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inflection points

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INVESTMENT FUNDS

Philanthropy's Bermuda Triangle

Inflection Points asked **Stephen Viederman**, retired president of the Jessie Smith Noyes Foundation and presently a member of the finance committee of the Christopher Reynolds Foundation, for his views on the power of philanthropic foundations to utilize their investment funds for change.

Philanthropic foundations are like old-fashioned slot machines. They have one arm and are known for their occasional payout. Their finance committees manage their endowments like investment bankers. Their portfolios give no hint that they are institutions whose purpose is the public benefit.

Although it is twenty years since the term "mission-related investing" found its way into the lexicon of philanthropy, the practice is limited. There is a chasm between mission – grantmaking – and investment. The logic of a synergy between the two has yet to take hold.

For example...

A number of reports circulated in the US and the UK in the last few years laid out ways that foundations can "win the war on climate." The focus was entirely on grantmaking. None made any reference to the various ways that assets could be used to add value to their grantmaking. My op-ed in the *Chronicle of Philanthropy*, pointing out the ways that assets could help "win the war" went unanswered by the authors of the reports and by foundations.

Among the 25 biggest climate funders very few have climate investments, but one is an active shareowner on climate issues.

US philanthropy is a big enterprise with over $500 billion in assets. Unfortunately share *ownership* is not taken seriously. Investing to avoid predictable and preventable surprises is smart investing. Voting proxies and filing resolutions is an ownership obligation rarely exercised.

The *Bermuda Triangle* of foundation investing seems to swallow up discussions of assets as an instrument of change. On one side of the triangle is the board and investment committee; the second is the investment office; and the third is the consultant. Their views on finance, formed in the same business schools, see reality – the world as it is – as an externality, and intangible. Water availability and utilization, climate change, human rights, working conditions, diversity on boards are issues not factored into their investment decisions, which are made for the short-term, as if the future did not matter. In the foundation setting, as in their day jobs, their awareness is bounded by what they have learned with few incentives to change.

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Philanthrocapitalism: a new philanthropy movement

Matthew Bishop and Michael Green produced their influential book *Philanthrocapitalism* in 2008. The book examined the emergence of a new philanthropy movement based around the giving pledges of Bill Gates, Warren Buffett and others. Philanthrocapitalism proposes a new approach to solving social problems, based on innovative partnerships between business, nonprofits and government. Rejecting the idea that business is about short-term profits, philanthrocapitalists think the economic winners should give back and that business can "do well by doing good."

Bishop and Green propose a "Philanthrocapitalism Manifesto" that includes a focus on the power of investment. They state in their manifesto "Foundations should be leading the social investment movement through active 'mission-related investment' of their endowments. A few, such as the Tudor Trust and Esmee Fairbairn Foundation, are leading the way but most foundations still think of their endowments as a source of investment income to fund grant-making rather than a strategic asset that can be used for social benefit. American foundations like FB Heron are showing the way."

The authors recommend that a proposed 5% payout rule for foundations being considered in the UK could also be structured to give credit for social investments to encourage the use of endowments as a pool of social investment capital.

They specifically call on government to use tax and other incentives to promote mission-related investment by foundations.

IPCM will examine impact investment in our next investor note. In the meantime we recommend the book, which has recently been updated: www.philanthrocapitalism.net

Matthew Bishop, who is the New York editor of the Economist, *moderated the discussion at IPCM's annual "Club of Davos" dinner at the World Economic Forum in Davos, Switzerland, in January 2011.*

Little time is spent in meetings on new ideas, leading to what has been called "willful blindness." And yet these same people after work and on weekends are often very eleemosynary, devoting their time and money to organizations seeking to remedy these issues. Vocation and avocation are split, as demonstrated by the philanthropy of Bill Gates and Warren Buffet.

Within the triangle outdated views of fiduciary duty prevail. The myth of underperformance is pervasive. Maximizing alpha, the old-fashioned way, takes precedence over benefit to meet the public good, and to harmonizing investments and grantmaking. These are complementary not conflicting activities.

Michael Jensen and his colleagues at the Harvard Business School are studying organizational integrity, "that group's or organization's word being whole and complete." The concept incorporates morality, ethics, *and* legality. Their model "reveals a causal link between integrity and increased performance, in whatever way one chooses to define performance (for example, quality of life, or value-creation for all entities)." Harmonizing mission and asset management, becoming whole, is an organizing concept to improve the practice of philanthropy.

For the moment business continues as usual. Though claiming integrity, foundations often fail the wholeness test. The pessimist sees the glass mostly empty, while the optimist sees it filling. The hopeful say change must occur, and it cannot come too soon.

ABOUT US

Inflection Point Capital Management is a new, sustainability-driven asset management boutique. A research-driven organization, IPCM builds on the knowledge base and networks of its predecessor company, Innovest Strategic Value Advisors. Innovest was ranked by the Thomson Extel survey of institutional investors as the #1 research firm in the world in the sustainability space. IPCM has offices in London, New York, Toronto, and Melbourne. **www.inflectionpointcm.com**

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MAKING A DIFFERENCE

It *can* be done

by **Stephen Viederman**

As president of the Jessie Smith Noyes Foundation in the early 90s I worked with my board to "reduce the dissonance" between our grantmaking and our asset management. We screened our portfolio, which was state-of-the-art at the time; filed a shareowner resolution with Intel in support of our grantee, the South West Organizing Project, as well as with other companies on environmental issues; voted all our proxies; and had our own social venture capital partnership seeking to invest in companies that were providing commercial solutions to the issues we were dealing with in our grantmaking. Our performance matched or exceeded the standard benchmarks we used to measure how were doing. And during the decade our payout averaged 7 percent each year, well above the IRS requirement.

I have also served on the Board and Finance Committee of the Needmor fund and the finance committee of the Christopher Reynolds Foundation during the last decade. Both funders view their portfolios through a sustainability lens and take seriously their ownership obligations. Performance has been competitive.

The F.B. Heron Foundation, whose mission is to build wealth in low- income communities, "seeks to accelerate the level of its assets invested in efforts with strong financial and social returns." They too have had competitive returns since initiating their program in the late 90s.

Keith Johnson describes institutional investors as lemmings, following each other in more or less of a lock step. Philanthropy needs a lead lemming that would be of fairly large scale with a good solid reputation within the community to create a new model of investing for all. There are a few baby lemmings that might grow up to be a leader, but it is still too soon to be sure how they will mature.

The World Economic Forum observes in its report, *Accelerating the Transition towards Sustainable Investing: Strategic Options for Investors, Corporations and other Key Shareholders*, the great transformational power of financial markets to accelerate the transition to more sustainable business practices and value creation. Foundation assets *can* make a difference.