

Maximizing Impact:

An Integrated Strategy For Grantmaking and Mission Investing in Climate Change

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FSG Social Impact Advisors is an international nonprofit consulting and research organization dedicated to accelerating social progress by advancing the practice of corporate social responsibility and philanthropy. Founded in 1999, FSG achieves its mission in three ways:

- **Advice** – Advising leading foundations, corporations, and nonprofits on how to increase social impact through strategy development and evaluation
- **Ideas** – Developing and sharing original research and innovative approaches
- **Action** – Identifying long-term initiatives that address critical challenges and opportunities in the field

FSG's staff of international consultants combines the highest standards of strategy consulting with a deep understanding of philanthropy and the nonprofit sector. Our ideas are regularly featured in such publications as *Stanford Social Innovation Review*, *Harvard Business Review*, *The Chronicle of Philanthropy*, and many others.

This study is the fourth in a series of research reports on key elements of mission investing, developed as part of a multi-year FSG initiative devoted to helping foundations better understand and utilize this important philanthropic vehicle.

For more information and additional resources, see www.fsg-impact.org.

About the Surdna Foundation

Surdna is a family foundation established in 1917 by John Emory Andrus. The foundation makes grants in the areas of environment, community revitalization, effective citizenry, the arts and the nonprofit sector, with annual grantmaking of approximately \$37 million.

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I. Executive Summary

Very few funders have yet developed a comprehensive approach that links mission investing and grantmaking into a single integrated strategy.

I. Executive Summary

Foundations and individual philanthropists are increasingly choosing investments that advance their social missions and also earn financial returns. The market for these mission investments (also known as program-related investments (PRIs), mission-related investments (MRIs), or impact investments) has grown rapidly in recent years. Very few funders, however, have yet developed a comprehensive approach that links mission investing and grantmaking into a single integrated strategy.

This study addresses that challenge. It is intended to help funders who are already familiar with mission investments to more tightly connect their investments with their grantmaking in ways that create greater social impact.

When funders combine grants and investments together, they can address problems more comprehensively than they could through grants alone. After all, global capital markets dwarf philanthropic funding, and environmental problems are influenced at least as much by market forces as by nonprofit grantees.

Funders are beginning to discover that, just as they use grants to influence the social sector, they can use mission investments to influence commercial enterprises and financial markets. These two different uses of funds produce different types of social impact. When combined in thoughtful and creative ways, grants and mission investments can reinforce each other and accelerate progress toward specific program goals. Developing such an integrated approach, however, requires a new way of thinking about foundation strategy.

When funders combine grants and investments together, they can address problems more comprehensively than they could through grants alone.

This study focuses on the link between mission investing and grantmaking as applied to the specific area of climate change, an urgent social issue that also offers many investment opportunities. The strategic framework we have developed for climate change, however, can guide funders who want to develop an integrated grantmaking and investment strategy in any program area.

Mission investments are usually categorized by asset type or as PRIs versus MRIs. We categorize them instead according to the three different ways they achieve social impact:

Conventional investments offer market-rate returns such as publicly traded securities or venture capital funds. These investments serve to harmonize a foundation's investment portfolio with its values and mission. If the investments offer fully market-rate returns, then the foundation's investment may only augment or displace funds from ordinary investors, so little incremental social impact may be achieved. Shareholder advocacy and signaling offer two ways to increase the social impact of conventional investments. A foundation that holds stock in a public company, for example, could sponsor a stockholder resolution to reduce carbon emissions, thereby increasing the social impact of its investment.

Subsidized investments offer below-market rates of return. Subsidized investments achieve social impact because they enable projects to be undertaken that could not be commercially financed. The leverage they create is limited because only the foundation's own capital is put to work to achieve social impact. Given the extremely limited amount of philanthropic capital in the world, subsidized investments can efficiently achieve targeted objectives, but are less likely to create change on a national or global scale.

Transformative investments have the potential to achieve market-rate returns and attract conventional investors, although they are still perceived as too new or risky to access traditional capital markets. Foundations have the opportunity to absorb early risks and demonstrate the reliability of these investments over time, paving the way for much larger amounts of conventional capital to follow. In climate change, experimental financing mechanisms are beginning to emerge that use future energy savings to pay for retrofitting buildings. Foundations that demonstrate the viability of these investments over time may be able to attract a vastly larger pool of conventional capital and bring these financing vehicles to national or global scale.

Each type of mission investment serves a useful role in an integrated foundation strategy, although they reinforce program strategies in different ways and require different competencies within the foundation. Many funders already use some or all of these tools, but few have fully integrated these investments with their grant portfolios.

Incorporating mission investments into foundation strategy requires two steps:

First, funders must examine the economic and commercial factors that contribute to causing or alleviating the problem they seek to remedy. How do public companies, emerging businesses, and financing options influence the issue? In the case of climate change, what are the commercial sources of greenhouse gases, the costs and benefits of different options to reduce them, and the relevant financing vehicles currently available? For most foundations, this will be an entirely new dimension of their research and strategy development.

Funders must examine the economic and commercial factors that contribute to causing or alleviating the problem they seek to remedy.

Second, foundations need to analyze the potential for using conventional, subsidized, or transformative investments, based on their goals, competencies, and other program interests. For example:

- A funder concerned with reducing carbon emissions globally might use shareholder advocacy within a conventional stock portfolio to persuade multinational companies to report their carbon footprints.
- A regional funder interested in preserving local forests as a carbon sink might prefer subsidized investments to buy conservation land that generates minimal income.
- A more risk-tolerant foundation working to support green jobs might guarantee the first losses on a transformative investment fund that uses future utility bill savings to finance the installation of energy-saving equipment.

Mission investments can also bridge finance and program areas, breaking down the silos that divide foundation staff. All mission investments require that program and finance staff collaborate, which in itself is both a challenge and opportunity. This approach can build collaboration among different program areas, too. A foundation interested in economic empowerment as well as climate change, for example, could invest in enterprises that employ entry-level workers to install solar panels. Another foundation focused on international development might reduce deforestation in Latin America through investments in ecotourism businesses. A third funder focused on strengthening local nonprofits might finance energy-saving improvements that reduce their operating costs.

The greatest strategic value of mission investments comes not only from breaking down silos and using different types of investments appropriately, but also from combining them with grants in synergistic ways to achieve specific programmatic outcomes. Hybrid investments pair an investment with a grant to a related organization, for example, to provide technical assistance to an early-stage enterprise, or to evaluate the social impact of a mission investment.

Grants can also influence policies, knowledge, and attitudes that indirectly alter the expected returns of different investments. Advocacy grants to promote a tax on carbon emissions could promote policy changes that increase the value of an investment in alternative energy. Grant-funded research on advanced battery technologies could increase knowledge in ways that make a venture-capital investment in electric cars more attractive. A campaign to build public will for energy independence could overcome zoning objections that limit the investment potential of a commercial wind farm.

Mission investments, on the other hand, can increase the ability of individuals and organizations to implement the changes a foundation seeks to encourage. Shareholder advocacy can motivate companies to adopt better environmental practices; subsidized investments can spread the installation of technologies that are not yet cost-effective; and transformative investments can pioneer new financial instruments that greatly expand the number of people who can afford to make energy-conserving improvements.

As foundations become more comfortable with the basic concept of mission investing, they will find it increasingly important to maximize their impact by tackling social problems simultaneously from the grantmaking and investment sides in mutually reinforcing ways. Ideally, funders will develop an integrated grantmaking and investing strategy, using grants to influence the context and investments to influence the implementation of the same set of interventions. We offer this paper as an initial exploration in that direction.

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II. Understanding Mission Investing Today

New dollars annually committed to mission investments have increased nearly sixfold over the last three years.

“There are ways to combine MRIs, grants, and sustainable investing to develop innovative opportunities to create impact — so that two plus two can equal five.”

— David Blood, Senior Partner, Generation Investment Management

II. Understanding Mission Investing

Mission investing is defined as the practice of investing foundation assets with the intention of furthering a foundation’s mission and recovering principal or earning additional financial returns. These investments are also sometimes referred to as program-related investments (PRIs), mission-related investments (MRIs), or more recently, impact investments.¹ They can take the form of debt, equity, or cash deposits, and they can be funded from either program or endowment funds.²

FSG’s research suggests that U.S. foundations have steadily increased their use of mission investments over the past decade. Most recently the growth rate has accelerated substantially, as new dollars annually committed to mission investments have increased nearly sixfold in just the last three years. Of particular note, the W.K. Kellogg Foundation announced a \$100 million commitment to mission investments in 2008, and the Bill & Melinda Gates Foundation announced a \$400 million commitment in 2009, which together will more than double the annual amount invested by the entire foundation field in earlier years. Growth among small and midsize foundations has also been strong, and market-rate mission investments have been growing more rapidly than below-market-rate investments.

Mission investing offers a tremendous opportunity to increase the social impact of foundations. It puts to work the roughly \$1 trillion held in the investment portfolios of foundations around the world, almost none of which is currently invested in ways that directly advance their charitable objectives. At the same time, the most sophisticated foundations have demonstrated that a wide variety of mission investments can produce financial returns that meet or exceed traditional investment performance benchmarks. During the current recession, many mission investments have even outperformed conventional investment portfolios by fully preserving capital and generating positive returns.

¹ Program-related investments are specifically defined in the U.S. Tax Code and may qualify as part of a foundation’s annual payout requirement. Although PRIs are not legally restricted to below-market-rate returns, the term is often used to describe such investments. MRIs more often refer to market-rate investments. Impact investments, a term coined by the Monitor Institute and the Rockefeller Foundation, span both types of investments. In practice, however, all these terms are often used interchangeably.

² Grants are sometimes referred to as “investments” in the field, although there are no expectations of financial returns from grants. For the purposes of this paper, we have used the term investment strictly for opportunities that are expected to generate financial returns.

³ The More for Mission campaign is led by the Annie E. Casey Foundation, the F.B. Heron Foundation, and the Meyer Memorial Trust.

⁴ “Compounding Impact: Mission Investing by U.S. Foundations,” FSG Social Impact Advisors, 2007; “Aggregating Impact: A Funder’s Guide to Mission Investment Intermediaries,” FSG Social Impact Advisors, 2007; “The Power of Strategic Mission Investing,” Mark Kramer and Sarah Cooch, Stanford Social Innovation Review, Fall 2007; “A Brief Guide to the Law of Mission Investing for U.S. Foundations,” FSG Social Impact Advisors, 2008; “Philanthropy’s New Passing Gear: Mission-Related Investing — A Policy and Implementation Guide for Foundation Trustees,” Rockefeller Philanthropy Advisors, 2008; “Solutions for Impact Investors: From Strategy to Implementation,” Rockefeller Philanthropy Advisors, 2009; “Handbook on Climate-Related Investing across Asset Classes,” Boston College Institute for Responsible Investment, 2009; “Investing for Social and Environmental Impact: A Design for Catalyzing an Emerging Industry,” Monitor Institute, 2009. Additional resources can be found at http://www.fsg-impact.org/advice/Mission_Investing; <http://www.primakers.net>; <http://www.moreformission.org/>.

⁵ Clean technology has now become the largest venture sector, according to the Cleantech Group, and many investment portfolios now include clean tech investments.

Foundations have demonstrated that a wide variety of mission investments can produce financial returns that meet or exceed traditional investment performance benchmarks.

A number of organizations have recently begun new efforts to promote mission investing as an important vehicle for social change. Three major foundations have launched a “More for Mission” campaign and have established a research center at Harvard University to encourage mission investing.³ PRI Makers Network has substantially expanded its membership and online resources, the Rockefeller Foundation has created a Global Impact Investing Network, and Cambridge Associates, a leading foundation investment advisor, recently launched a social investment division. In addition, several recent studies from FSG and others have documented current practices and offered detailed guidance to foundations that want to explore this new option.⁴

Despite all this recent activity, the mission investment market remains thin. Apart from conventional venture capital investments in clean technology, mission investing involves relatively small amounts of capital, a limited number of investment opportunities, high transaction costs, and few qualified advisors or intermediaries.⁵ These factors are all interdependent: As invested capital increases, so too will the number of intermediaries and investment opportunities, leading to more efficient flows of information, better tools for quantifying social impact, and improved financial performance. These results, in turn, will encourage additional investment capital and lower transaction costs. Such an iterative cycle is already under way, and the market is steadily developing every year.

Even more challenging is the new way of thinking required to link together mission investments and grantmaking programs into a single comprehensive strategy that creates social impact.

Even the foundations that already make mission investments, however, often tend to do so opportunistically and sporadically, responding to loan requests from grantees or deals from colleagues that happen to come their way. This is partly due to the still underdeveloped state of the market, but also to the unusual skill set needed to blend an understanding of social impact with financial analysis. Given that program and finance staffs at many foundations rarely collaborate, opportunities to combine grantmaking and investment decisions to address a social issue remain uncommon. The most sophisticated foundations have overcome this problem through the formation of mission investment committees that combine program and finance staff, or through the hiring of specialized program staff with financial expertise.

Even more challenging is the new way of thinking required to link together mission investments and grantmaking programs into a single comprehensive strategy that creates social impact. Most foundations, after all, are accustomed to developing program strategies that work exclusively within the nonprofit sector. They may find occasional opportunities to make investments that align with their program goals, but they have generally not thought about a strategy to tackle social problems simultaneously from the grantmaking and investment sides in mutually reinforcing ways.

This report is designed for foundation trustees, CEOs, program and finance staff, and individual funders who want to take that next step.⁶ They are already familiar with the basics of mission investing and now seek to align their mission investments more

strategically with their grantmaking. We have focused on climate change, so our analysis and the examples throughout this report will be of most interest to funders concerned about this issue. The framework we have developed, however, offers guidance to any funder who wants to develop an integrated grantmaking and investment strategy in any program area.

We have focused on climate change because of its urgency and timeliness, as well as the number of foundations interested in the topic and the rich range of mission investing opportunities available. Climate change has emerged as one of the most prominent social challenges of our time, with models predicting an increase in the average temperature at the earth's surface ranging from 3.2 to 7.2 degrees Fahrenheit above 1990 levels by the end of this century.⁷ Such dramatic changes are expected to significantly affect all aspects of our lives, including health, agriculture, transportation, and security. Climate change is also a timely issue, as the recent conference in Copenhagen has generated new opportunities and global initiatives, and the Obama administration has proposed legislation in the U.S. that would change the economics of domestic carbon emissions.

Climate change is also an excellent example of the multidimensional nature of large-scale social problems. Many other issues that foundations address—such as poverty, homelessness, education, health, and the arts—are influenced not only by the social sector, but by commercial enterprises, market forces, and the range of financial instruments available. Climate change is not only impacted by government regulations and nonprofit interventions through conservation or education, but also by investments in new technologies and the behavior of large corporations across a range of sectors (see Table 1). A program strategy that focuses exclusively on what nonprofit organizations can do about such a problem addresses only one side of the issue and leaves out many other important leverage points for change.

Table 1: Potential Climate-Change Interventions in the Commercial Sector⁸

Sector	Potential Interventions
Power	Reduce emissions from coal plants; support alternative energy
Industry	Adopt carbon caps and trading; implement carbon-saving technologies
Buildings	Adopt green building codes; retrofit buildings; support utility reform
Transportation	Improve fuel and efficiency standards; invest in mass transit; support smarter urban growth
Forestry	Participate in carbon markets; reduce deforestation

⁶ Throughout the report we refer generally to “foundations” or “funders”; however, the principles and ideas are equally relevant for individual high-net-worth donors who want to use their personal investments to achieve social impact.

⁷ U.S. Environmental Protection Agency Web site, <http://www.epa.gov/climatechange> (accessed on March 10, 2010).

⁸ Adapted from “Design to Win: Philanthropy’s Role in the Fight Against Global Warming,” California Environmental Associates, 2007.

A Growing Number of Specialized Advisors and Investment Vehicles

A growing number of investment advisors and vehicles are now available to assist foundations with their mission investments, particularly in the climate change area. These intermediaries serve foundations interested in alternative energy, carbon markets, sustainable real estate, and green jobs.

Several players are now working with foundations on equity investments, including:

Cambridge Associates, founded in 1973, is a leading investment advisor working with many of the largest foundations. Cambridge started its Mission-Related Investing Group in 2008 to develop mission investing plans for its clients. In addition, Cambridge announced in September 2009 that it will work with such institutions as the Fetzer Institute and Meyer Memorial Trust, a private foundation based in Portland, Oregon, to develop an emerging-markets fund for U.S. institutional investors that is screened on environmental, social, and governance (ESG) investments.

Equilibrium Capital Group invests in and builds operating companies executing sustainability driven investment strategies. The companies represent the next generation of hard asset management firms in key sustainability sectors, including green buildings, energy, water, land, carbon, and food production. Equilibrium pairs the expertise of these companies with an innovative asset-management platform to scale their growth. Equilibrium also works with private foundations, such as Meyer Memorial Trust, to develop their mission investing portfolios. One of Equilibrium's portfolio companies, for example, is Gerding Edlen Development, a leading green real estate developer in the U.S. Given its extensive experience, the company is able to develop green buildings at lower cost than the industry average, while also creating green jobs through its work.

Imprint Capital Advisors, launched in 2007, helps foundations, family offices, individuals, and their advisors develop mission-investing portfolios across a range of issues. In the area of climate change, Imprint works on green technology, environmental markets (e.g., carbon finance), and real assets (e.g., forestry, real estate). Imprint primarily engages in investments through funds or managers, and currently works with 11 foundation clients, including the W.K. Kellogg Foundation.

SJF Ventures, established in 1999, is a venture capital firm that invests growth capital in companies focused on such issues as clean tech, recycling, and organic products. SJF II is a \$28 million fund that offers investors risk-adjusted market-rate returns. Current investments include PRIs for foundations. In 2001, it created SJF Advisory Services, a nonprofit that offers managerial advice to entrepreneurial companies. Some of SJF's portfolio companies include groSolar, a provider of solar electric and hot water technology for homes and businesses, and CleanScapes, which provides efficient public space cleanup and waste reduction services for cities and companies.

In the fixed income area, **Community Capital Management (CCM)** is an investment advisor that specializes in managing portfolios of market-rate "community development" bonds that support green design and environmental sustainability, some of which are backed by government securities. CCM offers both a mutual fund and separately managed accounts for its foundation clients. For example, CCM created a bond to finance the development of solar cells in Toledo, Ohio, which offered a yield of 650 basis points above comparable maturity Treasuries.



III. Incorporating Investments into Program Strategy

Incorporating mission investments into program strategy requires that a foundation understands how public companies, emerging businesses, and financial instruments influence the social issues it cares about.

“Foundations need to understand the economics of the issues they are concerned about to identify opportunities for mission investing and to create greater impact.”

— Jed Emerson, Managing Director for Integrated Performance, Uhuru Capital

III. Incorporating Investments into Program Strategy

Systematically incorporating mission investments into program strategy requires that a foundation study how public companies, emerging businesses, investment capital, and financial instruments influence the social and environmental issues it cares about.

For any given social issue, a foundation must consider such questions as:

- **Is the issue affected by the behavior of public companies?** Wal-Mart’s recent move toward energy efficiency in its 8,000 stores, for example, will have vast and immediate social impact, and it was prompted in part by shareholder advocacy.
- **Are there private investment opportunities to expand profitable companies that advance the foundation’s objectives?** Google.org’s \$60 million investment in early-stage alternative-energy companies has the potential to bring new sources of clean energy to commercial scale while earning venture capital returns.
- **Can the foundation identify high-impact investments that would only be viable at below-market rates of return?** An affordable housing project might be able to repay a low-interest loan to install solar panels from the savings on its energy bills, but not save enough to pay back a risk-adjusted market-rate loan from a commercial bank.

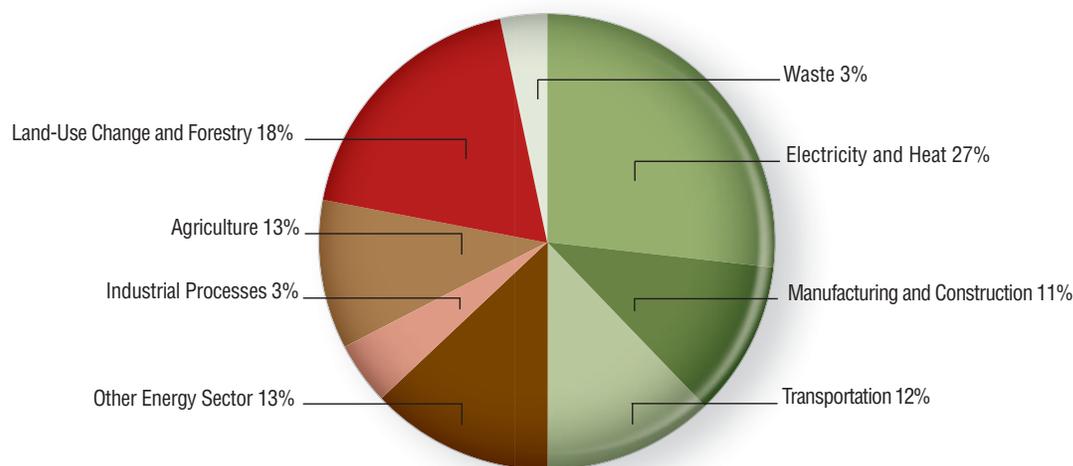
- **Can misalignments between program objectives and existing financial instruments be solved through new financing structures?** For example, tenants often pay energy costs, but landlords must pay for any capital improvements that would conserve energy. Unless a financing mechanism can transfer tenant savings into a return on a landlord’s investment, the financial and social incentives remain misaligned and energy consumption will not be reduced.

As they examine these different opportunities, foundations will discover that they can use their investments to address social issues more comprehensively than they can through grants alone. Yet it is still rare to find funders deliberately aligning their grants and investments in a coordinated strategy to advance a single set of program objectives.

Climate change is a particularly attractive area for studying the interplay between grants and investments.

Climate change is a particularly attractive area for studying the interplay between grants and investments, because the problem itself is deeply rooted in commercial activities. Consider the different sources of greenhouse gas emissions that contribute to climate change, as shown in Figure 1 below.

Figure 1. Sources of Global Greenhouse Gas Emissions



Source: EarthTrends, World Resources Institute, 2008, using data from the Climate Analysis Indicators Tool (CAIT).
<http://earthtrends.wri.org/updates/node/296>

In a traditional grantmaking strategy, a foundation might consider grants only to the limited number of specialized nonprofit organizations that have dedicated themselves to addressing climate change. Yet the wide range of commercial industries that contribute to greenhouse gas emissions shown in Figure 1 offers foundations a much wider set of opportunities to influence the issue.

In fact, the interconnected nature of social issues is often easier to address through investments that encompass multiple impacts than through the more specialized nonprofit organizations that focus on a single issue. For example, a McKinsey & Co. study found that nearly half of the most economically attractive carbon abatement opportunities involved forestry, agriculture, and waste disposal in developing countries (see Appendix C). Altering these practices to reduce greenhouse gases is inextricably tied to raising the income of smallhold farmers through agricultural development and improving the health of their families through safer cooking fuel. Foundations that consider the commercial factors behind climate change may find their greatest impact lies not in funding environmental nonprofits directly, but in funding global economic or agricultural development.

Similarly, a foundation that works in developed countries may discover that investing in energy-saving weatherization projects not only reduces carbon emissions, but it also creates entry-level employment opportunities that can revitalize depressed urban neighborhoods. Even foundations that do not consider climate change to be one of their program areas can address the issue indirectly through their investing. For example, the Christopher Reynolds Foundation, which focuses its grantmaking on U.S. relations with Cuba, invests 8 percent of its assets in private equity funds that focus on climate change.

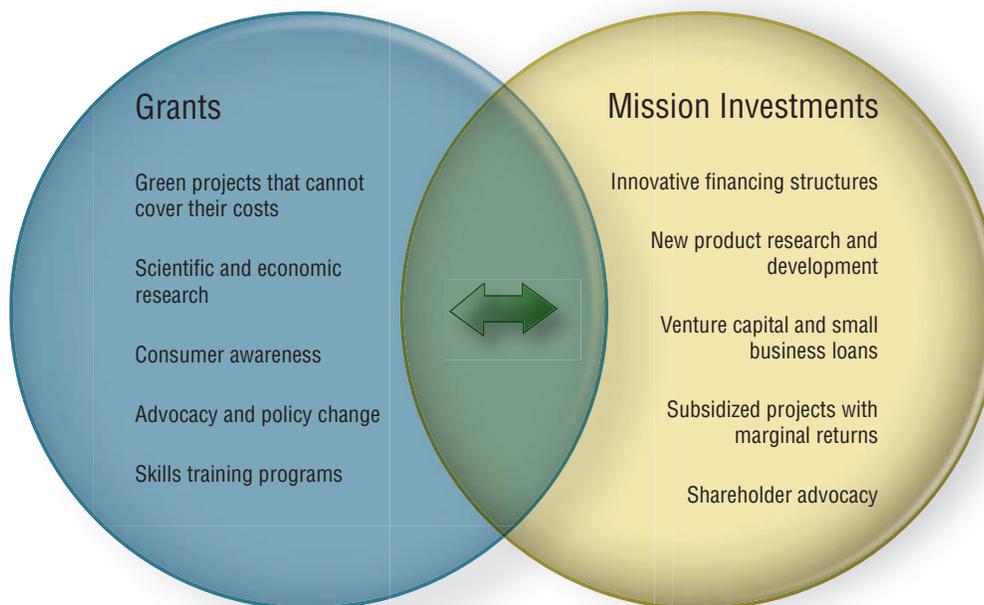
Mission investing can help to break down the traditional silos that isolate programs and functional areas.

In short, making the connections more explicit between multiple program areas through mission investing can engage foundation program staff, finance staff, and board members in a broader agenda and help to break down the traditional silos that isolate program and functional areas.

Mission investing provides foundations with a new set of tools through which to exercise their influence. Foundations can continue to use grants for advocacy and research where no financial returns are available to repay an investment. In addition, they can use investment capital to purchase forest land, invest in companies that provide clean energy, and influence global corporations to reduce their carbon footprints. Figure 2 below summarizes the expanded range of interventions available when foundations include mission investing in their strategy development.

To test our hypothesis that grants and investments together broaden the spectrum of potential interventions, we analyzed both the climate change grants and mission investments of the 26 foundations in our study (see Figure 3). We discovered a strong propensity to use grants in the areas of conservation, research, education, awareness, and public policy where financial

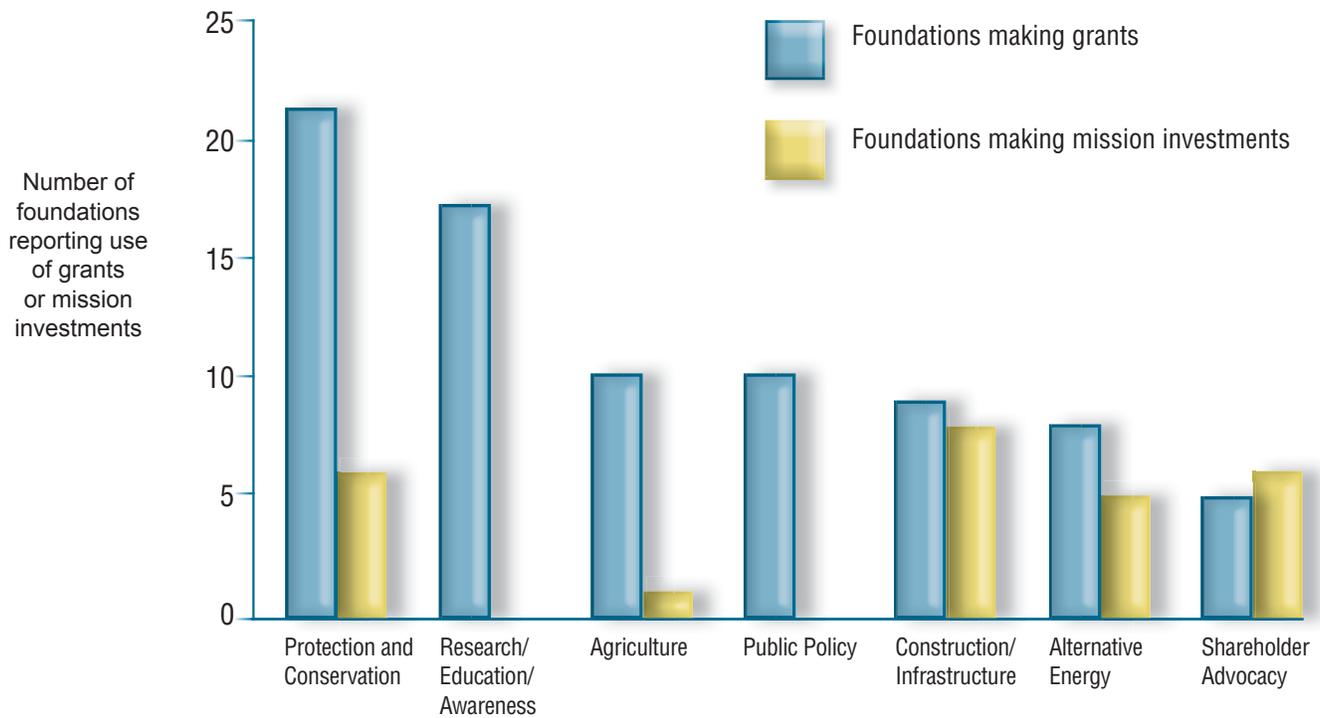
Figure 2. Potential Uses of Grants Versus Mission Investments



returns are rarely possible. Conversely, mission investments were concentrated in the areas of infrastructure, construction, alternative energy, and shareholder advocacy. A foundation strategy that integrates investments and grants would encompass the entire spectrum of activities shown in Figure 3. Only by including mission investments can a foundation bring the full force of its influence to bear on all dimensions of a social problem.

Only by including mission investments can a foundation bring the full force of its influence to bear on all dimensions of a social problem.

Figure 3. Activities Likely to Be Funded with a Grant Versus a Mission Investment
 A Survey of Foundation Climate Change Grants and Mission Investments by Area



Note: "Protection & Conservation" includes land-acquisition funds, timber investments, and funding for organizations such as Nature Conservancy; "Research/Education/Awareness" includes support for organizations that encourage consumers to engage in such activities as increasing recycling and reducing waste; "Agriculture" includes agricultural-development organizations and mission investing around seed technology; "Public Policy" includes grants to organizations influencing policy around such issues as carbon trading; "Construction/Infrastructure" includes investments in green building and housing/real-estate funds; "Alternative Energy" includes investing in such areas as clean-tech funds and carbon finance; "Shareholder Advocacy" includes grants or investments in organizations and companies organizing shareholder activism. Total number of foundations included in the analysis (N) = 26; numbers do not add up to 26 as each foundation may be counted in multiple areas.

Source: FSG survey of 26 foundations working on the climate-change issue.

Obviously, investments can only be used where a financial return is possible. This requires a more detailed analysis of the costs and benefits of different interventions that influence the issue. An examination of different carbon dioxide abatement activities, developed by McKinsey & Co. excerpted and simplified in Figure 4 below, offers such a detailed cost-benefit analysis.⁹ It shows that some activities to reduce carbon emissions are profitable under anticipated economic conditions, while others are borderline or significantly unprofitable.

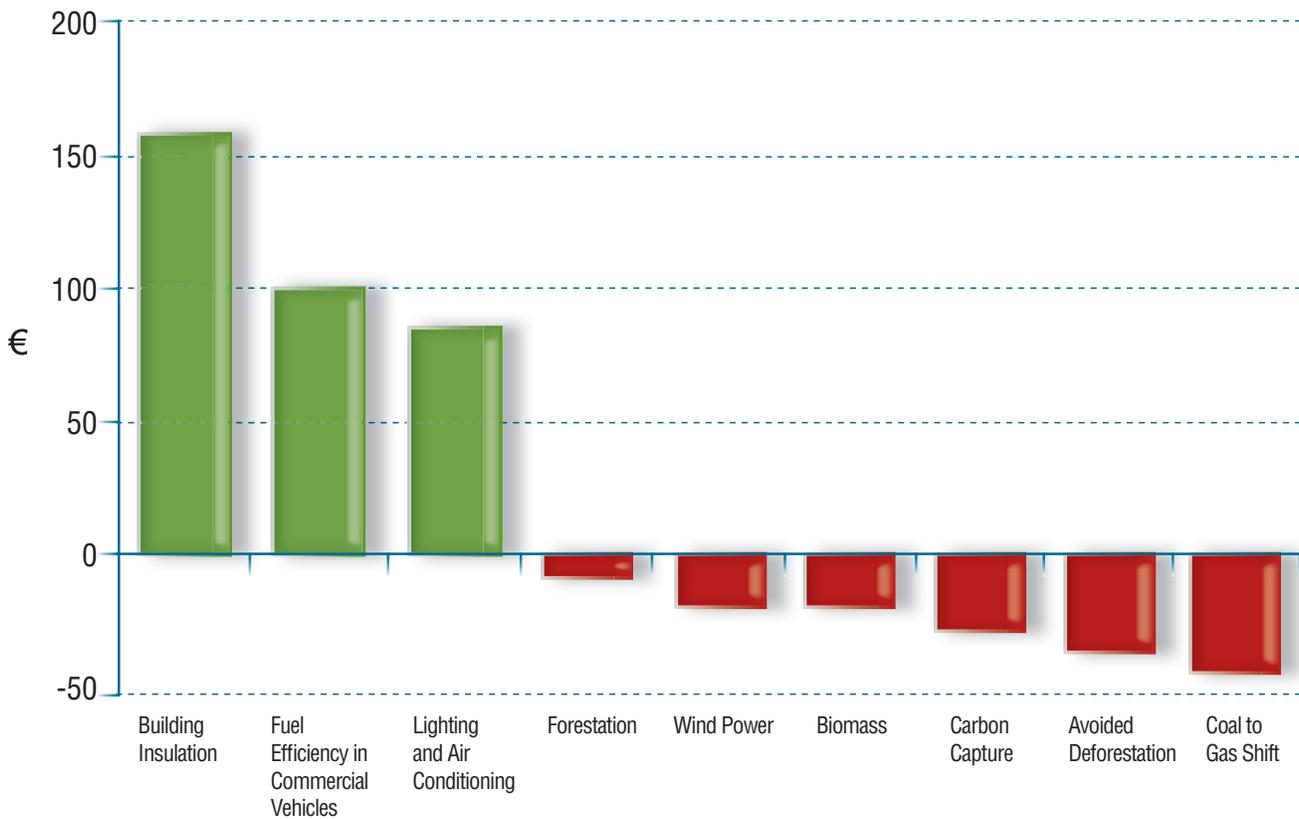
On the left side of the chart (in green), the immediate savings from building insulation, fuel-efficient commercial vehicles, and energy-efficient lighting and air conditioning are substantially greater than the costs. These are areas where the economics can support market-rate mission investments. The fact that such improvements are economically feasible, however, does not mean that they are already being implemented widely. Large corporations may simply be unaware of the potential savings until prompted to examine their carbon footprints through shareholder actions. New businesses with

the products and skills to implement energy-saving improvements may be unable to expand without access to growth capital. And institutional investors may be quicker to participate in new investment opportunities if influential foundations pave the way through their own investments.

Alternatively, the costs and benefits may be misaligned, as between landlords and tenants noted earlier, in which case new financial instruments will be needed before the theoretical economic and environmental benefits can be realized. Using shareholder advocacy, providing market-rate financing, investing in businesses that provide needed services, and developing innovative financial instruments are all promising mission investing opportunities in situations where the financial benefits outweigh the costs.

On the right-hand end of the spectrum shown in the chart (in red), the costs significantly exceed the current economic benefits. Foundations may work in these areas through grant funding but are unlikely to find

Figure 4. The Economic Value of Carbon Dioxide Abatement by Activity
Economic benefit (green) vs. cost (red) per ton of CO₂ emission abated (in euros)



Source: Excerpted from "A Cost Curve for Greenhouse-Gas Reductions," McKinsey Quarterly, 2007; Note: Numbers are approximate and adapted from the original graph.

⁹ For the complete chart, see Appendix C.

viable mission investing opportunities under existing technology and policy constraints. Even shareholder resolutions are less likely to succeed when they run counter to the economic interests of the corporation. These are areas where grant-funded research and advocacy are likely to be the most important interventions. Successfully advocating for a tax on carbon emissions or funding research to develop lower-cost energy technologies, for example, would move all bars on the chart upward, increasing the number of activities that offer attractive returns.

Those interventions in red in the middle of the chart, where costs modestly exceed benefits, offer particularly interesting opportunities. They are not yet attractive as conventional investments, but their basic economics are close enough to viability that creative financing or reduced costs from increases in scale and efficiency might make them commercially attractive. Foundations willing to absorb an extra layer of risk or accept a below-market return may find that their mission investments pay off well here, both socially and economically.

Building mission investments into program strategy therefore involves:

- 1) Identifying the ways that financial instruments and commercial enterprises influence the issues a foundation cares about;
- 2) Exploring which potential interventions carry a financial return that might repay an investment;
- 3) Examining the costs and benefits of different interventions to determine where conventional (market-rate), subsidized (below-market rate), and transformative (innovative) investment vehicles are feasible.

In order for foundations to take full advantage of these potential interventions, they will need to understand more fully how and when to use different types of investments.

The Evolution of One Foundation's Mission Investing

The Russell Family Foundation (TRFF), located in Gig Harbor, Washington, has developed an investment strategy aligned with its programmatic focus on environmental sustainability. The Russell family launched their foundation as a result of their success with the financial services firm, Russell Investments, creators of the stock market metric, the Russell Index. While TRFF focuses its environmental grantmaking on protecting the waters of the Puget Sound and not directly on climate change, it is mindful of the additional tools available through its investment portfolio. "We wanted to create impact on climate change through our endowment that provides greater resources than our grant budgets alone," says CEO Richard Woo. "The challenge for us was identifying how a small foundation with a modest endowment and limited staff could engage in mission investing in a cost-effective way."

The foundation decided to start slowly. In 2004, it allocated \$1 million to create a pilot mission-investing program. It invested in socially responsible mutual funds and certificates of deposits at community banks, and then began looking for equity opportunities. TRFF sought advice from leaders in the field, such as Doug Bauer, formerly with Rockefeller Philanthropy Advisors, who met with the board to explain the details of mission investing. The board has now committed 11 percent of the foundation's endowment (about \$13 million) to mission investing. Some of its mission investments include a \$2 million PRI to Enterprise Community Partners to support green affordable housing in the Puget Sound region of Washington, a customized domestic equity strategy narrowly tailored to the foundation's mission and \$1 million to a clean technology venture capital fund. TRFF embraces MRI as a learning opportunity and a way to advance the field. A \$500,000 PRI designed to support local sustainable communities recently failed and could not be repaid. Consequently, the defaulted loan was converted to a charitable grant on the foundation's books. Rather than simply closing the books on the experience and losing the learning opportunity, TRFF commissioned a third party "post-mortem" case study which is now being utilized to enhance the foundation's PRI due diligence and approval process. The foundation is also a member of the More for Mission campaign and a signatory to the Carbon Disclosure Project. TRFF works with its investment advisory firm to regularly convene an informal learning community in the Pacific Northwest, bringing together national experts and foundation staff from the region to discuss mission investing. In just a few years, TRFF has moved beyond its experimental stage to become a stronger advocate of mission investing.



IV. Creating Social Impact Through Mission Investments

Twenty years ago, the idea of making a small loan to an impoverished woman in Bangladesh seemed highly improbable. Today, microfinance attracts billions of dollars in conventional capital.

“Philanthropic capital should be considered as an alternate funding source where private capital is not flowing to programmatically important opportunities. Ideally it would leverage private capital, and then phase out as more private capital begins to flow.”

— *Curt Riffle, Program Operations Manager, The David & Lucile Packard Foundation*

IV. Creating Social Impact Through Mission Investments

Mission investments are often categorized by their financial returns, source of funds, or tax status. Viewed instead from the perspective of their social impact, we see three basic categories of mission investments in a foundation’s toolbox: Conventional, subsidized, and transformative mission investments. Each is discussed below, accompanied by sidebar examples.

1. **Conventional mission investments** offer risk adjusted market-rate returns and are therefore able to attract commercial funding. Examples include publicly traded debt or equities, venture capital or private equity funds, and market-rate loans to creditworthy borrowers.

Conventional mission investments offer the most plentiful investment opportunities and are the easiest way for foundations to begin aligning their endowment portfolios with their missions. When foundations only invest in conventional investments, however, they may merely augment or displace a small portion of the vastly larger pool of investment capital from traditional sources. In these cases, it is difficult to discern significant incremental social impact, since a different investor would likely have made the investment even if the foundation had not participated.

“Just putting your money in screened mutual funds is many steps removed from the actual environmental impact,” says Michael Fischer of the Consultative Group on Biological Diversity, a forum of grantmakers that focuses on conservation.

Adds Danyal Sattar of the London-based Esmée Fairbairn Foundation, “When there is a sustainable model for us to get our money back, a mission investment make sense. At the same time, if the opportunity seems too commercial, then it’s not for us. We apply the same standards of social impact to our investments that we apply to our grants.”

Viewed from the perspective of their social impact, we see three basic categories of mission investments in a foundation’s toolbox.

Nevertheless, there are two ways in which conventional mission investments can be used to create more direct social impact:

- **Signaling.** Leading foundations have considerable prestige and a reputation for savvy investing. When a foundation is an early investor in a fund, it can help bring credibility and visibility to the investment, lowering its transaction costs and enabling it to attract other investors more easily.
- **Shareholder advocacy.** Foundations can exercise their rights as stockholders of public companies to initiate or support shareholder resolutions that address social and environmental issues. Even when such resolutions do not win a majority of stockholder votes, they capture management’s attention and often lead to significant changes in corporate behavior.

Conventional Mission Investments in Climate Change

The simplest form of conventional mission investing is positive or negative environmental screening of equities in a foundation's endowment portfolio. This practice is growing, although it is still uncommon. More recently, organizations like Sustainable Asset Management, an investment research firm based in Zurich, have begun to offer "best-in-class" sustainability rankings for investors. These rankings identify the leading companies in each industry based on their sustainability practices, with the expectation that they will outperform their peers. As more investors take these rankings into account, companies have become increasingly sensitive to the importance of their environmental practices.

For the large number of foundations that are active in conservation, conventional investments in forestry, timber, and land can provide more direct social impact while producing reliable financial returns that are usually uncorrelated with other investments.¹⁰ In addition to abating carbon emissions through the prevention of deforestation, land protection can also preserve wildlife and ecosystems.

Many forestry investment and timber management companies have long track records and attractive financial returns. **Greenwood Management** has seen annual returns of 12 to 16 percent from managed timberland.¹¹ **Lyme Timber Company** has been in business over 30 years, and it manages investments for foundations as well as the Nature Conservancy and regional land trusts. **Ecotrust Forest Management**, generates returns from selling conservation easements, recreation leases, and carbon-offset credits while also exploring potential new markets like biofuels and species banks. **Beartooth Capital Partners** acquires and enhances the value of rural land in partnership with conservation organizations through habitat restoration, and ecologically appropriate development. The KL Felicitas Foundation, for example, has realized an 18 percent internal rate of return from its investments with Beartooth. Other similar firms include **EKO Asset Management Partners**, **Forest Trends**, and **TreeVestors**.

Debt and equity funds focused on alternative energy offer another conventional investment vehicle. In Europe, **Triodos Bank** is a leading "sustainable bank" that only lends to organizations pursuing social or environmental goals. Established in 1980 and with offices in Britain, Belgium, Germany, Spain, and the Netherlands, the bank offers over 20 funds to investors interested in alternative energy, microfinance, green real estate, culture, and socially responsible investing. Its 350 million euro institutional Ampere Equity Fund invests directly in large-scale biomass, wind, and solar-energy projects located in Western Europe, with a 12 to 15 percent net target return on equity. The Renewables Europe Fund offers a lower risk option, with a 7 percent target return through equity and mezzanine financing for clean energy services in developing countries.

Generation Investment Management, a fund started by former U.S. Vice President Al Gore and former Goldman Sachs Partner David Blood, has raised more than \$680 million for its Climate Solutions Fund. The fund plans to invest in renewable energy technologies, energy efficiency in buildings, cleaner fossil energy, sustainable agriculture, and carbon markets. Generation, along with green venture capital funds, views investing in climate solutions as an attractive commercial market with strong financial returns, rather than a concessionary investment to subsidize a social agenda.

Other foundations find conventional mission investments to be an important element of diversification in their portfolios, even if the social impact is not as powerful. "From an asset-allocation perspective, mission investing in hard assets, such as real estate, may provide foundations with steady returns that are less correlated with other asset classes," explains Stuart Davidson of Labrador Ventures. Yet other foundations view the impact of conventional mission investments as too limited. In the words of Danyal Sattar of the Esmee Fairbairn Foundation, "We assess a lot of opportunities that we turn away because we believe commercial markets will address them."

¹⁰ In some cases, the financial returns are partly due to the sale of land which may defeat some of the ecological benefits of conservation.

¹¹ Greenwood Management website, at <http://www.greenwood-management.com/forestry-investment-questions.html> accessed on 16 August 2009.

Shareholder Advocacy on Climate Change

The **Nathan Cummings Foundation** has long been a leader in shareholder activism as one of the few foundations that votes its proxies and files shareholder resolutions in line with both its grantmaking priorities and long-term shareholder value. “Our program areas determine the focus of our shareholder activities,” comments Laura Shaffer, Director of Shareholder Activities at the Foundation, probably the only such position in the foundation field. “All of our shareholder work is done with the dual purpose of enhancing long-term shareholder value and complementing our grantmaking efforts.”

Since 2003, the Foundation has filed more than 80 resolutions. 42 of these resolutions have been on issues related to climate change, focusing on energy efficiency and the disclosure of carbon footprints. In 2009, the Foundation led five resolutions on climate change and was a co-filer of one additional resolution.

While not everyone agrees with the value of shareholder advocacy, our research suggests that it can have demonstrable impact. For example, the Nathan Cummings Foundation filed a resolution in 2004 with Valero Energy Corporation, a petroleum refiner and marketing company, to disclose its emissions data. The resolution attracted only 9% of the votes, but that sufficiently motivated the company to disclose emissions data on its website and to explore low carbon alternatives for its future revenues. Similarly, a 2008 resolution filed with Centex, a U.S. home building company, attracted 28% of votes which led the company to issue its first sustainability report and increase the energy efficiency of the homes it builds by between 10% and 22% versus homes built to the most commonly used code.

In 2002, a shareholder resolution filed by **Trillium Asset Management** and the **As You Sow Foundation** called on Home Depot to phase out sales of “old growth” wood. Although the resolution only received support from 11% of shareholders, the company subsequently announced that it would discontinue all wood sales from endangered areas.¹² On the other hand, even a resolution with 30% support from shareholders has not altered ExxonMobil’s stance on global warming.¹³ “It may be tough to say how much corporate behavior changes because of shareholder advocacy, but there is still value in raising the issues and bringing it to the management’s attention,” concludes Taylor Jordan of Imprint Capital.

Even foundations that have the majority of their assets in co-mingled funds, like the Vermont Community Foundation, have begun to engage their investment managers in discussions about proxy voting in the hopes of influencing votes on all funds under management.

Several investor membership organizations that address climate change also play an important role in shareholder advocacy. **Ceres** is a national network of investors working with companies to address sustainability challenges. In the U.K., the **Carbon Disclosure Project** acts on behalf of 475 institutional investors, holding \$55 trillion in assets under management, to motivate companies to take action on climate change. As these coalitions have become more prominent in the last few years, large corporations have begun to take significant notice of the issues they raise.

¹² <http://trilliuminvest.com/news-articles-category/advocacy-news-articles/home-depot%E2%80%99s-endangered-forest-policy-the-view-from-five-years-later/>

¹³ <http://www.corporateresponsibility.net/2008/05/31/updated-exxon-repels-climate-change-shareholder-revolt/>

2. **Subsidized investments** offer below-market returns, and for that reason cannot attract funding from investors interested purely in financial returns. They achieve social impact from financing projects that could not otherwise be accomplished, while enabling the foundation to recover its investment and possibly earn a modest return.

Projects financed through subsidized investments can almost always be accomplished with grants instead. Using an investment structure, however, may enable the foundation to reuse its funds a second time, access endowment funds beyond its normal payout, or help build the borrower's financial discipline and credit history. The social impact achieved by funding a specific investment may be substantial,

but subsidized investments cannot leverage conventional funding. "Providing subsidized capital for areas where commercial capital is being invested can confuse the market," says Taylor Jordan of Imprint Capital. Subsidized investments, therefore, cannot achieve transformative scale as they are necessarily limited to the growing but still relatively small pool of philanthropically motivated capital.

The social impact achieved by funding a specific investment may be substantial, but subsidized investments cannot leverage conventional funding.

Subsidized Mission Investments in Climate Change

The David & Lucile Packard Foundation has been one of the leaders in subsidized mission investing for many years, primarily through PRIs. Just over 50 percent of the Foundation's PRIs are in the conservation area, and about 80 percent of these are low-interest bridge loans to NGOs to fund the acquisition of conservation land. Once the land has been acquired, the NGOs repay the loans over time through fundraising, the sale of conservation easements, or even revenues from ecosystem services like carbon offsets.

Subsidized mission investments are particularly useful for building the capacity of grantees with substantial earned income. In April 2009, **The Boston Foundation** (TBF) provided a five-year, \$500,000 loan to the nonprofit **Cambridge Energy Alliance** (CEA) for it to carry out more than \$100 million worth of energy-efficiency activities in Boston. The investment will help develop a \$3.5 million pool of funds that CEA will use to design, market, finance, manage, and document efficiency improvements in the use of energy, water, and transportation. Over the next five to seven years, CEA plans to reduce local electricity usage by 10 percent and demand by 15 percent, while also cutting Boston's annual greenhouse gas emissions by 10 percent.

When investors take on high levels of risk, they may earn substantial returns, yet the risk-adjusted returns may still be subsidized. The **Esmee Fairbairn Foundation** has developed a £20 million (about \$30 million) "Finance Fund" specifically for mission investments. In 2004, one of its grantees, Global Action Plan (GAP), a nonprofit that advises businesses on energy savings, faced severely diminished revenues as a result of a government cutback. Working alongside an intermediary, Venturesome, the foundation helped GAP expand through the downturn through an innovative "quasi-equity" revenue-sharing plan in which the nonprofit agreed to pay back a loan from the foundation based on a percentage of its future revenues. "It was a risky venture that commercial funders would not fund, yet it was a great business model," explains Danyal Sattar, Finance Fund Manager at the foundation. The investment allowed GAP to hire staff, expand its business, and achieve financial sustainability much sooner than expected, and the foundation has seen a 25 percent annual return on its investment.

3. **Transformative investments** are innovative options that are not yet commercially attractive due to a high perceived risk relative to the returns, or else simply to a lack of awareness, scale, or track record. Unlike subsidized investments, however, they have the potential to deliver risk-adjusted market-rate returns and ultimately to attract commercial capital. Transformative investments provide an opportunity to leverage substantial social impact: If the assumption of commercial viability proves correct, the investment vehicle can grow to vastly larger scale by accessing conventional sources of capital.

Microfinance is one example of a transformative investment. Twenty years ago, the idea of making a small loan to an impoverished woman in Bangladesh seemed highly improbable. The early funding for microfinance pioneers like Grameen Bank was philanthropically motivated. Over time, however, microfinance demonstrated the potential to deliver market-rate returns with a low default rate. Many microfinance institutions developed, and a market was created of sufficient scale and reliability to attract billions of dollars in conventional capital. The social impact from pioneering the development of such instruments is highly leveraged and highly sustainable.

Foundations that make transformative investments accept an added layer of risk not justified solely by the financial returns, either from investing in an untested model or from agreeing to absorb a disproportionate share of the losses in order to reduce the early risks and attract conventional investors. These investments take advantage of the fact that foundations can afford to act as long-term investors in social issues. “Foundations have a unique capacity to take on risk,” says Antony Bugg-Levine, who leads the Rockefeller Foundation’s Impact Investing work. “The role of philanthropic capital in mission investing should be to take higher risk and leverage their investments up with more commercial capital.”

“Foundations possess a unique ability to deploy multiple forms of at-risk capital – from grants, to program related investments, to market-rate instruments,” adds Kipp Baratoff, a Principal of Equilibrium Capital Group. “By appropriately allocating these forms of capital to match the risk of an investment opportunity, a foundation can innovatively finance the gap between the availability of public finance and the willingness of commercial funders through grants, guarantees or first-loss provisions.” Stuart Davidson of Labrador Ventures agrees: “The role of philanthropic capital should be to make mission investments safer for non-philanthropic capital. Foundations can help prove the case for certain opportunities by taking risk and demonstrating which opportunities can be brought to scale.”

While transformative investments offer large potential impact, they are often difficult to find and costly to structure. They are also dynamic over time — as the new financing instrument builds a track record, it will eventually become either a conventional investment if the returns justify the risks or a subsidized investment if it fails to perform as anticipated.

The role of philanthropic capital should be to make mission investments safer for non-philanthropic capital.

These three types of mission investments are not mutually exclusive. A portfolio may contain conventional, subsidized, and transformative investments, each serving different purposes and maximizing the foundation’s flexibility to achieve its objectives. Even smaller foundations can use the full range of mission investing tools. For example, the Merck Family Fund in Milton, Massachusetts, with assets of \$45 million, utilizes a combination of positive screening, shareholder resolutions, and private equity investments. The greatest impact, however, will come from aligning these investment vehicles with grantmaking in mutually reinforcing ways.

Transformative Mission Investments in Climate Change

Meyer Memorial Trust, a foundation based in Portland, Oregon, and **Equilibrium Resources Management (ERM)** created a \$10 million fund in Clackamas County, Oregon, to retrofit all county buildings with state-of-the-art energy saving equipment. Once the equipment is installed, the county will sell the equipment and a long-term power purchase agreement to a pool of private investors. Thereafter, it will pay two energy bills each month: one to the utility for the actual energy consumed, and the other to the investors for the energy savings.

Selling the equipment and savings to the investors will enable ERM to immediately recoup its original \$10 million in capital, which can then be used for additional building retrofits rather than gradually being repaid over a decade. From the county’s perspective, the arrangement is balance sheet neutral, requiring no legal authorization for loans or bond issues. If ERM’s model of securitizing the energy savings proves successful, it could expand rapidly, creating a powerful new type of security that finances energy saving equipment for both private and public properties. It requires a transformative investment from the foundation, however, to test the concept.

On a smaller scale, the **George Gund Foundation** in Cleveland, Ohio, engages in PRIs through loans, equity, and guarantees to invest in green buildings in economically depressed neighborhoods. Through its PRIs, the foundation attracts commercial capital to projects from investors who would otherwise consider the investments too risky, even though the foundation believes they will produce market-rate returns. “We think about leveraging our dollars by using our investments to bring in additional capital,”

explains John Mitterholzer, Senior Program Officer for the environment. “We’re often the first ones to invest in the neighborhood and we bring in the other investors.”

Other enterprises have been successful in attracting commercial funding on a larger scale in both developed and developing countries. **E+Co** is a nonprofit intermediary started 15 years ago, with initial funding from the Rockefeller Foundation, to invest in clean energy businesses in developing countries. To date, E+Co has invested about \$34 million and mobilized \$233 million from conventional sources in more than 240 investments. “We invest in projects such as solar rural electrification companies that other investors are still wary of,” says Christine Singer, cofounder and CEO.

E+Co’s investments earn about an 8 percent annual return, before operating expenses, in addition to delivering social impacts, which they measure by 34 different social, environmental, and financial metrics for each investment. For every dollar that E+Co invests, it spends about 20 cents of grant funding for capacity building. Even so, it has leveraged six times as much conventional capital as its combined grants and investments, creating significant impact on climate change, health, and poverty in countries such as Nicaragua, Ghana, and Cambodia.

In the U.S., the New York State Legislature passed a bill in September 2009, authorizing the creation of the **Green Jobs Green NY** program, which offers an exciting and ambitious example of the role foundations can play in transformative investments. The program aims to retrofit 1,000,000 homes over a five year period. Championed by the Center for Working Families, the legislation authorizes the program to be housed in the New York State Energy Research and Development Authority (NYSERDA) and advocates for a market based financing solution using private capital. Forsyth Street Advisors has provided ongoing financial assistance to the Center for Working Families, assisting in the creation of the legislation and continues its work in the development process. The program aims to raise approximately \$5 billion to provide loans for homeowners throughout the state to retrofit their homes to increase energy efficiency and reduce their energy bills. A portion of the savings in energy costs will be used to repay the loans and the remaining portion that will benefit the homeowners. Philanthropic capital can play a pivotal role, attracting conventional investors, in transformative programs such as Green Jobs Green NY.

The financial structures required to implement the Green Jobs Green NY program will draw from Forsyth’s earlier success in creating the \$200 million New York City Acquisition Fund. The Fund, which will finance 30,000 units of affordable housing in New York City, utilizes credit enhancement guarantees from philanthropic capital enabling it to offer advantageous loan terms. Six leading foundations, including Rockefeller and Ford, agreed to provide \$33 million of risk capital to be used as a loan-loss reserve. With this buffer in place, Forsyth was able to raise \$162 million of commercial funding from banks, leveraging the foundations’ investment by five to one. In the process, it is pioneering a new financing vehicle that — if it performs well — can pave the way for future financing without further foundation guarantees.

The **KL Felicitas Foundation** has invested in a forest reserve in Honduras named Pico Bonito through a PRI. The investment is expected to generate market-rate returns over a 10- to 15-year horizon from a combination of sustainable timber harvesting and the sale of carbon credits. Ultimately, these revenue sources should enable a refinancing to cash out the original investors. Given the long time horizon, the uncertainties of the carbon market, and the novelty of its exit strategy, the offering is not yet attractive to conventional investors. If the model performs as expected, however, more commercial funding will flow into forest-preservation projects like Pico Bonito.

Other investors we interviewed cited alternative energy as a promising area for transformative investments. “Alternative energy is the future in addressing climate change,” observes Ruth Hennig, Executive Director of the Boston-based **John Merck Fund**. “The technologies have been developed, but you need adequate capital to finance the projects.” Bas Ruter, Managing Director at **Triodos Funds Management**, adds “The most profitable and lowest risk opportunities are around onshore wind projects, followed closely by offshore wind. Solar power is expensive right now, but the price is dropping and technology improvements are very promising. Both wind and solar will be important sources of energy in the next decade.”

These examples all demonstrate the potential of transformative investments to underwrite the cost of climate change solutions by creating new financing vehicles that leverage foundation investments and potentially pave the way for much larger pools of commercial funding in the future.

¹⁴ see <http://www.nycacquisitionfund.com>

V. Pairing Grants with Mission Investments

Hybrid investments achieve impact that could not be accomplished through either the grant or the investment alone.

“Sometimes we use grants for promising opportunities because there simply isn’t a business model there. For example, grants are more appropriate for policy and advocacy work. But philanthropic capital needs to take the risk of investing in opportunities that commercial capital will not. We decide whether to do a PRI or not based on the business model and the leadership potential of the people involved.”

— Charly Kleissner, cofounder, KL Felicitas Foundation

V. Pairing Grants with Mission Investments

A foundation that seeks to maximize its effectiveness should go beyond an opportunistic collection of grants and mission investments by focusing on the synergistic ways that grants and investments can influence different dimensions of the same issue. (See Figure 5 on the following page.)

Some funders use a “hybrid” combination of grants and investments in the same projects as a way of making transformative investments and funding supplemental activities such as technical assistance or evaluation. The KL Felicitas Foundation’s investment in Pico Bonito, described earlier, was paired with a capacity building grant to EcoLogic, an NGO that manages the project. “Hybrid investments should achieve an impact that could not otherwise be accomplished through either the grant or the investment alone,” says Charly Kleissner, cofounder of the foundation.

Mission investments can motivate or enable individuals and organizations to implement the changes a foundation seeks to encourage.

Other funders use grants and investments to leverage different dimensions of a social issue, rather than making hybrid investments in the same project. In general, grants can promote knowledge, policies, and behaviors that may not produce direct financial returns but can increase the likelihood of success for mission investments. At the same time, mission investments can motivate or enable individuals and organizations to implement the changes a foundation seeks to encourage. Consider the following potential synergies between grants and investments:

- Grants to activist organizations fund a campaign to support a shareholder resolution filed by the foundation through its conventional investment in a public company.
- New technologies developed through grant-funded research are piloted with the help of subsidized mission investments until they become commercially viable.

- Transformative investments in new financial instruments greatly expand the number of people who can afford to make energy-conserving improvements. At the same time, a grant-funded public-awareness campaign piques local interest by politicians, while research grants support academic studies to model and document the financial performance of these investments, accelerating their acceptance among institutional investors.

Grants to support advocacy and demonstrate public support can also advance the likelihood that transformative investments will attract conventional capital. In Europe, government policies have long been essential to sustaining the multi-billion euro market in carbon trading. More recently, the Obama administration has indicated its desire to fight climate change and the House of Representatives passed a cap-and-trade bill in June 2009. If the administration were successful in imposing a tax on carbon emissions or dramatically increasing tax credits for energy efficiency, it would immediately expand the range of conventional investments that could be financed profitably.

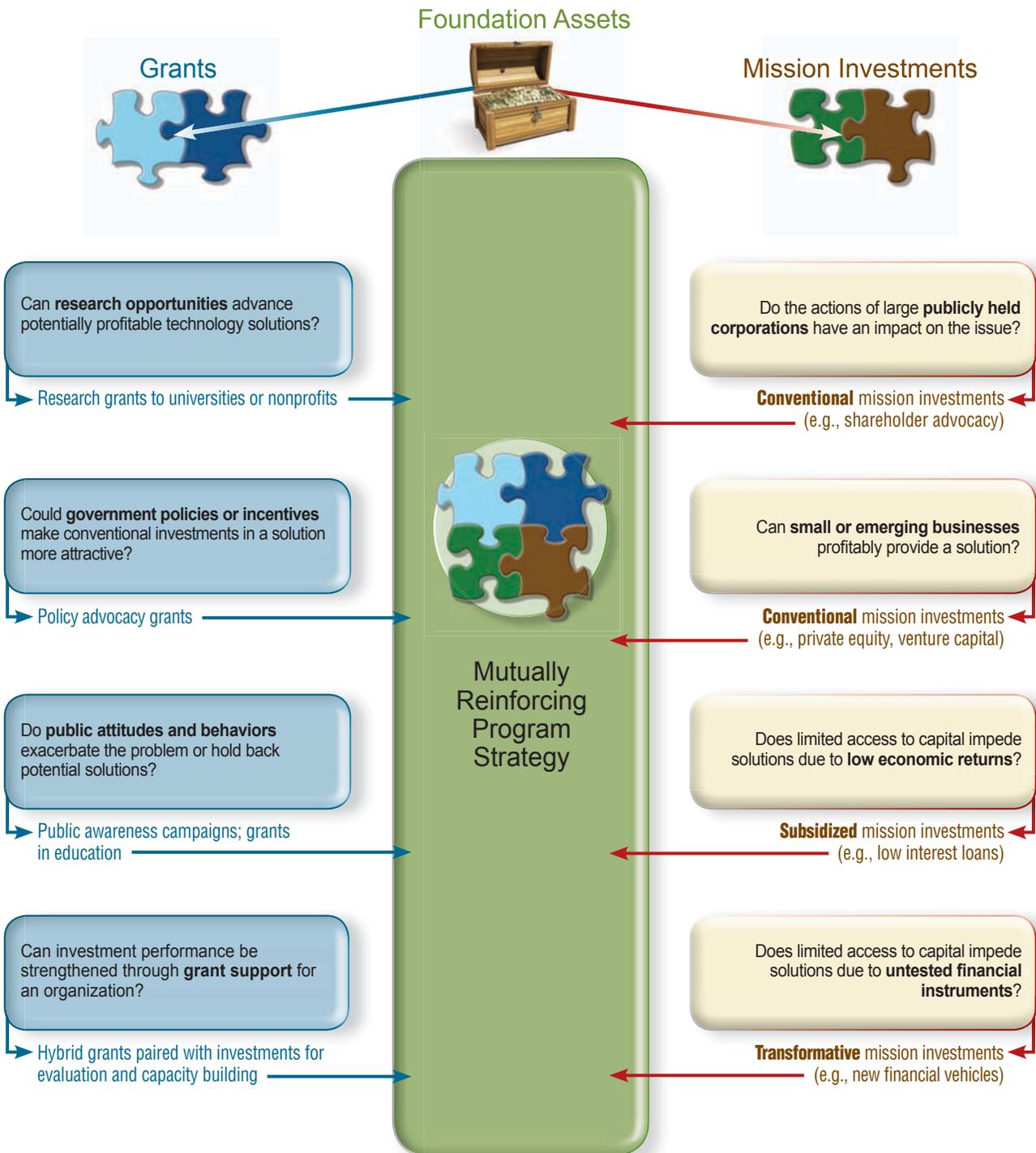
Even advocacy for state and local policy changes can have a profound effect. Most electrical utilities face a misalignment between social and financial incentives because they can only increase their profits by selling more electricity. In California, PG&E has been given the legal authority to pay for customers to install energy-saving equipment, recover the cost through their rate setting, and retain 11 percent of the savings as profit. This initiative encourages investment in energy conservation rather than additional power plants, and is already the second highest source of PG&E’s profits. Encouraging other states to adopt such a policy would have a significant impact.

Local legislation in the cities of Berkeley and Denver provides financing for the installation of solar panels which is repaid through incremental property tax assessments.¹⁵ Implementing this system has required innovative legislation that permits different property tax rates for individual buildings. Foundations can play a critical role in advocating for such innovative legislation. Similarly, funding research studies and public awareness campaigns that demonstrate the social and economic value of these legislative innovations can accelerate wider adoption. Another such innovation – the PACE (Property Assessed Clean Energy) bond, being introduced in 15 states in the U.S. – allows cities to issue bonds to finance retrofitting, and was highlighted by Harvard Business Review as one of the Top 10 Breakthrough ideas for 2010.¹⁶

¹⁵ http://articles.sfgate.com/2009-02-28/news/17189348_1_solar-panels-solar-system-tax-credit

¹⁶ Harvard Business Review, January-February, 2010.

Figure 5. Checklist for a Strategy to Link Grants and Mission Investments



Alternative energy offers another area for synergistic grants and investments. The success of venture capital investments in renewable energy often depends on research and development that is too costly for any one company to undertake. Research on solar and wind technology has been interrupted repeatedly when reductions in oil and gas prices undermine their short-term cost advantage.¹⁷

At those times, conventional venture capital disappears and projects under development rarely reach commercial scale. Transformative mission investments to commercialize projects in development, combined with grants to support academic research and advocacy for government subsidies, can sustain progress during times when the financial benefits are too remote to interest conventional investors.

Google.org offers some of the best examples of the synergy between investments and grants in addressing climate change. For example, Google.org has invested more than \$10 million in two for-profit ventures, Alta Rock Energy and Potter Drilling, which are developing commercial technologies to lower the cost of geothermal energy production. At the same time, grants to Southern Methodist University and Stanford University will improve understanding of the size, location, and potential power output of geothermal resources in the United States. Similarly, the foundation invested in Makani Power to finance R&D on large-scale high-altitude wind energy, and in eSolar and BrightSource Energy to further the commercial development of solar thermal power, while providing grants to fund related research at San Diego State University.

“We didn’t make a single investment at Google.org that didn’t advance our philanthropic mission.”

Google.org’s approach to promoting electric cars offers an even more intricate example of the synergy between grants and investments. It combines venture capital investments in for-profit companies that develop technologies to commercialize plug-in electric cars with grants to fund related research, increase public awareness, and influence government policies, such as:

- The Brookings Institution to support a conference on federal policy to promote plug-in cars;
- CalCars to educate the public about these vehicles;
- The Electric Power Research Institute to conduct studies of the environmental and economic benefits of plug-in cars;
- The Rocky Mountain Institute to promote new strategies for market adoption of plug-in vehicles;
- Plug-In America to raise public awareness of plug-in transportation options.

In this way, Google.org linked its grants and investments closely together into a single integrated strategy to support the development and implementation of alternative energy solutions. “We didn’t make a single investment at Google.org that didn’t advance our philanthropic mission,” says Gregory Miller, Managing Director for Google Investments from 2006 to 2009.¹⁸

Google.org’s perspective has been that grants and investments are merely two tools that can leverage social change in different ways toward the same ends. That mindset is essential to maximizing the synergistic impact of grantmaking and mission investing.

¹⁷ See, for example, “Alternative Energy Suddenly Faces Headwinds,” in *The New York Times*, by Clifford Krauss, 20 October, 2008.

¹⁸ As of the time this paper was being completed, Google had announced a major shift in its philanthropic priorities that is still being finalized.

VI. Conclusion

The rigid historical division between investing and grantmaking forces consideration about the potential use of funds down one of two entirely separate analytical paths, obscuring the potential for synergistic impact.



“Be transparent in your mission-investing efforts by sharing your failures and success stories. Recognize that there are emerging networks of peers you can share with and learn from to grow this industry.”

— Raul Pomares, Investment Advisor, KL Felicitas Foundation

VI. Conclusion

Now that mission investing is becoming more widely accepted, it is increasingly important for foundations to integrate this new tool into their strategy development process from the outset, rather than treating it as a separate set of activities that are only loosely related to grantmaking. The research, awareness, and advocacy that foundations fund through their grants, together with the conventional, subsidized, and transformative mission investments they make, can accelerate the development of new financial instruments and business opportunities that better align social and economic incentives to solve large-scale problems.

“We use exactly the same approach for our grants and investments. Treating them differently would elevate form over substance.”

For most foundations, the rigid historical division between investing and grantmaking forces any consideration about the potential use of funds down one of two separate analytical paths, staffed with different people and evaluated on unrelated criteria. This division obscures the way that both activities can work together to advance a foundation’s mission. Google.org has taken a different approach.¹⁹ In Gregory Miller’s words: “The first thing we ask is, ‘What problem are we trying to solve?’ Then we decide how best to deploy our capital to achieve that objective, whether through a grant to a nonprofit, an investment in a sustainable business, or direct advocacy to change government policy. We use exactly the same approach for our grants and investments. Treating them differently would elevate form over substance.”

Foundations that seek to deploy such an integrated strategy must extend their research beyond the nonprofit sector in developing their program strategies. Finance staff will need to research the economic aspects of the social and environmental issues the foundation seeks to address, identify misalignments between financial and social incentives, and analyze the expected costs and benefits of different interventions. At the same time, grantmaking staff will need to explore the ways that research, education, awareness, and advocacy can improve the context for the foundation’s desired investments. The overlaps between the two efforts can create a level of cross-fertilization that is in itself useful in breaking down the silos that isolate departments and program areas within many foundations.

As the field of philanthropy continues to evolve, foundations are moving beyond their typical role of “charitable bankers” that dole out funds to a variety of worthy organizations. Instead, they are developing well-researched strategies to achieve measurable change on targeted social issues, using every tool available to advance their missions. Mission investing is increasingly being recognized as one powerful tool for social change. It is even more powerful, however, when foundations find ways to link it to their grantmaking in mutually reinforcing ways.

Ultimately, foundations will need to learn from each other’s experiences as they discover how best to synergistically combine grants and investments. It is our hope that this study can promote more innovation, experimentation, and mutual learning toward that goal.

It is our hope that this study can promote more innovation, experimentation, and mutual learning among funders of all sizes.

¹⁹ Foundations may be wary of grants that benefit their investments because of the prohibition on self-dealing. This prohibits any grants that would benefit the investments of the foundation’s trustees or other disqualified persons. The self-dealing issue does not arise when the grant benefits the foundation’s own investments. However, to qualify as a grant, there must be a very clear charitable purpose distinct from advancing the success of the investment, especially if other investors might derive private benefits too. In the case of the examples cited here, all of the grants do serve broader public charitable purposes, even though they also might serve to bolster the foundation’s own investment returns. Whether a grant has a sufficient charitable rationale is determined on a case-by-case basis, and foundations should consult their own counsel if they have questions.

VII. Appendices

Appendix A: Bibliography

Appendix B: Interviewees

Appendix C: McKinsey Carbon-
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V. Appendices

Appendix A: Bibliography

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Appendix B: Interviewees

In addition to the Advisory Board members, we conducted interviews with:

- Cynthia Addams, Executive Vice President, **Collins Foundation**
- Kipp Baratoff, Principal, **Equilibrium Capital**
- Peter Berliner, Managing Director, **PRI Makers Network**
- David Blood, Senior Partner, **Generation Investment Management**
- Mark Campanale, Founder-Director, **U.K. Social Investment Forum**
- David Carrington, **Independent Consultant**
- Don Chen, Program Officer, Community and Resource Development, **Ford Foundation**
- Jon Cracknell, Foundation Director, **Environmental Funders Network**
- Stuart Davidson, Partner, **Labrador Ventures**
- Rick Duke, Director, Center for Market Innovation, **Natural Resources Defense Council**
- Michael Fischer, Executive Director, **Consultative Group on Biological Diversity**
- Owen Heleen, Senior Community Philanthropy Officer, **The Rhode Island Foundation**
- Ruth Hennig, Executive Director, **John Merck Fund**
- Stewart Hudson, President, **Emily Hall Tremain Foundation**
- Joshua Humphreys, Lecturer, **Harvard University**; Director, **Center for Social Philanthropy**

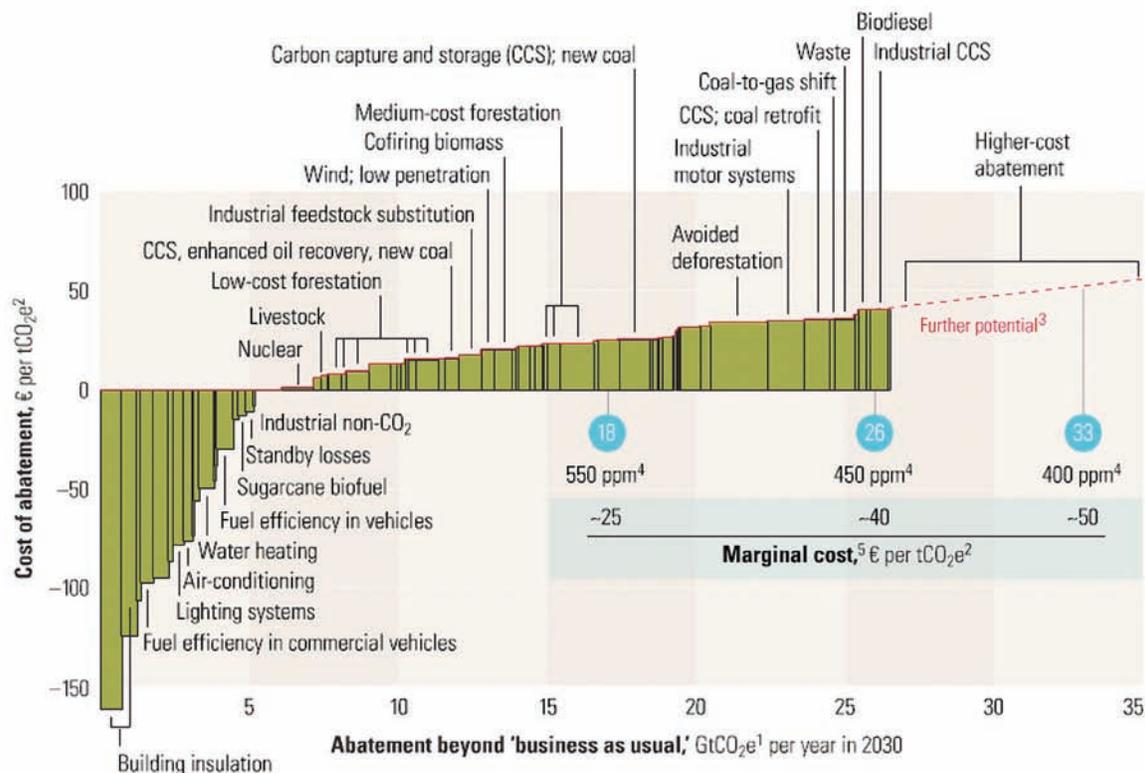
Appendix B: Interviewees (continued)

- Taylor Jordan, Co-Founder & Managing Director, **Imprint Capital**
- Liz Karan, Senior Associate, **Pew Charitable Trusts**
- Daniel Katz, Environmental Program Director, **Overbrook Foundation**
- John Kingston, Director, **Venturesome**
- Raj Kundra, Energy Portfolio Manager, **Acumen Fund**
- Leonardo Lacerda, Environment Program Director, **Oak Foundation**
- Henry Day Lanier, **Forsyth Street Advisors**
- Dana Lanza, former Executive Director, **Environmental Grantmakers Association**
- Denise Lee, Senior Advisor, Climate Change Programme, **Nand & Jeet Khemka Foundation**
- Valerie Lemieux, Grants & Communications Manager, **Catherine Donnelly Foundation**
- Patrick Maloney, Senior Program Officer, Climate Change, **Lemelson Foundation**
- John Mitterholzer, Senior Program Officer for the Environment, **George Gund Foundation**
- Bonny Moellenbrock, Executive Director, **SJF Advisory Services**
- Raul Pomares, Investment Advisor, **KL Felicitas Foundation**
- Nigel Purvis, President, **Climate Advisers**
- Curt Riffle, Program Operations Manager, **The David & Lucile Packard Foundation**
- Sarah Ridley, Executive Director, **Tubney Charitable Trust**
- Arlene Rodriguez, Program Officer, Environment, **San Francisco Foundation**
- Jenny Russell, Executive Director, **Merck Family Fund**
- Bas Ruter, Managing Director, **Triodos Funds Management**
- Danyal Sattar, Finance Fund Manager, Social investment, **Esmee Fairbairn Foundation**
- Holger Schmid, Head of Programmes, **Mava Foundation**
- Debra Schwartz, Director, PRIs, **John D. and Catherine T. MacArthur Foundation**
- Laura Shaffer, Director of Shareholder Activities, **Nathan Cummings Foundation**
- Christine Singer, Co-Founder and CEO, **E+Co**
- Mark Spalding, President, **Ocean Foundation**
- Peter Stein, General Partner and Managing Director, **Lyme Timber Company**
- Sarah Stranahan, Trustee, **Needmor Fund**
- Philip Varnum, CFO, **Lemelson Foundation**
- Gerry Watson, Vice President for Finance and Operations, **Rockefeller Brothers Fund**
- Lissa Widoff, Executive Director, **Robert and Patricia Switzer Foundation**
- Richard Woo, CEO, **Russell Family Foundation**

Appendix C: McKinsey Carbon-Abatement Cost Curve

Global cost curve for greenhouse gas abatement measures beyond 'business as usual'; greenhouse gases measured in GtCO₂e¹

● Approximate abatement required beyond 'business as usual,' 2030



¹GtCO₂e = gigaton of carbon dioxide equivalent; "business as usual" based on emissions growth driven mainly by increasing demand for energy and transport around the world and by tropical deforestation.

²tCO₂e = ton of carbon dioxide equivalent.

³Measures costing more than €40 a ton were not the focus of this study.

⁴Atmospheric concentration of all greenhouse gases recalculated into CO₂ equivalents; ppm = parts per million.

⁵Marginal cost of avoiding emissions of 1 ton of CO₂ equivalents in each abatement demand scenario.

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Disclaimer

All statements and conclusions, unless specifically attributed to another source, are those of the authors and do not necessarily reflect those of the Surdna Foundation or the members of our Advisory Board.

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Advisory Board

An Advisory Board comprising key practitioners and experts in the field of mission investing provided vital counsel for this project. FSG sincerely thanks them for their guidance and insight.

- Sharon Alpert, Program Director for Environment, Surdna Foundation
- Doug Bauer, Executive Director, Clark Foundation
- Susan Bell, Vice President and Senior Fellow for Energy and Climate, William and Flora Hewlett Foundation
- Shari Berenbach, President and CEO, Calvert Foundation
- Antony Bugg-Levine, Managing Director, Rockefeller Foundation and Chairman, Global Impact Investing Network
- Jed Emerson, Managing Director for Integrated Performance, Uhuru Capital
- Charly Kleissner, Co-Founder, KL Felicitas Foundation
- Ann Lininger, County Commissioner, Clackamas County
- Gregory Miller, Managing Director, Google Investments (2006 – 2009)
- Alexandra Readey, Senior Private Equity Specialist, Cambridge Associates
- Joshua Reichert, Managing Director, Pew Environment Group, Pew Charitable Trusts
- Jason Scott, Managing Partner, EKO Asset Management Partners
- Vince Stehle, former Program Director, Nonprofit Sector Support, Surdna Foundation
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- Steve Viederman, former President, Jessie Smith Noyes Foundation
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