



# Beyond the Grant: Foundations as Impact Investors

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# Table of Contents

|   |    |
|---|----|
| Introduction.....   | 3  |
| The Program-Related Investment: More Financial Tools<br>for Social Good.....          | 4  |
| Loans.....  | 5  |
| Loan and Volume Guarantees.....   | 6  |
| Equity Investments.....   | 7  |
| Grants Complement Impact Investments.....   | 8  |
| The Mission-Related Investment: Putting Endowments<br>to Work for Social Purpose..... | 9  |
| Putting Impact Investing to Work for Racial Equity.....                               | 11 |
| Collaborative Impact Investing.....   | 13 |
| New Ways of Working.....  | 15 |
| Collaboration between Investment and Program Teams.....                               | 16 |
| From Grantmaker to Asset Manager for Social Good.....                                 | 16 |
| Impact Investing Will Continue to Change How Foundations Work.....                    | 18 |

## Introduction

In just over a decade, impact investing has grown from niche to mainstream, a trend that has caught the attention, if not the commitment, of US foundations. Worldwide, investors of all types have poured upwards of \$715 billion into companies that seek both social impact and attractive financial returns.<sup>1</sup>

Foundations have compelling reasons to join in. Impact investing expands the scale and scope of a foundations' work beyond what is possible with grantmaking alone. Yet, to date, curiosity about impact investing runs higher than application.

Some 88 percent of respondents (almost three-quarters of whom manage less than \$10 million in assets) to a recent Foundation Source poll declared they were at least "somewhat" interested in impact investing.<sup>2</sup> Yet, many still haven't acted on that interest. Thirty-eight percent said they simply "don't know enough about" impact investing to give it a try.

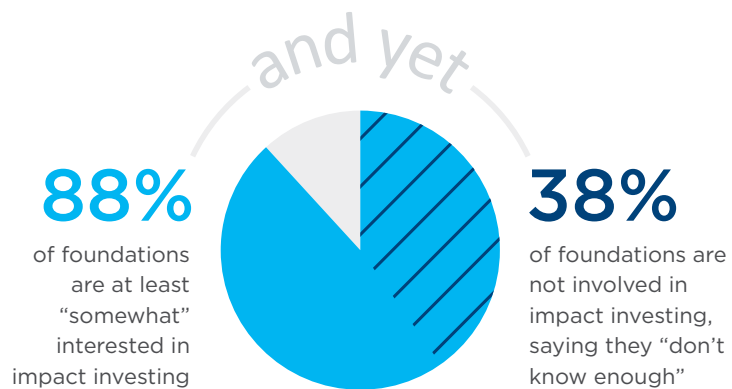
Philanthropic investments for social benefit aren't new. Since 1969, the IRS has permitted foundations to deploy loans, loan guarantees, and equity investments in support of nonprofits and for-profit business enterprises. The IRS calls these **program-related investments (PRIs)** because, to qualify, they must further a foundation's charitable mission.

Monetary gain can't be the primary motivation.

Given the charitable intent,

the IRS regards PRIs as akin to grants and includes them in the minimum 5 percent annual payout that a foundation must make to maintain its tax-favored treatment. Unlike grants, PRI investments generate financial return, though typically below market rates. Investment proceeds fund future grants or investments, recycling scarce philanthropic dollars. (See "What investments qualify as a PRI?" on page 5).

### Foundations want to learn more



**Source:** "Impact investing and Private Foundations," Foundation Source, November 2019.

<sup>1</sup> *Annual Impact Investor Survey 2020*, Global Impact Investing Network, June 2020.

<sup>2</sup> *Survey: Impact Investing and Private Foundations*, Foundation Source, November 2019.

In addition to PRIs, foundations can use their endowments for **mission-related investments (MRIs)** that align with their philanthropic goals and seek to generate a competitive rate of return.<sup>3</sup> Unlike PRIs, MRIs do not count as part of a foundation’s annual 5 percent payout.

Traditionally, grantmaking and endowment investing have functioned as separate activities, one championing social change and the other financial gain. “But the emerging field of impact investing invites a productive collaboration between these two disciplines,” impact investing advocates Jed Emerson and Amy Chung wrote six years ago.<sup>4</sup>

Today, that potential for productive collaboration has led a number of foundations to reimagine themselves as asset managers for social good, not just grantmakers. It’s a mindset shift that requires foundations to think holistically about how best to deploy their assets to effectively address the problem at hand. It also requires foundations to embed impact investing in strategy and to make the staff and operational adjustments necessary to carry through.

With both the potential and the challenges in mind, The Kresge Foundation engaged The Bridgespan Group to summarize the current state of impact investing in institutional philanthropy. Our research included a review of numerous articles and reports, drawing on the research and experience of organizations like the Mission Investors Exchange, Omidyar Network, and Rockefeller Philanthropy Advisors. We also interviewed impact investing leaders who shared practical advice and described timely initiatives that put impact investing to work in pursuit of racial equity and justice, and in emergent collaborations. We begin our report with an overview on the basic tools of impact investing that position foundations to advance their goals beyond grantmaking, a powerful motivator for those on the sidelines of impact investing to take a closer look.

## The Program-Related Investment: More Financial Tools for Social Good

Foundations have historically focused on grantmaking to help nonprofits provide programs and services for which they have little expectation to cover costs with earned income. In exchange for their grant support, funders require nonprofits to track results and report back periodically on progress toward their impact goals. Social impact (however defined) is the measure of success, not financial gain.

But grants aren’t the only option. Impact investing gives foundations a choice between loans, loan guarantees, and equity investments. Choosing typically involves setting up a process that matches a nonprofit’s needs with the right financial tool. The Bill & Melinda

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3 MRIs must meet the same state and federal prudent investment standards that apply to other investments. However, the IRS has determined that it is possible “to make a prudent (MRI) investment that advances the foundation’s charitable purpose, even if the investment offers a lower rate of return, higher risk, or lower liquidity than alternative investments that do not further charitable purposes.” See David Wilkinson, “[Steps to Catalyze Private Foundation Impact Investing](#),” The White House, April 21, 2016.

4 Amy Chung and Jed Emerson, “[Catalyzing Impact Investments Through Coordinated Grantmaking](#),” *Philanthropy News Digest*, March 18, 2014.

Gates Foundation, for example, describes its process this way: “Our first step is to identify the right tool to support [an organization’s] promising work,” reads the foundation’s Strategic Investment Fund strategy statement. “Is that a grant? An equity investment or loan? Or would an investment paired with a grant, a combination our team often leverages, be most effective? It’s a personalized approach to philanthropy, that ensures we are providing the right funding tool to support entrepreneurs and organizations—both nonprofit and for-profit—working on solutions for the world’s most important problems.”<sup>5</sup>

### What investments qualify as a PRI?



1. Its primary purpose must be to further one or more exempt purposes of the foundation



2. The production of income or the appreciation of property may not be a significant purpose of the investment



3. Influencing legislation or taking part in political campaigns on behalf of candidates is not a purpose

Source: “Program-Related Investments,” IRS.gov.

### Loans

When a nonprofit or social enterprise needs to borrow money but can’t rely on conventional sources, such as banks, foundation loans can fill this capital gap.

PRI loans make it possible for nonprofits or small businesses to cover up-front costs, such as purchasing equipment or building affordable housing, with future recurring revenue streams, such as fees for services or rent. Nonprofits and impact-oriented businesses, especially those run by people of color, find it particularly difficult to secure loans from conventional sources.<sup>6</sup>

5 “Our Strategy,” The Bill & Melinda Gates Foundation.

6 Sarah Lyons-Padilla, et. al., “Race influences professional investor’s financial judgments,” Proceedings of the National Academy of Sciences of the United States of America, August 17, 2019; Matt Onek, “Impact Investing and Racial Equity: Foundations Leading the Way,” *Stanford Social Innovation Review*, February 25, 2019.

Since the IRS requires PRIs to have a charitable purpose, interest rates on loans fall below market rates, typically in the low single-digits. Foundations can extend loans either to individual organizations or to small businesses, or they can work with intermediaries, such as federally certified community development financial institutions (CDFIs), which invest in housing and community projects in low- and moderate-income neighborhoods.<sup>7</sup> Since passage of the Community Reinvestment Act in 1977, CDFIs have emerged as important sources of loans in neighborhoods and sectors that banks and other lenders historically “redlined,” a form of systemic racism.<sup>8</sup>

Loans have typically been the primary PRI tool used by foundations. One study found that loans made up approximately 83 percent of PRI investments.<sup>9</sup> The relative simplicity of loans compared to loan guarantees or equity investment explains their popularity.

The McKnight Foundation’s \$50 million commitment to PRIs for social and environmental change is a case in point. “To date with our portfolio, we have structured most of our investments as low-interest loans,” said Elizabeth McGeeveran, McKnight’s director of investments. In 2009, for example, McKnight extended a 10-year \$5 million loan at 2 percent interest to the Greater Minnesota Housing Fund (a CDFI) to rehab existing apartment complexes for working people. In 2016, the foundation made a \$5 million, five-year loan at 2 percent interest to The Conservation Fund to purchase and join forested land into continuous, high-quality conservation landscapes, thereby enhancing water quality.

### Loan and Volume Guarantees

Foundations can also use loan guarantees to encourage conventional investors to support community development projects, such as affordable housing, economic revitalization, job training, and other activities designed to advance development, whether place-based, regional, or global in scope.

With a loan guarantee, a foundation agrees to cover an investor’s losses—up to a set amount and under certain agreed upon conditions—if the borrower fails to make timely repayments. Thus, a foundation’s guarantee helps shift the balance of risk and return for other investors—typically banks and CDFIs—making deals more attractive for them. Loan guarantees are a powerful way for foundations to advance their programmatic work while expending no money up front. Payouts happen only if the borrower defaults and investors stand to lose money.

The Kresge Foundation has used loan guarantees for more than a decade to de-risk investments, making them attractive for private investors. Since Kresge’s first guarantee in 2011, “the foundation has made \$70 million in guarantee commitments through 23 transactions,” Rob Manilla, Kresge’s chief investment officer, wrote in a 2018 blog post. “We have seen our guarantees effectively encourage investment from those shying away from known or perceived risks, help launch new organizations or business models, and support investments where repayment is based on the proof of positive social outcomes,”

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7 “What are CDFIs?” CDFI Coalition.

8 Amy Cortese, “Agent of Impact: Ellis Carr, Capital Impact Partners,” *ImpactAlpha*, February 28, 2020, [requires free registration or paid subscription].

9 Darren B. Moore, “Beyond Grantmaking: Additional Mechanisms for Mission,” Presented at the 34th Annual Nonprofit Organizations Institute, January 13, 2017 Austin, Texas, p. 16.

he added. “We have successfully catalyzed impact on the ground while unlocking \$780 million of additional investor capital,” all without any loan losses.<sup>10</sup>

Yet, loan guarantees have gained limited traction among foundations in the United States, according to a recent Global Impact Investors Network (GIIN) study commissioned by Kresge. The study found that the level of customization required to craft a guarantee agreement discourages greater usage.<sup>11</sup> As a result, “this valuable tool is extremely underutilized,” said Amit Bouri, GIIN’s CEO. The study led to a working group of foundations and financial institutions that continued exploring the use of guarantees, culminating in January 2020 with the launch of the Community Investment Guarantee Pool. A group of organizations led by Kresge has committed \$33 million to this first-of-its-kind loan consortium.<sup>12</sup> It aims to deploy guarantees to support financial institutions that serve people and communities that mainstream financial institutions avoid.<sup>13</sup>

Foundations have also used volume guarantees to influence business practices. The Gates Foundation, for example, led an initiative that convinced two large pharmaceutical manufacturers “to roughly double the supply and halve the price of contraceptive implants, a popular and effective method of birth control” in developing nations, as *Stanford Social Innovation Review* described it. The volume guarantee stipulated that if the market did not grow at the predicted rate, the Gates Foundation and its partners would pay for any unsold products. Demand for the contraceptives turned out to be higher than projected, which left the guarantee untapped.<sup>14</sup>

## Equity Investments

Equity investments support social entrepreneurs or mission-driven companies that may have a scalable solution to a social or environmental problem. Purchasing an ownership stake injects much-needed capital to finance growth. It can also give the foundation more of a say in governance, for foundations with the capacity to engage as a shareholder.

As with loans and guarantees, the primary purpose of a PRI equity investment must be social impact, not financial return. Nonetheless, there’s neither a ceiling on what a foundation might earn down the road if the enterprise prospers, nor a floor if the enterprise fails. So equity investments are both riskier and have greater potential financial upside for a foundation than either loans or guarantees.

The Lumina Foundation, the nation’s largest foundation devoted exclusively to higher education, makes equity investments in entrepreneurs aligned with the foundation’s goal

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10 Rob Manilla, “Mission, Money & Markets: Making ‘Cents’ of Guarantees, the View from a CIO,” The Kresge Foundation, May 1, 2018.

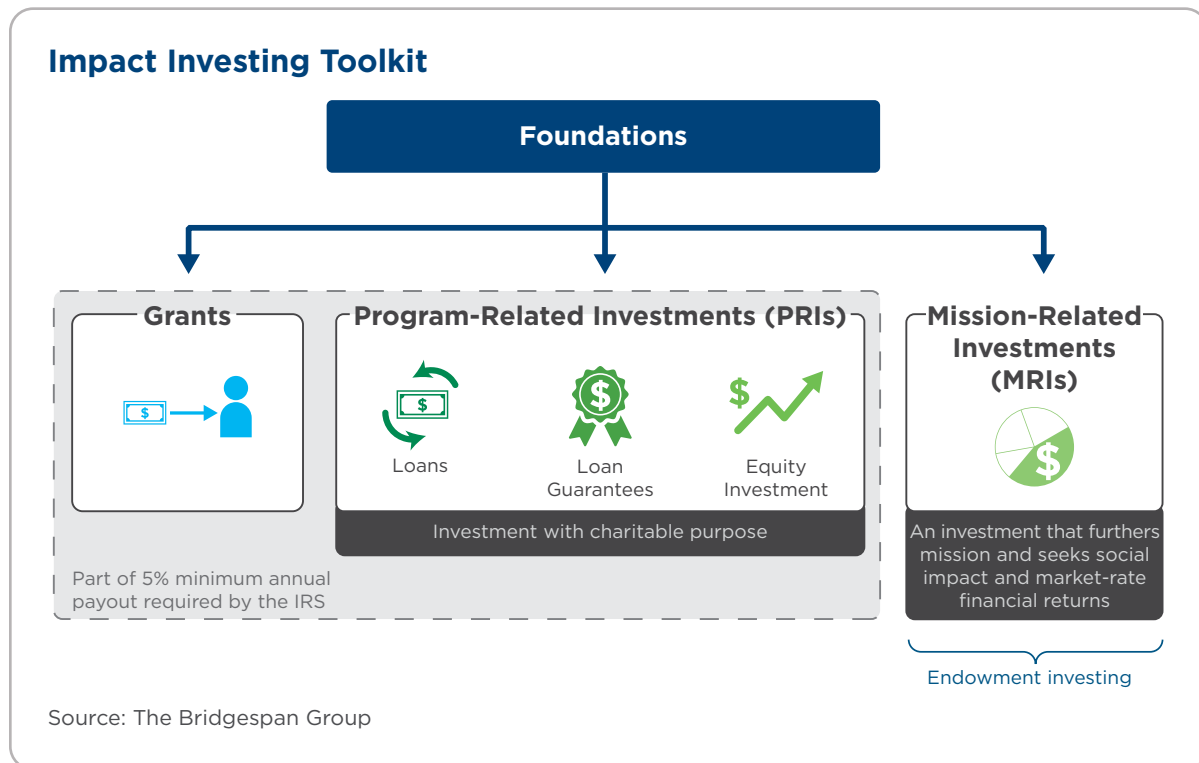
11 Hannah Schiff and Hannah Dithrich, *Scaling the Use of Guarantees in U.S. Community Investing*, Global Impact Investing Network, 2017, p. 2.

12 “U.S. sees launch of first guarantee pool for community development investments,” The Kresge Foundation, January 28, 2020.

13 Oscar Perry Abello, “The Hidden Power of Guarantees in Community Development Finance,” *Next City*, February 20, 2020.

14 David Blank, “Guaranteed Impact,” *Stanford Social Innovation Review*, Summer 2016.

to boost the number of young people who attain degrees beyond a high school diploma. Writing in *Stanford Social Innovation Review*, President Jamie Merisotis describes the large-scale educational innovation Lumina seeks: “We aim to serve more people better—to make high-quality education and training more widely available, especially among populations that have historically been underserved.”<sup>15</sup>



### Grants Complement Impact Investments

Different tools can also be used in combination with grants. Foundations sometimes pair grants with equity investments, for example, a familiar situation for early-stage companies with a lot of promise. A grant can help to keep the organization financially afloat during its proof-of-concept stage. An equity investment fuels growth and sends a positive signal to other investors. The Gates Foundation often uses this approach. “When we’re funding something that has broad applicability, like a cancer or malaria drug, it makes sense to fund that with equity,” explained Andrew Farnum, former director of the Gates Foundation Strategic Investment Fund. “If we say to the same company, we want you to develop a drug for a neglected tropical disease where it’s unlikely to find a market to earn any financial return, we’ll provide a subsidy in the form of a grant.”

And grantmaking can also dovetail with lending. The Northwest Area Foundation (NAF) in St. Paul, Minnesota, made a grant and PRI loan investment in the First Nations Oweesta Corporation, a Native CDFI intermediary, to invest in Native-owned businesses and grow the Native CDFI field. “Disinvestment of Indigenous communities has not been an accident: it’s been a design feature,” said Kevin Walker, NAF’s president and CEO. Though Native

15 Jamie Merisotis, “Impact Investing for Educational Progress,” *Stanford Social Innovation Review*, March 18, 2019.



people constitute 2 percent of the US population, only 0.23 percent of philanthropic funding flows to Native communities.<sup>16</sup> Oweesta estimates that loans supported by NAF's \$500,000 PRI investment will help 900 small businesses create 3,000 jobs and build 120 units for affordable housing. Oweesta will also use a \$1 million NAF grant to build capacity for other Native CDFIs across the West.<sup>17</sup>

## The Mission-Related Investment: Putting Endowments to Work for Social Purpose

Foundations make mission-related investments (MRIs) from their endowment to advance philanthropic goals *and* generate a competitive rate of return. As such, they aim for positive social impact while contributing to the foundation's long-term financial stability and growth.<sup>18</sup> Foundations in the United States hold \$890 billion in endowment assets, money that impact investing advocates argue could be used as a powerful tool to put capital markets to work to generate positive social or environmental change.<sup>19</sup>

Most foundations do not attempt to pursue their missions through their endowment investments, instead prioritizing financial growth and prudence. In essence, foundations traditionally function like private investment companies intent on growing their endowments while fulfilling the legal requirement to disburse at least 5 percent of asset value to charitable endeavors annually.

To critics, there's a flaw in this approach: "What flows to mission are the crumbs that are left over, and not the core assets," impact investing advocate Jed Emerson told the *Chronicle of Philanthropy*.<sup>20</sup> "You can't grant your way out of poverty or solve the climate problem with grants alone." A small but growing number of foundations agree. "If philanthropy's past half century was about optimizing the 5 percent, its next half century will be about beginning to harness the 95 percent as well, carefully and creatively," wrote Darren Walker, president of the Ford Foundation, in a 2017 blog post.<sup>21</sup> Walking the talk, the foundation has committed \$1 billion of its endowment (roughly 8 percent of all assets) for MRIs.

In the late 1990s, the Heron Foundation decided to use its endowment in order to advance its mission of helping people help themselves. By the mid-2000s some foundations experimented with negative screens to eliminate holdings, such as tobacco and oil companies, that did not align with its values. Today, foundations making socially conscious

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16 *We Need to Change How We Think: Perspectives on Philanthropy's Underfunding of Native Communities and Causes*, First Nations Development Institute, 2018.

17 Kevin Walker, "Equity for North American Communities: Using Mission Investments Alongside Grants," *Stanford Social Innovation Review*, April 1, 2019.

18 While the IRS has not issued a legal definition for MRIs, it published [clarifying guidance in the fall of 2015](#) to assure foundations that they can use endowment assets in a variety of ways to accomplish their missions.

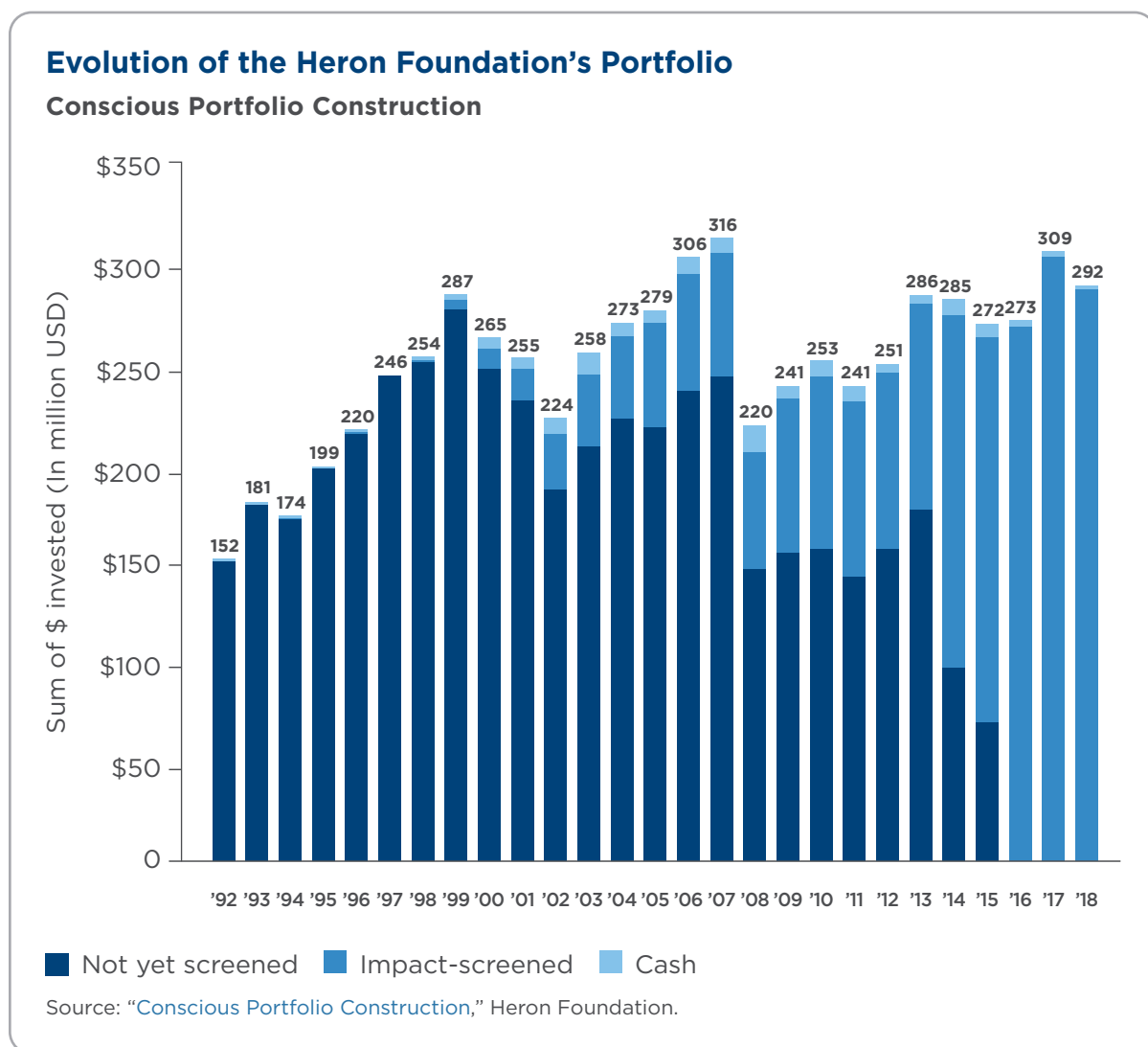
19 Paula D. Johnson, *Global Philanthropy Report*, Harvard Kennedy School Hauser Institute for Civil Society, 2018.

20 Marc Gunther, "Doing Good and Doing Well," *Chronicle of Philanthropy*, January 8, 2019.

21 Darren Walker, "Unleashing the power of endowments: The next great challenge for philanthropy," Ford Foundation, April 5, 2017.

investment decisions have adopted more intentional screening for environmental, social, and governance (ESG) criteria. MRIs apply ESG screens, at a minimum, and often go further to invest in specific people or places, guided by a foundation’s impact goals.

By 2010, the Heron Foundation had invested 40 percent of its roughly \$300 million endowment in MRIs.<sup>22</sup> But it wanted to do more. “Back in 2012, we determined that the challenges we were trying to address demanded every resource we could muster,” wrote then-CEO Clara Miller in a *Stanford Social Innovation Review* article.<sup>23</sup> “So we decided to invest 100 percent of our endowment toward fulfilling our mission by fiscal year end 2017.” Heron invested 100 percent of its endowment for impact by the end of 2016, and continues to optimize the portfolio for mission. (See “Evolution of the Heron Foundation’s Portfolio” below.)<sup>24</sup> To accomplish this goal, Heron integrated the investment and program sides of its operations while continuing to comply with IRS regulations.



22 Clara Miller, “Building a Foundation for the 21st Century: Part 1—On Full Philanthropic Engagement,” *Nonprofit Quarterly*, June 8, 2016.

23 Clara Miller, “Arriving at 100 Percent for Mission. Now What?” *Stanford Social Innovation Review*, March 7, 2017.

24 “Conscious Portfolio Construction,” Heron Foundation.

While expressing interest in impact investing for their endowments, many foundation leaders worry that MRIs remain unproven and will erode endowment returns. The majority of respondents (52 percent) to the recent Foundation Source survey either “strongly” or “somewhat agree” that “impact investing means settling for lower returns.”<sup>25</sup> These concerns have not dissuaded other foundations from taking measured steps to test the potential for mission investments.

At the McKnight Foundation, the board in 2014 culminated a year-long evaluation of impact investing with a commitment to carve out \$200 million (10 percent of its \$2 billion endowment) for investments that align with the foundation’s mission. Based on favorable investment returns, the McKnight board in August 2019 lifted the 10 percent cap and “opened the door for us to add impact investment to the endowment in an unlimited way,” said McGeeveran, director of investments.

McKnight has developed a framework for thinking about impact investments, characterized by “four points of leverage.”<sup>26</sup> As an asset owner, it has the opportunity to align its money with its mission. As a consumer of financial products and services, it can promote integrated thinking on ESG issues among the asset managers it hires. As a shareholder of corporations, it votes company proxies and raises questions about ESG practices, strategy, and risk management. And as an institutional investor, it works with others to source deals, create better market conditions, and share successes and failures related to its portfolios.

“This is actually the most fundamental part of our impact program,” explained McGeeveran. “We’ve spent a lot of time talking about being an asset owner, which is what I find my peers spend all their time thinking about. But we’re also super interested in what kind of leverage we can have as a customer of fund managers. Then we pay attention to shareholder engagement, like being involved in dialogues with publicly traded companies. And we pay attention to things at the regulatory level: shareholder advocacy and access to the proxy ballot. This is outside of the expertise of our program staff, but we care about it.”

## Putting Impact Investing to Work for Racial Equity

Early on, foundations made racial equity an impact investing goal. For example, one of the first Ford Foundation PRIs in 1969 supported Progress Plaza, the first shopping center in the United States owned and run by African Americans.<sup>27</sup> Equity has continued as a goal. The Kresge Foundation, for example, partnered with Capital Impact Partners (a CDFI) in 2013 to loan \$30 million to the Woodward Corridor Investment Fund for mixed-use, mixed-income housing in Detroit’s predominantly Black downtown Woodward Corridor. “We saw this as a first step in bringing investment and vitality back to the city following the bankruptcy [in July 2013],” explained Elizabeth Luther, Detroit program manager for Capital Impact Partners.<sup>28</sup>

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25 *Survey: Impact Investing and Private Foundations*, Foundation Source.

26 “How We Invest,” McKnight Foundation.

27 “A Legacy of Social Justice,” Ford Foundation.

28 Elizabeth Luther, “Woodward Corridor Investment Fund: Fostering Sustainable Community Development in Detroit,” Capital Impact Partners, July 2019.

“Six years later, that innovative idea spurred new housing and other projects that are now spreading beyond the Woodward Corridor into Detroit’s neighborhoods,” Luther said. The project also led to a \$100 million investment by JPMorgan Chase in the city’s revitalization. “In its essence, our social investment team addressed a market failure with our Woodward Corridor fund,” said Benjamin Kennedy, Kresge’s vice president of programs who also oversees the organization’s place-based work. The fund directed capital to more than a dozen development projects “in a hyperlocal geography,” demonstrating that the risk perceived by conventional investors did not match reality.

But foundations can—and should—do far more impact investing in service of equity, concluded a 2017 report by the Philanthropic Initiative for Racial Equity. The data showed that from 2005 to 2014, annual domestic foundation funding for communities of color never exceeded 8.5 percent of total funding.<sup>29</sup> As noted in the report: “Despite changing demographics and increased societal awareness of systemic racism, there has been no progress on expanding funding for people of color.” Color-blind philanthropy, grounded in a well-meaning attempt at equity, actually contributes to the problem, concluded a recent report coauthored by Echoing Green and Bridgespan.<sup>30</sup>

The ramifications cut across the social sector and demand a holistic response. “Racial inequity is inextricably connected to nearly every social challenge that philanthropy seeks to address,” wrote the authors of a 2019 *Stanford Social Innovation Review* series on impact investing and racial equity.<sup>31</sup> Contributors to the series, including 10 foundation presidents, advocated going beyond grantmaking “to put an additional tool—impact investing—to work in advancing these [racial equity] goals. Indeed, as the impact investing field continues to grow, it is important to ensure that racial equity is at the center of the movement, an integral element of impact.”

Some equity advocates, for example, have championed an increase flow of funds to asset managers run by women and people of color who, in turn, will invest in minority neighborhoods and businesses. Tellingly, asset management firms owned by women or people of color attract just over 1 percent of the \$70 trillion of global assets under management.<sup>32</sup>

This pattern misrepresents the risks of investing in communities of color and asset managers of color. A 2017 study by the John S. and James L. Knight Foundation, however, found no statistically significant difference in the performance of diverse-owned asset management firms and their peers.<sup>33</sup> Findings from a more recent study concluded that asset allocators “are missing opportunities for higher financial returns by undervaluing high-performing funds led by people of color or by overvaluing white-male-led funds.”<sup>34</sup>

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29 “What does philanthropy need to know to prioritize racial justice?” Philanthropic Initiative for Racial Equity, 2017.

30 Cheryl Dorsey, Jeff Bradach, and Peter Kim, “Racial Equity and Philanthropy: Disparities in Funding for Leaders of Color Leave Impact on the Table,” The Bridgespan Group, May 2020.

31 “How Foundations Are Using Impact Investing to Advance Racial Equity,” *Stanford Social Innovation Review*, 2019.

32 Lyons-Padilla, et al., “Race influences professional investors’ financial judgments study.”

33 Josh Lerner, *Diversifying Investments: A study of ownership diversity in the asset management industry*, Knight Foundation, May 2017.

34 Lyons-Padilla, et al., “Race influences professional investors’ financial judgments study.”

In managing their endowments, Kellogg, Kresge, and others have identified asset management as an equity issue and taken steps to be more supportive of minority owners. “Working in partnership with Progress Investments, we provide support and investment capital for a set of high-potential firms owned by African Americans, Latinos, Asian Americans, and women to help build their investment funds, unlock new opportunities, and eventually manage more of our \$8 billion portfolio,” La June Montgomery Tabron, Kellogg’s president and CEO, wrote in her contribution to a *Stanford Social Innovation Review* series.<sup>35</sup>

With equity as a guiding principle, Kresge announced in April 2019 that by 2025, 25 percent of its US assets under management will be invested in female and diverse-owned firms.<sup>36</sup> Kresge also became the first private foundation signatory to the “The Investment Manager Diversity Pledge” developed by the Association of Black Foundation Executives (ABFE).<sup>37</sup> “We believe that diversity of thought, background, and beliefs leads to better investment decisions and stronger financial returns,” said John Barker, managing director of Kresge’s Investment Office.<sup>38</sup>

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JOHN BARKER, MANAGING DIRECTOR,  
INVESTMENT OFFICE, THE KRESGE  
FOUNDATION

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Similarly, the Surdna Foundation has made investments in diverse fund managers with a commitment to equity a part of its impact investment strategy. For example, Surdna saw promise in Kesha Cash, who set out in 2013 to raise \$10 million for her Impact America Fund. The fund aimed to invest in tech-driven businesses that would benefit marginalized communities. Previously, Cash had cofounded Jalia Ventures to invest in early-stage ventures operated by people of color.

Venture capital firms staffed by experienced people of color have historically struggled to sign up investors. Surdna, however, saw an opportunity where others saw risk and invested \$1 million. “We said, this is the type of investment that we should be doing as an organization,” said Shuaib Siddiqui, Surdna’s director of impact investing. Siddiqui says he champions diverse fund managers who share the foundation’s social justice goals. The financial success of Cash’s first fund led to a second \$50 million fund, in which Surdna also invested.

## Collaborative Impact Investing

Like-minded foundations often focus on collaborative grantmaking to work on a common problem. They can also take collaborative approaches to impact investing, particularly for place-based investment in specific communities and for systemic change initiatives.

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35 La June Montgomery Tabron, “[Expanding Opportunity in the Capital Markets Through Racial Equity](#),” *Stanford Social Innovation Review*, February 25, 2019.

36 “[Kresge Foundation launches ‘25% by 25’ and pledges to invest one-quarter of U.S. assets in diverse-owned firms by 2025](#),” The Kresge Foundation, April 3, 2019.

37 Ibid.

38 “[The Investment Manager Diversity Pledge](#),” ABFE.

The Minnesota Impact Investment Initiative (MI3) exemplifies place-based impact investing. MI3 is a collaboration among a group of Minnesota-based foundations, large and small, led by the Minnesota Council on Foundations. It helps participants pursue targeted investments in affordable housing, small business lending, and socially beneficial municipal debt in Minnesota through a fixed-income mutual fund. MI3 is just one of many examples of foundations collaborating for place-based work highlighted in a 2018 report by the Urban Institute. The 2018 report found “place-based impact investing emerging all across the country in both rural and urban areas.”<sup>39</sup>

Other impact investing collaboratives form to take on big, systemic issues. The John D. and Catherine T. MacArthur Foundation, for example, launched the Catalytic Capital Consortium in early 2019 with co-investments from The Rockefeller Foundation and Omidyar Network. The consortium’s approach to catalytic capital is to make investments that are “patient, risk-tolerant, concessionary, and flexible” in order to bridge gaps left by conventional investors who might otherwise avoid a social enterprise’s concessionary rates of return. According to the consortium’s website, its goal is to use catalytic capital to open the door to conventional investment in innovative products or business models with high-impact potential.

The consortium plans to invest up to \$150 million in funds or financial intermediaries that will select investees with business plans that advance the UN’s Sustainable Development Goals (SDGs). The consortium’s call for funding proposals drew more than 100 ideas touching on all 17 SDGs and seeking upward of \$2 billion. More than 200 private investors subsequently stepped up to indicate interest in supporting a number of the organizations seeking funding from the consortium.<sup>40</sup>

Climate change is a systemic issue of increasing importance for foundations and the focus of another recent collaborative. MacArthur and The David and Lucile Packard Foundation announced in October 2019 the formation of Terra Silva, a \$90 million fund to invest in eight to 10 investment fund managers who seek to prove that sustainable tropical forests are a profitable asset class for commercial investors.<sup>41</sup> In an *ImpactAlpha* interview, Susan Phinney Silver, Packard’s mission investing director, noted that the foundations will back the fund with low-interest program-related investments with a goal to “build a new asset class where none currently exists.”<sup>42</sup> Terra Silva, she said, “is enabling investments in funds and intermediaries that otherwise would never have gotten the capital to launch or become viable in the first place.”

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39 Shena Ashley, Joycelyn Ovalle, “Investing Together: Emerging Approaches in Collaborative Place-Based Impact Investing,” Urban Institute, May 2018.

40 Debra Schwartz, “Ambitious Plans for Catalytic Capital,” MacArthur Foundation, October 2, 2019.

41 “New \$90 Million Fund to Address Global Climate Change through Catalytic Capital,” MacArthur Foundation, October 23, 2019.

42 Jessica Pothering and David Bank, “Terra Silva has \$90 million in ‘catalytic capital’ for carbon reduction in tropical forests,” *ImpactAlpha*, October 23, 2019, [requires free registration or paid subscription].

Collaboration typically takes time to get from concept to execution, but it can happen quickly in a crisis. The Response, Recovery, and Resilience Investment Coalition (R3 Coalition), for example, launched on May 12, 2020, to streamline impact investing efforts to address the large-scale social and economic consequences of Covid-19 pandemic. The initiative is a collaboration across prominent impact investing networks supported by a group of leading foundations.<sup>43</sup>

While working together has its benefits, “designing a collaborative from scratch is not the easy path,” added Silver. When an opportunity arises, “we always ask ourselves, why Packard? Why now? We don’t always have to build a new collaborative.” In fact, Packard and other foundations often work together on topics of interest without setting up a formal collaborative. Surdna, for example, works closely with Kellogg and the Ford Foundation to share what they are learning about supporting fund managers of color. “We trade deals and share diligence a lot,” said Surdna’s Siddiqui. “We’re also looking for market validation. Does everybody see what I see? Why does somebody else walk away from a deal, and why did someone do a deal?” Without question, the complexity of effectively deploying impact investing puts a premium on all types of collaboration, a feature of the new era likely to increase over the years ahead.

## New Ways of Working

In interviews with impact investment leaders at seven foundations, we heard a lot of practical advice about how to build and manage an effective impact investing team. The decision to pursue impact investing raises a “build or buy” question. Does the foundation build an impact investing team internally or engage the services of outside financial advisers and fund managers? The answer is often to do both.

Foundations looking to expand into program-related investments might start by hiring investment professionals with deals expertise. An investment specialist would know how to identify and do due diligence on potential investments, structure a range of deals types, and monitor investments after a deal closes, skills that are very different from those of most grant program officers.

Debt origination is more straightforward for those starting out. With experience, and as the investment team grows, foundations gain the confidence and capacity to move into more complex guarantees and equity transactions. The bigger the team, the more ambitious a foundation can be.

Foundations typically use outside asset managers to assist with endowment investments. Those beginning to incorporate MRIs may need to add asset managers explicitly committed to impact investing. That’s the path followed by CeniARTH, a private family office committed to impact-first investing. CeniARTH has declared a goal of moving 100 percent of its roughly half a billion dollars in assets into what it calls an “Impact-First Capital Preservation” strategy. Investments will serve “demonstrably poor and underserved communities” but aim for capital preservation, not market-rate returns.” While CeniARTH makes some

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43 “Response, Recovery, and Resilience Investment Coalition,” Global Impact Investment Network.

direct investments, it primarily deploys capital through intermediary fund managers such as Global Partnerships, GroFin, Water Equity, and Root Capital.<sup>44</sup>

### Collaboration between Investment and Program Teams

It is critical for investment teams—whether assigned to PRIs, MRIs, or both—to establish close working relationships with program teams. These teams have very different backgrounds, skill sets, and cultures, which creates opportunities for a lot of knowledge sharing but also necessitates careful management. Program officers are experts in their fields and deeply immersed in foundation priorities. They can guide investment teams in aligning their quests for investable opportunities with programmatic goals. For its part, the investment teams can help program officers learn to spot potential deals and analyze financial statements and capital requirements for sustainable organizations.

At Kellogg, the investment and program teams collaborate closely, bringing different skills and perspectives. “The most successful investments we’ve made are those where our program officers and investment officers operate in lock step,” said Cynthia Muller, Kellogg’s director of mission investments.

At Ford, the investing and program teams work closely together, aligning on opportunities where the use of investment capital can help to scale or complement the program team’s strategies. “The different approaches and strategies taken by the program teams and our mission investing team collectively helps advance the Foundation’s social justice mission,” noted Christine Looney, Ford’s deputy director of mission investments.

Other foundations have learned to calibrate carefully the number of programs where they deploy investments to ensure that investment team members can effectively collaborate with program staff over time. That’s what happened at the MacArthur Foundation. “We had a lot of programs and three investment people spread pretty thin for years,” said Debra Schwartz, MacArthur’s managing director of impact investments. She now has an investment team of eight, which she supplements as needed with advisors who bring specific content or domain knowledge. MacArthur also has trimmed the number of active program areas supported by investments. “As a result, our impact investing team members can now participate in our program team meetings.” She added “It’s vital. We can’t have grant and investment integration without it.”

### From Grantmaker to Asset Manager for Social Good

Close collaboration between program and mission investment teams lays the groundwork for transitioning from a grant-centric mode of thinking to a holistic approach that asks what grant or investment tool best serves the need at hand. The shift in thinking reimagines foundations as asset managers for social good.

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“The most successful investments we’ve made are those where our program officers and investment officers are in lock step.”

CYNTHIA MULLER, DIRECTOR, MISSION INVESTMENTS, W.K. KELLOGG FOUNDATION

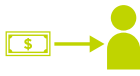
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<sup>44</sup> Diane Isenberg, “Fighting poverty and remaining rich: Ceniarth shifts portfolio to impact-first capital preservation,” *ImpactAlpha*, August 20, 2018, [requires free registration or paid subscription].



## Philanthropy's Investing Toolbox



|                   | Grants  | Loans   | Loan Guarantees  | Equity Investments  |
|-------------------|---|---|--|---|
| What it is        | Money given to nonprofits where they are required to track results and report back periodically           | Money given up-front to nonprofits/ small businesses to be paid back with interest  | The foundation agrees to cover an investor's losses (up to a certain amount/ under agreed-upon conditions) if the borrower fails to make timely repayments   | Purchasing an ownership stake in a mission-driven company or social enterprise  |
| Who it invests in | <ul style="list-style-type: none"> <li>• Nonprofits (without future recurring revenue streams)</li> </ul> | <ul style="list-style-type: none"> <li>• Nonprofits (with sources of recurring revenue)</li> <li>• Small businesses</li> <li>• Social enterprises</li> </ul>  | <ul style="list-style-type: none"> <li>• Mission-driven projects and enterprises</li> </ul>  | <ul style="list-style-type: none"> <li>• Mission-driven companies</li> </ul>  |
| Why it's useful   | <ul style="list-style-type: none"> <li>• Helps nonprofits provide essential services</li> </ul>           | <ul style="list-style-type: none"> <li>• Helps cover up-front costs</li> <li>• Meets unexpected costs not covered by grants</li> <li>• Provides capital unavailable from traditional sources</li> <li>• Complements place-based work</li> </ul> | <ul style="list-style-type: none"> <li>• Encourages conventional investors to support community development projects</li> <li>• Can extend to projects with regional/national scopes</li> <li>• Advances philanthropic work while expending no money up front</li> </ul> | <ul style="list-style-type: none"> <li>• Gives foundations a seat at the governance table</li> <li>• Results in financial and social dividends if the enterprise prospers</li> <li>• Helps facilitate scaling of a solution to a social or environmental problem</li> </ul> |

Source: The Bridgespan Group

Foundations new to impact investing typically maintain a grant-centric view of their work with occasional investments “bolted on.” Packard, for example, acknowledges the challenges involved with more closely integrating impact investing with grantmaking. “In the past we created grantmaking strategies and then looked for mission investments that fit them,” former Packard President Carol Larson wrote in *Stanford Social Innovation Review*. “Moving forward, we are developing climate mitigation strategies that incorporate both grantmaking and mission investing from the outset.... Our goal is to coordinate our grantmaking and mission investing, and to explore new platforms that attract more diverse, larger grant and mission investment capital to renewable energy and other climate mitigation projects.”<sup>45</sup>

45 Carol Larson, “Amplifying Impact with Mission Investments,” *Stanford Social Innovation Review*, January 19, 2017.

Packard pressed ahead with a more holistic approach to investing in climate change in large part because the market presents so many opportunities for investment, said Silver. For Packard and others, program areas with less developed or nonexistent market potential continue to be best suited for grants.

The Heron Foundation has fully made this strategic shift after “deciding to merge our program side and investing side into a single unit that deploys all the foundation’s capital (financial, social, reputational, intellectual, and moral, etc.) in pursuit of our mission.” Heron no longer separates grantmaking from investing “as if they exist in two different worlds,” then-CEO Clara Miller wrote in a 2016 *Nonprofit Quarterly* article describing the foundation’s new investment strategy.<sup>46</sup>

An integrated investment policy dramatically shifts how the foundation thinks about deploying assets for social good. Heron now looks to tailor its investment approach to meet the individual needs and circumstances of the enterprises it invests in, whatever those might be. This has significant operational implications. Heron now has an integrated team dedicated to deploying the foundation’s assets for mission. “While each member of our team arrives with a different level of expertise in finance and investing across asset classes (and including grants), all are expected to move up the learning curve,” Miller wrote. But this kind of mindset shift isn’t easy. At Heron, “the transition involved philosophical and cultural changes, alongside process and personnel changes,” she added.

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“While each member of our team arrives with a different level of expertise in finance and investing across asset classes (including grants), all are expected to move up the learning curve.”

CLARA MILLER, FROM “BUILDING A FOUNDATION FOR THE 21ST CENTURY,” *NONPROFIT QUARTERLY*

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Despite the challenges, we expect foundations increasingly will explore redesigning their strategies to think holistically about deploying the right capital tool to maximize the impact they wish to see, along with making associated operating model adjustments.

## Impact Investing Will Continue to Change How Foundations Work

The rising sophistication of impact investing has sparked new interest among US foundations to act like investors, not grantmakers. The untapped potential is tantalizing. While only a small percentage of foundations have ventured into impact investing, the recent Foundation Source survey found most expressed interest in trying it.

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46 Clara Miller, “Building a Foundation for the 21st Century: Part 2—Opening the Terrarium,” *Nonprofit Quarterly*, June 9, 2016.

For those considering a move from the sidelines, the experienced philanthropic impact investors we interviewed offered practical advice:



**Choose the right tool:** Match investment tools to the problems you are looking to address.



**Use your full endowment:** Consider ways in which you can use your full endowment (not just your annual disbursements) to generate positive social or environmental change.



**Place racial and gender equity at the center:** Make equity, racial and gender, a centerpiece of how you think about investing for impact.



**Match your strategic ambition to your capabilities:** Small investment teams should consider working with outside fund managers or limiting their scope to debt transactions. Larger teams can take on more complex guarantees and equity investments.



**Build out an investment team:** When building an investment team, hire experienced impact investing professionals and encourage them to work closely with program teams to ensure investments align with programmatic objectives.



**Collaborate with peers:** Given the complexity of effectively deploying impact investing tools to achieve meaningful change, consider opportunities to collaborate with peers, particularly those with significant experience of harnessing impact investing.



**Make the mindset shift from grantmaker to asset manager:** This shift means taking a holistic approach to identifying the proper financial tool for problem at hand.

Making impact investing part of foundation strategy can be a challenging journey with uncomfortable twists and turns as existing ways of thinking and working collide with new ideas. Those who have made the journey acknowledge the benefits.

Impact investing gives foundations tools to achieve social or environmental benefits that grants alone could never duplicate. Loans, guarantees, and equity investments can support community revitalization, build businesses, stoke innovation, and make risky bets safe for conventional investors. No problem is too big or too small. Impact investments can provide a loan to a restaurant or hair salon, or channel capital to take on structural racism or combat climate change. The possibilities are limited only by the imagination—and the willingness of more foundations to embrace a new way of thinking and working.

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### About The Bridgespan Group

The Bridgespan Group is a global nonprofit organization that collaborates with mission-driven organizations, philanthropists, and investors to break cycles of poverty and dramatically improve the quality of life for those in need. With offices in Boston, Mumbai, New York, San Francisco, and Johannesburg, Bridgespan's services include strategy consulting, leadership development, impact investing, philanthropy and nonprofit advising, and developing and sharing practical insights.

### About the Kresge Foundation

The Kresge Foundation was founded in 1924 to promote human progress. Today, Kresge fulfills that mission by building and strengthening pathways to opportunity for low-income people in America's cities, seeking to dismantle structural and systemic barriers to equality and justice. Using a full array of grant, loan, and other investment tools, Kresge invests more than \$160 million annually to foster economic and social change. For more information visit [Kresge.org](http://Kresge.org).

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