

Investor contribution in public and private markets

Discussion document

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About the Impact Management Project

The Impact Management Project (IMP) is a forum for building global consensus on how to measure, manage and report impact.

The IMP works with a community of over 2,000 practitioners to share best practices in impact measurement and management.

It also facilitates the IMP Structured Network, an unprecedented collaboration of standard-setting organisations that, through their specific and complementary expertise, can provide complete guidelines for impact measurement and management.

We want your feedback

The Impact Management Project is continuously incorporating feedback to ensure that the work stays current and is shaped by the ongoing experience of all kinds of practitioners.

If you already see or have integrated the IMP’s conceptual framework in your impact measurement and management practices, we would appreciate hearing from you. Have you found it helpful and practical? How can we improve it?

Share your insights with us at

team@impactmanagementproject.com



Context and purpose

Everyone knows that enterprises have enormous impacts on people and the planet - but what do investors specifically add to those impacts?

The concept of “investor contribution” is under scrutiny. Public markets investors are not just being asked about the impact of the enterprises they invest in; they’re being challenged as to how they’re making any difference to that impact. Even within private markets, where investments in untested geographies or business models have long been assumed to be impactful, asset managers are increasingly challenged to demonstrate and disclose their value added.

The purpose of this note is to explain the current Impact Management Project (IMP) consensus on the topic of “investor contribution” – that is, the contribution that the investor makes to enable enterprises (or intermediary investment managers) to achieve impact – and to solicit further feedback, examples and best practices from the investment community.

Since 2016, the IMP has provided a forum for over 2,000 practitioners to agree on norms for impact measurement and management. In 2018, the IMP led a consultative process to co-create more detailed norms on a number of high-priority topics, including investor contribution. This note reflects those norms as they currently stand, and references various documented contributions of people whose expertise has been essential input (excerpted in the Appendix).

In 2019 the IMP will work with investors across sectors and asset classes, as well as with specific members of the [IMP Structured Network](#), to articulate and disseminate consensus on good practice in measuring and managing investor contribution. The IMP aims to publish this consensus as guidance that enables market participants to communicate investor contribution using a generally accepted language.

Request for feedback

The IMP is facilitating discussions around investor contribution via the use of this discussion document. We welcome you to share feedback and insights via the *Managing Impact* forum on [Idea Lab](#), in partnership with Harvard Business Review. This online platform will be used to facilitate conversations on various topics regarding impact management for investors and enterprises.

Alternatively, you can send feedback directly to team@impactmanagementproject.com. We can post views anonymously on your behalf, or simply ensure that they are considered as part of the consensus-building process.



Questions for the reader

We invite the reader to reflect on the following questions while reading the document, and to provide feedback to us via the online forum that we are hosting on this topic, in partnership with HBR's Idea Lab, or directly at team@impactmanagementproject.com.

1. Case studies: What organisations have you seen that are actively creating, measuring, and managing investor contribution (including your own) that we could point to as examples or case studies?

2. Terminology: The existing IMP consensus around investor contribution uses the terms “growing new / undersupplied capital markets” and “providing flexible capital.” In both cases, some aspect of the financial investment, such as amount, cost, terms, tenor, collateral required, or subordination, goes beyond what is likely otherwise available to the enterprise, enabling it to increase its impact. The difference is that “flexible capital” indicates willingness to accept a concession on risk-adjusted financial return. Does the terminology clearly communicate the intended definition? If not, what alternate terms would you propose?

3. Differences across asset classes: How do strategies for Investor contribution differ between the asset classes (e.g., public equities, public debt, private equity, private debt)? In the asset class(es) that you are familiar with, what are examples of actions that investors can take that represent greater or lesser investor contribution? What is the follow-on impact of those actions on enterprises, and ultimately on people and planet?

4. Reporting: What indicators and data sources can investors rely on to assess their investor contribution? How do these vary by asset class? How do you think investors should report against these strategies? Is self-reporting, supported by reasonable evidence, sufficient? Is third party auditing the way to guarantee the standardisation and trustworthiness of impact data reported?

5. Asset owners' contributions: When investing through intermediaries, should asset owners assess both their own and the intermediary's contribution?

6. Contribution through exits: Where does the strategy of an investor's "exit" approach fit (meaning, private investors exiting an investment in a manner that should allow the impact to be maintained)?

7. “Signalling that measurable impact matters” in public equities: Are there circumstances in which individual investors or funds “signalling that impact matters” can directly cause an impact on people and planet? Or is it only once the market as a whole takes impact into account - once most or all other investors are doing the same, once “systems change” has occurred - that impact will happen on the ground for people and planet? What is the state of systems change in public equities markets at the moment, and what are the prospects of systems change in the future? What examples can we point to? What would accelerate progress?



8. The contribution of “providing flexible capital”: In relation to the “flexible capital” strategy, there is an observation that some investments provide less than risk-adjusted market return but likely do not create impact that would not otherwise have occurred. Put differently, some investments are concessionary but do not provide an investor contribution.

- a. What norms would you propose for investments such as these and why?
- b. How should fund managers and asset owners disclose the existence of such investments in their portfolios?

9. Finding the right balance of investor contribution strategies in the market as a whole: What norms will appropriately recognise the contributions of investors that expand the addressable market and create impact that would not otherwise have occurred? Is this possible to achieve without encouraging potentially counterproductive practices, such as providing unnecessary financial concessions or discontinuing investment in the most successful enterprises after attracting other investors?



IMP consensus on investor contribution strategies

An investment's impact is a function of:

1. The impact of the underlying asset(s) / enterprise(s) that the investment supports, and
2. The contribution that the investor makes to enable the enterprise(s) (or intermediary investment manager) to achieve that impact.

The first two phases of the IMP achieved consensus on four strategies by which investors can contribute to the impact of the enterprises in which they invest. These strategies can be used individually or in combination:

- **Signal that impact matters:** A commitment to factoring in the measurable impact that enterprises have, such that – if all investors did the same – it would lead to a "pricing in" of social and environmental impacts by the capital markets. Often referred to as values alignment, this strategy expresses the investor's values and is an important baseline. But alone, it is not likely to advance progress on societal issues when compared to other forms of contribution.
- **Engage actively,** using expertise and networks to improve the environmental/societal performance of businesses. Engagement can include a wide spectrum of approaches - from dialogue with enterprises to investors taking board seats and using their own team or consultants to provide hands-on management support (as often seen in private equity). While a significant dialogue with enterprises, including about environmental, social and governance factors, is a normal part of the fund management process, the phrase "engage actively" reflects a strategy that involves, at a minimum, significant proactive efforts to improve businesses' impacts on people and the planet.
- **Grow new or undersupplied capital markets,** by anchoring or participating in new or previously overlooked opportunities. This may involve more complex or less liquid investments, or investments in which some perceive risk to be disproportionate to return.
- **Provide flexible capital,** by recognising that certain types of enterprises do require acceptance of lower risk-adjusted financial return to generate certain kinds of impact. For example, creating a new market for previously marginalised populations can require very patient capital that cannot offer a commercial return.

"Provide flexible capital" is the concessionary subset of "grow new or undersupplied capital markets", while both are a subset of "signal that impact matters". "Engage actively" can be deployed alongside any of the other three strategies.

Investors express a consensus that these strategies describe roles that investors may choose to play in the market, depending on their financial and impact goals, opportunities and constraints. For instance, while all investors can "signal that impact matters" and many can "engage actively," not all can "grow new or undersupplied capital markets" or "provide flexible capital," nor should all be expected to. For this reason, the investor contribution strategies are put forward in a descriptive rather than hierarchical or normative manner.



Finally, investors note that it should not be assumed that all impacts are positive. Beyond demonstrating attentiveness to enterprises' ESG practices, which is increasingly a baseline expectation, investors point to the need to look at the results of those practices on the ground, and in particular to identify and remediate any unanticipated harms to people and planet which may arise from their investment. Some point to the efforts of Accountability Counsel to establish community feedback mechanisms to ensure that those who have been harmed or fear harm from an investment have a predictable way to be heard and seek remedy, as a necessary complement to enhanced efforts to measure and manage positive impacts.



Signal that impact matters

Investors that proactively and systematically consider measurable positive and negative enterprise impacts in their investment decision-making and communicates this consideration to investee enterprises and to the market at-large, are pursuing what the IMP consensus terms a “**signal that impact matters**” strategy.

The current consensus is that for investors to classify their strategy as “**signalling that impact matters**,” both positive and negative impact on people and/or planet, should significantly affect the investment decision. This means that impact considerations could lead to a different investment decision.

Investors that have contributed to the IMP consensus indicate that “**signalling that impact matters**” is the only one of the four investor contribution strategies that they would recommend to be implemented by all investors – whether public or private, debt or equity, self-described as “impact”, “ESG” or “mainstream”.

Some would go further to propose that the “**signalling that impact matters**,” along with “**engage actively**,” are sufficient. In this view, for investors to go further and measure or manage the extent to which they are “**growing new or undersupplied capital markets**” or “**providing flexible capital**” may be counter-productive. The concern expressed is that an undue focus on each investor’s own unique contributions to impact may deter investors from rallying around the enterprises with the greatest potential, and may lead to impractical and burdensome reporting expectations for transactions that do occur. This remains a matter of active debate.

What is not a matter of debate amongst IMP stakeholders is the desire to rapidly increase the proportion of asset owners and fund managers that “**signal that impact matters**.”

Example components of “**signal that impact matters**” strategies (both public and private markets)

- Base investment decisions in part on the current and expected future positive and negative social and/or environmental impacts of enterprises, and communicate to investees and the market at-large that you are doing so
- Ask investees about social and/or environmental practices and performance
- Publish research and opinions on the positive and negative impacts of enterprise practices
- Provide appropriate transparency to stakeholders about the negative and positive impacts of the enterprises in which you invest, and encourage enterprises to provide similar transparency



Engage actively

Investors that go beyond “**signalling that impact matters**” to proactively supporting or advocating for investee enterprises in order to increase their social and/or environmental impact – for instance by filing a shareholder resolution, joining the board, providing consulting or mentoring, or participating in industry-level or regulatory efforts to promote considerations of social and/or environmental impact in financial markets – are additionally pursuing what the IMP consensus terms an “**engage actively**” strategy.

For investors to classify their strategy as “**engage actively**,” their engagement (above and beyond their financial investment) should have the potential to affect the impact of the enterprise on people and planet, by mitigating or reducing negative impact and/or increasing positive impact. Investors that are engaging actively typically have a systematic process for selecting enterprises which with to engage, a well thought-through engagement strategy and a rationale for why this strategy will create impact.

Example components of “**engage actively**” strategies – public markets

- Vote on shareholder resolutions
- Ally with social and/or environmental advocacy groups
- Communicate to investees your expectations about the negative impacts you expect them to avoid and the positive impacts you expect them to generate
- Provide in-depth support to efforts to improve measurement and management standards that are relevant for issue area and asset class

Example components of “**engage actively**” strategies – private markets

- Join boards of directors and advocate for improving social and environmental practices
- Provide consulting or technical assistance to help enterprises reduce negative social and environmental impacts and increase positive ones
- Introduce enterprise managers to experts relevant to their social or environmental impact
- In majority ownership situations, support enterprises post-investment in setting and achieving performance targets around impact



Grow new or undersupplied markets

Investors should self-classify their investor contribution as “grow new or undersupplied capital markets” if they have reason to believe that their investment itself directly caused or will cause:

- A change in the amount, cost or terms of capital available to an enterprise that enables it to deliver impact that would likely not otherwise occur, or
- A change in the price of the enterprise’s securities, which in turn pressures the enterprise to increase its social and/or environmental impact and/or rewards it for doing so.

Investments are classified in the IMP consensus as “growing new or undersupplied capital markets” if they meet the criteria above and are still targeting a competitive or market-beating risk-adjusted financial return. If investments meet the criteria above but also deliberately accept a financial concession in order to do so, they are additionally classified as “providing flexible capital”.

If two investors – or any small, defined group of investors – collaborate to invest in an enterprise, and their joint investment meets the criteria above, it is recommended that all of them should self-classify those investments as “growing new or undersupplied capital markets.”

The definition above is expressed by investors both in public and private capital markets. Beyond this, public and private markets – and debt and equity within each – are sufficiently different that investors tend to use different terms and rationales to explain their strategies for creating investor contribution.

In public markets, ownership and financing of enterprises is generally widely distributed and anonymous, meaning that no individual investor’s purchase or sale of a security can significantly move market prices, except under certain circumstances described below. By contrast, in private markets, ownership and financing of enterprises is more concentrated, less anonymous at least to those involved in any given enterprise, and individual investors’ investment decisions can more often directly affect the amount, cost, and terms of capital available to enterprises.

Descriptions of “grow new or undersupplied capital markets” strategies that seem intuitive for private market investors may not resonate for public market investors, and vice versa, potentially leading to unnecessary confusion and controversy. Likewise with debt and equity investors. For this reason, this note addresses private and public markets separately, and within public markets, debt and equity separately.

Private markets (both debt and equity)

In general, private debt and equity investors should self-classify their strategies as “grow new / undersupplied capital markets” when there is some aspect of



their financial investment (e.g., amount, cost, terms, tenor, collateral required, subordination, etc.) that goes beyond what is otherwise available to the enterprise to improve its impact – even if it is difficult or impossible to prove ex-post.

It is this difference in amount, cost or terms of capital versus the likely best available alternative that demonstrates “growing a new or undersupplied capital markets” – not the acceptance of a financial concession per se, which is simply one means of providing something that goes beyond what is otherwise available to enterprises.

Examples:

- Provide an equity investment or loan with terms or in amounts that the enterprise likely would not have received but for the investor
- Provide a guarantee or credit enhancement that others would not have, and that makes the above possible
- Lead a round of investment in an early-stage enterprise when other investors are not stepping up to do so
- Serve as lead lender for a syndicated debt transaction when other lenders are not stepping up to do so
- Accept a role or component of a larger financing package that no other investor accepts
- Facilitate or arrange additional financing from third parties with terms or in amounts that the enterprise likely otherwise would not have obtained
- Financing from third parties is contingent upon the investor’s own investment
- Make a cornerstone investment in a first-time fund manager
- Identify a misperception of risk in a certain geographical location and set up a fund there, seeking to attract institutional investment to the region
- Take on complexity that other investors wouldn’t, in order to structure a new type of financial product (e.g. a first-loss guarantee that enables the pilot of a new financial product)

Public equity markets

The consensus of investors in public equity markets is that the widely distributed nature of those markets means that purchases and sales of small blocks of shares do not generally influence the market prices of securities or the behaviour of the underlying enterprises. In such circumstances, it is not reasonable to expect public equities transactions to meet the above definition of “growing new or undersupplied capital markets.”

The effect of public equity transactions on enterprises’ social and environmental impact can be mediated by movements in the share price, or in certain situations, by directly affecting the amount, cost, or terms of capital available to the enterprise.

Many enterprises that are already publicly listed rarely issue further equity. For these enterprises, movements in the share price may not directly affect the cost of capital that the enterprise may be raising elsewhere (e.g. bond issuances). However, movements in the share price serve as a referendum on investors’ views of the enterprise’s management and prospects, albeit often with a short-term outlook narrowly focused on the financial dimensions of company performance.



Steep declines in share price can lead investors to buy up cheap shares, build up an ownership stake, and demand board seats and/or changes in management. In the extreme, investors may buy enough shares to take control of the enterprise and replace management outright. For this reason among others, enterprise managers watch the share price closely and are motivated to keep their investor base satisfied.

Therefore, public equity investors should classify the investor contribution of a transaction as “**growing new / undersupplied capital markets**” when they have reason to believe that the transaction caused or is expected to cause a material change in the share price. Investors are not omniscient and will need to make this determination on the basis of available market intelligence. If they cannot, then they should classify their transaction or investment strategy as “**signalling that impact matters.**”

Situations in which a public equity transaction might directly cause a material change in the share price include, but are not limited to:

- Transactions involving very large blocks of shares
- Transactions by investors with particularly strong reputations (e.g., Berkshire Hathaway)
- Transactions by investors or funds that are known to be "activist" (e.g., Legal & General's Future World GIRL Fund), or that are known to ally with issue-based activists, if that activism is expected to result in a change in company valuation

There are some circumstances in public equity markets in which ownership is more concentrated, and therefore individual investors' purchases and sales of securities can directly affect the amount or terms of capital available to an enterprise. An example of this is a new issuance of public equities, whether from previously-unlisted enterprises (i.e., IPOs) or from previously-listed enterprises (i.e., secondary offerings). As described in a recent [IMP paper with Neuberger Berman](#), “This effect is most pertinent for new issuances in public securities investments because at this point investors are able to influence the cost at which a company needs to raise additional capital. If many investors are interested in a stock, this demand drives up the stock price and reduces the cost of capital for the company.”

In these situations, the purchase or sale of public securities could directly cause a change in an enterprise's opportunities, constraints, and choices, which in turn could lead that enterprise to increase its social and/or environmental impact. These transactions should also be considered as “**grow new or undersupplied capital markets.**”

Public debt markets

In contrast to public equity markets, the effect of investors' debt transactions on enterprises is mediated largely through the cost of capital. Many enterprises issue sizeable amounts of debt on a regular basis. If the investors who purchase these primary issuances of bonds become averse to an enterprise for any reason, including its social and environmental impact, they may decline to purchase new debt issued by the enterprise, driving up the interest rate that the enterprise must pay. This effect, however, depends on many factors including the overall level of investor demand for an enterprise's debt, and the enterprise's ability to find alternative purchasers of it.



Low-volume and illiquid public debt and equity

Public debt and equities markets begin to take on the characteristics of private markets in cases where the assets in question are illiquid, small in volume, and/or difficult to value. In these cases, individual transactions can not only affect the cost of capital to an enterprise, but they can determine whether the enterprise is able to access capital at all. The potential effects of these transactions on enterprises (and on enterprises' social and environmental impacts) is correspondingly larger than transactions of securities that are heavily traded, large-cap, and/or about which more information is publicly available.

The debate on public markets and systems change

Investors in public markets often describe the impact of “**signalling that impact matters**” strategies in terms of the contribution to systems change. That is, if all other investors did the same, it would lead to a "pricing in" of social and environmental impacts by the capital markets.

This is a topic of debate. Some public markets investors describe themselves as participating in or contributing to systems change in capital markets, while also acknowledging that their investments do not directly cause a change to people and planet.

Other public markets investors point out that there are still empirical questions that would need to be addressed before concluding that the collective action of investors in public markets causes a change in corporate behaviour:

- At the micro-level, starting from a baseline in which most investors are impact-neutral, if impact-motivated investors start purchasing stocks of socially well-performing enterprises, the prices of those enterprises will rise above the level justified by those enterprises' shorter-term financial fundamentals. This may cause impact-neutral investors to sell or short those enterprises until the stock price returns to its previous level. The net result would not be a benefit to the socially well-performing enterprise, but rather a transfer of wealth from impact-motivated investors to impact-neutral investors.
- At the macro-level, as these changes in ownership play out, the net result may be a change in who owns which stocks, rather than a change in the amount or terms of capital available to enterprises. That is, public markets might reach a new equilibrium in which impact-motivated investors own socially well-performing enterprises, and impact-neutral investors own the rest of enterprises, but the prospects and incentives of the enterprises themselves remain unchanged.

Still, other investors make the counter-argument that if impact-neutral investors learn to expect that the market will "price in" impact – for instance, because of a large increase in the proportion of impact-motivated investors – they will buy or hold stocks even if those stocks are overvalued relative to what a fundamental analysis would imply.



In general, "systems change" arguments about the impact of investing in public markets tend to be speculative, depending on the possible behavior of large numbers of other investors now or in the future. Some investors and asset owners find these arguments satisfactory; others do not. Empirically, much will depend on the proportion of investors that are "impact-motivated" versus "impact-neutral", and on the specific goals and tactics of both.

The debate on “growing new or undersupplied capital markets”

Investors typically do not know the counterfactual of what would have happened but for their investment. For this reason among others, some investors argue that efforts to measure and manage “grow new or undersupplied capital markets” strategies (including “providing flexible capital”) may be impractical and even counterproductive.

Others advocate that investors are in the business of taking well-informed, calculated risks, and can approach the question of their investor contribution with the same sagacity that they approach other unknowns in their investments. In this view - by being sensitive to context and alert to the other financing options available to each investee enterprise, and/or to the movements of security prices - investors can ascertain a reasonable understanding, supported by evidence, of whether they are growing a new or undersupplied capital market, even if they cannot prove it.

In the process of developing the IMP consensus, proponents of “grow new or undersupplied capital markets” strategies did not propose that all investors should implement the strategy, but rather that only a small segment of the market should. In this view, the role of “grow new or undersupplied capital markets” strategies in the broader market is to determine the following: Of the prospective transactions that fall on the margins of existing markets and hence might or might not occur, which should take place and how? Thus, these strategies have the potential to expand the frontier of the addressable market and create impact that would not otherwise have occurred.

Sceptics note that, taken too far, the drive to “grow new or undersupplied capital markets” can lead to counterproductive practices such as:

1. Compromising too much on underwriting standards and/or investment terms; at the extreme, approve transactions that should not be approved;
2. Approving the most attractive investment opportunities simply because other investors are pursuing them; and
3. Declining to make follow-on investments in successful enterprises that are growing and attracting new investors.

This is the challenge faced by investors that seek to “grow new or undersupplied capital markets”: to identify "good" investment opportunities that others have overlooked while avoiding "bad" investment opportunities that others have rightly rejected. The challenge is complicated by the need to define "good" and "bad" investment opportunities not only in terms of their expected financial performance, but also their expected social and environmental impact. For investors that do not intend to concede on financial return, transactions that “grow new or undersupplied capital markets” might include those that other investors have overestimated the risk of – or overlooked entirely – and that thereby offer attractive risk-adjusted return while also creating social and environmental impact.



Provide flexible capital

Investors should classify their investor contribution as “**providing flexible capital**” if they meet the requirements for “**growing new or undersupplied capital markets**,” and if in addition, they are accepting a lower financial return than they could obtain in investments with similar risk, liquidity, subordination, size, and other financial characteristics. In this sense, “**provide flexible capital**” is the concessionary subset of “**grow new or undersupplied capital markets**,” while both are subsets of “**signal that impact matters**.” Investors note that opportunities to provide concessionary capital occur primarily in private rather than public markets.

Investors observe that a willingness to make concessions on risk-adjusted financial return opens up expanded opportunities to create investor contribution. For investors that “**provide flexible capital**,” the reason for doing so is that in the presence of deep market failures, some socially-valuable investments would not occur at all if not for investments that are flexible on risk-adjusted financial return. For these investors, such investments offer an opportunity to create direct impact on people and planet, or to catalyse system-wide impact, more effectively and/or more cost-effectively than would be possible with a purely philanthropic approach.

One challenge faced by investors that “**provide flexible capital**” is the need to ensure that they do not “crowd out” more-commercial investors, for instance by using philanthropic capital simply to undercut commercial investors on price. Another challenge is the difficulty of determining the right “amount” of financial flexibility to offer, so as to avoid squandering resources unnecessarily.

Financial concession does not necessarily imply investor contribution. Occasionally investments provide less than risk-adjusted market return (i.e. they are concessionary) but do not make a contribution to impact that would not otherwise have occurred. Investors observe this especially at the boundaries between well-served and underserved markets and especially among non-profit or multilateral investors. Possible reasons for this include a sudden influx of capital that an investor needs to deploy, a scarcity of investment opportunities, or an increase in competition amongst investors. Regardless of the reason, such investments are not considered to be “**providing flexible Capital**,” since the investor is not credibly contributing to impact.

Appendix: Excerpts of relevant writings

Contents (in chronological order):

From “[When can impact investing create real impact?](#)”, Paul Brest and Kelly Born. Stanford Social Innovation Review, 2013

From “[Response to ‘When can impact investing create real impact?’](#)”, Amit Bouri. Stanford Social Innovation Review, 2013

From “[How investors can \(and can’t\) create social value](#)”, Paul Brest, Ronald Gilson, and Mark Wolfson. Stanford Social Innovation Review, December 8, 2016

From “[Big League: Transforming the capital markets with impact rigor and disclosure](#)”, Clara Miller. impactalpha.com, September 28, 2017

From “[Companies should maximize shareholder welfare not market value](#)”, Oliver Hart and Luigi Zingales. Journal of Law, Finance, and Accounting, 2017, 2: 247–274

From “[Multilateral development banks’ harmonized framework for additionality in private sector operations](#)”, Joint Working Paper of nine multilateral development banks, September 2018

From “[The elusive quest for additionality](#)”, Patrick Carter, Nicolas Van de Sijpe, and Raphael Calel. Center for Global Development Working Paper 495, September 2018

From: “[Almost everything you know about impact investing is wrong](#)”, Wendy Abt, Stanford Social Innovation Review blog, December 18, 2018

Abstract of “[Beyond returns: Investigating the social and environmental impact of sustainable investing](#)”, Julian F. Kölbl, Florian Heeb, Falko Paetzold, and Timo Busch. White paper, December 2018



Excerpt from “When can impact investing create real impact?”, Paul Brest and Kelly Born. Stanford Social Innovation Review, 2013

This article is addressed to impact investors who wish to know whether their investments will actually contribute to achieving their social or environmental (hereafter, simply “social”) objectives. We introduce three basic parameters of impact: enterprise impact, investment impact, and non-monetary impact. Enterprise impact is the social value of the goods, services, or other benefits provided by the investee enterprise. Investment impact is a particular investor’s financial contribution to the social value created by an enterprise. Non-monetary impact reflects the various contributions, besides dollars, that investors, fund managers, and others may make to the enterprise’s social value...

An impact investor seeks to produce beneficial social outcomes that would not occur but for his investment in a social enterprise. In international development and carbon markets, this is called additionality...

Having impact implies causation, and therefore depends on the idea of the counterfactual — on what would have happened if a particular investment or activity had not occurred. The enterprise itself has impact only if it produces social outcomes that would not otherwise have occurred. And for an investment or non-monetary activity to have impact, it must increase the quantity or quality of the enterprise’s social outcomes beyond what would otherwise have occurred...

Debra Schwartz, director of program-related investments at the MacArthur Foundation, has alliteratively summarised the kinds of capital benefits that impact investors can provide in terms of five P’s, to which we add a sixth, perspicacity:

- Price. Below-market investments
- Pledge. Loan guarantees
- Position. Subordinated debt or equity positions
- Patience. Longer terms before exit
- Purpose. Flexibility in adapting capital investments to the enterprise’s needs
- Perspicacity. Discerning opportunities that ordinary investors don’t see

These capital benefits enable the enterprise to experiment, scale up, or pursue social objectives to an extent that it otherwise could not.



Excerpt from “Response to ‘When can impact investing create real impact?’”, Amit Bouri. Stanford Social Innovation Review, 2013

In seeking the defining elements of the impact investment market, we may consider evidence of additionality, but additionality is not a pragmatic threshold for determining whether an investor is an impact investor, especially given the volume and diversity of impact investments, nor is it easily scalable or comparable. Practically speaking, how would one expect a lender to sustainable farms and cooperatives — whether in rural Kenya or the English countryside — to consistently assess what would have happened to the borrower if not for each of its loans? Demonstrating additionality for every impact investment is often impractical; at the very least, managing and standardising the measurement of additionality is costly, difficult, and time-consuming.

Requiring additionality as a defining criterion also inherently marginalises the impact investment market, implying that it will never be robust with competing investors vying for good deals and bringing with them all the benefits of a healthy investment market. With multiple investors who might be able to make a given investment, the counterfactual to one investor closing a deal may then be that another impact investor makes the investment instead. This would be intrinsic to a well-functioning market, which is necessary to have scale and to provide competitive pricing and liquidity for investors and investees.



Excerpt from “How Investors Can (and Can’t) Create Social Value,” Paul Brest, Ronald Gilson, and Mark Wolfson. Stanford Social Innovation Review, December 8, 2016

The three main points of this essay are:

1. Impact investing in public markets. It is virtually impossible for investors to affect the outputs or behaviour of firms whose securities trade in public markets through the financial mechanisms of buying and selling securities in the secondary market. Socially-motivated investors who would like to make ESG standards the norm must join forces with consumers, employees, corporate activists, and regulators.
2. Concessionary investments in private markets. However, it is possible for concessionary impact investors to affect the outputs of firms in private market transactions by providing subsidies in the form of accepting financial returns below the level that socially-neutral investors would require. Foundations’ program-related investments are paradigmatic of such subsidies. The difficulties of concessionary impact investments lie in targeting the subsidy so as to benefit one’s intended beneficiaries rather than other investors or the company’s management, and in not adversely distorting the markets in which the firm operates.
3. Non-concessionary investments in private markets. It is also possible for non-concessionary impact investors to affect the outputs of firms in private markets by taking advantage of private knowledge that they or their fund managers possess. Non-concessionary investors’ claims to have private information should be taken with a grain of salt, however. These investors are playing in a highly competitive game with the universe of private equity investors whose success depends on developing value-relevant private information...

To say that a socially-motivated investment creates social value is to say that the investment produces a social impact — an outcome that would not occur but for the investment. For an investment to have social impact, it must meet both of these conditions:

- Enterprise impact. The investee business must produce the investor’s intended social outcomes; and
- Investment impact, additionality, or social value-added. The investment must increase the production of those outcomes.

To illustrate enterprise impact, suppose that you have invested in an enterprise that provides health care for the very poor in a developing country. Enterprise impact requires that enterprise-related health care professionals are in fact serving the poor (or will when the enterprise strategy is implemented) and, as a result, that their clients have (or will have) better health outcomes.



The matter of investment impact, additionality, or as we'll call it henceforth, social value added, is unique to impact investing. For an investment to meet the condition of social value added, it must increase the amount or quality of the investee firm's socially valuable outputs or practices. As we will explain below, an investor who believes that mobile telephony has tremendous social and economic benefits might have social impact by investing in a risky mobile telephone start-up in a developing country, but cannot have impact by investing in AT&T. In the former case, the investor may provide essential capital that the start-up cannot get elsewhere; in the latter case, his investment will not result in additional phone access for even a single customer.

An investment can affect a business's operations in two fundamental ways: through financial impact or signalling impact.

- **Financial Impact.** Assuming the investor believes that the investee enterprise has opportunities to increase its production of social value, an investment yields expected financial impact if it provides more capital, or capital at lower cost, than the enterprise would otherwise get from ordinary commercial, socially-neutral investors. Under these circumstances, the investment meets the criterion for social value-added. Conversely, a divestment would have financial impact if it deprived a wicked enterprise (that is, one that generates negative welfare consequences to the public at large) of needed capital that it cannot replace at an equivalent cost. But if the capital can be replaced at the same cost, then the divestment may create value alignment but does not create social value other than possibly through signalling impact. As we will see, divesting stock in a publicly traded company will generally not directly deprive a wicked enterprise of capital. Social impact investors, like general partners in private equity firms, may also provide non-monetary assistance, such as improving management and governance, fundraising, and networking. Because such assistance is almost always ancillary to providing financial impact, we will include it in this category rather than create a new one. (Investments are occasionally designed to improve an entire sector. This is the rationale for some of Omidyar Network's and Gates Foundation's investments.)
- **Signalling Impact.** The investment decision may indirectly affect an enterprise's cost of capital by signalling approval or disapproval of the enterprise to consumers, employees, regulators, or other stakeholders, and thereby affect their behaviour; or the investor may engage in shareholder activism by initiating or voting proxy resolutions with the goal of affecting the corporation's behaviour."



Excerpt from “Big League: Transforming the capital markets with impact rigour and disclosure”, Clara Miller. impactalpha.com, September 28, 2017

For some, the only real impact investing is intentional, and contra-market, or uncorrelated. For others, it’s simply rigorous investor exploration of the mounting social and environmental risks that companies face.

As far as I can tell, the market can encompass these (and other) versions of impact investment with integrity if we build segmented, enterprise-level data infrastructure that supports disclosure, rigour, and transparency across the marketplace.

But impact investing culture, it appears, may be eating its own strategy for breakfast (or less decorously, our young!) While we donors — including foundations and individuals — have been instrumental to the development and growth of the field, we need to let go so our progeny can scale.

Those with strong roots in philanthropy and charitable giving typically exhibit the greatest orthodoxy. Doctrines such as “additionality” (is my dollar making the difference?), “attribution” (will I be able to measure the impact of my investment dollars?), and “intentionality” (do managers and investors intend to make a positive social impact?) seem to be a non-negotiable threshold for labelling impact investments for some.

These practices undermine both capital access and scale without improving data integrity. Their focus on the needs of the individual philanthropic investor mean that small social enterprises (regardless of tax status) are routinely under-capitalised and creak under weighty bespoke metrics and naïve scaling expectations.

At the other end of the spectrum, public company managers scratch their heads over (or dismiss entirely) a flurry of highly customised data requests from investors. Some in both camps simply report on intentions, commitments, and policies, not performance. Worse yet, much of the data is non-standard, non-auditable, and unreliable, making these approaches ineffective as measurement tools.

We need to “true up” impact reporting with conventional data practices across the market. This is not to do away with real differences and nuance in various kinds of economic activity, but to avoid circumscribing the sector into irrelevance.



Excerpt from “Companies should maximise shareholder welfare not market value”, Oliver Hart and Luigi Zingales. *Journal of Law, Finance, and Accounting*, 2017, 2: 247–274

Abstract: What is the appropriate objective function for a firm? We analyse this question for the case where shareholders are pro-social and externalities are not perfectly separable from production decisions. We argue that maximisation of shareholder welfare is not the same as maximisation of market value. We propose that company and asset managers should pursue policies consistent with the preferences of their investors. Voting by shareholders on corporate policy is one way to achieve this.

Excerpts related to additionality and investor contribution:

The existing literature on social investing (Hong and Kacperczyk, 2009) assumes that some, but by no means all, investors are pro-social. Under this assumption, the strategy of divesting from stocks of companies engaging in unethical/sinful/polluting behaviour seems at best ineffective, at worst counterproductive.

If the divestment of pro-social investors were to depress the stock price of a targeted company, the non-socially concerned investors would flock to the stock, attracted by the higher yield, driving the price back to the pre-divestment level. Thus, unless the amount of wealth held by pro-social investors greatly exceeds the amount of wealth of selfish investors, divestments cannot have persistent effect on prices and the cost of capital.

If – in spite of the previous argument – divestment had an impact on prices, it would move controversial stocks into the hands of the least pro-social investors, who will maximise the negative externality.

For this reason, we think that a strategy of “invest and engage” is potentially much more successful. Yet, this strategy is available only if moral issues are regularly brought up for a shareholders’ vote, something that does not happen today.

When Friedman wrote his piece, 80% of publicly traded equity was owned by households and only 16% by institutional investors (Zingales, 2009). Now the numbers are reversed: only 27% of public equity is owned by households and 60% by institutional investors.

The growing role of institutional investors in corporate governance has raised a new and important question: what should asset managers maximise? This question is particularly important when the funds in question are part of a retirement system, since they guarantee the support of older people.

In the United States the fiduciary duty of private pension funds is defined by the Employee Retirement Income Security Act (1974) (ERISA). While not obliged to do so, state pension funds, mutual funds, and endowments tend to follow the ERISA rules as well. Another important normative source that provides guidance on investment decisions for nonprofit and charitable organisations is the Uniform Prudent Management of Institutional Funds Act (abbreviated UPMIFA), currently adopted in 49 U.S. states.



The ERISA rules state that “a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries...” This obligation is generally expressed in financial terms given that the goal of these plans is to provide retirement benefits. UPMIFA, by contrast, provides more discretion to the fiduciary allowing him (or her) to “consider the charitable purposes of the institution and the purposes of the institutional fund” in managing an institutional fund. It allows him to consider also “an asset’s special relationship or special value, if any, to the charitable purposes of the institution.”

This ambiguity has generated an active debate on whether asset managers should (or even could) factor in other considerations (often defined as environmental, sustainability, and governance or ESG) in their investment decisions (Sullivan et al., 2015). The intensity of the debate is driven by the fact that there are two opposite risks. On the one hand, if other considerations are allowed, there is the risk of transforming asset managers into political decision makers, without any accountability. On the other hand, preventing any considerations except financial ones will lead to an amoral drift in the way companies are run...

We believe that shareholder welfare maximisation should replace market value maximisation as the proper objective of companies.



Excerpt from “Multilateral development banks’ harmonised framework for additionality in private sector operations”, Joint Working Paper of nine multilateral development banks, September 2018

The term additionality captures a clear and simple premise: interventions by multilateral development banks (MDBs) to support private sector operations should make a contribution beyond what is available in the market and should not crowd out the private sector. While the premise is clear, determining the presence of additionality is more complex because of the dynamic nature of markets, the multiple factors that affect private sector behaviour and decision-making, and the diverse ways in which MDBs engage with markets and private sector actors, and the goals of those engagements...

Starting with financial additionality, the terms, conditions and structure of finance provided by MDBs can be materially different from what is available commercially. Demonstrating better financing structures can also contribute to market development. MDB terms may include innovative features that are new to a specific market.

With regard to non-financial additionality, there are MDB private sector interventions that contribute to better project outcomes that would not have been required or offered by commercial financiers. Those can include, among other things, strong safeguards, capacity building for clients, potential for market creation, or other positive externalities.



Excerpt from “The elusive quest for additionality”, Patrick Carter, Nicolas Van de Sijpe and Raphael Calel. Center for Global Development Working Paper 495, September 2018

Abstract: Development Finance Institutions (DFIs) are frequently asked to demonstrate their additionality—meaning that they make investments that the private sector would not—but what evidence of additionality would look like is rarely articulated. This paper examines potential quantitative and qualitative evidence. We investigate whether it is possible to infer additionality from observational investment data, and show how the demand-led nature of DFIs’ business model can create bias in standard statistical techniques used to identify causal effects. Having established that rigorous evidence of additionality may continue to elude us, we discuss circumstantial evidence that would increase confidence that additionality is present, and propose a probabilistic approach to additionality.

Excerpts: Within the field of development finance, making an investment happen that would not have happened otherwise is referred to as ‘additionality’. DFIs are routinely asked to demonstrate or measure their additionality, and are routinely criticised for being unable to do so. What acceptable evidence would look like, or how it could be obtained, is rarely articulated. That is the subject of this paper. The primary focus will be on the question of whether quantitative evidence of additionality could be found by applying statistical techniques to investment data, but qualitative evidence will also be analysed.

Our analysis suggests that definitive evidence of additionality may always be elusive, so the paper concludes with a discussion of evidence that might not demonstrate additionality, but which might cause a reasonable person to believe it is present. We propose that DFIs should take a similarly probabilistic approach to evaluating additionality when making investment decisions...

The fact that definitive evidence of additionality may always prove elusive should not alarm the development community, where uncertainty is often the norm. Given this, we should stop talking about ‘measuring’ additionality, and start asking under what circumstances we think additionality is more likely. Acknowledging uncertainty may not be easy for DFIs, most of whom regard additionality as a binary and only authorise investments when they are confident of it.³⁹ Boards of directors and shareholders may not be ready to hear: ‘we think there is 50 per cent chance this project is additional’. But even if additionality is a binary, one may form a subjective estimate of its probability. In reality investment committees will inevitably be more confident in some cases than in others...

In the absence of proof beyond reasonable doubt, we should seek circumstantial evidence that would cause a reasonable person to update their (probabilistic) belief that additionality is present. The short discussion of qualitative evidence in the preceding section found fault with everything, but imperfect evidence is better than nothing...



There are two main areas for improvement: DFIs could do more to collect and share data on what sorts of deals private investors are doing in the markets in which they operate; and when DFIs are doing deals that resemble those that private investors are doing, they should more carefully document their reasons for thinking they have a reasonable chance of being additional, in a format that can be made public...

Because investment professionals within DFIs are best placed to judge whether an investment is additional, the incentives within DFIs matter. If DFIs are under pressure to hit volume targets, or staff incentives are tied to volumes, it will be harder to hold the line on additionality than if DFIs are mission oriented and staff only wish to deploy capital where they believe it will have development impact.



Excerpt from “Almost everything you know about impact investing is wrong”, Wendy Abt. Stanford Social Innovation Review blog, December 18, 2018

Impact investors sincerely want to know that their investments “make a difference.” They are attracted to the idea that the financial and social benefits of an investment would not have occurred without their participation, a concept known as additionality that thought leaders such as Paul Brest have described. If impact investors cannot demonstrate additionality, then many people argue that the foundation of the whole impact investing project gets shaky.

Impact investing has backed itself into a corner because it’s difficult to test whether a change in an indicator can be reliably attributed to an investment or company. Doing so at scale is often impossible because rigorous testing involves establishing an experimental or quasi-experimental design with a counterfactual. Often, impact investors end up relying on bad science. They count the number of hours children spent exercising, the number of meals delivered, or other metric that is too often loosely based on a complex theory of change with no credible way to verify connections between impacts and a company’s actions, products, or receipt of a specific investment. This is a recipe for disappointment that over time will increase the already pervasive cynicism about “greenwashing” or “impact washing.”



Abstract of “Beyond returns: Investigating the social and environmental impact of sustainable investing”, Julian F. Kölbel, Florian Heeb, Falko Paetzold and Timo Busch. White paper, December 2018.

While many studies have examined the financial performance of sustainable investing (SI), little is known about the social and environmental impact of SI. We address this research gap in a multi-disciplinary literature review. We begin by developing a definition of investment impact, and a framework that clarifies the relationship between an investor’s impact on a company and a company’s impact on the real world. Focusing on investor impact, the literature review brings together evidence on three mechanisms: shareholder engagement impact, capital allocation impact, and indirect impacts. We find direct evidence that investors can affect companies through shareholder engagement, especially when the costs of demanded reforms are low, investors wield influence, and companies have prior experience with engagement. We find only indirect evidence for the capital allocation impact, yet studies indicate that this impact is more likely when SI investors hold a large market share, deviate strongly from the market portfolio, and focus on assets that are hard to substitute. The capital allocation impact is also more likely when companies depend on external financing for growth, and when the cost of conforming with the expectations of SI investors is low. Indirect effects, where investors rely on intermediaries to influence companies, have little support in the literature. Our results suggest that investors can increase their impact by expanding engagement efforts, by focusing on widely shared priority issues, making sure these issues are assessed consistently, and by targeting markets where external capital is a limiting factor.

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