. The⁴ interest

Table 1. Ranking of the endowment management companies as of December 31, 2015 ¹⁰

No.	Company	Founded	Region	Number of endowment owners	Number of endowments	Endowments (without funds of SRO, mln. Rub.) as of 31.12.2015
1.	VTB Capital Investment Management Companies	05.09.1996	Moscow	17	26	5 665.63
2.	Gazprombank Group	21.12.2005	Moscow	37	41	4 314.57
3.	ALPHA CAPITAL	26.09.1996	Moscow	5	7	3 745.84
4.	RUSFIN	23.08.2012	Moscow	1	1	900.72
5.	OTKRYTIE	08.12.2000	Moscow	4	6	773.36
6.	LIBRA CAPITAL	20.07.2004	Moscow	2	2	681.19
7.	TKB BNP Paribas Investment Partners	18.11.2002	St.Petersburg	2	2	629.09
8.	EG Capital Partners Group	22.08.1994	Moscow	-	-	578.55
9.	April Capital	23.04.2002	Moscow	1	1	382.42
10.	CAPITAL ASSET MANAGEMENT GROUP	03.06.1999	Moscow	2	2	348.45
11.	Sberbank Asset Management Company Group	01.04.1996	Moscow	4	4	295.17
12.	EVROFINANSY	21.06.2004	Moscow	4	4	178.50
13.	NATIONAL MANAGEMENT COMPANY	25.07.2002	Moscow	1	1	174.14
14.	RONIN Trust	21.06.2002	Moscow	1	1	166.19
15.	BFA	05.08.2002	St.Petersburg	3	3	99.39
16.	TRINFICO Group	28.02.1997	Moscow	1	1	45.00
17.	DOHOD	29.07.1997	St.Petersburg	1	1	15.60
18.	Veles Management	16.07.2004	Moscow	3	3	12.09
19.	URALSIB	21.10.1996	Moscow	1	1	12.08
20.	SOLID MANAGEMENT	02.10.1997	Moscow	2	2	11.86
21.	Metropol	30.12.2002	Moscow	2	2	7.28
22.	ATON-Management	19.12.2000	Moscow	1	1	6.33
23.	Pallada Asset Management	08.08.1996	Moscow	1	1	4.37
24.	RWM Capital	29.11.2005	Moscow	1	1	3.71
25.	Univer Management Group	21.09.2002	Moscow	1	1	3.50
26.	AGANA	15.11.2000	Moscow	1	1	3.00
27.	Rosselkhozbank Asset Management	17.08.2012	Moscow	1	1	3.16

received from this operation may be added to the formed endowment. We would like to point out that after the endowment is formed, its replenishment can be carried out only through securities and real estate, while it can be formed only by monetary assets. Thus, securities or real estate can be received only after the point when at least 3 million rubles have been collected in the form of donations and transferred for fiduciary management⁶.

Considering the existing market rates on deposit contracts and the timeframe for the endowment formation, it is necessary to collect the largest share of the required amount of 3 million rubles⁷.

Besides, we would also like to consider the situation when a nonprofit organization receives the sum of money sufficient for the formation of the endowment (3 million rubles or more) and can increase the available donations through placing the funds on deposit accounts. In accordance with the legislation, the transfer of funds for fiduciary management should be carried out within two months.

If additional donations for a nonprofit organization are made in monetary form, the transfer of these funds for fiduciary management should be carried out within 30 days of their receipt. A nonprofit organization – the owner of the endowment – has the right to replenish it with the interest from placing the funds obtained during the formation and (or) replenishment of the endowment on deposit accounts of credit institutions. Consequently, a nonprofit organization has the right to open a deposit and increase the collected funds⁸.

As we have already noted, it takes time to start and replenish an endowment, while the effect of its creation cannot be seen at once. Moreover, it is necessary to ensure the constant replenishment of the endowment with new donations, which is a difficult task in case of the lack or underdevelopment of interaction with endowers⁴.

The subject of endowment is still new for Russia since the Russian Federation adopted the legislation concerning this issue only about 8 years ago. Over this period, according to the Donors Forum⁹, over 130 endowments were created, with most of them in the field of education and research (62%) (Table 1).

All over the endowments creation in Russia, experts had different opinions on pros and cons of this phenomenon. There are many nonprofit organizations and donors who see this form of financing the nonprofit activities as

a promising one, whereas there are others who doubt its viability¹.

At the end of 2015 the total amount of funds transferred to fiduciary management amounted to 19.061 billion rubles (or 16.87 billion rubles at the end of the second quarter of 2015). The high levels of concentration registered earlier remained the same: about 72% of the funds account for the absolute top three in this sector – VTB Capital Investment Management Companies (5.66 billion rubles), CJSC Gazprom bank Asset Management (4.31 billion rubles) and Alfa Capital Management Company LLC (3.74 billion rubles). The next companies in the ranking were Univer Management Group, Rosselkhoz bank Asset Management and Metropol¹⁰.

The main disadvantages of endowments include, first of all, the fact that they do not solve social problems then and there, but “conserve large sums” rather than send them to solve many pressing issues of the society, and, secondly, many experts doubt the economic benefit from endowments: it is not obvious since the income from investing in endowments often cannot keep up with inflation¹¹.

One of the biggest challenges endowment funds face is the complexity of explaining to philanthropists the need to donate money to solve long term problems. Potential donors can better understand a situation when money should be collected to treat a child, to construct a temple, or to purchase humanitarian supplies for victims of natural disasters. In these cases, it is always clear who the recipient of the funds raised is, and it is also possible to see the effect of the aid. However, when a person donates to an endowment, for example, a university, he will not see new buildings after two years or renovated lecture theaters after a few months⁵.

Talking about the advantages of endowments, the first one is transparency and proper use of a benefactor’s funds that are ensured by legal regulations (public reports and an obligatory donation contract which specifies the program to which the funds are allocated).

“The cornerstone” of the endowment funds is their transparency and clarity of spending. What reporting procedure management companies apply in their funds, how well financial regulators monitor the management of this capital¹², and how accurate donors can assess the resources they provide, –for many nonprofit organizations it would be a very good idea to study and use all this experience (Figure 4).

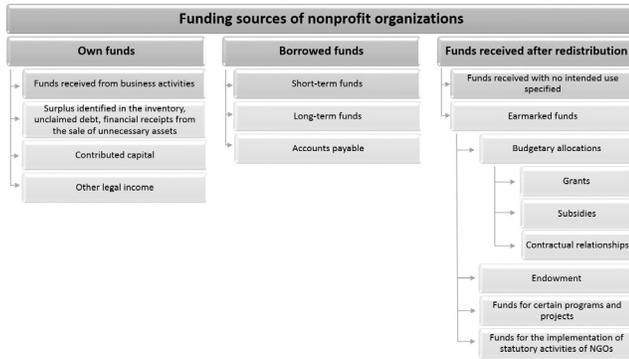


Figure 4. The structure of the funding sources of nonprofit organizations¹².

Preferential taxation is another advantage of endowments. However, so far it can be used only by individual donors, who can apply for a tax deduction up to 25% of taxable income. This does not refer to corporate donors yet, which basically agrees with the general policy of charity taxation in Russia.

Endowment is an additional source of funding. Due to the fact that the received donations can be multiplied through efficient management, the endowment can improve the financial standing of nonprofit organization¹³.

A nonprofit organization independently determines the proportions of the endowment allocation among its management companies. The ability to place the endowment in several management companies would considerably simplify the process of donations accepting by nonprofit organizations¹⁷. It is also necessary to mention the risks that inevitably arise in connection with investments in real estate. At the securities market a management company operates according to the legislation regulating the individual fiduciary management: it performs exchange operations only and buys securities that meet the legal requirements¹⁴. However, such regulation does not apply to the real estate market, which significantly increases the manager's freedom of action. Under the agreement, Trustor is entitled to a refund of property in the event of poor performance of the management company, but in case of real estate the return of property can take up to a few months¹⁵.

By law, the endowment must transfer funds to the endowment management company; that is why it is always professionals who invest this money and who can choose the best financial instruments to achieve the

objectives set by the fund, at the same time saving the capital and protecting it from devaluation due to inflation. The resulting income allows funds to plan their spending in the long term and not to depend on the results of fundraising, often applying it just to replenish the principal capital (Figure 5).

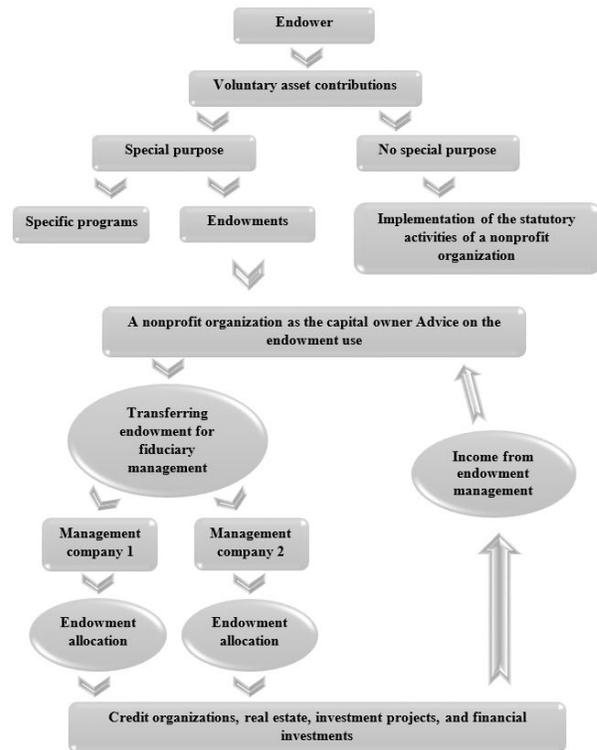


Figure 5. The model of a nonprofit organization allocating endowment in several management companies¹².

Definitely, in Russia there is distrust of long-term planning and the capital market on the whole. It is still hard to imagine that the fund created today would run for 50 or 100 years. However, the experience of Western endowments shows that it is possible. For example, the most famous US endowments – the funds of Harvard, Yale, Princeton and Stanford Universities – have a long history; they are operating successfully and are increasing their capital.

Russian endowment funds have a great opportunity to use the international experience and learn from it (Figure 6). At least, studying the operation of the Western endowments, we can already get some really useful recommendations and suggestions for the Russian practice of endowments¹².

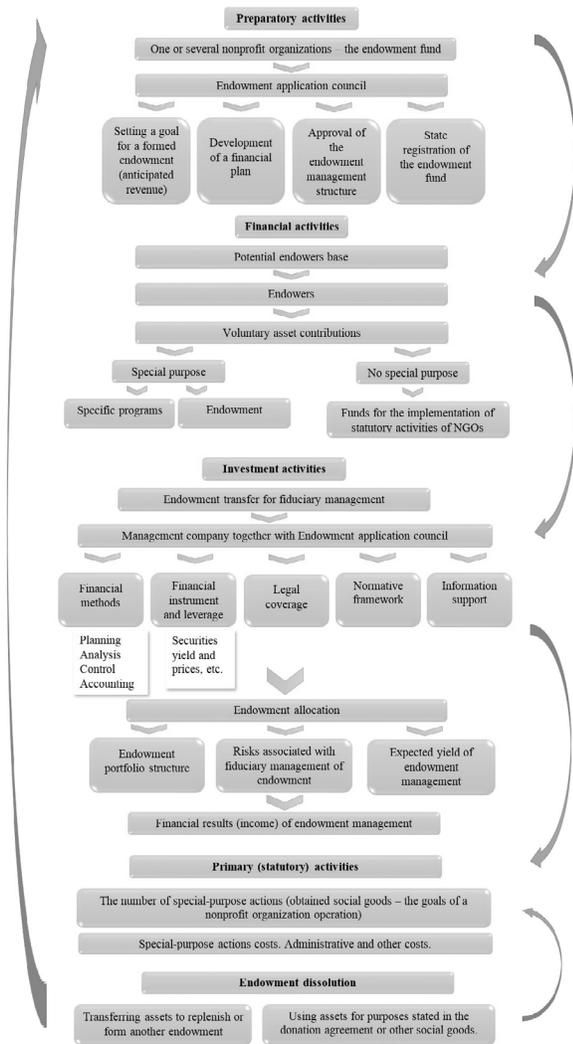


Figure 6. Diagram of the endowment management by a nonprofit organization¹².

4. Conclusion

Firstly, we should mention tax incentives. They must be given to anyone who donates money to charity. Preferential taxation greatly contributes to raising funds for endowments and increasing the size of these funds.

Secondly, investments in risky instruments, for example, real estate and hedge funds, allow achieving a higher return on investment, though they can result in greater losses. Today in Russia, most endowments resort to extremely conservative investment policy by investing in bonds and placing funds on bank deposits, which is understandable in conditions of high market volatility and economic uncertainty.

Thirdly, fund spending (administrative and project costs) in Western countries, as a rule, makes up about 4% of the endowment size per year. The practices of Russian funds demonstrate the inclination to use 5-10% of the endowment to fund their projects.¹²

Finally, many Russian funds resort to the policy that implies the reduction of administrative costs of funds at the expense of the development of partnerships with business and government, as well as with other nonprofit organizations.¹²

It is necessary to highlight the significant advantages arising from the creation of endowment funds¹⁶.

1. The fund can support several nonprofit organizations simultaneously (universities, museums, etc.).

2. Small nonprofit organizations receive an additional long-term funding source. A nonprofit organization becomes independent from one-time donations, which would enable a regular renovation and reconstruction of theaters, exhibition buildings, sports facilities and equipment on a predetermined schedule.

3. Endowers can monitor how the endowment is spent.

4. It is possible to attract new contributors, while there is a closer communication between the fund and donors.

5. It becomes possible to organize the system for financing special social programs and priority research at the discretion of nonprofit organizations within the union (association).

6. It is possible to reduce administrative and management costs associated with the formation and management of a single nonprofit organization.

5. References

1. Federal Law of the Russian Federation of No. 275-FZ. On the procedure of formation and use of the endowment of nonprofit organizations; 2006 Dec 30.
2. Bokareva EV, Chernikova LI, Egorova EN, Egorova SK. Functioning and development of target capital by nonprofit organizations. *Asian Social Science*. 2014; 10(23):223–30.
3. Shitkov SV. The procedure of registration of endowment funds in higher educational institutions under Russian legislation. In: *Theory and practice of endowment funds operation in Russian higher education: Collection of practical recommendations for the participants of the International Scientific-practical Conference*, 2010 Apr 27–29; 2010.
4. Morozov VYu, Khavanova NV, Bokareva EV. Formation of the endowment. *Services in Russia and Abroad*. 2016; 10(62):20–30.

5. Bokareva EV. Analysis and evaluation of the endowment operation in Russia. *Financial Analytics: Problems and Solutions*. 2013; 21:7–10.
6. Kutyeva DA. Multidimensionality of the funding sources of nonprofit organizations. *Issues of the Modern Economy*. 2013; 4(48):195–8.
7. Commentary on the ranking of endowment management companies for 2015 [Internet]. [cited 2016 Sep 05]. Available from: <http://www.ra-national.ru/ru/node/58914>.
8. Subanova OS. Endowment funds of nonprofit organizations: the formation, management and use. A monograph. Moscow: KURS; 2011.
9. Donors Forum site [Internet]. [cited 2016 Sep 05]. Available from: <http://www.donorsforum.ru/>.
10. Kozarezenko LV. Alternative sources of human development financing. *Krasnoyarsk Science*. 2014; 4(15):93–121.
11. Grishchenko YuI. Optimization of the capital structure in nonprofit organizations. *Nonprofit Organizations in Russia*. 2013; 1:46–9.
12. Zavgorodnyaya VV, Khamalinsky IV. Endowment: Its role and potential for financing of educational institutions. *Audit and Financial Analysis*. 2015; 2:231–6.
13. Lavrova S. Some aspects of establishing a university endowment fund: practical tips. In: *Theory and practice of endowment funds operation in Russian higher education: Collection of practical recommendations for the participants of the International Scientific-practical Conference - Theory and practice of endowment funds operation in Russia*, Moscow State Institute of International Relations, The Ministry of Foreign Affairs of the Russian Federation. 2010 Apr 27–29. Biryukova ES, Degttereva DA, Stelmakh AV, editors, Moscow: MGIMO; 2010.
14. Kirilina NA, Morozova LS. The essence and characteristics of competition in the market of educational services. *Current Issues of Economic Science*. 2010; 15(2):182–6.
15. Larina LR, Baigulov RM. The control strategy for an endowment of a nonprofit organization. *Bulletin of the University (State University of Management)*. 2014; 20:118–22.
16. Zaitseva NA, Chernikova LI. Features and prospects in the development of the services provided in the field of travel insurance. *Middle East Journal of Scientific Research*. 2013; 16(7):996–1002.
17. Morozova LS, Ananjev AN, Morozov VY, Havanova NV, Litvinova EV. Influence of tourism industry development on the regional labour market (on the example of the Yaroslavl region). *Review of European Studies*. 2015; 7(3):51–65.