Social Performance Standards in the Impact Investing Industry

Potential Consequences for Impact Investors

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KTH Industrial Engineering and Management

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ABSTRACT

In the recent years, a new type of investments called Impact Investing has been growing rapidly. Those investments are made with the intention to improve social and/or environmental conditions in the world while generating financial returns. In this case, financial metrics are not enough to measure whether the investor objective was reached, and tools for measuring the social performance of the investments are needed. From that need, various measurement approaches were created, but the fragmentation of methods leads to a huge inefficiency in the impact investing industry. Efforts towards creating standards for measuring and reporting social performance are emerging, but there is still little understanding among impact investors about the real benefits and possible challenges the standardization would bring. In this context, an important question arises, which is the subject of study in this research:

What are the potential consequences of establishing social performance standards for the impact investing industry?

The purpose of this research is to analyze the possible consequences of establishing social performance standards on the impact investing industry.

Qualitative approach and interpretive paradigm were chosen to be followed in this research. Primary data was collected in the form of interviews with impact investors and specialists in social performance measurement. Secondary data comes from books, articles, journals and websites. The data was analyzed using the consequences of innovations framework presented by Rogers (2003).

The results suggest that obviously there are potential desirable and undesirable direct consequences, but also indirect consequences that are not perceived without a thorough analysis.

Key words: Impact Investing, social performance, social performance standards, social businesses.

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TERMS, DEFINITIONS AND ABBREVIATIONS

BOP - Bottom of the pyramid, refers to the 4 billion people living on less than 2 dollars a day.

GIIN - Global Impact Investing Network

GIIRS - Global Impact Investing Rating System

IRIS - Impact Reporting and Investment Standards

IFRS - International Financial Reporting Standards

Impact Investing – "investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return "(GIIN, 2009).

SME´s - Small and Medium Sized Enterprises

Social Business – a financially sustainable company that has as its top objective to generate social and / or environmental impact, such as provision of affordable housing, water access, education or financial services to low income communities.

Social Performance – how well a social business translates its social mission into reality.

Social Performance Standards – a standard framework that would provide a common definition of the terms used in the impact investing industry, common indicators to track social performance and common reporting practices of those indicators.

SRI - Socially Responsible Investments

1. INTRODUCTION

This chapter begins with a background introduction to establish the context in which this research takes place. The problem statements, purpose and scope are also defined.

1.1. Background

The world today is going through a major transformation, where technology is revolutionizing the way people communicate, work, create and ultimately how humans lives. But despite our growing capacity to innovate and generate wealth in many fields, there is still a huge part of the world's population that is not benefiting from our advances. There are approximately four billion people living on two dollars a day or less; taking the economic pyramid as a reference, those people are called the bottom of the pyramid – BOP (Prahalad, 2009).

In this scenario, the business sector has an important role in helping reducing and eliminating poverty. The time is definitely favorable for entrepreneurial approaches that attempt to solve social problems (Dees – the meaning of Social Entrepreneurship); entrepreneurship is essential for the solution to poverty (Prahalad, 2009).

The BOP represents an opportunity for the companies to achieve sustained growth while helping the poor. However, a new approach for serving their necessities is needed, where partnerships between the companies and the poor are constructed in order to create win-win solutions (Prahalad, 2009).

Those social businesses goes beyond the social corporate responsibility, aiming to cause a positive social impact though its activities and the commercialization of their products and services, which are developed with the objective to address the needs of the low income population (Vox Capital,2009).

As social businesses arise, the need for investors willing to back those companies in their creation and expansion process also emerges.

The concept of impact investing, which attempts to improve social and environmental conditions while generating financial returns, is changing the principle that for-profit investments should have a unique objective to generate financial returns, while investors who are concerned about social and environmental problems should donate their money or leave the responsibility of solving those to the governments (Bugg-Levine, Emerson, 2011).

Impact investing is being called a new industry and it is still in its early days (Bugg-Levine, Emerson, 2011). It faces many challenges to its development, and one of the main issues is related to the way investors measure the social performance of their investments.

If investments are made with the intention to improve social and/or environmental conditions in the world, pure financial metrics are not enough to measure whether the objective was reached (Nicholls, 2007).

Today there are still no industry-wide standards for social performance measurement and reporting, and the absence of standards results in a fragmentation of methodologies that are used by impact investors, making it hard to compare performance within investment portfolios, as well as among other organizations; it precludes performance benchmarking and sector analyses (Bouri, 2011).

However, some concerns emerge when it comes to developing performance standards that should be able to capture the value created by different social and environmental interventions, and at the same time be sensitive to the nuances of the wide array of organizations (Simon, Barmeier, 2010).

1.2. Problem Statements

In the recent years, some initiatives to establish social performance standards have emerged, in an attempt to increase the transparency, accountability and comparability of the information related to social performance in the impact investing industry. Those efforts are very recent and the problem is that there is little understanding among impact investors about the real benefits and possible challenges it would bring. In this context, an important question arises, which is the subject of study in this research:

What are the potential consequences of establishing social performance standards for the impact investing industry?

1.3. Purpose

The purpose of this research is to analyze the possible consequences of establishing social performance standards on the impact investing industry. It is important to emphasize that it is not a purpose to reach definite conclusions on the topic, but rather shed some light into this complex and little researched field and hopefully contribute useful information that would help impact investors to take better investment and management decisions.

1.4. Scope

1.4.1. Delimitations

Due to the limited timeframe of the thesis project and the newness and complexity of the problem studied, some delimitation was imposed in order to increase the quality of the work:

- This research will not address the discussion about the following issues: how to measure impact, which is the best way to measure social performance, the pros and cons of different methodologies for social performance measurement, whether the adoption of social performance standards will increase or decrease actual social impact .
- This research investigates the potential consequences of standards that would be adopted only within the impact investing industry, not considering that such standards would be used by every type of organizations that have as main goal the creation of social improvements, such as NGOs.
- No specific social performance standard will be analyzed in depth.

1.4.2. Limitations

This research was limited by three main constraints: a limited timeframe to complete the project, the limited amount of previous research in the impact investing field and the lack of consensus within the industry on nearly every aspect that involves impact investments, ranging from the meaning of terms to who should be considered impact investors. The definitions and conclusions taken in this paper were based in a small sample size for interviews therefore it cannot be considered to represent the position and thoughts of the whole impact investing industry. As 5 out of 6 of the interviewees are from North American institutions, there is a possibility of sample bias and the research findings cannot be applied to the impact investing industry in the global level, but rather it better represents a small part of the North American investors and impact specialists vision (details on the interviews selection and interviews process are found in the section 3.5 - Interviews). It is important to emphasize that this paper contains insights that contributes to the discussions about social performance measurement and reporting standardization and is far from providing conclusions that could be taken as ultimate truths.

1.4.3. Perspective

This research is conducted from the impact investor perspective about the problem identified. This is due to the fact that most of the claims and representative efforts in creating a standard for performance measurement and reporting comes from the investors' side. Usually investors can impose to investees what standard to use, but the contrary is unlikely to happen (Bugg-Levine, Emerson, 2011).

Therefore, it is considered that the investors are the driving force in the social performance standardization process.

1.4.4. Target Groups

The two main target groups of this research project are:

- The stakeholders involved in the impact investing industry, such as direct investors into social businesses, the entrepreneurs running social businesses seeking impact investments and social performance measurement specialists.
- Academics in the field of entrepreneurship in general

2. LITERATURE REVIEW

This chapter begins with a general theory about the impact investing industry. Subsequently, important aspects regarding social performance are presented, followed by concepts about accounting standards, which helps in the understanding of performance standards. Finally, the theory of consequence of innovation is presented, which is the framework used to analyze the empirical data.

2.1 The Impact Investing Industry

What is Impact Investing?

The GIIN (Global Impact Investing Network), a not-for-profit organization dedicated to increasing the effectiveness of impact investing, defines impact investments as follows : "Impact investments are investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets, and target a range of returns from below market to market rate, depending upon the circumstances " (GIIN, 2009) .

Organizations or individuals who simply undertake investments in poor countries are not qualified as impact investors. The idea is that impact investments should support and seek to improve the life conditions of the population, rather than exploit them; impact investors treat impact measurement as a core activity (Bugg-Levine, Emerson, 2011). For example, a venture capital fund that invests in SME´s in Uganda and is only interested in companies that can generate the higher financial returns regardless the social or environmental impacts cannot be considered impact investors.

Impact Investments also differ significantly from Socially Responsible Investments. SRI investments seek not to damage the society or the environment by not investing into companies that somehow produces harmful products or services, such as firearms or tobacco companies. SRI investments do not have as a primary objective supporting social businesses (Simon, Barmeier, 2010).

History

The origin of impact investing cannot be set to a specific date, but aspects and elements of this investment approach can be found in the anti-apartheid divestment campaigns of the 1980s and the more recent fair trade consumer and socially responsible investments (Bugg-Levine, Emerson, 2011).

Who are impact investors?

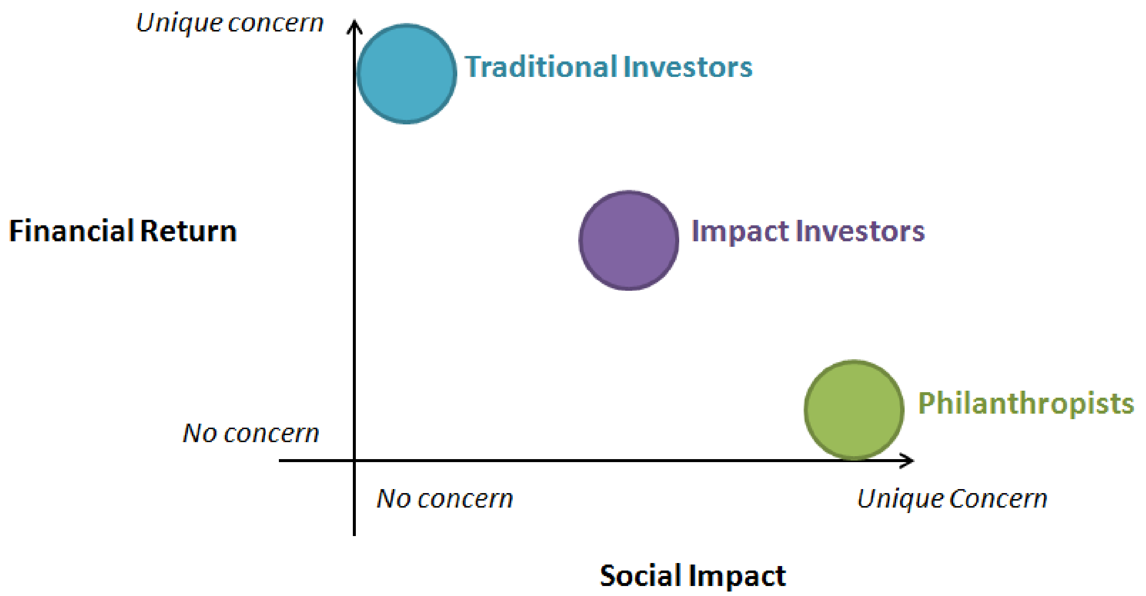
Impact investors are diverse, and range from traditional foundations, financial institutions, high net worth individuals, and government agencies (Bouri, 2011). Important to highlight that not all foundations and government agencies are involved in impact investing, but only the ones who created special branches for this specific activity. Within those groups, there is also a variation in terms of goal, risk/return expectations and stage of the investment. Table 1 shows a typology of potential impact investors (Simon, Barmeier, 2010). A research conducted in 2011 by the GIIN and JP Morgan , a financial firm with global reach, with 52 impact investors provides some insights regarding this diversity, showing that in general, impact investing can hold a broad range of impact goals and return targets.

Table 1: Typology of Impact Investors

	Ultra-High-Net-Worth Individuals	Development Finance Institutions	Foundations	Values- and Faith-Based Investment Networks/ Funds	Retail Investors	Large Corporations/ Financial Institutions
Primary Goal	Application of business principles to philanthropic pursuits	Achieve development results without sacrificing financial sustainability	High social impact with the discipline of an investment	Diversified portfolio of investments consistent with social values	Achieve social impact – view investment as akin to a donation	Support for corporate social responsibility (CSR) programs
Risk/ Return Expectation	Moderate to high, willing to take more risk for social impact, but expect a return	Moderate, need to preserve Institutional stability, but often “funding of last resort”	Moderate to high, sometimes can forgo return for social impact	Low, may be willing to trade off return for social impact, but seeking safe investments	Low, because vehicles available to retail investors cannot be too risky by law	Moderate to low, not willing to take inordinate risks outside core business
Examples	Bob Johnson, John McCall MacBain, George Soros	OPIC, IFC, FMO,Proparco, DEG	Rockefeller, Kellogg, Gates, Skoll, Omidyar, Google	TIAA-CREF, Thrivent, MMA Praxis, GuideStone, Amana, Saddleback	Buyers of/ Donors to Calvert Community Investment Notes, Microplace, Kiva	Cisco, Storbrand, Shell, Chevron, Starbucks

The figure 1 provides an overview of how impact investors are positioned in the spectrum that varies from unique concern on social impact (philanthropists) and unique concern on financial returns (traditional investors).

Figure 1: Financial Return vs. Social Impact concern for investors



Current size of the industry and forecast

The current size of the industry is difficult to estimate since the impact investing is diverse and in an early stage of development; in order to provide a rough picture, a survey conducted by JP Morgan with 52 impact investors showed that the sum of impact investments planed to be undertaken by this group along 2012 amounts to around US$ 4 billion. The Monitor Group, a strategy consulting firm and Money for Good, a research and strategy project within the impact investing industry, published a report in 2009 that estimates that impact investing could attract US$500 billion annually within 10 years.

2.2 Social Performance

In order to have a better understanding about social performance, the impact value chain is presented, as well as the current status of standardization and the potential benefits and risks it could bring to the impact investing industry.

2.2.1 The Impact Value Chain

The different dimensions of social performance can be identified in the impact value chain (figure 1), which is a representation of the process by which impact is created (Clark et al, 2004). It is used not only in the context of impact investing, but in any field where social change is created.

Following the definition of Clark et al. (2004), the steps in the impact value chain are defined as follows:

Inputs: the resources that are put into the social business

Activities: the primary activities undertaken by the social business

Outputs: results that the social business can measure directly

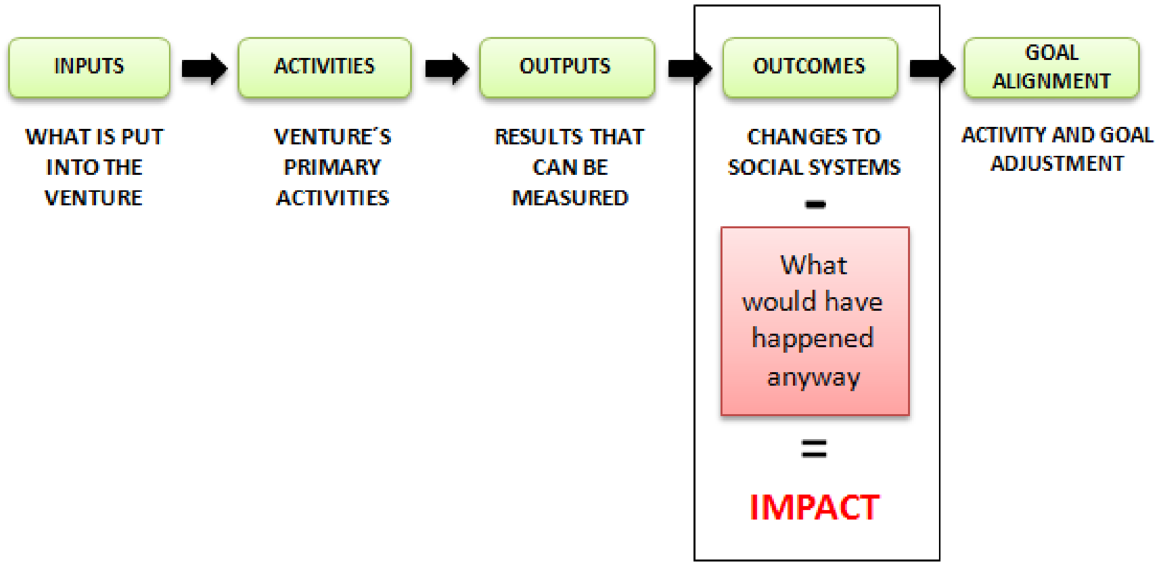
Outcomes: the fundamental changes in the social systems

*Impac*t: the portion of the total outcome that happened as a result of the activity of the social business, above and beyond what would have happened anyway.

For example, considering a social business providing an after-school program, the inputs could be teachers, equipments and capital. The activities, training and workshops provision for the children. The outputs, number of children enrolled in the program, number of children that dropped out. Outcomes, the higher (or lower) educational achievement of the participants after taking part in the program. Finally, to measure the impact, a group of children could be assigned to the program under evaluation and another group to a similar after-school program in most relevant aspects. The educational achievements of both groups would then be evaluated after it has been completed, and the real impact would be the difference between the performance of the program group and the control group (Clark et al, 2004).

Impacts usually are affected by several different factors and actors, and attributing the exact portion of the total outcome that occurred as a result of a specific intervention can be very complex (Ebrahim, Rangan, 2010). The more abstract the mission of the social business is, the more difficult is to measure outcome and impact (Sawhill, Williamson, 2001).

Figure 2: The Impact Value Chain



2.2.2 Current State of Standardization in the Impact Investing Industry

The leading standard in the impact investing industry is IRIS (Impact Reporting and Investment Standards) which is a framework for measuring and reporting social performance of social business and is emerging as a candidate for becoming the standard in the impact investing industry. It was first developed by Acumen Fund, The Rockefeller Foundation and B-Lab in collaboration with PricewaterhouseCoopers and Deloitte back in 2008, but now GIIN has taken over the responsibility of developing and incentivizing the adoption of IRIS within the impact investing industry. The aim of IRIS is to "create a common language for reporting social and environmental performance". It is defined as a public good and can be viewed as similar to financial accounting standards in the traditional business sector.

Some similar efforts are also emerging around the world, such as NEXII (Nexus for Impact Investing), created in South Africa.

2.2.3 Potential Benefits of Social Performance Standards

The main potential benefits of such standards are:

- Comparability and Industry Benchmarks

A standard framework for social performance measurement and reporting would allow performance comparability and industry benchmarks. The use of common terms decreases the transaction costs for mainstream investors. (Bugg-Levine, Emerson, 2011).

- Enhances accountability and transparency

Social performance standards could contribute significantly to increase the accountability and transparency of the social businesses (Kramer, 2005). If the organizations are not incentivized to be transparent about their social performance data, only the good results will likely be presented, negatively affecting the whole social sector (Tuan, 2008).

- Enables the creation of additional services

Reporting standards would be used as a base for the creation of other types of services that would be useful for impact investors, such as rating agencies and quality assurance institutions (IRIS, 2010).

- Enhances credibility

Social performance standards would allow investors to distinguish real impact businesses from "greenwashers" – organizations that promote the perception that they are environmentally friendly when they are not indeed. This is what economists call a problem of "lemons", referring to the used cars market: if consumers cannot distinguish between a good used car and a bad one – a lemon – they will shy away from the market, and will be likely to underpay for the good used cars (Brooks, 2009). The cost of such situation would incur not only the amount by which the investor is cheated, but also the loss from driving legitimate business out of the market (Akerlof, 1970).

- Eliminates the need for investors to develop their own frameworks

In the absence of standards, investors could not be willing to spend resources to develop their own measurement systems and this might prevent them to step in the impact investing industry. The impact investing industry will be formed in its majority by investors and organizations that do not have the expertise in measuring social performance and they will probably not be interested in developing their own proprietary systems for doing so (Bugg-Levine, Emerson, 2011).

2.2.4 Potential Risks of Social Performance Standards

Some potential risks were also indentified reviewing the literature in the social performance standardization topic:

- Investments would flow to easy-to-measure sectors

Investments could flow to areas where the social performance can be readily measured, and social businesses whose impact is beneficial for the society but not easily measured, will suffer from a lack of capital. The overreliance on quantitative social performance measures could cannibalize funding and incentives for organizations that produce more qualitative outcomes (Brandenburg, 2010).

- Social businesses would attribute exaggerated importance to standard metrics

Entrepreneurs would prefer to start social businesses targeting easy-to-serve populations, where they can maximize their performance score and increase their chances of being funded by impact investors (Tuan, 2008). To qualify for funding, social businesses may have to reshape themselves to fit standardized guidelines (Bornstein, Susan, 2010).

- Social impact would be misinterpreted

If standards for measuring and reporting social performance are adopted, impact evaluation could be oversimplified and social impact would be misinterpreted, where investors and social businesses would claim impact based solely on social performance metrics. Social scientists argue that the term "impact" could be misappropriated, as it requires detailed information regarding outcomes and attribution (Tuan, 2008).

- Complex standards would overload the social businesses

There is a risk that exhaustive reporting requirements would become a laborious activity for social businesses, distracting them from their social objectives (Simon, Barmeier, 2010).

2.3 Accounting Standards - IFRS

It is of high value to analyze the standardization of accounting reporting, as the social performance and reporting standards discussed in this research would be essentially the equivalent to a “social accounting” system, therefore some lessons from the financial standards could be useful. IFRS (International Financial Reporting Standards) was chosen to be analyzed because by the time of conclusion of this paper it was the most adopted accounting standard in the world. The arguments presented in this section are based in Ball (2005).

The essential economic purpose of accounting standards is to provide “agreement about how important commercial transactions are to be implemented” (Ball, 2005). The standardization of terms is also a very important function. If a company commits to present to its shareholders information about its profits, it is necessary that both parts agree on what profit means (Ball, 2005).

The IFRS, adopted by over 100 countries, are accounting standards issued by an independent organization based in London, UK, called International Accounting Standards Board (IASB). The purpose is to establish rules for financial information reporting that would be applied equally to public companies worldwide.

There are potential advantages for investors in the international adoption of IFRS (Ball, 2005):

- Lowers risk for investors due to better informed valuation of companies in equity markets. In comparison to the national standards replaced for public financing reporting, IFRS provides more precise, understandable and timely financial statement information.

- Reduces risks for small investors, as they usually are not able to have access to anticipated financial statement information. By improving the quality of financial reporting, small investors can compete in a more equal basis with professional investors.

- Decrease costs of processing financial information, by eliminating differences in accounting standards and setting a standard format for reporting and therefore eliminating the need for information adjustment to make it comparable internationally.

- Considering the standards are implemented consistently, the adoption of IFRS increases the comparability of information and hence lowers information costs and information risk to investors.

- It increases transparency and incentivizes managers to act towards the interests of shareholders.

However, there are some risks in the adoption of IFRS (Ball, 2005):

- Uneven Implementation

Ball (2005) argues that the uneven implementation of IFRS could be a problem. He points that international differences in reporting quality are inevitable, and this is caused by the local political and economic influences in reporting practice and implementation of rules. In this case, investors could believe that there is more uniformity than actually exists in reality and the differences in the quality of information would be masked by the apparently uniform standards. This could lead to lower transparency and accountability, increasing the information risk and cost.

He states an intriguing and important question on the differences in implementation across countries: "Do we seriously believe that managers and auditors will comb through firms' asset portfolios to discover economically impaired assets with the same degree of diligence and ruthlessness in all the countries that adopt IFRS?"

Another point is related to the level of uniformity of implementation: he argues that uniformity in a global level would be very difficult to achieve. However, a certain level of uniformity is desirable and could be in the firm, industry, regional or national level. Which is the optimal level of uniformity, though, is far from clear.

- Incentives to cheat

The IFRS is perceived as a signal of quality and provides credibility to the countries that adopt it. But there is an important concern: in the absence of a strong "reinforcement mechanism", that is, ways to guarantee that the standards are being applied in reality in the right way and that the data reported is reliable, summed with the fact that IFRS is a public good and therefore free to adopt for everyone, the high quality financial reporting regimes could not be distinguished from low quality regimes. This would "underpay" the ones who follow the standards correctly, and "overpay" the ones who just follow it as a marketing tool.

2.4 Consequences of Innovations

This section is based on Rogers (2003) theory of diffusion of innovations. I will look more precisely in the consequences of innovations diffusion in order to establish a framework for analyzing the primary and secondary data collected, assuming that a performance and reporting standard would be an innovation for the impact investing industry.

As defined by Rogers (2003), consequences are "the changes that occur to an individual or to a social system as a result of the adoption or rejection of an innovation".

In turn, an innovation is defined as "an idea, practice, or object that is perceived as new by an individual or other unit of adoption" (Rogers, 2003).

A social system is defined as "a set of interrelated units that are engaged in joint problem solving to accomplish a common goal" (Rogers, 2003). For this research, the social system can be considered to be the Impact Investing Industry.

The studies about consequences of innovations are very rare and three main reasons can be identified: the assumption is that the consequences will be positive; the current methods used, especially surveys, might not be adequate and consequences are not easy to measure (Rogers, 2003).

There are three main classifications of consequences: desirable versus undesirable, direct versus indirect, and anticipated versus unanticipated (Rogers, 2003).

- desirable versus undesirable

Desirable consequences are “the functional effects of an innovation for an individual or for a social system”. Undesirable consequences are “the dysfunctional effects of an innovation for an individual or for a social system”. It is often erroneous to expect that desirable consequences will be achieved without bringing undesirable effects, as many innovations cause both. Usually is not possible to separate the desirable and undesirable consequences and innovations have to be managed taking this fact into consideration (Rogers, 2003).

- direct versus indirect

Direct consequences are “the changes to an individual or a system that occur in immediate response to an innovation”. Indirect consequences are “the changes to an individual or a system that occur as a result of the direct consequences of an innovation”. These can be called the consequences of the consequences of an innovation (Rogers, 2003).

- anticipated versus unanticipated

Anticipated consequences are “changes due to an innovation that are recognized and intended by the members of a system”. Unanticipated consequences are “changes due to an innovation that are neither intended nor recognized by the members of a system” (Rogers, 2003).

In most cases, the innovation consequences that are undesirable are also indirect and unanticipated, as the desirable are direct and anticipated but definitely other combinations can happen.

3. METHODOLOGY

In this section, the methodology used to conduct this research is presented. First, the research approach and paradigm are defined. Subsequently, the sources of information are stated, followed by the validity and reliability of this thesis project.

3.1 Research Approach

The qualitative approach was chosen to be followed in this research, which implies designing a study that involves collecting qualitative data and analyzing it using interpretive methods (Collis, J. et al., 2009). Due to the given complexity of the problem studied and the limited scope and timeframe of the project, the qualitative approach seemed more appropriate and feasible than a quantitative approach, which involves collecting quantitative data and analyzing them with statistical methods (Collis, J. et al., 2009).

3.2 Research Paradigm

This research project makes use of the interpretive paradigm, where the ontological assumption is that reality is subjective and multiple and the researcher interacts with what is being researched (Collis, J. et al., 2009). This paradigm is appropriated for this research because the problem studied is somewhat subjective and is inserted in a context of high uncertainty, since the impact investing industry is very new and solid theories and consensus on performance measurement and reporting standardization are still far away from be reached. Therefore, the result of this research is "subjective and "qualitative" data, characteristic of interpretivism (Collis, J. et al., 2009).

3.3 Primary Sources

The unique primary source of data was interviews with impact investors and specialists in the field of social performance measurement and evaluation.

3.4 Secondary Sources

Previous works in the field of impact investing, social performance measurement and evaluation, standards as well as standardization process were analyzed in order to gain knowledge in the field of this research. The main sources were books, articles, journals, websites as well as reports published by different organizations related to impact investing.

3.5 Interviews

The interviews were conducted in a semi-structured way in order to guide the conversation towards the researched topic but avoiding narrowing the questions too much and risking missing valuable insights that could arise from a more open discussion.

Two types of respondents were selected: impact investors, as the research is being conducted from their point of view, and social performance measurement specialists, in order to gain important insights about this complex issue that would not necessarily be related to standardization but would contribute to increase the value of the knowledge generated in this research.

Six interviews were conducted, each ranging from 20 to 25 minutes long, all by phone and fully recorded. In the section 4 – Empirical results, only the relevant parts of the interviews were transcribed.

The criteria for selecting the interview respondents were the following:

Impact investors - The respondent should represent an impact investing fund that is currently undertaking direct investments in social businesses or are in the process of selecting investees and be directly involved in investment decisions and / or impact assessment activities.

Specialists – Be directly involved in research in the field of social performance measurement and evaluation and / or have significant practical experience in the field.

Both specialists and impact investors should represent leading organizations in the field of impact investing, regardless their geographical location or sector of activity. These criteria could lead to a selection bias, since most of the impact investors and researchers are based in North America, especially USA; however, since the industry is very new, an attempt to diversify the interviewees sample would require a wider timeframe and resources that are out of the scope of this research.

Regarding the role of the interviewees within the organizations they represent, a great variety is found, as it includes two metrics specialists, a Chief Investment Officer, an organization founder and a researcher in the impact investing field.

3.6 Validity of Fieldwork

Validity refers to "the degree to which a study accurately reflects or assesses the specific concept that the researcher is attempting to measure" (Colorado State University, 1993). The interviews were conducted with representatives of some leading organizations in the field of impact investing and very high experienced specialists in the field of social performance measurement, which increases the validity of the fieldwork. However, it is impossible to accurately predict all consequences that social performance standards would have for the impact investing industry; therefore, this research is of low validity.

3.7 Reliability of Fieldwork

Reliability is defined as "the extent to which an experiment, test, or any measuring procedure yields the same result on repeated trials" (Colorado State University, 1993). Therefore, the reliability of this research can be considered as low, because the findings were based on qualitative information that could vary significantly depending on the characteristics of the sample used for collecting data and even the researcher characteristics and background.

4. EMPIRICAL RESULTS

In this section the main points of the interviews conducted will be presented. For further information about the interviews see Appendix 1 – List of Interviewees.

4.1 Interviews Findings

Saurabh Lall - Research Director at ANDE (Aspen Network of Development Entrepreneurs)

Saurabh points that the need for standards is growing into a consensus, but there is a lot of work to be done, particularly convincing new investors, about the need to adopt standards. He says that the two main challenges in the moment are how to help the investors who adopted standards make it more effective and make it part of their operations and as a second challenge how to help new investors adopt the standards.

The biggest benefit, in his opinion, is to be able to compare across different types of investments, creating benchmarks for social enterprises that investors can use to make comparisons. He points that this standardization can only happen from a sector-specific perspective (such as agriculture, education, microfinance) because there many different business models within and across sectors.

One of the challenges mentioned by him is that on some level it is needed to go beyond the firm level indicators (outputs) and look at how specific business models work in terms of their impact in households. He alerts that one may assume that by tracking outputs such as the number of products being sold, it is enough to claim impact, but the real question is to go beyond to find out if those products are really improving the beneficiaries' lives in some way.

Pernilla Bard - Founder of Social Initiative

Pernilla Bard said that in her opinion there is a need for standardization and that she really appreciates the efforts that some players are making to trying to standardize (social performance metrics and reporting), because it's a very difficult endeavor. She points that there is equally a need to use the standards in a correct way, because otherwise is very easy that one could compare data in a wrong way.

The main benefits she see is that it could bring benefits to impact investors to be able to do the due diligence process, compare between different investment opportunities and also to be able to aggregate results in a portfolio level.

One very clear risk, in her opinion, is that investments and money could go towards the easy to measure projects. In this case the investments might not go to the ones that need it the most, but to the ones that can show according to the standard indicators the best progress or any progress for that matter. So in essence, one could invest in the wrong projects.

Another important point mentioned by her is that if investors steer their investments decisions solely based on standard outputs metrics, they could be taking wrong decisions. She thinks that in addition to having the standard metrics, it is needed to develop indicators that are unique to each specific organization the investors are supporting.

Finally, in her perception many impact investors would agree that standardization is good, but has to be used very carefully and very few would say we shouldn´t make any attempt of standardization.

Allison Basile - Metrics Officer at Grassroots Business Fund

Alisson argues that so far the lack of standards hasn´t prevented impact investments to be done. In her opinion, the question that is usually asked is if to really increase the amount of investments coming into the impact investing industry there is a need to have more common definitions and get more systematic, and she would agree with that assumption.

In her opinion, the important question to be asked by impact investors is: Is our work really making a difference in the world?

When asked if there is a risk that standard social metrics would cause an over reliance on outputs metrics and hide the deeper impact , she firmly disagree and clarify that investors just have to understand what those metrics really mean, and shouldn't use the word impact if it is not impact. She adds that it is still hopeful to be able to compare "apples to apples" when it comes to outputs.

The main benefits, in Alison´s opinion, of having standard social metrics and definitions are:

For organizations that don't know what to measure in terms of outputs standards (she refers specifically to IRIS) provides a good framework. Furthermore, she states that a future aspiration is the market intelligence that will come from many data from different organizations, and different ratios and benchmark it is possible to get from that. Finally, she points that another benefit is the confidence, either right or wrongly, in investors and partners who see shared definitions as one important step in the growing of an industry.

Brad Presner - Metrics Manager at Acumen Fund

In Brad´s opinion, there is definitely a need for standardization (of social metrics and definitions). He explains why Acumen Fund was one of the pioneers in creating the leading standard in the industry, by saying that there was an inability to have conversations with their peers around relative impact; he gives an example, saying that if a peer says that they have created 10 thousand jobs, he needs to be able to understand what they mean by a job; is that a full time job with benefits, or a part time job? So he points that it is the ability to have "apples to apples" conversation and to understand what is working and what is not working.

He adds that is very important that they can compare themselves but also so they can learn more about what is more or less effective, the ability to take a data and slice it against a particular sector or particular country.

Another benefit in his opinion is that standards are part of a necessary infrastructure to prove impact so that investors become more comfortable with the impact investing concept. He says that there is a growing claim from investors for accountability, as they want to know the results and has been done with their money.

Another use for the standards, as he explains, is the possibility to supplement qualitative data with standard quantitative data when describing the impact of their activities.

He calls the attention for an uncomfortable situation that could arise in the creation of benchmarks, as by definition a benchmark means half of the players will be below medium and half will be above the medium. In this situation, the environment where the actions are taking place have to be considered to make a fair interpretation, as the ones who target the poorest of the poor and countries under extreme hard conditions will probably be below the benchmark .

Another potential challenge, in his perception, is that all adopters would probably have to adapt themselves to the standards, and this would require some effort; therefore, in order to be willing to make this effort, investors need to see the value of the standardization.

He also points that the real benefits of standards (he refers specifically about IRIS) will be when a significant number of investors adopt it.

Brad says that a question he often hear is “Will investors shift their money away from activities that are more difficult to quantify, or that are quantifiable but don’t perform as good? And these, Brad adds, is the harder to reach population, the poor of the poor, countries that are difficult to operate, where the need may be greater. In his opinion, there is a risk of priorities shifting, but he adds that this is more a question of interpreting correctly the data and using it in the right way.

Finally, he points that generally investors think standards are needed, they see a value on it, but many are waiting in the sidelines for others to adopt before they step in.

Christian Novak - Chief Investment Officer at TBC Capital Asset Management Inc.

Christian provides an interesting argument related to the definition of impact investing. In his opinion, it is not necessary that everybody (in the impact investing industry) is aligned on what is impact investments; he thinks that it is important that investors have clarity when they are investing in an impact fund, what is the definition of impact for the asset manager; however, he states that there must be a consensus in at least one thing: whatever definition of impact investing is being used by an investor or fund manager the organizations where the investments are being directed to must have a good intent. By intent, he means it has to be an organization that sells products and services that have the intent of having a positive impact in the world. For example, a microcredit institution has the intent to provide services to improve the recipients´ life; a manufacturer of solar panel has the intent of developing energy in a clean way.

Regarding standardization, he manifests a concern that the standards that are being put in place are adopted appropriately and not that people feel that they need to oblige themselves to adopt the standards.

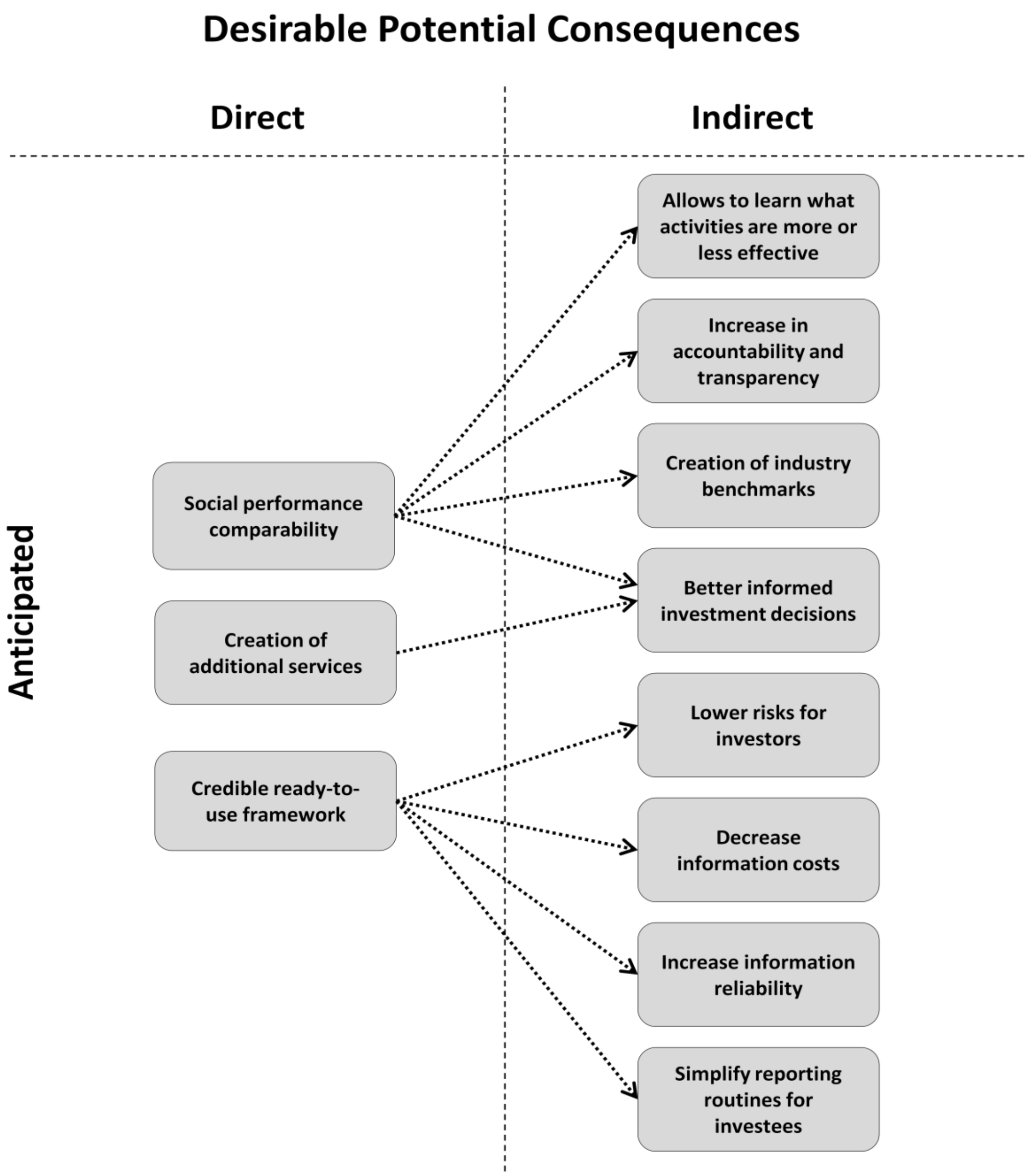
In his opinion, it is important that third party organizations are involved in creating and spreading standards in the impact investing industry, not only standard social metrics but also rating agencies (he talks specifically about IRIS and GIIRS, a project created by the non-profit B Lab, which evaluates the social and environmental impact of companies and funds using a ratings system). Those efforts, according to Christian, bring more credibility for the companies and funds; moreover, he says that a motivation in supporting those efforts is the possibility to compare their work with their peers in the industry.

5. ANALYSIS

In this section, a summary of the empirical findings and the information gathered from the literature review is presented using the consequences of innovations framework presented by Rogers (2003). An integrated analysis of the data is also presented.

In order to make the analysis clearer, the potential consequences of the establishment of standards were divided in two main groups: Desirable and Undesirable. In the figure 3, the relation between desirable, anticipated direct and indirect consequences are presented. In the left column, the direct consequences are presented, that is, the ones that would be directly attributed to the establishment of social performance standards; in the right column, the indirect ones are showed, that is, the consequences of the direct consequences. The arrows indicate to which indirect consequence each direct consequence leads.

Figure 3: Desirable Potential Consequences



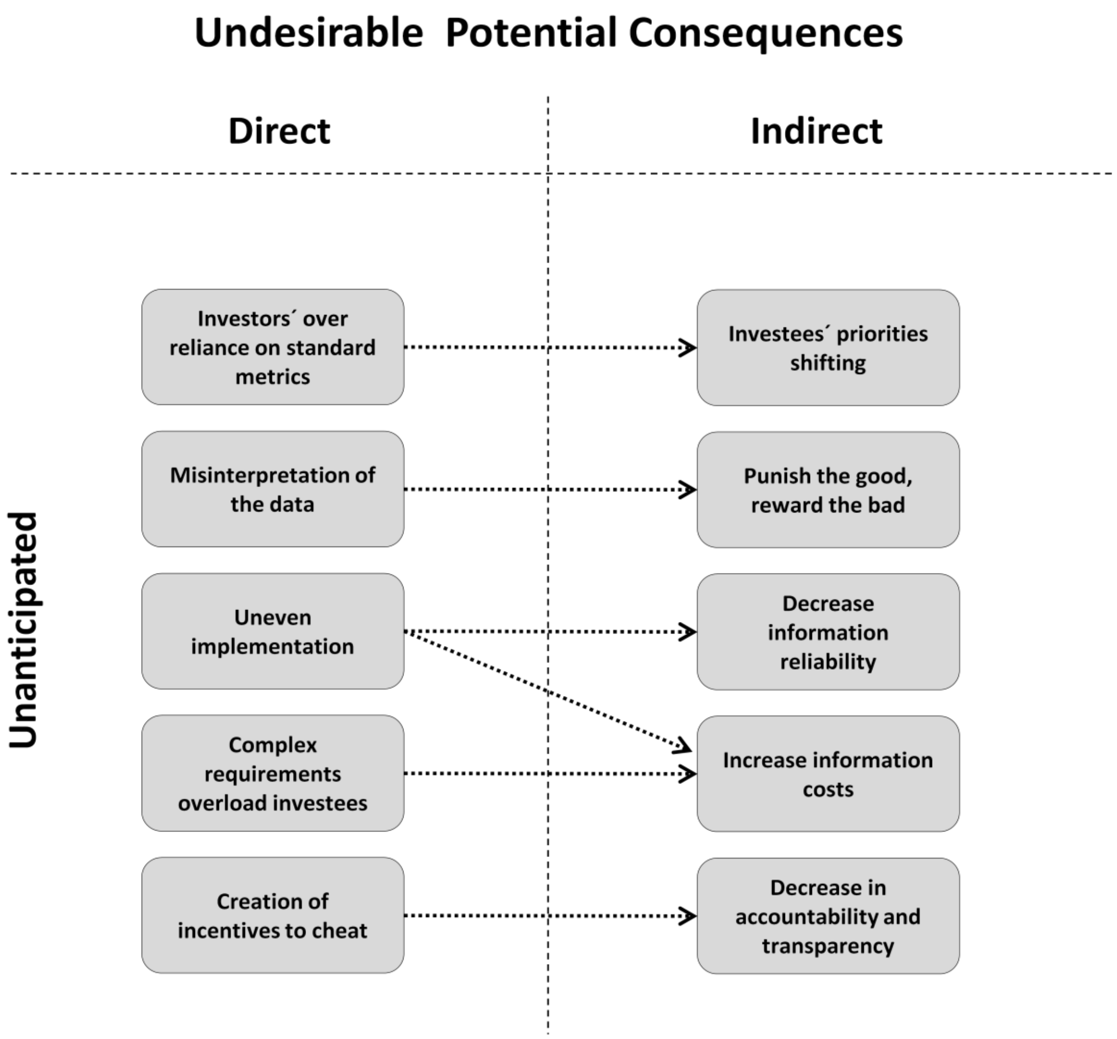
Only anticipated consequences of that type were indentified, that is, all are intended to happen when developing social performance standards.

The three main direct consequences are the possibility to compare data from different sources, as there would be a certain level of uniformity in the meaning of terms, metrics reported and reporting format. From that possibility of putting the performance results in a context and then compare it to peers in the industry, investors could start to learn better what kind of activities are more or less effective, as they could compare themselves; the accountability and transparency would also increase, as common understanding of terms makes the analysis of data much clearer; it would allow the creation of industry benchmarks, which in turn would set performance levels for the organizations and probably would also facilitate the identification of the truly transformational activities. Being able to compare would provide investors a better position to make investment decisions, as social metrics could help them to evaluate how much impact they are getting from their money in comparison to other options of investments.

A second direct consequence would be the possibility to create additional services, such as rating agencies, which could base their impact evaluation in the standard social metrics and definitions. This would be an important step towards creating additional tools that would help investors to make their investment decisions.

A third consequence is that the establishment of standards would provide an existing framework for measuring social performance and reporting it. For investors and social business that do not have the expertise and/or resources to build their own measurement system, this fact would be of high value, reducing the costs of tracking social metrics. It would also decrease the risks for investors, as by adopting a reliable standard they would be more confident that they are tracking and evaluating the right aspects of their investee's activities. Finally, social business might have more than one investor, and in the absence of standards each one would require different reporting formats, have different understanding of terms and social metrics; if all those aspects are standardized, it would significantly simplify the routines for the social business receiving impact investments.

Figure 4: Undesirable Potential Consequences



Following the same logic of the desirable consequences, the undesirable, unanticipated, direct and indirect consequences are presented.

Only unanticipated consequences of that type were indentified, that is, it is assumed that no harmful consequences would be created intentionally.

One possible harmful consequence of social performance standards in the over reliance by investors on the standard metrics. Since performance metrics only tells a small part of the true impact a social business is generating, if investors base their evaluation too much on those metrics, they could be missing important aspects of impact. Consequently, the investees, knowing that investors place a major importance on those metrics, would focus on actions that maximizes it, shifting their priorities to what is really necessary for achieving impact to what can maximize their score according to standards, and doing so might not realize all the potential they have to generate positive social change.

Another potential risk is the misinterpretation of data provided by the standards and benchmarks. The information provided by social metrics, as already mentioned, are not enough to claim or evaluate social impact; to figure out the changes caused in a society due to the activities of an organization require extensive and detailed data collection and analysis. Investors could interpret social performance standards as being metrics of impact, which could lead to a wrong evaluation of what is working and what is not, and maybe punish some of the real impact businesses and rewarding some others that are not so effective. This is also a potential problem of benchmarks; as some social business operate in extremely hard to serve conditions, they are likely to be under the benchmark for their type of activity if the majority of the other organizations are operating in easier to server environments, which doesn't mean that one is necessarily performing better than the other. In this case, by only looking at the standard metrics, and not considering the whole conditions and facts influencing the performance of the social business, unintended negative consequences could result from the decisions.

The implementation of the standards is a key issue; it is likely that the implementation would not be even among the regions, countries, and perhaps not even sectors, as the business models used by the social business and local forces, such as politics or culture, plays a huge influence in the standardization implementation and use. If investors implement and use the standards in non uniform ways, the information and benchmarks will be of no value as investors could not trust the information reported. To avoid it, mechanisms to assure the quality of the implementation of standards and reporting of data would have to be created, and this implies the need for specialists, third-party firms and systems which in turn would increase the costs of quality information generation.

Another fact that could help increasing costs for the social business mainly is that if the standards are complex to implement and use, this would require the allocation of usually scarce resources in the correct adoption of standards. This could not only increase the costs, but also distract the social businesses from their core activities to bureaucratic reporting requirements of standards.

Finally, if standards are developed as a public good, are free to adopt and there are no reinforcement mechanisms in place, it is possible that social businesses adopt it only seeking to take advantage of the credibility that the "brand" of the standard brings, not adopting it for real or worse, reporting fake data. In this case, the transparency of the benchmarks would be extremely low and real impact investors would not be able to differentiate themselves from profiteers, making it difficult to hold social businesses accountable for their real results.

6. CONCLUSION AND FUTURE RESEARCH

In this chapter, the conclusions taken from the research are presented, followed by recommendations of topics for future research.

The need for standards is not still a consensus, but in general there is an inclination in recognizing that there is a need. What is important, though, is that there is still a lot of uncertainty about how those standards can really be useful for investors.

During the execution of this research, I discovered that there is still a huge confusion regarding the meaning of terms used in the industry, and even what really constitutes impact investing; without common understanding about basic things, it will be very difficult to establish any kind of standard for tracking and reporting social performance. I also found that impact investing is becoming very trendy, and clear boundaries to establish what really is and what is not impact investments are essential, to avoid "free riders" to take advantage of the good intentions of people truly committed to social change.

Another important issue is related to the emerging initiatives for establishing standards; the most representative efforts are from institutions based in developed countries, especially from the USA; in my opinion, as much of the work undertaken by social businesses takes place in developing nations, institutions based on those countries have to have greater involvement in the development and diffusion of social performance standards, in order to avoid a bias issue.

There are risks in establishing standards, but most of them can be avoided if the industry understands clearly what exactly the social metrics and definitions mean, if they interpret and use the data correctly, and also if there are reinforcement mechanisms assuring that the data reported is reliable and investors can trust in the benchmarks, and therefore use it in strategic decisions.

Furthermore, social metrics and definitions are really a small part of the impact caused by an activity. It is needed to go beyond the outputs level towards a more detailed evaluation of real impact. If a social business is creating products or services with the intention of causing a positive impact in the world, that does not necessarily means that the people who really need it are benefiting from those products or services; in turn, it could even harm them. By over relying on outputs metrics, important aspects of social change can be missed.

It will take a long time for standards to be widely adopted, but this is not only a question of the standardization process per se, but also about the real potential of the impact investing industry, as the establishment of standards is an important aspect for the industry success, but many other factors will determine whether this new investment concept will realize its potential.

The consequences of any kind of innovation are hard to predict, especially when the environment where the innovation takes place is such a new and complex one like the impact investing industry.

Finally, I would argue that it is still early to take any position about which potential consequences of social performance standards are more likely to become true; nevertheless, investors need to collaborate and be really careful when developing, adopting or interpreting any information related to social performance and impact in order to avoid making decisions that would have unintended negative consequences.

Future Research

The following questions remain unanswered and would be interesting topics for future research in the field of impact investing:

- How to create reinforcement mechanisms that would provide reliability to the data reported from investors and social businesses? Who should create those mechanisms?
- At what level (e.g. sector, country, industry) should social performance benchmarks be created?
- How essential is the wide adoption of social performance standards for the impact investing industry?

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8. APPENDICES

Appendix 1: List of Interviewees

Saurabh Lall, research director at ANDE (Aspen Network of Development Entrepreneurs)

Saurabh Lall leads ANDE’s research initiative, which focuses on understanding the impact of small and growing businesses on poverty and economic development. Saurabh was previously the Research Officer of the New Ventures program at the World Resources Institute, where he studied the investment potential of environmental entrepreneurship in developing countries. Originally from Mumbai, Saurabh has also worked on rural water and sanitation issues in several states across India. He has a Master of Public Policy degree from George Washington University and a Bachelor of Engineering degree from the University of Mumbai. He is currently pursuing a PhD in Public Policy and Administration at the George Washington University, focusing on impact investing and program evaluation (http://www.aspeninstitute.org/people/saurabh-lall).

Allison Basile, Metrics Officer at Grassroots Business Fund

Allison joined the Grassroots Business Fund (GBF) in 2009 and serves as its Metrics Officer, a role in which she oversees the organization's Impact Planning, Assessment and Learning Framework (iPAL). Prior to joining GBF, Allison worked on monitoring, evaluation, and social performance at the Grameen Foundation and the IRIS Center. She earned her B.A. in economics and a minor in international development and conflict management from the University of Maryland, College Park. She spent two summers in East Africa, first as a volunteer with a juvenile detention center in Moshi,Tanzania, and later as a Political Section intern at the US Embassy in Nairobi.

Allison is also a founder of the DC Time Bank, an alternative currency based on time, and Hub DC, a space and platform for social innovators that is connected to a network of spaces around the world (http://www.gbfund.org/meet-the-team#4).

Christian Novak - Chief Investment Officer - TBC Capital Asset Management Inc.

Christian has over 20 years of experience in emerging markets, having worked for JPMorgan, ING, Morgan Stanley and National Bank Financial Group, in their Credit Risk Management, Fixed Income, and Investment Management divisions. He also possesses over 10 years experience in microfinance, sustainable development projects, and impact investing.

Christian is a former member of the Advisory Board at and first social investor of FIS (now Emprenda), the leading MFI in Argentina, where he contributed to the creation of a strategic and creative social debt investment fund (recognized by Ashoka as one of the most creative ideas in 2000). Christian also developed one of Microsave’s most consulted training programs: Capital Structuring and Equity Valuation for MFIs. He is a member of the Loan Committee of ACEM, the leading community loan fund in Montreal. He co-founded and led 2 foundations in Argentina, Fundación Cruzada Argentina and Fundación Makro, respectively aimed at implementing sustainable development projects and fostering education, and he co-founded the Montreal Microfinance Club. Christian has authored several papers and research reports, and he has been an active speaker in microfinance investments and in credit risk management globally.

Christian graduated as a Public Accountant and holds a Bachelor's degree in Business Administration from the Universidad Católica Argentina (http://www.tbccapital.com/about_us.html)

Pernilla Bard – Founder of Social Initiative

Previous to founding Social Initiative, Pernilla Bard worked among other things as management consultant at the Boston Consulting Group and at EF Education. She holds degrees in economics from the Stockholm School of Economics. (http://www.socialinitiative.se/english/about-us/staff-members/)

Brad Presner – Metrics Manager at Acumen Fund

Brad Presner is Acumen Fund's Metrics Manager. In this role, he manages the development of the Pulse social metrics platform and helps define Acumen Fund's performance assessment strategy. He joined Acumen Fund in July, 2008, having worked closely with the Pulse team while an employee of Google.org. He joined Google.org in December 2006, where he led M&E efforts that built a culture of rigorous, thoughtful, analytical impact assessment; he also worked with the portfolio teams to create and track metrics for their initiatives. Prior to Google.org, Brad worked at Google Inc. where he began, and later helped manage, the Business Analytics team in Google's Online Sales and Operations department. Brad began his career as a mechanical engineer at a Silicon Valley hardware company, later working at multiple start-ups in business analytics roles. Brad holds a BS degree in Mechanical Engineering from Stanford University. (http://www.acumenfund.org/about-us/our-team/brad-presner.html)

Appendix 2: Interview Questions

1. When we talk about impact measurement, and the impact of social organizations such as NGOs or social businesses, what is your understanding of the term "impact"?

2. Within the social sector, is there a common understanding about what the term "impact "means?

3. We have recently seen the emergence of efforts towards standardization of social performance metrics and reporting, such as IRIS (Impact Reporting and Investment Standards) Is there a need for such standards in your opinion?

4. What kind of benefits could such standards bring to the impact investing industry?

5. What kind of risks could such standards bring to the impact investing industry?

6. Within the impact investing industry, is there a consensus regarding the need of standard performance metrics and reporting?