



Formerly the National Center for Nonprofit Boards

# *History Matters*

## *Lessons from The New-York Historical Society's Board Room*

By Kevin M. Guthrie

**The board of The New-York Historical Society voted yesterday to shut down the institution's library on February 19. All public programs are to be canceled, with the exception of a traveling show of 90 Audubon watercolors that had been planned, and 41 staff members will be dismissed; a skeleton crew of 35 will be left to handle security, conservation, and disposition of the collections.**

— *New York Times*, February 4, 1993

The catalyst for The New-York Historical Society's crisis was really quite simple. After many years of operating deficits that had eroded the Society's capital base, there were insufficient resources to pay the day-to-day operating costs of the institution. In other words, the Society had run out of cash. The *New York Times* laid much of the blame on the board of trustees, describing a "depressing saga of crisis management." It emphasized the erosion of the Society's endowment in the 1980s and the failure of trustees and administrators to focus on an attainable mission.

The 1993 temporary closure of The New-York Historical Society's museum (and five weeks later, its library as well) was not the first time that crisis had enveloped the Society. In 1988, the Society laid off one-fourth of its employees and announced plans to sell roughly 40 European paintings — a decision that drew sharp criticism from the museum community. Museum professionals considered the plan unethical and a violation of accepted museum practices. (Deaccessioning — the term for selling works from a museum collection — is generally only accepted if it serves to improve the permanent collection.) In addition to receiving criticism for deaccessioning and laying off employees, the Society faced further criticism when the *New York Times* learned that some paintings had been damaged because of horrendous conditions at an off-site storage facility.

Elitism, inability to engage the community in its collections and programs, and intense financial difficulties were the three main charges levied against the Society in the press. But these problems were not new; in fact, the historical antecedents for the Society's problems are striking. Ninety-four years earlier, in 1899, an article in the *New York Herald* claimed that the Society was not doing enough to educate the public about its priceless collections. In 1825, similar notice was paid when the Society faced a debt that threatened its very existence. Indeed, the challenges of 1993 had been faced before.

Most observers, eager to fix blame, assumed that the Society was poorly managed and improperly governed. However, the rush to fix blame can have highly undesirable consequences. It can deflect attention from the root causes of difficulty and lead one to believe that problems will be solved by replacing the chief executive and restructuring membership on the board of trustees. The fact that the Society suffered a similar crisis just five years before suggests that the Society's problems were more deeply seated — more structural — than may be immediately apparent.

The history and experiences of The New-York Historical Society illustrate a number of issues common to nonprofit organizations and their boards. The Society's board faced both material and philosophical challenges, including focusing and refining the organization's mission;

securing adequate storage and display facilities; understanding endowment management and abiding by a total return investment policy; and providing effective governance.

The story of The New-York Historical Society also illustrates quite clearly that history matters. Decisions made in the past — some of which were made *very long ago* — shaped the Society's current activities, programs, and difficulties and determined, in large measure, the organization's future. It is hoped that sharing The New-York Historical Society's saga will have predictive power; that it will equip other nonprofit board members to grapple with similar situations and challenges.

Even under the best of circumstances, the Society's problems would not be easy to solve. Two hundred years of institutional inertia is not reversed quickly. Any attempt to uncover the root causes requires an investigation of its history. But how far back do we need to look? Very far, actually. To understand fully the Society's modern difficulties, we must reach back to the Society's earliest days.

# The History

Founded in 1804 to collect and preserve materials relating to the early history of the state of New York and the United States, The New-York Historical Society<sup>1</sup> is home to one of the nation's most distinguished research libraries. Its collections include approximately 800,000 volumes and more than three million manuscripts, maps, photographs, prints, and architectural drawings that collectively provide an unparalleled picture of the early history of New York. But it is not just a library. The Society's museum is New York's oldest, predating the founding of the Metropolitan Museum of Art by nearly 70 years. The art holdings have grown to a collection of over 1.6 million objects, including world-renowned Hudson River School paintings, an extensive collection of Tiffany glasswork, and 433 of the 435 original watercolors used for John J. Audubon's classic work, *Birds of America*.

## THE FORMATIVE YEARS, 1804 – 1920

With a mission “to collect and preserve whatever may relate to the natural, civil, or ecclesiastical history of the United States in general and of this state in particular,” The New-York Historical Society sought to record authentic history. The breadth of the Society's mission seems ambitious (it did not change for nearly 150 years!), but as only the second institution of its kind in the small nation, so comprehensive an agenda was understandable. The population of the entire United States in 1804 was only about six million people, the population of New York state approximately 600,000.

From the beginning, the Society struggled to make ends meet. In 1824, after the state assembly withdrew plans for a lottery that, in part, was going to support the Society, the Society faced insolvency. Unfortunately, it had borrowed against the projected lottery revenues. In a quote that sounds eerily similar to the Society's problems in the 1990s, a newspaper reported that:

*The committee confesses its entire inability to devise any means to liquidate a debt of this magnitude. Every possible economy was used to save further expense. It had been suggested that [several libraries in the city] combine to form one great public library but nothing came of this proposal. . . . It was proposed that the Society sell its library to pay its debts. This, of course, raised a storm of protest both in and out of the Society and it was suggested that the Society might not have the legal right to sell gifts. . . . The Society's situation was indeed desperate.*

In 1827, the legislature appropriated \$5,000 to solve the Society's debt problem. Nevertheless, through the first half of the century, the Society shuttled from location to location around the city with precious few financial resources.

In 1857, the Society constructed a new building on 11th Street. The completion of the new building, one of the few fire-safe depositories in New York City, made the Society a most attractive place for the protection and public display of valuable materials. Between 1858 and 1867, the Society's art and library collections grew significantly through both donations

---

1. The New-York Historical Society's name has been hyphenated since the organization was originally incorporated. The act of incorporation specifically recognized the name including the hyphen, and it has never been “modernized.”

and purchases. It was during this period that the Society acquired its most valuable museum artifacts.

The growing collections did not come without cost. Short of space to store and display its increasingly valuable holdings, the Society once again petitioned the state for assistance. In response, the New York State legislature set aside building sites in Central Park in 1862 and again in 1868. Unfortunately, funds for construction on those sites could not be raised, and the Society was unable to secure the Central Park locations. The land originally set aside in 1868 for The New-York Historical Society later became the site of the Metropolitan Museum of Art.

The final quarter of the 19th century was a defining period for the Society. Although its library was among the largest and fastest-growing in the nation and its art collection was the finest in New York City, its external environment was changing at a rate so fast and in ways so profound that maintaining that standing would be difficult. Because of the nature and permanence of these changes, the Society's strategic choices would prove to have long-lasting impact. For example, the Society set itself apart from similar institutions that were part of a movement to professionalize historical study. When the American Library Association was founded in 1876, the Society was one of only two libraries in the city that did not join immediately.

Meanwhile, the Society continued to confront an issue that had dominated its life in its earlier days: how to house its growing collections. Not only was the Society slow to adopt the tools available to manage its holdings, it continued to accept all donations of art and books, even though it was unable either to store or to catalog them. The huge backlog of uncataloged items created a future liability that would someday have to be addressed.

Critical choices were also made at the turn of the century concerning relations with the public sector. Although early in its history the Society received government assistance, during this period it committed itself to pursuing only private financial contributions. By spurning public support, the Society chose another direction that ran counter to the trend established by other cultural institutions. The Society did not petition the city or state for operating support again for nearly 100 years, until it was forced to do so by its crises in the late 1980s.

In the beginning of the 20th century, the Society purchased a building site at Central Park West and all efforts were directed toward raising the money needed to finance building construction, which began in 1904. Like the move to 11th Street in 1857, moving the collections to Central Park West breathed new life into the Society. The executive committee ended the policy of requiring visitors to be introduced by a member, and attendance at the Society increased. Many hoped that the Society would begin to provide more service to the public.

## **PROFESSIONALIZATION AND POSTWAR EXPANSION, 1921 – 1958**

By the end of the 1920s, leadership of the Society library was being gradually handed over to Alexander J. Wall, whose knowledge and charisma enabled him to bridge the gap between historical societies and the scholarly community that had widened during the tenure of his predecessors. Wall took several steps to “professionalize” the Society. In 1928, the state legislature approved Wall's petition to modify the Society's act of incorporation to include

language specifically recognizing its educational mission. The Society also decided to update its governance structure to put it on par with its peer organizations. In 1937, at the last general meeting of the membership, the Society approved a change to the organization's bylaws establishing a board of trustees and placing complete control of the Society's affairs with the board.

By the late 1930s, Wall had decided that the library could not survive without the museum, but he also realized that operating a museum required different management processes than running a scholarly library. In 1937, Wall created a separate museum department, allowing the museum to pursue its mission free of entanglements with the library. By the time Wall died in 1944, not only was the Society a leader among historical societies, it was more professionally managed than it had ever been.

Despite Wall's successes, the late 1940s and early 1950s were a difficult period in which the Society's aspirations had begun to exceed its financial resources. The already difficult mandate to operate both a library and a museum was exacerbated by pressures to provide educational programming to the public.

Just when the Society was being forced to narrow its programmatic focus, relief came from the extraordinary performance of the financial markets — a development that substantially increased the value of the endowment, the Society's primary revenue source. The library, the museum, and the education program were all beneficiaries.

During this period, an issue of increasing importance was the need to gain professional control of the collections. The Society could barely keep pace with the new acquisitions each year. Virtually nothing was done about the cataloging backlog.

By the latter part of the 1950s, the long-term impact of not having a collections policy was brought to the Society's attention, even though management took no immediate steps to resolve it. In 1956, the Society commissioned a study carried out by Lawrence C. Wroth, the librarian at Brown University. The study was highly critical of the library's huge cataloging backlog. In addition, Wroth criticized the Society for its "unchecked, uncritical accumulation of materials" and its lack of either a collections or an acquisition policy.

As the Society faced the 1960s, four years after the Wroth report, 49 years after the formal establishment of the New York Public Library's research collections, more than 75 years after the birth of the Metropolitan Museum of Art, and 155 years after its own founding, The New-York Historical Society began to think about narrowing its broad reach.

## **THE TURNING TIDE, 1960 – 1982**

In 1960, James J. Heslin, a librarian by training, was named director of the Society, a position he would hold for 22 years. His tenure can be divided into two distinct periods: a relatively prosperous period from 1960 to 1969, when investment returns were strong and inflation was relatively modest, and a difficult period from 1970 to 1982, when poor performance of the financial markets and limited public and private support constrained revenues at the same time that inflation drove up expenses.

The issues that emerged toward the end of the 1950s — acquisition policy and cataloging — dominated Heslin's early years. The Wroth report provoked Heslin's interest in the catalog and acquisitions policy. Finally, the board adopted a new acquisition policy to guide future additions to the collection. One reason Heslin and the board were able to pay such close attention to cataloging and acquisitions was the Society's prosperous financial condition. By 1962, the Society had posted its ninth consecutive annual budget surplus.

In 1963, the board president, Frederick B. Adams, acknowledged that although the Society's endowment had increased significantly, expenses were rapidly increasing as well. Adams pointed to the need for major capital investments in the building — including the installation of an air-conditioning and ventilation system. As a result, the Society launched a capital campaign. Although it raised a significant sum through the campaign — approximately \$574,000 — the money did not cover all of the construction expenses and the Society was forced to draw from its reserves.

Struggling to balance revenues and expenditures and hoping to sustain the endowment's long-term growth, the Society's board of trustees adopted a “total return” investment policy, enabling the Society to look at its investments holistically and recognize dividends, interest, and capital appreciation on equal footing (for a complete explanation of total return, see page 17).

Prior to this action, the Society was permitted to spend only the dividend and interest income generated by its endowment, rather than any portion of realized gains from the capital appreciation of the portfolio. As a result, to maximize the spendable income, the Society chose investments that would yield the greatest current return (such as bonds) rather than those that would appreciate over the long term (such as stocks). By striving exclusively to maximize growth in current, spendable income, the Society ran the risk that it would not increase its capital base and protect its endowment from inflation.

The new total return policy allowed the Society to spend up to 5 percent of the endowment's market value annually, irrespective of whether the endowment actually generated that amount of dividends and interest.

The 1970s proved to be an extraordinarily difficult decade for all cultural institutions, especially those that depended on endowments for much of their income. The “stagflation” of the period affected these institutions negatively in both revenues and expenses.

Pressure to ensure that funds would be available to make important accessions led the Society to entertain the possibility of selling some of its collections, particularly European paintings. The Society maintained that the paintings did not fall within its mission. In 1971, the Society sold nearly 200 paintings and used the proceeds to establish a fund to be used only to purchase paintings.

Between 1971 and 1973, the Society's annual attendance figures nearly doubled. This was due in part to the first-time exhibit of the Society's entire collection of Audubon watercolors. Despite this increased public awareness, the Society confronted severe economic difficulties in the 1970s. Pressures to grow the endowment led the Society to place 90 percent of its portfolio in equity investments (stocks); so when the stock market faltered, the Society's endow-

ment was hit hard. The market value of the endowment shrank from \$17.5 million in 1972 to \$10.5 million in 1974. Naturally this increased the pressure on the Society to find the money to pay for the cost of operations. It was in 1974 that the Society first exceeded the 5 percent spending limit imposed under the total return policy.

As the 1970s progressed and the Society's financial situation continued to deteriorate, in retrospect it seems clear that the Society's move to a total return spending policy was improperly regarded by the board as a way of increasing spendable income rather than as a way of maximizing the growth of its investment portfolio. The trend of exceeding the spending limit continued into the 1980s. At one point, the Society spent a staggering 28 percent of the endowment's total value in one year. Although the return on the endowment exceeded 28 percent in that year, growth of the endowment was forfeited in favor of current spending.

### **NEW INITIATIVES AND ECONOMIC SHOCKS, 1982 – 1987**

Between 1984 and 1986, the Society relied heavily on consultants and self-study. Fees paid to consultants amounted to approximately \$1.6 million during this period, but surprisingly few decisive actions were taken. One consultant's study would prove to have a dramatic impact. In 1985, Dr. Bryant C. Tolles, director of museum studies at the University of Delaware, performed a comprehensive analysis of the museum, library, publications, public programming, and education functions of the Society. Tolles' report was highly critical, especially regarding the conditions in a warehouse holding some of the art collection.

Once again in 1987 the Society's financial woes were compounded by poor performance of the stock market. It became undeniable that the Society could not indefinitely hide its operating deficits behind transfers of realized gains from the endowment. The Society looked once again to sell some of its European paintings. At this time, the board changed how the funds from those sales could be used, relaxing the restriction that proceeds only be used for new acquisitions. The change was in direct contradiction to generally accepted museum practices.

As financial problems worsened, the Society began to consider drastic cuts in staffing and programmatic activity. The board had decided to lay off 21 of 133 employees, close two of four floors of galleries, and sell parts of the collections. Needless to say, there was a great deal of discontent on the staff, and someone released the Tolles report to the *New York Times*. An article appeared in the *Times* detailing the plans and reporting on the abominable conditions at the off-site warehouse. Although the works had been transferred out of the warehouse nearly two years before, there had been no money to restore them. The controversy escalated when it was discovered that some of the damaged paintings were not even owned by the Society but were on permanent loan from the New York Public Library. An investigation was launched by the New York State attorney general. James Bell, the director of the Society, attempted to contain the damage, but it was too late. Bell resigned in 1987 and the associate director was dismissed.

## ATTEMPTING A TURNAROUND, 1988 – 1992

As negative publicity and turmoil swirled around the Society, the immediate challenge for the board of trustees was to stabilize the institution. The first step was to assemble an advisory committee composed of a stellar group of professionals representing a wide spectrum of backgrounds and experiences. The second step was convincing Barbara Debs, a former board member, to come back to the Society and serve as interim director. Debs worked to establish administrative stability and the board acted to improve its governance structure and increase its capacity to provide financial support. The board increased its maximum allowable membership from 29 to 50. The title of president was changed to chairman of the board. A process of systematic rotation and evaluation of trustee performance was established and was to be administered by a new committee on trustees. The director's position was renamed president and was invested with all the powers of a chief executive officer, including *ex officio* status on the board of trustees.

By the latter part of 1988, the circumstances improved. In October 1988, the Society held a fundraising event, the inaugural History Makers' Gala, which netted nearly \$400,000. In addition, public attention on the Society's financial difficulties during the summer had helped increase private contributions, especially from trustees.

Working with the advisory committee, Debs and her staff developed a long-term financial and programmatic plan for the Society. The committee, while developing a new mission statement, determined that saving the Society in something close to its present form and in its present location was important. Having determined these initial variables, the Society constructed what came to be known as the "bridge plan." It detailed the steps along a three-year path that the board hoped would lead to institutional stability.

The plan had three priorities: to emphasize care of the collection, to emphasize the Society's identity as a great educational resource, and to achieve financial stability. Any one of the components of the plan would have been challenging; to pursue them all simultaneously was a monumental undertaking. Revenues to pay for the expenditure base were to come from four sources: fundraising, investment income, earned income, and public support. If all of the pieces were to fall in place, by June 1992 the Society would have an unrestricted endowment of approximately \$28 million and a restricted endowment of \$14 million.

In April 1989, the advisory committee presented its report to the Society's board of trustees. The committee recommended adopting a more precise mission that focused on the integration of its collections, emphasized the educational responsibilities, and served as a guide to refining the Society's collections. In 1989, Debs accepted a permanent position as president and CEO of the Society.

An unforeseen obstacle to the bridge plan arose when, after extensive study, the board learned that the Society's 85-year-old building was badly in need of \$10 to \$12 million worth of repairs. These repairs were not budgeted in the bridge plan, but were required to make the building safe to house the collections.

To make matters worse, the New York State attorney general's investigation launched a year before had still not been resolved. Answering the attorney general's inquiries took time and

resources that prohibited the Society from pursuing other goals; in fact, it was estimated that over \$1 million in professional and attorney's fees was spent responding to the investigation. If one were to include staff time in the calculation, the burden was higher still.

As the second half of the 1990 fiscal year progressed, it became clear that the Society was going to have difficulty balancing its budget. Revenues were running far behind projections. Although programs had been initiated that were well received by the public, the programs did not translate into increases in the Society's unrestricted cash balances.

In 1991, the Society began actively to seek affiliations with other organizations. The Society's focus shifted from overseeing the implementation of the bridge plan to investigating whether a more radical solution might be feasible. Some ideas under consideration included merging with another cultural entity, affiliating with an educational institution, moving to a less expensive location, or closing the Society. When the 1991 fiscal year ended with a \$2.4 million deficit, the Society could no longer afford to continue in a "business as usual" mode.

## **STRUGGLE FOR SURVIVAL, 1992 – 1994**

When Debs stepped down in 1992, the Society was once again careening toward institutional crisis. The 1992 fiscal year ended with a deficit of \$2.5 million. The interim chief executive, Norman Pearlstine, predicted that without an infusion of cash, the Society would be forced to close its doors before year-end. Debs' departure also created a power vacuum that fed the natural and growing rivalry among the three chief deputies.

Pearlstine pursued affiliations with other cultural institutions and managed to get the board of trustees of the New York Public Library to approve a plan to loan the Society \$1.5 million, but closing the loan proved to be difficult. In conducting its due diligence, five members of the New York Public Library's financial staff spent three weeks at the Society, learning all they could about its financial situation and evaluating the Society's capacity to repay the loan. The Society's precarious financial condition mandated that collateral for the loan come from the Society's collections. Because of that necessity, the Society had to prove that it was acting within its rights to sell any works it was offering as collateral. This meant that the attorney general would once again have to become involved to ensure that proper procedures were being followed.

The New York Public Library loan had not yet come through and in early December 1992, there was some question whether the Society would be able to make its Christmas Eve payroll. The Society had only \$55,000 left in its unrestricted account; its projected December payroll was nearly \$140,000. A member of the Society's board who was also a senior vice president of Sotheby's suggested that perhaps Sotheby's would be willing to loan the Society the money under more flexible terms than the New York Public Library. Sotheby's agreed to loan the Society \$1.5 million for one year.

Despite efforts to make the situation palatable, professional museum administrators were critical of both the loan and even the basic concept of putting collections up as collateral for a loan. The closing of the Sotheby's loan and its associated public controversy marked the beginning of yet another chapter in the Society's saga.

A second special advisory committee, this one headed by Wilbur Ross, senior managing director at Rothschild, Inc. and chairman of the National Museum of American Art, was charged with recommending a course of action. Ross' specialty, restructuring troubled and bankrupt companies, seemed tailor-made for the Society's financial difficulties. Under Ross, the advisory committee wasted no time taking bold and decisive action. The Sotheby's loan for \$1.5 million, which had become official only a week before, was not going to provide the amount of cash necessary to keep the Society open through June as originally expected. At its first meeting, Ross' committee voted to close the Society, recommending that 41 of the Society's 76 remaining employees be relieved of their duties. The action, which was scheduled to take effect on February 19, 1993, ended public access to the Society's library and discontinued the Society's lecture series and school programs. Closing the institution would allow the Society to conserve its limited remaining resources until an appropriate solution could be reached.

Outside of the Society, reaction to the announced closing was swift and dramatic. Particularly vocal in its response was the scholarly community, who considered access to the Society's library collections irreplaceable. The Society closed its doors, as scheduled, at the end of the day on Friday, February 19. More than 100 scholars demonstrated on the front sidewalk, holding placards pleading for the rescue of the Society. Editorials also appeared in all of the New York papers calling for city, state, and other funders to save the Society.

On February 23, the Society received an emergency grant of \$66,000 from the public sector to reopen the library and keep it open for three days per week through April 2. The grant was pieced together from funds contributed by the city, the state, the Manhattan borough president's office, and the city council.

The emergency grant, small as it was, marked the first time the Society had received financial support for general operations from the government in more than a century. It had taken the threat of total dissolution to make it happen.

On March 11, 1993, the advisory committee's report was released to the public. In addressing the Society's financial difficulties, the report focused primarily on the Society's sources of revenue rather than on its level of expenditures. It emphasized that although the Society owned over \$1 billion in assets, it was able to generate less than \$1 million in recurring revenue. For the Society to survive, it would simply have to find ways to generate more annual revenue.

The committee recommended a more narrowly defined mission statement: "The primary mission of The New-York Historical Society shall be to develop, preserve and interpret to the broadest possible public, material relevant to the rich history, cultural diversity, and current evolution of New York City and state and the surrounding region." A major component of the plan, that flowed from the development of a more narrow mission, involved deaccessioning. Narrowing the Society's focus would allow it to raise funds through the sale of a portion of its collections.

In making its recommendations, the committee emphasized that all components of its report were absolutely interdependent. If even one of the major components could not be fulfilled, the plan would fail.

Meanwhile, the Society entered into discussions with New York University (NYU) to determine whether its library staff would be willing to help manage the Society's library on a contract basis. On August 1, 1993, NYU agreed to manage the Society's library for one year. In September, a little over a month into the arrangement, NYU's library staff was finding the job of managing the library far more difficult than expected. Upon closer inspection, they were surprised by the general condition of the Society's library holdings. Surveys of the shelves revealed that many items on the shelves were not only uncataloged but also not even property stamped.

On December 13, 1993, the Andrew W. Mellon Foundation's board of trustees awarded a conditional grant of \$1.25 million to NYU to inventory and catalog the collections of the Society library and to prepare new bibliographic records. As a condition of the grant, NYU and the Society needed to come to agreement on several items. After much negotiation, the two groups were unable to do so and the Mellon Foundation's appropriation lapsed.

On June 20, 1994, Betsy Gotbaum was named president. Like her predecessors, Gotbaum inherited an institution with morale problems, a board in turmoil, a depleted endowment, and a staggering deficit.

Almost immediately after assuming her new position Gotbaum faced controversy — one of her first tasks was to oversee deaccessioning of \$20 million worth of the Society's collections recommended by the Ross advisory committee. By January 1995, the Society raised nearly \$16 million.

Another major project Gotbaum undertook was renovating the Society's aging building with a special appropriation from New York city and state. During the course of the repair work, the Society's museum remained closed and its library was open just three days a week. On May 11, 1995, the Society opened its doors to the public with an exhibit designed to highlight both the Society's museum and library collections.

Unfortunately, in spite of efforts to reach a broader audience, the reopening of the Society has not resulted in a dramatic increase in visitors. Gotbaum has balanced the budget in each of the last two years, and has cut expenditures substantially, yet efforts to attract general operating support from local government have been unsuccessful so far.

In June 1995, the Society got a boost from the Henry Luce Foundation when it committed \$7.5 million (the second largest ever made by the foundation) to install a study/storage center.

Clearly Gotbaum and her staff have accomplished a great deal in the first two years, yet there remains much to do.

## MAJOR ISSUES AND TOUGH CHOICES

At first glance, one can't help but wonder about the Society's chances for success. Its endowment has dwindled, its donor constituency is narrow, and it has run deficits in 20 of the past 25 years. The major issues facing the Society fall into three broad categories: the burden of caring for valuable old collections and an aging physical plant, the responsibility to provide public service, and the inherent institutional and governance issues that arise from the need to balance both a museum and library.

The oldest problem for management stems from the undisciplined accumulation of materials during the Society's first 150 years. In its first 75 years of existence, library and museum norms for cataloging simply did not exist. Today, the backlog remains extremely large; there is no doubt that cataloging the Society's entire collection would take a very long time, probably decades.

Another consequence of the historical lack of a collections management policy is that the Society now owns a collection without clear geographical, chronological, or thematic boundaries. Still, it is difficult to narrow the collections because of professional attitudes regarding deaccessioning even for objects not related to the Society's mission.

Conserving and preserving valuable collections is also a never-ending expense. Unfortunately, for much of its history the Society did little to protect its holdings from the effects of time. The rapid growth of the collections, the lack of resources, and the limited availability of preservation techniques in early years all contributed to this neglect. Consequently, many paintings, manuscripts, drawings, and books are in need of serious and expensive attention.

Adding to these collections-related challenges, the Society also struggles with the limitations of its physical facilities. Inadequate storage and exhibit space, an aging building with extremely high fixed costs, and a large deferred maintenance bill that recently came due are several immediate problems facing management.

But the Society's difficulties are not just internal. The Society faces the tough challenge of changing the attitudes and patterns that have made it extremely difficult for it to appeal for public funds. A key first step is to transform its elitist image. Although the Society's history is dotted with successful exhibits and public programs, it still suffers from the widely held perception that it has made few attempts to engage the general public.

A large cataloging backlog, expensive conservation responsibilities, maintenance of an aging physical plant, and changing the image of an institution nearly 200 years in the making; these together represent the mountain today's staff and board members must scale if the Society is to thrive in its third century.

## OPTIONS FOR THE FUTURE

Shown below are a few possible strategic options the Society might pursue. There are surely other options that are not discussed here, as well as paths that combine aspects from several alternatives.

**Status Quo.** The least controversial course is to keep the collections together in the Society's present facility. However, the amount of money required to keep the Society operational at its present location may prove unattainable.

**Dissolve.** The most drastic alternative is to dissolve the Society and sell or distribute its collections. If the Society chooses this option, it runs the risk of having the most valuable items taken, leaving the great majority of less renowned, yet historically important, items orphaned and at risk. If the Society were to take this path it must ensure that all of its collections are appropriately cared for by other cultural institutions.

**Merge.** The Society could merge with another cultural institution. When contemplating possible mergers, the Society must consider the allocation of space, whether the collections are complementary, how the merger might improve prospects for long-term financial stability, and the division of governance. Unfortunately, in most cases a merger would not directly solve space problems.

**Transfer.** Another option is to save the Society, but transfer part of its collections. By transferring either its library or museum collections to another institution, the Society could focus its limited resources.

**Relocate.** Many people believe that the unique aspect of the Society's collections is its breadth. For example, while researching the Civil War, a person could read books on the war, handwritten letters of soldiers, generals, and loved ones; view prints, photographs, and works of art relating to the topic; and see the uniforms, weapons, and other materials used in fighting battles. One way to retain this breadth is to keep the collections together but move them out of New York City. Sale of the Central Park West building and the reduced fixed costs could enable the Society to bolster its endowment to provide capital to support the Society in a new location.

# Analyses and Lessons for Nonprofit Boards

Events that occurred more than a century ago continue to have an impact, as do management decisions made much more recently. But what can other nonprofit institutions learn from the Society's story? Do any general propositions emerge from an analysis of the Society's situation? Any analysis will tend to apply more directly to older institutions; institutions that own valuable fixed assets; institutions that own and maintain collections of art, artifacts, or library materials; institutions with high fixed operating costs; and institutions that do not generate significant levels of earned income. The general lessons that emerge from this analysis fall into three categories: the nature of a nonprofit institution's assets, the need for balance between a nonprofit institution's sources and uses of funds, and the signal importance of governance to the long-term health of an organization in the nonprofit sector.

## NATURE OF NONPROFIT ASSETS

The New-York Historical Society owns assets valued at more than \$1 billion. The original watercolors for John James Audubon's *Birds of America* alone are supposedly worth nearly \$100 million. The Society's building and real estate have been appraised at more than \$50 million. These estimates raise one of the most common and most perplexing questions asked about the Society: If its assets are so valuable, how can it be in such severe financial distress?

One major source of confusion regarding the Society's situation stems from the unwitting use of financial terms and concepts developed for the for-profit sector to assess the standing of the Society and its collections. A perfect example of such a failing is the use of the term "asset" to describe the Society's collections. An asset is an object that has value either because it can be exchanged for cash or other goods or because it can be used to increase the amount of cash at an organization's disposal.

This definition effectively establishes two tests to determine whether an item owned by an institution is an asset. The first test considers whether the item is fungible: Can it be exchanged for money or other items of value? The majority of the Society's holdings fail this test. For example, in the case of gifts to the collections that have been made with donor-imposed restrictions, the Society is legally bound to retain them. To sell a restricted item requires a special ruling from the courts. Even if items in the collection are free of direct restrictions, the Society's ability to sell is limited by the museum community's professional standards regarding deaccessioning.

A second defining test to identify an asset is whether the item itself can generate revenue without being exchanged or sold. A small portion of the Society's best-known collections, such as the Audubon watercolors, meets this standard. They attract visitors, bringing in admissions income; reproductions of the works can be sold, creating royalty income; and the collections themselves can travel to other museums, producing fee income. But most of the Society's collections do not offer these revenue-generating opportunities.

In fact, from a purely financial standpoint, the sum total of the Society's collections resemble liabilities more than assets. They are actually a net drain on resources. Incumbent with ownership of those collections is an unremitting obligation to catalog, conserve, protect, and make accessible millions of items. Although not shown on a nonprofit institution's financial statement, the present value of this future stream of expenditures represents a very real financial liability.

If these collections cannot be called assets, does that mean that they are not valuable? Of course not. It is precisely the inherent value of these collections that is at the heart of the Society's reason for being. But how does one express that value, if not in dollar terms? Do we have any other way to keep score?

Why does the Society continue to exist and why should it continue to expend substantial resources to preserve and maintain millions of items that most people will not pay to see? The answer, of course, lies in our belief in the Society's broader purposes. Because our culture attaches a value to their missions, the Society and similar nonprofit institutions are offered some protection from the harsh disciplines of the market. This "cultural value," which is quite separate from quantifiable economic value, is, by extension, also applied to a nonprofit institution's collections. Thus, even though the financial value of a "cultural asset" may be negative, it is still considered valuable if it belongs to and is being cared for by an institution with a mission that the community has deemed worthy of support. The value of a cultural asset is not determined solely through a net present value calculation of the future cash flow it can generate; rather it is also determined by the relevance of the asset to the broader cultural purposes and capacities of the institution to which it belongs.

Because cultural assets are costly, care must be taken to ensure that resources will be available to maintain them for the long term. In some cases, it may be prudent to decline a gift, even if it is enormously valuable. Also, nonprofit leaders should consider asking the donor to help pay for the ongoing maintenance of the gift. After all, the nonprofit institution is not receiving a financial benefit from the donor; rather, it is taking on a financial obligation.

## ENDOWMENT MANAGEMENT

The importance of endowment to the Society's long-term financial viability makes the events of the past 25 years especially tragic. In 1969, the market value of the Society's unrestricted endowment was \$15.7 million, a figure more than 20 times larger than that year's total operating expenditures. Investment proceeds from the endowment exceeded the Society's total operating expenditures. Even if the Society had not generated a single dollar of contributed or earned income, it would have had an operating surplus.

By 1989, the Society's endowment base had been almost totally eradicated. Nominal endowment had fallen to just \$5.5 million, \$1 million **less** than that year's annual total expenditures. Whereas investment income accounted for 91 percent of total revenues in 1969, it represented just 13 percent of the total in 1989. Obviously, the magnitude of this decline had profound implications for the Society.

The growth of an endowment depends on three primary elements: investment performance, the addition of capital gifts, and the amount of investment income spent on operations or otherwise drawn down. Before addressing the Society's experience in each of these categories, it is helpful to first summarize some basic principles of endowment management.

### **TOTAL RETURN**

The return on a capital investment has two fundamental components. The first component, the current return or yield, usually comes in the form of dividends and interest and can be spent without affecting the nominal value of the capital base that generated it. The second component, capital appreciation, is not fungible unless some part of the underlying capital asset is liquidated. Selling units of capital generates realized gains or losses, which are the difference between the selling price and the price at which each unit of the capital in question was purchased.

Take a simple example: An organization buys a stock for \$100 at the beginning of the year. Let's assume the stock pays a dividend of \$6. Let's also assume that the value of the stock appreciates to \$110 by the end of the year. To calculate the total return on the investment, add together the dividend payment (\$6) and capital appreciation (\$10). The total return on the stock is \$16 or 16 percent of the original investment.

In the 1960s, most institutions, including the Society, operated under the assumption that it was inappropriate to "invade" the principal of the endowment by spending realized capital gains. Since stocks, if purchased, were rarely ever sold, investing in them did not generate much usable income. Only dividends and interest generated by the portfolio could be spent. As operating costs rose, so did pressure to generate more current spendable income. For many institutions needing a steady and predictable income stream, maximizing current yield became their investment managers' primary objective. This emphasis on current returns led many managers to sacrifice the long-term growth of their investment capital.

Eventually nonprofit organizations — encouraged by a Ford Foundation report — realized that this emphasis on current yields was causing them to lose opportunities to increase their endowment assets by investing in stocks. In 1967, the Society adopted a "total return" investment policy for its endowment, the primary objective of which is to maximize the total return on the portfolio, independent of whether that return came in the form of interest, dividends, or gains from capital appreciation. A total return approach is based on the premise that the decision regarding how much of the total return should be spent in a given year can and should be separated from the decision about what assets the portfolio should be invested in.

A total return investment policy must always be paired with a spending rate, a formula that governs what percentage of the market value of the endowment can prudently be spent on operations in a single year. Established by an institution's board of trustees, the spending rate should strike a balance between short-term spending needs and long-term capital growth.

## WHAT WENT WRONG

The failure of the Society to protect its endowment can be attributed to a mix of factors. The Society's investment assets have been managed by the same reputable firm since the late 1960s, and returns have been competitive with appropriate market benchmarks. The erosion of the Society's endowment during the 1980s was not due to poor management of the investments.

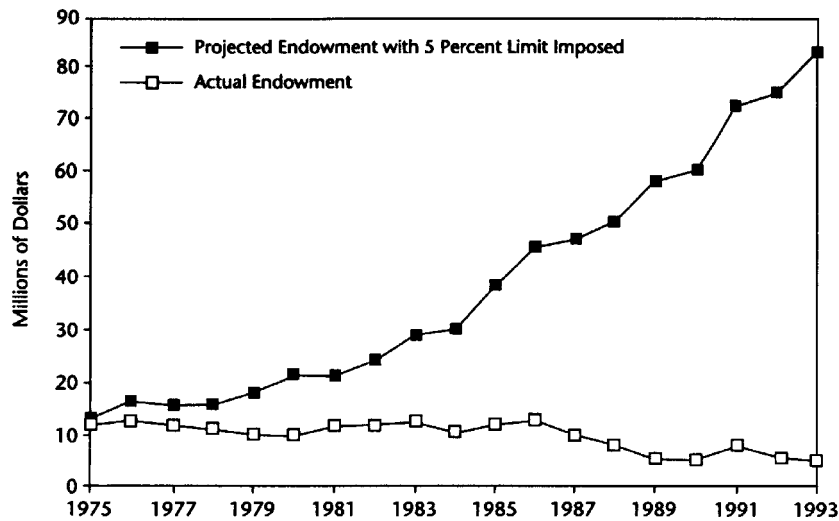
Capital fundraising is a critical element of a comprehensive endowment management policy. New gifts provide a boost to an institution's financial base when investment returns are good and help it maintain that base when they are not. Unfortunately, the Society was not successful in capital fundraising. Except for 1977, when capital gifts totaled \$259,000, the Society raised a total of just \$85,000 in capital gifts in 16 years, an average of just \$5,300 a year.

The final element of endowment management concerns the use of investment returns to help pay operating expenses. When the Society adopted a total return philosophy in 1967, the spending rate established by the board of trustees was 5 percent of the three-year moving average of the market value of the unrestricted endowment.

For a period, the Society kept its spending from the endowment within the 5 percent constraint; however, in 1974, pressured by a variety of financial factors, the Society spent 7 percent of the market value of its endowment. That action set a very bad precedent. By the mid-1980s, the Society appeared to ignore entirely the maximum spending rate established as part of the total return policy.

During this period, the extraordinary level of spending from the endowment was hidden by the tremendous performance of the equity markets. In 1985, for example, the average total return in the equity markets was 31.6 percent. Consequently, even though the Society had spent huge sums from the endowment, in nominal terms the value of the portfolio at the end of the year was still higher than it had been at the beginning of the year. For board members not well-versed in the details of endowment management policy, such nominal increases can hide the underlying long-term impact.

Unrestrained spending from the endowment has consequences. The graph on the following page isolates the impact of the Society's spending from the endowment since 1975. It uses the Society's actual investment performance and the actual capital gifts received, and it follows the board-designated spending policy. It reveals that had the Society operated within the 5 percent spending policy, by the end of 1993 the market value of its endowment could have been nearly \$84 million, instead of the actual value of approximately \$5 million. Under this scenario, the justifiable 5 percent spending from the endowment in 1993 would have been \$3.5 million.



**PROJECTED GROWTH OF THE ENDOWMENT WITH 5 PERCENT SPENDING LIMIT IMPOSED, 1975 – 1993**

## GOOD GOVERNANCE

No lesson manifests itself more clearly than the critical importance of governing boards to the long-term health and viability of organizations in the nonprofit sector. After all, the Society’s trustees are ultimately accountable for the decisions and policies, pursued over many years, that brought the institution from a position of relative financial stability to near insolvency. What are the responsibilities of a nonprofit board? In brief, the primary responsibilities include hiring (and firing) the chief executive, setting and updating the organization’s basic mission, overseeing strategic planning, ensuring that the necessary resources are available to achieve the organization’s objectives, and building and sustaining the diversity and effectiveness of the board itself.

Unfortunately, the Society’s board cannot be said to have fulfilled these responsibilities. Over most of its history, the Society did not reexamine or update its mission, even though its operating environment had changed drastically. In addition, the long string of operating deficits serves as clear evidence of the board’s failure to ensure that the institution had sufficient resources to meet its objectives. Most important, there is little evidence to suggest that prior to the crisis of 1988, the board faced up to the problems besetting the Society and then set a strategic direction for the institution.

The purpose of this discussion is not to affix blame, but to help other nonprofit leaders recognize the warning signals of impending trouble. The Society’s saga demonstrates that recognizing trouble and taking steps to overcome it in a timely way are enormously important. Trustees of institutions facing difficulty must resist the very real temptation to wait for circumstances to improve; they must take action while they still have the power to be effective.

Maintaining accountability is an important function of nonprofit boards. Nonprofit institutions have few external forces to exert discipline on their activities. The only outside agencies that will step in to investigate nonprofits are state attorneys general, but they generally do so only when there is a strong suspicion of illegal activity. Nonprofits with relatively narrow constituencies have few voices to alert them when things are headed in the wrong direction. Therefore, the long-term success is almost exclusively dependent on the effectiveness of trustees.

When an institution has a capital base that is at risk of being eroded to finance unsustainable deficit spending, the importance of the board's oversight role grows larger still. The primacy of a nonprofit organization's mission makes it more complex to govern in the long run. How should the Society's board quantify the importance of cataloging the collections or conserving a particular group of paintings? When should it pull the plug on important projects that are costing more to manage than they generate?

If nonprofit boards are not extremely vigilant, they can easily fall into a pattern of authorizing, perhaps even for justifiable reasons, levels of activity that are not financially sustainable. Nonprofit leaders tend to think in terms of the costs of operations first, and then about revenues. At least in part, this expenditures-first approach is probably a legacy from the days when managing a nonprofit institution was a simpler endeavor. For organizations without predictable revenue streams, this approach can result in setting unattainable fundraising goals.

During the planning process, nonprofit leaders need to think less in terms of what their organizations must do and more in terms of what they realistically can do. To guard against these tendencies, nonprofits should develop an overall financial and strategic plan with realistic objectives and clearly defined expected outcomes.

Once an organization has slipped, it is very difficult to get back on its feet. For instance, the Society considered merging with the Museum of the City of New York, yet negotiations barely got started. The Society had insufficient resources to help effect the merger and its cash flow problems were well known. As a result, its bargaining position was very weak.

Further complicating the issue, when a nonprofit's difficulties become a matter of public debate, the board invariably loses control. Because the nature of any organization's problems are more complex than can be encapsulated in a newspaper article, some issues will be oversimplified, and others will be exaggerated.

## Conclusion

The New-York Historical Society is not a typical nonprofit organization. Few institutions have the privilege of caring for over \$1 billion worth of irreplaceable collections. Nor do most have to be concerned about how articles in the *New York Times* portray their activities. But that does not make this case unrepresentative; it just makes the lessons it yields more dramatic. The experiences of the Society support the proposition that it is easy for nonprofits to get in financial trouble and that detailed planning processes are essential at nonprofit institutions of all types and sizes. It also shows quite clearly how declining financial stability erodes the board's flexibility and ability to make strategic decisions.

Perhaps the most dramatic lesson documented by the Society's long struggle has been the change in the nonprofit operating environment. There was a time when managing and overseeing a nonprofit organization was a far simpler process. To be elected to a board, particularly of a large cultural institution, was to become a member of a prestigious club. Board membership was, in a sense, a reward for professional achievement and a recognition of valuable associations. Times have changed. Over the past 25 years, many intelligent people with the best of intentions have worked heroically in attempts to turn the Society around, only to leave the board later, sometimes with their reputations tarnished. And still the Society struggles to attain a level of financial stability. Serving on this nonprofit board of trustees has been no sinecure. Rather, it has been an excruciatingly difficult tour of duty.

## Suggested Resources

**Andringa, Robert C. and Ted W. Engstrom.** *Nonprofit Board Answer Book: Practical Guidelines for Board Members and Chief Executives.* Washington, DC: BoardSource, 2001. BoardSource has created the next best thing to sitting down face to face with thousands of board members and chief executives! Our revised edition of the best-selling *Nonprofit Board Answer Book* is organized in an easy-to-follow question-and-answer format and covers almost every situation you're likely to encounter in nonprofit board governance, from structuring a board for success to nurturing strategic alliances with other organizations. Also included are action steps, real-life examples, and worksheets.

**Fletcher, Kathleen.** *The Policy Sampler: A Resource for Nonprofit Boards.* Washington, DC: BoardSource, 2000. In addition to steering an organization's activities, nonprofit boards are also responsible for setting policies that govern their own actions. This resource provides nonprofit leaders with more than 70 sample board policies and job descriptions collected from a wide variety of nonprofits. The user's guide provides a basic overview for each of the policies. An accompanying CD-ROM contains the full selection of sample policies and job descriptions that can be easily customized to suit your organization.

**Fry, Robert P. Jr.** *Minding the Money: An Investment Guide for Nonprofit Board Members.* Washington, DC: BoardSource, 2004. Learning how to utilize and invest reserves is imperative for nonprofit organizations in the 21st century. This new book was written to increase your understanding of nonprofit investment management. With action questions, helpful tips, and real-life case studies, you will understand challenging financial concepts that can be part of your investment strategies. Don't miss the accompanying CD-ROM for customization and easy distribution of the appendices.

**Grace, Kay Sprinkel.** *The Nonprofit Board's Role in Setting and Advancing the Mission.* Washington, DC: BoardSource, 2003. Is your board actively supporting and advancing your organization's mission? Learn how board members can actively contribute to the creation of mission as well as communicate the mission and purpose to the community. Discover how your board can partner with organizational staff to implement mission and supporting policies.

**Guthrie, Kevin.** *The New-York Historical Society: Lessons from One Nonprofit's Long Struggle for Survival.* San-Francisco: Jossey-Bass, 1996. This book takes an in-depth look at the history and challenges of The New-York Historical Society. The author provides analyses and lessons pertinent to all nonprofits, especially managing cultural issues.

**Ingram, Richard T.** *Ten Basic Responsibilities of Nonprofit Boards.* Washington, DC: BoardSource, 2003. More than 150,000 board members have already discovered this #1 BoardSource bestseller. This revised edition explores the 10 core areas of board responsibility. Share with board members the basic responsibilities, including determining mission and purpose, ensuring effective planning, and participating in fundraising. You'll find that this is an ideal reference for drafting job descriptions, assessing board performance, and orienting board members on their responsibilities.

**Lahey, Berit.** *Nonprofit Governance: Steering Your Organization with Authority and Accountability.* Washington, DC: BoardSource, 2000. This book outlines the essentials of nonprofit governance and describes ways that boards and board members can add value to the organizations they serve. BoardSource governance consultant Berit M. Lahey defines the difference between policy making and management and outlines the basic responsibilities of a nonprofit board to set organizational direction, ensure the necessary resources, and provide oversight.

**La Piana, David.** *The Nonprofit Mergers Workbook: The Leader's Guide to Considering, Negotiating, and Executing a Merger.* St. Paul, MN: Amherst H. Wilder Foundation, 2000. This practical guide addresses why a merger is an important strategic tool for organizations focused on doing their best for their community. The text walks you through the entire merger process from assessing your reasons and readiness, to finding a partner, negotiating the deal, and completing the merger.

*Managing Change: Lessons Learned from Nonprofit Leaders.* Washington, DC: BoardSource, 2002. In *Managing Change*, leaders from a variety of nonprofit organizations share their experiences in dealing with change and offer real-life solutions that you can apply to your own organization. You'll discover lessons learned regarding board composition, organizational leadership, organizational structure, and critical turning points. Each section offers an examination of key issues, illustrative case studies and abstracts, and important action steps.

*Self-Assessment for Nonprofit Governing Boards.* Washington, DC: BoardSource, 1999. BoardSource's proven assessment book is designed to help nonprofit boards determine how well they're carrying out their responsibilities and identify areas that need improvement. This evaluation toolkit includes a user's guide and 10 board member questionnaires so that you can easily distribute them to your board. This resource is also available in a quick and easy-to-use online version. Contact BoardSource for more details.

*This booklet is based on Kevin Guthrie's book, The New-York Historical Society: Lessons from One Nonprofit's Long Struggle for Survival, published by Jossey-Bass. To order the book, contact Jossey-Bass Publishers, 989 Market Street, San Francisco, CA 94103, 415-782-3194.*