Strategy

The World Has Changed and So Must We: Heron's Strategy for Capital Deployment

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A rude awakening

Like other American foundations, The F. B. Heron Foundation has for years focused on helping families at the bottom of the economic and social scale — inheritors of persistent poverty, racial and ethnic discrimination, social and geographic isolation, and various failures in markets, social policies, and safety nets. The goal has been to equip them to join what progressive reformers confidently called "the mainstream." As have others, we have concentrated on helping lower-income families purchase homes and acquire assets, the cornerstones of the "ownership society" that was one of few values on which the American left and right could generally agree.

We also sought to help disadvantaged families develop the financial skills necessary to save, borrow wisely, manage budgets and assets, and survive periods of economic stress. These were all useful, often successful efforts. But they were based on a view of social need that presumed the existence of a healthy and growing labor market — a reliable main stream that, if it could be entered, would flow steadily toward prosperity, or at least toward fair opportunity that provided employment and with it, steady income.

That view had become comfortable for foundations and government alike, for two reasons. First, for a few decades it was true, and many families and communities were made materially better off by the opportunities that this approach helped to open up for them. But second, this view was soothing because we had grown*used to it,* and it carried the reassuring promise of a happy ending — a persuasive connection between philanthropic, for-profit and government initiatives and expanding economic and social opportunity on which a generation of orderly Logic Models and Theories of Change relied.

This calm contentment has been shattered: more Americans experience poverty today than at any time in the 53 years the Census Bureau has published such figures, and in 2010 the percentage of Americans living below the poverty line (a household income of $22,314 for a family of four) was at its highest level since 1993.[2] We have come to conclude that unfortunately, our comfortable habit appears to have outlasted the accuracy of the premises on which it was founded, and in the process has grown less useful year by year. The world has changed, and so must we. It's time for a new approach.

The premises on which most of the economic access and opportunity strategies were based were in many ways drawn from a post-World War II story. This story featured steady expansion in industrial employment, mass upward mobility (or at least opportunity) across the social ladder, ever-broadening homeownership and accumulation of assets, escalating rewards for education and hard work, and a concentration of economic hardship and social disadvantage in a small but persistent "underclass." That blend of widespread opportunity and marginal poverty is plainly over. For the great bulk of the U.S. population, social and economic mobility have been stagnant for decades. Industrial and technological advances now lead as often to reductions in employment as to increases. Loyalty, diligence, and a history of regular promotions no longer inoculate most workers from the risk of sudden, enduring unemployment that raises the odds of lasting poverty. Employment at a living wage is neither reliable nor commonplace. Poverty is structural, not marginal.

In its current state, our economy isn't likely to reverse these trends. A particularly hair-raising study, "An Economy that Works: Job Creation and America's Future," issued by McKinsey Global Institute in June 2011, intones a litany of daunting statistics: "…7 million decline in the number of US jobs since December 2007… 60 months projected length of 'jobless recovery'… 20 percent of men in the population not working today, up from 7 percent in 1970… 23 percent drop in rate of new business creation since 2007, resulting in as many as 1.8 million fewer jobs, and 58 percent of employers say that they will hire more temporary and part-time workers." The executive summary goes on to say, "only in the most optimistic scenario will the United States return to full employment (5 percent unemployment) before 2020." Possibly the most worrisome findings are that we have experienced lengthening "jobless recoveries" from recessions in the past two decades, coupled with a documented mismatch of predicted opportunities with the available skills and education levels of U.S. workers.[3]

An economy capable of offering a job to every willing worker, or at least to every household—as well as a workforce capable of seizing the available opportunities—is a fundamental prerequisite to achieving most other societal aspirations. Conversely, lack of work invites in a witches' brew of health, educational, and social problems that accelerate one's spiral into poverty.

Indeed, beyond the mere availability of work, the nature of work itself is changing, with temporary, contingent, or episodic employment dominating the working years of more and more people. And, as noted above, jobs in some industries are more complex and demanding. By itself, a high school diploma—the great goal of social reformers for half a century—is now more a guarantor of severely limited opportunity than of possible advancement. The extra-national job flight, now driven primarily by lower labor costs abroad, will likely be further accelerated and accentuated by U.S. workers' lagging skills and education levels.

And yet, in much of American philanthropy and social policy, the old narrative and its familiar assumptions linger on, sometimes questioned but rarely discarded. One result is that despite the widespread structural change transforming the economy, the assumptions behind most antipoverty policy and programs, both in government and in civil society, remain fundamentally unaltered: poverty is an outlier, a temporary condition brought on by temporary conditions in a fundamentally sound system.

It's the economy…!

A course change in our economic vision, antipoverty strategy, and day-to-day tactics must overcome two limiting narratives. The first is that access strategies alone—appropriate to marginal but not to structural poverty—are adequate. They are not. The second claims that we must tolerate expanded poverty and income inequality as the price of economic globalization, coupled with the equally dour view that government programs for the poor are the only route out of poverty. Neither narrative acknowledges the need to rebalance the economy *itself* so it can fulfill three fundamental American promises: full livelihood, democracy, and opportunity for all. To invest in the building blocks of that economy and to assure the basics of entry are critical responsibilities not only of philanthropic institutions and government but also of banks and businesses. We plan to engage accordingly.

The notion that our society must move backward economically and socially to compete in a global economy is mistaken. Technological and social innovation—from information to biotech to enterprise evolution—will change the nature of work, community, opportunity, and philanthropy. As the mainstream evolves, we must invest in models of innovation that share future value with those now excluded or unserved, and at the center of this proposition is work. The first and most fundamental prerequisite to helping people help themselves out of poverty is reliable work for adequate pay. A corollary to this belief is that economic and technological innovation must include and enrich people and communities in poverty.

Delivering on this promise is not beyond our reach. We believe we can realize an economic vision for a more universally prosperous society, one that supports democratic pluralism and civic vibrancy, provides dependable work for adequate pay, protects the most vulnerable, and successfully competes in the global market. This approach emphasizes investment in small and midsized enterprises, a strengthening of the direct connection of local and regional economies with global as well as local and regional markets, and the primacy of reliable revenue (as opposed to a default position favoring investment in fixed assets such as real estate) in economic development strategies. In a sense, this pragmatic middle represents nothing more than a revitalization of America's traditional vision of an economy that delivers value and opportunity to a larger rather than a smaller number of workers and stakeholders.

"Business as usual" must change

If our field is to address a more fundamental set of issues, our tactics must change, broadening our approach to go beyond a traditional set of activities. Admittedly, this emerging approach lacks some of the theoretical certainty of the dominant view, discussed earlier, which sees access and ownership strategies as reliable steps into mainstream opportunity. Yet given the reality that access strategies have been helpful but not adequate, we must be intentionally experimental. Only by rigorously questioning and transcending our own cherished assumptions will we progress. Our path at F. B. Heron represents an effort to do so.

How might philanthropy realistically contribute? We know that neither the F. B. Heron Foundation, nor philanthropy, nor the nonprofit sector, nor government can take on these issues alone. Furthermore, we believe that these problems and their solutions are interconnected. Not only is "changing the economy" unattainable by one actor, the dominant context for our work is a range of mega-problems in the environment, health, global security, and civil society (to name just a few) that expands and accelerates the challenge. Business as usual—with respect to both strategy and the way we operate as a foundation—is no longer an option.

The urgency and size of the problems we face require that we work differently. Everything at our disposal is now a mission-critical resource. Grants are one tool but not the only tool we have at our disposal, and to define ourselves primarily as a grantmaking foundation is limiting. Endowments have always been a source of investable capital for fostering businesses, industries, and nonprofit organizations that may be able to help in overcoming the new economic challenges. This foundation along with others has made such investments for years, but we must do more. Philanthropy's financial tool kit should include every investment instrument, all asset classes, and all enterprise types.

The *ways* we deploy capital and the assumptions and approaches we use to do so can in themselves make a difference. We plan to invest 100 percent of our endowment—as well as other forms of capital—for mission. Beyond money, we are obligated to deploy all of the resources at our disposal—capital, revenue, ideas, talents, influence, and natural allies—toward the broad, multi-sector approach, which will be necessary for the pursuit of goals that are, admittedly, much bigger than those we have pursued in the past. Philanthropy's collective talents and influence provide valuable intellectual and social capital alongside its money. We will not only wield all our capital to the fullest, we will affirmatively and reflexively seek opportunities to influence and be influenced by others through co-investment, advocacy, and example.

Beyond the scope and scale of our financial capital investments, we will operate differently as a foundation, a prerequisite to the broader market engagement we seek. Here are some of the actions we are taking:

- We will invest through a single capital deployment department, removing the traditional foundation's separation of investment from grantmaking. In our current operations, we have combined them into a single, dedicated activity: to deploy capital for mission. Essentially, the "foundation as enterprise" will have as its sole purpose the effective deployment of philanthropic capital to achieve our mission.

- As noted above, we will engage with both social and business enterprises as a capital investor dedicated to the viability and mission productivity of organizations and their business engines, regardless of legal form of business or tax status. By taking on the role of capital provider, we will seek to stabilize, make more effective, and build sustainability in the sector's key enterprises, whatever their tax status or legal form of business.

- We will routinely look outside our foundation, sector, and industry for opportunities to become a joint investor, working with individuals, banks, government, foundations, and businesses.

- Our grants will be concentrated on providing philanthropic equity, and building this capacity within Heron and more generally in the sector.

- We will renew our determination to promote the simplified sharing of data, methods, underwriting, and research with others to reduce transaction costs, improve efficiency for our investees, and generally promote better-functioning, more efficient, and more productive enterprise investing relevant to our mission.

- We will scrupulously avoid rebuilding, undermining, or creating redundant infrastructure where institutions such as CDFIs (Community Development Financial Institutions) exist to retail our funds or partner with us.

Rebalance to a focus on work and income

Our belief, at this stage, is that our financial capital investment will focus first on opportunities that, above all, add jobs to the economy and help combat persistent poverty and unemployment. Other investments would focus on influence through public companies and partnerships and on innovation/effectiveness in work and opportunity for low- income people through nonprofits, cooperatives, hybrids and for-profits with "mission first" orientation. We are encouraged that progress along these lines is already underway: we are seeing a diverse universe of opportunity in proven industries refreshed by new technology; place-based commercial "supply chains" powered by institutions and businesses; and experimentation with reimagined community economies, business types, technologies, and forms of employment. Companies along the spectrum of size and tax status are paying attention to a broader value proposition.

We see no reason to target investment to a particular industry, subsector or tax status, although not every financial investment tool is relevant to every organization. For example, it is highly unlikely we will make a PRI[4] to a public company or buy tradable stock of a nonprofit without significant regulatory changes, and don't think we need such changes to have a full spectrum of tools or opportunities. Our internal enterprise framework will continue to be the private foundation, and we assume we will exist as long as we can add value to society. We also assume that there will be investment opportunities in the full spectrum of enterprises, regardless of industry or sector, and that those we pursue can help produce vitality, job growth and economic activity fully inclusive of low-income people.

We expect that while our portfolio has for years emphasized opportunities for low- and moderate-income people to invest in real estate and own homes, this emphasis will change as time passes and we will seek more tactical balance. In much of the community development world, lenders' business exigencies—the need to secure transactions through leveraged real estate coupled with the interaction of transaction size, tenure and profitability, and the resulting industry-wide focus on dedicated streams of federal subsidy—have driven anti-poverty investment and strategy to become overly narrow. As bankers and developers, community development organizations have tended to overinvest in real estate assets and underinvest in other assets such as enterprise innovation, technology, and human capital. We are looking for ways to diversify.

Diversification in our portfolio is likely to emphasize investment that improves lower-income people's access to reliable income and opportunity. From our point of view, owning fixed assets is important to an individual's longer-term prosperity only insofar as jobs and income are steady and reliable, and cash is obtainable. Non-cash assets such as real estate, securities and even education derive their *financial* value largely from the income they attract and embody. When borrowers acquire these assets with debt, revenue reliability is even more important to protect acquirers from risk. Our strategy puts reliable income and cash first, and illiquid assets, especially those acquired with debt, second.

For the F. B. Heron Foundation all financial investing is a *direct* means to enact strategy, so our fundamental question for deployment of *all* capital will be, "what is the highest and best use of this asset for furthering our mission?" Financial returns to our own portfolio will be a necessary part of answering that question, but so will returns to society, to the organizations in which we invest, and to the fields of social endeavor on which we focus. We include grants among the investments we think of in this way—and we will deploy them as a primarily financial tool. The protective "equity holders' ethic," so central to successful commerce, is relevant to other investment tools—including grants.

Making common cause

We harbor no illusion of being a unique, prophetic voice in American philanthropic or financial markets. In fact, success requires a chorus rather than a soloist. It is an unavoidable reality that with assets of roughly a quarter billion dollars as of 2011, the F. B. Heron Foundation is not in a position, purely on its own, to make much of an aggregate difference in the way investors, enterprises, and labor markets function. Neither, for that matter, is any other single philanthropic actor, even much larger ones. Ultimately, we will succeed by influencing the attitudes and behavior of *many* other investors, perhaps beginning with philanthropy but extending well beyond. Forming networks of thought, communication, and action with other investors will become a central priority.

Some of what we are attempting may not work. We have much to learn about the possibilities of success, failure, reinvention, co-investment, and "the foundation as enterprise" with this approach. Yet, we are determined to contribute, by advocacy, by example, and, just as powerfully, by joining our colleagues in their efforts, to the development of an increasingly expansive, dynamic, and effective philanthropic response to poverty. The pathway of out of poverty for many Americans in the 21st century requires economic reinvention, not only marginal access to assets and service. The work of philanthropic organizations can be a full-spectrum contributor to that end, both through enterprise reinvention and by guiding the full deployment of capital in the mainstream to promote a more inclusive, just, and productive society.

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[1] This article is based on the writing of several contributors and excerpts from F. B. Heron's Strategy Document. Miller was a contributing writer and served as editor of this piece. Other contributors, reviewers and editors included the Foundation's board of directors, staff members Kate Starr, Dana Pancrazi, John Weiler and Jim Metzinger; and consultant Tony Proscio.

[2] Tavernise, Sabrina, "Poverty Rate Soars to Highest Level Since 1993," *New York Times,* September 14, 2011, page A1.

[3] "It took roughly 6 months for employment to recover to its prerecession level after each postwar recession throughout the 1980s, but it took 15 months after the 1990–91 recession and 39 months after the 2001 recession. At the recent pace of job creation it will take more than 60 months after GDP reached its prerecession level in December 2010 for employment to recover." (p.1; James Manyika, Susan Lund, Byron Auguste, Lenny Mendonca, Tim Welsh, and Sreenivas Ramaswamy, Executive Summary, "An Economy that Works: Job Creation and America's Future." [McKinsey Global Institute, June, 2011])

[4] "Program-related investments (PRIs) are investments made by foundations to support charitable activities that involve the potential return of capital within an established time frame. PRIs include financing methods commonly associated with banks or other private investors, such as loans, loan guarantees, linked deposits, and even equity investments in charitable organizations or in commercial ventures for charitable purposes." Source: The Foundation Center, Grantspace, http://grantspace.org/Tools/Knowledge-Base/Grantmakers/PRIs