THE METRICS CHALLENGE:

Assessing "Impact Capacity" at the Firm Level

An ImpactAssets issue brief exploring critical concepts in impact investing

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Defining and understanding "impact" is a central consideration for any impact investor. In addition to direct impact at the company/enterprise level, impact investors must also consider impact capacity at the firm level—namely, how an investment manager approaches the creation of social/environmental impacts through the management of the investment group itself. This was an important component of our assessment of impact when constructing the ImpactAssets 50 and is explored in this Brief, with an emphasis on firm intent, firm practices and investment impact and metrics. Discussion is also presented regarding different tools used by impact investors, with a focus on support for the IRIS and GIIRS systems that are referred to below.

OVERVIEW

The challenge of assessing the performance of impact investing funds and products is one with which any impact investor is well versed. For many years, the field has entertained a host of discussions and debates regarding how performance frameworks should be applied to funds and what specific metrics should be used by fund managers to assess the impact they generate through their investment of capital. For investors new to impact investing, many of the questions related to assessing impact are entirely new territory to navigate: how to assess something less quantifiable than a financial return, how to assess risk, and how to compare "impact returns" across different funds seeking to "alleviate poverty" or "increase sustainability" and so on. Some of these topics are covered in more detail in other briefs on the ImpactAssets site at **www.impactassets.org**.

When working with our client partners to create multi-manager strategies, ImpactAssets will engage in deep due diligence. However, in the context of ImpactAsset 50 (our roster of impact investing firms we offer to interested parties as a starting place to explore impact investing) the challenge is different. ImpactAssets 50 seeks to assess not individual funds or investment products, but rather the management firms that bring those funds to market. In this case, our interest is not how a particular product or fund has performed on a social/environmental basis, but rather how a firm thinks about the social and environmental impact created by their investing practices, as well as how managers seek to practice what they preach within their own company. We have defined this as "Firm Impact Capacity" which we use to discuss the degree to which a firm is positioned to create meaningful impact through its investing process as well as through its own sustainable and impact management as a company.

ImpactAssets assesses "Firm Impact Capacity" on the basis of three levels of performance:

- Firm Intent
- Firm Practices
- Investment Impact and Metrics

As detailed below, it would be rare to find a firm which is truly able to "check all the boxes" in the various categories which follow. That is fine. Our intent is to give potential investors and asset owners a sense of the degree to which a firm is presently advancing the full vision of impact investing—while recognizing that at this stage of their (and the field of impact investing's) development, many firms will only be able to lay claim to some of the criteria discussed as a measure of a company's Impact Capacity. Our goal at ImpactAssets is to participate in and assist in advancing the broad interests of our field; we offer both the concept of Firm Impact Capacity and the specific indicators below as an initial framework upon which, together with others in the field, we intend to build over coming months and years. Not all investors care about all of these to the same degree—our intent is to capture what we can, distill and translate it in easy-to-use format, and let investors and their advisors decide what impact is most important to them.

FIRM INTENT

The first level of assessment is that of firm mission and values. As the environmentalist and socially responsible investor Paul Hawken has promoted in his own work, if a company does not demonstrate a fundamental commitment to and intent to pursue sustainability as a core part of its company vision, anything else it signs up for or "bolts on" to its operations will fall short of the firm's truly advancing deep sustainability and impact. When discussing investment practice of firms that claim to be oriented toward impact investing, the first step any firm should have in place must be a clear statement of intent to engage in, advance and promote the vision and practices of impact investing.

At this level, ImpactAssets would want to ensure firms were one or more of the following:[1]

- A GIIRS Pioneer Fund

- Signatories of the United Nations Principles for Responsible Investing
- Participants in the Global Reporting Initiative
- A B-Corp certified firm
- Participants in other field-based sustainability or impact reporting and transparency initiatives
- Had in place a corporate statement of impact investing Vision and Intent
- Held membership in Impact or Industry specific associations, networks or working groups

In the case of membership, if the firm is active in a mainstream investment industry group which is not an "impact oriented" network, the investor could explore whether the firm can point to specific examples of using that membership to advance the interests and practices of impact investing among mainstream investors.

FIRM PRACTICES

In addition to having the stated impact intent, at a most basic level, impact investing firms should have specific practices in place that reflect the values of the field, broadly defined. These values speak to a commitment to sustainability, the generation of positive social and environmental impact, racial and gender equity, fair employment practices, etc. Not all firms will be able to demonstrate governance and operating practices that meet the expectations below in all categories, but we believe that by framing and asking these questions as part of the ImpactAssets 50 selection process, we are signaling how critical we believe these issues are to overall impact. We also believe that this information is of increasing interest to investors and that collecting and disseminating it will be a useful tool for the mainstream financial advisor audience we are trying to reach.

We would define these elements as follows:

- Gender Diversity:
  - Leadership
  - Staffing
- Racial/Ethnic Diversity:
  - Management Leadership
  - Board Participation
  - Staffing
- Defined Sustainability Practices within Firm Management/Administration (carbon off-sets for travel, low-impact commuting practices, clear efforts/practices to integrate sustainability into firm operations, etc.)
- Fair Employment Practices (benefits for employees, policies around child and prison labor, etc)
- CSR or Other Corporate Practices Statements/Programs

- Impact-Focused Governance Structures (such as dedicated, annual philanthropic contributions in support of impact at the General Partnership level of the firm or a structure that uses profits from the investment vehicles to further impact activities, e.g. a firm wholly owned by nonprofit promoting economic development broadly in low-income communities around the world.

INVESTMENT IMPACT AND METRICS

Finally, measuring actual impact in the field—that is clearly tied to and the result of the capital being deployed by a firm's investments—is the most challenging and essential part of this nascent area of impact investing and an area in which a great deal of work is currently taking place. Many efforts are being developed and fine-tuned that will be important contributions to the important process of "rating" and/or "verifying" impact investments as they are introduced over coming years.

A complete overview of the metrics challenge and field is beyond the scope of this brief. The reader will find many other sources that provide an introduction to organizations active in this effort. One approach gaining momentum within the impact investing field is that of IRIS and GIIRS. IRIS—which stands for Impact Reporting Information System—offers specific definitions of impact indicators. For example, in the impact arena two enterprises may be creating "jobs", but one may be creating part-time, low-paying positions with no benefits, while another may be creating full-time employment with support services and benefits. Differentiating between these two levels of impact is critical for investors assessing the social returns on their capital. In this case, IRIS defines what a "job" is, in this way offering a set of uniform definitions for a wide array of impact indicators in order to help make it easier for investors to compare "apples to apples" when assessing impact at the enterprise level. GIIRS—the Global Impact Investment Reporting Standards—is an approach to creating a common set of standards by which impact investors may assess the performance of investment funds and products. It is a detailed, in-depth reporting standards framework which promises to create a common approach to reporting at the fund level of impact investments.[2]

For ImpactAssets 50, a critical part of assessing a firm's intent and actual results at the level of firm investment operations is the question of whether and how firms track the impact of their investments. While IRIS/GIIRS promise to help investors assess actual performance of specific investments, a component of ImpactAssets 50's analysis is whether or not a firm has a social management information system in place to assess and track impact, how a firm tracks that performance and the level of transparency regarding its eporting systems—these all speak to how a firm makes real its commitment to impact.

At this level of assessment, ImpactAssets is interested in four primary questions:

- Is the firm's metrics system IRIS compliant—meaning does it make use of the Impact Reporting Information System definitions in tracking its impact?
- Are there other, domain-specific systems in place that may have greater importance than IRIS for the firm's demonstration of credible performance and impact? If so, what are they and how are they being used?
- Does the firm have a functional, formal information system to track the impact of its investments?
- Does a third party entity validate both that system and its stated performance measures?

Again, not every firm will have all of these components fully in place. But in articulating what is important for effective tracking of impact, IA 50 hopes to help set the standard for best practices. Many investors new to this space are initially most interested in ensuring their investments do the least harm. They may also be interested in seeing their capital proactively advance specific areas of interest (for example, wanting to fund only in Africa, fair trade, etc.), but as their initial starting point the ImpactAssets 50 approach offers investors a landscape of firms and presents impact information across a range of issues and levels of interest. With this in hand, investors may then pick and choose what areas are the highest priority for them as they begin to develop their comfort and expertise within the impact investing arena. In this way, the approach to the metrics challenge offered by ImpactAssets enables investors to "ramp up" on the metrics side of the due diligence equation—using the aforementioned IRIS/GIIRS frameworks or other tools to then "drill down" into their actual investment performance over time.

Achieving broad agreement upon what indicators to use, how to define them, and establishing standards for managing impact analysis among the ever growing universe of investment funds becomes especially critical when we acknowledge that the majority of reporting being done at this time is self-reported. The field of impact investing simply does not have in place a set of "independent" ratings agencies to attest to the quality and practices of impact reporting at the firm level. For example, GIIRS has invested significantly in training fund managers in how to report, but only has the capacity to audit 10% of those firms participating in its GIIRS Pioneers initiative. Over time, this may change, but for now simply having common definitions and standard reporting practices is a great place for us to start. As we progress in our work, we will see whether a field of "impact auditing" evolves to complement the work being done at the firm level. In the meantime, standard practices and the type of assessment conducted by ImpactAssets 50 are a solid ground upon which to build.

CONCLUDING THOUGHTS ON FIRM IMPACT CAPACITY

In three to five years this growing field will look very different than it does today. We expect the creation and use of rating systems will be standard practice for all impact investment fund managers, making it far easier for investors to compare impact across investments and see clearly the social return from those investments. ImpactAssets is focusing much of its current work at the firm level in recognition of the good work being advanced by B-Corp and others promoting deeper, more nuanced tools for performance assessment. ImpactAssets offers potential impact investors an overview of critical issues that should be kept foremost in mind when evaluating possible investment firms with which to either partner or invest with.

As more and better performance rating systems and platforms come on line, as part of our commitment to field building and investor education we look forward to adopting and promoting those systems to our clients and stakeholders. We are not waiting for the "perfect system" to be in place to assess all possible aspects of firms which promote impact investing practices, but rather seek to distill the most important developments for those making use of the ImpactAssets platform and looking to us for additional information on how best to engage in impact investing. After all, our shared goal is to encourage all investors to ask questions about social return as well as financial return and to create new approaches to incorporating these values/strategies into their portfolios.

This ImpactAssets Issue Brief was co-authored by Jed Emerson, IA's Executive Vice President for Strategic Development and Sarah Williams, co-founder of the Advective Fund and philanthropic and impact investment advisor to foundations and donors. As part of ImpactAssets' role as a nonprofit financial services group, Issue Briefs are produced to provide investors, asset owners and advisors with concise, engaging overviews of critical concepts and topics within the field of impact investing. These Briefs will be produced by various ImpactAssets staff as well as collaborators and should be considered working papers—you're feedback on the ideas presented and topics addressed in IA Issue Briefs are critical to our development of effective information resources for the field. Please feel free to offer your thoughts on this Issue Brief, as well as suggestions for future topics, to **marketing@impactassets.org***. Additional information resources from the field of impact investing may be found at the IA website:* **www.ImpactAssets.org***.*
We encourage you to make use of them.

FOOTNOTES

[1] Space limitations prevent us from going into each of these in detail, however the reader interested in additional information on each of these will find specific details on their respective web sites.

[2] A full description of both IRIS and GIIRS is available at the Global Impact Investors Network web site.