ABFE
A Philanthropic Partnership
for Black Communities

Foundation Investment Management Practices:

Thoughts on Alpha and Access for the Field

Introduction

As the first affinity group recognized by the Council on Foundations, the Association of Black Foundation Executives (ABFE) has been an advocate and catalyst for diversity, inclusion and equity in the field of philanthropy. This advocacy has ranged from increasing diversity among foundation leadership and staff, to promoting greater awareness of grantmaking for impact in Black communities. An area yet addressed by ABFE is the inclusion of diverse investment managers in the management of foundation endowments. ABFE is extending its advocacy platform to focus on increasing opportunities for minority-owned management firms to act as fiduciaries on behalf of foundations and endowments.

We recognize that alpha is among the most important considerations in manager selection for those responsible for achieving returns on invested assets. With this understanding, we assert that both foundations and managers could be working together to create even greater opportunities for growth and performance:

- emerging managers, including people of color-led and women-owned funds, can and do deliver top quartile returns while allowing organizations to better align strategic investment partnerships with the organization's mission and long-term objectives; and

- market performance and a spate of scandals in the financial service industry brought home the reality that bigger is not necessarily better, and size does not mitigate institutional or investment risk. To meet the performance needs of shrinking endowments and to respond to the unprecedented volatility in the financial markets, foundations will need to deepen their bench of investment managers and insist on higher standards for due diligence in assessing potential managers – large or small.

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Introduction *continued*

While the above-mentioned ideas are significant reasons for taking on this work, in the long-term, we are also interested in creating new wealth among investment managers of color for the express purpose of creating new sources of philanthropy to support Black communities. Even a cursory look at highly publicized philanthropy and partnerships initiated by Black investment managers or Black-owned firms reveals the significant potential for grantmaking in Black communities. For example, two successful Black investment managers or firms – Ariel Investments and Eddie and Sylvia C. Brown – have pledged, donated or leveraged more than $15 million to support education, the arts, youth development, research and the advancement of race relations. As such, to align with the organization's mission to promote effective and responsive philanthropy in Black communities, ABFE is interested in further engaging managers of color in the field who are critical donors themselves, as well as employers of Black professionals.

Barriers to Engaging Minority Investment Managers and Recommendations to the Field

At its 40th anniversary celebration in April of 2011, ABFE convened a *Foundation and Emerging Manager Roundtable* at the William Penn Foundation in Philadelphia, PA; participants included minority investment managers, as well as foundation executives interested in the topic. The convening was an opportunity for networking and relationship-building between foundation executives and a select group of highly qualified managers in addition to candid peer-to-peer conversation on the topic.

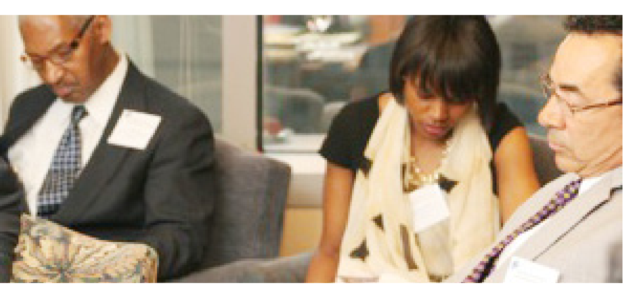
In September of 2011, ABFE convened a smaller group of the participants from the April gathering to further refine the case for this work and the potential role that ABFE can play in the field . Based on these two ground-breaking discussions, we have identified five key barriers that prevent minority managers from working in philanthropy. Along with barriers, we have outlined recommendations to the field to increase the engagement of minority managers in search activity and selection.

1 Foundation policies and practices, and those of their consultants, can inadvertently prevent the identification of, and connection to, qualified minority managers.

Traditional tools and screens used to identify and select managers, like assets under management and track record, by definition, can reinforce biases against minority firms. This is true even for firms with strong performance track records.

Field Recommendations:

- Foundations can incorporate an explicit policy to include minority managers in the manager selection process into existing practices.
- Foundations can request that consultants provide a qualified diverse pool of managers for consideration.
- Foundations and consultants can routinely conduct racial equity impact analyses on investment policies and practices to uncover unintended or potential bias preventing identification and engagement of minority managers.
- Foundations and consultants can establish direct relationships with manager-of-managers or fund-of-funds to identify and invest with pools of vetted minority managers.
- Foundations and consultants can utilize qualitative and quantitative tools and criteria that measure a manager’s performance, as well as other areas of impact, like management expertise, strength of research, or their philanthropic endeavors that align with their mission.
- Foundations and consultants can promote policies that facilitate minority manager engagements to the broader field, such as the inclusion of at least one minority manager for a final interview, along with other “majority managers” to allow investment committees and boards to gauge performance beyond size and track record.



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2 Misperception among foundation and consultant decision-makers that an intentional focus on engaging minority managers results in higher investment and/or institutional risk or compromised returns.

Studies show that small firms, often minority-owned, perform better in down markets. Nonetheless, these firms are often unfairly dismissed as inexperienced, even if they oversee considerable assets and are run by experienced founders and portfolio managers.

Field Recommendations:

- Foundations can invest in a messaging and awareness campaign promoting the positive performance of minority managers.
- Foundations can create a pooled fund with different asset classes to demonstrate performance of minority managers and to mitigate perceived risk. Use of pooled funds can identify new talent for direct engagements. These programs may complement efforts to revise existing investment policies and practices that prevent engagement of minority managers.
- Information on performance of minority managers can be provided in public forums to address the perception that smaller minority firms do not perform as well as larger firms.

3 Foundations have limited access to avenues for sourcing vetted minority investment talent in different asset classes.

It has been a challenge for foundations and their consultants to readily identify quality minority firms because they have had less exposure to these groups. Where there has been success in using minority firms, it is not widely shared and known among foundation peers.

Field Recommendations:

- Foundations can partner with manager-of-managers or fund-of-funds investment firms that carry emerging, women- or minority-owned firms in different asset classes on their platforms.
- Foundations can direct their consultants to include qualified minority managers in searches or to adjust certain parameters that will broaden the universe of identified managers.
- Foundations can learn about strategies and sources of talent from public pensions that have experienced success with minority manager mandates.
- Foundations can learn from each other about talent utilizing peer exchange strategies.
- Foundations can create open search processes that broaden the scope beyond consultant screens and existing networks to create avenues for smaller firms to discover search activity and enter the process.
- Foundations can strongly encourage their consultants or advisors to develop and maintain active lists of top performing women and minority managers in different asset classes.

4 Limited marketing resources among investment management firms of color inhibits their visibility and access to potential foundation clients and their key decision-makers as internal champions..

In general, minority-owned firms have less access to capital to support business operations and to fund their growth. This disparity is a barrier to a minority investor's capacity to build relationships that lead to business opportunities.

Field Recommendations:

- Key foundation stakeholders and decision-makers (CEOs, CIOs, CFOs, Trustees) can intentionally engage minority managers in existing and planned conferences.
- Foundation associations (regional associations, professional groups, Council on Foundations, etc.) can organize special opportunities for minority managers and foundations to meet and identify potential business opportunities.
- Foundations can invest in messaging and awareness campaigns promoting the positive performance of minority managers.
- Foundations can encourage consultants and staff to attend events that attract or assemble large numbers of women and minority managers.

5 Foundation efforts to engage minority managers may require the re-appropriation of existing investments and divestment from larger firms.

Foundations and their consultants develop trusted relationships with investment firms over time. While performance should be a driver of investment strategies, it can be difficult to end long-standing business relationships and to develop new ones.

Field Recommendations:

- Foundations can use this period of market volatility to review existing managers and their performance and develop opportunities to identify new minority manager talent.
- Foundations can diversify the manager roster by having at least two managers in a particular asset class, which can benefit investors as smaller managers have generally been found to have less correlation to their respective indices.