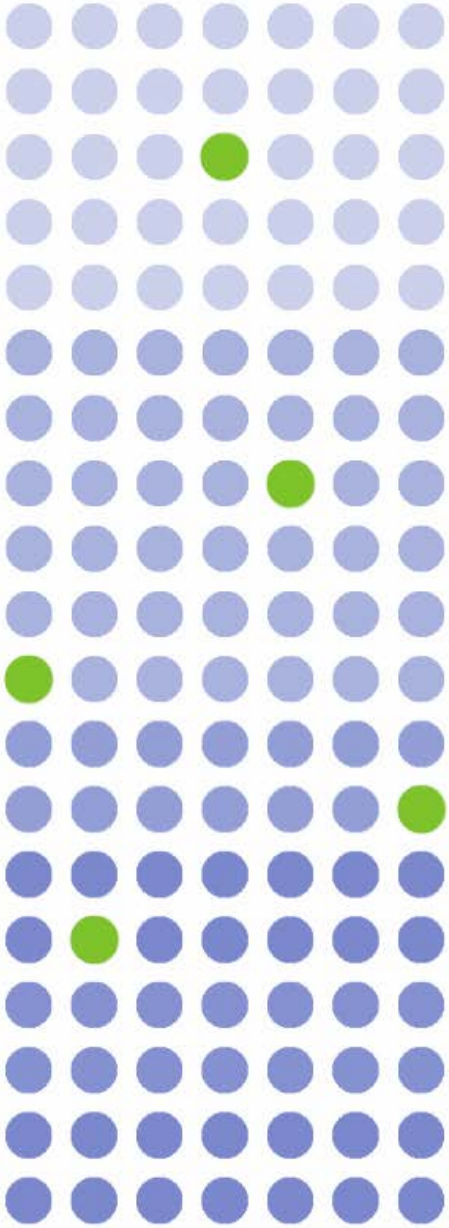
Building a Foundation for the 21st Century

by Clara Miller



HERON

Heron's Aspiration: A Philanthropic World

For over fifty years, the global economy (and that includes the U.S. economy) has felt the effects of three related long-term trends, widely reported and acknowledged. They are: first, a weakening of the pull of place (geography has become less critical to transshipment and the manufacture of value-add products and, therefore, city location is less of a factor for business' location decisions); second, disintermediation (cutting out the middleman, whether it's broadcast and print media, music distributors, Main-street retailers, bricks-and-mortar banks or financial printers to name just a few); and third, closely related to both, the explosion in the use of information technology, meaning that in labor markets there are more journeymen, no assurance of life employment and a continual evolution of skills needed to make a living.

In the social sector, as we build enterprises and invest capital, we may be depending on assumptions based on an obsolescent economic framework. This is especially true in the foundation world, where endowments create a certain amount of insulation from the market economy. But the accelerated rate of change in society has made it urgent that we develop adaptive business knowledge and practices for our work. While permanence may be a key mission requirement for some (preservation of artifacts and cultural treasures, for example), fossilized thinking cannot be. We simply can't succeed in a vacuum, especially when the pace and nature of the gaps we are called upon to fill have become larger and more frequent, the problems more intertwined and the needs more urgent. These conditions prompted Heron to begin a journey of reinvention, not only of strategy, but of business model.

Reinvention has involved three basic guiding principles. First, we must go beyond marginal and auxiliary philanthropy (the traditional and appropriate model for charity) to engage actively with the whole economy, positioning ourselves to be fully engaged for mission both inside the foundation and outside in the economy. Second, we must develop and adopt practices that allow us and our allies to have broader influence, always looking to fulfill our mission beyond our own walls. And third, we must call for all enterprises, in all sectors—public and private companies, partnerships, nonprofits, government—to be actively and broadly philanthropic in their regular operations.

For Heron, this approach is nothing more nor less than a return to the basics of what philanthropy is meant to be: first and foremost, an orientation to life, available to and shared by all, every day; and second, a distinctive part of commerce with a specific role in it, rather than an island protected from it. Money and mission were never meant to be apart.

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A Changed World

In 2011, still reeling from the global financial crash and the ensuing Great Recession (and on the heels of our own leadership transition), the F.B. Heron Foundation paused for a hard look at the way we pursue our mission: helping Americans help themselves out of poverty. It wasn't the mission that needed revisiting; regrettably, that was more needed and relevant than ever. What needed some fresh thought was how we expected to achieve it, and what progress we had been making thus far, if any.

Outside our walls, some things had clearly gone awry. Not only was the country light years away from achieving the gains we sought, but in many cases things had become worse for Americans in poverty. And while a number of our grantees and investees had won battles, it seemed that we were losing the war. After a sobering strategic review, we concluded that the world had changed, and that we must change as well.[1] The run-up to our "new approach" was, first, to admit that our dominant strategy of helping people get access to assets—a prevalent approach to poverty alleviation in the sector—wasn't adequate to the task. Acquiring a home, getting access to credit, and investing in education were helpful anti-poverty approaches only insofar as people could get jobs that produced reliable and adequate income. But in an environment where unemployment and underemployment were high, contingent and low-wage jobs prevalent, and the negative effects of information technology and globalization rampant, these traditional programs weren't enough. We had to admit that we were undermining our own (and more importantly, others') prospects for success by not adapting ourselves to this changed environment.

We concluded that the accepted view—that American poverty was the result of expected and temporary market failures for a small and declining percentage of the population—had been contradicted by decades of experience. Accordingly, the expectation that poverty was thus treatable with philanthropic remedies designed to help people on the margins was equally flawed. The sobering reality we faced was that the "market failure" that philanthropy was expected to address in this case was in the market economy itself, that is, in the market economy's failure to deliver on its promises to a growing percentage of Americans. We were failing to achieve economic integration in the mainstream, and marginal fixes would not be enough.

There was never a question that, as a philanthropic institution, we needed to do our utmost to be more effective. But what might that entail? Heron was already pushing past the philanthropic margins, with a multi-year track record of mission-related and program-related investing.[2] By 2010, the foundation had invested 40 percent of its assets in enterprises that were consistent with its mission. The portfolio spanned asset classes (bonds, private equity, public equities, private loans, and program-related investments) and legal forms of organization (government entities, funds, nonprofits, small businesses, and cooperatives). The answer was not, as is sometimes suggested in the euphoria of a new strategic plan, a matter of "expanding the toolkit." The toolkit was already broad.

The portfolio itself—Heron's permanent capital, sometimes called an "endowment"—was in the vicinity of $300 million. This, by itself, was hardly enough to move the economy. Moreover, even if we recruited all our peers to do exactly as we had done, we, together, would comprise a total of one percent of assets under management globally. Even one percent would be a start, but we needed to look further. Our work, and our investing, must be influential not only beyond our walls, but beyond philanthropy.

So we decided to look beyond our portfolio of investments, to examine the way we operated and how we interacted with the economy as a whole. Our goal was to do more, and the route we saw was to move beyond *marginal* and toward *fundamental* philanthropy, where philanthropy is

[1] Heron's 2011 strategy document, "The World Has Change and So Must We…" was published in a compendium by the Federal Reserve Bank of San Francisco and is available on Heron's website, www.heron.org
[2] See the timeline at www.heron.org/enterprise for more information.

seen as essential to the functioning of the economy, not as separate and in ways protected from it. We realized that our dominant model was designed to address problems at the margins, in isolation from the commercial mainstream. But this meant that the model itself left on the shelf one of its key distinguishing strengths as an enterprise: the ability to approach all forms of commerce with social benefit in mind.

Possibly the current operating model of the private foundation was logical in an era where economies were subject to the "pull of place," when business owners lived near their workers and were visible in the community; where shared "enlightened self-interest" was manifest and actionable; and where problems seemed bounded by geography (such as transshipment points), political sub-divisions and mid-20th century technology. But from Heron's point of view, current conditions demanded something that went beyond a hermetic, self-protective model.

The Terrarium and the Docket: Limits to the Conventional Foundation Model

> *The science behind terrariums is simple–the environment inside the closed glass jar creates a sort of greenhouse effect, as little that is produced can go out of the jar… plants emit a lot of oxygen and moisture, and these emissions are enough to sustain them inside… [T]he temperature and humidity are controlled by the closed lid of the jar, which makes these bottled gardens immune to changes in weather conditions.*[3]
>
> *[Inside], you can … let the plants fight for space amongst themselves!*[4]
>
> *…The main disadvantage with terrariums is that the plants grown under them are 'soft'. With high humidity, the plant can put more energy into growth, and less into structure and protective mechanisms. When exposed to lower humidity, plants grown in soft conditions often wilt. Another disadvantage that I have found is that no matter what type of lighting is used, it can never beat natural sunlight.*[5]

It seemed likely that the private foundation model was designed to be protective and separate, much like a terrarium. There were a number of parallels: life for the "plants" inside the terrarium is self-contained, dedicated to protecting resources from the downside of external competition, yet internally competitive (i.e., for grant budgets, staffing, attention, power, status and similar). Amid a world of seeming abundance, a scarcity mentality dominates. Energy is spent generating the means for self-preservation through investments with only a small portion (typically five percent) of resources going beyond the confines of the glass. In the absence of outside "sunshine" on the success, failure or, possibly, irrelevance of foundations' work, ideas generated inside the foundation could grow spindly, and subsequently wilt under the pressure of competition and similar market forces brought to bear when internally nurtured theories were taken outside the hothouse.

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[3] "About Terrariums." Bloxhome Terrarium Workshop and Supplies. Website. https://terrarium.wordpress.com/about/ Accessed November 17, 2015.
[4] Teichreb, Chris. "Building and using a terrarium." Coastal Carnivires. Website. http://webspace.webring.com/people/bc/cteichreb/terrarium.html Accessed November 17, 2015.
[5] *ibid.*

As we took note of our limitations in light of 21st-century realities, we concluded that not only were we ill-equipped to take on large, ambitious goals such as helping people escape poverty, but that foundations' operating models in general were simply not "built to purpose." Given the urgency, size and systemic nature of the tasks we take on, we needed not only to more strongly embrace the role of philanthropy in society as a whole (which had been part of foundations' rhetoric for some time), but to rethink the form and substance of the enterprise itself, to question our operating model, and to look for ways to make sure it supports rather than impairs philanthropic effectiveness.

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Beyond the mission concerns, the mere existence of the foundation terrarium itself reinforces the notion that there is an inhospitable economy out there where money and its rules and battles are a necessary and even desirable evil, and where good behavior and profitability are fundamentally incompatible. This separation of "good program" from "good investing" relies on a black and white world view, defining philanthropy as not only separate from, but needing protection from the rest of the economy. In this tidy universe, a relatively small clean-up crew of nonprofits and social enterprises get grants (and possibly even loans) and solve problems, while a much larger complement of mainstream for-profit companies (investees of 100 percent of foundations' assets) run rampant, with license to create the problems the "program side" is meant to solve. It implies that this world view is the inalterable and natural order of things, that the economy is a separate world, and that a philanthropic model that toes this line has the best, or, more accurately, the only chance of succeeding in its assigned role.

But this world view, aside from being overly simplistic at best, leaves much philanthropic clout on the table: it splits staff, systems, skill sets and roles into a "program side" (which administers grants with little regard for finance) and an "investment side" (which manages the endowment, with little regard for mission).[6] This hermetic division makes it difficult for most foundations to coherently mobilize *all* their assets for mission and to interact positively with, rather than ignoring, money, enterprise finance and the economy in fulfilling their goals.

Reinforcing this separation from the economy is a highly structured and internally determined set of program-side protocols which revolve around a board docket—a process by which the Board of Trustees bestows a Yea or (very rarely) Nay vote on the staff's grant recommendations. A bit like the court system after which it is named, the docket model of philanthropy relies on the fact that the market demand for its services (grants) is unrelentingly reliable, and on the belief that results can be assured through compliance (elaborate scrutiny of grantees and detailed restrictions on funds) connected to foundation-determined metrics. A bit like law clerks preparing briefs for court dockets, expert program officers write detailed briefs

[6] The current model represents a hypothetical point on what I see as a rough evolutionary continuum that runs from the "charitable trust," established for the benefit of a specific person, place or group, then continues through the institutional private foundation prototypes established by Rockefeller and Carnegie, and arriving at the example presented as typical for today. In this modern iteration, the modifications of federal regulatory legislation of 1950 and the Tax Reform Act of 1969 have been fully absorbed. While a number of foundations have packed some imaginative additions into their tool kits, few, if any, have made fundamental changes to their operating models, investment policies, or market orientation.

in support of carefully worked out theories of change (case law), perform "due diligence" on grantees, and recommend that authorities bestow rewards (or punishments) accordingly.

By contrast, the "investment side" of most foundations is meant to efficiently preserve the status quo: protect assets and fund grant budgets with no substantive regard for the mission. Guided by strict principles of conventional investing, the usual imperative is to invest 100 percent of assets for financial returns to (1) fund the foundation's grants and operating expenses in accordance with tax regulations and (2) maintain or increase grant-making/purchasing power over time or "in perpetuity" based on the original donor's wishes.[7] The investment team is empowered to move funds fairly freely—many millions are invested on behalf of the foundation—with little scrutiny of the effects that investee enterprises have on society, how they operate (overhead rate doesn't enter the conversation) or how mission outcomes might be improved through a different kind of operation and investment approach.

It appears that this division is designed to protect the foundation's "program side" from the messiness of the market and protect the "investment side" from the fuzziness of the mission. Thus investing and grant-making operate in a balance of church and state (some foundations actually use those terms)—one devoted to ethereal good, the other to gritty extraction of financial returns. Baked into this structure is the sacrosanct belief that mainstream profit-making cannot be philanthropic and philanthropy cannot be market-connected, that grants could not be available without the profits that only unfettered capitalism can provide, and that furthermore, the best use of philanthropic grants is to finance nonprofits to be a cleanup crew for the inevitable mess real capitalism leaves in its wake. Economic man is ring-fenced from and somehow dangerous to philanthropy, and vice versa.

There are many things wrong with this structure. For example, it sentences the foundation to a business model life as an investment management shop with a small charitable-giving program welded onto it. Investment side managers manage funds in the market for maximum profit, prudence and minimum friction. They are generally unaware of the nature of the underlying enterprises that give their asset classes value and provide return. The small granting program, nestled in the terrarium, faces almost no accountability from competitors, customers, or any other market forces. Yet by most measures—including the number of staff and governance time devoted to it—the small giving program consumes most of the organization's resources and is touted as the focus of its business. In fact, grants and operations together comprise around a five percent "spend" of asset value annually.

How the Conventional Model Undermines Our Mission Effectiveness

How does the cultural "split" in the conventional foundation's business model translate into sub-optimal performance on both the program and the investing sides? And conversely, how might combining these separated sides lead to improved effectiveness and mission performance? After all, optimal or not,

[7] Unless the foundation uses a spend-down model.

foundations (including Heron) have been helpful in enabling partnerships between for-profits and nonprofits to improve access to affordable housing, to cite one program area among many. The example of collaboration of foundations with banks, housing developers and Community Development Financial Institutions (CDFIs) to finance affordable housing is a familiar and instructive one. It illuminates the shortcomings of the program/finance split and the potential benefits of a model that would combine them.

While there was (and is) plenty wrong with the banking industry, as the crash of 2008 made obvious, their ability to work together through financial syndicates was reasonably strong and useful, and based on shared, well-understood practices (notwithstanding a general lack of interest in mission and a monomaniacal focus on being repaid). And while most bankers lacked program knowledge or passion, they were generally transparent, predictable and clear about their business requirements (a source of repayment, reliable subsidies or credit guarantees, preferably in the form of grants); what their interest was (credit for complying with the Community Reinvestment Act, or CRA); and what reports they would need (standardized, with some geographic specificity). They typically liked to follow trusted colleague banks on common terms, since it reduced their costs, and almost always paid a "lead bank" to be the main point of contact for the borrower.

Foundations were different. Virtually all the foundations' grants and program-related investments were subject to layers of individual legal review and program restrictions. And it seemed that each document and restriction had to be just a little different from those of our peers, almost competitively so, so we rarely, if ever, empowered a single "lead" foundation in a transaction. As a result, the most highly skilled program officers—especially those with hybrid financial and program expertise—spent time and energy working *around* their internal barriers, gaming their systems to fit with other investors rather than being enabled and empowered by an internal preference for simplicity and standardization. The typical foundation toolkit seemed too focused and fussy for our collaborative ambitions.

Admittedly, we foundations sometimes thought of that as part of our "value-add." Most believed with near-fundamentalist fervor that restricting funds was necessary to assure results and the "but-for" that dominated internal discussions and justifications. Virtually none of us treated grants or loans as fungible cash but as a bespoke form of currency with a unique set of requirements relevant solely to each foundation individually. In addition, there was substantial evidence that our nonprofit borrowers, anxious to complete a long and laborious transaction without upsetting any of us (and therefore derailing the collaborative financing), accommodated each of these bespoke program strictures, entailing customization and high transaction cost for them.

Retail bankers appreciated foundations' ability to certify program quality and, therefore, revenue reliability, and to act in various roles as financial guarantors. Banks typically shied away from borrowers that seemed financially shaky, in peril of losing revenue, unfamiliar, untrustworthy, or otherwise complicated or outside their credit box. In some cases, foundations shored up a gap in lender confidence, debt service coverage or collateral with a grant or guarantee.

But more often, foundation financial practices baffled bankers versed in commercial finance, since our so-called "financial best practices" routinely impaired the financial health of borrowers. The foundations' multiple and routine restrictions on the use of cash, discomfort with profitability and reserves among nonprofit participants, and a tendency to view overhead as a frill were, to bankers, odd—and contrary to good financial management tenets. More importantly, however, was that these financial practices were

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sure to impair the borrowers' ability to provide services and products reliably, grow (i.e., go to scale)—and in the process, deliver results both programmatically and financially.

Thus, despite much time and sincere effort by foundations to be transparent and highly collaborative, to help "solutions reach scale," and to publicly embrace the values of cooperation and effectiveness, it seemed that barriers to achieving these objectives were built into our program sides' "financial best practices," and segregated from a possible market-savvy connection with financial expertise on the investment side.

Opportunity was missed on the investing side as well. As the mortgage default crisis gathered steam, community development program officers heard early reports from CDFIs of predatory lending in the housing arena, including a puzzling run-up in new home mortgages among obviously unqualified buyers (outside the nonprofit CDFI's portfolios[8]). From a program viewpoint, there would be damage. In the words of one program officer, "predatory lenders were destroying in a month or two what it had taken our field years to accomplish."

But program officers did not report these events to the "investment side," even when foundation investment departments had invested in those same predatory lenders. The program officers' counterparts on the investing side were wielding hundreds of millions to companies with nary a glance at their business practices (predatory or not, overhead rate and project budgets didn't enter the conversation, either), and, frequently, only vague knowledge of exactly what the companies did. A mission connection was as verboten on the investment side as a finance connection was on the program side.

As it turned out, many of the real estate and financial services companies in foundation portfolios were engaging in risky and hyper-extractive business practices, including predatory lending. And while the "program side" operated in a separate world of small dollars and big restrictions, it had rich information that could have allowed the side with big dollars and small restrictions to have a very different orientation and outcome, not only from the point of view of program, but from the point of view of financial results.

What if both sides of the house had worked together? It's possible to imagine a different scenario, where a united team of investors and program officers could exchange richer market information and wield more capital and muscle to influence *all* investors, given the market bellwethers and realities the program side saw and the portfolio knowledge the investment side could access? Might they even have been able to use their philanthropic voice to save the economy trillions and prevent or mitigate the largest stripping of assets from the poor in American history? Admittedly, this is unlikely if we accept the conventional world of

[8] Heron's CDFI loan portfolio was the best-performing asset class in the portfolio during the financial crisis.

investment/program split. But it is possible—and necessary—if we are to make a difference in today's world.

The combined investment strength of affordable housing experts and financially-savvy debt and equity investors is powerful in a way each alone cannot be. And beyond affordable housing, versions of these possibilities exist in health care, food, energy, employment, human rights, creativity, science and many more. Given such a perspective, might the foundation investors be looking to finance deals (or hire managers to build portfolios) that expand economically integrated, financially sustainable (i.e., profitable) housing *generally* across their real estate and financial services portfolio? Of course.

There is another benefit to combining the investment and program function at foundations. It helps both sides of the for-profit/nonprofit divide understand that the economy is not meant to be split, either. Nonprofits, especially those serving the poor, are auxiliary, and not meant to be a scaled and separate system for those excluded from full economic participation. The economy is meant to provide value to an expanding proportion of the country. Mission and money were never meant to be apart.

As Heron assessed the damage done in the wake of the financial crisis to our mission of "helping people help themselves out of poverty," we had to conclude that the divided foundation model *itself* contributed to sub-optimal results, just as an increasingly divided economy was also undermining this goal. We knew that simply doing more—even doing more within our current model, to the point of having 100 percent of assets invested for mission, would not only be inadequate to the task at hand, it would be counter-productive from a philanthropic point of view.

To fully engage all of our assets for mission, we would not only need to unify the financial and mission goals of the foundation in practice, we would need to push ourselves to break down our protective terrarium and rebuild an operating model that would require that we engage more actively with others—nonprofits and for-profits alike. Reinventing the private foundation would require that we build a model that requires the combined strengths of dispassionate, efficiency-oriented bankers and passionate, mission-focused program officers to make the most of philanthropic as well as broader societal assets, both inside and, more importantly, outside the terrarium.

Opening the Terrarium:
How a Change in Operating Model Can Expand Effectiveness and Impact

When we set out on Heron's current journey, we did so with the idea of building incentives into our own operating model that would propel us outside our terrarium—to become not only open to but forcibly engaged with the entire economy. As noted above, we realized that the strict segregation of "giving grants" (program side) and "extracting maximum profits" (investment side) as embodied in most foundations is mirrored in society: poverty is made more searing by economic segregation and the isolation of poor people and of antipoverty work from the economy as a whole. Modeling and replicating that separation within the business model of the foundation might actually be undermining our goals. In Gandhi's words, a better path was to "be the change" to which we aspired. And we thought that approach should be applied more generally to foundation philanthropy.

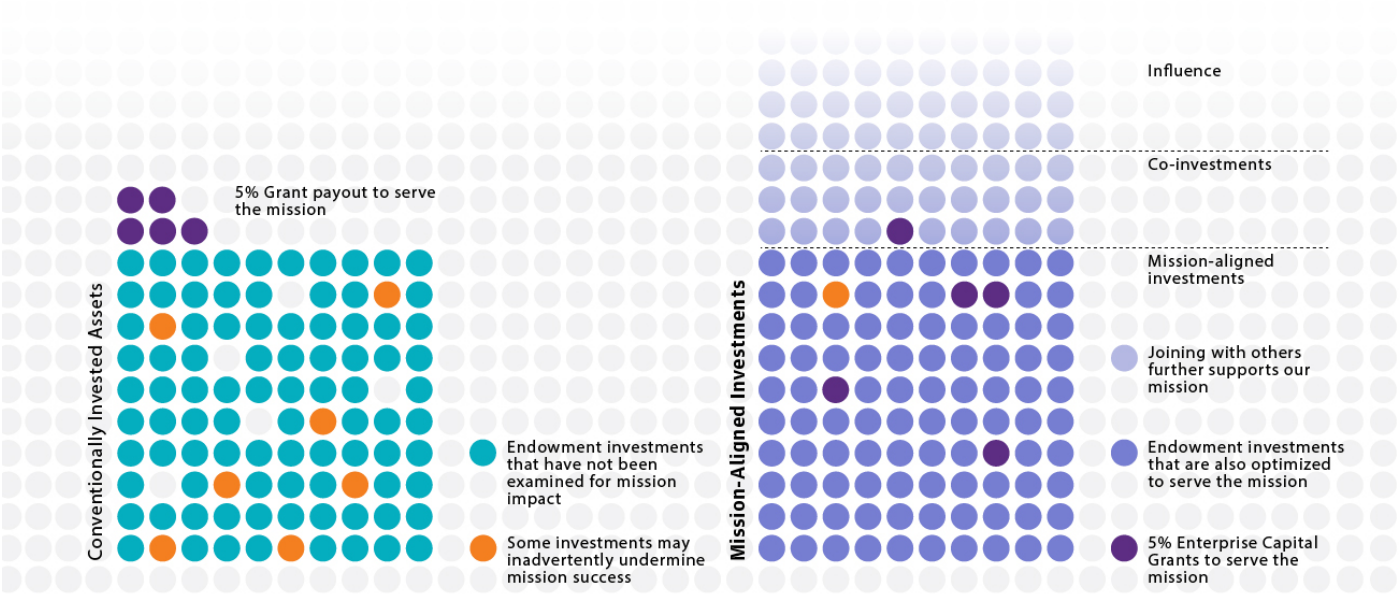
With that in mind, we set about to build and test a foundation that might better suit the challenges and opportunities of the 21st century. We asked ourselves, "What kind of operating model might we build if we focus *all* of our resources on achieving our mission, assuming that we will continue to operate under the regulatory rubric of the private foundation?"

Our first step was to merge our program side and the investing side into a single unit that deploys all the foundation's capital (financial, social, reputational, intellectual, and moral, etc.) in pursuit of our mission. In this way, we positioned the foundation (along with the rest of the nonprofit sector) as a distinctive part of, rather than as distinct from, the larger economy. Our success is thus defined and measured by the mission and financial success of *all* of our investees, whether nonprofits or for-profits, beyond our walls. We no longer separate grant-making from investing as if they exist in two different worlds. We aspire to monitor the financial and mission activity of the holdings of the foundation as a whole rather than as two disconnected parts.

As noted above, we believe that this approach is, simply, philanthropy. Philanthropy is, first and foremost, an orientation to life, available to and potentially shared by all, every day; and second, a distinctive part of commerce with a specific role in it, not a special class of operating entities protected from it. As Jim Collins put it in Good to Great and the Social Sectors,[9] "The critical distinction is not between business and social, but between great and good." Heron seeks a portfolio of *great* organizations that will deliver over time.

Our transition has involved philosophical and culture changes, alongside process and personnel changes. One guiding principle of that transition is our view that "all investing is impact investing, and all enterprises are, essentially, social." That view comes with these corollaries: that the impact of all our investees and investments may be positive, negative, or even neutral; and that the enterprises we invest in could be intentionally or unintentionally socially positive or negative based on their "net contribution" to the world, and that social performance, broadly construed, varies over time in the same way as financial performance does. In a very real sense, all foundations are already doing "impact investing." They just don't know if their impact is positive or negative.

[9] Collins, Jim. Good to Great and the Social Sectors: Why business thinking is not the answer: a monograph to accompany Good to Great. Boulder, Colorado: Harper Collins, 2005.



Traditional Foundation

Maximizing grant stream through optimizing financial risk/return tradeoff

Heron Aspiration

Maximizing mission impact through optimizing mission risk/return tradeoff
Note: Mission return is a function of economic, social & environmental impact

At Heron, we have been on a journey of change for the last three years, and we're not yet done. We have transformed ourselves from a Docket Model foundation (with the traditional bright line between investing and grant making, notwithstanding a strong track record in impact investing) into a more streamlined and market-facing "Pipeline" model, that tries to tailor capital investment to meet the needs of enterprises, takes a specific financial role (growth capital investor) and injects opportunism into our process. We are now in the early days of building our ultimate "Platform" model, which we anticipate will open our terrarium even wider by looking to broaden our reach and that of our allies both within and outside our sector. Given that foundations endowments comprise less than one percent of assets under management, we must invest to influence others if we are to achieve our goals.

As we continue to evolve, some operating imperatives have already emerged. The most universal principle, exemplified by removing the mission and finance divide, is that integrating mission and finance creates the best possible menu of outcomes.

An integrated investment policy: mission & finance together

If "all enterprises are social enterprises," and "all investing is impact investing," our governing documents and operating structure must reflect this reality. Our 2014 Investment Policy Statement notes:

"All enterprises, regardless of tax status, produce both social and financial results, on a spectrum from positive to negative, including 'neutral.' Their financial and social performance is measureable and varies over time. The conscientious investor takes note of both."

Even if the IRS has divided the world into "charitable" and "non-charitable" assets, these distinctions are an artificial construct created for tax compliance, not a reflection of the realities of our missions or markets. The distinction is relevant and important for good legal compliance, but it is in no way a business model requirement or a strategic imperative. Our corporate governance documents reflect this policy, including full compliance with a philanthropic institution's fiduciary duties of loyalty, care, and obedience to mission, which apply to the deployment of *all* our assets, including grants.

A single philanthropic staff

With one unifying investment thesis, and a market that includes all kinds of enterprises and asset types, it's confusing to maintain two segregated staffs with separate missions, skill sets and world views. Heron eliminated the distinction, and now has one staff dedicated to deploying the foundation's assets for mission. While each member of our team arrives with a different level of expertise in finance and investing across asset classes (and including grants), all are expected to move up the learning curve. Though colleagues have asked good questions about the availability of talent, we have not to date had a problem attracting good people. Generally, specific skill sets are less important than judgment and temperament: comfort with experimentation, uncertainty, change and, most importantly, operating in an environment that welcomes the challenge of persuasion and influence outside the foundation—with no direct control over outcomes.

Knowledge of what we own: Full examination of all our holdings at the enterprise level

As a philanthropic institution, we have a fiduciary duty of obedience to mission, and that requires that we track impact of all our assets on society, and make decisions in light of that knowledge. All holdings perform both positively and negatively on social as well as financial dimensions. Performance variation applies to all kinds of enterprises. Nonprofits aren't always "good" and for-profits "bad": both have an impact on the value foundations are meant to foster, and their performance varies over time. While our accounting ambitions now outstrip the scope of available data, we have examined all our investments to discover at a high level their base performance, financial and "social."

A challenge in fully examining our holdings for mission was to gain visibility into the enterprise view, that is, to see through the "top-down" asset classes to the underlying enterprises that give those assets value. These enterprises are the level at which "impact" occurs and foundations can foster value, both financial and social. At the end of the day, we're looking for greatness.

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The ability to measure, with integrity, positive and negative financial and social performance across enterprises and asset classes over time

We recognize that knowing what we own is a first step. Given that all assets are mission assets and can perform on both financial and social dimensions positively or negatively, we must track our market performance accordingly, across all legal forms of business (nonprofits, for-profits, cooperatives, partnerships, public companies, governments, and more) and benchmark them against peers, outside our own walls. While management intent is important, it is not determinative; and while due diligence can be helpful, it measures only a single segment of time. Our operating response has been to fully examine all

holdings in our portfolio (as noted above), and to contribute to the development of the infrastructure needed to track and benchmark all our holdings in real time. For our direct investments, we do not keep any special reports inside the foundation, but instead we direct reporting to an outside data warehouse called CoMetrics. For our indirect investments, we partner with managers capable of providing financial and social performance data, and look to developed data capacity from providers such as Bloomberg, MSCI, and similar.

Collaborative, cooperative, outward looking routines

Given a much-too-large pipeline of deals (all capital across all asset classes) with a range of projected financial and social returns and liquidity characteristics, we cannot be blind to the importance of the wide world of co-investors and fellow customers to achieve our goals. We have a powerful incentive to share underwriting and follow trusted partners into deals. Collaboration, syndication, and the use of funds and managers are not merely desirable for program reasons but mandatory for financial reasons given a relatively small operation. We therefore are developing, with others, data infrastructure, comparable performance analyses, certification protocols, investment vehicles, standard documentation, cross-mission financial vehicles, and the like, to stimulate and enable influence and co-investment and reduce transaction costs. Some specific projects include:

Common data standards and cohorts

If Heron (or any foundation) requires specialized data reported to it *alone*, it creates an expensive world apart for its own purposes (with the costs borne mainly by its grantees and investees). I am not aware of any foundation that requires specialized reporting from its conventional investment holdings—hedge funds or for-profit corporations, for example. The investment side of foundations depends on standard reports on investment positions, and can find data to compare its performance, and that of its managers to peers. We aspire to extend that capacity to all of our holdings, including grants. We avoid distinctive forms of measurement, customized data or keeping specialized internal databases of financial or social metrics on our direct investments (typically nonprofits, small for-profits, and cooperatives). Instead we are working with sources that provide current, comparable data on financial and, where possible, social performance across asset classes, and look to make the social finance market simpler and more standardized.

Extensive standardized financial data are available from publicly listed companies, but environmental, social and governance data (known as ESG) are neither consistently reported nor standardized. With an enterprise capital grant to the Sustainability Accounting Standards Board (SASB), we are participating in an effort to build that capacity into the DNA of public and private company reporting, connecting for-profits to social performance consistently and comparably. While ratings and analysts' reports encompassing ESG data will become key to investment decisions, it is paramount that the basis on which those reports are developed, like the basic elements of financial reports, rely on consistently reported data, in exactly the same way as is required by the Financial Accounting Standards Board (FASB). With an equity investment in CoMetrics, we are working to build the same kind of comparability—financial and social performance data—for nonprofits and privately held businesses as well. We acknowledge that this will take time and money.

A transition from a "docket" culture (inwardly driven) to a platform/network culture (responsive to external opportunities and conditions)

Our operations and operating routines are continuing to evolve. We are looking for ways to not only carry out business in two-party transactions (where we expect social and financial return from enterprises), but with groups of affiliated customers, investors and enterprises who seek success systemically.

In addition to working on developing the internal and external infrastructure to extend this style of investing beyond Heron and beyond philanthropy, we are developing knowledge and communications as a strategic imperative, bringing financial and non-financial impact to bear—with the goal that an economy that expands the number and contentment of its participants becomes standard.

Looking Forward

One of the distinctive duties of social sector nonprofits is to push to the margins—that is, to work toward a world where we are no longer needed, exiting businesses where the mainstream economy is working well and where problems are episodic (and readily treated by charities) not endemic. Especially in areas such as health, anti-poverty, environment and social justice, our goal is to make ourselves superfluous.

For Heron, that means looking forward to the day when our goal of helping people and communities help themselves out of poverty is met. That would be the day when the current market failures end and the mainstream economy reliably provides jobs, livelihood and opportunity; when poverty is rare and marginal rather than growing and structural; and when philanthropic resources are directed toward market failures that exist where economic value is unknown and unknowable: basic research in science, the arts, spirituality and similar—while "return" tends to be outsized and widely shared.

For us, this means a focus on making the market and the economy work for and include all of us. Given Heron's core business of investing, it means deploying *all* assets to achieve our mission, so the mainstream economy works for more and more people. Today and in the future, we will be constantly working to improve the standard of investing more broadly, and all along the way, to assure quality and integrity in our portfolio. Beyond that, and the ultimate test of the platform business model, will be our ability to recruit (and join with) as many additional aligned investors (including donors and investors of non-financial capital) as is possible. To fulfill our fiduciary duty of obedience to mission and public purpose, we are working toward the day when the investors who are deemed to be out of step with the market and society are those who fail to examine, vet, and optimize their investments for social as well as financial results.

Clara Miller is President of The F. B. Heron Foundation, which helps people and communities help themselves out of poverty. Prior to assuming the Foundation's presidency, Miller was President and CEO of Nonprofit Finance Fund which she founded and ran from 1984 through 2010.

In addition to serving on Heron's board, Miller is on the boards of the Sustainability Accounting Standards Board (SASB), Family Independence Initiative, The R.S. Clark Foundation and StoneCastle Financial Corp. She is a member of the U.S. Advisory Committee to the G8 on Impact investing, named in 2014. She is a member of the Social Investment Committee of the Kresge Foundation. From 2010-2014 Miller was a member of the first Nonprofit Advisory Committee of the Financial Accounting Standards Board.

Appendix A: How we are Evolving, Docket to Pipeline to Platform/Network

Model	Docket → Modified Docket	Pipeline → Modified Pipeline	Pipeline → Network
Investment Thesis	• Investing meant solely to fund operations and grants. • 5% "real" plus growth, to fund grants, operations. • Investment in asset classes, not enterprises. • Grants not part of investment thesis.	• Investing a powerful tool for addressing problems. • Increased use of PRI/MRI and portfolio for socially focused investing, compliance with IRS rules. • Enterprise level investing for PRI and MRI parts of portfolio. • Social screens, especially negative, typical.	• All investing is impact investing = broader influence (beyond 5% real). • Enterprise level investing, transparency into "funds" needed. • Grants part of investment thesis. • Financial and mission role defined for all assets. • Feed the agency of others.
Time Horizon	• "Perpetual" or "spend down."	• As long as mission is relevant to society.	

Model	Docket → Modified Docket	Pipeline → Modified Pipeline	Pipeline → Network
Leading Question(s)	• Will an investment contribute to financial goals • Does a grant further our theory of change?	• Will an investment contribute to financial goals? • Will an investment contribute to social goals? • Does a grant further our theory of change?	• Will an investment contribute to social and financial goals together? • Will an investment contribute to the success of an enterprise, and its benefit to society? • Will an investment influence others?
Transparency	• Regulatory, some voluntary disclosure (CEP) • Substantial use of Level III investments (opaque)	• Regulatory, some voluntary (CEP) • Sharing of documents and deals • Specific disclosure of program "failures" on websites	• Regulatory, some voluntary (CEP) • Sharing of documents and deals • Beneficiary voice • Public comparable data on performance for self and investees • May use level III investments; must see through to enterprises (but not transparent to public)

Model	Docket → Modified Docket	Pipeline → Modified Pipeline	Pipeline → Network
Key Systems & Routines	• Docket process (driven internally, by "payout") disbursement risk shed by foundation • Customized and internal reports • Extensive customized grant reporting	• Pipeline, managed to comply with IRS and investee requirements • Timed to investee requirements, disbursement risk managed • Customized grant reporting	• Focus on co-investment • De-emphasis of volume, emphasis of success of enterprises • Balance of direct and indirect • Standard reporting to external data warehouses
Transaction Size	• For investments, typically in funds, including hedge funds with minimal	• Chosen to balance foundation capacity and investee requirements • Active recruiting of other investors to deals	• Focused on analyzed need and absorption capacity of enterprises • Optimized for foundation operations • Consciousness of revenue and market

Model	Docket → Modified Docket	Pipeline → Modified Pipeline	Pipeline → Network
Staff Structure	• Bright line distinction between granting and investing; plurality of staff in granting.	• Addition of expertise in social/program-related/mission investing; distinctions continue among investments, grants and social investments.	• All staff, including communications and operations, fully integrated. • Staff role is not "application processing" but investing and giving rise to more investing and success in the communities and enterprises aligned with it.
Staff Skills	• Either investing or giving, with PR and operations supporting, mainly, granting. Giving: subject expertise.	• Investing, social investing, giving, all in separate operations.	• Fully integrated, skill sets that combine investing, subject expertise. Flexible attitude and market facing comfort.

Model	Docket → Modified Docket	Pipeline → Modified Pipeline	Pipeline → Network
Reporting & Data	• For investing, external databases and benchmarks for performance; for grants, internal evaluations. • FFOG comparisons for ops. • For Grants, PRIs and MRIs: Compliance driven; extensive program reports and specialized metrics, rule of thumb financial reports, i.e., overhead rate, compliance with budget, projects not enterprises, "what happened to our money?"		• Similar reporting goals across asset classes and enterprise types. • Focus on internal and external impact re: foundation's mission aspirations. • Reporting based on market comparability with like enterprises.
Planning Model	• IRS based, modern portfolio theory.	• Flexible planning model based on changing market conditions, enterprises.	
Market	• Investment funds, nonprofit organizations, sometimes individuals.	• Investment funds, financial intermediaries, social enterprises, nonprofits.	• The whole economy.
Communication and influence	• Announcements of grants. • Reports on the foundation's work. • Participation in policy activities and studies through grants.		• Communication and influence operation fully integrated in and a required partner of investing, focused on making investments have broadest possible influence.