Polynomial Ventures

Protestor Demands of University Endowments

By Steve Valentor

Recently, a number of people have asked me questions about protestor demands regarding university investments. These are great questions because most people don't spend much time thinking about how university investments actually work.

As pro-Palestinian, anti-Israeli encampment protests continue at university campuses across the US, university leaders juggle many competing issues. These including free speech, trespassing, moral conscience, safety, protestor demands, antisemitism, obligations to financial donors as well as the obligation to maintain law and order.

News media across the political spectrum are quick to report the unrest. Few however identify or explain the demands of the protestors or accommodations offered by university administrators.

Protestor demands vary slightly from campus to campus and across the country. The common demands seem to include:

- Calling for a ceasefire in Gaza
- Denouncing Israel's actions
- Ending collaboration with Israeli universities
- Abolishing university or municipal police forces on campus
- Amnesty for protestors
- Disclosure and divestiture of university investments

Almost incredulously missing from these demands are the release of the hostages being held by Hamas or accountability for crimes that may have been committed on October 7, or in retaliation.

However, a number of the demands have to do with university investment policies. Our purpose here is to explain the types of assets that universities invest in and analyze the potential impact and ramifications of the protestors demands of the endowments.

Before diving into the details of that topic, I feel that I must make a comment regarding protestor amnesty. As an absolute defender of free speech, I fully support

the right of every person to peacefully express their opinion. However, the moment that protestors threaten, intimidate, resort to any level of violence, illegally enter property or damage it, they should be arrested and charged as criminals. It should not matter whether the protestors are storming university buildings or the nation's capital. These are crimes which must be prosecuted through the justice system, where the offenders may be convicted or acquitted.

At Trinity College in Dublin, Ireland, administrators agreed to fully disclose the universities investments and divest from those that protestors find objectionable. This was done in exchange for the peaceful dissolution of the encampment. A similar agreement was made at Northwestern University near Chicago. In the agreement, Northwestern agreed to disclose information and address questions from interested parties. Northwestern employs a large staff that manages its more than $14 billion fund. They have nearly complete control over their investments.

At DePaul University in Chicago, the president's team attempted to negotiate a resolution with protest leaders. After more than a week, the president issued a letter declaring that negotiations had reached an impasse. The encampment was then dismantled. In full disclosure, I am a faculty member at DePaul.

Universities control a significant amount of wealth. They have accumulated this over many decades, and in some cases centuries. When John Harvard donated £780 to the Newtowne Colledge in 1636, he could hardly have envisioned that his gift might grow into the $53 billion endowment of the university that now bears his name.

In some cases, universities maintain their assets in separate foundations. In other cases, the universities manage their investment funds as part of the normal operation of the university. The sources of these funds can vary. Most common however is money that is donated to the university by wealthy alumni, families, or outside foundations. Those donors often provide these funds with the condition that the principal of their donation be preserved and that only the interest generated from the investment of the funds be used. Sometimes additional restrictions are imposed. Sometimes the funds are given without any restriction in terms of how the interest from the investments should be used. In most cases, the principal must be retained. We will use the general term "Endowment" to describe these funds. The most important feature of these endowments is that they are intended to ensure the long term financial viability of the universities and that they may insulate the

institutions from general economic conditions. Ultimate oversight of the endowments usually resides with a board of trustees.

Universities with the largest endowments have created their own management companies to oversee their investments. Harvard, Princeton, MIT, Columbia, Yale, Northwestern, University of Chicago, Stanford, and many others that typically exceed $10 billion employ large staffs to invest and manage the funds. Because the management company has full control of the funds, it can easily choose investments which are consistent with the directives of its benefactors as well as the moral, ethical, or other principal standards of the university.

The majority of universities engage outside advisors to manage their endowments. In these cases, a universities investments are pooled with those of other investors with similar interests and are managed accordingly. When a university engages an advisor, it typically will require that the advisor agree to comply with any mandates or guiding principles that have been imposed by the benefactors or the trustees.

Examples of restrictions might include prohibiting the endowment from investing in fossil fuels, in countries where apartheid practices exist, or in countries with questionable human rights records. Many endowments impose strict environmental, social and governance (ESG) constraints on investment managers. These restrictions can sometimes lead to conflicting dilemmas.

For example, benefactors may prefer that an endowment invest in renewable energy, electric vehicles, and battery technologies. This requirement may clash with the fact that the six most common elements mined for use in EV batteries are cobalt, copper, lithium, manganese, nickel, and zinc. Many are mined in Africa where child labor law and human rights violations are common.

With all of this in mind, the fund managers will diversify the fund into some mix of risk-free assets, fixed income securities, bonds, stocks, real estate, mutual funds, exchange traded funds, and potentially alternative investments.

To achieve the goals of the endowment, satisfy benefactors, attract new donors, and meet the demands of all interested parties is indeed a balancing act.

While individual mandates vary, the goal of most endowments is to contribute approximately 5% of the fund balance to the universities annual operating budget.

For the fund to continue in perpetuity, it must then earn at least 5% more than the Consumer Price Index (CPI), which tracks inflation.

There is no risk of loss investing in US Treasuries, but returns will be limited to approximately the CPI. As of May 13, 2024, the 10-Year Treasury Bond yields 4.69%. Adding that to the 5% projected spend, we get 9.69%. A reasonable target would be 10%.

It is important to note that this target return must be achieved on the entire fund. Consider the case where a conservative fund manager wants to invest 50% of the fund in risk-free Treasury bonds yielding less than 5% on average. They would need the returns on the other half of the fund to exceed 15%, as a weighted average.

10% (Fund) = ~5% (Fund/2) + ~15% (Fund/2)

There are few investment options with the possibility of returning 15%. This cannot be achieved with bank certificates of deposit or money-market accounts. It is unlikely to be achieved by real estate, even over an extended period. Investment grade bonds currently yield only 5.8%. A diversified stock portfolio is likely to come close with a long-term expected risk adjusted return of 8.5%. Precious metals have done remarkable well over the last 24 years yielding nearly 10% annual returns. But all of these fall well short of the ~15% return that is required for the aggressive portion of the fund.

In order to satisfy these targets, fund managers must rely on alternative assets which include private debt, hedge funds, private equity, and venture capital. All of these are relatively illiquid and require extended capital commitments of typically 10 years. Once a manager is chosen, it is very difficult for the university to influence the specific investments that the manager will make. It is also very difficult for the university to withdraw from a fund earlier than the planned cycle.

Each of these alternative asset investments are readily available to institutional investors, but at very high fees. Typical fees include a 2% annual management fee as well as 20% of the profits going to those offering the investments. The most successful alternative asset managers charge even higher fees. Therefore, investors must measure their returns on these assets “net of fees.” These returns must also be measured in terms of “risk adjusted returns.” While they may at times deliver extraordinarily high returns, they may at other times incur losses. Sometimes these losses can be quite significant.

Private debt tracks the CPI and is unlikely to yield the target 15% on a risk-adjusted basis. Performance will generally increase as the CPI increases, but it is important

to note that debt is always based on a negotiated rate over a time period, so there is effectively no opportunity for “unlimited upside” as there may be with the other alternatives.

Hedge fund strategies vary widely but seek to deliver outsized returns by using leverage, derivatives, options, futures, rapid trading, quant analysis, arbitrage, activist tactics and of course, hedges.

Traditional private equity (PE) seeks to take equity position in privately held companies. Quite often, PE is used to take public companies private. This is what happened when Elon Musk bought Twitter (now X). Other famous transitions from public to private include Dell, Burger King, Heinz, and Panera Bread. Often after a time period, the private companies are again offered to the public. This what happened with Dell. The transition back to public can create a significant liquidity event for the PE investors.

Of these alternatives, perhaps the most productive in terms of bringing new businesses to the world is the small subset of PE known as venture capital (VC). This asset class seeks to invest in new businesses early and benefit as they succeed and are either acquired or are taken public through an initial public offering (IPO). There are many incredible success stories of VC funded IPOs including recently, Uber, Twitter, and AirBnB. Further back, Microsoft, Apple, Intel, Facebook, Google, and just about every other household name were VC-backed IPOs.

Performance varies widely within these alternative investment categories. So, there is no guarantee that any particular manager or fund will consistently deliver above or below average results. Where a particular manager in a particular period may deliver astounding returns, that same manager may suffer losses in another time frame. There are many factors and few controls that determine how a particular manager may perform.

Remember that endowments that are chartered to contribute 5% of their value to their universities annual operating budget - MUST invest a portion of their fund into these alternative assets in order to maintain (or better yet, grow) their fund.

It would be impactful to educate the leaders of these recent protests so they understand the complexities associated with managing the endowments that they are making demands of.

A tremendous amount of good comes out of the use of endowments. They fund research, infrastructure, facilities, student scholarships, financial aid, academic

programs, faculty development, and ensure that our universities will continue to operate in perpetuity. Healthy endowments also reduce the universities dependence on taxpayers.

I wonder to what level protestors understand all of this and give it consideration when they make demands.

At my firm, Polynomial Ventures, we have compiled what we believe to be the most comprehensive database of 1553 universities in the United States that control just over $1.02 trillion in their endowments.

We are here to help. Our mission is to provide venture capital investments for university endowments. We are investing in US-based, early-stage technology companies in the underserved markets outside of Silicon Valley and New England. This strengthens universities, builds American businesses, enables innovation, supports university-based research, collaboration, incubator opportunities and creates jobs for US citizens.

Steve Valentor is a 30-year technology industry veteran who has worked in computer engineering, semiconductor R&D and software development for companies ranging from startups to the Fortune 200. He has held positions from entry level engineer to senior technical management, CEO and board chair. Currently the managing partner of Polynomial Ventures and an adjunct professor at DePaul University, Valentor holds an M.B.A. in finance and a bachelor’s degree in math, both from the University of Illinois at Chicago.

Polynomial Ventures invests in early stage technology companies outside of Silicon Valley and Boston. The Chicago-based firm is an emerging, registered investment adviser (RIA) operating an evergreen fund.