# Mission-Related Investing in an Age of Scarcity

## By Steven Godeke and Doug Bauer

In the coming weeks and months, unprecedented losses to foundation endowments will soon hit grantmaking budgets throughout organized philanthropy. The instinctual response of foundation trustees and investment committees will be to cut back to the basics, fund existing grantees and hope that the market will return or other sources of funding will emerge before too much damage is inflicted on the organizations and communities we care about. These instincts are, unfortunately, wrong.

Let's be honest: there is a structural disconnect between the current availability of foundation-generated funding and the needs of the organizations and communities we seek to support. The 5% payout model is not designed to work as a stabilizing force in an economic downturn such as this one. In fact, the opposite is true. In the recent years of plenty, some funders — flush with investment gains — struggled to meet their 5% minimum payout requirements. Now they are confronted by a dramatic drop in resources — just when nonprofit organizations need them most.

When the dust settles on the current crisis, we will find ourselves on a very different playing field:

- Assumptions about continuing growth in philanthropic assets driven by increases in wealth may prove invalid. Capgemini/Merrill Lynch's 2007 World Wealth Report estimated that the world's 10.1 million high net worth individuals (persons with more than $1 million in financial assets) had $40 trillion. This number was forecast to hit $59 trillion by 2012. This scenario now appears highly unlikely.

- As unprecedented government interventions restructure our financial and industrial sectors and calls for deficit-funded spending increase, our assumptions about the limited role of the public sector are going to be (probably) unfounded. To put this in context: next year's U.S. federal budget deficit could easily exceed the amount of total U.S. foundation assets. Concurrently, we are also seeing a further fraying of the social safety net at the state, regional and local level, and the nonprofits that make up that web of services are receiving less support. Much of the federal, state and city dollars dedicated to those safety net issues are discretionary and likely to shrink as the federal government (and its emergency dollars) focus on stabilizing entities essential to the U.S. economy.

### Going Beyond The 5%

A fundamental question now is how can foundations remain relevant and vital in this new landscape?

In this age of limited private resources, philanthropy must squeeze efficiency out of all of the assets at its disposal. The social, cultural and environmental challenges and issues which foundations are seeking to address continue to worsen. Society continues to need the flexible, innovative and risk taking capital that only foundations are in the position to provide. Assuming in the next few years that foundation endowments are not going to grow as they have historically, where can foundations find the additional resources needed to generate impact?

We believe that Mission-Related Investing (MRI), which we define as any investment activity which seeks to generate a positive social or environmental impact in addition to providing a financial return, will be a key element of philanthropy in this Age of Scarcity.

Mission-related investing is driven by the fundamental belief that using only 5% of your foundation's assets limits your impact and limits your ability to generate positive social change.

## Impact and Rigor

As we stated in our recently-published guide, *Philanthropy's New Passing Gear: Mission-Related Investing:*

> "The desire to generate measurable positive impact has become paramount in the boardrooms of private foundations across the U.S. and around the world. The discipline of business thinking appears to enhance the effectiveness of non-governmental organizations and to achieve positive outcomes for communities and society at large. The language and execution of philanthropy have embraced the principles and concepts of the private sector."

We believe that impact and rigor will continue to drive philanthropy. The power of markets will continue to drive social change. Given the new limitations we are facing, philanthropy needs to do a better job of generating positive social change more efficiently and effectively. As foundations seek to create positive social and environmental impact in this Age of Scarcity, it is unlikely we can rely solely on grants.

## But Aren't Market-Based Solutions The Cause of Our Current Problems?

Some may argue that now is a poor time to focus on mission-related investing as investment committees grapple with losses, non-profits need grants not debt, and "innovative" leveraged structures are surely part of the problem, not the solution.

We would beg to differ.

In fact, mission-related investing can anchor and reconnect markets to people and their needs rather than focusing on engineering money from money.

As investment committees review the performance of their endowments in the wake of the market downturn, it is an opportune time to discuss mission-related investing in your organization. Investment consultants and managers should be more receptive to undertaking the necessary due diligence for mission-related investment opportunities given the recent performance of the so-called mainstream alternatives. If your current investment consultant is unwilling or unable to take this on, you may want to consider changes.

This crisis creates an opportunity for conversations about how to align and embed your investment decisions within your philanthropic mission. And remember, prudent mission-related investing can and does achieve results for endowments which are comparable to non-MRI performance. Indeed, the performances of certain foundations deploying MRI in their asset allocation strategies have demonstrated strong results — even in this current market.

## Concrete Mission-Related Investing Tools & Tactics

As we move forward, we are specifically recommending that philanthropic leaders like you considering adding the following tactics to your philanthropic toolbox:

### Active Ownership Strategies

As long-term owners and fiduciaries of significant positions in publicly-traded securities, foundations have the ability to influence corporate behavior and further their own missions through proxy voting, shareholder resolutions and informal shareholder engagement with the corporate management of the companies which they hold in their endowments. Many of the recalcitrant companies that have changed their policies and practices on a host of issues important to foundations did so because their shareholders demanded change — not because of the market or other forces.

#### Screening

Screening is the practice of buying and selling publicly-traded securities based on an evaluation of non-financial return criteria that reflect your foundation's mission. Your investment decision may be to avoid certain companies (negative screening) or to support particular companies (positive or best-in-class screening). The goal is for your portfolio to reflect the values of your organization, guard your reputation, mitigate risks, and use your investment capital to encourage or discourage specific corporate behaviors.

Both Active Ownership Strategies and Screening can be accomplished at low cost and fully leveraged by partnering with other investor groups.

#### Below-Market Investments

Below-market investments made by foundations are typically categorized as program-related investments (PRIs). By providing a PRI, you can usually provide more capital to an organization than through a grant. The repayment of the PRI returns to your foundation and can then be recycled out to other organizations. These investments can be in the form of debt or equity and must be made with the intent to further program objectives. The expected return on a PRI must be below the risk-adjusted market return for such an investment. While there is speculation in the foundation world that PRIs are not an appropriate vehicle in a time of suppressed payouts, we believe that PRIs will remain a potent instrument to support grantees and can be more effective than grants in helping certain organizations.

#### Guarantees

Guarantees can be attractive alternatives to cash loans when providing debt capital in a mission-related investment. Guarantees separate the credit risk of an organization from the funding of a loan to that organization. A foundation typically uses its endowment as collateral to provide security (guarantee) to an intermediary which then funds the organization based on this security. Transactions of this kind would not necessarily require a disbursement of cash from your foundation. If the risk is underwritten carefully, the capital may not be drawn at all. In a time of scarce grant budgets, foundations can extend their impact through guarantees. We believe guarantees and other forms of credit enhancement are underutilized tools which need to be more fully deployed by foundations.

#### Market-Rate Investments

Foundations which invest in market-rate MRI transactions will find opportunities to co-invest with a broad range of institutional investors which seek to earn a risk-adjusted market rate of return in addition to creating environmental, social and governance benefits. These are investment opportunities which direct capital to organizations or projects which create specific social outcomes in alignment with your mission.

### But Why? Answer: Efficiency, Collaboration, and Innovation

The current environment requires us to squeeze out as much impact as possible for each philanthropic dollar while balancing the need to support social and/or environmental innovation for the future. Collaboration among philanthropy, the public sector, individuals and corporations is also expected to increase.

### Specific Actions You Can Take:

Bargain Hunt for Impact: Through mission-related investing, you can recycle scarce philanthropic capital. Review your existing portfolio of grantees for potential PRI recipients. You may find that highly effective grantees have expensive commercial bank credit lines or may even be facing cuts in their lines. Explore providing PRIs to these grantees; a well executed PRI can provide a grantee with the needed capital to weather the current crisis and continue to create impact.

#### The Two-for-One Special: Guarantees

Guarantees and other forms of credit enhancements can permit you to generate impact with your assets without reducing the amount of funding available for grants or liquidating endowment assets. Your assets can serve double-duty.

#### Buy Local

Cash Deposits with Local Institutions: By placing an FDIC-insured certificate of deposit with a local community development financial institution, you can create customized, placed-based impact without additional risk. Through the CDARs program, you can receive the benefit of FDIC insurance on up to $50 million.

#### Safety in Numbers

Collaborate: Leverage is not always a bad word. Collaborate with other funders (philanthropic as well as public and corporate). As the public sector's role changes, the need for innovative public/private partnership transactions may increase. While collaboration can be cumbersome and require compromise from all parties, across-the-board limitations on resources may expedite the process. Scarcity can drive creativity. Step outside your usual circles and seek co-investors among individuals and institutional investors. Philanthropy has always relied on other sectors to co-create and sustain positive impact.

#### Listen to Your Customers

Through MRI, you can provide a broader and more flexible range of tools and services for your real clients — the communities and/or issues you are trying to help. For example, your non-profit grantees with government earned income contracts may need working capital loans. The traditional bricks-and-mortar facilities focus of PRIs may not be the right vehicle.

#### Necessity is the Mother of Invention

Innovation will continue — be a part of it. In fact, it may accelerate in certain sectors. Acknowledge that innovation and market building will cost money. In fact, many of the mission-related investment products mentioned above were launched through past philanthropic investment. Changes to existing MRI investment structures and the construction of new vehicles may be needed to target your specific program objectives. Fortunately, there are leaders in the MRI field who have already taken the steps to align their mission and investments and can share their expertise and products.

## Conclusion: There is the Old Way and There is a Better Way

In times like these, it is essential to use all of the tools in your philanthropic toolbox. If we want to truly maximize the impact foundations can have in addressing the issues and challenges in this time of diminishing resources, we cannot solely rely on grantmaking based on our 5% payout.

In this Age of Scarcity, we are dealing with a crisis environment. We can panic, pull back and/or give up. Or, we can search for and develop innovative solutions. The field of philanthropy needs to use mission-related investing to engage 100% of our assets for the positive impact we need and desire across the spectrum of issues we care so deeply about.