Upstart Co-Lab

Our Cultural Institutions: Mission, Values and Impact Investing

Updated October 2020

What is impact investing?

Impact investing is defined as investing with the intent to generate positive, measurable social or environmental impact alongside financial return.[1] It is an investment approach, applicable to all asset classes, that counters the traditional separation of environmental, social, and governance risk factors from investment decisions that are focused on financial returns alone. Impact investors consider how their investments align with their social and/or environmental goals and values, as well as their financial return objectives.

While terminology varies among practitioners, for our purposes impact investing is the umbrella term that includes concepts such as Mission-Related Investing, Sustainable Investing, Triple-Bottom Line Investing, "ESG" (investing in companies operating with best Environmental, Social and Governance practices) and "SRI" (Socially Responsible Investing, or Sustainable, Responsible and Impact Investing). For definitions of commonly used terminology, please refer to the end of this document.

While the term impact investing was only coined in 2008 and the mainstreaming of this approach is 10 years old, the underlying philosophy has many examples throughout history. Investors have long used their investments to reflect their values and drive social change: from Quakers who refused to allow their financial resources to support the slave trade, to religious orders that would not invest in "sin stocks," to the anti-apartheid divestment movement of the 1980s.

In addition to such negative screening,[2] more proactive strategies have emerged. These approaches do not simply limit the investable universe through exclusion but actively engage constructive opportunities. Community Development Financial Institutions (CDFIs[3]) target investments to generate economic opportunity in underserved communities. Impact venture capital funds strategically invest in companies that promote renewable energy, or intentionally back women entrepreneurs. Pooled funds of public equities, built around themes like social justice or the United Nations Sustainable Development Goals,[4] invest in companies with aligned best-in-class corporate practices.

Does impact investing mean sacrificing financial return?

Often the first question asked about impact investing is whether investors sacrifice financial returns when incorporating social and environmental concerns into their investment considerations.

There is a preponderance of evidence demonstrating that impact investing does not inherently sacrifice financial return and can actually outperform conventional investment strategies. In *Sacrifice Nothing*, a 2019 report summarizing a review of 2,200 studies assessing the connection between ESG criteria and investment performance in multiple asset classes, advisory firm Cornerstone Capital concluded that "the results of these studies have consistently confirmed that social screens do not compromise investment performance."[5] Other financial institutions have confirmed similar findings across asset classes, and impact investors have shared consistent experiences from their own portfolios.

By Asset Class

Public Equity: Morgan Stanley's study of the performance of nearly 11,000 sustainable mutual funds from 2004 to 2018 concluded that "there is no financial trade-off in the returns of sustainable funds compared to traditional funds, and they demonstrate lower downside risk."[6] Similarly, Nuveen's study of the performance of responsible investing stock indexes since inception (ranging from 15 to 27 years) compared to the S&P 500 and Russell 3000 found "no systematic differences in the long-term performance," a finding that is "remarkable considering the (responsible investing) indexes included only a portion of the stocks in broad market indexes."[7] And outperformance is possible: the oldest impact investing public equity index, the MSCI KLD 400 Social Index, which includes large, mid, and small cap U.S. companies with outstanding ESG ratings, has out-performed its benchmark, the MSCI USA, for the period from May 1994 to the present, as well as for the trailing one-, three-, and five-year periods.[8]

Corporate Bonds: Barclays' 2016 study, *Sustainable Investing and Bond Returns*, found that "a positive ESG tilt resulted in a small but steady performance advantage," and found no negative performance correlation with bond issues with high ESG scores.[9] Deutsche Asset & Wealth Management found a "disproportionate positive correlation between ESG and corporate financial performance as it relates to nonequity classes such as bonds and real estate."[10] The bond funds included in the previously mentioned Morgan Stanley study found no statistically significant difference between sustainable taxable bond funds and traditional funds.

Private Equity: In a 2015 analysis, the Global Impact Investing Network and Cambridge Associates compared the financial performance of their private equity and venture fund Impact Investing Benchmark with the performance of 705 peers, finding that funds that "pursue social

impact objectives have recorded financial returns in line with a comparative universe of funds that only pursue financial returns."[11] Also in 2015, *Great Expectations: Mission Preservation and Financial Performance in Impact Investing*, a Wharton School study focused on the tradeoffs private equity funds face between maximizing financial returns and ensuring the preservation of portfolio companies' missions, demonstrated that concessionary returns were not necessary in order to preserve the social or environmental purpose of 53 global private equity impact funds.[12]

By Investor Type

Institutions: The Global Impact Investing Network (GIIN) is a membership network of more than 20,000 asset owners, asset managers and service providers around the world seeking to accelerate the development and adoption of impact investing. In the GIIN's 2020 Annual Impact Investor Survey,[13] over 88% of respondents reported financial performance in line with or exceeding expectations. In addition, respondents indicated that across strategies and asset classes, top quartile funds seeking market-rate returns perform at similar levels to peers in conventional markets.

Universities: A 2020 Intentional Endowments Coalition report[14] on the performance of eleven U.S. college and university endowments utilizing an ESG strategy provided additional confirmation of impact strategies: "For endowment fiduciaries asking whether they can implement mission-aligned strategies without sacrificing financial returns, these examples demonstrate that it is possible to take a thoughtful approach to ESG factors, have a meaningful impact in driving positive change for institutions' stakeholders and communities, and maintain or improve investment performance."[15] The *2017 NACUBO-Commonfund Study of Endowments* similarly found no significant difference in the average short- or long-term returns of universities using SRI policies versus those that did not incorporate SRI policies.[16]

Foundations: Foundations are also reporting impact investing strategies that are meeting or exceeding benchmarks. After moving its $150 million endowment from 40% to 100% mission alignment in 2016,[17] the F.B. Heron Foundation reported moving from second quartile to top quartile financial performance when compared with foundations of comparable endowment size. A 2019 study, *Divest Invest Philanthropy: Five Years after Launch,*[18] reported that 94% of the 60 philanthropic foundations that had divested from fossil fuels as part of the Divest-Invest pledge had experienced a "positive or neutral" impact on returns. In 2020, the Rockefeller Brothers Fund reported that since committing to fully align investments with mission, financial performance has outstripped the market benchmark, posting an average annual return of 7.76% versus a benchmark investment portfolio that returned only 6.71% annually over the five-year period that ended December 31, 2019.

What is the current status of impact investing?

The amount of capital committed to impact investing has grown significantly in recent years as leading global financial institutions add expert impact investing advisory teams and launch new impact funds in response to client demand and an evolving understanding of the role of business in society.

Growing Capital Allocations

According to US SIF Foundation's 2018 *Report on U.S. Sustainable, Responsible and Impact Investing Trends*, over $12 trillion, or one-quarter of assets under professional management in the United States, were invested with impact investing strategies. This is triple the 2012 level, when decades of slow but steady growth began accelerating, and reflects a 38% increase over 2016.[19] $5.6 trillion of this capital belonged to institutional investors, including public funds, insurance companies, educational institutions, labor unions, and foundations, a 19% increase from 2016. Globally, SRI assets under management exceeded $30 trillion at the beginning of 2018, an increase of 34% over 2016.[20]

Top Financial Firms

Impact investing has expanded beyond boutique firms to the largest names in the financial industry: Apollo Global Management, Bain Capital, Bank of America, BlackRock, Blackstone, Goldman Sachs, J.P. Morgan, Morgan Stanley, and UBS all have dedicated impact investing groups. The ImpactAssets 50 2020 database of leading private capital impact fund managers reveals that over half are managing $100 million or more, with 11 managing over $1 billion, including funds from Prudential Financial, LeapFrog Investments, and Turner Impact Capital.[21] Beyond this juried list, the $1 billion-and-up club includes funds from Generation Investment Management, KKR, and UBS, which has committed to investing $5 billion aligned with the United Nations Sustainable Development Goals,[22] and has made sustainable investments "the preferred solution" for clients of its $2.6 trillion global wealth management business.

A New Standard for Business

Corporations and financial institutions are responding to shifting expectations for the role business plays in society. In 2020, the Carlyle Group, one of the largest private equity firms in the world, announced a firm-wide commitment to "investing for impact," stating "it is precisely the societal goals of the impact investor – diversity and inclusion, environmental sustainability, responsible governance – that increasingly generate the above-market returns sought by the market as a whole."[23]

In its 2019 Statement on the Purpose of a Corporation, the Business Roundtable, an association of CEOs of the largest U.S. companies, made a commitment to all stakeholders – including customers, employees,

suppliers, communities and the environment – as well as shareholders, and "urge(d) leading investors to support companies that build long-term value by investing in their employees and communities."[24] A 2020 progress report finds that signatories still have progress to make in shifting corporate practice.[25]

In 2019, Ray Dalio, founder one of the world's largest hedge funds, Bridgewater Associates, published his views on the potential of impact investing in *Why and How Capitalism Needs to Be Reformed (Parts 1 & 2)*.[26]

Since 2018, Larry Fink, CEO of BlackRock, the world's largest asset manager, has stressed the link of profit to sustainability, long termism and purpose in each of annual letters to shareholders and CEOs. In his 2020 letters, he affirmed "sustainability should be our new standard for investing."[27]

Racial Equity

Responding to nationwide calls to reckon with racial injustice, U.S. impact investors are deploying capital to funds led by Black managers, funds that focus on Black-owned companies, and companies enabling Black prosperity. They are reconsidering criteria that might be exclusionary when selecting fund managers, for example requiring a GP commitment of 2% of capital in private equity funds. Investors are also actively avoiding companies such as pay day lenders that perpetuate injustice and harm in Black communities, and are voting their proxies to promote diversity, equity and inclusion within public companies.

Foundations and other impact investors are prioritizing the selection of racially diverse managers in an effort to address implicit bias and other factors that constrain capital allocation to Black-led companies. Currently 26 of the nation's 50 top foundations have allocated an estimated $5.93 billion, or 9.3%, of their $64 billion in assets to firms led by people of color.[28]

Investment firms owned by white men represent 98.7% of all AUM in the U.S.[29] Given the lived experience and networks of the predominantly white fund managers controlling the majority of investment capital, it is not hard to imagine why Black business founders received just 1% of venture capital investment over the last five years. Investors are hiring diverse fund managers not just for reasons of equity, but because these managers are identifying untapped opportunities, resulting in over-representation in the top quartile for fund performance.[30]

Upstart Co-Lab's research has revealed a correlation between the creative economy and entrepreneurs of color. Businesses in the $878 billion U.S. creative economy drive local economic development and community wealth building, while reflecting the culture, tradition, and heritage of a place through food, media, fashion, design, health & beauty, and more. 38% of all minority-owned businesses in the U.S. are in the creative economy, which Upstart believes reflects lower barriers to entry compared to other sectors and the role that originality and merit play in business success.

Demonstrating how the creative sector can be a source as well as a use of impact capital, media giant Netflix is reallocating $100 million of its cash holdings from global banks to community development finance institutions and Black-owned lenders where it will benefit Black-owned businesses.

Why do institutions engage in impact investing?

Institutions are utilizing impact investing to further their mission and values, and respond to the demands of constituents and stakeholders. US SIF's 2018 report noted that for the $317 billion of educational institutions' ESG-managed assets, the top impact criteria included tobacco, governance, climate change/carbon, and diversity, likely influenced by nation-wide student and staff protests. Foundations' $68 billion in ESG-managed assets also prioritized human rights, sustainable resources/agriculture, affordable housing, and fair consumer lending.[31]

Foundations

The Rockefeller Brothers Fund has divested from fossil fuels and added impact investments in renewable energy and other environmental innovations, as well as affordable housing and health-related funds. RBF's investments in global equity funds focus on factors including carbon emissions and land use, labor management, health risk, and board diversity. Board member Justin Rockefeller acknowledged the irony of divestment given the fossil fuel origin of the foundation's endowment, but noted that fighting climate change was a key RBF program area: "we realized that our investment decisions can help or hurt our mission and we had to make sure the two aligned."[32]

The Ford Foundation's $1 billion commitment to mission-alignment of its endowment followed decades of pioneering program-related investments made from its grant budget (i.e. low interest rate loans with the primary purpose of advancing mission). Foundation President Darren Walker explained, "We are making this commitment because we believe Mission Related Investments have the potential to become the next great innovation for advancing social good. We can't neglect the tremendous power of markets, including the capital markets, to contribute—and with today's announcement, we are putting a significant amount of our money where our mission is."[33] With a mission to challenge inequality, Ford's initial strategy focuses on private investments with diverse managers and fund portfolios that provide quality affordable housing, expand access to financial services for the underserved, and create quality jobs.

Cultural Institutions

Since 2018, the Louvre Museum has allocated 5% of its €250 million Endowment Fund to socially responsible investment with a focus on artisan and traditional craft businesses, cultural tourism, cultural heritage and other themes connected to the Museum's mission.[34] The Louvre is an anchor investor in Eiffel Tourisme

et Culture, an impact fund focusing on cultural tourism in France from impact fund manager Eiffel IG, and Patrimoine Vivant, a private equity fund focused on European artisan and traditional craft businesses from socially-responsible Mirabaud Asset Management.

Since 2015, the Arts Council of England, along with philanthropic and community-focused institutional investors, has invested in Nesta's Arts Impact Fund and Arts & Culture Impact Fund to make capital available to arts organizations and social purpose creative economy businesses in the U.K. that drive social impact in the areas of youth and education attainment, citizen and community, and health and well-being. The Arts Council of England also invested in the Creative Land Trust in 2018 to secure long-term affordable space for artists and creatives in London.

In the U.S., the Field Museum and the American Museum of Natural History pledged in 2016 to divest from fossil fuels in alignment with their program and policy stance on climate change. Similarly, in 2015, California Institute of the Arts (CalArts) divested from fossil fuels in response to pressure from students and alumni.

In the last two years, the Andy Warhol Foundation has moved 25% of its $280 million endowment to a socially responsible strategy; the Souls Grown Deep Foundation adopted a 100% for impact investing policy; and Building for the Arts and Creative Capital each invested from their endowments in the Local Initiative Support Corporation's NYC Inclusive Creative Economy Fund, the first fund for impact investing in the creative economy in the U.S.

Conclusion

As cultural institutions face challenges related to tainted donations, the public trust, and resource constraints, impact investing provides a viable approach to address these issues in an effective and comprehensive manner that does not impede financial performance. There is an opportunity for America's leading cultural institutions to set an example by aligning investment of their endowments with their role as anchor institutions in livable communities; the commitment they express to diversity, equity, and inclusion; and their stewardship responsibility as caretakers of our treasures across the generations.

A NOTE ON TERMINOLOGY

The field of impact investing encompasses many overlapping terms. Please see below for definitions of the most common ones, sourced primarily from the Mission Investors Exchange (MIE) online glossary:[35]

Environmental, Social and Governance (ESG) factors are nonfinancial data which investors may consider as part of their investment analysis as a way to evaluate whether their investments promote sustainable, fair and effective practices and mitigate potential risks.

Impact investments are investments made into companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets and target a range of returns from below market to market rate, depending upon the circumstances. Impact investors actively seek to place capital in businesses and funds that can harness the positive power of enterprise.

Mission Related Investing (MRI) is the practice of foundations who invest to advance their missions and programmatic goals. A mission investment can be either a program-related investment (PRI) or a mission-related investment (MRI). Private foundations make PRIs as part of their annual distribution strategy. MRIs are risk-adjusted, market-rate investments made from the foundation's assets. MRIs are not an official IRS designation and are conventionally distinguished through the explicit advancing of the foundation's mission and programmatic goals. Opportunities for MRIs exist across asset classes and issue areas.

Socially Responsible Investing (SRI), socially conscious, "green" or ethical investing, which is any investment strategy which seeks to consider both financial return and social good. In general, socially responsible investors encourage corporate practices that promote environmental stewardship, consumer protection, human rights, and diversity.

Sustainable investing is investing with long term gains expected in social, environmental and governance areas. A vision of a sustainable future is set as a reference point for developing strategic actions.

Endnotes

1 www.thegiin.org/impact-investing/need-to-know/#what-is-impact-investing

2 Negative screening refers to the exclusion of companies that do not comply with specific, pre-set social or environmental criteria.

3 Community financial development institutions (CDFIs) are private financial institutions committed to expanding economic opportunity in low-income communities by providing access to financial products and services for local residents and businesses. See

4 The seventeen United Nations Sustainable Development Goals (SDGs) were adopted by all UN Member States in 2015 as a universal call to action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity by 2030. See www.undp.org/content/undp/en/home/sustainable-development-goals.html

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