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The opportunity and challenge of Equity-Lens Investing

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How to avoid good intentions going wrong or worse, bad intentions being covered up

Diversity, Equity & Inclusion initiatives, as well as impact investing through an Equity Lens, have taken a true foothold in firms advising U.S. clients. Investors are increasingly seeking ways to align financial returns with more equitable economic prosperity. However, portfolio construction that enacts long-term systemic change is not as simple as picking funds across asset classes.

We remain optimistic about promising signs that investors and investments in the capital markets are prioritizing improved outcomes for those impacted by systemic racism. More than 182 signatories from around the country (including Tiedemann Advisors) signed the Confluence Philanthropy pledge for racial equity (the Belonging Pledge), representing $1.88 Trillion in AUM, mid-way through 2020. In addition, business organizations proposed legislation such as "Improving Corporate Governance through the Diversity Act of 2019." Despite this positive wave of enthusiasm for shared learning and effecting change, it is not always clear which uses of capital intended to solve this problem fit naturally into an investment portfolio structure, and which remain better served by philanthropy and public policy.

Here, in crafting an Equity-Lens thematic strategy, there is an added layer of nuance. How do we, through investment of capital for return, unravel centuries of systems meant to advance some and weaken others? How does improved access to the capital markets equate to more equitably shared economic upside? A tall and complex order, to say the least.

A Start

As a first step, investors are increasingly reflecting their values in the publicly traded companies they choose to keep, by seeking those which are measurably more diverse in leadership and recruiting, with clear policies to protect and advance successful employees irrespective of background or how they identify. These same investors are increasingly interested in putting their cash into community banks where it can support borrowers in need, rather than just seek out an institutional money market return. Both decisions are clear expressions of the values of diversity and inclusion through investing, and those actions are important over the long term. However, do they actually ***effect change*** within these communities? Do they remove any barriers to sharing in growth and prosperity? We would suggest that no, they cannot do more than reflect sentiment for a moment in time.

Similarly, for less liquid, longer-term and higher-risk investments, many impact investors have emphasized important strategies like affordable housing, access to the financial system through technology and apps, while venture capitalists compete to fund diverse startup leadership teams. When does an investment evolve from reflecting the values of the investor who will benefit from the return, to enabling real change in equity for other communities?

How to invest

Almost by definition, a deeper Equity-Lens approach to impact investing begins with filling in the gaps and creating a Theory of Change. The strategy doesn't lead with traditional risk analysis and a range of diverse investments, but instead with a firm's commitment to learning and collaboration, with patience, humility and diligence. After all, if that properly diversified set of investments is intended to produce both a financial return and a measurable improvement in the economic life of a community, then there is likely a need for research and understanding around what that community really needs and wants. How can more people access the "upside" and return enjoyed by wealthy investors? Based on those answers, how can we ascertain which actions or interventions really should produce the intended shared prosperity?

This work is full of "others' history" – learning about the past for communities we often don't see clearly or fully understand. It risks leading with good intentions gone-wrong or worse, bad intentions well-hidden. Before making high-conviction recommendations toward specific outcomes, investors have some homework to do.

Identifying and Achieving Goals

Impact investors increasingly seek to do even-more-good with their capital and to address issues of injustice and marginalization. If an investor makes the distinction between investments for return (some at market rate/ some concessionary) and grant dollars, and they're seeking advice from their financial firm, how can an advisor guide a client to invest with an Equity Lens, and how does a Theory of Change influence that advice?

To begin this work - particularly as inequities with respect to race and gender are highlighted during the battle with Covid-19 - the need grows for a deeper look at how the capital markets are tied to – and in some cases perpetuating – unequal access to opportunity and prosperity. Unraveling the complex systems and stories that underpin our current national conversation on race and equity is an endeavor that takes time and conviction.

It starts first with asking difficult questions. Understanding how capital can be invested to effect change means first establishing a theory about how the financial system benefits white communities but not others, and then asking about the unintended consequences of trying to unblock barriers with investible capital. If done the wrong way, impact investors could reinforce the power of banks to benefit the few, thus maintaining the status quo of disparate borrowing practices, or inadvertently reward inequitable business ownership practices. And how should investor decision-making in this area be instructed by the overlap of equity with other major themes, such as climate change, entrepreneurship, and health and wellness?

To begin answering these questions, we can start with what we do know. There have always been parallel systems at play in this country: pathways providing authority open to some, and barriers removing control for others; laws to protect many and loopholes to punish the few – all of which have created opportunity for wealth creation in some communities, and reinforced a lack of opportunity and agency in others. How do we change that with investment? The answers lie in what we must learn first – what we need to understand and commit to changing before we can talk about solutions.

***Theory of Change:** The methodology for planning, participation, and evaluation that is used in philanthropy, not-for-profit and government sectors to promote social change.