Aligned Investing:
Tools for Philanthropic Success

Thank you for inviting me to speak with you today.

My goal, my work, is all about helping philanthropic individuals and institutions do their work better. We bring data, research, analysis, strategy, and measurement tools to people who have put their resources where their personal interests and passions are.

The American philanthropic industry is one of this nation's greatest inventions. Its diversity, freedom, and scope are unmatched. The system allows all of us to make decisions about how we want our charitable funds to be used. It requires only that the funds be accounted for, used ethically, and for legitimate charitable purpose.

I frame the issues this way because philanthropy is an odd beast – it is personal, fragmented, and anonymous. It is also strategic, brand-oriented, and – in the aggregate – enormous. Its most generous participants – as measured by percent of net worth given – tend to be the poor, not the rich.

I also believe that whatever causes individual or institutional philanthropists choose to support, they do so because they really want to make those things better. The definitions of "problems" and "better" range across the full spectrum of American diversity – political, racial, religious, gender, sexual orientation, and geographic. A foundation for free market education is as legitimate as one for the preservation of Marxist theory. Foundations can support pro-life organizations and they can support pro-choice organizations. Though you probably can't find one that is working on both side of that issue.

While the range of issues they can support is almost limitless; the number of tools that philanthropists have at their disposal is rather small. They have really 7 things to bring to

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the table: money, knowledge, time, expertise, connections, patience, and independence. Using each of these tools well, and making the most of them in combination, is the challenge for successful philanthropists.

Endowed foundations are usually thought of in terms of only one of these tools – their money. So far everyone on this panel has noted the size of certain foundations as being relevant to the reasons they should do one thing or another. I'm much less of a size freak than others – I don't equate bigness with effectiveness.

I do equate strategy, knowledge, and alignment with effectiveness. Which is why it makes sense that you won't find one foundation supporting both pro-life and pro-choice activities with its grant funds. Similarly, it makes sense that a funder wouldn't support a set of organizations with its right hand – (its grant dollars) – while investing in other organizations with its left hand – (its endowed dollars) – that are odds with the first.

When I consider the chance to use 100% of my resources to accomplish my goals versus using 5% the smarter choice is to use more of what I have available.

When I consider the opportunity to apply effective management principles to both the selection of grant investments and the selection of asset investment choices it makes sense to do both.

And when I consider that endowed foundations are essentially in the business of choosing management teams and making investments in them – on both the grants side and the investment side – it is clear that what foundations need are clear, consistent principles of good management and wise investing on both sides of the house.

Actually, I stole that last idea from a certain investor named Warren Buffet. Buffett has often said, "I never made a good investment in a company with bad management." He has practiced this for decades at Berkshire Hathaway. Buffett also use these principles to

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explain his choice to invest his philanthropic dollars in an established foundation. Management matters.

So what does using endowment dollars to advance a social mission have to do with "good investments and good managers?" Just about everything.

There are more than 38,000 public companies in which you can invest your money. Obviously, we need some kinds of screens to whittle this number down to a manageable portfolio. Many of the screens investors use are quantitative. But businesses are creatures of context and leadership – and quantitative measurements are not all that good at measuring either of those variables.

Qualitative management screens are what help at this stage. How to find the leaders to back, the external conditions that will force change or require innovation, or understand customer trends – these are what hedge fund managers, angel investors, venture capitalists, industry analysts, and, yes, Warren Buffett, use when making **qualitative judgments about management**.

There is a set of these qualitative management measures that look at how a company will succeed given the limits of our **environmental** resources – what economists call a "carbon constrained economy" and what the rest of us –Jon and his AEI colleagues notwithstanding - call global warming. These measures have actually served as "searchlights" in finding companies that are leading the way on alternative fuels, clean technology, and sustainable business practices. The result – Toyota ROI is 10:1, Ford is flat, GM, hmm, not so good. The result – a better bottom-line for the companies, a better return for investors.

There are sets of these qualitative management measures that look at **social** issues – how the company values a diverse management team, how it treats its employees, how it seeks a workforce that represents and reflects the demographics of its desired customer base. Once again, these measures are helping investors identify companies with lower

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employee turnover, greater innovation, and more profitable R & D. The result - a better bottom-line for the company, a better return for investors.

Finally, excellent companies need both top-notch management and high quality **governance**. The qualitative management measures that screen for governance standards help investors spot problems before they show up on the P & L statement, or worse, with board members doing the "perp walk" on the evening news. The result – a better bottom-line for the company, a better return for investors.

These are predictive measures. They are tried and tested that help investors select the best performing companies in their classes.

There are also opportunities for investors to use their role as shareholders to effect change at companies that might meet some, but not all, of the management standards. While we think of recycled paper as a standard option nowadays, available at any office supply store, it was **shareholder activism** that led places like Office Depot and Staples to stock these options. It was shareholder activism that moved HP and Apple to adopt goals for use of recycled products, Time Warner to change the paper it prints on, and Coke and Pepsi to source recyclables for their soda bottles. The results –better bottom lines for the companies, better returns for investors, foundation missions supported.

Finally, when resources are limited its always good to find a way to use them once, get 'em back, and use 'em again. Taking a lesson from community banks, credit unions, and even microfinance mavens, more and more endowments are discovering the ROI they can achieve by making some of their assets available to communities in the form of low-interest loans and program related investments. The money is invested directly in communities or enterprises that further the foundation's mission. The investment/loan is paid back and the foundation does it again. These activities truly bring both sides of a foundation house together – the grant side and the investment side – in pursuit of the organization's missions. The result – a better bottom line and social goals supported.

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There are tools, indices, investment advisors, peer organizations, and research available to help endowment managers do this. The industry of social responsible investing – which support the development of the ESG management screens, shareholder activism, and community investing – currently manages 1 in every 10 dollars managed professionally. More than $2.29 trillion dollars of the $24 trillion in managed assets in 2005 were in SRI investments. Historic trend data showing that the indices built around these kinds of investments outperform other major indices – the Domini 400 has bested the S & P 500 over the last 15 years, and foundations with actively managed SRI portfolios have beat the S & P at 1, 3, 5, and 10 year intervals – in both real and risk adjusted returns. There is no tradeoff between investing in line with an organization's mission and reaping strong returns. Doing the former may even improve the latter.

And this is what finally matters. Endowment directors have a fiduciary responsibility to use the resources under their management for the public good. Not 5% of the resources, all of the resources. The tools of aligned investing – the use of qualitative management screens, shareholder activism, and community investing – allow philanthropists to develop strategies that use everything the foundation has to achieve its goals. Whatever those goals might be.

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