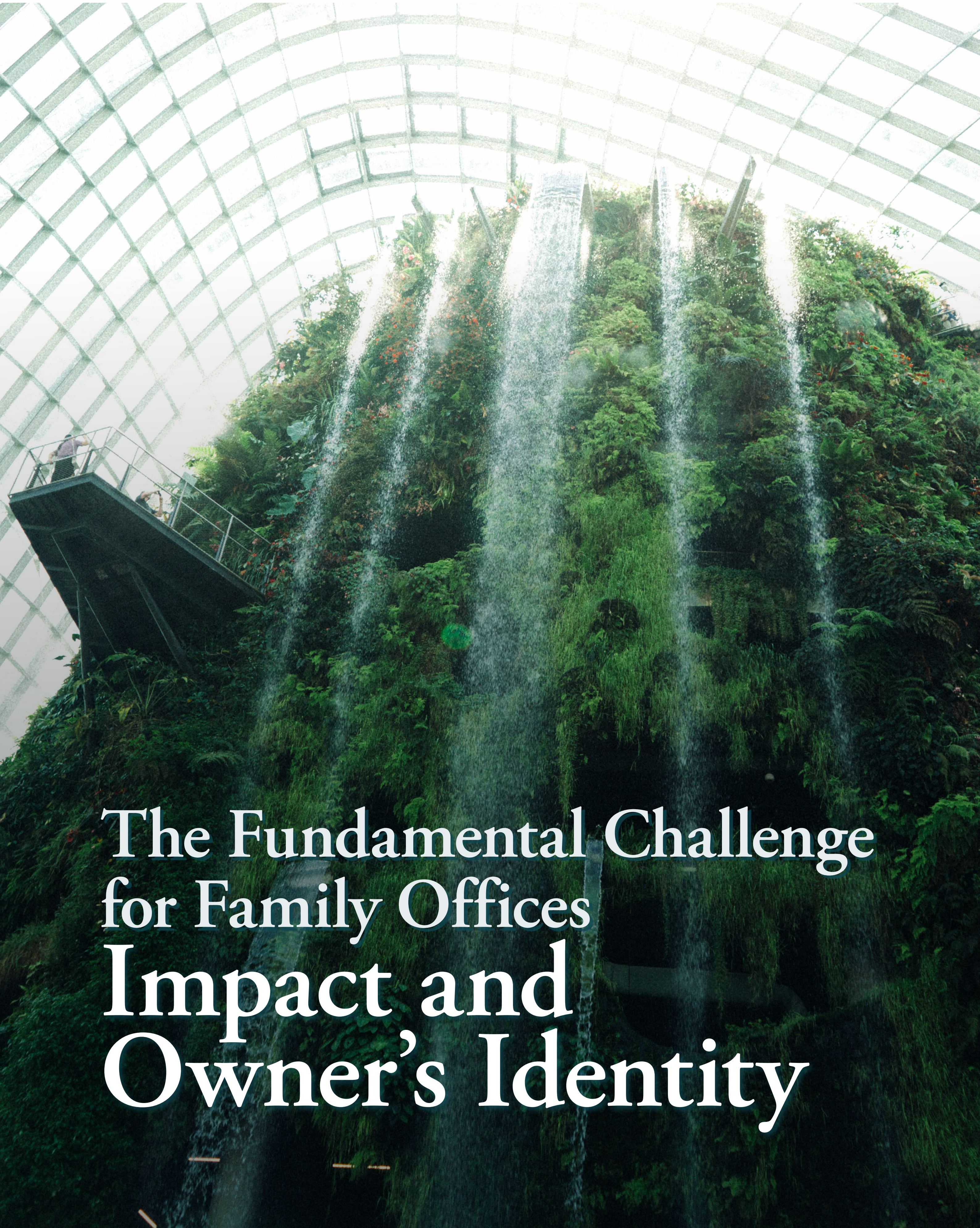
WEALTH MANAGEMENT INSTITUTE

IMPACT

THE FAMILY OFFICE JOURNAL

Issue 1 | October 2022



The Fundamental Challenge for Family Offices

Impact and Owner's Identity

Foreword

Welcome to **WMI Impact: The Family Office Journal.**

Established in 2003, the Wealth Management Institute (WMI) is committed to building capabilities for investing in a better tomorrow. Founded by GIC and Temasek, our vision is to be Asia's Centre of Excellence for wealth and asset management education and research.

In October 2021, WMI launched the Global-Asia Family Office Circle, a family office network platform supported by the Singapore Economic Development Board (EDB) and the Monetary Authority of Singapore (MAS). In partnership with the family office community across family principals, family office professionals and service partners, the GFO Circle aims to foster a trusted environment to build capabilities and community in the family office sector.

Advancing thought leadership is a key aim of the GFO Circle. In line with this, we are glad to launch a new publication, **WMI Impact: The Family Office Journal,** to share and create practical, applied knowledge relevant to the family office ecosystem in Singapore and beyond.

Through the GFO Circle, we have heard from many family offices about what are the topics and concerns that matter most to them. The journal is envisaged to directly address these topics along themes such as impact and investment as well as entrepreneurship and governance. We hope that it will also ignite and invigorate new dynamism for the current and next generations of family businesses. The journal will strive to spark discussion among family office principals as well as their professionals and advisors and bring impact to the family office community.

The Family Office Journal

The timing of the journal's launch is significant as this builds on the success of the inaugural Global-Asia Family Office Summit 2022 where family offices were galvanised towards purposeful wealth in areas such as spurring new enterprises, sustainability and philanthropy. Indeed, the bedrock for such wealth application will be on impact which is the core thrust of the journal.

Each issue in the journal is structured as follows:

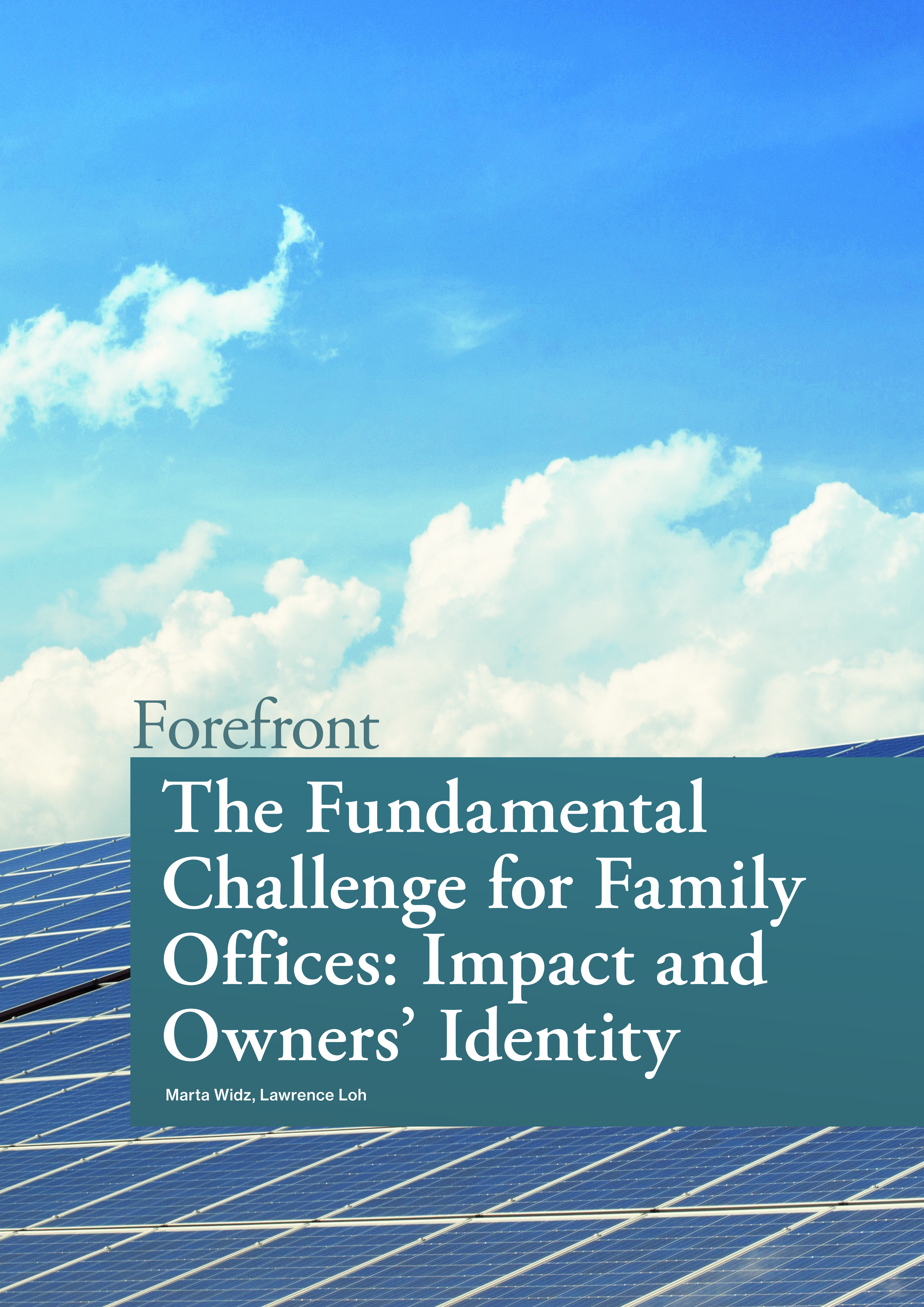
- The ***Foreword*** presents the strategic significance of the focal theme covered by the issue.
- The ***Forefront*** is a compendium of key insights to provide the reader with a concise overview of the critical points with an emphasis on application.
- The ***In-Depth*** section comprises the full-length articles and is directed toward the readers who are seeking extended expositions of the theme as well as academic perspectives and bibliographic sources.

The birth of this journal would not have been possible without the contribution of many supporters. My special gratitude for the invaluable insights is due to the family offices that have engaged WMI over the years, including the various owners and leaders. WMI also had the benefit of inspiration from many institutional funders and thought leaders who have been generous to offer guidance to WMI.

Credit naturally goes to the editorial team at WMI comprising Dr Marta Widz, Visiting Professor Dr Lawrence Loh, and Brian San, Executive Director, Programmes and Strategic Development.

May I wish you an enriching journey into the world of impact with the **WMI Impact: The Family Office Journal.**

Ms Foo Mee Har
Chief Executive Officer
Wealth Management Institute



Forefront

The Fundamental Challenge for Family Offices: Impact and Owners' Identity

Marta Widz, Lawrence Loh

As the sustainability agenda becomes one of the most important long-term priorities for organisations and society at large, owners and investors have embraced the movement toward capitalism with a human face.

Roots of Impact

The current emphasis of family businesses on sustainability builds on milestones of a journey that go back to the 1950s.

- Howard Bowen in his 1953 publication, Social Responsibilities of the Businessman, first used the term "social responsibility".
- In 1969, John D Rockefeller III called for the amalgamation of business practice with a social and philanthropic purpose, and the Rockefeller Foundation coined the term "impact investing" in 2007.
- In 1994, John Elkington established the TBL (Triple Bottom Line) concept, urging businesses to rethink capitalism and to include two other factors in decision-making—the society and the environment—apart from financial profits. Later on, a variation of TBL, 3Ps became an accounting standard to report on People, Profit, and Planet aspects of the organisation.
- In 2000, the UN created the United Nations Global Compact (UNGC), which laid the foundation for the development of ESG (environmental, social, and governance) goals. The term "ESG" was first promulgated by a landmark report entitled "Who Cares Wins" in 2005 which was published under the auspices of the UNGC.
- In 2006, the B Lab movement was started to certify companies meeting high standards of social and environmental performance, accountability, and transparency as B Corporations, based on B Impact Assessment (BIA).
- In 2015, the UN General Assembly adopted the 2030 Agenda for Sustainable Development and defined the 17 Sustainable Development Goals (SDGs).

Identities and Impact Approaches

Both investors and owners agree that the time has come to move away from the oft-cited Milton Friedman's proclamation of shareholder primacy. However, their approaches on how to move toward stakeholder capitalism are very different because of the distinctive intentions of their impact philosophies. Owners and investors display heterogeneous aspirations, targets, risk exposures, competencies, non-ownership ties, and capital allocation strategies because of their unique identities.

Identity is a fundamental feature of any individual and any organisation, including family office principals and owners of family businesses. It defines "who we are" and connotes the presentation of a public image to multifarious stakeholders.

For family offices, there is often a dichotomy between the identities of the investor and the owner. While minority shareholders develop investor identity, owner identity is typically developed by so-called strategic owners – controlling shareholders or blockholders, also referred to as large owners–who have significant jurisdiction over the firm's operating and strategic direction.

Investor identity dictates that investors should follow the capital market's standards and meet their fiduciary obligations to shareholders. Strategic owners, on the other hand, identify strongly with their businesses and craft strategies to follow their visions and reflect their values. In the end, they are the ones who are held responsible for the operation of their businesses and their footprint on society and the environment and hence they can intentionally ensure that their patient capital embraces the full range of SDGs.

Identities in Family Offices

Interestingly, business families can be strategic owners, investors and also philanthropists at the same time. As a result, they can bring impact through a variety of means, such as private grants and seed funds provided to the next generation of family members for their impact investing ventures. In addition, these means may include investing in ESG funds, financing sustainability start-ups, becoming angel investors for green entrepreneurs, collaborating with early-stage ventures, incubators, and fostering accelerators to make an impact locally.

In fact, in single-family offices, the division between investor identity and strategic owner identity is blurred because family offices act as investors on behalf of the strategic owners. Wealthy families and the chief executive officers or chief investment officers of most family offices face a wide range of possibilities on how they can be involved in social impact. Often, the chosen path depends on the stage of development of the business family.

Bringing Impact through Intentionality

For all, however, there is a lesson to learn: embarking on a genuine impact journey for family offices requires a holistic approach. This necessitates a smooth convergence of investor identity with owner identity as well as a coherent investment and impact thesis that reflects the ambitions and values of the business family. Further, it leverages the organisation's business model to bring impact and nurtures the potential to embed sustainability into an organisation's core DNA in the long run. In totality, the intentionality for impact is a skillful balancing act that embraces the paradox of seemingly conflicting goals of financial returns and a purposeful mindset.

The following questions may prove useful in finding the family office's own way to bring impact:

Drivers and Meanings

- Is the investment strategy of our family office driven by investor identity or owner identity or both?
- What does impact mean for us? What are the drivers of our purpose – what is the balance between external factors versus our internal family values and vision?

Approaches and Gaps

- How is our business family creating impact, i.e., through the operational business, family office, philanthropy, or other ways?
- What is the gap between our desire to make an impact and embedding impact into the business model of our family office?
- Is our approach to impact holistic enough? Have we performed the materiality analysis? Are we ready to self-assess against B Corp standards?

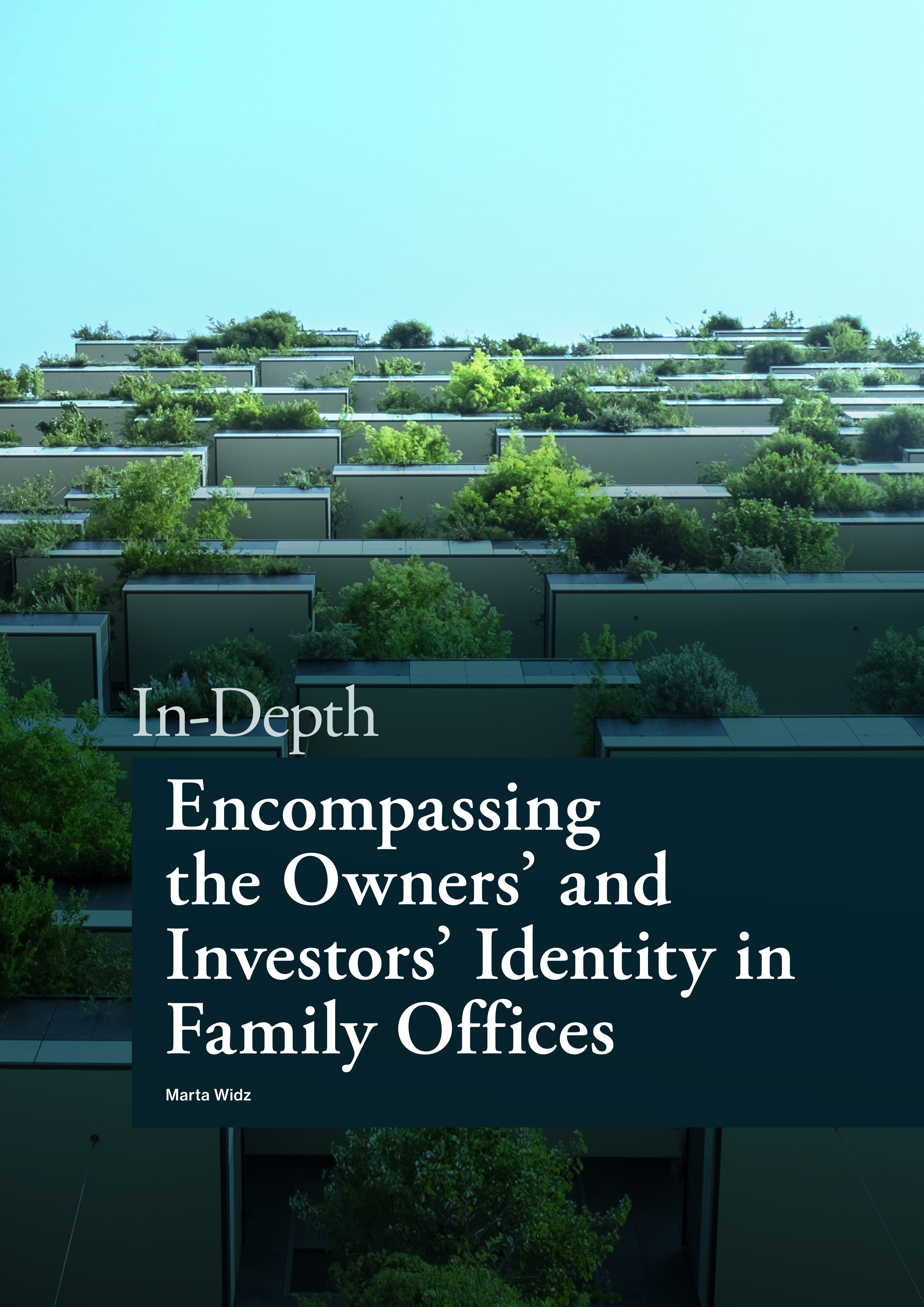
Metrics and Actions

- How do we measure the depth and breadth of impact? How should we use ESG metrics, being aware that they would seem like merely proxies to assess the company's impact?
- How do we reward those with a sustainability mindset? How do we balance sustainability goals and financial goals in the way we compensate our investment officers?
- Are our actions sufficient? What type of impact do we want to create in the future?

Actions in a Nutshell

In essence, amidst the ongoing global emphasis on sustainability, it is even more critical that family offices reconsider their impact and identity imperatives. In line with the emerging evolution of thought and practices, there are three key takeaways:

- Integrate the identities of the investor and owner with a deep sense of value-driven purpose.
- Internalise the impact across the organisations through meaningful materiality analyses and ESG metrics.
- Incentivise clear actions with goal-oriented rewards with an eye to the future.



In-Depth

Encompassing the Owners' and Investors' Identity in Family Offices

Marta Widz

As humankind faces a climate emergency, sustainability becomes one of the most important long-term priorities for organisations, individuals, and society at large. Those with wealth and abundance are looking for ways to use these to make the maximum *impact* on the most pressing issues of the day. Against this backdrop, a fresh wave of *strategic owners* and *investors* have emerged, who are adopting innovative approaches to sustainable investing and impact.

The Impact Journey

The movement toward *capitalism with a human face* is not new, though the momentum has accelerated significantly in recent years. For decades, politicians and businesses have attempted to define metrics to identify, name, measure, manage and report *stakeholder capitalism* This has led to the development of various definitions and indicators of responsible investing and corporate responsibility, which are all encompassed under the umbrella of *impact*. As the field consolidates, Figure 1 (below) looks back at some early examples and the milestones marking the journey of this movement.

Many business families were at the forefront of "sustainability", long before the term was even coined.

One example is Velux Group, a Danish family business that dates back to 1941, which is the global market leader in roof windows. As early as 1965, Villum Kann Rasmussen, the founder of Velux, had formulated the *Model Company Objective*[1], which required Velux products to be useful to society, its stakeholders to be treated "better than by most other companies", and the company to remain financially independent and profitable. In the 1970s, the foundation-based ownership structure was established and since then Velux Group[2] has ultimately been owned by both family members and the philanthropic foundation Villum Fonden[3]. The foundation receives approximately 90 percent share of annual dividends, which are majorly donated towards research, environment, social projects, and children, youth & science[4].

The term *social responsibility* was first used by Howard Bowen in his 1953 publication, *Social Responsibilities of the Businessman,* and he is often called the *Father of Corporate Social Responsibility (CSR).* In 1979, Archie B Carroll provided what is, arguably, the first unified definition of CSR, stating, “The social responsibility of business encompasses the economic, legal, ethical, and discretionary expectations that society has of organisations at a given point in time”.[5]

Even though the term *impact investing* was coined only in the year 2007 by the Rockefeller Foundation, it was as early as 1969 that John D Rockefeller III called for the amalgamation of business practice with a social and philanthropic purpose.[6] In 2007 and again in 2008, the Rockefeller Foundation convened meetings to discuss the creation of a new global investment industry focused on achieving purposeful and positive social and environmental impact, as well as connecting financial markets with the real economy by supporting organisations that create benefits besides financial returns.[7]

In 1994, John Elkington established the TBL (Triple Bottom Line) concept, urging businesses to rethink capitalism and to include two other factors in decision-making – the society and the environment – apart from financial profits. The TBL was meant to bring systemic change; it was a genetic code, a triple helix of change for capitalism[a]. However, in 2018, Elkington did a strategic recall of the TBL concept, stating that it was being misused as merely an accounting term and had become ineffective in gauging and managing the systemic effects of human activity.[8] In his latest book *Green Swans: The Coming Boom In Regenerative Capitalism,* he introduces the term *Green Swans* (e.g. electrification of vehicles) calling them solutions that result in exponential positive gains in the areas of economic, social, and environmental wealth creation.[9]

In 1999, the then UN Secretary-General, Kofi Annan, while addressing business leaders at the World Economic Forum, called upon them to partner with the UN in creating the *United Nations Global Compact (UNGC)* to encourage the integration of environmental, social, and corporate governance into capital markets. It was launched in July 2000, gathering 44 global companies, 6 business associations, and 2 labour and 12 civil society organisations[10]. This laid the foundation for the development of ESG.[11] Later, a landmark study entitled “Who Cares Wins”[12] produced by The Global Compact used the term ESG goals (environmental, social, and governance goals) for the first time.

a By 2018, John Elkington acknowledged that TBL failed to meet its initial goals to contribute to *system change* – pushing toward the transformation of capitalism. Instead, he said, businesses were using TBL just as an accounting standard and adopting a trade-off mentality, making no significant changes in the way they conducted business. Source: Elkington, J. (2018, June 25). 25 Years Ago I Coined the Phrase “Triple Bottom Line.” Here’s Why It’s Time to Rethink It. *Harvard Business Review.* https://hbr.org/2018/06/25-years-ago-i-coined-the-phrase-triple-bottom-line-heres-why-im-giving-up-on-it

A variation of TBL, 3P became an accounting standard to report on People, Profit, and Planet accounts, and was adopted by many companies and ESG investors. Today, there is a growing need for uniform sustainability accounting linked to financial accounting, and the first attempts to track social metrics in public companies have been made by the Sustainable Accounting Standards Board (SASB).

In 2006, the B Lab movement was started to certify companies meeting high standards of social and environmental performance, accountability, and transparency as B Corporations. B Lab, a nonprofit network, offers an assessment tool called the B Impact Assessment (BIA), which evaluates a company's entire social and environmental impact based on metrics including worker engagement, community involvement, environmental footprint, governance structure, and customers.[13]

At the UN Sustainable Development Summit in September 2015, the UN General Assembly adopted the 2030 Agenda for Sustainable Development, with the 17 *Sustainable Development Goals (SDGs)*. The interlinked global goals were a "blueprint to achieve a better and more sustainable future for all"[14] and it was hoped they would be achieved by 2030.[15] The UN estimates that achieving the SDGs could open up US$12 trillion in market opportunities and create 380 million new jobs.[16]

Other milestones on this journey have been driven by wealth-owners themselves. These include *The Giving Pledge*[b], which was created by Warren Buffett, Melinda French Gates, and Bill Gates in 2010; the development of the *Family Business for Sustainable Development (FBSD)*[17] as a joint initiative of the United Nations Conference on Trade and Development (UNCTAD) and the Family Business Network (FBN)[c] in 2019; the establishment of a platform called the *Economics of Mutuality (EOM)* by Mars Inc[d] and the Oxford University's Saïd Business School in 2020.[18]

b The Giving Pledge is a movement of philanthropists who have committed to giving the majority of their wealth to charitable causes, either during their lifetimes or in their wills. To date, over 230 signatories from 28 different countries have signed the Giving Pledge. Source: The Giving Pledge. (n.d.). *Frequently Asked Questions.* Retrieved May 31, 2022, from https://givingpledge.org/faq

c The Family Business Network (FBN) is a global community of family businesses. It brings together 4,000 business families – encompassing 17,000 individual members of which 6,400 are Next Generation (between 18 and 40 years old). Source: Family Business Network. (n.d.). *About Us.* Retrieved May 30, 2022, from https://www.fbn-i.org/about-us

d Mars is a global family-owned business with 30,000 employees, called Associates, in 80 countries. Its flagship consumer products include the brands M&M and Snickers in foods; Pedigree and Whiskas in pet care. Source: Mars. (n.d.). *All About Mars.* Retrieved May 29, 2022, from https://www.mars.com/about

e In a 1970 New York Times essay, Milton Friedman, a recipient of the Nobel Memorial Prize in Economic Sciences, introduced the Friedman Doctrine arguing that a company has no social responsibility to the public or society and that its only responsibility is to its shareholders. Source: Friedman, M. (1970, September 13). A Friedman doctrine - The Social Responsibility of Business is to Increase its Profits. The New York Times. https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html

Investor Identity, Strategic Owner Identity, and their Approach to Impact

Even though there is a common agreement among *investors* and *strategic owners* that the time has come to move away from Milton Friedman's understanding of shareholder primacy[e], their approach toward impact is very different. It can be ascribed to their distinctive *identities,* i.e. the way they define "who they are", and thus attributed to the intentionality of their impact philosophies.

Investor identity *dictates that investors should follow the capital market's standards and meet their fiduciary obligations to their shareholders.* The natural point of reference of investors is potential economic returns. Therefore, some of them claim that embracing impact comes at a cost. An illustration of such thinking is the spectrum of investments that places traditional investment with purely financial goals on one end and philanthropy with purely social goals on the other end. However, there is increasing recognition that impact investment strategies – *social finance, social impact investing, blended value investing, or impact finance*[33] – can also be consistent with strong financial returns.

Investor Identity, Strategic Owner Identity, and their Approach to Impact

Investors and owners are terms that are sometimes used interchangeably, but a more nuanced view brings up subtle differences. While all owners can be classified as shareholders, not all investors fall into the category of owners.[19] The most common investors are financial institutions and portfolio investors, such as banks, insurance companies, pension funds and investment companies.[20] They often act as intermediate agents for final owners.[21] On the other hand, one of the most prevalent ownership types is the ownership by founders and their families.[22]

Adding the notion of *identity*, and in particular, that of investor identity and owner identity, into the mix makes this distinction even more clear. Identity is a fundamental feature of any individual and any organisation, including family office principals and owners of family businesses. It defines "who we are"[23] as an individual and as an organisation. It is socially constructed[24], i.e., it emerges from "the interchange between internal and external definitions of the organisation" (Hatch & Schultz, 2002, p.1004)[25], and therefore connotes the presentation of a public image to the multifarious stakeholders.

Investor identity is particularly visible within minority shareholders, as their chief interest is to maximise the financial value of their investment. *Owner identity* is, however, typically developed by so-called *strategic owners*[26] – controlling shareholders or blockholders, also referred to as large owners. Strategic owners have significant control over the firm's operating and strategic direction.[27] While identity determines the preferences and goals of the shareholders, the ownership concentration determines shareholders' power and incentives to enforce these preferences and goals.[28]

Because of their distinctive identities, historically, owners and investors have displayed heterogeneous aspirations, targets, risk exposures, competencies. Owner identity is, however, non-ownership ties, and capital allocation strategies[29]. "These [...] affect the way they exercise their ownership rights and therefore have important consequences for firm behavior and performance."[30]

That is why academic research distinguishes between *investor-owned companies and owner-managed / owner-governed* companies[31] such as family businesses and investigates their distinctive ways of doing business. For example, investor-owned companies are more likely to undertake ambitious investment programs to exploit economies of scale. Owner-governed companies, on the other hand, often pursue niche strategies related to flexibility or differentiation.[32]

Realizing these differences between investors and owners is crucial to understanding why and how investors and (strategic) owners engage in and embrace impact.

More and more investors, therefore, adopt sustainable investing (SI), that is, investing that takes ESG standards into account[34]. The global ESG assets are projected to surpass USD 41 trillion by 2022 and USD 50 trillion by 2025[35]. This trend reflects the rapid rise of ESG assets from USD 35 trillion in 2020, which was about 36 percent of the total assets under management (AUM) globally at that time, as reported by the Global Sustainable Investment Alliance, a collaboration of membership-based sustainable investment organisations around the world.[36]

***Strategic owners** identify strongly with their businesses and craft their strategies to follow their visions and reflect their values.* Strategic owners are ultimately held responsible for the operations of their businesses and their footprint on society and the environment. Often, this is the trigger to embed sustainability in internal business models and across all layers of the organisation. Despite being fully aware of the potential repercussions on their financial returns[37], strategic owners can ensure that their *patient capital* embraces the full range of Sustainable Development Goals (SDGs). They can also make purpose-driven investments and ensure the depth and breadth of their impact.

Velux Caselet

The owners of Velux Group have intentionally committed to becoming *Lifetime Carbon Neutral* by the 100th anniversary of the company in 2041[38]. The company underwent an unprecedented exercise to measure its lifelong carbon footprint, going back and analyzing carbon emissions since its inception. There was no obvious way to calculate this, so Velux developed its own method. It commissioned Carbon Trust to verify its calculations and approached the World Wide Fund for Nature (WWF) to do an additional review. Further, the owners added a safety buffer of 25 percent on top of the calculations. The company has decided that taking into account all its past and future carbon emissions, it will launch large-scale forest conservation projects (to be developed and managed by WWF) to capture 5.6 million tons of CO2 emissions.

The Velux Group has also committed to dramatically cutting down on future carbon emissions for its company and throughout its value chain, in line with the Paris Agreement's most ambitious 1.5°C reduction pathway. Its membership in the global coalition *'Business Ambition for 1.5°C'*[f] under the Science Based Targets initiative underlines this commitment. This shows the transformation of the Velux business model across its operations, the most impressive of which is the decision to focus on circularity. The sustainability and innovation strategies are fully integrated and reflected in the upcoming cycles of product development. Velux has created a dedicated circularity research team and has recruited experts in environmental engineering. It has committed to becoming a 100 percent carbon neutral company by 2030, as well as to reducing 50 percent of its value chain carbon footprint, which is challenging for a company that traditionally uses carbon-intensive materials like metal and glass as raw materials to produce windows. "This forces us to look at the whole lifecycle of the product and innovate", says Jens V. Kann-Rasmussen, a third-generation family owner, senior director at the Velux Group, and Chairman of the Villum Fonden. "For example, we are looking at new material combinations that combine longevity with low carbon footprint", he adds. Significant investments in recycling materials complement these efforts in reducing and reusing waste.

In 2020, Velux launched a 10-year sustainability strategy, called *It's our nature*[g], which is a transformational journey for *the Decade of Action to Deliver the Global Goals*[h]. Based on a materiality analysis from 2018 and an extensive two-year bottom-up and top-down internal process, the sustainability strategy includes 15 bold targets, assigned to company's senior vice presidents.

f *Business Ambition for 1.5°C is led by the Science Based Targets* initiative in partnership with the UN Global Compact and the We Mean Business Coalition. An urgent call to action from a global coalition of UN agencies, business, and industry leaders to commit to setting ambitious science-based emissions reduction targets to hold temperature rise to 1.5°C above pre-industrial levels. Source: Owen-Burge, C. (2021, June 30). *Business Ambition for 1.5°C.* https://climatechampions.unfccc.int/team_member/business-ambition-for-1-5c/

g Launched in 2020, *It's our nature* is the VELUX sustainability strategy - a 10-year transformational journey in which it seeks to pioneer climate and nature action, innovate sustainable products and secure a responsible business. Source: VELUX. (n.d.). *Sustainability Strategy.* Retrieved June 1, 2022, from https://www.velux.com/what-we-do/sustainability/sustainability-strategy?consent=none&ref-original=https%3A%2F%2Fwww.bing.com%2F

h *The Decade of Action* calls for accelerating sustainable solutions to all the world's biggest challenges – ranging from poverty and gender to climate change, inequality, and closing the finance gap and is an ambitious global effort led by the UN to deliver the Sustainable Development Goals by 2030. Source: United Nations. (n.d.). *Decade of Action.* Retrieved June 1, 2022, from https://www.un.org/sustainabledevelopment/decade-of-action/


TRIDENT

Family Offices: Encompassing the Owners' and Investors' Identity

Interestingly, in *single family offices (SFOs)* – investment arms of single business families – the division between *investor identity and strategic owner identity* is blurred because family offices act as investors on behalf of the strategic owners, i.e. wealthy families.

Historically, business families have been solely viewed as owners of a single operational company[39] who will lose their wealth and business by the time they reach the third generation, a notion made popular by the proverb *Shirtsleeves to Shirtsleeves in Three Generations*. In fact, enterprising families hold, on average, three to four operational companies in their portfolio[40] at any point in time. They also hold many other entities in their complex governance systems, such as family offices and philanthropic foundations, just to name a few.

In reality, business families are strategic owners, investors and usually also philanthropists at the same time. As a result, they can bring impact through a variety of means, such as private grants, seed funds provided to the next generation of family members for their impact investing ventures, and so on. Apart from investing in ESG funds, their family offices may also engage in direct investments into sustainability start-ups, becoming angel investors for green entrepreneurs, collaborating with early-stage ventures, incubators, and accelerators to make an impact locally, etc.

Family Office Stage, Identity and Impact

Integrating impact into the operations of an owner-governed company usually requires a very different set of skills and a unique way of managing expectations as compared to external impact investing. As a result, the stage of development of the business family defines where their family office is on the wide spectrum of family offices involved in social impact.

Many family offices established by *owners-entrepreneurs* pursue impact as mere philanthropy, often via donations to well-known charitable foundations. It is so because these business founders are driven by *investor identity* so they rarely think in terms of future generations yet.

On the other side of the spectrum are *SFOs of multigenerational families,* whose investment activities express their family values and the ownership of *family identity.* For example, VP Capital[41] is the B Corp certified SFO of the Belgian-Dutch Van Puijenbroek family with an entrepreneurship history spanning six generations and about 150 years. The family has a long tradition of investments and a socially conscious vision of the business that was started by the family founder. Driven by the goal of *"Strong heritage. Sustainable progress."*, the family has the vision to become an "investment family with an eye for tradition and a drive to make a positive impact."[42] Today, with a team of ten professionals, VP Capital manages about 50 families' investments across eight industries, such as real estate, agriculture, private equity, and energy transition.[43]

Multiple family offices (MFOs), usually fall in between these two extremes, especially if they had developed from SFOs and later expanded beyond managing the wealth of a single family. Driven by both *owner identity and investor identity,* they may, for example, craft their investment strategy to reshape it into a green portfolio to attract a larger base of other wealth owners to their MFOs. That is why there is a steep upward trend in the number of MFOs that have been granted the B Corp certification, which requires completing a rigorous assessment and certification process to deliver a more holistic and measurable business impact.[44]

Lessons for Family Offices on How to Bring Impact

Genuinely embarking on an impact journey requires a holistic approach that merges an investor mindset with an owner mindset, an integration of the *'why'* and the *'how'* factors, hence an amalgamation of the *purpose* and *material ESGs.*

Ensuring Depth and Breadth of Impact: Risks of Overreliance on ESG focused Investing

Investments in so-called ESG-focused funds have skyrocketed in recent years, and ESG metrics have become the common language of impact that is dominated and twisted by the financial sector – but it is gradually also being used by other industries, such as manufacturing, e-commerce, tech and telecom. Indeed, the Global Sustainable Investment Alliance reports that out of USD 35.3 trillion in sustainable investing assets globally, USD 25.2 trillion were employed with an ESG integration approach in 2020.[45]

However, ESG metrics should be approached thoughtfully and carefully, as they can be easily misused. For example, many businesses measure and offset their carbon footprint by buying carbon credits, thus improving their ESG ratings, a practice that lacks *owner identity* – the intentional alteration of the business model to bring impact in the long term. Even worse, other businesses hide under the ESG garb and misrepresent – *greenwash* – their sustainability credentials.

The declarative power of ESG metrics as a measure of impact is further put into doubt by the ongoing debate on whether funds that claim to be ESG-focused are selecting companies that are doing good for the world[46]. Largely, ESG relies on excluding firms if they operate in harmful industries. That is why on the *Responsible and Ethical Investment Spectrum* map, simplified to ABC (Avoiding harm, Benefitting stakeholders, Contributing to impactful and sustainable solutions)[47], many common strategies such as negative screening are placed under the A (Avoiding harm) category.

Another challenge for many ESG-focused funds is their backwards-oriented approach, as per which they chose firms based on their past ESG performance. However, impact cannot be based on a static metric; in fact, companies change over time, and investors make an impact by triggering or speeding up such change.[48] Further, ESG metrics rarely reflect the degree of impact made because most analysis only compares whether ESG portfolios perform better or worse than non-ESG portfolios, instead of finding out the various ways in which (impact) investing improves or worsens ESG ratings.[49]

Additionally, there is a wide disparity between the ESG ratings of prominent agencies such as Moody's and Standard & Poor's[50], as well as a lack of convergence between the ratings of six well-established social raters – KLD, Asset4, Calvert, FTSE4Good, DJSI and Innovest–in their assessments of CSR[51]. *The Sustainability Initiative* at MIT Sloan[i] has therefore launched *The Aggregate Confusion Project* to reduce the level of noise in measuring specific ESG categories (such as labor treatment, carbon emissions, and product safety) and to develop smarter ways to aggregate ESG factors into composite indices.[52]

All in all, a careful interpretation of ESG metrics would seem like merely a proxy to assess the company's impact.[53]

Ensuring Intentionality: Investment and Impact Thesis

While relying solely on the *exclusionary criteria* approach is certainly myopic, ESG metrics – if used with the right intention–have the potential of becoming a powerful starting point on the impact journey.

First, they can be seen as "*a data toolkit* for identifying and informing [the investment] solutions" that are to be thoughtfully integrated with the investment process, as suggested by BlackRock, the world's largest asset manager. In other words, ESG metrics can provide a frame of reference and good guidance on how to set and measure initial targets and KPIs towards impact.

Second, "there is increasing awareness that *material* environmental, social and governance (ESG) factors can be tied to a company's long-term performance."[55]. Therefore, there is a growing need for holistic approaches, which would include ESG metrics alongside materiality assessments, drawing of impact maps, and the identification of the broader stakeholders' ecosystem.

i The MIT Sloan School of Management (MIT Sloan or Sloan) is the business school of the Massachusetts Institute of Technology, a private university in Cambridge, Massachusetts. Source: MIT Sloan School of Management. (n.d.). *About MIT Sloan.* https://mitsloan.mit.edu/about/why-mit-sloan

A well-crafted, coherent *investment and impact thesis*[56] that integrates these elements and leverages the organisation's business model to bring impact, has the potential to embed sustainability into an organisation's core DNA for the long run. Therefore, family offices are encouraged to ask themselves the following questions:

- Is the investment strategy of our family office driven by *investor identity* or *owner identity* or both?
- What does impact mean for us? What are the drivers of our purpose – what is the balance between external factors versus our internal family values and vision?
- How is our business family creating impact, i.e., through the operational business, family office, philanthropy, or in other ways?
- What is the gap between our desire to make an impact and embedding impact into the business model of our family office?
- Is our approach to impact holistic enough? Have we performed a materiality analysis? Are we ready to self-assess against B Corp standards?
- How do we measure the depth and breadth of impact? How should we use ESG metrics?
- How do we reward those with a sustainability mindset? How do we balance sustainability goals and financial goals in the way we compensate our CIO?
- Are our actions sufficient? What type of impact do we want to create in the future?

Slowly but surely, impact has become a necessity for those who aspire to become better investors; the sustainability agenda has become the ultimate priority as humanity races against time to decarbonise. While the eyes of the entire world are turned toward private capital and businesses, urging them to do more, embarking on a genuine impact journey for family offices is not so straightforward. It requires a holistic approach, smooth convergence of *investor identity* with *owner identity, a* coherent *investment and impact thesis* that reflects the ambitions and values of the business family - all of this in a skillful balancing act while embracing the paradox of seemingly conflicting goals of *financial returns* and *a purposeful mindset.*

Acknowledgements

The birth of the WMI Impact: The Family Office Journal would not have been possible without the contribution of several people. Our special gratitude for the invaluable comments, insights, and guidance in the shaping of the journal to:

- Pramodita (Dita) Sharma, a Professor and the Schlesinger-Grossman Chair of Family Business at the Grossman School of Business (GSB), University of Vermont. Dita is a visiting professor at the John L. Ward Center for Family Enterprises at the Kellogg School of Management at Northwestern University, and a Senior Research Fellow at the Thomas Schmidheiny Center for Family Enterprise at the Indian School of Business. She received her Ph.D. from the University of Calgary and has received honorary doctorates from the Jönköping University in Sweden and the University of Witten/Herdecke in Germany.
- Nupur Pavan Bang, an Associate Director at the Thomas Schmidheiny Center for Family Enterprise at the Indian School of Business. She is also a key member of the team that publishes the Family Enterprise Quarterly – an applied journal for Family Businesses published by ISB. Nupur holds a Ph.D. in Finance, was a Post-Doc Fellow at the Indian School of Business and is a Fellow of the Association of Certified Chartered Accountants (ACCA) of the UK.

The first issue of WMI Impact: The Family Office Journal could not have taken its final shape without the contribution of several thought leaders who shared their theoretical and practical knowledge of family offices and their impact:

- Morten Bennedsen, the André and Rosalie Hoffmann Chaired Professor of Family Enterprise at INSEAD, and the Niels Bohr Professor in Economics at the University of Copenhagen. He obtained his Ph.D. from Harvard University and has served as an advisor to the Danish and UK governments, the EU, the World Economic Forum, private equity funds and the World Bank.

- Asher Noor, the Chief Investment Officer for AlTouq Group, a Saudi Arabian family investment office with an international office based in Singapore. He is a former board and faculty member of the Family Firm Institute, the former chairman of the STEP SIG on Business Families, and was on the editorial board of the STEP Journal.
- Salil Patel, who hopes to honor a generational legacy of entrepreneurship and public service as the Managing Partner and Investment Director of Virtuosity LLC, guiding impact-oriented venture capital portfolio construction for family offices. He is a graduate of the Johns Hopkins School of Medicine, a former NASA scientist, a patent-holder in neurographic human-computer interaction technology, and a Fulbright Scholar.
- Christine Scheef, the Assistant Professor for Family Business and Entrepreneurship at the Center for Family Business (CFB-HSG) at the University of St. Gallen. She was also the former General Manager of the St. Gallen Institute of Management in Asia (SGI-HSG) in Singapore.
- Yann LeMoël and Riddhima Bhatnagar from the Living Labs Federation, which unites global actors for local impact with a “glocal” approach to sustainability. Living Labs Federation focuses on impact investing projects around the needs of the green and the blue lungs of the planet – rainforests and oceans – as well as urban life, which is a major cause of climate change.

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