BIZCOMMUNITY

Impact management and impact investing

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Impact investing and impact management has come of age. There is an explosion of materials and information about the subject matter. The aim of this article is to provide a snapshot and a quick orientation to the current landscape of impact measurement, management and reporting.

What is impact investing?

Impact investments are investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return. Impact investing refers to an **investment strategy** that not only generates financial returns but also creates constructive outcomes. The strategy actively seeks to make a positive impact by investing, for example, in companies and enterprises that benefit society or in clean technology that benefit the environment. Impact investing attracts individuals as well as institutional investors including hedge funds, private foundations, banks, pension funds, and other fund managers.

Impact investments are usually made in private markets and draw on traditional financing methods, such as direct investment in social enterprises that make use of angel investing, venture capital, and/or private equity.

The market has also responded to the demand for tools combining social and financial returns by creating several new initiatives, including community bonds (debt instruments that non-profit organisations offer to purchase an asset), social impact bonds (contracts with public-sector bodies that incentivis
e improved social outcomes), and community investment notes (impact-focused investment vehicles with a modest rate of return).

Impact investing is distinct from philanthropy in that its explicit goals include the financial sustainability of investments and the competitive profits they produce. It is distinct from traditional investing in that consideration of impacts is also required.

Impact investing can generally be understood to fall into several major categories: thematic investing, sustainable or environmental, social, and governance (ESG) investing, and socially responsible investing (SRI).

What does impact mean (in impact investing and impact management?)

The social impact task force of the G8 has defined impact as - The reflection of social [and environmental] outcomes as measurements, both long-term and short-term, adjusted for the effects achieved by others (alternative attribution), for effects that would have happened anyway (deadweight), for negative consequences (displacement), and for effects declining over time (drop-off).

All investments, whether intended as “impact” or not, have outputs, the measurable products or services and byproducts that result from the investment. They have positive or negative outcomes, the longer-term changes in behavior or effects on individuals, communities and the environment that follow as a result of an activity. And they have impacts, the outcomes or long-term effects on stakeholders adjusted for what would have happened anyway.

The term “impact” has become the pivot with the growth of impact investing and has led to an unprecedented focus on impact measurement and management.

What is impact management?

Impact management is the practice of intentionally defining, measuring, and making decisions using information about the social and environmental changes caused by investments. Impact management relies upon clarity about what major potential or actual social and environmental changes result from a given investment, and which of these are a priority from the investor’s point of view. It requires metrics by which those changes may be understood and ongoing assessment of those changes. All of this is tempered by what can actually be measured and what can be justified as cost effective or necessary.

What is impact measurement?

Impact Measurement is a process of understanding how much change occurred and can be attributed to an organisation or investors’ activities. Measuring and evaluating is not new. The philanthropy sector has been doing it for decades. Different techniques have been adopted in Monitoring, Evaluation, Research, and Learning (MERL). Organisations use Randomised Control Trials (RCT), Monetisation/Social Return on Investment (SROI), or Lean Data or specific evaluation methods to measure impact including developmental evaluation, impact evaluation, mixed methods evaluation, etc.

The process of impact management

The first step in impact management is a robust **impact strategy**. Whether you are a funder, an investee enterprise or an organisation working in the field, you might want to align with multiple frameworks, such as IRIS, Impact Management Project, and Sustainable Development Goals. The impact strategy is supported by a clearly defined **impact statement and policy** which outlines the **impact philosophy and mandate**.

The impact strategy also needs to be aligned to the **investment cycle** – from due diligence, to approval, management, through measurement to reporting and exit.

Of course, the **impact objectives** must be clearly defined as well. This process includes articulating a theory of change, defining the scope, scale, depth, breadth/reach of desired impact, and deciding what resources (both human and monetary) to dedicate to ensuring these impact objectives are met. Failing to take this basic step-up front can make future decision making around impact measurement priorities, compromises, and tradeoffs unnecessarily difficult, particularly in the face of restricted resources.

The process of impact measurement

The first aspect to consider includes what kind of **evidence** will suffice to validate that impact has been achieved. The second aspect to consider is what kind of **metrics or indicators** to use to measure impact and lastly, what **methodology** will be used to determine the impact.

Because impact data is still largely self-reported by investees, investors must **verify** it. This can be done in several different ways, and for peace of mind, investors should use some version of each.

The first, perhaps most obvious method of verifying impact data is to **independently validate** it: looking at external research reports, databases, government statistics, and other readily available online resources can help confirm the trends observed and reported by an investee. Another verification method is **competitive or comparative analysis**. To the extent possible, comparing an investee's reported impact data with that of other comparable organisations can help an investor gauge whether the investee is performing appropriately and identify contextual factors that might be important to understand when appraising the investee's performance. The most involved approach to data verification is to meet directly with key stakeholders. Conducting occasional field visits, speaking regularly with the investee's leadership team and staff, and holding focus groups with (to the extent possible) randomly selected beneficiaries can bring to life the numbers reflected on the investee's impact dashboard.

Impact reporting

Reporting primarily serves to communicate relevant **impact findings** to various investment stakeholders, including funders, service providers, and beneficiaries. Reporting can also provide accountability and feedback throughout the investment lifecycle. When investors and investees make use of transparent, consistent and good reporting, the investment it is more likely to generate greater impact.

Broadly speaking, there are three different objectives that impact reports should accomplish based on stakeholder expectations.

- Reports for private investors, who often invest in niche areas of interest that are values-informed, should highlight the **kind of impact** that the investor is after.
- Reports for funds need to communicate information about the impact that will motivate the **investor to continue allocating resources** to the reporting entity (including material results other than what was intended or expected).
- Likewise, reports to government entities should provide the **impact evidence** necessary to show compliance with the investor's set of impact objectives.

In conclusion:

Overall, the practice of impact management in investing today reveals a picture of professionals who are increasingly aware of the need for **quality information about the changes experienced by stakeholders due to the investment**, and who are striving to inform not only themselves but also their own investors and peers about **how their investments drive change that matters.** There is frustration with the ease with which those who are not well informed can be duped into thinking outputs (whether ROI or head count) reflect change that matters; this frustration is building momentum toward a generally accepted and more rigorous definition of "impact" than what has prevailed to date.

There is some progress toward defining and embracing **standard metrics at the sector level**. And there is growing awareness of a conundrum: the lack of standardised metrics makes it seemingly impossible to gauge impact at the portfolio, let alone industry level, but such metrics are often inherently insufficient to reveal all or even much of what matters. This conundrum is creating an opportunity for skilled impact analysts to step in who can **understand and interpret the complex information necessary to a true understanding of impact in investing.**

"Impact management" implies that investors (or others) make decisions informed by the effects of business on people and on the planet ("impact"). It implies **systematic inquiry** into the experience of those directly affected, combined with other relevant, quality research evidence where available, in a way that is simultaneously decentralised, networked and aggregated, similar to how financial accounting data is used to assess financial value.

The big picture is that ESG and impact are quickly becoming not just additional or optional social norms that investors need to manage. They are being hardened into professional standards, regulatory requirements, and even laws. The advance of impact reporting and ESG investing today is indicative of an upcoming paradigm shift in market capitalism. There will be innovations to manage this sea change through new algorithms for risk-adjusted return on investment, for balancing competing stakeholder values, and for pushing investments toward new efficient frontiers. And along the way - there will be assets that are stranded by the old paradigm and outdated methods. Impact investing together with credible impact management and measurement practices can contribute to a new future that is more balanced, inclusive, effective and more sustainable.

ABOUT THE AUTHOR

Reana Rossouw is the owner of Next Generation, a specialist management consultancy that focuses on impact management and measurement. Next Generation have also developed their own proprietary and trademark impact assessment methodology, which is supported by a technology platform - The Investment Impact Index that is used to visualise impact data, analyse and triangulated impact data and produce a variety of impact reports.

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