When colleges and universities have reported in recent years on their endowment gains, the pattern has been that the wealthiest have been even wealthier. When the National Association of College and University Business Officers released its last report on endowment gains, in January, it found that the previous year’s increase in Harvard University’s endowment ($3.4 billion) was greater than the combined total endowments of the bottom 188 institutions in the study.

A new study — by three investment experts at Harvard and the Massachusetts Institute of Technology — provides a long term look at the “rich getting richer” trend, and finds that it has been dramatic since the 1990s. The study also explores the reasons that these universities not only outperform the rest of higher education, but much of the investment world. While the study notes plenty of advantages that these wealthy institutions have, and will continue to have, it also questions some of the conventional wisdom on salaries for investment managers and warns that these institutions could lose some of their competitive edge as others copy their strategies.

“Secrets of the Academy: The Drivers of University Endowment Success,” is being posted to the Social Science Research Network. Its authors are Josh Lerner, the Jacob Schiff Professor of Investment Banking at Harvard Business School; Antoinette Schoar, the Marie M. Koemer Associate Professor of Entrepreneurial Finance at MIT’s Sloan School of Management; and Jialan Wang, a Ph.D. candidate in financial economics at the Sloan School.

The paper starts off by noting in various ways just how much more wealthier institutions have benefited from recent gains. In 1992, for example, the top 10 percent of endowments had assets that were worth 160 times those of the bottom 10 percent of endowments. By 2005, the top 10 percent had assets worth nearly 400 times the bottom 10 percent. Most of the total gains in endowments during this period went to either Ivy League institutions or to other institutions with high SAT averages, the paper says.

During the period studied, endowments overall increased by 270 percent in inflation adjusted dollars. But the study finds that institutions in the top quartile by SAT score grew by 310 percent.

A big part of the reason for this success by already successful institutions, the authors write, is that wealthier universities are much more willing to make “alternative” investments (hedge and equity funds and the like) that provide great payoffs, but that are risky — and frequently seen as too risky for institutions with modest endowments. Endowment experts have noted that factor for years, but the new paper adds to the analysis by noting that many of the best equity and hedge funds are effectively closed to new participants, and that the
investors who have had the most success with them have been working on these strategies for years — suggesting that endowment managers who haven’t used these strategies aren’t going to be able to just start doing so.

At the same time, however, the paper warns that the wealthy universities may become victims of their own success. The paper notes that imitation can hinder the effectiveness of investment strategies and that the choices of top universities “are being scrutinized and imitated as never before.” For example, the paper notes that “within a couple of years of Harvard initiating a program to invest in forestland, for instance, many other institutions had adopted similar initiatives.”

Even with the roadblocks facing new institutional investors using Ivy-type strategies, there could be an impact that could hurt those who first used the strategies, the paper says. (An article Saturday in The New York Times noted that smaller institutions that hope for large investment gains are in fact hiring people from Ivy endowment offices and using their strategies, sometimes relying on alumni connections to get into closed funds.)

In a footnote to the new paper unlikely to be popular with student activists, the authors write that the fear of imitation issue is so important that it should be considered when various organizations demand changes in endowment strategy. “It is ironic that on the campuses of a number of elite universities, student activists are demanding greater disclosure of their endowment’s holdings. Such steps would be likely to intensify the problem of imitative investment, leading to lower returns and fewer resources for future generations of students,” the authors write.

The researchers also explore another controversial topic: the compensation that endowment managers receive, which is frequently much more than that of college presidents, let alone that of successful professors. Here, the paper finds that endowments that are doing well are managed by investors who are paid well. But on the question of causation, the authors’ assessment is inconclusive. “Are these schools successful investors because they pay their endowment managers more, or does compensation merely reflect success (and deep pockets)?” the authors ask.

And while the paper notes the advantages of having investment managers with experience, it cautions against assuming that high pay will make it possible to hold on to talent.

“More qualitatively, there does not appear to be a sure association between the level of compensation and staff longevity,” the authors write. “For instance, a number of schools that have offered or discussed offering substantial incentive-based compensation to their staff, such as Harvard and Stanford ... have also been among those hit by large-scale defections of investment staffs. While it is difficult to show analytically, it seems that many of the schools with established, successful investment staffs have maintained them by emphasizing the non-pecuniary benefits that come from being a part of an academic community.”

— Scott Jaschik

The original story and user comments can be viewed online at http://insidehighered.com/news/2007/11/05/wealth.

© Copyright 2007 Inside Higher Ed