BRIDGES
Fund Management

The role of foundations

Ford's Mission Investments programme is demonstrating how foundations can direct more of their capital to impact. But they can also play a broader role in building the impact investing market

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N.B. This essay is an edited version of the transcript of Roy's 20/30 Visions interview, which you can watch at www.bridgesfundmanagement/2030Visions.

The Ford Foundation is an endowed perpetual charitable foundation with a social justice mission. Every year, by law, 5% of our resources are expected to be deployed in a way that helps advance human welfare.

But that raised the question in the mind of Darren Walker, President of the Ford Foundation: what about the other 95% of our resources? How are we using those resources? And can we use more of them toward achieving our mission?

That was the genesis of Mission Investments, the programme I run at the Ford Foundation. In addition to grant capital, we have additional resources that can be used to try to advance the Foundation's mission.

We're not the first foundation to look at this question (can we do more with the 95%), and we're not the first to move in that direction. But we are the largest. We have made a commitment of $1bn of market-rate seeking, 'double bottom line' endowment capital, to test the question: is it possible to generate positive social returns and positive financial returns in a way that is acceptable to a perpetual foundation?

Thanks to the wisdom of our trustees, the allocation process was designed in a very thoughtful way. The $1 billion endowment commitment will be spread over 10 years, so we can methodically examine progress over time. And there are no specific return requirements, because everyone agreed that this was a worthwhile experiment in line with the mission of the Ford Foundation. Instead, we are trying to explore, with integrity, how we find the frontier of positive social returns and positive financial returns that works for us.

SO FAR SO GOOD

Last year, our President Darren Walker published a five-year report card on Mission Investments. And it's a case of so far, so good. Our financial and social returns have, I think, been surprising: many people didn't expect that we'd be able to do well and do good.

After five years – and given that we restart the J-curve with our annual allocations of endowment capital every year – normally you'd expect still to be in negative financial returns territory, because we haven't really started harvesting our investment returns yet. So it was remarkable to me (and I think to others) that at the five-year mark, our compound annual financial return was 28%.

Now there are lots of caveats to that. It's not an 'apples to apples' comparison with other foundations or endowments; first of all because 100% of our impact investing endowment is invested in private markets, and second because we don't have to manage liquidity (many endowments need to have a cash reserve that earns little or no money). Nor are we chest-thumping about the numbers, because they came in a period of unusually high financial returns.

We also had great social returns from several of our impact investing themes, which include affordable housing, financial inclusion, quality jobs, biotech/healthcare, and diverse fund managers. In the latter case for example: in the US, only about 1.4% of the $80trn of assets under management was managed by firms owned by women and people of colour – even though women and people of colour make up 70% of the US population. In our portfolio, it's 63%. So we're outperforming the market significantly.

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Appalachian Community Capital, a non-profit community development financial institution supported by Ford's Mission Investments programme, focuses on attracting new sources of capital for small businesses, including minority and women-owned business owners, in underserved places in Appalachia (Photo via Ford Foundation)

The point of making all this public was not to say: "Oh, everyone can make 20% returns," or to pat ourselves on the back. It was just to address what appears to be the automatic view: that it's impossible to generate both positive social impact and attractive financial returns.

LESSONS FOR THE MARKET

The key, in our view, is very similar to traditional investing: portfolio construction. But in this case, portfolio construction is not just about allocating to fixed income, early stage, venture capital, equity, public equities and so on. It's also about selecting areas of impact.

How do we decide what categories of impact fit with the Ford Foundation's mission? Where do we have expertise? And in what areas are there investment fund managers who have demonstrated an ability to generate both positive financial and social returns?

Then the next step is manager selection and a rigorous due diligence process, so you can make bets on talented people.

When you create that type of filter – which requires an additional level of diligence and portfolio construction that goes beyond traditional investing – we believe that's a general framework for success.

However, we're just getting started. We may refine our impact and manager selection processes. We may refine our portfolio construction. So for example: during this economic period, should we pivot into private credit? We may also allocate to public equities in the reasonably near future, when we believe conditions make sense.

But other than that, we will stay the course, continue to learn, and share those lessons so that others can learn from our successes and failures.

Because our work is so high profile, we benefit from an enormous volume of inbound interest. We're invited to conferences, to give speeches and participate on panels. We also try to write and publish content.

Although our days and weeks are very full, we see that as a vital element of our work. We don't see ourselves merely as investors; we also want to be sounding boards for those who want to join us in this journey.

THREE BARRIERS TO PROGRESS

I think there are three big systemic barriers to the future growth of impact investing.

The number one thing is fear. And that relates to the incentive structures that exist in many investment organisations, which are oftentimes based on financial returns and rankings. If you've been directed by your trustees or your board to try to achieve the highest absolute returns, and then someone raises the idea of impact investing – and you don't know how that's going to work out... There are probably not that many people who are willing to put their compensation and status on the line to test the notion.

The second problem is a lack of leadership. If you work for an organisation, you do what your management tells you to do, or you find another place to work. So we need leadership coming from the top saying: let's give impact investing a try. Without that, I have a hard time understanding how it's going to happen.

The third barrier is around data. If we had the right type of data that could be quantified financially, it could really change the game.

Take the current ESG backlash. ESG is essentially a disclosure-based risk

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framework, whereby companies provide information that can help investors make decisions and manage risks based on that information.

What SASB (the Sustainability Accounting Standards Board) is saying is: there's information not captured by GAAP (Generally Accepted Accounting Principles) that's also important for investment decision-making.

So how do you quantify these negative and positive externalities? How do you turn ESG into numbers? If you can do that, you have better information for investors to include in their investment modelling. You have better information for consumers to make their purchasing choices. But even more importantly, you have better information to help policymakers figure out how to regulate and tax better.

So I see ESG as a first step in the pathway to the quantification of externalities. And once we get there, then impact investing and traditional investing will become one – because you'll have all the information necessary to make investment decisions.

WISDOM WILL PREVAIL

Foundations can definitely play a bigger role in advancing progress. If you're a tax-advantaged organisation, the question of whether we can allocate more than 5% of our resources to advancing the human welfare is a worthwhile one for every foundation to ask.

But I would also love for the US to catch up with certain parts of Europe who have broadened their view of fiduciary obligation beyond that which existed 100 years ago. Because again, there's a fear factor. Why should any employee of a public pension fund, for example, put their job at risk by taking what might be a more reasonable approach to fiduciary obligation, when the tradition and expectations and norms today require behaviour within a more constrained definition of fiduciary obligation?

That said, I feel absolutely optimistic about what can be achieved. There's so much attention on these issues. There are some really smart people working on every angle of the argument; and when you have that, wisdom is in a great position to prevail. Then you have millennials, and Generation Z, who are very much attuned to the impact of investments on society. So all the pieces are in place; and there's a whole crew of us – here at the Ford Foundation and elsewhere – working to make sure it happens.

Roy Swan leads Ford's Mission Investments team, managing the foundation's portfolio of mission-related investments (MRIs) and program-related investments (PRIs), and working to expand and strengthen the impact investing field.

Before joining Ford, Roy served as managing director and co-head of Global Sustainable Finance at Morgan Stanley. During his time at Morgan Stanley, Global Sustainable Finance committed over $13 billion in community development transactions.

Among his prior experiences, he was the founding chief investment officer of New York City's Upper Manhattan Empowerment Zone (UMEZ), a federal initiative to bring new resources to distressed urban communities. He also worked in corporate law at Skadden Arps, investment banking at The First Boston Corporation, Salomon Brothers, and JPMorgan, and finance at Time Warner.

20/30 Visions is a series of interviews with global thought-leaders, exploring how we build a more sustainable and inclusive world in the next decade

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