Earning Justice: The Returns on Equity, Diversity, and Inclusion in Investing

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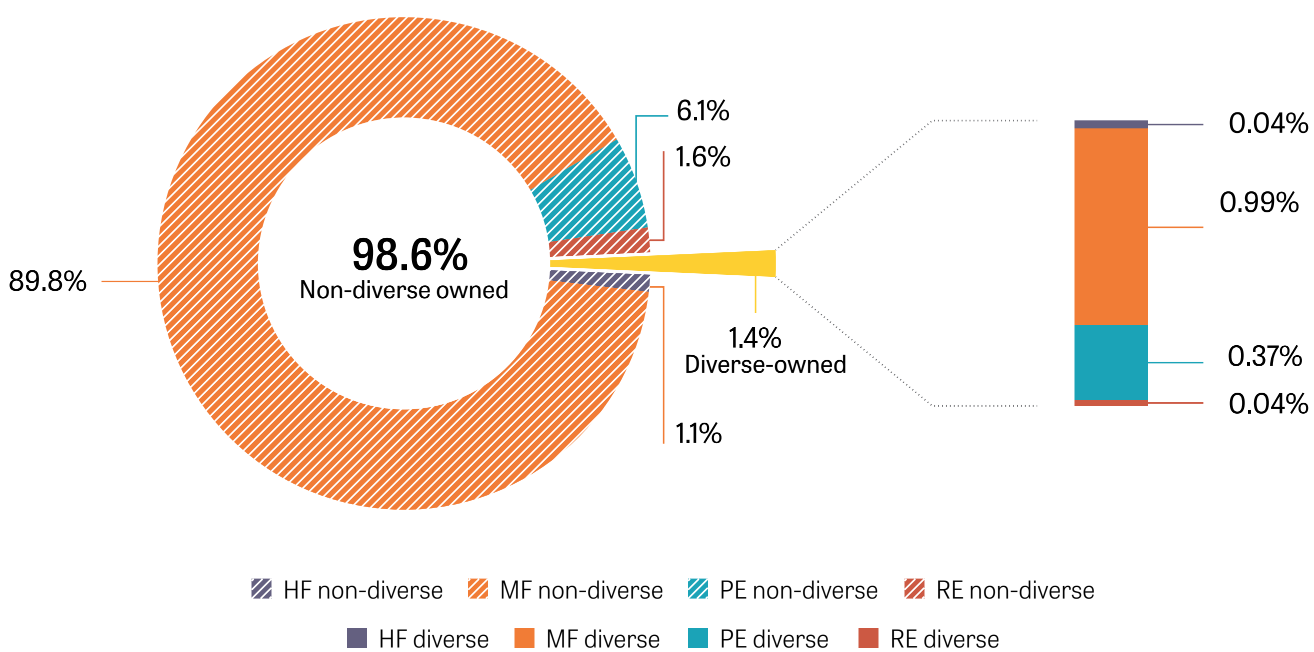
The Case for Justice, Equity, Diversity & Inclusion in Higher Education Endowment Investing

The most effective climate solutions center on diverse communities, advancing racial, economic, and environmental justice while solving clean energy challenges (Henriques da Silva, 2022). Yet racial inequity has been, and remains, a core driver of many of the world's most pressing social and environmental challenges. Of the investment industry's $72 trillion in assets, 98.7 percent is managed by teams without diverse representation, and only one percent is managed by women and people of color (Knight Foundation, 2021). Even less is managed by people who are Black. While most of us are aware of our nation's racial wealth gap, its persistence among even the wealthiest households illustrates how pervasive it is. Even among the top one percent of American households, the median net worth for Black families is one million dollars, while the median for white families is $12 million (Nixon, Higgins, 2020).

This paper is intended to catalyze more diverse investment leadership and promote the redirection of higher education endowment capital and employee retirement investment options into pathways that accelerate measurable action for racial equity (e.g., by investing though BIPOC-owned investment firms or investing in companies that positively impact social justice and equity).

Breakdown of study sample firm AUM by asset classes



HF = Hedge Funds ; MF = Mutual Funds ; PE = Private Equity ; RE = Real Estate

Source: Knight Foundation, 2021

By **investing with diversity and equity in mind**, institutions stand to:

Increase endowment returns - Research demonstrates that women managers and managers of color outperform investment benchmarks (Jones, 2021).

- Higher levels of diversity at companies correlate to improved financial performance (Morgan Stanley, 2020).
- Diverse-led investment management teams perform as well or better than non-diverse peers, even after controlling for fund-level and firm-level characteristics (National Association of Investment Companies, 2020).
- In addition to improving investment performance (Gompers, Kovvali, 2018), diverse investment team members are more likely to themselves back diverse teams (Stone, 2020).

Solve several problems at once - Investing with a justice, equity, diversity, and inclusion lens can help accelerate climate efforts (Henriques da Silva, 2022).

- Helps bridge the racial wealth gap that has cost the US economy $51 trillion in lost surplus since 1990, and could cost the US as much as 6 percent of its real GDP over the next six years (Noel et al., 2019).
- Supports innovative solutions that may not otherwise be devised. Women and people of color often create products and services that address problems more frequently faced by women and people of color, and in turn, these solutions often end up benefiting everyone.

Mitigate risk - Perpetuating racial inequity in investment practices, intentionally or unintentionally, exposes portfolios to additional risk (Henriques da Silva, 2022; Morgan Stanley, 2020):

- Investment risk – Non-diverse teams are less likely to outperform, will post lower revenues, and will have more challenges attracting younger talent.
- Regulatory risk – government agencies are putting increasing pressure on companies to improve transparency and initiatives around diversity and inclusion. (KPMG, 2021)
- Social risk – Social movements can embroil institutions and firms in negative attention, which can affect stock price, valuations, and goodwill over multiple time periods.

Framework for Implementation - A Call to Action

The collective action of university endowments could be instrumental in demonstrating the value of racial equity investing to institutional investors. JEDI investing offers higher education leaders an opportunity to go beyond educating students of color, to investing in them, their futures, their communities, and a society that is more sustainable. A clear commitment to justice, equity, diversity, and inclusion from trustees, boards and presidents, and across all sectors of the university, including endowment investment management, will lead to greater institutional resilience and relevance. The intersection of environmental and social justice issues directly affects endowment performance, and the sustainability of the higher education business model. However, emerging opportunities to advance racial equity through endowment investing decisions are uderappreciated as a vehicle to drive systemic change.

To realize the potential of the nation's $675 billion in endowed higher education institution assets (National Council for Education Statistics, 2022), investors should consider the JEDI implementation framework below.

<table>
<tr><td>Learn</td><td>Commit to discussing racial equity at investment committee meetings.

Assess how institutional investments provide solutions to or perpetuate racial inequality.

Conduct bias training as perceptions of race can inform both business and investment operations through hiring and retention, manager selection and risk assessment.

Review existing data.
A recent study by Aon and the National Association of Investment Companies (2020) found that from 200-2019, diverse private equity funds outperformed the Burgiss Median Quartile in 78.57% of vintage years studied.
Studies and reports published by several other organizations, including West River Group, the Knight Foundation, and Stanford University have shown that diverse funds are disproportionately represented in top quartile performance figures</td></tr>
<tr><td>Build Consensus</td><td>Achieve buy-in from stakeholders about your institution's racial equity goals, investment strategies and next steps.</td></tr>
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Update Standards	Update your institution's investment policy to reflect your diversity and inclusion priorities Ensure there is no language in your investment policy that could bias against you or your investment allocator investing in BIPOC-led firms. Develop definitions for key terms, and/or seek definitions for diversity and equity from BIPOC-led research or academic organizations. Consider developing or adopting frameworks for racial, social and/or gender equity and diversity. There are separate frameworks and approaches, such as Gender Smart JEDI investing toolkit. Set actionable parameters (Hull, 2020) based on the reach of your institution.
Engage	Determine what approach, if any, investment managers apply to diversity, racial and social equity within their firms, portfolio, and industry. Engage with companies as a shareholder on issues that relate directly to diversity, equity and inclusion. This can include, but is not limited to: • Requesting that companies connect executive pay to diversity and inclusion related outcomes. • Requiring transparency from your external allocators as to how they engage with or evaluate managers on these issues (if you invest in commingled funds). • Shareholder and proxy voting on issues related to diversity, equity, and inclusion. Use investor voice in partnership with organizations focused on racial justice to advance anti-racist public policy through investor statements, pledges and public comments to spur collective action. Offer internships in the investment office for underrepresented students to aid in diversifying the field, or create a student-managed fund focused on diversity of the team as well as a racial equity investment strategy.
Invest for Impact	Evaluate the impact of specific industries on various BIPOC communities, and leverage these insights to inform your investments. Invest in companies and funds with a proven social impact record. Allocate to community development financial institutions (CDFIs), which offer stable cash or fixed income like investment returns while providing financial services to help low-income, low-wealth, and other disadvantaged people in their communities.

Evaluate & Share	Evaluate progress at regular intervals. Disclose information on your diversity and inclusion investment strategy and progress to encourage transparency and accountability.
Promote Racial Equity	Engage with racially diverse consultants. Ask your asset managers about their approach to internal diversity and inclusion, BIPOC ownership of the firm, how firms owned by BIPOC are included in searches, and how race and social identity is factored into the investment processes and economic projections. Hire BIPOC individuals in investment roles, or include BIPOC individuals in your investment committee. Provide BIPOC team members with opportunities for leadership, and support the initiatives they lead within and on behalf of your organization–this can be a catalyst for change. Leverage the extensive and growing list of existing resources for investing in more BIPOC and women managers. Center your approach on specific BIPOC communities, informed by best available research. Select allocators who take the above actions (if you work with external advisors, consultants, or investment offices).

While diversity of investment management teams is important, measuring diversity alone doesn't always capture how investments interact with specific groups of people who have been marginalized, excluded, or harmed by systemic inequities. To address this, higher education institutions can work with their investment managers to develop and/or adopt racial and social equity investment frameworks.

Global Endowment Management (GEM) provides institutional investment capabilities for a number of higher education endowments and foundations. In 2019, GEM launched an integrated, cross-team approach to research racial and social equity in the investment industry and to develop racial and social equity lens frameworks the firm could apply to all of its investments. Each framework centers on groups that face or have faced significant structural or systemic inequities, both in our society and within capital markets. The frameworks are applied during investment diligence, and assessed separately at the firm leadership and investment level for each investment manager. You can learn more about GEM's racial and social equity lens frameworks here.

Non-exhaustive list of JEDI-focused mutual funds and companies

Adasina Social Capital

Impact Shares - NACP ETF

Community Investment Management

Reinventure Capital

Nia Impact Capital

Low Income Investment Fund

Endowments Leading the Way

Below are some examples of institutions with whom the authors have worked that have made proactive commitments to diversity, equity, and inclusion in their investment processes.

Warren Wilson College

In 2015, Warren Wilson College's endowment fund undertook steps to be more intentional in the management of its investments. As part of a comprehensive response to a student-led effort to divest the portfolio of carbon, the endowment fund managers created a Responsible Investment Policy to guide the endowment fund, its consultant and underlying asset managers. A core part of the policy is the endowment fund's commitment to diversity, equity and inclusion.

Letters of authorization are a valuable tool for shareholder engagement. When used correctly, institutions can use these letters to allow other organizations to take action on their behalf.

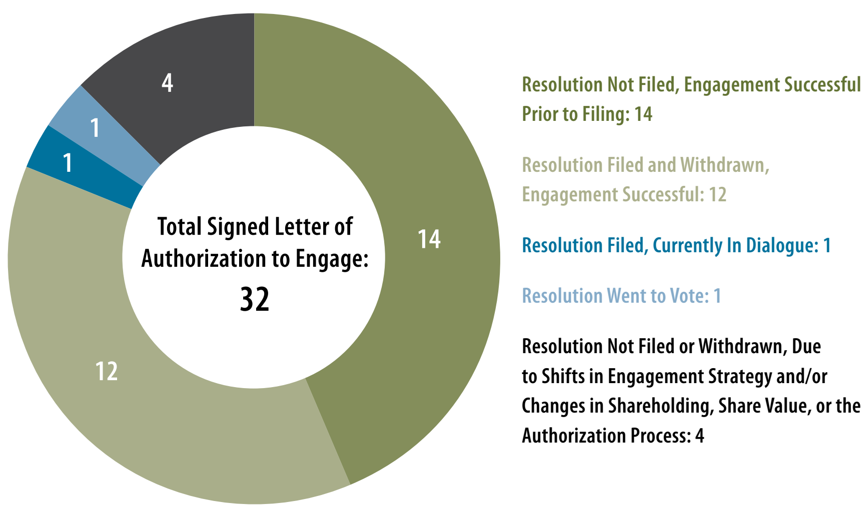
During the 2021-2022 shareholder engagement season, Warren Wilson College signed 32 letters of authorization (Warren Wilson College, 2022)). for all outcomes at companies where WWC authorized engagements (Intentional Endowments Network, 2022). These agreements included:

- setting next zero emissions targets and interim emissions targets,
- performing net zero scenario analysis;
- publicly reporting EEO-1 data;
- publicly disclosing workforce retention, recruitment and promotion data, and
- working with local communities to address environmental justice concerns.

Byron Hall at Warren Wilson College.

Highlights

- New DEI-focused Responsible Investment Policy to guide investment managers
- Recent increase in women and BIPOC investment managers
- Shift to proxy voting and shareholder resolutions



Source: Intentional Endowments Network, 2022

Additionally, Warren Wilson College's Responsible Investment Policy statement highlights that the investment committee and their investment consultant "seek to utilize a diverse group of investment managers including minority- and women-owned investment management firms." The college has sixteen investment management firms across various asset classes. Of these, three are led by people of color; two are woman-owned; and another, a manager's collective, is majority owned by people of color and women. Warren Wilson College has been successful in partnering with diverse managers by expanding its search pool. Specifically, the endowment fund does not rely on just its consultant but utilizes professional and social networks of investment firms of color, relationships and subject matter experts to assist. Warren Wilson College looks for investment firms of color in all asset classes. For example, one of Warren Wilson College's asset managers is 5 Stone Green Capital, an African American owned green real estate fund that invests in the intersection of communities of color, green technology, and sustainable infrastructure.

Over the next several years, Warren Wilson College's endowment fund is looking to:

- Add additional asset management firms of color to its endowment fund management, particularly African American- and Latino-owned asset managers;
- Engage with every asset manager that manages money for Warren Wilson on incorporating racial equity, diversity and inclusion principles into their respective investment management processes when evaluating the underlying companies for investment;
- Ramp up the endowment's shareholder engagement and proxy voting efforts to support racial equity and diversity and inclusion issues with the asset managers and underlying companies in which the endowment fund has a stake;
- Amend the college's Responsible Investment Policy to uniquely highlight the importance of racial equity as a focus for the endowment fund and its sustainability.

EcoDorm at Warren Wilson College.

University of California

Diversity is one of the pillars of the University of California's Sustainable Investment Framework. Since 2015, the Office of the Chief Investment Officer has: strengthened its commitment to diversity within its own team; engaged in dialogue with investment partners around diversity and inclusion policies; and sought to increase access to top-performing firms owned by women, African Americans and Hispanic/Latino individuals (University of California, Office of the Chief Investment Officer. (2020). In 2020, the office began publishing annual reports on diversity and inclusion ("D&I") strategy and progress. Key features of the University of California's diversity and inclusion strategy include:

UC Merced students form the state of California.

Highlights

- Diversity is one of the pillars of the UC Sustainable Investment Framework
- Increase in investment managers who are women, African Americans and Hispanic/ Latino
- Senior-level position formed to develop D&I programs
- "Diversified Returns" Program

Executive Leadership, Team Diversity and Metrics: D&I has been added to the Chief Investment Officer's performance goals, creating a senior professional level position to develop D&I programs and forming a diversity advisory committee. To increase accountability for progress, UC Investments' employee demographics trends are annually tracked and reported.

Partner Firms: UC Investments engages with existing investment partners around D&I to communicate the importance of diversity and inclusion through a demographics survey of partner firms in every asset class. The survey helped to establish a baseline and will be used to track the results over time as an indicator of progress.

Learning: The UC Investments team participated in "emerging managers" conferences organized by third parties, including GCM Grosvenor, Texas Teachers Retirement System and the Hispanic Heritage Foundation. UC Investments also established formal relationships with associations of minority investment professionals such as the National Association of Investment Companies, New America Alliance and Asian American Association of Investment Managers.

"Diversified Returns" Program: University of California launched this program in 2020 in order to access the superior returns often associated with firms owned or led by women and people of color. Diversified Returns consist of three pillars:

- Ensure a diverse pool of qualified potential partners in all searches for investment partners.
- Track and report the demographics of investment partners and compare it to the baseline
- Identify and address cognitive, racial and gender biases and train investors "to overcome their biases by revamping their investment criteria and strategies and ensuring they are knowledgeable about the success of firms led by people of color" (Lyons-Padilla, 2019).

Howard University

At Howard University, a private Historically Black College in Washington DC, the endowment has approximately 65 continuing money managers on its roster. As of June 30, 2020, minority firms managed 14.9% of Howard's endowment assets and 16.6% of total pools managed by the investment office. (Bogunjoko, 2020)

Highlights

- Over 16 percent of total investment pools
- Active program for seeking diverse-owned managers and service providers

Howard University's investment policy statement outlines the university's commitment to promote diversity and actively search for diverse owned asset managers and service providers. The investment office believes that "minority managers have added value to the program and the investment office" and directs its consultants to seek such managers throughout the investment process. (Bogunjoko, 2020), In their search for diverse talent, the investment office has also participated in seeding new diverse managers through one of its investments and has worked with diverse broker dealers to execute trades. Howard University plans to continue their search for more diverse managers to include on their roster, monitor and report on their progress, and strengthen institutional buy-in by engaging the Board for supporting these managers.

The University of Chicago

In 2008, The University of Chicago launched efforts to increase the racial and gender diversity of the investment managers that manage the endowment. This was a collaboration between the University's Office of Business Diversity, Office of Investments (led by the institution's Chief Investment Officer), and key supporters from the Board of Trustees.


University of Chicago

Highlights

- Section of business diversity symposium dedicated to diverse investment managers
- University's endowment employs 33 diverse managers and has $1.7 billion of its endowment allocated to diverse managers

To build out a network of diverse managers, the University first dedicated a section of its [Business Diversity Professional Services Symposium] to diverse investment managers specifically. The Symposium is an annual gathering of diverse-owned businesses that the University hosts to increase supplier diversity. Through the Symposium, the University connected with diverse managers across asset classes. The Office of Investments then conducted due diligence and allocated capital to those managers that met the investments criteria.

The University had $200 million allocated across five diverse managers in 2010. As of June 2020, the University's endowment employs 33 diverse managers and has $1.7 billion of its endowment allocated to diverse managers, totaling 16 percent of its overall portfolio. (Bengabsia, 2020) The University shares that increasing the diversity of its investment managers has been beneficial to the endowment overall. Specifically, the Office of Business Diversity reports:

"Diverse investment managers bring a unique set of perspectives that increase cognitive diversity across the University's investment portfolio. This increases the opportunity set for the overall portfolio of managers, improving the chances for outperformance, but moreover, it exposes the University to investment themes and ideas that can be leveraged beyond just the mandate of the managers. For example, one of the managers in the program has a unique investment thesis, investing in 'disruptive innovation' across an array of sectors and using unique inputs. University staff are studying the thesis in depth and are looking to apply it through other thematic investments across the broader portfolio, as it aligns well with the University's long horizon and growth orientation. Exposure to such perspectives can improve decision-making and ultimately lead to superior results." (Bengabsia, 2020). University of Chicago's efforts are also highlighted in Racial Equity Investing: Opportunities for Impact & Alpha (Bengabsia, 2020).

New York University

Since 2017, the NYU Stern Center for Business and Human Rights has been working to promote greater diversity among asset managers that are investing university endowment funds. In this work, it has partnered with the Diverse Asset Managers Initiative (DAMI), RFK Human Rights, and Knight Foundation among others.

In 2018, the Center and its partners co-hosted a convening at NYU of representatives from 13 large university endowments. The agenda focused on understanding current challenges to enhancing diversity among fund managers and tactics to overcome them. Following this meeting, the Center encouraged schools to systematically track and report on the percentage of their portfolios managed by firms owned by women and people of color. (Bogunjoko, 2020).

New York University

Highlights

- Partnership with the Diverse Asset Managers Initiative and RFK Human Rights
- Co-hosted a convening on the challenges to enhancing diversity among fund managers and tactics to overcome them
- Developed and implemented a survey to gather diversity data

To support university and college efforts to increase work with diverse-owned managers, the Center worked with Knight Foundation and Global Economics Group to develop a survey to gather diversity data from 50 of the largest university endowments and a few other schools that have expressed interest in improving diversity among their fund managers. An interim report on the survey's findings was released in June 2022, and the Center is now working with its partner organizations to gather data from other institutions. Once additional data is collected, the Center will work with participating universities to establish an approach for measuring progress.

The Center continues to facilitate cross-university collaboration to share best practices and develop strategies for identifying high-performing diverse-owned managers. Additionally, the Center brings lessons from this work to the MBA classroom to ensure that future investment professionals understand barriers to diversity in asset management, recognize how those barriers result in missed opportunity, and are armed with a toolkit for countering practices that perpetuate the underrepresentation of women and people of color in investment.

Closing

Higher education endowments are increasingly examining how their investments align with their institutional mission, values, and sustainability goals. Selecting investment managers that are BIPOC-owned is a good first step. To maximize positive impacts from institutional investments, it's critical to work with these managers to guide investment decisions toward funds and businesses that promote racial justice and social responsibility.

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