BakerAvenue
WEALTH MANAGEMENT

The Other 95%

How Philanthropic Foundations Can Do Good *and* Do Well

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What is commonly known as "the Rule" within the philanthropic space is a fact that is little-known to the general public–in order to maintain foundation status, organizations have to grant out 5% of their endowments per year.

Last year, foundations donated over $88 billion dollars to charitable giving.

According to a survey from Foundation Source, the average distribution percentage in 2020 across foundations of all sizes was 7.4% of assets. This was during a year that saw record philanthropic giving due to the urgency of the global Covid-19 pandemic. The largest average distribution size–which was concentrated amongst the smallest foundations–reached 15%.

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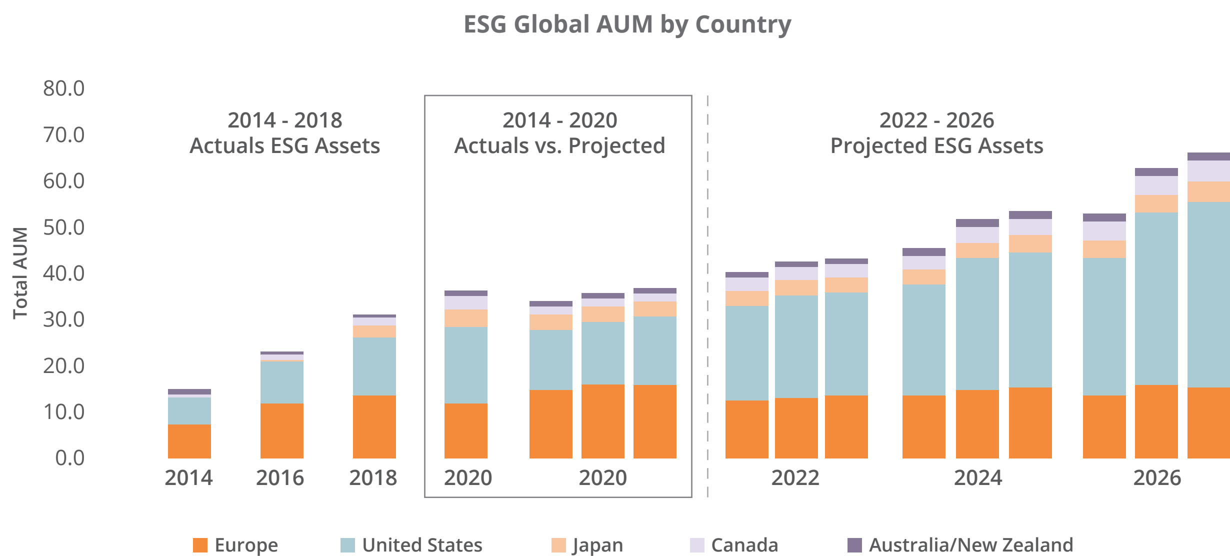
So what happens to the other 85-95% of endowments?

They're invested to grow and sustain their endowment. If examined through the lens of asset allocation, foundations today are often more private asset managers than they are philanthropic donors. Their investment strategies, however, are lagging.

Amidst the rapid wave of demand that banks and institutional investors reallocate assets towards socially and environmentally sustainable companies, foundations have been spared due to their smaller base of stakeholders.

While major banks began answering calls from activists, regulators, and fiduciaries years ago to "do well by doing good" (see Figure 1), foundations have been generally spared the scrutiny–until now.



Source: Bloomberg 2.3.22, ESG by the Numbers: Sustainable Investing Set Records in 2021

Major foundations might fund initiatives that increase access to clean water in a developing country, for example, yet also hold shares in an energy company that pollutes that same community.

This lack of alignment stifles long-term impact and places private foundations in the hot seat of accountability on issues of green washing, pink washing, etc. If a foundation's sole mandate is to fight the ills of society, why invest in businesses that create and exacerbate them?

Some foundations have been leading the charge to align assets with impact goals and values

However, the recency of their action alludes to the slowness of the rest of the philanthropic sector. The Rockefeller Foundation, one of the largest foundations in the United States, only divested from fossil fuel companies in 2020, despite three of their five grantmaking pillars being increasing access to quality food, improving health, and scaling renewable energy. The Harvard Endowment followed suit in September of 2021, and the Ford Foundation the next month, amongst others.

But many more foundations have yet to take the leap into a wholly sustainable portfolio.

If foundations want to maintain their position as leaders and a voice of authority on societal issues, they need to speed up this transition.

There is a strong case for family offices, major foundations, and academic endowments to align their investment strategies with their grantmaking strategies, and be mission-driven through and through. A paradoxical misalignment is not only an ineffective strategy for maximizing impact, it also poses unnecessary risks to the longevity and credibility of the organization.

Aligning strategy for maximizing impact

By aligning investment strategies with grantmaking strategies, foundations can create a mutually reinforcing system where their two primary organizational operations work toward the same cause.

A foundation that gives to organizations that tackle racial and gender inequity should also ensure its external managers include women and people of color, and have inclusive policies that support their success and well-being. Foundations should screen portfolio companies for positive performance on human capital management measures and engage with those who might have room to improve.

In other words, instead of buying band aids for the problems their investments might be contributing to, they can change the rules of the game so the problems lose their oxygen.

Recognizing and mitigating risks to philanthropic longevity

Foundations survive through intergenerational engagement. To keep younger family members engaged and excited to continue this work, foundations will need to make sure that their portfolios align with their modern values.

Over the next 30 years, $58 trillion of wealth will transfer primarily to women and millennials. These demographics are twice as likely to consider both returns and positive impact when deciding on investments.

The next generation of leaders won't want to inherit a tarnished legacy.

There is a reason why so many asset managers and asset owners are applying ESG (Environmental, Social, Governance) lenses to their portfolios, and beginning to assess their inwards and outward impacts.

The physical risks of climate change, and the reputational and turnover risks of poor human capital management are material. The stability of the global economy is at risk and foundations are not immune to the consequences.

Recent research examining the long-term performance of a sample of 745 Europe-based sustainable funds shows that the majority of strategies have done better than non-ESG funds over one, three, five, and 10 years. ESG considerations are no longer a "nice to have" but rather a driver of outperformance.

Misalignment of strategies is a risk to credibility

The past decade has seen:

1. An explosion of public, critical inspection of plutocracy
2. Examination of tax payments by individuals and organizations
3. Scrutiny over how financial institutions are allocating their capital

For foundations, these three trends hit close to home.

Recently, endowments have been highlighted for having little or no accountability–from the marketplace or electors. Critics note that they are given special federal tax status to make the world a better place, as they define it, and that exception should come with great responsibility.

Finally, private foundations have long existed as a black box, and black boxes do not bode well in this age of radical transparency. Should foundations' portfolios be left unaligned, it is likely the general public will be intolerant.

Foundations' investment portfolios lie at the intersection of these three pressures, and therefore are at risk of losing their credibility if they fail to shift their investment strategies. Credibility is the bedrock of foundations' voice of authority on what causes are worthy of social and material investment.

Luckily, fixing this misalignment is a challenge foundations are most fit to tackle

Given these characteristics, foundations are also presented with an immediate opportunity to have huge societal impact once more by modeling successful impact investing for the finance industry. The world's largest banks, asset managers, and asset owners are scrambling to move from passive ESG screening to proactive, benefit-generating investing, and are lapping foundations in their own area of expertise.

Of the current impact investment market, foundations only represent 17% compared to asset managers' 70%. The fastest growing sector in impact investment is WASH (water, sanitation, and hygiene)–projects that foundations have decades of experience managing.

Why not capitalize on this knowledge, then turn that profit into increased impact?

Instead of watching institutional investors build impact-investment practices from scratch, foundations can use their expertise to swiftly realign their portfolios, lead the industry by example, and ensure that true impact is reached in every corner of the market.

We have progressed past the business case that you can do well and do good. Now it is clear that if you are not doing good, you may not do as well over the long-term.

As experts in impact investing via decades of impact-driven, community-level grantmaking, foundations have unique insight into both the business practices that are contributing to societies' largest problems, and the business solutions needed to solve them.

Furthermore, unlike institutional investors who are bound to their fiduciaries' slow approval, foundations have the flexibility to make more rapid changes to their portfolio management strategies.

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Purpose. Passion. Performance.

As a certified B Corporation member, BakerAvenue guides foundations and endowments to solutions for long-term value creation through active portfolio management, plus in-depth investment and grant research.

We are proud to partner with organizations to build a more inclusive and sustainable economy through the highest verified standards of social and environmental performance, transparency, and accountability. As fiduciaries, our mission is to protect our clients' interests ahead of our own.

Driven by our purpose, we strive to make a positive impact on society alongside financial return. We do so by delivering intelligent wealth management strategies while fostering initiatives that catalyze positive societal change.

We're headquartered in San Francisco with offices in New York, Dallas, Seattle, San Diego, and Sun Valley. For more information, please contact us or visit us at bakerave.com.

Amy Hepburn

Head of Impact and Philanthropy

Amy believes in pushing the boundaries of philanthropy. She accelerates social change by strategically leveraging resources, talent and amplifier platforms for maximum social impact. She has spent 20 years driving change in the public and private sectors, and advises governments, philanthropists, corporations, and foundations on impact strategies committed to finding new solutions to our most complex challenges.

Doug Couden, CFA

Chief Investment Officer & Partner

Doug is a tested market specialist with multiple cycles under his belt. He leads the firm's multi-disciplined (technical, fundamental and macro) investment approach including BakerAvenue's Impact Strategy. He is a member of the firm's executive committee, is responsible for managing the investment team, the firm's research process, and the overall performance of the strategies.

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