# Navigating the "Alphabet Soup" of Mission-Related Investing

Mission-related investing. Socially responsible investing. Impact investing. Sustainability investing. Environmental, Social, and Governance. Also known as: MRI, SRI, II, SI, ESG.

The lexicon of mission-related investing can sometimes feel like "alphabet soup." There is no universal framework for the terminology and the strategies that we include under the umbrella of mission-related investing are expansive—and often quite distinct. Various institutions and stakeholders use the same terms to mean different things—or use different terms to mean the same things.

While this scenario is not unique to impact investing—the term hedge fund, for example, can apply to a myriad of strategies where the only common denominator might be the approach to fees—the opaque taxonomy can sometimes present a barrier for institutional investors wishing to explore and potentially implement a mission-related investment portfolio.

We recently surveyed 159 institutional investors around the world,[1] and nearly a third of them, 31%, said they are currently engaging in mission-related investing by making investments designed to align with or advance institutional goals or values and also provide financial returns. Of that group of mission-related investors, 44% said they've increased these allocations over recent years, and 62% expect to grow them in the near future. None said they plan to cut back.

Would these numbers be higher if some of the definitional and conceptual hurdles were removed, or at least better understood?

The alphabet soup, or the web of words, and its nuances can make it difficult for asset owners and investment decision makers (e.g., investment committees and trustees at foundations, colleges, universities, religious institutions, pensions, and family offices) to initiate and advance discussions about mission-related investing programs. Those early discussions are critical in helping investors develop objectives for mission-related investing initiatives, agree on priorities and processes, and establish criteria for evaluating results and outcomes. If those discussions stall, or don't even begin, the programs won't go very far.

We've found that the alphabet soup barrier begins to vanish if investors re-frame the discussion to put less emphasis on terminology and nomenclature, and instead to focus on three key questions or topics:

1. *Intention:* What does the institution want to achieve in a potential mission-related investing effort beyond conventional financial objectives? How important is the degree of alignment between mission and investment assets?
2. *Returns and Risk:* What role or purpose do the assets serve within the context of the enterprise? What return and risk profile is required to support the institution's objectives?
3. *Knowledge:* To what extent does the institution have knowledge of mission-related investment opportunities, and what other information is needed?

[1] "Mission-Related Investing: Current Practices and Views of Non-Profit Investors" (February 2017)

## WHAT ARE OUR INTENTIONS WHEN CONSIDERING MISSION-RELATED INVESTMENTS?

"Intentions" in this context refer to the ways in which the institution might want to make investments that align with or advance the overall mission of the enterprise. One intention might be to avoid, mitigate, or eliminate exposure to investments that conflict with the institution's values, or investments that are deemed to pose unacceptable risks. This approach might involve negative screens, which constitute what is commonly called "socially responsible investing" (SRI). For example, some religious institutions screen out investments in munitions manufacturers because they conflict with institutional values. An example of risk avoidance might be steering clear of high-carbon footprint investments to reduce risks associated with commodity price volatility, current or potential regulations, and assets left "stranded" due to climate change.

A different kind of intention might be to define a specific environmental or social objective, and then direct institutional investments to target that goal. Among the terms commonly used to describe this approach are "impact investing" and "double/triple bottom-line investing." Examples might include shareholder activism that aims to encourage good corporate governance and enhance the rights of equity owners, or private investments that target specific outcomes in certain areas, such as water safety and availability, education, and resource efficiency.

Overall, we've found that when investors translate their intentions into a framework and investment policy statement that clearly articulates the intention of their mission-related investment program, they tend to stack the deck in favor of success. An effective framework that we developed centers on the three P's: "Purpose, Priorities and Principles," as further detailed in a previous research report.[2]

## HOW SHOULD WE THINK ABOUT RETURNS AND RISK?

An equally critical topic to address is the context in which institutions consider financial return and risk objectives when it comes to mission-related investments. What are the financial requirements for the assets to support the mission of the institution? Defining return objectives up front allows the institution to set appropriate goals for the mission-related program and to measure its effectiveness.

Often, discussions about mission-related investing pertain to an institution's endowed pool of assets, and investors generally expect their impact investments to generate "market-rate" returns, i.e., returns that are in line with similar investments made without regard to their social or environmental impact. For example, an impact investing venture capital fund should be expected to perform in line with non-impact venture funds, just as an environmental, social, and governance (ESG)-focused global equity fund should perform in line with a non-ESG global equity fund. There may be some unique risks to be aware of, but the integration of impact criteria does not necessitate lowering financial return expectations.

However, some investors may be comfortable accepting "below-market-rate" returns from their impact investments, particularly if they believe the social outcomes of the investment will adequately compensate them for any expected shortfall in the investment's financial returns relative to other investments of

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[2] "The Foundation of Good Governance for Family Impact Investors: Removing Obstacles and Charting a Path to Action" (September 2016)

comparable risk. An example of this is supplementing traditional philanthropic grants with "Program-Related Investments" (PRIs), such as loan guarantees, low-interest loans, or angel capital where the primary aim of the investments is a philanthropic, rather than financial, objective.

While both market-rate and below-market rate opportunities can exist within a mission-related investing portfolio, it is important to be clear about return expectations when developing a strategy and selecting appropriate investments.

## WHAT ELSE DO WE NEED TO FIND OUT ABOUT THE MISSION-RELATED INVESTMENT OPPORTUNITY SET?

The universe of potential mission-related investments is wide and varied, and allocating effectively requires knowledge about and data on the available opportunities. It usually helps for mission-related investors to take a step back and make sure they know enough about their options to pursue an investment strategy that reflects their intentions and goals. Institutions that have already begun making mission-related investments should regularly review their current exposure and research the manager landscape to see if any new opportunities that emerged since the last evaluation.

If, for example, an investor wants to focus its mission-related investments on the environment, there are funds available across asset classes that take both the risks and opportunities from a changing climate into consideration.  Within public equities, there are several low-carbon fund options, each with its own approach to reducing carbon exposures relative to a benchmark. There are also proactive-solution-oriented strategies that capitalize on investment opportunities linked to climate change, many of which are in the private markets. The same exercise is helpful for any impact theme—e.g., education, community development, health and wellness, and/or social justice—to understand how today's opportunity set may align with mission-related investors' intentions and goals.

Beginning the discussion by addressing these three questions—about intentions, performance expectations, and investment opportunities—rather than getting bogged down in alphabet soup can remove the frustration and, sometimes, paralysis out of efforts to explore, initiate, and expand mission-related investing programs. Regardless of the language an investor ultimately uses to describe its approach to mission-related investing, a thorough review of these topics can be the first step to forging a successful path forward.