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Defining Your Double Bottom Line: Philanthropy and the Investment Landscape

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Philanthropy and the Investment Landscape

Philanthropy, from the Greek *philanthrōpia,* meaning "love of humankind, especially as evinced in deeds of practical beneficence and work for the good of others," today describes the myriad ways in which organizations help others, primarily expressed through donations of money to worthy causes of interest.

Philanthropy is almost as old as human civilization itself. A brief perusal throughout history of the tenets of any organized religion or belief structure, from Christianity to the Hindu Vedic scriptures, generally reveals a deep respect for charity and selfless benevolence. From an early modern perspective, the 16th century saw a rise in conscious state-sponsored activity, from Juan Luis Vives' influential text "On the Relief of the Poor," in which he maintained it was the duty of civil administrators to provide welfare to the needy to maintain social cohesion, to the resurgence of the Islamic philanthropic tradition with the expansion of the Ottoman Empire in the form of public complexes constructed to provide board and services to the poor and orphaned (National Philanthropic Trust, 2016). Throughout history people have relied on the kindness of others to help correct the arbitrary nature of birth and circumstance, and in providing such services and funding through public and private means, humankind has in the most hopeful instances been able to alleviate the suffering of others.

Foundations usually have well-defined missions, which they are charged with supporting in perpetuity. One of the ways this has traditionally

Key Points

- Grantmaking traditionally has been at the heart of philanthropy, whereas impact was the exclusive expectation of any desired result. While there is still a place for this kind of pure push for change, many investors today expect more, leveraging the power of the markets to invest in a way that is both impactful and able to maximize their financial rewards. This is particularly true of foundations with an eye toward supporting the perpetuity of their missions and organizations.
- This approach also offers a range of innovative mission-based benefits, including extending the utility of philanthropic capital and generating more capital to reinvest into impact initiatives, potentially in partnership or in tandem with grantmaking. However, the focus of impact has also shifted in radical new ways, especially over the last few years, in response to social developments and generational shifts in value. These shifts call for greater intentionality in defining the nuance and complexities involved in any use of the term "impact."
- This article argues the key importance of defining and crystalizing specific thresholds, metrics, and language around foundations' missions to ensure demonstrable qualitative and quantitative measures of progress toward success (financially and impact-based); discusses how the long-term pursuit of values-based goals and financial performance are mutually inclusive and self-reinforcing, and can be combined to great effect with more traditional forms of philanthropy (i.e., grantmaking); and demonstrates how impact investing provides the opportunity for the

(continued on next page)

been accomplished is through grantmaking: as just one of many examples, the $258.3 million in grants provided by the Bill & Melinda Gates Foundation (2005) to combat malaria as part of its broader global goal of ending poverty, disease, and inequity around the world. This activity is generally separate from the investment activities that support the funding of such grants and focus on financial return. However, today, as concerns for the future of society and the health of our planet increasingly permeate activities formerly shielded from such scrutiny, many investors and organizations are becoming aware of the power of investing to both supplement and buoy missions beyond such direct assistance as grants, in essence demanding impact as well as financial returns from their portfolios.

Key Points (continued)

engagement of additional stakeholders and members of the community.

- This article also addresses several key questions: How has the use of philanthropic capital evolved from an investment perspective? What does an effective impact definition include? In which ways do impact and financial priorities buoy each other? How does one find credible sources of ESG/impact data and what determines high-quality data? And, finally, how can organizations best articulate their missions in their investment policy statements to better define their double bottom line?

ESG, SRI, and Impact

Since goods and services have been exchanged, people have invested their time and resources according to their personal prerogatives or moral inclinations. Early Jewish law (collected or developed over 2,000 years ago) encouraged a principle of justice in business and economic dealings, *tzedakah,* reflecting an early form of socially responsible investing (Telushkin, 1991, as cited in Jewish Virtual Library, n.d.). In the United States in the 18th century, the Christian Protestant branch of Methodists avoided the slave trade, gambling, and alcohol- and tobacco-related ventures as unaligned with their religious convictions (Christian History Institute, n.d.).

Every dollar invested is a vote cast for the future in a certain direction, regardless of investor intentionality. Today, myriad "sustainable investing" solutions have emerged in response to demand from capital owners and allocators to find ways to increase returns, diversify portfolios, and target sustainable investing outcomes. These solutions largely fall into three broad frameworks:

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- *Environment, social, and governance (ESG) investing* — enhancing traditional investment analysis by incorporating environmental, social, and governance factors to identify potential risks and opportunities;
- *Socially responsible investing (SRI)* — applying positive or negative value/impact screens to decide specific investment priorities; often involves implementing factor tilts to address specific risk factors; and
- *Impact investing* — investing funds with the primary intent of delivering specific, measurable, and permanent near-term improvements in the real world alongside expected financial returns.

While these definitions make impact, ESG, SRI, and subsequent measures of success sound monolithic, the reality is that most solutions carry elements that fit into more than one of those categories. As the world has advanced and technology has progressed, ethical, social, and environmental issues have become more convoluted and wide-ranging (Steinbarth, 2021). In the past, philanthropic capital would be deployed through grantmaking or gifts to tackle these issues. Today, there is a growing awareness of

the power of the markets themselves to enhance the response to these issues and align portfolio investments with the philanthropic mission. To be truly effective, such investments still need to be able to satisfy the financial objective of the portfolio to support the broader organization in perpetuity, ensuring its core functions and services remain intact. This is achievable through a disciplined approach to defining mission and desired impact.

Impact in Action

Incorporating ESG, SRI, or impact in investments requires a process of factorizing the issues/topics the investor deems relevant — for example, using a workforce diversity metric to determine the level of commitment to inclusivity, or measuring an organization's carbon emissions as a tool to assess its commitment to environmental sustainability. This factorization process depends on subjective definitions of the issues. To add further complexity, ESG and SRI are not asset classes themselves, but rather a way of investing within each class, subject to the idiosyncrasies and particularities of the services and products represented by the relevant sectors. It is highly contextual, and generally subjectively defined by relevant capital stakeholders. For example, if a religious-affiliated organization today chooses to comprehensively halt investment in traditional "sin" stocks such as tobacco, alcohol, or gambling, an exclusionary screen can filter these from its investment universe. However, depending on one's definition of mission and impact, ESG criteria can be applied based on the specifics of each of these industries to responsibly invest in context: for example, in the case of tobacco or alcohol, a reduction in water use and waste, a responsible use of limited, sustainable farmland, and fair trade agreements to ensure labor practices protect those workers harvesting and preparing the raw materials; for gambling, stricter regulation to prevent excessive or underage play, resources dedicated to prevention, detection, and intervention, and lower-risk options for a safer gaming environment.

This is where impact investing can be leveraged in tandem with the above to determine which outcomes an organization finds most conducive to their definition of success, and underscores the primary importance of crystallizing the mission of each portfolio to determine measurable metrics that reflect such success. Importantly, success is how each organization defines it, based on its own values and financial expectations.

At this juncture, it is important to note the dependence of this process on ESG/impact data. To incorporate ESG, SRI, and impact into the investment process, appropriate data proxies for the issues must be identified.

In prior years, this activity proved difficult due to the limited availability of data. This situation has improved recently, especially as we continue to see a proliferation of ESG data providers — ISS ESG, Sustainalytics, MSCI, RobecoSAM, and Reprisk, to name a few. Since "perfect" data remains a goal to aspire to, a keen eye is needed to assess the quality of the available information. However, to gain a better understanding of such sources, several criteria can be assessed to help validate the usefulness of the information — for example, review for disclosures on methodology, data collection, and verification to determine the comprehensiveness of the data set. This includes identifying time periods to understand the timeliness of the data and evaluate how frequently data are updated. Consistency and relevance are also key inputs. Check if the data are consistent with other publicly available information, and relevant to the issue or industry being analyzed; for example, a financial services company may report low carbon emissions, but this may not necessarily be as meaningful a metric for assessing its ESG performance as are carbon emissions from a company in the transportation industry. The general quality of the information source can be assessed by looking into its level of detail and transparency — for example, determining the source uses verifiable raw data inputs according to well-defined metrics across companies based on industry, as opposed to offering amalgamated scoring with less underlying transparency or using data only relevant to ESG-identifying managers.

The Double Bottom Line (Achieving Outsized Returns and Impact)

Traditionally, foundations that have deployed grantmaking capital have done so with impact in mind and have structured their assessment process to measure success at achieving the defined impact. In parallel, investors who have put capital to work in the financial markets have structured their assessment processes to measure financial return. Impact investing creates an intersection of these ideas and allows for the achievement of multiple objectives — the double bottom line.

Investors have historically considered the achievement of their mission-based goals in investing to necessitate a trade-off, or relatively small financial rewards for demonstrable impact. In the past this may have been true, and earlier periods may not have offered viably profitable alternatives for ESG-responsible investment in certain industries — for example, across much of the early modern period through the 19th and early 20th century, a broad swath of the U.S. and global economy, from textiles to livestock, deeply depended on the institutional exploitation of workers without feasible legal protection; completely divesting of one's involvement in goods and services produced in this manner across industries would in many cases necessitate not participating at all.

However, cultural mores and the direction of society have a significant influence on the future landscape of industries and their ultimate direction, and with an increasing focus on supporting inviolable human rights and civil liberties, the advent of the information age, exponential scientific advancement, and mounting crises surrounding human exploitation of the man-made and natural world (e.g., COVID-19), society is becoming more aware of broader socio-environmental concerns (Rousseau & Deschacht, (2020). Investing to make the world a better place, however defined, is likely to overlap with continuing to make the world investable, period. ESG and impact concerns, beyond the ethical implications and mission achievement, anticipate trends and developments that will eventually be necessary for all companies to address to maintain competitive, sustainable positioning across their respective industries. Some of these concerns, as applied, already suggest engagement is more profitable than avoidance.

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For example, diversity, equity, and inclusion, as a consideration of socially responsible investing or as part of a mission to facilitate greater diversity at higher levels of management, is not just desirable for the basic justice underlying its cause. Diversity of life experiences, across age, race, gender, etc., allows for diversity of perspective, and adding value through active management in finance requires a differentiated way of considering the markets, or personal and professional insight unavailable to others. A truly diversified portfolio will reflect a range of such perspectives, enhancing the chances of generating outsized returns or mitigating losses across a variety of market environments; incorporating specific DEI thresholds into an investment policy is a fundamental way of capturing this value-add. This is not just theoretical; diversity is correlated with stronger risk-adjusted performance in private equity (Mirchandani, 2022). In such a case, the greater amount of capital generated by the enhanced performance of the portfolio can be either reinvested into other or similar impact- or mission-based initiatives, or the surplus can be appropriated to expand the reach of more direct mission-based work, such as grantmaking or programmatic funding.

Importantly, every organization cannot solve every challenge all of the time. Achieving a double bottom line of potentially outsized financial returns alongside relevant, desired impact outcomes requires a disciplined definition of

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objectives, parameters, and intentionality. The first step is to memorialize the impact sought in an organization's investment policy statement, with clear thresholds to determine allocation amounts, results desired, and appropriate measurement tools based on the specifics of each organization's ultimate objectives. This facilitates accountability and transparency at the manager and portfolio level, allowing for a more meaningful assessment of success or failure, with the ultimate goal of a repeatable strategy aligned with a foundation's overarching mission to ensure long-term investment-committee conviction and a sustained long-term investment horizon toward outsized returns.

Crystalizing Metrics and Thresholds

The ability to merge the objectives of philanthropic and investment capital has piqued the interest of many foundations. Purely philanthropic capital deployed toward a specific impact goal without an investment objective may lack a financial return or feature relatively concessionary returns compared to the market-rate performance expected from capital earmarked strictly for investment purposes. While these two types of capital have different objectives, combining their objectives can lead to synergistic benefits. The pertinent question here is, "Can capital be invested for both impact and financial returns without one outcome cannibalizing the other?" The answer is strongly reliant on an organization's ability to define the desired impact and outline an investment strategy to achieve that impact with a specified financial return profile. As a result, many foundations are now tasking their boards and investment committees to invest their endowments in mission-aligned strategies that maintain the return profiles they are used to seeing in the market. This in turn allows the return on capital to be reinvested in an increasing number of mission-aligned opportunities, thereby expanding the scope of impact without sacrificing investment returns or depleting a corpus.

This evolution increases the stakeholder pool and changes the ways in which organizations consider impact. For instance, grantmakers within a foundation might find they are required to expand their understanding of fixed-income asset classes to structure agreements with grantees constituting impact investments — for example, the Ford Foundation's partnership with various money managers has led to the creation of mission-related fixed-income products investing in debt instruments with the goal of generating market-rate profits alongside a positive social or environmental impact, including affordable housing and financial services for people in developing countries (Chasen, 2017). Similarly, on the donor side, capital allocations may be structured with ESG and impact requirements for designated investment pools reflecting an interest in specific areas. Our investment advisors at Crewcial Partners are seeing more scenarios in which clients direct capital into both a core investment pool and separately managed mission-aligned investment pools. Whatever the situation, the changes would involve adaptation on the part of an expanded pool of stakeholders to comprehensively enhance their understanding of both the investment and impact landscape to develop actionable solutions.

As with all innovative strategies, some opportunistic managers have sought to take advantage of a new angle to attract investors, and the vague nature of ESG and impact is particularly susceptible to such exploitation. This is colloquially known as "greenwashing," when an organization presents itself as ostensibly environmentally or impact friendly without sufficient impact follow-through, effectively

playing on the concept as a marketing tool to attract consumers and investors. As a result, the industry has started to see policy changes that regulate this evolving investment path. Though more progress has been seen in Europe and in some Asian countries (e.g., the Sustainable Finance Disclosure Regulation, Japan's FSA Social Bonds Guidelines), the United States is beginning to catch up.

On May 25, 2022, the U.S. Securities and Exchange Commission (2022a) proposed two amendments to improve and standardize ESG-related disclosures, and to increase regulation around the naming of funds with a purported ESG focus. This follows the SEC (2022b) proposal announced on March 21, 2022, that would require registrants to include certain climate-related disclosures in their registration statements and periodic reports, including information about climate-related results of operations and certain related metrics in their audited financial statements.

These developments by the SEC are attempting to broadly categorize certain types of ESG strategies, requiring funds and advisors to provide more-specific disclosures in official documents (e.g., fund prospectuses) based on the ESG strategies pursued. Among the stipulations, funds claiming to achieve a specific ESG impact would be required to define in more detail the impact intended and report on progress.

It cannot be overstated how nascent this space is in regard to determining the best or most transparent ways to address impact as a broader function of investment management. For organizations today, defining impact based on mission and measurable outcomes becomes a function of each organization's goals.

For foundations, the impact on an investment policy statement is tied to a need for greater intentionality and better articulated language around objectives. Determining acceptable parameters for impact and financial rewards defines each organization's definition of success, which is dependent on each organization's particular values-based goals, funding needs, funding goals, etc. A questioned commitment is most likely also a weakly defined commitment. Long-term investing, which widens the path toward eventual outsized returns, underlined by a specific commitment toward buoying the mission of an organization, should not be derailed by short-term market events or macro-economic headlines. While investing mandates can be amended when necessary to account for structural or long-term developments that must be accounted for from a values- or financial-based perspective, a well-defined plan for amplifying the impact of one's mission through high-return-potential investing should constitute the primary focus of each organization, to ensure the money entrusted to such organizations is being put to work in support of its goals and can be sustained in perpetuity (or over the defined timeline).

Conclusion

Mission-forward investing does not preclude strong financial returns. By anticipating or leaning into changing trends and progressive industry developments, one can get ahead of ESG-friendly and value-aligned shifts to be on the vanguard of change and generate returns able to support missions in perpetuity. The continued health of our planet and the orderly functioning of society calls for a shift toward more sustainable and efficient means of production and solutions to the ever-growing complications introduced by globalization, geopolitical tension, and environmental degradation. In tandem with broader legislation and more comprehensive information conducive to greater transparency, by thoughtfully defining a portfolio's role in measurably supporting one's overarching vision alongside financial goals, foundations can enjoy the double-bottom line of mission-based success and long-term financial rewards, complementing such traditional philanthropic activities as grantmaking to buoy each organization's overall impact.

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