GSAM SEMINAR: BRIDGING THE GAP
28 September 2004

THE WORLD BEYOND FUNDRAISING AND INVESTMENT RETURNS

Introduction

I've been asked to look into a gap – that between investment decisions made by charities where the sole return required is a financial one; and those decisions made by those same charities to invest funds (through grants or the deployment of other resources) in activities where the only return required is a social one – a social benefit in line with the mission or purpose of the charity.

In most charities with assets to invest, this gap is a deep one; seldom, if ever, is there any communication across it.

A caricature of it – perhaps – in an endowed grant-making trust or foundation would be that there existed:

- on the one side a group of city folk making up an investment management committee that sees its only purpose as being to secure the maximum financial return (preferably at the lowest possible risk) on the charity's investments – they take little or no regard of the charity's purposes in their investment strategy or decisions; and
- on the other side, a grants committee, the majority of whom read the Guardian and do not know anything about equities or bonds, earnestly distributing the income generated by the investment committee's efforts.

One commentator described this as "pervasive dissonance" as foundations can "find themselves in the position of supporting with their investment dollars activities that are antithetical to the charitable purpose of their grant-making." He asserted that foundations accepted as "axiomatic the Iron Curtain between making money and giving it away."[1]

Is this gap – or this curtain – compulsory? As another writer in the USA asked: should not "a private foundation be more than a private investment company that uses some of its excess cash flow for charitable purposes?"[2] Are there alternative ways of tackling the investment of a charity's assets so that the purpose, the mission, of the charity informs the investment management strategy as well the grant-making policies? In this brief presentation, I will say a bit about some of the opportunities for a different approach – it's called Mission Related Investment (MRI) – and provide some examples – mainly from the USA because more has been done there than in the UK so far to bridge the gap, to explore ways to get full charitable value out of all available resources.

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[1] *Dissonance, Responsibility and Corporate Culture; Or, How Two Camps Struggle For Our Hearts and Minds and What We Can Do About It*, Stephen Viederman and Edward Tasch, Jessie Smith Noyes Foundation Annual Report 1994

[2] *New Frontiers in Mission-Related Investing*, Luther M Ragin Jr, The F B Heron Foundation 2004

It's important to emphasise that this is not just an issue for endowed trusts and foundations. There is a comparable gap or fissure within many fundraising charities; it lies between, again the decision making focused solely on financial returns and the decision making about raising philanthropic funds – from trusts and foundations or from individual donors.

I will cover aspects of this under two main headings:

- MRI within mainstream or orthodox asset management
- Social Investment – MRI outside the mainstream

I'll also briefly cover another current use of the term 'investor' in relation to the support of charitable activity – when it is used to describe the grant-making style or practice of a trust or foundation – or lottery fund distributor or government department or agency; every funder seems to be claiming to be an investor at present!

MRI in the mainstream

First, then, Mission Related Investment within 'ordinary' investment management: Not possible, many claim; securing maximum financial return is **the** obligation of a charity trustee.

Not quite. What the Charity Commission actually says is not so absolute. It's certainly true that "…trustees are not free to use their investment powers to make moral statements at the expense of their charity." But the Commission asserts that trustees "need to keep in mind the underlying principle that their power of investment has to be used to further the purposes of the trust." It's strange, therefore that, for many endowments, just 3% or 4% of the total resources for which the trustees have responsibility are used directly or deliberately to "further the purposes of the trust."

The Commission acknowledges that "those purposes will normally be best served by seeking the maximum return consistent with commercial prudence" but it sets out in its guidance to trustees on their investment powers[3] several wholly legitimate ways that trustees can ensure that their investment strategy is governed by considerations that go beyond just the level of investment return – indeed, in anticipating possible reputational risks to which some investments might expose a charity, they might be advised to do so. This may be by positive or negative screening – or it may be by direct interventions in specific investments.

I won't dwell anymore here on these options as there is lots of guidance and information around[4] – except to recall a situation when I was employed to set up a newly endowed charity; its primary purpose was to address health needs; it had over £400M of cash to invest. The investment committee conformed exactly to the caricature I outlined earlier. I suggested to them, somewhat nervously, that

[3] Charity Commission, CC14: *Investment of Charitable Funds* (Version February 2003)

[4] see, for example, the UK Social Investment Forum http://www.uksif.org

they might like to consider setting aside, maybe, 5% of that asset for selective investment in property in some of the poorest communities within our inner cities that could then be used for community health activities and primary care. This proposal was regarded as completely naïve and out of order – "after all, David, that is high risk stuff and will probably have a below market return; no we must concentrate on equities, risk free and strong performers like Marconi…oh, and I hear our investment managers are very enthusiastic about Railtrack…" As the Commission acknowledges in its Guidance, a screened strategy can perform as well as an unrestricted one; in fact, most UK foundations with orthodox investment management strategies would love to have seen their portfolios perform as well, say, as those of the Joseph Rowntree Charitable Trust which has operated a screened policy for many years.

Activism

Activism is another option; the example[5] this time from the USA. The New York based Nathan Cummings Foundation seeks to "build a socially and economically just society that values and protects the ecological balance for future generations and promotes humane health care." The Foundation has a prominent environmental stance and a programme that seeks "to address the root causes of environmental degradation" and to give priority "to projects with the potential of having state, multi-state, or national impacts."

A couple of years ago, it made four grants, totalling $650,000, aimed at holding big agri-businesses environmentally accountable. Shortly afterwards, the Chief Finance Officer noticed from a routine report sent to her by one of the Foundation's investment managers, that shares with a market value of $717,952 had been bought in the largest hog producer and pork processor in the world, a company with a decidedly chequered environmental record. The investment was in direct conflict with the Foundation's charitable aims. It was a completely legitimate investment as – until then – the Foundation's investment committee maintained what was described as an absolutely "impermeable wall between investing and programming – what's business is business and what's social is social, and never the twain shall meet."

This investment prompted a review of that 'certainty.' The Foundation decided no longer to stay passive as an investor. But they also decided nor to disinvest these shares – a tactic many foundations might have adopted to avoid the obvious reputational risk of being tainted by their ownership. They chose instead to become an activist investor, requesting, for example, a shareholder resolution noting the environmental violations that the company had already been cited for and linking up with another shareholder, the Sierra Club, to ask the company to prepare an environmental, social and economic audit of its hog production operations. Having started, the Foundation has gone on to adopt activist guidelines that state that when a grant programme policy interest "is at stake, the foundation will vote in line with the programme interest. On matters of corporate

[5] This example is described in more detail in *Where Money Meets Mission*, Jed Emerson, Stanford Social Innovation Review Summer 2003

governance, the foundation will vote in line with the broader programmatic objectives of accountability and transparency."

Other US foundations, small and large, are also adopting a more activist role. Recently Rockefeller Philanthropy Advisors published a guide to how "active foundation proxy voting can protect endowments and boost philanthropic missions". The Guide is called 'Unlocking the Power of the Proxy. The Nathan Cummings Foundation is also featured here – including a quote from its President that "Foundations are major investors…We need to recognise and exercise the responsibilities of ownership…the real leverage for change is an asset that most foundations ignore – the proxy vote."

As in so many ways, the US situation is different from here – but maybe we will see over the next few years charity trustees in the UK beginning to look for ways they, too, can exercise the responsibilities of ownership in ways which are supportive of their charitable purposes – or at least do not contradict them. For starters, they might have a look at the ACEVO report[6] which suggested a set of Charity Investment Principles.

MRI – as Social Investment

Now, MRI as Social Investment – and an opportunity to draw your attention to another significant bit of guidance produced by the Charity Commission – in a set of what they called 'useful guidelines', which made me ponder the possibilities of an organisation publishing guidelines that they described as not useful! These guidelines were prompted by the publication of the report of the Social Investment Task Force[7] (a body unique if for nothing else than the two voluntary sector members have been two of your speakers this morning!).

Published first[8] as guidance on Programme Related Investment (PRI) and then in a revised version in 2002 with the new title of 'Charities and Social Investment', the guidance describes Social Investment as being about "double bottom line transactions" – financial transactions that are intended both to deliver a financial return to the investor and to achieve social objectives. For a charity – say a trust or foundation which does most of its charitable 'business' through grant-making – Social Investment is the use of funds from either assets or income to provide loans or other forms of 'patient capital' investment in another charity or community organisation which will not only be used in some way to further the trust or foundation's charitable purpose but will also generate a financial return which can come back to the trust or foundation so that the money can be used again…and again.

Such investments are not, in charity investment jargon, 'ordinary investments' and are not, therefore subject to the same rules as mainstream asset management.

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[6] *The CHIPS are down – a template for improving Charity Investment Practice*, ACEVO, 2003

[7] *Enterprising Communities: Wealth Beyond Welfare*, Social Investment Task Force 2001

[8] Charity Commission *Useful Guidelines - Charities and Social Investment* October 2002 (the 2002 Guidelines replaced *Useful Guidelines - Charities and Programme Related Investment* published in May 2001)

So how can charities incorporate Social Investment or PRI into the menu of ways of financing charitable endeavours? Here are some possibilities:

- Loans – short or medium term, interest free or low interest. This could involve not only asset development by a community organisation – the development of a building within which income generating activities can be established – but also start up finance for a new social care or other service for which a governmental agency or department pays, the repayments becoming one of the costs recoverable through the contract with the purchaser.

- Patient recoverable capital – risk capital, usually in the form of loans that have very patient terms in that no repayments are due for a long time – perhaps not even fixed when the loan is made but a date being agreed when the possible repayment terms will be discussed – a date by which the growth and success of the enterprise can be assessed.

- Underwriting – not even paying the money over but providing the 'comfort' that may be needed to enable trustees of a charity to risk some of their own resources, knowing that the underwriting charity has accepted an obligation to pick up the tab if some aspect of a planned self-funding initiative does not succeed fully; such a commitment may also prove useful in 'levering' funds from other sources.

- A PRI property portfolio – if a charity's objects are to relieve poverty (or indeed are just for general charitable purposes), a property investment in one of the poorest communities could generate a return and some capital growth – but also contribute to the regeneration of that area: a social return in line with the charity's objects and a financial return, albeit a smaller one than you would probably get from investing in property in a wealthier area.

- An equity stake in a community business or social enterprise – if an appropriately defined stake for a charitable investor can be worked out, PRI could support the development or growth of an enterprise that aimed to meet some aspect of the investor charity's objects.

Social Investments of this kind have always been an option for most trusts and foundations in the UK but few have practiced it. That is beginning to change – as is indicated by the funds placed by trusts and foundations with the Charity Bank.

Moreover, as the Charity Commission has pointed out, any charity that can give grants can undertake social investment. That does not restrict it to trusts and foundations. As the splendidly titled report *'The Magic Roundabout – how charities can make their money go further'*[9] demonstrates, almost all charities could use such

[9] *The Magic Roundabout – how charities can make their money go further* Bircham Dyson Bell and Sayer Vincent 2003

investments to address some aspects of their charitable purpose – and expect to get the money back to use again in the future.

But adopting such an approach is a challenge – to concentrate grants where they are the only or clearly the most appropriate option and to use other types of funding wherever possible to further their charitable objectives. That way charitable funds work harder and go further.

That way, also, charitable funds could work quicker and cheaper. Let me give you an example. I met recently with the fund raisers for a charity which is about to launch a large appeal which is mainly intended to raise capital funds to build a new special childrens' facility. This will replace and substantially extend an existing project which has already established that a market for the service exists and that local authorities will pay the full cost of the service provided.

You won't be surprised that I suggested they look again at their revenue projections since it seemed to me that minimal 'tweaking' should enable them to build a sufficient margin into their projections to fund most of their capital needs with borrowed money – the fees they were charging were sufficient to include the repayment of the loan.

But - quicker and cheaper? Well, a loan (or combination of loans from commercial and charitable sources) would be secured a lot quicker than any capital appeal could achieve – so:

- they would not have to invest so much of their resources in the costs of fund raising; and
- they would be able to go on site within a few months so the considerable contingency they had built into their capital cost projections to allow for having to wait for the two or three years that the capital appeal will take to raise the funds would not have to be paid.

Investigating the possibility of using debt finance along these lines is not rocket science – but it was not part of the 'culture' in that charity either of the fund raisers or the financial staff or trustees.

'Investor' Grant-Making

I mentioned at the beginning of this presentation that the title of 'Investor' was being used increasingly by funders[10]. As most such uses do not involve any sort of financial return, some might feel the term is in danger of being devalued. However, it does have resonance because it describes attempts by donors, grant-makers, individual philanthropists to become more engaged in the work that they are supporting; to 'protect' their investment, if you like, so that the chances of achieving its purpose are increased, by helping the recipient of the funds to acquire or to strengthen its capacity to deliver the planned outcomes.

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[10] see, for example, *The Investor Approach – a Way Forward for the Community Fund?* David Carrington , The Community Fund June 2002; and *The Grant-making Tango, Issues for Funders*, Julia Unwin, The Baring Foundation 2004

The grant, therefore, is just one ingredient of the relationship between funder and funded – the total transaction can go well beyond just the grant. It's what some call 'grant-making plus.' The 'Plus' can also involve combining different forms of funding for the same initiative – grants plus one or more forms of loan or patient capital.

Filling The Gap

Back to the Gap – or chasm or curtain – with which I started. All of the activity that I have described is happening in the space between investments made solely to generate financial return and wholly philanthropic investments or donations where the giver is an entirely passive contributor.

Ten years ago, that space was pretty empty. Now it is filling up with new institutions like the Charity Bank, Venturesome, and a growing number of Community Development Finance Institutions or CDFIs – all require some sort of financial return from their investments, albeit not necessarily at market rate; all invest a lot of time and technical assistance in the organisations asking for their support.

Trusts and foundations are also clambering into that space, along with new individual philanthropists, all seeking to strengthen the organisations they support by linking capacity building with their grants and donations.

Charities and community organisations of all kinds are also adding the deliberate use of debt to the range of financing methods they use to achieve their objects.

Even the Government is there – arguably moving faster than many in the charitable sector – introducing funding initiatives such as Futurebuilders and the Adventure Capital Fund through which voluntary sector led distributors package together funds and technical support, the funds being a mixture of grants and patient capital loans.

The Government has also been encouraging mainstream institutional and individual investors to dip their toes into this arena, through, for example, Community Investment Tax Relief[11].

In total, the numbers (of players or sums of money) may not be huge, but the Gap is filling and there are lots of models in there which could pave the way for new ways of making charitable funds work harder and more effectively – and the investment management community, no less than the charity sector itself, might benefit from looking for opportunities to enter that gap.

David Carrington
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[11] see http://www.inlandrevenue.gov.uk/specialist/citc_guidance.htm