

## A Value Vision for the 21<sup>st</sup> Century: The Role of Foundations in Creating Sustainable Capitalism

By Jed Emerson

### ***The Past is Always Present, but the Future Must be Created***

It could well be argued that the primary battle of the last century was that over the future of global economics. The closing decades witnessed the triumph of market-based solutions over planned economies and demonstrated how broad-based democratic practices may lay the foundation for both free enterprise and free peoples.

This century, however, we have the opportunity to advance beyond our antiquated capitalistic practices to a new form of capitalism that is not simply about opening markets and economic opportunities, but the establishment of a global system of capitalism capable of maximizing the *full* value of our human prospects and enterprise. Having won the previous century's fight, we now face a new and exciting challenge: mustering the political and social will to renew economics, social justice, and environmental integrity in every corner of the earth. And make no mistake—this could not be a more critical undertaking.

The form of capitalism we have engaged in to date is based on the thinking and conceptual frameworks that gave birth to the Industrial Revolution. Today, well more than 150 years after that historic revolution, we still approach our understanding of economics, investing, and capital with a 19<sup>th</sup> century mindset—we think of business as the place to create economic value and financial returns and charity as the place

within which we “do good” and contribute to our communities.

We have created our nation's entire framework of corporate law (with its artificial definition of “nonprofits” and “for-profits”) and finance (with its limited focus on shareholder value and maximizing financial returns as the arbiter of what it means to create “wealth”) upon the belief that one can, in fact, *disaggregate* value—indeed, that value may be bifurcated, with economics on one side and social or environmental value considerations on the other.

Within this common framework, what cannot be calculated on a firm's balance sheet and then returned to investors is conveniently defined as an “externality” or “intangible,” while value that is generated from the common efforts of a free society -- social capital returns and contributed environmental services of the earth -- are taken, gratis, into our equation of corporate success and profitability.

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While these past practices remain in our present, asset owners of all stripes and managers of various organizations are now striving to move beyond these constricted definitions and approaches to value creation. Through our strategies of asset management, our business and enterprise development activities, and our investment of philanthropic resources in efforts to create a better world, we can actively work to advance the next generation of capitalist practice and investing to better reflect the value we create. If economic value creation were fully integrated with social and environmental value creation and impacts, how would our perception of the world change?

We would see business practices focused upon bringing products to market with endless life cycles, as all parts and production waste would be re-engineered back into other uses. We would see social activists advancing not only advocacy and community service strategies, but consistently undertaking efforts to leverage economic value and manage the potential of their efforts to generate financial returns. And we would see asset owners—foundations, pension funds, and high-net-worth individuals—seeking to leverage the full value of those assets by demanding their fund managers bring them more innovative options for asset allocation and application in pursuit of their institution's full mission and value potential.

If you think about it, the value we create through the course of our lives and the growth curves of our investment indices is, in fact, *blended* value. All we need do is take the appropriate steps to capture that full value for both our portfolios and communities.

## ***Moving From Industrial Capitalism to Sustainable Capitalism***

Traditional global capitalism has, in its own crude way, created societies, both in the United States and abroad, that are financially wealthier than at any previous time in our world's history. Many who starved have been fed and those without means to support themselves employed. Our economic systems and policies of practice have assisted many of the world's nations to advance from a valley of significant poverty to mountains of prosperity from which we may view the lands still awaiting capitalism's many blessings. From the great heights of wealth documented by our national annual growth numbers and various economic statistics, it all might look fairly promising...and many continue to suggest to us that it is so, with more wealth there to be created if we simply do more within our current framework of industrial capitalism—increase market share, expand traditional global trade, make more innovative products.

But perhaps this expansive, traditional view of capitalism, while initially one of shared vision and celebration, is actually coming into greater focus with the passage of each decade. And with this sharpening focus, it is hard to escape the growing sense that as we move through the early years of this new century, the industrial capitalism of the past is increasingly found to be wanting.

We have proven we can create great economic wealth for many of us, but could our approach to wealth creation itself be part of a shared problem for which we cannot buy a solution?

Today we are, each one of us, confronted with the limitations of what is fundamentally an outdated approach to capitalism. As new markets are opened, old employee and social contracts seem to crumble. Despite the great and laudatory technological innovations of previous decades, well more than half the world's people remain mired in abject poverty, living on less than a few dollars a day. And advancing economic development brings creeping destruction of both local communities and our very planet. As we climb each stair to our next, greater success, the very foundation of our house disintegrates beneath our feet.

This process of creative destruction (a term coined by the economist Shumpter) has been promoted by traditional economists as the necessary ingredient to economic success—that markets move and leave behind winners and losers—and it has been that very success that itself has brought us to this point of understanding the limitations of traditional capitalism, corporate practices, and mainstream investing. While we could continue to celebrate the victory of capitalism over communism, that very fight has left us ill-prepared, for we stand today with the promise of the past now realized, and the challenges of the future spread before us—holding the wrong tools, leaving our best resources behind, and lacking the clarity of vision needed to light our way along an increasingly dangerous path.

And, yet, all is certainly not lost.

### ***An Emerging Framework of Unified Investing, Asset Management, and Corporate Governance***

Previously, I made the case that traditional industrial capitalism, an enormous engine for growth and prosperity in the 19<sup>th</sup> and 20<sup>th</sup> centuries,

is not the right recipe for success in the current century. I suggested that economic value creation must be fully integrated with social and environmental value creation if we expect to accurately measure the benefits and impacts of different types of investments.

If one stands within the stairwell, one sees only the next step. But if we move back, if we gain a broader perspective on the nature of both value and progress, it is possible to understand that the emerging answers, the new approaches upon which we will build the future of sustainable capitalism, are there to be seen, in both the for-profit and nonprofit sectors.

Take the *General Electric Corporation*. In stark contrast to its past history of ignoring the consequences of its business practices, GE's current financial and strategic commitment demonstrates its corporate belief that positive growth is expected from a strategy of using "green" product design to its corporate advantage—and that of its customers and shareholders. In May 2005, GE "surprised investors" by announcing it would *double* its investment in energy-efficient and environmental technology to \$1.5 billion by 2010. Jeff Immelt, chief executive, stated, "Our customers want a more prosperous, cleaner future... We are taking a new approach to solving some of our customers' toughest environmental problems." GE believes the "ecomagination" initiative will reduce its environmental footprint and increase its regulatory "license to operate" in the context of a more environmentally sensitive and carbon-constrained world.

Ecomagination is not simply a marketing commitment, but came about as the result of internal strategic reviews, assessment of business processes, and a response to changing customer needs. In reviewing business units, GE

executives realized that environmental issues developed into a *strategic* factor for their customers. In particular, GE has set an annual growth target of 8 percent—a goal that cannot be achieved without significant increases in the business GE conducts in China, India, and other emerging economies. Such customers are clear on the fact that helping them wring greater efficiencies from energy resources is critical in a world with decreasing amounts of oil and related supplies. What is especially striking is GE's commitment to this new area of business development came not simply in response to demands of outside stakeholders, but rather in response to the vision and interests of internal stakeholders—its employees—who felt GE could move to address a real, felt need of customers.

The fact that GE management both solicited the input of and heard the thoughts of its employees reflects the type of culture being cultivated by current management. GE is taking a leadership role that will force competitors to either step up to the challenge or lose market share and incur possible losses. GE is seeking to convert what more traditional firms might view as a cost center into a competitive advantage in the market place. The launch of GE's Ecomagination initiative is the latest evidence of a business-driven convergence of sustainability challenges and shareholder interest in value creation.

Consider *Generation Investment Management*. Founded by a former CEO of the investment banking group Goldman Sachs Asset Management and a former vice president of the United States, "Generation" seeks full financial return on its investment in global public equities through the *integration* of social and environmental factors into its asset allocation and portfolio management

practices. This is not a screened fund based upon the moral convictions of its investors, but rather a strategic decision to manage financial assets on the basis of how long-term social and environmental factors will affect corporate performance.

Or the *Acumen Fund*, which receives philanthropic investments from foundations and high-net-worth donors, but uses that capital to offer equity and debt options to organizations in the Third World that are bringing new enterprise strategies to market, addressing everything from water resource challenges to malaria to affordable housing.

Or the *Heron Foundation*, based in New York City, but pursuing a unified investment strategy across the United States that integrates its market-rate investments with below-market-rate and philanthropic investments in order to maximize the value generated by its *total* financial assets—not simply its grant making that results from a 5 percent annual payout.

The list goes on and on (for example, see the Blended Value Map at <http://www.hewlett.org/Programs/Philanthropy/Publications/blendedValueMap.htm>), but the central point is constant:

There is not a single answer or one solution emerging as the one new form of sustainable capitalism. What is clear is that a new vision and practice of capitalism is being advanced that promises to build on the strengths of the past while moving beyond its limitations. What is emerging is an understanding that what is required is not the traditional practice wherein we make money Monday through Friday and do good on weekends, but rather a unified strategy for both corporate management and asset investment that seeks to maximize the full, *blended* value of all the

resources under our control. It is a unified strategy of both asset management and corporate governance that seeks to maximize the full value potential of modern capital investing and organizational leadership; it is an approach to 21<sup>st</sup> century economics that forces externalities onto balance sheets and, through the use of enhanced analytics, expands our metrics to directly integrate intangibles into our calculations of worth.

What we are witnessing is the advance of Sustainable Capitalism.

### ***Barriers to Bringing Forth Sustainable Capitalism***

In previous sections of this essay, I outlined the evolution from Industrial to Sustainable Capitalism, presenting a few examples of what is a significant trend. As noted previously, this emergence of a new, sustainable capitalism is moving forward, but not without its own challenges. The forces built upon industrial capitalism—forces of mindsets, financial infrastructure, legal frameworks, and so on—remain strongly in place, though they are confronted each day within markets, communities, and global society. What are the key barriers to bringing forth this new -- and potentially most rewarding -- form of capitalism? How can we overcome them? A book could be written addressing these questions, but for now the following may be said:

*Short-Term Vision.* Sustainable Capitalism is founded upon a long-term perspective with regard to asset management and the generation of multiple returns (financial, social, and environmental). It would seem reasonable that institutions managing assets for the long run would engage in investment practices that looked to the horizon, and that entrepreneurs creating

the companies of tomorrow would manage them with an eye toward the creation of long-term value. Despite these seemingly self-evident assumptions, both our money and companies are managed to maximize not long-term value, but short-term gain. A bird in the hand is worth two in the bush—even if our stated goal is to gather a flock—and so we engage in a drive to the bottom in our efforts to turn a quick dollar. Pension funds are managing assets for retirees decades from now as well as current pensioners, yet most pension funds invest on the basis of maximizing immediate financial returns and many companies are now attempting to jettison such funds at the public's expense. Foundations and educational institutions—many charged with building future financial security—also engage in investment practices focused upon the short term. If we never look up, we will never see where we are headed, and in this way a short-term vision of investing and corporate management will get us somewhere—but certainly not where we might like to go.

*Narrow Value Perspective.* We see all around us the reality that value is more than what is in one's bank account—it is social, it is environmental, it is beyond what can be calculated with traditional econometrics. The reason we cry when miners die in West Virginia or when Pakistanis freeze in the elements without shelter is not because of any loss to our bank accounts, but due to a sensed loss to our collective value as people. The reason we invest financial assets is not simply to grow them for their own sake, but rather to grow them in order to create other things in our lives—security, opportunity, choice. We know this to be true, yet allow our capital markets and firms to function as if it were not. Just as we know X-rays exist despite the fact we cannot see them, making use of simply those

aspects of value that can be documented numerically leaves huge swaths of value unconsidered, much less fully utilized, in pursuit of our institutional missions. Sustainable Capitalism seeks to capture the full value spectrum for shareholder and stakeholder alike.

*Limited Asset Assessment.* Industrial Capitalism understands the nature of assets in their most limited sense. True value, however, is generated not only from effective management of financial assets, but social capital, environmental services, intellectual capital, and a host of related assets. By expanding our understanding of the tools we may draw upon and the assets we have to support the pursuit of our organizational mission, we are creating a new, expanded understanding of not simply the assets under our control, but the potential value we might create through their effective application. Sustainable Capitalism seeks to work with the whole tool box to maximize our value potential.

*Middling Leadership.* Finally, a long-term vision, broader value perspective, and more comprehensive understanding of assets do not come from God above (although with any luck they may have divine inspiration!). They are found in an emerging class of entrepreneurs, investors, and intellectual *leaders* that transcends the current crop of trustees, managers, and program officers. The main barrier to advancing a more effective, sustainable form of capitalism rises from within our own communities as we accept middling leadership and lukewarm aspirations from many of those presently guiding our society's philanthropic, corporate, and nonprofit institutions. These are not bad or evil people. They are simply leaders without the vision required for the critical task at hand.

### ***The Role of Philanthropy in Advancing Sustainable Capitalism***

While there are many potential angel investors within the vision of Sustainable Capitalism outlined in the previous sections of this essay, philanthropy has an especially unique role to play in this effort.

Long acknowledged as the “venture capital” of the social sector, foundations have a solid history of investing in new ideas, leaders, and organizations. By funding new thinking and advocacy, foundations may play a central role in supporting the creation and execution of new ideas to help flesh out the details of our world's Sustainable Capitalism. We will need new conceptual frameworks to understand strategy, just as we will require new approaches to management of both nonprofit and for-profit organizations working to create full, blended value. And, of course, the dissemination and vetting of new, emerging practice will be key to its future success. Philanthropy has a central role to play in supporting work in each of these areas.

In addition to the role played by charitable giving in supporting innovative ideas and inquiry, foundations also have the potential to leverage the 95 percent of their assets that constitute the bulk of their pure financial value. Money managers have many talents, but perhaps one of their best is structuring portfolios in accordance with the demands of the asset owners for whom they work. Trustees of foundations, rather than taking a back seat to the creation and execution of the investment strategies executed in their names, should be front and center in demanding new approaches to investment that will maximize not simply the financial

returns of their capital, but the full, blended value of the funds under management.

This does *not* mean that every foundation trustee needs to be an expert in asset management—that is not their job nor obligation. However, it does mean that foundation trustees establish the performance bar for their fund managers who *do* have such expertise and who, if challenged, could advance investment options and strategies capable of generating both financial performance and multiple returns.

This is not a complex task, as there are a number of ways to begin leveraging greater value from investment portfolio practices. Investing in certificates of deposit and money market accounts of federally insured community development banks is one very simple, yet underutilized, aspect of effective fund management. Engaging in active proxy voting and oversight of corporate governance is another. Investing in funds and individual investment instruments that both return financial and social value is a third. The central point is that foundations, at their core, are not private investment trusts that should be managed solely for monetary gain, but are private trusts that should be managed for the public good in accordance with their charitable status. While under traditional capitalism it may have been acceptable for endowed foundations to utilize 5 percent of their assets (their grant making budget) to pursue 100 percent of their mission, Sustainable Capitalism calls for us to seek out every appropriate strategy to apply our full array of assets. (For more on this concept of foundation asset management, please see various articles on Total Foundation Asset Management and the specific article titled “Foundation Overdrive” at [www.blendedvalue.org](http://www.blendedvalue.org).)

Furthermore, as stewards of our public trust, foundation executives and board members must carve out a new vision of evolved fiduciary responsibility. Prudent trustees are those who look to the future, steer the boat around the shoals of both the market and the world, and understand their responsibility is not to concepts of the past, but rather the solutions of the future. The responsible fiduciary of foundations is one who builds conservatively on the past, but takes informed risks to advance our institutions toward a sustainable future. (For more on fiduciary responsibility, see “The Prudent Trustee” at [www.genfound.org](http://www.genfound.org).)

Sustainable Capitalism is emerging from the shortcomings of Industrial Capitalism, but it will not come forth fully formed or ready made. Foundations as institutions and trustees as their leaders are called to play critical roles in supporting (through philanthropy, asset management practices, and effective public policy) the future creation of *truly* sustainable capital, markets, and organizations.

This essay has reviewed the rise of a new form of capitalism that will replace Industrial Capitalism over the coming decades. Sustainable Capitalism is an evolved, market-based approach to value creation that seeks to maximize the full value potential of both our capital and our corporations. It views the main focus of our efforts, whether manager or investor, to be that of generating blended returns that include economic, social, and environmental components. And, most important, it recognizes one cannot consider the practices in pursuit of economic value in absence of our understanding of the social and environmental value of which it is a part. Value is whole, integrated, and blended at its core.

What is required for us to capture this full, blended value is an approach to modern-day capitalism that moves beyond the initial barriers of short-term vision, narrow value perspective, limited asset assessment, and middling leadership, and takes us to the next stage of our own individual and our society's development. There are any number of corporations and investors leading this advance, but there is not any single answer to be championed. All of us must honestly assess our core, long-term goals and then work to implement an approach to our philanthropy and market rate investing that places our capital where it may be most effective in generating our greatest, fullest set of returns. All of us must work to create corporations and institutions capable of carrying this work forward. And, yes, all of us must come to the defense of a new, expanded capitalist practice before the old approaches seal our future fate and destroy the very wealth and freedoms our forefathers worked to create and our children deserve to inherit.