MRI Thought Leadership Series

Evaluating Collaboration Models for Family Foundations and Their Investment Advisors

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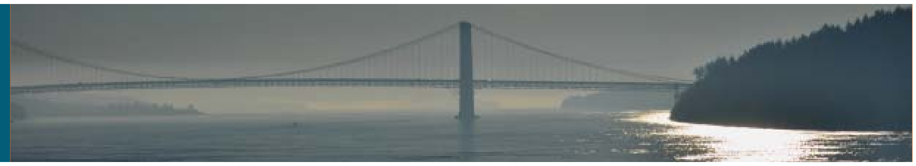
ThresholdGroup

Helping Successful Families Achieve What Matters Most



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Introduction

Family foundations and their investment advisors are increasingly exploring frameworks, working relationships and investment portfolios designed to align investment strategy and implementation with the mission and values of the philanthropic organization. Investing for financial return and giving for charitable return originated as disparate activities, but today we increasingly must view them as interrelated acts requiring some level of collaboration or, even better, a degree of complementary effect or synergy. This need for alignment has blurred the lines and tightened the bonds between investment capital and social capital; now family foundations are working with investment advisors to find equilibrium.

This meeting of disciplines has, in turn, created new learning curves and experimentation in the field now loosely defined as Mission Related Investing (MRI)[1]. Much of the recent research and analysis centered on MRI has focused on the availability of suitable MRI investment products across various asset classes. Those interested in investing for mission are no longer relegated to small cap niche stocks, venture capital, private equity or any other lone investment category. Moreover, foundations now have access to implementation of broader MRI service offerings, including:

- Strategies designed to treat MRI as part of a holistic investment service
- Tactics for articulating and better defining a mission statement
- Tools aimed at measuring impact of capital both qualitatively and quantitatively

Still, this effort to blend philanthropic and investment disciplines is young. An evolutionary refinement process is occurring organically and in real time. With all the recent related academic work and the ongoing availability of various investment products, it's now time to structure a decision-making process – a setting up of clear "rules of engagement" – for the primary stakeholders in a family foundation. These "rules" of play would benefit and bring definition to the roles of foundation trustees, foundation program staff and investment advisors. A framework of agreed-upon roles, protocols and responsibilities can help advance rather than impede progress toward cohesive impact. **The primary goal of this paper is to briefly define three potential collaboration models and, in each case, explore the challenges, benefits and key considerations involved in adopting or enhancing a decision-making partnership that aligns both social and investment capital with organizational mission.**

Model 1
Advisor as Fiduciary Sherpa

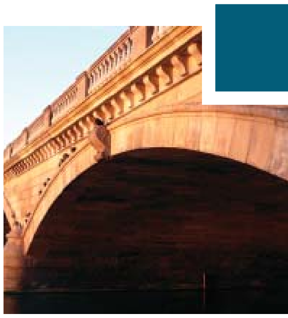
The historical push/pull paradigm between foundations' MRI investments and their investment advisors is reflected in our first model, described here as "Advisor as Fiduciary Sherpa." This traditional arm's length relationship between trustees, foundation staff and investment advisor creates an orderly structure of silos and working relationships that permit each stakeholder group to make decisions independently while clearly understanding each other's roles. This silo model minimizes potential conflicts between investment fiduciary and the work of philanthropic program managers. The foundation works to attain its program goals, and the investment advisor serves as "Sherpa" by carrying the primary responsibility of aligning the investment portfolio with the program. In this model, the investment decision-making process is dominated by traditional measures of fiduciary responsibility—manager research and portfolio construction. For example, an advisor in this model would typically provide a roster of "approved" investment products that fit their interpretation of the foundation's mission from a thematic standpoint. The consultant would then work to integrate these products within their existing asset allocation model.

"Mission investing requires foundations to change how they do business. It requires much deeper conversations and collaboration across professional roles. Both program and investment expertise is needed to achieve satisfactory financial and social returns. It's rare that this expertise is combined, and the effect of increased interaction can be transformative."

Peter Berliner
Managing Director
PRI Makers Network

In this model, implementing MRI investment strategies is often accomplished by utilizing established socially responsible (SRI) public equity managers. Preference tilts toward well-known asset managers with a track record of servicing MRI investors and a safe, low-maintenance approach to MRI investing. This approach resonates easily with foundation trustees and is understood and recognized by foundation staff. From the perspective of an investment advisor, this reliance on self-branded MRI managers also provides a mechanism through which the advisor can learn about MRI investing as part of their own client-driven efforts. This train-the-trainer effect helps the advisor internalize a broader base of MRI knowledge as they fulfill the foundation's directive. This approach also allows minimal customization of investment strategies, which limits innovation and investment choice but simplifies execution and the requirements for sophisticated oversight. In terms of investment education for trustees or foundation staff, asset managers or specialist MRI consultants often can provide briefings, research or tutorials tailored to the mutual needs and interests of all stakeholder groups. When managed correctly, these sessions can be genuinely instructive, low-cost and free of product-driven sales inducements.

This model is often well-suited for foundations wishing to support broader mandates in the areas of sustainability, environmental investing or social responsibility. It's also an ideal model for those making an initial foray into the MRI arena. Many foundations utilize a look-and-learn-before-we-leap approach in order to improve understanding and acceptance among both the trustees and investment advisors. Resource-constrained organizations, including both foundations and investment advisors, also find this approach offers a relatively cost-effective path to MRI. With most MRI investment managers, any fees associated with MRI research or integration are included in overall investment management fees. A focus on established products with liquidity, transparency and MRI expertise integrated within the investment management process makes this model a good introductory step for many organizations. In addition, foundations interested in promoting MRI offerings or services in the advisory marketplace may find this approach a suitable method for increasing their advisor's acumen on MRI issues. In turn, investment advisors seeking to gradually increase their internal MRI capacity would be well served by this model, as would those seeking to limit their service offerings to standardized, self-identified MRI products.



For all its simplicity and order, this model also comes with substantial constraints. From an organizational perspective, this approach limits opportunities for stakeholder groups to innovate and work outside of their normal capacities. Both foundations and their investment advisors are limited to investment products encompassing a variety of values, criteria and mission impacts, but not necessarily correlated or customized to their own. Accompanying this, the lack of customization may reinforce the perspective by trustees that their only option is to invest in managers that are perceived to have historically underperformed their non-MRI peers. This approach also can suffer from a limited ability to gauge the impact[2], sometimes referred to as "non-financial performance," of MRI investment strategies. The concept of impact is typically and more readily measured in private equity, venture capital or direct investing. The diverse business lines of publicly traded companies often limit the availability of reliable information on impact criteria. The complexity of business practices results in a greater number of business activities; this complexity makes it challenging to measure impact. Private investments and direct investments that have a primary goal tied to a mission component often generate impact metrics that are more easily quantifiable.

Model 2
Resident Expertise

Often utilized by organizations with longstanding interest and/or previous experience in the MRI arena, this model highlights the flexibility possible among stakeholders interested in MRI. The most prominent feature of this model is the concept of an internal champion within the foundation, either as a foundation executive or among the trustees. This "resident expert" serves to prioritize and direct MRI efforts while promoting the concept to other stakeholders and peers. Having an internal proponent and champion on staff often gives the foundation leverage in conversations with investment advisors who have not historically offered MRI services. As a function of this high-level dialogue, trustees are often involved in MRI-focused conversations, even if primarily for educational purposes. To exaggerate the point, imagine the galvanizing effect among trustees when luminaries such as George Soros, Jimmy Carter, Bill Clinton or Winthrop Rockefeller also play the role of internal resident expert within their charitable organizations. This same effect can occur outside of celebrity circles whenever an internal expert is viewed with professorial knowledge or insight pertaining to a specific area of MRI. Program staff, whether fully integrated with a high-visibility program or not, also tend to stay informed and connected to the championed cause. This visible leadership acts as a lightning rod for like-minded stakeholders and goes a long way toward dissolving any sort of us-versus-them mentality that may exist between program staff and investment advisors.

"Foundations with an internal champion who can act as a 'lightening rod' for like-minded stakeholders can significantly advance the MRI agenda and conversations with advisors that have not historically offered MRI services. Similarly, we see leaders in More for Mission's network galvanizing their peers around mission investing, dissolving misperceptions and perceived barriers."

Lisa Hagerman
Director
More for Mission at Harvard University

With its MRI strategy remaining heavily focused on the investment product side of the equation, this model builds on the above-mentioned "Sherpa" approach and often incorporates thematic investments specific to a foundation's mission. The willingness and ability of all stakeholders to move beyond highly visible, well branded and marketed MRI products can add flexibility to the array of investment options available for consideration. A resident expert within the foundation often creates a catalyst for this flexibility, and therefore a willingness to move beyond the standard fare of ready-made MRI offerings. With a wider range of investment choice comes a tradeoff between liquidity and mission. Foundations may find strategies that fit their mission more closely but require a longer-term commitment of capital. Similarly, investment advisors will find that the norms of modern portfolio theory, portfolio construction and asset allocation may need some adjustment or rethinking. In short, a move toward less traditional, more customized MRI investment strategies may cause a need for less traditional portfolio construction, tracking and reporting of results.

In some cases, the investment advisor may designate a subset of investments as "mission first" assets. For those advisors utilizing goals-based approaches to asset allocation, specific allocations can be designated from foundation's risk capital while continuing to protect the foundation's grant-making resources. This allows the foundation to view "mission first" assets as part of a category where longer-term commitment and less liquidity is part of the acceptable risk/return equation. To implement this approach, shareholder engagement, either through investment managers or via a proxy voting service, often enters into the picture. Again, foundation leadership through a resident expert often enables the planning and implementation of this sort of strategy. The resident expert also brings a more exploratory approach to the foundation's program side, where foundation staff may consider program-related investing (PRI)[3] as a way to complement their grant-making and further enhance the MRI focus of their investment portfolio.

By accessing a wider variety of organizations, partners and service offerings, this model also raises a wider range of challenges. The prerequisite for this model's effectiveness is a willingness by both investment advisors and program staff to explore options outside of the normal course of business. From the standpoint of an investment advisor, this approach may raise questions concerning the traditional business model, i.e., whether asset-based fees or fee for services are most appropriate. What exactly is the advisor being paid for, and how are they compensated for advice outside of the traditional scope of investments? Where original research is necessary, are resources available? How do consultants, who measure value based on relative or absolute performance, account for any perceived implications on performance? Advisors also may be hesitant to fully partner with foundation staff and allow input from program managers as part of the investment process. Similar challenges hold true for program staff. Will staff members feel comfortable playing a bigger role in the investment process? Will they be willing to involve themselves in issues apart from their own program assets? Despite some significant challenges, this model is currently the most common approach among foundations committed to exploring MRI, and it can be an appropriate evolutionary step for organizations seeking a more holistic and integrated relationship between foundation and investment advisor.

This model also serves all parties as a barometer of both ability and willingness to change. It provides an effective litmus test and training tool for leaders of family foundations who are considering additional integration of MRI foundation and advisor services. Foundations are able to challenge the historical decision-making process and urge trustees to embrace roles that are broader or deeper than those they have occupied in the past. Similarly, investment advisors seeking to expand their intellectual capacity on MRI topics – alternative energy, environment, health care—may use this as a proving ground for applying their internal knowledge to areas historically deemed “non-traditional” or “non-financial” within the investment community.

Model 3

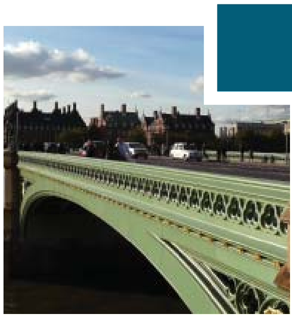
Integrated Foundation/Consultant MRI Services

The effort to create integrated foundation and consultant MRI services requires a willingness both to learn and make mistakes. Existing program and investment staffs must be able to not only adopt new decision-making structures, but to invite and integrate their partners into their respective philanthropic and investment efforts. For example, expect program staff to participate in investment manager meetings with an MRI focus; ask investment staff to listen in on grant-making activities. This level of interactivity provides fertile ground for understanding the benefits possible in this model. To complement this exchange, the establishment of joint decision-making and learning cohorts provides both organizations with fresh skills not only in the context of new program and investment opportunities, but also in the work of decision-making itself.
A learning cohort can consist of MRI subject matter experts, peer groups or even a family member with a strong point of view. Threshold Group and The Russell Family Foundation have taken initial steps down this path by establishing an MRI Committee (a self-governed group) that will engage in learning sessions and collaborate on evaluating potential PRI opportunities, with an intent to eventually encompass shareholder engagement, proxy voting and impact measurement. Foundations interested in capacity building and advancing the field of MRI can utilize this learning cohort approach when the organization and its advisors have at least acknowledged and perhaps addressed the conceptual and practical barriers that often exist between program and investment staff—historically an impediment in MRI circles.

Implementation in an integrated model requires true collaboration and some desire to embrace the cutting edge rather than just a leading edge. It may require a gradual paradigm shift for those directly serving the model. For example, instead of exploring investments from the perspective of financial suitability, the foundation must first examine investment services from the perspective of strategic suitability. Put another way, does a potential investment strategy's goal align with the mission or themes within the mission? If so, how does the structure fit within a foundation's overall investment strategy? To illustrate, it is possible to philanthropically support efforts to reduce homelessness while investing the corpus in institutions that pursed predatory lending practices. Likewise, a foundation may support clean water activities but invest in businesses that pollute the water table. This is not to suggest that all investments need to be closely aligned with the foundation's mission, but simply that the mission lens should be applied to all investments and be a conversation point between trustees and advisors. One way to address this issue, and a topic that will be addressed in greater detail in a subsequent paper, is through the creation of benchmarks that cover not only the traditional investment metrics, but also attempt to measure the impact of the portfolio relative to mission criteria.

True integration of foundation and investment advisory MRI services is a challenge given the disparate focus ingrained in the various stakeholders. The foundation's emphasis is on creation of social capital and not maximizing investment returns. For investment advisors, a focus on investment capital and financial return typically warrants a different decision-making process than utilized in grantmaking. The need to demonstrate value by generating investment returns dominates the long-term nature of foundation/advisor relationships, and integrating mission adds another layer of complexity to the equation. The fixed income asset class provides a good example of this conundrum: Are community development housing bonds suitable from an investment perspective, given the needs for investment diversification and a desire to match liabilities with income generation? Many investment advisors would be reticent to employ this type of strategy. Instead, they seek out "traditional" fixed income instruments that are more actively traded and perceived to have higher credit quality. An advisor well versed in MRI would likely see community development bonds as a way to generate income, reduce correlation within the portfolio and have a mission impact. Think about it from the perspective of the advisor that lacks knowledge and comfort in MRI. They would likely ask themselves, "What's my incentive to potentially generate less income, negatively impact performance and put my job as your advisor at risk?" Foundation CIOs and trustees need to wrestle with the same issues.

For this integration model to work, those involved must be both willing and able to bend and stretch beyond their traditional roles. The investment advisor must have knowledge and passion for MRI, and frankly, the marketplace suffers from a shortage of providers who can claim this as core skill set. The same holds true for foundation program staff, where an improvement of investment acumen and knowledge is needed among people who have historically relied on traditional grant evaluation as job number one. Collaboration from both inside and outside the foundation is a prerequisite, as is the ability for all interested parties to balance altruism with realism as they learn to work more closely together. More importantly, this approach requires that foundation trustees genuinely support the interweaving of MRI themes within investment and program efforts.



Philosophically, foundation boards and staff must have an appetite for fresh ideas and a willingness to share both successes and failures. Advisors must be willing to open their process for critique to perhaps their biggest skeptics—clients who pushed them beyond their comfort zone and still hold them accountable for risk-adjusted returns. The prospect of greater synergy is accompanied by the potential for conflict. Therefore, for this method to succeed, all stakeholders must accept and contribute to the benefits of a long-term strategic relationship.

For organizations that attempt this approach, the benefits are directly related to implementation challenges. Truly integrated MRI services will evolve as the organizations grow and learn together. Leveraging existing skill sets and expanding the capacity of both organizations ultimately result in empowerment for foundations to achieve their mission through both the program efforts and the investment portfolio. Similarly, investment advisors learn to provide unique insights on the impact that their clients' missions may ultimately have on corporate and portfolio performance.

Conclusion

Regardless of the model used to inform MRI decision-making, potential dilemmas include mission support versus corpus perpetuity, financial return versus impact, MRI versus PRI, and the list goes on. Only when exploring the field of MRI are foundations and their advisors able to evaluate and construct a model and investment strategy that is suitable for their goals. Foundations are unique in that they are established to generate social capital, yet they are reliant on the investment markets to generate the financial capital necessary to achieve their goals. For most foundations, investment advisors pay an integral role in achieving financial goals, and this reinforces the importance of having a decision-making process in place to integrate MRI within an investment strategy.

Foundations interested in pursing MRI need to challenge their advisors. Financial advisors that are not well versed in MRI need to connect with peers and educate themselves in order to be responsive to their clients. Each organization needs to fit their respective attributes to the characteristics, requirements, benefits and challenges of the appropriate model. It may be helpful to try some aspects of the various models for a subset of groups within an organization. Certain programs may be more suited for integration than others. Organizations should not be afraid to try to advance from one model to another, and should not expect to change colors overnight. This is a process, so in the practical sense, organizations and their approaches will evolve rather than transform.

As our next installment in this series, we will explore the evolution of Threshold Group and The Russell Family Foundation from the Sherpa model to the integration model—and lessons learned in the process.

FOOTNOTES

1 Mission Related Investing (MRI) is defined as the effort to utilize the investment management process, in addition to grantmaking, as a tool for pursuing philanthropic purpose or mission. This approach can encompass the use of social or environmental screens on securities, the voting of proxies, and other investor advocacy such as use of venture capital.

2 Impact investing is defined as an investment strategy in which an investor places capital in businesses and/or programs that can generate financial returns as well as an intentional social or environmental goal. The number of investment managers engaged in impact investing has grown during the past five years, including a focus on microfinance, community development finance and clean technology.

3 Program-related investing (PRI) is a philanthropic approach in which foundations make capital available to organizations or initiatives to address social or environmental concerns. Unlike grants, PRIs are expected to be repaid either with or without a net financial return. PRIs provide charitable organizations or commercial ventures with needed capital, typically at favorable terms. In turn, foundations can have a broader programmatic impact and are able to count PRIs toward their minimum 5% payout of net assets.

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Craig is responsible for recommending, implementing and monitoring investment strategy for Threshold's clients . His work includes identifying investment philosophy, policy and asset allocation in close alignment with the goals and missions of families and their foundations. Craig also manages the development and implementation of Threshold's comprehensive mission-related investment service offering.

With more than 15 years of experience in investment services, Craig joined Threshold after serving as managing director at IW Financial, a Portland, Oregon-based investment research and consulting firm dedicated to values-based investing. Craig currently serves on the advisory committee for Impact Capital, a Seattle-based community development organization. Previously, he established a global wealth management platform at Envestnet Asset Management, and researched international equities, merger and acquisition opportunities and other asset classes as part of the investment team at both Credit Suisse HOLT and Nuveen Investments.

Craig earned a BS in Finance from Northern Illinois University and a master's degree in public administration from the University of Illinois, Chicago.