METROPOLITAN *Universities* OPEN ACCESS

Original Research

Return For Good: A Model for Impact Investing for Endowments

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Cite as: Schor, A. (2020). Return for Good: A Model for Impact Investing for Endowments. *Metrpolitan Universities*, 31(1), 24-43. DOI: 10.18060/23237

Editor: Valerie L. Holton, Ph.D.

Abstract

As the calls for responsible investing grow, universities will be asked about their endowments' investment policies regarding impact investing, wherein endowments seek opportunities that provide investment returns and social impact. A common concern for the investment committees, however, is how to incorporate impact investments without compromising the goal of maximizing asset values and the benefit to its university. This paper offers a way forward. Using standard portfolio optimization models and a broader way to consider return, this paper suggests that an endowment can still meet the goal of maximizing expected value while investing with a purpose. It also offers examples of how to incorporate impact investing opportunities throughout the traditional asset classes in an endowment's portfolio. The paper also addresses some reasons why endowments have been hesitant to incorporate impact investments. While other papers have addressed aspects of impact investing, this paper seeks to offer an accessible and holistic approach to the topic.

Keywords: responsible investing, endowments, investment policy

Introduction

The rising importance of responsible investing suggests that foundations and endowments are thinking beyond just what their portfolios can make; they are considering what their money can do. Impact investing, the responsible investing offshoot where an endowment can direct its investment assets to areas with important social impact, is emerging as the next frontier in social awareness. It is a more active step than guidelines about environmental, societal, and governance (ESG) issues or a socially responsible investing policy (SRI). ESG and SRI policies often describe what not to do, whereas impact investing seeks investment opportunities. It goes beyond avoiding "doing bad" and tries to "do good." Endowments are, in many ways, advantageously positioned to incorporate impact investments relative to foundations and other institutions, such as public or private pension plans, yet the concept remains vexing to many university boards and their investment committees. This paper, therefore, offers a framework for endowments that wish to consider impact investing, including implementing a policy, assessing returns, and reconciling impact investing with the typical investment policy goal of maximizing risk-adjusted returns of an endowment. It also shows how to incorporate impact investing into many asset classes in the typical endowment portfolio.

A great deal of literature addresses social awareness as part of an investment policy for an endowment or foundation, including an increasing focus on institutions as anchor institutions, where a university and other institutions do more to improve the communities they occupy (Kebea, 2019). *Metropolitan Universities* journal, for example, dedicated its February 2018 issue to anchor institutions. Impact investing is more broadly discussed for foundations, with much of the literature focused on the societal benefits with some discussion of risk and return factors. Emerson (2018), for example, has written a great deal about "blended value," which considers the social and financial results of an investment. Epstein and Yuthas (2014) discuss quantifying social impact, although with an emphasis on larger-scale projects, and much of the literature focuses on large-scale investment themes, such as global health, environmental issues, and economic development. Aggarwala and Frasch (2017) address the conflict in investor mandates by considering endowments as "one big impact investor" and incorporating a simplified modern portfolio theory approach. Mission Investors Exchange (Community Foundation Field Guide to Impact Investing, 2013) and the Institute for Responsible Investing (Wood & Hoff, 2008) for example discuss the benefit to fund raising from an impact investing framework and are among organizations that have published detailed guides about where endowments can allocate money. Smith and Smith (2016) have suggested the benefits of impact investing to the endowment and to the university. Chowdhry et al. (2019) discusses how impact investing can blend with traditional investing to optimize outcomes, although, unlike this proposal, there is an implicit assumption that impact investors or "socially motivated" investors must sacrifice return. The issue may be definitional. Some investors define impact investments as any investments with below-market expected returns but having targeted social benefits. As discussed later, this paper will not use this definition, however, and indeed finds it too narrow. This paper blends these concepts into a central idea to guide those considering impact investing. It takes a holistic and accessible approach to implementing impact investing, detailing the steps required, how to consider returns, how to incorporate portfolio analysis tools, and discusses investment opportunities across of range of asset classes. It focuses on endowments, which, unlike foundations, may not have a specific social mission. This paper contends that impact investments can be considered in a typical risk-return paradigm and that smaller organizations with narrower goals and leaner staffs can participate in impact investing. It addresses the difficulty of measuring returns, drawing on previous work but seeking more precision. While addressing reasons why few endowments have yet implemented impact investing, it also suggests that a university can do more; the paper proposes not only that a university endowment can incorporate impact investing and honor its investment policy mandate to grow its assets, but also that the university is advantageously positioned to do so to the benefit of its students and community.

SRI vs. ESG vs. impact investing

A university's concern about where it invests is not new, yet the framework for responsible investing has only emerged in the last two decades. In the 1970s and 1980s, for example, a number of endowments debated or implemented anti-apartheid policies of divestment. Yet the call to consider social outcomes clearly has grown louder in the last decade (Höchstädter & Scheck, 2015). Under the umbrella of responsible investing, one can consider a spectrum of involvement from less to more active directives. ESG, at the passive end of the continuum, has gained considerable momentum. The UN Principles of Responsible Investment, an organization launched in 2006 that offers guidelines for ESG investors, has grown from 100 signatories to more than 2,200, representing more than $80 trillion of assets (Principles For Responsible Investing, 2019). Interestingly, the organization has no specific criteria for excluding an investment; a signatory only agrees to explicitly consider ESG factors as part of its investment process. ESG investing from the perspective of an endowment is an outsourcing of responsibility. Institutions may require their own investment teams or their outside managers to incorporate ESG guidelines, but the policies have no real say on what assets these managers purchase. To that extent, it is a passive approach.

Socially responsible investing represents a more active step. SRI differs from ESG in that an organization will typically provide a list of prohibited securities or a manager will operate with the idea of explicitly excluding certain type of stocks. An endowment's prohibited names typically reflect the ethos of the university, such as banning firms involved with contraceptives, weapons manufacturing or, more recently, operating in carbon-based industries. As SRI and ESG directives often are combined, the use of SRI guidelines is unquestionably rising as well (Dawkins, 2018). Although the factors under consideration could overlap, SRI is not necessarily a subset of ESG. An SRI-focused investment policy could eliminate a company by the nature of its business while another endowment could find no fault.

Impact investing, or mission-based investing for foundations, goes further yet. The term impact investing itself is relatively new, dating only from 2007, and it still lacks a common definition (Höchstädter & Scheck, 2015). The Commonfund, an organization meeting investment needs of endowments, defines impact investing as those with "the express goal of generating and measuring mission-related economic, social or environmental change alongside financial return" (Foundations Survey, 2016). It is key that impact investments seek financial returns and furthers the social goals of the organization, especially in the context of investment policies. These investments can span the portfolio, from cash with community-banks to housing loans for low-income residents to direct investments in impact funds to loans and equity stakes in small businesses. Impact investments, also known as mission-based investments, are different than grants, which can have no financial return, or, more accurately, a negative 100% return. Unlike ESG or SRI, impact investing is quite active; it is not an exclusion policy but an explicit policy of targeting certain investments. Emerson writes that impact investing is the "*intentional* deployment of resources across the entire capital continuum wrapped around itself, transcending the dualism of doing good and doing well." It must have an explicit goal of social benefit and financial returns (Emerson, 2018).

Despite the growing popularity of ESG, SRI, and impact investing, foundations and especially endowments have been slow to incorporate these approaches. In the Commonfund survey, only 25% of respondents have investment policy statements referring to one of these areas. For endowments, 21% of the respondents reported SRI as part of their plans, making it the largest category for those with a policy. Impact investing was by far the least popular, with only 3% of endowments reporting its use, although the scope of implementation and even how each respondent defines impact investing is unclear. Impact investing acceptance was much higher among foundations, likely reflecting the mission-based nature of foundations (Foundations Survey, 2016).

There should be no reason to expect a decline in the interest in ESG, SRI, or impact investing. Much as the anti-apartheid investment controversy started with students a generation ago, it seems logical that students or other constituents will demand the same level of accountability of their endowments in terms of social impact. As acceptance grows, an endowment without an explicit policy on responsible investing will likely need it soon. Impact investing will certainly be part of the demands. The trade journal *Pension and Investments* quoted Matt Onek, president and CEO of Mission Investors Exchange, as saying "There is no foundation CIO that isn't considering impact investing. All foundations are going to have to consider how to utilize impact investing in their portfolio" (Bradford, 2018). One should assume his view would apply to endowments at some point as well.

The investment case

Why Endowments

Endowments in general have a differentiated position compared with public plans and with many foundations in terms of their ability to incorporate impact investing. Unlike pension plans, endowments typically do not face long-term liability streams, other than modest distribution requirements, and are not subject to stringent regulations on liquidity or solvency. Like foundations, endowments are ultra-long-horizon investors. Yet endowments differ from many charitable foundations because endowments typically lack a broader social or charitable goal. A foundation can choose to wrap up its operations or change its focus at any point, but universities are typically large forces in their communities, through employment, their role in education and, often, their physical presences. Finally, endowments bring together a range of academic and professional disciplines that can be harnessed and combined with the resources of its student body. For example, many schools have public security investment programs that include students managing endowment assets, and a smaller number have student-involved venture capital programs. The following sections suggest that many of these attributes make endowments advantageously positioned for effective impact investing.

The Portfolio Fit

Socially-motivated investment guidelines have been criticized and avoided because of the concern that they will diminish returns and, therefore, violate fiduciary duties. The Commonfund survey found 71% of respondents seeing returns from impact investing as a substantial or moderate impediment to implementation. Additionally, 37% saw concerns about fiduciary duty as a substantial or moderate impediment (Foundations Survey, 2016). Portfolio theory suggests that limiting an investment universe leads to sub-optimal risk-reward trade-offs, yet the observed impact of social policy on risk-adjusted returns is less clear in practice. While some studies have found drags on returns from ESG and SRI policies, an increasing number of studies suggest a benefit to returns (Verheyden, T., Eccles, R. G., & Feiner, A. (2016). The counter-argument to the risk of limiting the investment universe is that the companies meeting certain social criteria are better firms and, over the long term, more likely to create value. That debate is beyond the point of this paper. Suffice it to say that the issue of how ESG guidelines impact investment returns is far from settled.

The return implications of impact are more difficult to study; it is relatively new, and one cannot use publicly traded stocks to measure returns. In addition, institutions that use impact investing sleeves would not normally break out segment returns. The Global Impact Investing Network reported that among investment managers running funds that seek profitable returns, the majority earn market level returns. Those willing to accept lower returns typically end up with below-market returns, unsurprisingly (Annual Impact Investor Survey, 2018). The implication is that returns for impact investment are not inherently poor. They depend on the projects selected, as it is with all investments. What is also clear and different from ESG or SRI policies is that impact investing does not require limiting an investment universe. Impact investments can be an additional asset class that expands the universe, just as many large endowments have moved beyond traditional asset categories and into alternative asset classes.

A lack of adequate empirical data leaves a theoretical debate whether impact investments can provide adequate returns. While one could follow a model suggested by Chowdhry et al. (2019) that classifies investors are either “profit-motivated” or “socially motivated,” there is no inherent reason why one investor cannot be both. While the authors use this model to examine designing contingent social contracts and not as a discussion about implementing impact investing, the intuition holds.

An efficient market argument would suggest that social needs exist because there are no proper private sector incentives, such as attractive returns, to address them. Such an argument ignores the fact that many impact investments are small and thus difficult to find or lacking enough scale to warrant investments from larger pools of money. As discussed below, the argument does not necessarily need to be that impact investing are the highest return investments but only that they offer attractive risk-return trade-offs and favorable correlations with other portfolio assets. In addition, as discussed later, the return calculation may not be as straightforward as with other asset decisions. As long as an endowment can choose which investments to fund and assuming it has some skill in choosing, or at least not a bias toward poor decisions, returns need not suffer. An impact investment that "does good" can also do well.

Portfolio Optimization

The decision to include impact investing can, therefore, be viewed as part of the traditional asset allocation process, which takes into account risk, return, and asset correlations. Impact investments can be extensions to existing asset classes, such as cash and fixed income where they introduce a modest change to the risk profile. In the case of equity-like impact investments they can be considered as alternative asset classes with distinct risk and return characteristics. Examples could include direct equity stakes, loans with enough risk to be considered equity-like or investments into impact funds that invest in these type of securities.

Table 1. Risk-Return Assumptions by Asset Category.

	Expected Return	***Standard Deviation (σ)***	***Comments***
Equity	9.7%	10.8%	MSCI All Country World Index - Trailing 3 years
Fixed Income	4.1%	3.5%	Barclay US Aggregate Bond/Hilgh Yield Blend -Trailing 3 years
Impact Investments Low	8.0%	5.0%	Global Impact Investing Network
Impact Investments Blend	12.5%	11.5%	Global Impact Investing Network
Imact Investments High	17.0%	18.0%	Global Impact Investing Network
Cash (Risk Free)	1.0%	0.0%	
Correlation: equity to FI		0.43	Lipper US large cap equity fund vs fixed income blend (1990-2014)
Correlation: equity to II		0.46	Cambridge Associates Global Private Equity Index vs. fixed income blend
Correlation: FI to II		0.14	Cambridge Associates Global Private Equity Index vs. fixed income blend

Fixed Income blend refers to blend of Lipper aggregate core bond fund and Lipper aggregate high yield fund. Correlation data covers 1990-2014 quarterly results.
Sources: MSCI, Global Impact Investing Network, Invesco, Morningstar

The model uses this framework and the tools of Modern Portfolio Theory (MPT). As an overview, MPT considers the risk and return characteristics of each asset as well as the correlation of their returns to all other portfolio holdings. An asset whose correlation with the other assets is less than perfect can improve the overall risk-return trade-off of a portfolio, even if the asset itself offers a less attractive risk-reward combination than other the assets. An extension of MPT is the Sharpe Ratio, which measures the risk a portfolio takes and compares it to the additional return a portfolio generates by taking that risk; a higher Sharpe Ratio is desirable as it means an improved portfolio in terms of expected return and risk. The assumptions for each asset category are important to the analysis and subject to debate. While one scenario appears here, the larger point is that impact investing can, and should, be considered as any other investment sleeve.

The scenario starts with an endowment portfolio that has 60% of its assets in equities, 35% in bonds and 5% in cash. Table 1 details the risk, return, and correlation assumptions, which rely on the historical data noted. Note there are three scenarios for impact investing. GIIN reports returns for two type of investors: those seeking market level returns and those willing to accept below market returns. Both sets of return numbers, plus an average of the two, are used. As the portfolio shifts out of equity exposure and into an equivalent exposure of impact investments with equity like characteristics, the Sharpe Ratio improves. In other words, the inclusion of impact investments improves the risk-return tradeoff for each set of assumptions, as seen in Figures 1, 2, and 3. Depending on the assumptions for impact investing, the Sharpe Ratio peaks between 20% and 60% exposure for impact investments.

Figure 1. Sharpe Ratio with below market assumptions.

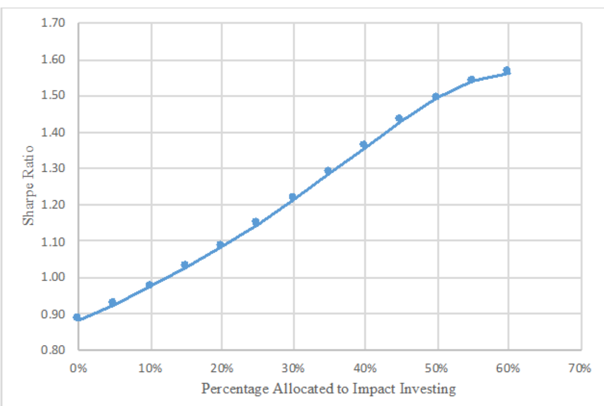


Figure 2. Sharpe Ratio with blended returns market assumptions.

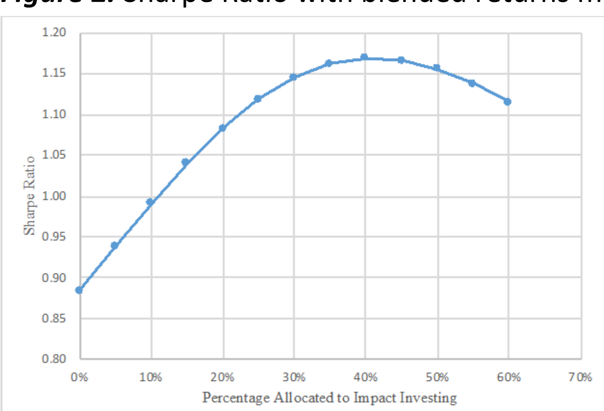
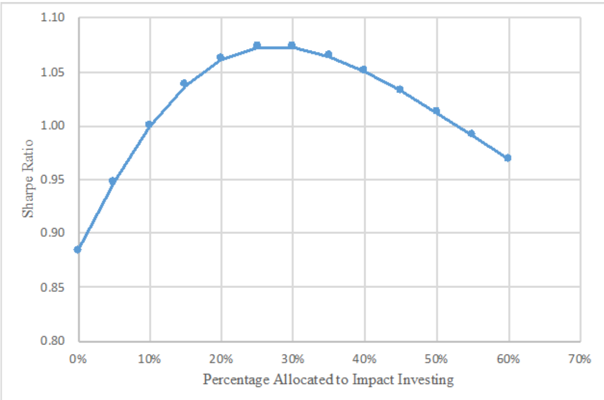


Figure 3. Sharpe Ratio with market return assumptions.



Such a high weight should not be entirely surprising given that many endowments already have meaningful exposures to alternative investment classes. The numbers also coincide with a Commonfund survey, where respondents set a target allocation to impact investing between 1% and 20%. The analysis does not consider liquidity as a risk. Endowments, however, have the advantage of being ultra-long-term investors and can tolerate low liquidity as long as the impact investing sleeve is properly sized. In summary, the analysis suggests that an investment committee with a goal to maximize return with a reasonable risk can improve its portfolio by incorporating impact investing.

The Expected Return Calculation

For an endowment, the calculation of return should be more complex than the simple internal rate of return, even if the endowment's investment policy is simply to increase value. While an endowment can expect market-level returns from impact investing, it can justify lower economic returns if it rightly considers more than direct cash in from the investment. An endowment grows when its funding and investment returns exceed its dispersals. The value of the endowment is the beginning value times the return plus new contributions less dispersal of funds or

$$EV = BV * (1 + r) - D + C$$

where EV is ending value, BV is beginning value, r is period return, D is dispersal and C contributions

Under normal circumstances, there is no real link between the investment return and the ability to attract new funds; that is, within a wide range of outcomes, investment performance should neither motivate nor discourage donors. To maximize EV, therefore, an endowment's investment committee is correct to seek to maximize *r* or, perhaps minimize D, although internal standards, university funding needs and external regulations govern dispersals. In addition, with no expected relationship between C and r, it makes sense to consider fund raising goals independent of investment policy. On the other hand, an investment that can increase contributions, C, could have a lower return and still maximize the portfolio value. Impact investments serve that role. One could foresee an investment campaign featuring an impact investing program in the same way a new building can generate donor interest. As impact investing gains awareness, it creates a stronger tool to use for fundraising. Rising public acceptance can also lead to the risk that not addressing responsible investing slows contributions.

Note the calculations only consider the measurable monetary benefit of impact investing. One could add another component to the endowment return, which is the social benefit, S. The return calculation thus becomes:

$$EV = BV * (1 + r) - D + C + S$$

where S is a measurable social value from the investment

The social benefit could be the value to employees from low-cost housing loans, the benefits to students from a business that offers jobs, say, or any number of social goods provided by many charitable organizations. Naturally, explicit estimates of S are imprecise, but the idea remains that impact investing can pull more levers in raising the value of an endowment. Considering the value of S could also improve the ability to raise contributions, C.

Calculating S and C

Measuring C, or additional contributions, is subjective but easier than quantifying S. Many development professionals would attest that raising assets for a specific cause or project offers many more opportunities for success than merely general fundraising. In a publication by the Mission Investment Exchange, two foundation executives write that donors are "intrigued" by the ability to get a return and then "recycle charitable dollars and achieve a financial return as well as a social, economic and/or environmental return." In addition, they write, "By educating the broader donor community about opportunities for impact investing, the community foundation will be positioned more prominently and favorably to a broader audience of perspective donors – next generation and entrepreneurs especially – who believe in the power of market discipline in community investments" (*Community Foundation Field Guide to Impact Investing, 2003*). Smith and Smith (2016) consider SRI as an extension of a university's brand effect and as a signal; the same logic could apply to impact investing. A university's impact in the community should be seen as its brand. Impact means how it educates students but also, one could argue, how it improves the community that the students occupy or will soon enter. An endowment seeking to raise money can ask on behalf of its students alone or can ask on behalf of the community and its students. The second message might be more compelling to donors.

Table 2. Adjusted Return incorporating additional contributions.

Actual Return	Donor Matching Percentage	Adjusted Return	Value of C
10%	10%	11%	1%
10%	20%	12%	2%
10%	30%	13%	3%
10%	40%	14%	4%
10%	50%	15%	5%
10%	60%	16%	6%
10%	70%	17%	7%
10%	80%	18%	8%
10%	90%	19%	9%
10%	100%	20%	10%

The impact of additional contributions is easier to measure and incorporate into a return analysis, especially if the donations are explicitly tied to a program. An incremental donation increases the return by the percentage that the donation comprises of the endowment's investment, as shown in Table 2. For example, a matching grant, where a donor co-invests at the same level as the endowment, essentially doubles the return on investment of the project. An impact investment policy that draws more general donations, but is not tied to the specific investment, serves the same role. If the added donations are 5% of the endowment over five years, say, then the annualized rate of C is at least 1%, adjusted by the returns generated by reinvesting the funds elsewhere in the portfolio.

Measuring S is more elusive, although several tools exist, the most prominent the notion of social return on investment (Yates & Marra, 2017). SROI requires a way to measure the net present value of the social benefit as a percentage of the net present value of the investment, which is difficult in practice (Millar & Hall, 2013). In theory, one could look at the incremental benefit returned to the community from the investment. The success of a community business, for example, likely has an economic multiplier throughout its neighborhood. The stability of affordable housing for students and their families or for university employees benefits the university in an indirect manner. Measuring these impacts is difficult and subjective but not impossible. Yates and Marra point out issues with the measurements, including the imprecision, but also note that SROI improves comparison among competing plans and can motivate stakeholders to participate. While focusing on health care projects, Banke-Thomas, A. O., Madaj, B., Charles, A., & Broek, N. V. (2015) point out the need to consider the counterfactual, that is, what would have been the outcome had the project not been undertaken. While our equation considers S as a percentage return, one could overcome the fuzziness of measurement by thinking of S on a scale depending on the university's goals. A business employing students in the neighborhood might rank higher than one operating farther from the university and with less local impact. Housing might merit a higher score, for example, than transportation, and thus if projects in each area had the same returns, the endowment could favor housing. Additionally, the endowment perhaps tolerates a housing-related impact investment with a return below market levels, if it ranked housing with a higher S.

There's a risk that an over-reliance on S conflicts with a goal to maintain the infinite life of an endowment. A high value of non-financial returns could be seen as worthwhile but effectively drain the endowment, it is unlikely an endowment would embrace the value of a social return so enthusiastically that the time horizon changes. In any case, the investment policy statement can address this concern, should it arise. Epstein and Yuthas (2014) describe a scoring system for measuring the social impact, with each important criterion ranked and then compared to the financial return. Thus an endowment could assign points from job creation or student health in one project with an above average return and compare it to another potential investment with a fewer social impact points but a higher financial return. The choice between the two may not be clear but at least a model exists. GIIN introduced a measurement called the Impact Reporting and Investment Standards (IRIS), which presents criteria to validate impact, although it does not offer a specific method to quantify the impact in terms of numerical return. Similar measures have emerged as well (Epstein & Yuthas, 2014).

Eventually, and with study, it might be possible for a university to consider the social benefit more explicitly, as the United Kingdom does with its national health care system, where policies address the sensitive issue of pricing and allocating medical resources by assigning a monetary value to the expected remaining years of a person's life. Epstein and Yuthas (2014) highlight a system that measures the present value of incremental wages from a job training program and divides it by the cost of the program to quantify SROI. An extension for an endowment might be to add a coefficient to the numerator to consider the incremental return to the university from those higher wages. It is a complex and naturally imprecise measurement, to be sure, but not one that is unattainable.

Implementation framework

The mission and investment policy statement

With an intellectual framework for impact investing, the next step is developing a structure for implementation. Implementing an impact investment program is not only an endowment decision, but requires a university to consider its mission. While the endowment must tackle a range of structural decisions, the first question for the university is broader: Who should it help? If it wants to invest with impact, where should that impact be felt? The answer starts with the university's mission statement and then feeds into the investment policy statement of its endowment. If a university wants to impact its community, then it must define that community. This section addresses these questions, but not necessarily the difficult answers, and offers some basic structural steps on implementation.

An endowment designed to provide tuition expense, for example, implicitly defines its community narrowly as students and their needs to cover school costs. However, an endowment could consider improving job prospects or training as equally valuable as tuition support. One could argue for a yet broader definition and consider the community as the neighborhoods around the institution or the neighborhoods where its students live. A religious university could consider all members of its church. An endowment could, perhaps, help its students by investing in them, potentially even including their children or their parents. Each endowment will need to customize its approach, taking into account the nature of the university and the needs of the community, once defined. The answers require deep reflection by university leadership and the endowment board and refinement of the university mission statement. The difficulty of the questions, however, does not diminish the importance of the answers.

Without a mandate to help its community, a great number of endowment investment policy statements may struggle to implement impact investing, stuck with the belief they sacrifice return to do so, this paper notwithstanding. With a clear mandate endowment can address how to consider return in terms of measuring the economic return, the social impact, and the boost to new contributions.

Process and people

Endowments must establish a process to consider impact investments, a specific plan about how decisions are made, and must address factors such as the level of due diligence, the approval process, the monitoring of existing investments, and a host of other implementation-related issues. The process is the template that an endowment holds up to an investment decision. The clearer and firmer the process, the more effective an impact investment program can be. Process depends on the people charged to implement it. Some universities have robust investment departments that are already adept at analyzing alternative investments; others will have to look for resources, either internally, externally, or both.

Many endowments without deep investment offices rely on consultants to find and evaluate managers and aid with allocation decisions. Many impact investment funds and programs have opened in recent years and manage billions of outside funds, and they offer the investment value that endowments seek when hiring other outside managers. They charge fees and lack the ability to tailor the investments to the specific goals of a university. If personnel resources are an issue or if the endowment goals are broad enough, outside managed funds are a viable option. For a dedicated, internally-led impact investing program, it is likely that the endowment would need to identify one person or a small group, likely with some investment knowledge and the ability to garner the university resources, to lead or oversee the process. The person or group would do well to draw on the vast resources of a typical university. The endowment should consider using an advantage that many foundations and non-endowment plans do not possess: universities can tap into knowledge of its professors, alumni and, often, highly accomplished professionals on their own boards as well as the eager and low-cost workforce of its students. Here, again, the concept of social benefit and community matters. For example, many universities have an entrepreneurship class or even entrepreneurial academic program; it may make sense to include in the curriculum the evaluation and monitoring of investments in community-based entrepreneurs. Many other courses in areas such as marketing, operations, accounting, and finance would benefit from the real-world exposure brought in through impact-based investments. If the university considers the role of the endowment to help its students, and most do, albeit typically in a financial perspective, then the idea of giving students practical experience is compelling and another input to S, the social benefit.

Investment Opportunities

The opportunity for impact investing is large. The range is no different than what one sees across the spectrum of traditional investment options from high-risk, high-return, low-liquidity venture capital investments to the low-risk, low-return, high-liquidity cash, and cash equivalents. What follows is a broad overview, with general asset classes and how an endowment could include impact investments in each. Full implementation requires building out or utilizing existing legal, accounting, and compliance personnel as well as developing the process to monitor investments. The examples come from several important publications that have researched the opportunities, including the Mission Investors Exchange and the Institute for Responsible Investing. Numerous local and national organizations offer advice or can be a source of potential investments. Many of these organizations are non-profit but the endowment could build relationships with community banks or other for-profit organizations that seek investors. It is also important to collaborate with other endowments, especially as implementation becomes more widespread, to build scale and leverage resources.

In considering the following asset classes, the process starts by defining the return potential, including the values of C and S, determining the risk and the liquidity and understanding where the investment opportunity would sit within the asset allocation framework. Three key areas are:

- **Cash:** Deposits in community banks which lend locally can be more impactful than cash in national or global financial institutions. There should be little difference in yield, especially in the current low-rate environment. A step further might be to deposit cash in organizations with specific lending mandates, such as subsidizing mortgages for low-cost housing loans. Cash could also support loans to small business in low-income areas.

Institutions include community development finance institutions (CDFIs), which garner federal grants if they direct a specified percentage of business to support those who lack access to financial markets. CDFIs can take in outside, insured deposits to bolster their capital bases. Community development banks and community development credit unions can effectively use local knowledge to find opportunities in traditionally underserved communities. They too can take in outside deposits.

- **Fixed income:** Opportunities include lending for low-income and affordable housing and for community entrepreneurs unable to access traditional bank networks, perhaps because those in need do not fit a traditional profile. While the expected return, at least risk adjusted, could be lower, the ability to generate a return through a social benefit could be higher than with cash investing. Depending on the nature of the loans, these investments could offset some duration risk in traditional fixed income allocations; that is, their values may fall less if interest rates rise.
- **Equity**: Equity-like investments, such as direct investments in small business or even higher-risk loans to them, could be considered an alternative asset class. The equity-like exposure could be venture capital investments for entrepreneurs in the university community, as defined by the mission statement or investment policy statement. An endowment could use an outside-managed fund for this exposure or could harness local resources, including its faculty and students, to source ideas. Many community-based organizations and local banks help underserved entrepreneurs with loans. An endowment could use the vetting and analysis of these organizations but invest as an equity-holder, perhaps increasing the credit-worthiness and capital of the fledging business. The opportunity also exists to co-invest with other local universities with similar agendas and communities to create the ability to diversify among many opportunities.

Implementation Roadblocks

University endowments have sought out alternative investments, including hedge funds, venture capital, and real assets, in an attempt to diversify and to seek alpha. At the same time, the university community, including faculty and students, have spoken out for greater social awareness in the endowment's portfolio, if not explicitly referring to impact investing then at least addressing its key attributes. Nevertheless, the implementation by university endowments has been minimal. There are examples, such as University of Cincinnati, which invested almost $150 million or 13.6% of its endowment to finance real estate development in a Cincinnati neighborhood (Dubb, McKinley, & Howard, 2013). Other examples exist, but as noted, fewer than 3% of university endowments have an explicit impact investment policy, and one might wonder about this number given the loose definition of impact investing and the frequent conflation with socially responsible investing. Many endowments allocate funds for students to invest through university courses, which can be considered an impact investment with the social benefit of practical experience for students. These examples notwithstanding, when one moves down from SRI and ESG and consider only investments with direct benefit for the university community, it would seem that a barrier exists between the spirit of the university community and the actions of its investment board. The barrier cannot be explained by a lack of interest in non-traditional investments or by abnormal risk-aversion. Some asset classes offer opportunities for impact investing without requiring notably higher risk tolerances. Instead, it appears that structural and behavioral factors have prevented implementation, and if not addressed, could continue to slow acceptance, despite an existing investment rationale.

Phillips and Johnson (2019) interviewed leaders of non-profit organizations and others involved in funding affordable housing and community development projects to highlight barriers in implementation. While the interviewees were not from endowments, one can infer common apprehensions. The authors found that a lack of market knowledge and the challenges of measuring social impact were among the reasons to not invest. Similarly, Emerson and Bugg-Levine (2013) highlight the lack of markets, a poor structure to access deals and, importantly, a lack of a common measure to measure social impact. The lack of a method to measure impact might be the biggest barrier. Endowments could rightly argue that their traditional investments have impact already, as their capital finances companies that create jobs and improve lives. If impact investing requires a sacrifice in returns, therefore, it belongs as part of the distribution of the endowment and not the management of its corpus. The view is not without merit, but Emerson (2018) dismisses this oft-heard quip of “all capital has an impact.” He is a long-time advocate of “blended value” and argues that the lack of a perfect measure is not a reason to abandon the effort to consider social value.

Ford Foundation President Darren Walker (2017) suggested changing a prevailing attitude where an organization considered 5%, the distribution, of the portfolio in terms of social impact and the remaining 95% in terms of financial returns. He writes that “the time is right … to consider how we might start to bridge the gap between philanthropic impact and investments.” This bifurcated view of a portfolio that he criticizes, however, could explain the slow adoption of impact investing, especially among endowment boards and investment staffs that lack a specific social-welfare goal. Again, without a framework to measure returns, boards may not feel comfortable moving away more traditional investment options. Other hesitations may run deeper. For example, Larry Kramer, president of the William and Flora Hewlett Foundation, suggests that impact investing is wasteful for an endowment because it blurs the line between grants and investments. Sacrificing investment returns for impact investing, he suggests, diminishes the value of future grants and thus reduces their benefits (Gunther, 2019). His views also would argue against program-related investments, an increasingly popular method of equity and loan that combine grants with financial return expectations. The then-president of Harvard University, Drew Faust, was even more emphatic in 2013 when he said, “The endowment is a resource, not an instrument to impel social or political change” (Mufson, 2019). While Faust was commenting on student and faculty requests to divest shares of companies focused on fossil fuels, his attitude might extend to impact investing. Accepting the idea of a broader return measure for impact investing and considering them as viable portfolio options, as this paper suggests, could very well require a mindset not common in endowments, what Emerson and Buggs-Levine (2011) call the “mutant manager.” A second hesitation is access to investment options, although many funds exist that cater to impact investors. While these funds have seen tremendous growth, they may not be suitable for endowments seeking local impact. The problem is also scale; a large endowment with a robust staff can best evaluate impact investments, but for efficiency it must consider large deals that can be meaningful within a portfolio. A smaller endowment can handle smaller deals but may not have the staff or investment sophistication to evaluate the prospects. One method to marry community impact and scale would be to partner with other local institutions or with many community-based institutions focused on local economic development.

Even if an endowment investment team accepts that impact investing might not require a sacrifice of returns, the issue of time horizon could be a deterrent to implementation. Most endowments, to the extent that a university plans to remain in existence, have an extraordinarily long investment horizon, excluding its annual distribution requirements. While Jaeger, et. al. (2010) speak of the multi-horizon paradigm for endowments, segmenting between current distribution needs and long-term growth of the corpus, the substantial long-horizon portion allows universities to be paid for liquidity risk that other investors could not accept. A potential conflict, however, would arise if investment decision makers at endowments do not also have long investment horizons because of their compensation plans or career goals. For example, the University of Michigan set investment staff bonuses on the rolling three-year performance relative to benchmarks and to peers (*Investment Office Incentive Plan* 2017). Linking compensation to performance is not inherently bad and quite common in the investment community. The point is not to criticize Michigan in particular but to note that incentives can influence the willingness to take on a longer-term perspective inherent in some impact investments.

It may be unfair, however, to blame the manager, who is really the messenger of the university’s mission statement. Real adoption among endowments likely will start with leadership at the university to establish a goal to incorporate impact investing into its endowment and then align interests and allocate resources. The decision could stem from the perspective of a university as an anchor mission and the role of place-based investing. Emily Sladek of The Democracy Collaborative, a non-profit organization dedicated to harnessing resources for community development, writes that universities now recognize themselves as “important place-based engines that play key roles in key economies.” That awareness is “the beginning of the story,” she writes. “It is one thing to be an anchor institution. It is another to consciously and intentionally adopt an anchor mission, leveraging all available institutional and operational resources,” states Sladek (Sladek, 2019).

Given the mandate to do so, an endowment investment team will seek out vehicles for an impact, either through CDFIs, local banks and funds, teaming with other groups with similar community goals, and many other options. The need to seek investments could lead to greater effort to measure the impact, both in contributions and social returns, to justify and monitor the money spent. Each university will have to develop its own tools, tailored to its resources and definition of community, but there will be similarities among endowments and benefits to sharing knowledge. Processes improve with feedback loops.

Conclusion

Endowments often see impact investing as a choice between increasing assets and allocating money for social good. This paper sets out to show that this tradeoff can be a false one, especially as one considers the effect on contributions and values of the social benefits to the university's community. Incorporating impact investing requires a robust policy and a thoughtful debate on the definition of the community, but it can be a powerful and, if properly measured, a fair-return strategy for a university. An endowment could undertake impact investing while remaining a prudent person, as investment policy statements and outside standards often require. It is important to distinguish impact investing from grants. Impact investments should not crowd out grants with strong social impact but negative financial returns. This paper suggests these two paths are complementary, rather than conflicting.

However, adoption has been slow and this paper suggests endowments must overcome some structural biases against impact investing to match the level of acceptance seen in foundations. While the lack of precision in measuring social impact is an important barrier, there are investment options that can still make sense. In addition, an endowment can overcome the difficulty in measuring the social benefit or the incremental contribution with a thoughtful and iterative approach based on experience. An endowment, unlike a foundation, has the additional benefit of involving its students and enhancing their knowledge. In all, the rising voices outside the endowment and the advantages within it argue for a new look at incorporating impact investing.

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