CAF America

Sustainable Finance & Philanthropy: Addressing the World's Most Urgent Problems
Host: Ted Hart
Guest: Erika Karp – Cornerstone Capital

Announcer: Welcome to the *CAF America Radio Network*, a production of the Charities Aid Foundation of America. As the leader in global giving, CAF America offers more than 20 years of experience and expertise to corporations, foundations, and individuals who wish to give internationally and with enhanced to due diligence in the United States. To it's industry leading grants management programs and philanthropic advisory services, CAF America helps donors amplify their impact.

This show is dedicated to these donors and the charities they support. CAF America is unique positioned to serve as the bridge between these important partners and transforms vision into meaningful action. Guests on the *CAF America Radio Network* are leaders in their field who share tips for success and stories that inspire. Our host is Ted Hart, the CEO of the Charities Aid Foundation of America. This is a live call in show. Add your voice by calling 914-338-0855. After the show, you can find all of our podcasts at cafamerica.org. Don't forget to dial 914-338-0855. Now, welcome the host of the *CAF America Radio Network*, Ted Hart.

Ted Hart: Welcome to this latest edition of the CAF America Radio Network. Thank you so much for joining us today. Our guest is Erika Karp. She's the founder, CEO, and chair of the board of Cornerstone Capital. The mission of the firm is to apply the principles of sustainable finance across the capital markets, enhancing investment processes through transparency and collaboration in seeking positive societal impact at scale.

Cornerstone offers wealth and investment advising, research and strategic consulting, and investment banking services. Working with investors, corporations, and financial institutions, the firm drives the systemic analysis of environmental, social and governance factors throughout the social capital markets. Erika, thank you for being my guest here today on the *CAF America Radio Network*.

Erika: It is a pleasure to be here.

Ted: Erika, this is a very meaty topic and one that is timely for a lot of our listeners who want to learn more about this and to understand how these approaches, market -based approaches can be successful in the philanthropic marketplace. Although, market-based approaches to solving some of the world's biggest issues are becoming more and more common, for many for profit institutions and like minded individuals they are relatively uncharted waters.

However, philanthropy has been active in addressing these issues for decades. Do you think that marketplace approaches can provide innovative solutions? Do you think there's room for market-based approaches to learn from what has already been attempted?

Erika: Well, Ted, not only is there room. There's a critical essential here. Market-based solutions really do represent the best chance of introducing sustainability to the main stream business markets, to the mass markets. What you get when you do this, to use market-based approaches, use the private market, you're helping to really embed sustainability in the economy for the long run.

When it comes to philanthropy, I mean, clearly, philanthropy has for 100 years paved the way to address these big environmental and social issues. That said, philanthropy is dependent on a limited budget cycle. When we talk about market-based solutions, we're talking about transforming the demand and supply patterns in the capital markets, in the business markets globally. You can argue that the innovation in bringing together market-based solutions in philanthropy is hindered by some of the traditional models, both for philanthropy and for capitalism.

Again, I mentioned the institutional philanthropic organizations that are limited by their budget cycle. They're limited or they're guided by a 5% grant making rule. Again, you're not using 95% the corpus, the big money. Sometimes, the philanthropic organizations can lack co-operation. They can lack alignment of their grant-making. Again, the investment of the corpus. When it comes to capitalism, the private market, then you see that they are bound often by short term views. Those views would encourage negative externalities, damage to the society when it comes to the world's biggest issues.

You see you have challenges on both sides. Back to the issue of market-based solutions, these solutions can be more self-sustaining and they can happen at scale. Again, the grant work is really important but the limits of the funding that's only committed to purpose is problematic. Back to market-based solutions, here you can have returns and they can be recycled for more impact. This is where we're talking about the economic multiplier effect of capitalism.
Again, there's issues on both sides with regard to the philanthropic angle. They can definitely help to de-risk opportunities in the private markets. If an investor can partner with a philanthropy and the philanthropy can provide a first loss guarantee of some sort, that reduces risk, that frees up capital. Also, philanthropies can act as first capital. Hopefully, that nudges the private sector in.

There's plenty of room for market-based approaches. It's still unclear how well the products out there address the underlying issues. It's still unclear how competitive the performance would be. That said, I think you should definitely have to use all approaches. The private markets have to be a huge part of fixing the environmental and social issues. You just can't get the scale without the markets, the public markets.

Ted: What is the unique factor that philanthropic organizations bring to that equation? Why would you say that they are or should be part of that mix?

Erika: Well, again, they've led the way. Certainly, you think about some of the faith-based organizations, they've absolutely lead the way. They are driven by purpose and they're driven by mission and that's fantastic. That said, the scale is simply too small. If you think about all the capital that is sitting at all the foundations out there, you're talking still about 1% of the market cap. You're still talking about a small amount. Again, they can lead the way but there's simply not enough scale. Again, the philanthropic group and the market-based group have a lot to learn from each other.

Ted: It's your position or that you feel that oftentimes these partnerships haven't come together because maybe nonprofits are either ignored or not seen as serious enough because they lack scale?

Erika: I don't think they're ignored or not seen as serious. I think, well, maybe ignored. I think, there is a lack of attention. A lack of consciousness and a lack of alignment. When you look at the capital markets, to some degree, there's some dis-intermediation that goes on. You're seeing the investment banks, you're seeing the asset managers, and you're seeing the asset owners not necessarily talking to each other directly. That's challenging because that way you don't have the alignment that you should have. Both sides have a lot to learn from the other.

Ted: You brought up with this idea of alignment. Corporations are becoming more involved in real efforts to address social issues across the globe. However, we're all aware of the fact that with some companies they treat their philanthropy as entirely separate from their core business needs. Should more companies approach philanthropy business strategy investment under the same umbrella? What are the pros and cons, or what's the right mix?

Erika: Well, let's go to the issue of business models. In the private sector, we need to look at a business model. We need to see the extent to which it is potentially creating environmental degradation or public health challenges or unsafe products or working conditions or noninclusive workforces. All of these which are damaging occur off-balance sheet and maybe without the consciousness or consent of the stakeholders. That's the company.

What we're seeing is a change in corporate behavior because there's a consciousness of the extent to which business models can be fundamentally unsustainable if they're doing those things that I referenced before. Back to the business model, if you see a company that's operating with a deep and honest assessment of costs and benefits. If you see a focus on long-term stakeholders, then potentially you have business and society working together. We’re redefining the role of the corporation and society. I think, that's really important. Because at the worst case, a company, the risk is existential. They can lose their license to operate if they're not operating sustainably. In most cases when we go to corporate philanthropic efforts, unfortunately, there are probably sub optimal and they are probably completely disconnected from the business model and that's challenging.

Here's where a foundation, for instance, could potentially benefit from the knowledge of a company. Again, the company could benefit from the know-how of a foundation. It is looking for these synergistic business models. That’s why this discussion of how a company makes its money and how transparent it is, is so important. Business practices--

Ted: Is there a concern that maybe more integration has more involvement or oversight of shareholders who may not support that effort, or may not understand that effort? Is there a sense of being a little bit disconnected on purpose?

Erika: There could be that, but here is where I talk about the issues of business models. When you think about like a Qualcomm and their spending on technological literacy, that's improving the workforce for the long-term. If you think about a Novo Nordisk and they want to educate on health care. The treatments for diabetes that they sell, that's helping the business. If you think about Unilever, when they talk about hand washing and health and save thousands and thousands of children lives through health. That's the basic business.

When we talk about building philanthropic efforts into the business model, this is good for everybody. It ultimately impacts the company's ability to do business. Further, you talk about mining companies. Their provision of, let's say, health care or education services in local communities. This helps them with their license to operate, again. This goes on and on but it does make a difference if a company infuses their very business model with the mission of a philanthropic purpose. The key is that you get much more capital flowing into various thematic areas.

Ted: There is obviously or has been, I think we're all aware, more emphasis on transparency and holding players accountable in the philanthropic space. You advocate specifically for socially responsible investing. Can you explain what that entails and how that might be different or similar to what philanthropy encourages?

Erika: First of all, I do want to define terms a little bit. I don't love the term "socially responsible investing" just because it can sound a little divisive, is all other investing irresponsibly?

Ted: Or off mission, right? It can be a scary phrase.

Erika: Yes. Again, there are lots of phrases you can use. Social responsible investing, values-based investing, double bottom line, triple bottom line, impact investing, and then of course there's ESG investing, that's the Environmental Social and Governance investing. I do prefer that term because it implies simply an enhanced analytical approach to systematic integration of ESG factors. It’s not ideological, it's not politicizing, it's not divisive. If we're talking about ESG investing, then transparency again becomes really, really interesting.

What we are seeing is corporations starting to disclose factors that affect fundamentally the business. Does it affect some ESG issues. Does it affect revenues. Does it affect cost. Does it affect risk. It goes back to the discussion we had on corporations and their role in society. These days, given the economic concentration we have in the private sector, there is a different expectation of corporate behavior. What I would argue is you may consider-- and again, I'll use the term SRI not just because we started with that but you might consider SRI as a natural extension of the transparency that is sought by thunder.

That's both the philanthropic and the private markets. Actually, I should add that when it comes to transparency, I should add that it's really complex. When it comes to philanthropic giving, the KPIs, the key performance indicators that are being watched for successful grants can be very well established but they can also be very complex and somewhat narrow. In the corporate framework, the idea of key indicators it's probably a longer process. You have to select the right ones and it has to be tied to incentivization. It's a little bit different but in both cases, we have to have transparency to be able to evaluate investments.

Ted: You're absolutely right. This is a movement that has been active in the philanthropic space really for many years now, but is there a capacity issue and maybe a concern on the part of corporations as they look to this space to find appropriate partners that can actually provide that kind of true impact with measurable KPIs?

Erika: Yes. I think there's a complexity associated to specific opportunities in terms of opportunities that exist at scale, which we need to bring systemic change. It's tricky. The costs are still quite high. If we're talking about issues of due diligence or building platforms, building infrastructure for partnerships, we have a long way to go. The proof of concept is not really there. What I would say is that private market investors are clearly looking for these solutions that would represent, hopefully, a piece of their investment portfolio but there's definitely room for more creative solutions.

Again, finding the structures where we have the greatest chance of success there's still a lot of research to be done. Again, we have to somehow bring scale to the philanthropic activities. We haven't quite been able to do that. By the way, in terms of creativity, we are seeing a number of foundations who, for example, have completed program related investments using a pay-for-success model. That's utilizing private and public partnerships. There may be real opportunity for impact investors and philanthropists to go into the venture space. Again, sometimes, there's a scale that's needed that can't be deployed on small solutions. We do have kind of a capacity problem.

Ted: Yes, capacity issue. Also, in moving in that direction that can be successful when there's a proper alignment of the risk and reward on both sides.
Erika: Yes, but we don't exactly know sometimes how to measure it and there are sometimes at cross purposes.

Ted: Right, and that becomes the issue. I'm curious you being one of the foremost experts in this area when you start a dialogue and someone's contacted you to begin a process, what are the concerns that are often put on the table first? What are the hurdles that you have to help corporations get over as they start down this year?

Erika: You're kind to say that. I do operate in the public equities market for the most part, the capital markets. What I would say is, one of the things that has-- a blocking factor that we have to put aside is that there has to be a concessionary level of returns on the investment if you are systematically looking at environmental, social and governance factors. We have so much empirical data now that we can't put that aside. Not only is an organization fulfilling its fiduciary responsibility, chief investment officer and portfolio managers.

If they are not looking systematically at material ESG factors, then arguably they're breaking a fiduciary duty of care. All right? We can put it aside from all the studies that are out there that you do not give up any return, by virtue of analyzing ESG factors. Why would you not want more information than less? That said, there is still a perception that you are fighting. That when you do SRI investing or ESG investing or whatever you want to call it, values-based investing, there's still a perception that you're giving up lower returns for mission and we really reject that notion.

Ted: Okay, so those don't go hand in glove. I mean, it is possible to break out of that perception. Although, I would imagine that perception had come from maybe some early less than successful approaches, but what you're saying is a more robust approach does not have to have that as its assumption?

Erika: Absolutely. Not only that. I mean, I do go further. I would argue that a serious analysis of ESG factors offers predictive insight so that there can be outperformance. We have enough managers, in particular, Cornerstone. This is what we do. We have enough managers on our platform that can outperform and offer social impact. We're getting there in terms of putting this aside, but perceptions take a long time to change. I understand why it's gone slowly and if the language was divisive, that's problematic too. Because, then, you just lose the attention of many serious investors.

Ted: We're live here with Erika Karp. The founder, CEO and chair of the board at Cornerstone Capital and one of the foremost experts in the area of sustainable finance and philanthropy. As you know, Erika, and as many of our listeners know CAF America specializes in donor-advised funds as a vehicle for international giving. Donor-advised funds are unique in that they have the flexibility to make both charitable grants and financial investments.

Do you see this unique nature of donor-advised funds as having a potential for perhaps double impact with respect to philanthropy and investment or what do you think is the essential for maximizing that kind of impact?

Erica: You know, it does seem to me as though an ideal vehicle for investing in different ways. Potentially, hybrid investment strategies that make risk reward more attractive. I would argue that the effectiveness of many of charitable funds has been limited historically by this separation between mission and finance. The 95% and the 5%. The complexity in the foundation world seems challenging whereas in the depths world it seems like this could be very, very interesting.

Investment managers have believed that their sole responsibility is to deliver returns that can be donated for the charitable purposes, but the reality is, it doesn't have to be that way. We can apply the whole corpus to mission related activities if you're thoughtful about it. The depths, by the way, and other charitable funds would seem to be able to increase the scale of the mission related impact. That's what we talked about before, how critical it is to get scale.

I would also offer that, a full mission alignment not only is becoming more important for philanthropies but it's also a generational issue. We are seeing a merging of the objectives of the financial profile and a social profile on a generational basis. There is a demand for this kind of capability. Yes, it seems like the potential for depths would be tremendous. It does call into question a couple of things that have to be looked at.

The fact that there is the absence of a payout requirement might make it longer for funds to flow to the charity, to the recipients, that it otherwise would. Also, the fees associated with managing the funds are being accrued to asset managers and not being shared by the charities. It might be worse thinking if there are any inherent conflicts of interest. In light of all that, it certainly does seem like to have certain incredible opportunity for change and impact.

Ted: To that point, private foundations as you know have a 5% payout requirement. What is, I think, meant to be a floor often becomes a ceiling. More could be invested but often it's not because that's the norm. Where there is not a requirement for donor-advised funds, the average donor-advised funds expends 22%. I think donor-advised funds maybe arguably moving more money into the philanthropic space, certainly, than private foundations are.

We only have sadly about three minutes left, it's such a pleasure to chat with you and these are such dense topics. I did want to ask you to just wrap us up today, bringing us back to the topic of sustainable finance and philanthropy. Ask how not proper to the socially minded individuals can further engage in private financing investment. At the end, because we're only going to have about less than three minutes left if you can make sure that our listeners know how they can reach you.

Erika: Okay. Well, the final thing I would say is as a starting point, we have to be willing to share insights. There has to be a conscious discussion in terms of the interest in engaging with private finance, with investments and vice versa. What I would say is there is expertise from each side to be drawn from the other. There's products that need to be constructed.

There are themes and strategies around which these products can be created. Ultimately, the economic objectives that we're all trying to get to we'll get to them faster if we see cross-sector partnerships. Again, it's a pleasure to be on the show, Ted. I'm available for any of your clients at erika.karp@conerstonekarpinc.com. Again, it's a pleasure.

Ted: Wonderful to have you here on the show and helping us make sense, again, of some very complex and dense topics. As I think you pointed out here at the end, they may feel more complex and dense because they're relatively new to us. By creating those models and creating those case studies and those norms, this can and could become a more regular part of a sustainable finance and philanthropy.

That sector comes together with the expertise of Erika Karp. We really appreciate having you as a friend and a colleague with CAF America. Everyone, thank you so much for being our guest here on the *CAF America Radio Network*.

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