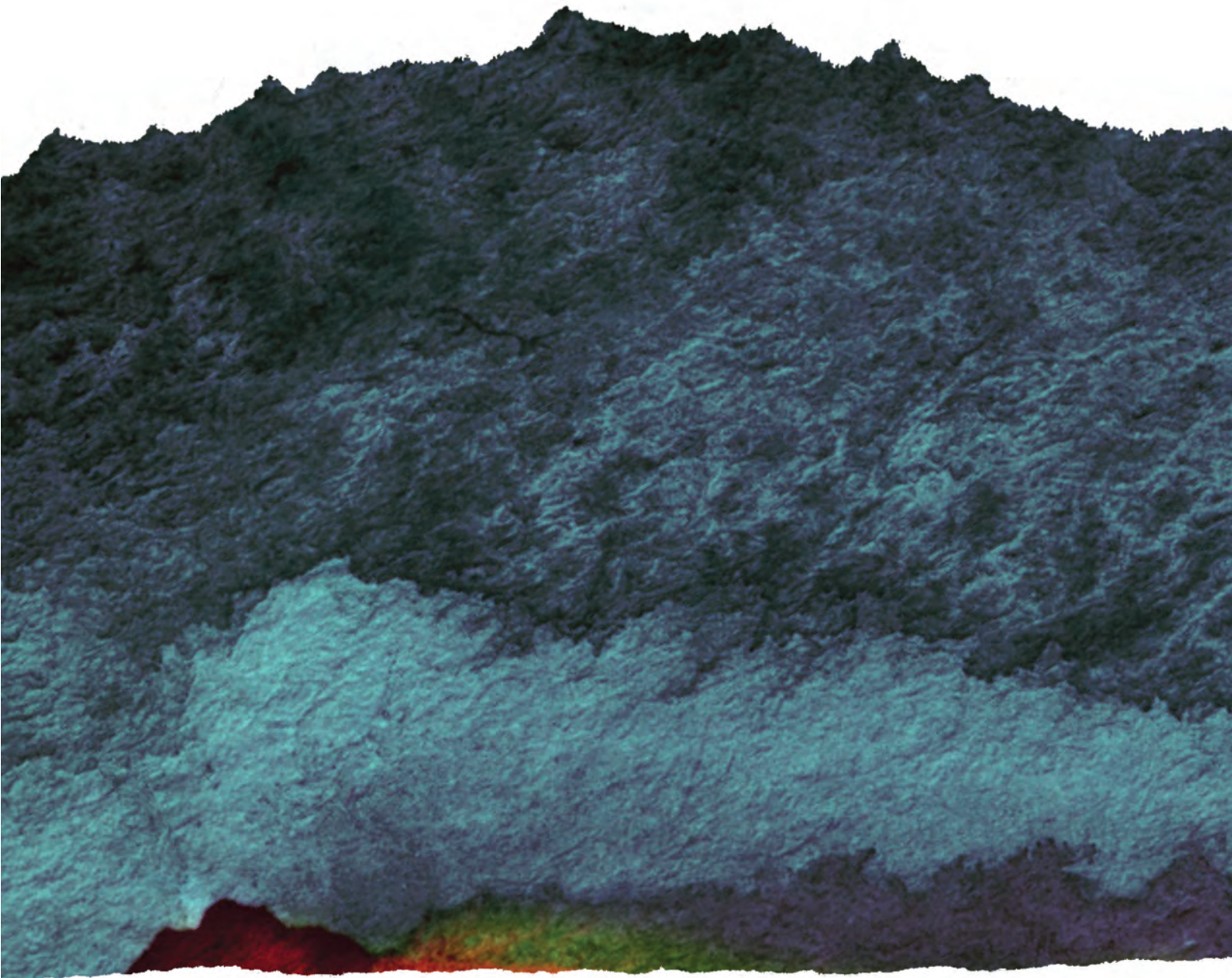


Breaking Barriers:

A Practical Guide to Unlocking Foundation
Endowments for Mission and Returns



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A Practical Guide to Unlocking Foundation Endowments

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Approach

Builders Initiative partnered with Social Finance to conduct market research on the current use of mission-related investments (MRIs), barriers to further adoption, and promising strategies to help unlock endowment assets for greater impact. As part of this research, we conducted interviews with a total of 30 stakeholders, including:

- 20 private foundations, family offices with private foundations, and impact platforms
- 5 investment managers
- 3 legal experts
- 2 industry conveners

We took a human-centered approach to this market research, recognizing that private foundation endowment allocations are decided by individuals (e.g., staff, board members, investment committee advisers, vendors, and community members) who are influenced by a variety of factors. These factors might include personal goals, incentives, emotions, time constraints, and risk appetites. In our interviews, we sought to take a careful, human-centered lens to understand how these individual-level decisions impact further MRI adoption.

There is **no uniform definition for MRIs across the field**. Definitions depend on the preferences and risk tolerance of organizations and individuals, and the usefulness of the MRI term itself is still widely debated. For the purposes of this work, we leveraged Mission Investors Exchange’s definition of MRIs as risk-adjusted or "prudent," often market-rate investments made from a foundation's endowment to advance its mission.¹

Motivations for Mission-Related Investing

Prior to exploring barriers to MRI adoption, we sought to understand the primary motivations and incentives for pursuing MRIs. Our conversations revealed that there is **no singular reason why organizations and individuals pursue MRIs**. The array of responses spans three categories—impact, influence, and insulation:

- **Impact on Social and Environmental Challenges.** The most cited answer is that MRIs provide a tool for allocators to align more of their endowment with their charitable mission and goals. Additionally, stakeholders said they pursue MRIs to build the field of impact investing by displaying track records of performance.
- **Influence on Peer Behavior.** Applying an MRI label to an investment can signal and attract other mission-oriented funders to an investment, particularly in for-profit organizations. Also, by building a track record for MRIs, there is a hope that mission considerations will become a standard part of investment evaluation.
- **Insulation from Charitability Risk.** MRIs, especially following the IRS guidance released in 2015,² can help answer questions about the charitability of an investment that an organization seeks to qualify as a program-related investment (PRI). For example, if an investment gains additional investors that risk diluting its charitability, categorizing that investment as an MRI can be a safer bet for allocators.

¹ [“An Introduction to Mission-Related Investments,”](#) Mission Investors Exchange.

² [“Investments Made for Charitable Purposes Notice 2015-62,”](#) Internal Revenue Service, 2015.

Despite legitimate reasons to pursue them, a variety of barriers nonetheless stem the flow of endowment assets into MRIs. We hope our findings help illuminate what these barriers are—and aren't—and point the field towards promising paths to overcome them.

Barriers to Mission-Related Investing

A simple rule clarification from the U.S. Department of the Treasury and Internal Revenue Service (IRS) won't solve all the barriers preventing further adoption of MRIs. Very few **interviewees cited regulatory concerns to mission-related investing as a barrier, indicating that there are not hard and fast regulatory guardrails preventing private foundations and other allocators from pursuing MRIs.** Some of our interviewees went so far as to say, "I see zero meaningful regulatory barriers to MRIs," and "regulations have only made it easier and clearer over time." **The primary barriers we uncovered are more entrenched, both philosophical and operational in nature, and will take both time and effort to solve. These barriers include:**

Belief in the Purpose of Endowments

"It is a bit of a red herring to focus on the tool (e.g., MRI, PRI.). What matters is what decision-makers think the purpose of private foundations is. We need to get more folks to question the purpose of a perpetually endowed institution, and whether a 95%/5% split of the endowment is best. There is an overriding cultural belief in the foundation space that grants are the single best vehicle for impact."— Capital Allocator (i.e., private foundation, family office with a private foundation, or impact platform)

There are stakeholders within foundations, family offices, and investment management companies who believe that fiduciary duty and acting in the best interest of their clients means maximizing financial returns above all other considerations, including environmental and social impact. This is in part because many investment committees (ICs) and board members come from a traditional finance background, both in training and practice, where they evaluate investments only from a financial perspective and have not had to grapple with the impact dimension of prudence. Over half of our interviewees mentioned that a key impediment to MRIs is how governing bodies view their role as fiduciaries. Interviewees expressed how critical it is to (1) invest time into educating and engaging IC members on mission-related investing, and, in some cases, (2) identify new champions of mission-related investing to serve in these roles.

For many, this is the single biggest *barrier* they face, while for others, the presence of aligned board and IC members was the single biggest *builder* of momentum for MRI adoption and implementation.

Expectation of Loss of Income and Risk Perception

"Board and IC members are optimizing for career risk rather than impact of endowment funds. In doing so, there is little incentive to recommend change in strategy or inclusion of MRIs out of fear that the strategy will go poorly, so they tend to be biased toward traditional investments."— Investment Advisor

Overlapping with the previous barrier, nearly half of interviewees said that **MRIs and impact investments more generally are typically assumed to have more risk and deliver concessionary returns, even though this is not always the case.** As one of our interviewees eloquently put, "No IC wants to hear that you'll lose money and compensate with all these nice things you accomplish instead." Given that many ICs and board members rely on paradigms of traditional financial markets, the framing of MRIs is critical because it is naturally assumed that there is a tradeoff between impact and return. In reality, well-planned MRIs

perform consistently with the market and can even be a source of alpha, as many of our interviewees' MRIs have shown. Ultimately, it's a personal or philosophical decision for foundations to determine where they pursue investments along the return/impact spectrum.

We also spoke with a foundation leader who conducted a live experiment to test the assumption that MRIs compromise returns. The foundation developed a carve-out of the endowment for MRIs and implemented it as a mini endowment with the same asset allocation of the actual endowment. After several years, they found the financial performance of the mission-related carve-out and the broader endowment were identical, encouraging their board and IC to further align their endowment with mission.

Capacity and Dichotomy of Foundation Staff

“Mission-related investing marries the investment skills an organization may have with programmatic goals and expertise. It is difficult to find experience on both sides.” – Capital Allocator

Over two-thirds of interviewees indicated that the way foundations are inherently organized is a barrier to mission-related investing. **The dichotomy between programmatic/grant teams and investment teams often makes MRI adoption difficult because there is no logical home for mission-related investing.** Also, from a purely skill-based perspective, MRIs require skill sets typically found in both traditional investment and programmatic teams (e.g., underwriting, programmatic expertise). This barrier is particularly acute in small-to-medium sized foundations that may not have in-house investment teams, let alone a dedicated impact investing team. In this scenario, it is not one particular team's job to think about impact investing, let alone do it. Asking staff to take this on in addition to their normal work without proper incentives does not lend itself to progress.

Misaligned Incentives

“Investment teams and managers are compensated based on the financial performance of the portfolios they manage. Including an impact component to compensation structures is not common and difficult to execute for two reasons: (1) it is hard to measure impact, and (2) impact typically occurs over the long-term, creating a timing mismatch.” – Capital Allocator

Investment staff and managers are often compensated and evaluated based on the financial returns of their investment portfolios, creating a disincentive to pursue investments that may present more risk or less potential financial return in exchange for impact—even if just in perception. Over half of interviewees were quick to admit the outsized effect that compensation structures have on further adoption of impact investments, but they were also quick to note how difficult it would be to realign incentives and to tie remuneration to impact or mission in some way. Disincentives can be created not just through compensation structures but also organizational structures. When chief investment officers and investment staff report directly to the board of directors—whose priority may be return maximization—this can create a rift between the strategic goals of the president and the priorities of the board.

Lack of Investment Pipeline

“The biggest barrier is product—continuing to have compelling investments come to market.” – Capital Allocator

“We have no issues sourcing and there are actually more investments coming in than we could ever consider ... The pipeline argument is a bit of a red herring.” – Capital Allocator

As the contradictory quotes above reflect, barriers surrounding the lack of a sufficient impact investment pipeline vary, depending on who you speak with. Some interviewees were quick to dispel the notion that lack of pipeline is a barrier to MRI adoption. This was typically expressed by larger foundations and organizations that have the internal staff and expertise to pursue MRIs. There seem to be two primary commonalities among the organizations that cited pipeline barriers: (1) some smaller foundations lack staff capacity and access to robust but affordable intermediation, and (2) some foundations have very specific sectoral interests that can limit the array of impact investment options they source.

Importantly, some interviewees felt that the lack of a pipeline was not reserved to small-to-medium sized organizations. Interviewees noted there is a gap in the marketplace for high-quality impact investment intermediation. More specifically, there is a need to solve business model constraints that prevent intermediaries in the market from providing affordable services. Without such constraints, these intermediaries could more sustainably offer the technical assistance foundations need—beyond off-the-shelf resources—to begin an impact investing practice.

Promising Paths and Tactics

While our research uncovered several barriers to MRI adoption, it also surfaced many promising paths and tactics for overcoming those barriers. These paths and tactics are not ‘one size fits all,’ and in some cases we heard divergent points of view. The specific context of a given organization must be considered before implementing any one of these paths. Moreover, these tactics employed in isolation will likely not be a comprehensive solution.

Start Small: Carve-Out Approach

Some organizations have found that developing an asset carve-out for MRIs and other mission-aligned assets has proven to be a good way to begin and grow their impact investing practice. We’ve learned that the incremental approach of a carve-out can help solve for the following barriers:

- **Return-Focused Governance Structures:** An impact investment carve-out can have a governance structure separate from that of the broader endowment. This allows foundation leaders to get impact investment portfolios up and running by having governance bodies comprised of individuals focused on aligning investments with the programmatic goals of the foundation.
- **Misaligned Incentives:** The financial performance of the impact portfolio should not roll up to that of the broader endowment. As such, staff behavior in pursuing impact investments is not dictated solely by incentives surrounding financial performance of the endowment.
- **Loss of Income:** A carve-out allows organizations to build a track record of MRIs and to prove the thesis that impact does not necessarily need to come at the expense of financial performance.
- **Dichotomy of Foundation Staff:** Through a carve-out, foundation leadership can be deliberate in building collaboration between program, impact investing, and investment teams. This can strengthen the rigor of diligence and decision-making processes.
- **Lack of Pipeline:** Interviewees spoke to how a carve-out can serve as a “proving ground” for new and emerging fund managers who, upon successful financial performance, may be elevated into the broader endowment portfolio.

While we heard several success stories of foundations taking the carve-out approach, other organizations have had success in embedding MRIs across the entirety of their endowments. We spoke with foundations that have accomplished having 100% of their endowment, or close to it, aligned with mission. In these

scenarios, the organizations often had a board and foundation leadership that championed this comprehensive shift toward impact.

Shift the MRI Narrative

Reframing impact considerations as an inherent part of risk mitigation and prudence can flip traditional conversations surrounding MRIs and reduce potential pushback. An example came from an investment manager who indicated that—in engaging boards, ICs, and foundation leadership on mission-related investing—they seek to flip the argument surrounding MRIs. Instead of arguing why an organization should allocate more of their endowment to MRIs, they ask what happens if investment decisions do *not* consider systemic and material risks (e.g., climate, inequality).

Publish Thought Leadership

Capital allocators can share more information about the process of beginning and expanding mission-related investing within their endowments. Interviewees expressed that it is important to share both what has worked well and what has not to avoid perceptions of ‘impact washing’ that can sometimes discredit impact investing. Transparent and authentic thought leadership of this kind can be a source of evidence to educate and convince ICs and boards to further align endowments with mission.

Identify IC and Board Members

Individuals with impact investing experience and exposure are needed to fill the ranks of ICs and boards, but they are not easy to find. Interviewees emphasized it is important to go beyond a traditional network-based approach to identifying new IC and board members. An interviewee raised the idea of a **central repository of information surrounding individuals with robust impact investing experience that can be leveraged by foundations to fill IC and board seats.** Developing such a repository would allow organizations without robust networks in the impact investing space, nor resources to engage an executive search firm, to access individuals with MRI expertise.

Signal Impact Commitment

Providing clear signals to the market about an organization’s impact investing goals can reduce sourcing barriers in two critical ways. Signaling impact orientation as a foundation can introduce investment opportunities via direct outreach. The more that foundations, family offices, and other allocators signal a demand for impact investment products, the more investment managers will adjust their offering to meet client demand.

Realign Compensation

While most interviewees agreed that compensation structures are a barrier to MRI adoption and that an opportunity exists to develop and test alternative models that incentivize impact, there is little to no alignment on how to do so. As noted above, tying compensation to impact is not common and is difficult to execute for two reasons: (1) it’s hard to measure impact, and (2) impact typically occurs over the long-term, creating a timing mismatch. To counter these facts, interviewees argued that measuring intention is not hard and utilizing metrics surrounding the portion of assets aligned with mission is something that can be measured immediately and over time. Interviewees also suggested other high-level strategies, including requiring chief investment officers and investment staff to be responsible for and

accountable to advancing the programmatic priorities of the foundation and incorporating incentives for investment selection aligned with impact (e.g., selecting diverse managers).

Create Opportunities for Co-Investment

Organizations already participating in impact investing can cultivate opportunities for co-investment, including sharing technical expertise and due diligence, to attract new impact investors. While this concept is not new, it can be expanded upon and systemized. Some interviewees identified legal and operational hurdles that prevent and dissuade foundation leaders from doing this today. From a legal perspective, leaders may be hesitant to share due diligence materials out of caution that it may be considered investment advice, which could land these organizations in legal trouble—especially since many are not registered investment advisors (RIAs). In testing this legal hurdle with interviewees, several indicated that simple non-reliance letters and nondisclosure agreements allow for the sharing of information. From an operational perspective, many impact investment recipients may not be able to accommodate several different co-investors, raising the need for syndication. Organizations may be unwilling to take on the burden of syndicating all co-investors, which underscores the need to build intermediation capacity in the market.

Closing

While our market landscape uncovered no shortage of barriers to MRI adoption, it also made it clear that aligning endowment assets to mission is doable as long as individual actors within organizations take deliberate action to do so. **We hope that this research will equip and empower individuals within private foundations to take the next step in pursuing MRIs.**

Ready to Act?

Here are action items individuals within private foundations can get started with today:

- Advocate for **carving out a portion of endowment assets** for MRIs.
- **Share transparent learnings** about your organization's experience with MRIs.
- Seek impact investment experience for your **board and investment committee**.
- **Provide clear signals** about your impact investing goals.
- Consider **alternative compensation models** for investment staff and/or managers.
- Cultivate opportunities for **co-investment**.

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