Impact Investing Handbook

An Implementation Guide for Practitioners

Steven Godeke & Patrick Briaud

A PUBLICATION OF

ROCKEFELLER Philanthropy Advisors

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For Ted.

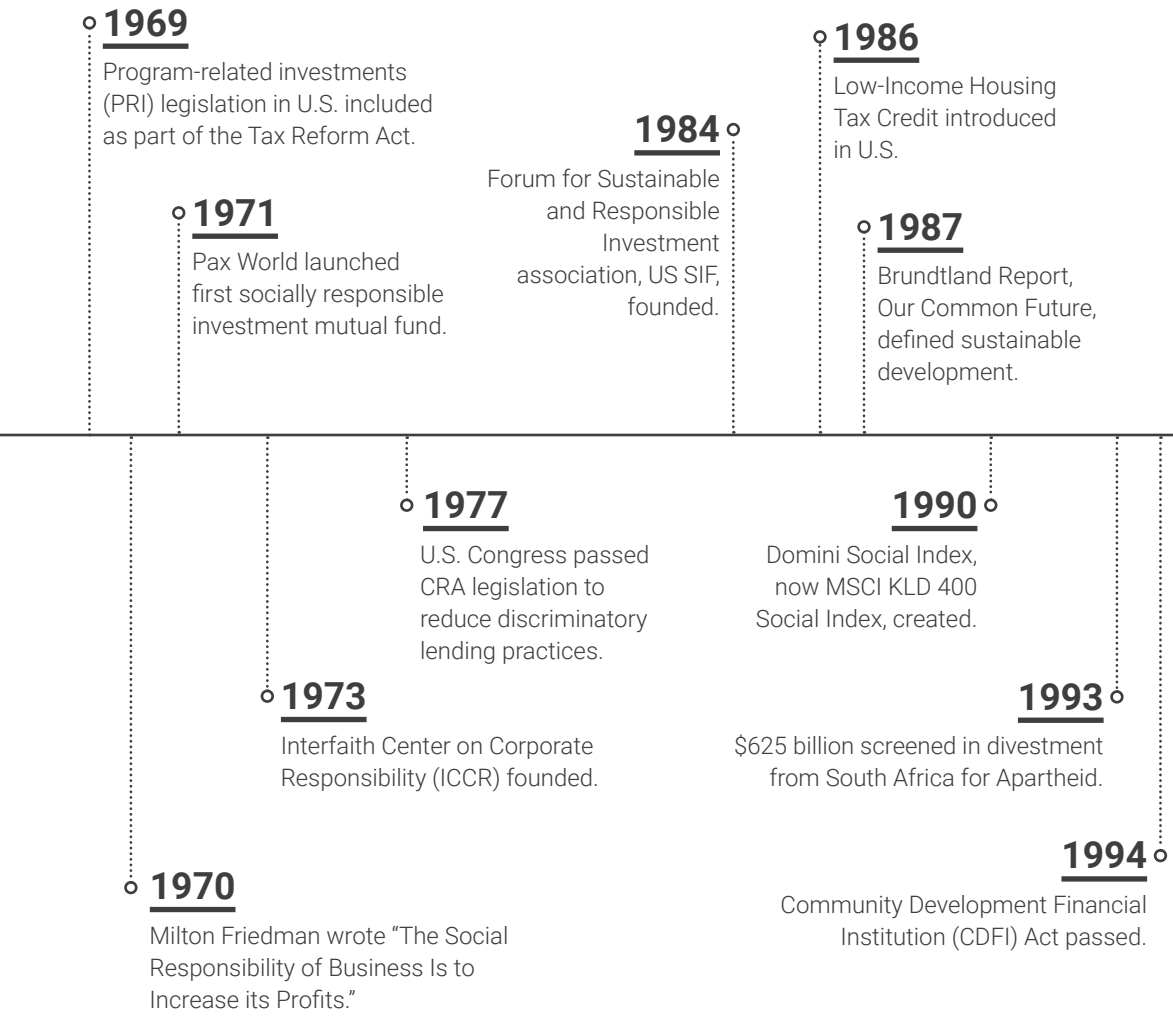
For Angela, my tender companion.

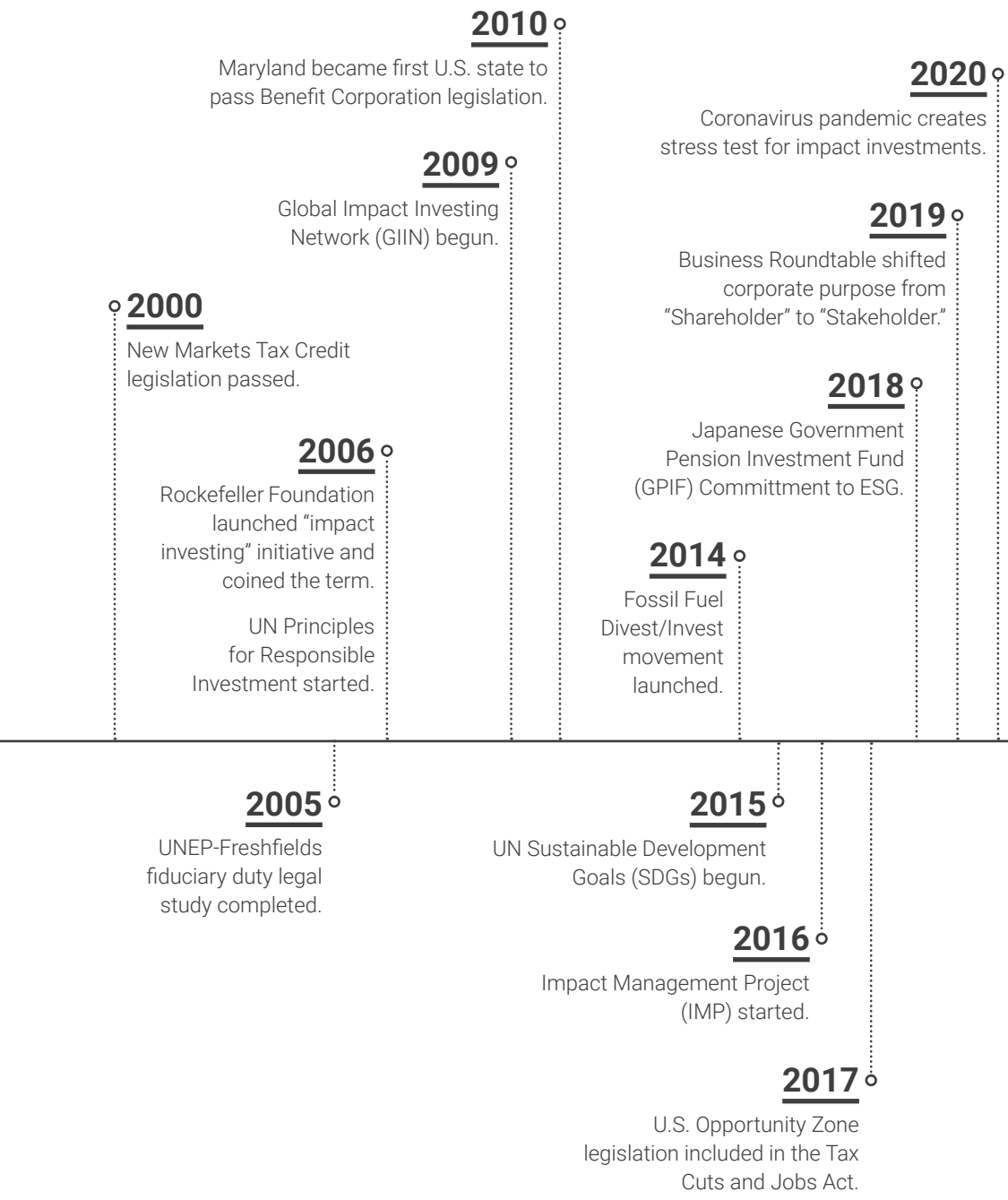
Contents

Case Studies

A Modern History of Impact Investing

The concept of integrating values into investment decisions is not at all new. History is full of these examples: from early religion-based investing to the more recent role of divestment in key social and environmental movements, such as apartheid-era South Africa and fossil fuels. Building on this long history, we are now at the end of an historic decade of significant interest and activity. Past events and recent growth provides the backdrop for this handbook. The following is a sampling of modern impact investing milestones.




2000
New Markets Tax Credit legislation passed.
2005
UNEP-Freshfields fiduciary duty legal study completed.
2006
Rockefeller Foundation launched "impact investing" initiative and coined the term.
UN Principles for Responsible Investment started.
2009
Global Impact Investing Network (GIIN) begun.
2010
Maryland became first U.S. state to pass Benefit Corporation legislation.
2014
Fossil Fuel Divest/Invest movement launched.
2015
UN Sustainable Development Goals (SDGs) begun.
2016
Impact Management Project (IMP) started.
2017
U.S. Opportunity Zone legislation included in the Tax Cuts and Jobs Act.
2018
Japanese Government Pension Investment Fund (GPIF) Committment to ESG.
2019
Business Roundtable shifted corporate purpose from "Shareholder" to "Stakeholder."
2020
Coronavirus pandemic creates stress test for impact investments.

Foreword

Why is a philanthropic service organization publishing a handbook on impact investing? Well, in part it's because we hold an expansive definition of philanthropy. Like many, we see philanthropy as the voluntary use of private resources for public benefit. Nowhere does that concise formulation say this resource can only be money that's donated.

So as the field began to emerge with energy some ten to fifteen years ago, Rockefeller Philanthropy Advisors published two pragmatic guides[1] on creating positive social and environmental impact and public benefit at the intersection of philanthropy and investment. More than 10,000 print copies (and untold downloads) later, we and our advisors made the decision that it was time for a fresh handbook to reflect the broadening and deepening of impact investing during the past ten years. This is a pivotal moment with more than $35 trillion in assets standing behind the Paris Accords fighting climate change, and the world's largest money manager committed to sustainable investing. The idea that one should integrate the search for financial returns with the search for social and environmental impact has gone from heresy to a niche approach to practically business as usual.

Since the publication of our original guides, Rockefeller Philanthropy Advisors has been an active participant in the field, incubating the Global Impact Investing Network (GIIN), Confluence Philanthropy, and the U.S. National Advisory Board on Impact Investing. Currently, the Catalyst Fund (supporting developing world fintech entrepreneurs) and Upstart Co-Lab are among the projects we sponsor. Our guides have been translated into several languages, including Chinese. And we work directly with funders to help them shape strategy and plans for impact investing.

For Rockefeller Philanthropy Advisors, engagement in impact investing is integral to how we fulfill our mission. Impact investing is a powerful force that is reshaping how philanthropy defines its operating models, as we've learned in the research that created *The Philanthropy Framework*.[2] It's a critical tool for fulfilling philanthropy's role in achieving the UN Sustainable Development Goals.[3] Without impact investing, the kind of systems change we need to solve deeply persistent challenges and inequities will continue to elude us.[4] That's part of why we're so optimistic about the next decade for impact investing.

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1 Steven Godeke and Douglas Bauer, *Philanthropy's New Passing Gear: Mission-Related Investing—A Policy and Implementation Guide for Foundation Trustees*, Rockefeller Philanthropy Advisors (2008); and Steven Godeke and Raúl Pomares with Albert V. Bruno, Pat Guerra, Charly Kleissner, and Hersh Shefrin, *Solutions for Impact Investors: From Strategy to Implementation*, Rockefeller Philanthropy Advisors (2009).

2 https://www.rockpa.org/wp-content/uploads/2019/02/The-Philanthropy-Framework-1.pdf.

3 https://www.rockpa.org/project/sdg.

4 https://www.rockpa.org/project/scaling-solutions.

We offer our heartfelt thanks to the funders of this guide—The Sidney E. Frank Charitable Foundation, MacArthur Foundation, The Atlantic Philanthropies, Alabama Power Foundation, Rockefeller Brothers Fund, Skoll Foundation, The Nathan Cummings Foundation, Ford Foundation, Woodcock Foundation, and Porticus—as well as to our expert advisory board, representing 18 leaders from the private, philanthropic, and public sectors. For this new handbook, our team at Rockefeller Philanthropy Advisors is very pleased to collaborate again with Steven Godeke, the lead author of the two previous impact investing publications. More than 40 advance readers gave us valuable reactions, and we're grateful to them as well. Our board of directors has been a staunch source of encouragement, support, and guidance.

Melissa A. Berman
President and CEO
Rockefeller Philanthropy Advisors

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skoll

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THE NATHAN CUMMINGS FOUNDATION

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PORTICUS

Advisory Board Members

Our Advisory Board has worked alongside us during the past year to guide the research and frame the handbook, while providing detailed feedback with each draft. The handbook has benefited greatly from their guidance, expertise, and support.

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Contributors

During the course of our project, we also conducted a series of interviews with the following impact investing advisors who shared their insights about their direct work with clients and the state of the field.

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We would also like to acknowledge the two impact investing practitioner monographs Rockefeller Philanthropy Advisors produced a decade ago, including coauthors Doug Bauer and Raúl Pomares. As this topic and field continues to evolve, we have sought to continue the tone and approach of these previous guides by providing practical, objective, and actionable resources for practitioners.

Finally, please let us know what you think. Send any comments or feedback to info@rockpa.org. We hope you find this guide useful and meaningful to the important work of creating positive impact through investment.

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Godeke Consulting

Patrick Briaud
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About the Authors

Steven Godeke

Founder
Godeke Consulting

Through his consulting, writing, and teaching, Steven has worked at the intersection of investment and mission since 2001. His practice helps families and foundations create impact investing strategies and connects them with the right partners and resources. His clients have included the Rockefeller Foundation, Ralph E. Ogden Foundation, Robin Hood Foundation, Voqal, Heron Foundation, KL Felicitas Foundation, MacArthur Foundation, The World Economic Forum, American Jewish World Service, and Principles of Responsible Investment as well as investment management firms such as PGIM, Deutsche Bank, and Domini Impact Investments. Steven speaks at industry, philanthropic, and academic gatherings such as Responsible Investor, Bloomberg, and Confluence Philanthropy.

Steven is currently adjunct professor of finance at New York University's Stern School of Business, where he created and now teaches Investing for Environmental and Social Impact and Impact Investing in Family Offices. He has served on the board of the Jessie Smith Noyes Foundation, a private family foundation that focuses on social justice and has a long history of aligning its investment and mission goals. Steven served as board chair and led the Investment Committee at Noyes. Steven has been at the forefront of knowledge building for the impact investing industry through several publications. He is the author of *Building a Healthy and Sustainable Social Impact Bond Market: The Investor Landscape*; *Solutions for Impact Investors: From Strategy to Implementation*; and *Philanthropy's New Passing Gear: Mission-Related Investing, A Policy and Implementation Guide for Foundation Trustees*.

Prior to establishing his own firm, Steven worked in corporate and project finance at Deutsche Bank, where he structured debt and equity products and advised corporate clients in the natural resources, telecommunications, media, and real estate industries. Steven grew up on a family farm in Southern Indiana and attended Purdue University, where he received a BS in Management and a BA in German. He studied as a Fulbright Scholar at the University of Cologne and earned an MPA from Harvard University.

Patrick Briaud

Senior Advisor, Impact Investing
Rockefeller Philanthropy Advisors

As lead advisor for Rockefeller Philanthropy Advisors' Impact Investing Practice, Patrick helps individuals, foundations, and corporations use a range of assets to achieve their social-impact goals. His expertise includes consensus building, theories of change, portfolio construction, corporate social responsibility, and program-related investments. In addition to advising asset owners on mission-aligned investment strategies, he oversees four customized portfolios of charitable investments including debt, equity, and recoverable grants. Patrick is also steeped in corporate social responsibility (CSR), helping companies with a full range of tools from employee engagement, grantmaking, pro-bono services, and signature programs.

Patrick leads RPA's impact investing thought leadership, including coauthorship of this handbook as well as two impact investing primer guides commissioned by the Bill & Melinda Gates Foundation: *Introduction*[5] and *Strategy & Action*.[6] Working closely with the Ford and Skoll foundations, Patrick leads one of three working groups for the *Scaling Solutions Toward Shifting Systems*[7] project, focused on the role of return-seeking capital toward an impact economy. He regularly speaks at industry events and contributes to relevant media outlets, including Mission Investors Exchange, SOCAP, Thomson Reuters, *Fast Company*, *Barron's*, and *Financial Advisor Magazine*.

Prior to Rockefeller Philanthropy Advisors, Patrick was head trader and investment analyst at Lee Financial Corporation in Dallas. He led trade execution along with marketable-securities due diligence for LFC's $900M portolio. As a professional tennis player, he earned a world doubles ranking of 125 and played in Wimbledon 2008. He earned a BS in Industrial Engineering and Operations Research from the University of California, Berkeley, and an MBA from Yale's School of Management.

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5 https://www.rockpa.org/guide/impact-investing-introduction.

6 https://www.rockpa.org/guide/impact-investing-strategy-action.

7 https://www.rockpa.org/project/scaling-solutions.

What to Know About This Guide

We designed this guide to present you, the impact investor, with the tools to develop and execute a tailored impact investing strategy. We aim to provide an objective, agenda-free resource that will inspire readers while also being realistic about the limitations and possibilities of this increasingly popular investment strategy. We will propose new approaches while keeping the principles of traditional investing in mind.

This guide will be most relevant to mission-driven asset owners, such as private and community foundations, endowments, high-net-worth (HNW) individuals and families, seeking to drive social and environmental changes through their investments. These investors want to be accountable for all of the impacts of their assets—both positive and negative. While retail investors, wealth advisors, and large institutional investors are not the primary audience of this guide, we hope that the process and tools are valuable to them as well.

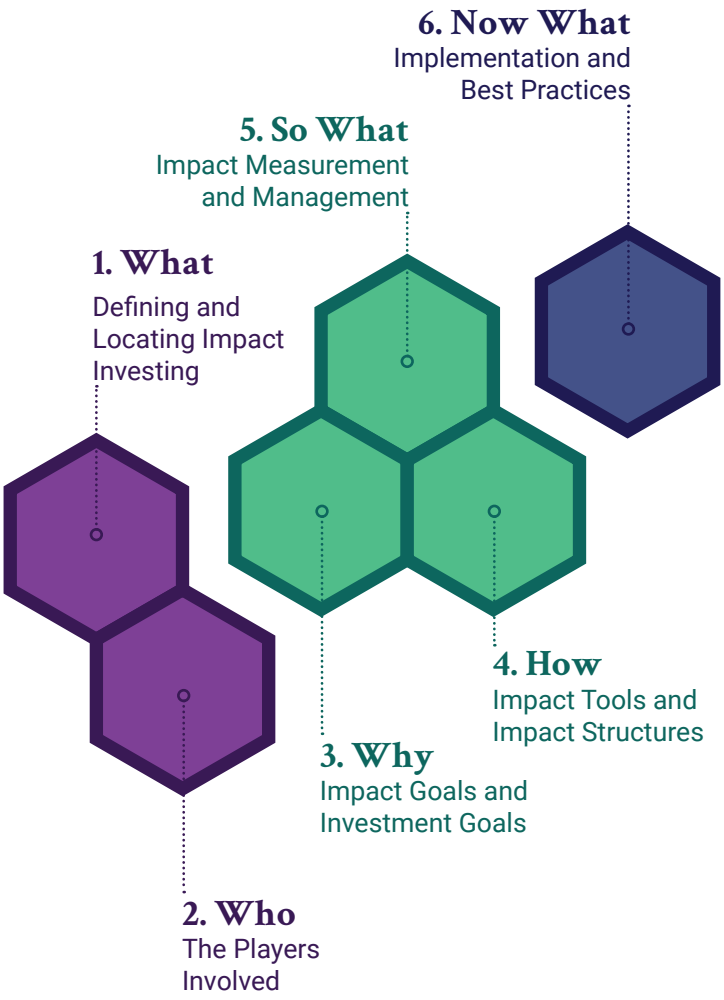
As industry observers and practitioners, we created this roadmap to offer some common methods to achieve the varied impact objectives of asset owners while also building upon traditional investing frameworks. We will define impact investing broadly and apply it across a wide array of approaches and asset classes—from the global public equity and debt markets to less liquid markets and more catalytic strategies.

How to Use this Guide

We have structured the guide to answer a series of fundamental questions about impact investing. Placed in a sequence, these questions—and each corresponding Practitioner Exercise—become the building blocks of your own impact investing implementation plan.

In the "What" chapter, we place impact investing at the intersection of philanthropy, investment, and policy while identifying its boundaries. The "Who" chapter describes the landscape of key market participants and stakeholders and provides the first steps for you to understand who you are as an impact investor. We then move into "Why" investors pursue impact investing to help you develop relevant goals and map them onto a theory of change—the central anchor for your impact investing process. These goals inform "How" you can use the right structures and tools—for both impact and investment—in order to build an impact investing portfolio. Finally, we look at how investors can measure success in "So What," and then share concrete organizing approaches and best practices in "Now What."

Impact Investing Roadmap

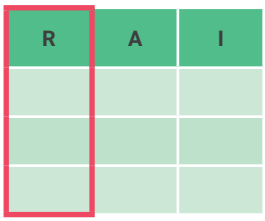


Practitioner Exercises

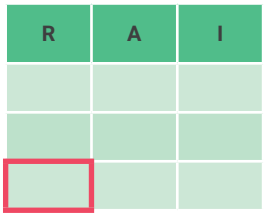
Each chapter presents key field-level concepts, practices, and case studies. At the end of each chapter, we help you apply these concepts to your own context and experience through a series of framing questions and Practitioner Exercises. We also follow Sophia, a hypothetical impact investor, as she and her family follow these exercises to develop and implement an impact investing strategy. The Practitioner Exercises and Sophia Examples build throughout the handbook using the following framework: (1) What Resources—financial, human, and social—do you have; (2) What Activities do you hope to engage in; and (3) What Impact do you hope to see. Chapter by chapter, you can also see how Sophia uses the Practitioner Exercises to create important tools such as a Resource Inventory, Stakeholder Map and Power Analysis, her own Theory of Change, a customized Investment Policy Statement and Impact Measurement and Management Plan, and finally an Implementation Plan. The framework below maps out how the Practitioner Exercises relate to each other.

Resources What Resources (financial, human, and social) do you have?	**Activities** What Activities do you hope to engage in?	**Impact** What Impact do you hope to see?

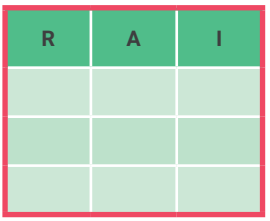
Chapter 1: What
Resource Inventory



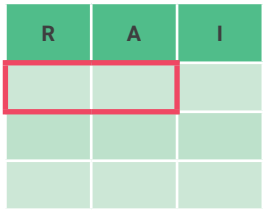
Chapter 2: Who
Stakeholder Map and Power Analysis



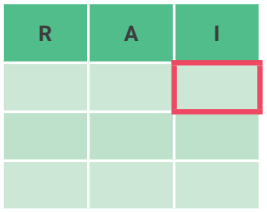
Chapter 3: Why
Initial Theory of Change



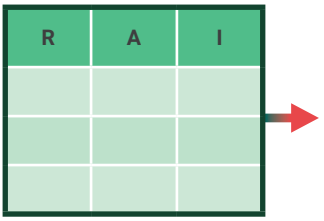
Chapter 4: How
Investment Policy Statement



Chapter 5: So What
Impact Measurement and Management Plan



Chapter 6: Now What
Implementation Plan



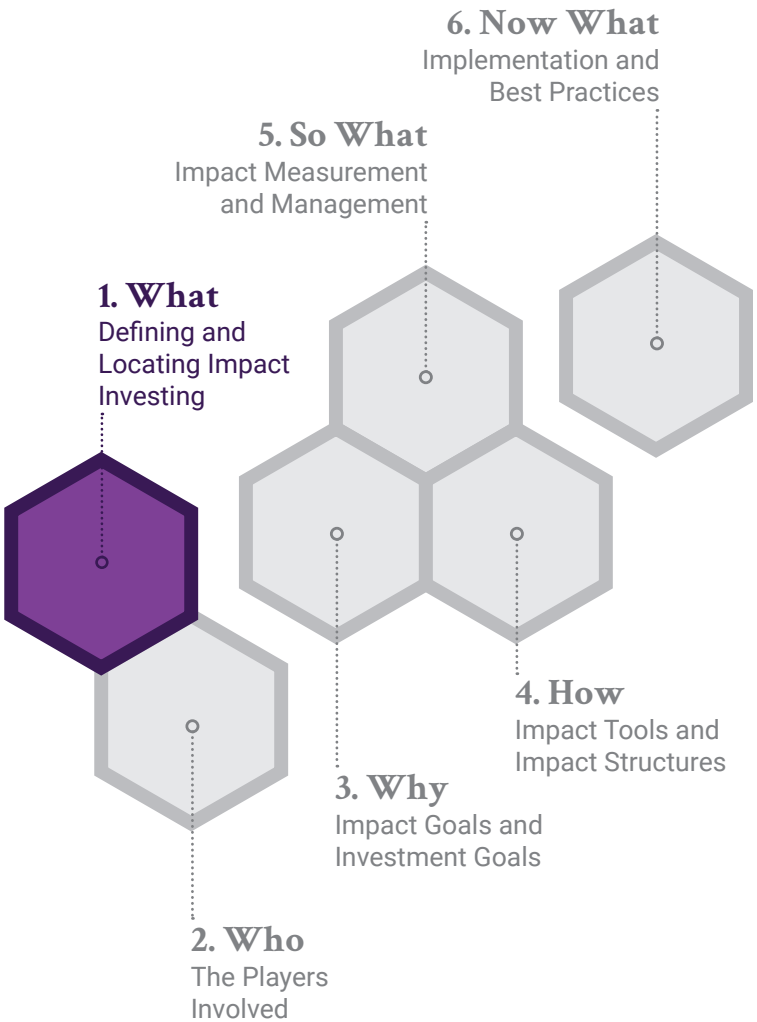
While the design of this impact investing roadmap is linear, you can move directly to areas of specific interest. Whether you are an individual, a family, or an institution, we want to help you find the right entry point to first begin and then continue your impact investing strategy. Some investors may undertake elements of the roadmap simultaneously or go deeper into specific sections. We have included best practice case studies that highlight elements of the guide along with additional resources. Where numerous primer guides cover trends, definitions, and products, the bulk of this publication will focus on the Why and the How. Our goal is for readers to finish the guide not only with essential current knowledge from the field but also with the resources and customized tools needed for them to take action with their investments.

We invite you to begin your own impact investing journey.

CHAPTER 1

What

Defining and Locating Impact Investing



All Assets Have Impact

> All Investments have impact—both positive and negative.

> Impact investments are made with the intention to generate positive, measurable social, and environmental impact alongside a financial return.

These two statements help us locate and define impact investing and reflect the two distinct faces of impact investors:

Investors as Engaged Asset Owners *and* Investors as Intentional System Changers.

Impact is broadly defined as any meaningful change in the economic, social, cultural, environmental, and/or political condition due to specific actions and behavioral changes by individuals, communities, and/or society as a whole. For investors, impact means a deeper accountability for all of the positive and negative impacts of our assets and our intentional use of those assets to make a positive difference for society and the planet.

Investors as Engaged Asset Owners

The most important element in the definition of impact investing is that **all investments have impact**.

As investors, we are increasingly aware that our assets create impacts in the world—both positive and negative. Your current investment portfolio is made up of enterprises,[8] funds, real estate, and other financial instruments that exist in and influence a dynamic world. They have supply chains, employee practices, products and services, leadership teams, and environmental footprints. Impact investing is a tool you can use to develop your impact goals and shift the net impact of your portfolio toward the outcomes you are seeking.

In recent years, "knowing what you own" has become the motto of impact investors. Our decisions as consumers, investors, philanthropists, and citizens can have both positive and negative impacts. We have the ability to make these decisions in ways that align with our personal values or organizational mission. Due to better data, transparency, and tools, we have an expanded ability to articulate our values through our assets. As engaged owners who consider this impact, we are able to shift portfolios away from the investments we view

8 We will use the word "enterprise" to refer to all investable entities, such as companies, investees, partnerships, projects, etc.

EXHIBIT 1-1

An Evolving Strategy: All Investments Have Impact

Heron Foundation

In 1996, the Heron Foundation decided to reframe its mission and be more than a private investment company that only used its excess cash flow for charitable purposes. It chose to move away from the standard foundation practice of allocating 95% of its assets to investments and 5% for charitable giving by moving to mission-related investing. After shifting to this new paradigm, the foundation built out its mission-related investing to 40% of its total endowment. In 2012, Heron decided to move all of its assets to support its mission. "For the F.B. Heron Foundation, all financial investing is a direct means to enact strategy so our fundamental question for deployment of all capital will be: What is the highest and best use of this asset for furthering our mission?" By the end of 2016, Heron moved the last unscreened piece of its endowment to a slate of impact-aligned exchange traded funds (ETFs). Heron is committed to further optimizing its portfolio to better align with its mission.

Source: F.B. Heron

as negative and move them toward the positive. This reframing of what it means to be an asset owner continues to expand. The Heron Foundation's pioneering journey, outlined in Exhibit 1-1, describes this change in the foundation's understanding of its role as an investor.[9]

The Philanthropic Paradox

Impact investing is trying to address what is known as the philanthropic paradox: Philanthropy can aim to solve problems that may have been caused by the source of a donor's wealth. A growing movement questions whether wealth generated by businesses that cause harm should be lauded for their charitable activity. Two examples of this paradox include Purdue Pharma and the Sackler family's philanthropy resulting from the profits of opioids, and the negative effects on the climate coming from the Rockefellers' oil wealth. This paradox also exists on a personal level, as we seek to manage the carbon footprint of our investments, make sustainable purchases, or avoid investing in companies that may increase inequality. By internalizing the social and environmental effects of capital, impact investing attempts to reduce these misalignments. Large institutional investors, who have historically focused solely on the financial results of their portfolio companies, are redefining who they are as investors by calling for corporations to consider their effects on the planet and society rather than exclusively focus on maximizing shareholder value. In Exhibit 1-2, the leader of BlackRock, the world's largest asset owner, clarifies this call for corporate purpose.[10]

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9 Clara Miller, *The World Has Changed and So Must We* (New York: Heron Foundation, 2012), https://www.heron.org/engage/publications/world-has-changed-and-so-must-we.

10 Larry Fink, "Larry Fink's Letter to CEOs," BlackRock (2019), https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

EXHIBIT 1-2

Purpose, Profits, and World's Largest Asset Owner: BlackRock

Companies pay attention to Larry Fink, chairman and CEO of BlackRock, the world's largest asset owner. In the last few years, he has written letters to the CEOs of BlackRock's portfolio companies calling for an end to the primacy of profit and articulating how purpose is interconnected with profits. He draws on a tradition of understanding a corporation as being responsible to a broader range of stakeholders beyond just shareholders:

> "Purpose is not a mere tagline or marketing campaign; it is a company's fundamental reason for being—what it does every day to create value for its stakeholders. Purpose is not the sole pursuit of profits but the animating force for achieving them. Profits are in no way inconsistent with purpose—in fact, profits and purpose are inextricably linked. Profits are essential if a company is to effectively serve all of its stakeholders over time—not only shareholders but also employees, customers, and communities."

Video

For a discussion between Larry Fink and Darren Walker, president of the Ford Foundation, please follow this video link from the Aspen Ideas Festival.[11]

Investors as Intentional System Changers

We now live in a world of increasingly open systems, and impact investing promises to create innovative and effective new investment products at the boundaries of existing systems. Many people believe that the complex challenges and wicked problems[12] facing the world today can only be solved through integrated approaches to policy, philanthropy, and investment. A wicked problem is a social or cultural problem that is difficult or impossible to solve for as many as four reasons: incomplete or contradictory knowledge, the number of people and opinions involved, the large economic burden, and the interconnected nature of these problems with other problems. Systems change is about addressing the root causes of social and environmental problems, which are often complex and embedded in networks of cause and effect. It is an intentional process designed to fundamentally alter the components and structures that cause the system to behave in a certain way (we will further explore systems and systems change as part of "Why" in Chapter 3). Investment has become a fundamental component and influencer of systems. Our world has become more integrated, but frameworks and practices remain largely separate—with the private sector actors, policy makers, and philanthropists staying in their own lanes.

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11 Aspen Ideas Festival, https://archive.org/details/theaspen-2019_Aspen_Ideas_Festival_Opening.

12 The concept of wicked problems was introduced by Horst W. J. Rittel and Melvin M. Webber, "Dilemmas in a General Theory of Planning," *Policy Sciences* 4, no. 2 (1973): 155–69.

Although systems change is traditionally viewed as the realm of policy makers and philanthropists, impact investors introduce investment capital as an additional tool to change systems.

Intentionally or not, investors change systems. As impact investors become more accountable for their assets, they have the opportunity to engage with other stakeholders who have not historically been involved in the investment process. An investor is just one of many stakeholders in the impact investing ecosystem. Investors rely on their investments to eventually create impact on the ground level. Impact investing can trigger legitimate debates about the appropriate roles and boundaries among the private, public, and nonprofit sectors. For example, the charter school movement in the United States, in which private organizations receive public funding to construct and operate schools, has attracted both accolades and criticism. The model has been touted as a critical innovation to address underperforming schools, but it is also criticized for questionable effectiveness and negative effects on public school systems.

Investors are not elected democratically, so questions also arise about the legitimacy of them using financial power to establish priorities for social and environmental spending. Some investors may try to use impact investing for bridging gaps in public services or incentivizing nonprofits to create more financially sustainable business models. However, a lack of public funding does not automatically mean impact investing will be a better solution. Some stakeholders view impact investing as an inadequate and inefficient tool for driving environmental and social rights and, therefore, will favor clearer regulation and enforcement. Successful impact investing will not solve these debates, but investors need to understand how their deployment of capital can be viewed and judged by other stakeholders.[13]

Aggregating Utility Curves

In traditional investing theory, financial returns are simply a means to achieve the end goal of consumption. In other words, the benefit—called "utility" by economists—comes from consumption, not from investment. This makes financial returns fungible. Under this assumption, the utility we receive from an investment in an oil refinery would be the same as an investment in a solar farm, assuming the risk-adjusted financial returns are equal. Exhibit 1-3 summarizes the distinctions between impact investing and traditional investing.

Incorporating impact into an investment makes transferability and comparability of impact difficult. In other words, any generated impact creates utility for the investor, as well as for the planet and society—independent from financial return. This blurring of utility and financial return is driven by an impact investor's dual objectives of doing well financially while also creating social good.

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13 For recent critiques of the role of philanthropic wealth, see Anand Giridharadas, *Winners Take All: The Elite Charade of Changing the World* (New York, NY: Alfred A. Knopf, 2018); Edgar Villanueva, *Decolonizing Wealth: Indigenous Wealth to Heal Divides and Restore Balance* (San Francisco, CA: Berrett-Koehler, 2018); and Rob Reich, *Just Giving: Why Philanthropy Is Failing Democracy and How It Can Do Better* (Princeton, NJ: Princeton University Press, 2018).

EXHIBIT 1-3
Traditional vs. Impact Investing

	Traditional Investing	Impact Investing
Utility/Benefit	Utility/benefit comes from consumption, not investment	Utility/benefit to an investor varies depending on the investment's environmental and social impact
Fungibility	Investments fungible across investors	Impact investments not fungible across investors
Deployment	Investments primarily deployed based on risk and return	Investments deployed with additional considerations of environmental and social benefits

Core Components of Impact Investing

As defined by the Global Impact Investing Network (GIIN), **impact investments are made with the intention to generate positive, measurable social and environmental impact alongside a financial return**. From this definition, the two key components are the *intention* and *measurement* of the investor toward both a social and financial return. With not as much industry consensus, some also argue that a critical third component is *contribution*. It is important to point out that each component is an attribute of the investor rather than of an investee or an investment product.

Intention

The first component of impact investing is *intention*. The investor must have the intention to achieve both financial returns and positive impact. In this way, impact investing is a prism through which the investor makes decisions. It is possible for two investors to make similar investments, though only one is making an impact investment. For example, two investors in electric car manufacturing (U.S.-based Tesla and China-based BYD) may have different intentions for making the investment. Investor A makes this investment for purely financial reasons, while Investor B includes a reduction in carbon emissions as one of the priorities. In this simple example, Investor B has the critical intention of making an impact investment.

Measurement

The second critical component to impact investing is *measurement*. Financial measurement is standard practice for most investments, but the impact investor must also seek to measure the impact of the investment. As with philanthropy, the measurement of impact is nuanced and the approaches vary widely—from annual impact reports, quarterly key performance indicators (KPI) reporting, or structured qualitative evaluations. Given that impact measurement is a new field without widely accepted standards, we are not prescriptive in the approach. However, we do want to emphasize the importance of measurement in some form at initial selection and throughout the life of the investment, at both the portfolio and transaction level.[14] Like intention, impact investors can seek and measure different impacts from the same investment. "So What" in Chapter 5 will address impact measurement and management in more detail.

Contribution

Some impact investors also include a third variable: *contribution*, also known as *additionality*. This variable requires an investment to meet a "but for" test: But for your investment, would the impact goals have occurred anyway? Paul Brest and Kelly Born define[15] this variable as "an increase in the quantity or quality of the enterprise's social outcomes beyond what would otherwise have occurred." The inclusion of contribution as a hard boundary of impact investing is still being debated.

In its report on the state of the impact investing field, the International Finance Corporation (IFC) segmented the impact investing market by asset classes (see "How" in Chapter 4 for an explanation of asset classes), then assessed whether specific asset classes have the impact investing attributes of intent, contribution, and measurement (see Exhibit 1-4). You will notice that the IFC concluded that contribution readily occurs in private markets, while it is more difficult to demonstrate in the public markets.

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14 For high-level trends of measuring impact investing, refer to this report by the Rockefeller Foundation. Jane Reisman and Veronica Olazabal, *Situating the Next Generation of Impact Measurement and Evaluation for Impact Investing*, The Rockefeller Foundation (December 7, 2016), https://www.rockefellerfoundation.org/report/situating-next-generation-impact-measurement-evaluation-impact-investing.

15 Paul Brest and Kelly Born, "Unpacking the Impact in Impact Investing," *Stanford Social Innovation Review: Informing and Inspiring Leaders of Social Change* (2013), https://ssir.org/articles/entry/unpacking_the_impact_in_impact_investing#.

EXHIBIT 1-4

Investors, Types of Assets, and Whether They Have the Three Distinctive Attributes of Impact Investment

	AUM		**Defining Attributes of Impact Investment**		
Asset Pool	US $, billions (2018)	**Market(s) of Operation**	**Intent** for social or environmental impact	Credibly established **contribution** to the achievement of impact	**Measurement** of improvements in social or environmental outcomes
Outstanding Private Sector Operations Portfolio of 25 HIPSO Signatory DFIs	$742	**Private**	**YES**, the investor has an explicit mandate to promote social and economic impact	**YES**, insofar as the investor can: (a) change the investee's cost of capital, (b) transfer knowledge or technology to investees, or (c) exert influence that induces investees to improve relevant outputs or processes	**YES**, the investor uses indicators to assess whether the investment contributes to improvement
Non-Treasury Assets of 81 Development Banks	$3,083				
Private Investment Funds with Intent for and Measurement of Impact	$71				
Green and Social Bonds Outstanding	$456	**Public and Private**	**POSSIBLY**, one might purchase the product with intent to create social or environmental value The manager's marketing materials may emphasize "sustainable" or "responsible" investment, rather than "impact" Alternatively, one might purchase the product with a desire to gain (or reduce) exposure to ESG risk factors		**POSSIBLY**, to the extent indicators are reported by investees
ESG integration strategies*	$10,369			**NO**, particularly in public portfolios, strategies are unlikely to (a) change investee's cost of capital in the presence of other investors indifferent to social or environmental impact. Further, limited direct relationship with investees precludes managers from (b) transferring knowledge or (c) exerting influence	
Negative screening of securities (e.g., "sin" or "dirty" stocks)*	$15,023			**NO**, securities negatively screened may end up being held by those who would prefer to produce less social value	
Corporate engagement and shareholder action*	$8,365			**UNCERTAIN**, given board members' fiduciary duty of obedience to shareholders who are indifferent to social value	**YES**, through reporting on whether engagements and actions are successful

**Values refer to year-end, 2015.*

Sources: Preqin, Impact Base, Impact Asset, EMPEA, Symbiotics, Bloomberg, Thompson Reuters, Global Sustainable Investment Alliance, PwC, and Development Bank annual reports. Note: Asset values are not mutually exclusive.

Source: IFC, Creating Impact—The Promise of Impact Investing, 2019, page 15.

Impact Investing Misconceptions

A number of prevalent misconceptions exist about impact investing.

Fallacy 1: *Considering impact or values in investment decisions violates fiduciary duty*. A summary[16] of interviews with policy makers, lawyers, and senior-investment professionals shows that "failing to consider long-term investment value drivers, which include environmental, social, and governance issues, in investment practice is a failure of fiduciary duty." The Business Roundtable has also released a new Statement on the Purpose of a Corporation signed by 181 CEOs who commit to lead their companies for the benefit of all stakeholders—customers, employees, suppliers, communities, and shareholders.[17] We will explore fiduciary duty further in "Who" and "Now What" in Chapters 2 and 6.

Fallacy 2: *An inherent trade-off exists between impact and financial returns*. Empirical evidence suggests otherwise. A meta-study[18] of 2,000 other studies finds a positive correlation between environmental, social, and governance (ESG) considerations and corporate financial performance. To be clear, the data is still in its early days; the key is that no conclusive evidence indicates impact considerations inherently lower returns. A study[19] by Nuveen TIAA finds "no statistical difference in returns compared to broad-market benchmarks, suggesting the absence of any systematic performance penalty. Moreover, incorporating environmental, social, and governance criteria in security selection did not entail additional risk."

Fallacy 3: *Impact investing is an asset class*. Impact investing is not dependent on a particular asset class, investor structure, corporate form, or investment tool. As you will see in the "How" chapter, impact can be achieved across a full range of tools and approaches.

We will further address these misconceptions throughout the guide.

16 Rory Sullivan, Will Martindale, Elodie Feller, and Anna Bordon, *Fiduciary Duty in the 21st Century*, Fiduciary Duty 21 (2019), https://www.unepfi.org/fileadmin/documents/fiduciary_duty_21st_century.pdf.

17 "Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans,' " Business Roundtable (2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans.

18 Gunnar Friede, Timo Busch, and Alexander Bassen, "ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies," *Journal of Sustainable Finance & Investment* 5, no. 4 (2015): 210-33, https://www.tandfonline.com/doi/pdf/10.1080/20430795.2015.1118917.

19 Amy O'Brien, Lei Liao, and Jim Campagna, "Responsible Investing: Delivering Competitive Performance," Nuveen TIAA Investments (2017), https://www.tiaa.org/public/pdf/ri_delivering_competitive_performance.pdf.

Spectrum of Impact Investing Approaches

Given the field's growth and increased number of actors, the last ten years have also seen a proliferation of definitions and terminology related to impact investing. In fact, strong opinions prevail regarding whether or not the term "impact investing" is the best to capture this field. While some prefer mission-related investing or sustainable/responsible investing, we have chosen to use impact investing. We ask you not to focus on the term, but rather on the core approaches. We will explore the Who question in the practitioner exercise at the end of this chapter and throughout Chapter 2. As you will see in the "Why" chapter, we argue that knowing your *Why* is more important than the definition so that you can measure success against your stated goals.

Rather than arguing about the terms, we propose three approaches and one overarching strategy to describe impact investor practices. Depending on who you are—and your goals and capacity—you may have the resources and willingness for some but not all of these approaches. We will build out and expand on these approaches as we move through the guide.

We see the image of the home as a good metaphor (Exhibit 1-5) for describing these approaches to managing and being accountable for your assets.

Clean Up: This approach reflects the belief that your assets should align with your values, and by holding or divesting specific assets you can increase that alignment and express your values. For example: Clean and remove toxins.

Renovate: In this approach, you select assets based on specific investment criteria that define eligible and ineligible investments with the goal of incorporating the positive and negative externalities into your investment decision. For example: Paint your house.

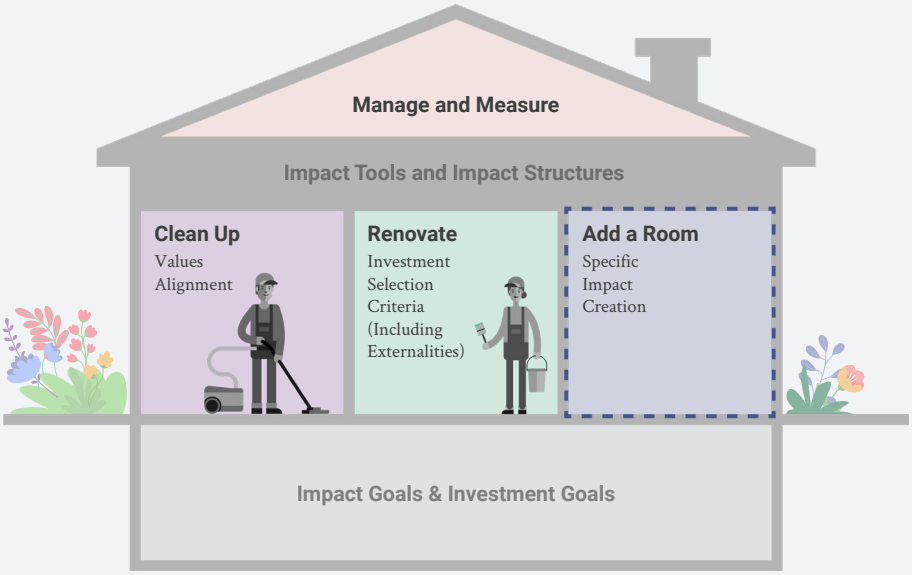
Add a Room: By picking a specific theme, you are using your capital to drive the generation of a specific environmental or social impact. For example: Add a new addition to your house.

Manage and Measure: This overarching strategy is to continuously measure and manage the positive and negative impact of your assets and respond to new data and events. You will track the emergence of new environmental and social movements, as they become impact investment products.[20] For example: Maintain and repair your roof.

We use the umbrella term impact investing to encompass all of these approaches.

20 The Impact Management Project (IMP) has developed an ABC framework to describe the three distinct approaches that an investor can use to create impact: avoid harm, benefit stakeholders, and contribute to solutions. We will revisit these IMP approaches in Chapter 5.

EXHIBIT 1-5
Spectrum of Impact Investing Approaches



These approaches can all be executed to meet the impact investing criteria of investor intention, measurement, and contribution. These methods do not assume specific risk/returns or asset classes or impact intensities. **They are not mutually exclusive and can be pursued together across portfolios and/or within the same investment**. In the past, these approaches have sometimes been connected to specific return/impact trade-off assumptions that have not addressed the underlying impact goals but rather followed existing industry, sector, and product norms. The house will be expanded later in the guide, at which point we will attach specific tools and structures to each of these approaches.

In the Land Beyond Trade-offs

Impact is not simply a third dimension of the financial risk/return relationship that can somehow be optimized. Impact may occur independently from or not be directly correlated to risk and return. A simple trade-off of financial return does not exist for impact. The

concepts of impact-first and financial-first investors have been helpful constructs, but this binary is no longer adequate and also embeds an unfortunate trade-off mentality. As outlined in a recent ImpactAlpha podcast series, "In the Land Beyond Trade-offs, investors know their own objectives for social and environmental impact and craft investment strategies and portfolios that fit their unique appetites for risks and returns."[21] The Omidyar Network has also created a helpful spectrum of investment options that create social value.[22]

We have now reached a juncture in impact investing where we can have a clearer understanding of when combining impact and investing is additive. With expanding data, transparency, and measurement tools, we can now test our impact investments and adjust our approaches in a way that was unimaginable a few years ago. Nevertheless, impact investing cannot simply replace public support or philanthropy and multi-sector innovation is not always the best approach. Combining these tools may raise legal and regulatory considerations as our legal system operates in silos—with corporate law distinct from the rules affecting tax-exempt organizations. We need to understand the boundaries between impact investing and these other tools while seeking out the contexts in which impact investing will be the best tool to achieve our goals.

Recent Trends and Drivers

Interest and activity for impact investing have surged during the last ten years. Using one of the broadest definitions of impact investing as defined by the US SIF, sustainable and responsible investing from U.S.-based asset owners has grown more than 300% since 2012 to a current market size of $12 trillion or 26% of total assets under professional management. In Exhibit 1-6A, these assets under management are categorized using specific investment-selection criteria, Shareholder Advocacy, or a combination of these strategies.

The market size is under debate, with current estimates ranging from $500 billion to $12 trillion. This variance is the result of the roles and goals of specific investors and the definitions they use for reporting. For example, the $12 trillion estimate could include the assets of an entire pension fund, even if it is using single-issue screening such as tobacco that reflects only 1% of the fund, while the GIIN uses a more conservative bottoms-up survey methodology, which leads to a total market size of roughly $715 billion.[23] Regardless of the market-sizing approach, impact investing is a rapidly growing field.

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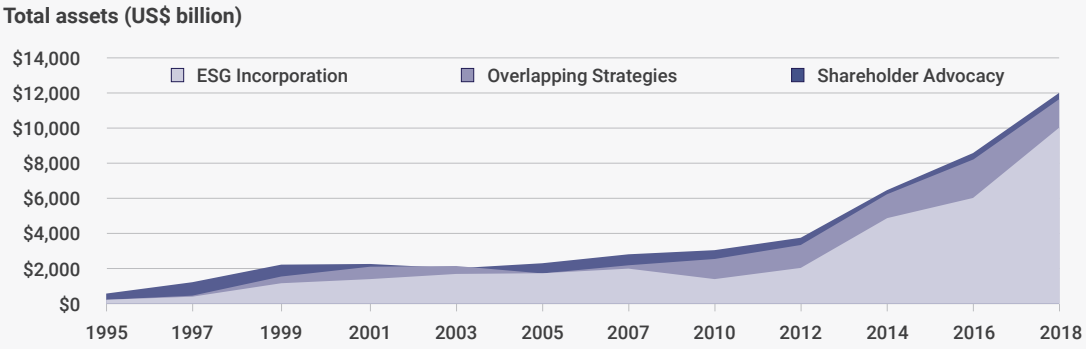
21 Beyond Trade-Offs, ImpactAlpha (n.d.), https://impactalpha.com/category/features/series/beyond-tradeoffs.

22 Matt Bannick, Paula Goldman, Michael Kubzansky, and Yasemin Saltuk, "Across the Returns Continuum," *Stanford Social Innovation Review* (2017), https://ssir.org/articles/entry/across_the_returns_continuum#.

23 Global Impact Investing Network Research Team, 2020 Annual Impact Investor Survey, (2020), https://thegiin.org/assets/GIIN%20Annual%20Impact%20Investor%20Survey%202020.pdf.

EXHIBIT 1-6A

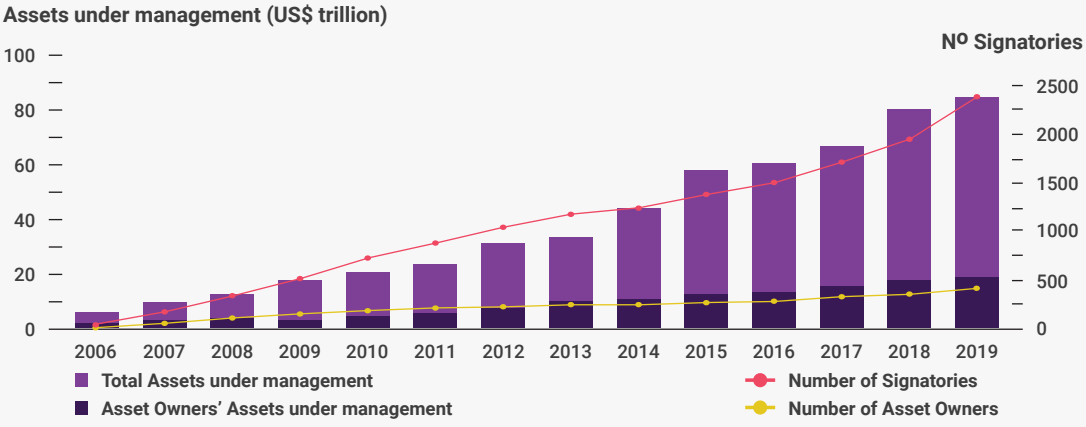
Sustainable and Responsible Investing in the United States 1995–2018



Source: US SIF Foundation

EXHIBIT 1-6B

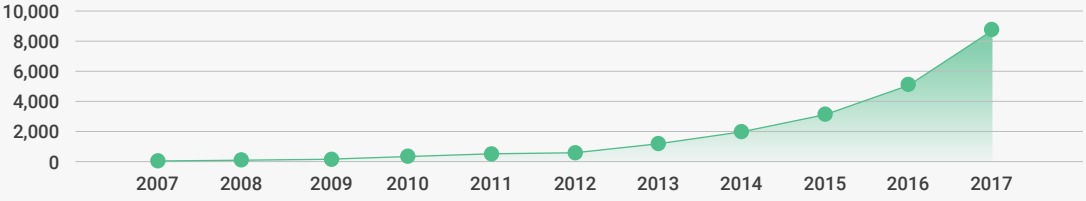
Principles for Responsible Investment Signatories 2006–2019



Source: Principles for Responsible Investment

EXHIBIT 1-6C

News Articles Containing "Impact Investing" 2007–2017



Source: Global Impact Investing Network

Another indicator is the number of investors becoming signatories to the Principles for Responsible Investment (PRI).[24] PRI works to understand the investment implications of ESG factors and to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions. Since the Principles for Responsible Investment's founding in 2006, the number of its signatories has grown dramatically (see Exhibit 1-6B).

Institutional investor interest in impact investing has also seen a significant increase in the last five years. Most, if not all, of the largest asset managers have developed or acquired impact-product offerings. These firms include BlackRock, Goldman Sachs, Bain Capital, J.P.Morgan, Morgan Stanley, KKR, and TPG. This growth is also correlated with more coverage from the world's leading financial-media sources, as demonstrated by the substantial growth in the number of news articles mentioning impact investing during the last five years (see Exhibit 1-6C).

Significant drivers of impact investing will be the impending generational wealth transfer and the increased role and power of women in investment decisions. The next generation's role will grow even more with $30 trillion changing hands to them.[25] In addition, women now control nearly 60%[26] of the wealth in the United States and continue to control more assets globally: from $34 trillion in 2010 to $72 trillion in 2020.[27] Combining these two trends, "women will inherit 70% of the money that gets passed down over the next two generations."[28]

Movements, Systems Change, and Markets

Impact investing has emerged out of social and environmental movements as well as the intention of investors to use investment tools to shift systems and drive positive change. Specific examples include:

- Divestment from South Africa in the 1980s in order to change the apartheid system;
- Passage of the anti-redlining Community Reinvestment Act (CRA) in the U.S. in the 1970s due to the civil rights movement struggle for economic equality; and
- Recent expansion of gender-lens investing.

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24 Principles for Responsible Investment (n.d.), https://www.unpri.org.

25 *The "Greater" Wealth Transfer: Capitalizing on the Intergenerational Shift in Wealth*, Accenture (2015), https://www.accenture.com/nl-en/~/media/accenture/conversion-assets/dotcom/documents/global/pdf/industries_5/accenture-cm-awams-wealth-transfer-final-june2012-web-version.pdf.

26 "Financial Facts for Women's History Month," The Quantum Group (2017), https://thequantum.com/financial-facts-for-womens-history-month.

27 "Investment by Women, and in Them, Is Growing," *The Economist* (2018). https://www.economist.com/finance-and-economics/2018/03/08/investment-by-women-and-in-them-is-growing.

28 Lisa Stern, "Why Wall Street Is Wooing Women and Their Future Wealth," *Money* (2014), https://money.com/what-do-women-investors-want.

The contrasting motivations and goals of investors and movement activists create opportunities and challenges for impact investing. Although new impact themes will continue to emerge out of social and environmental movements and then appear as impact investing products, the culture and practice of social change, and movement building is alien to most investors.

Impact Investing Weaves Together Investment, Philanthropy, and Policy

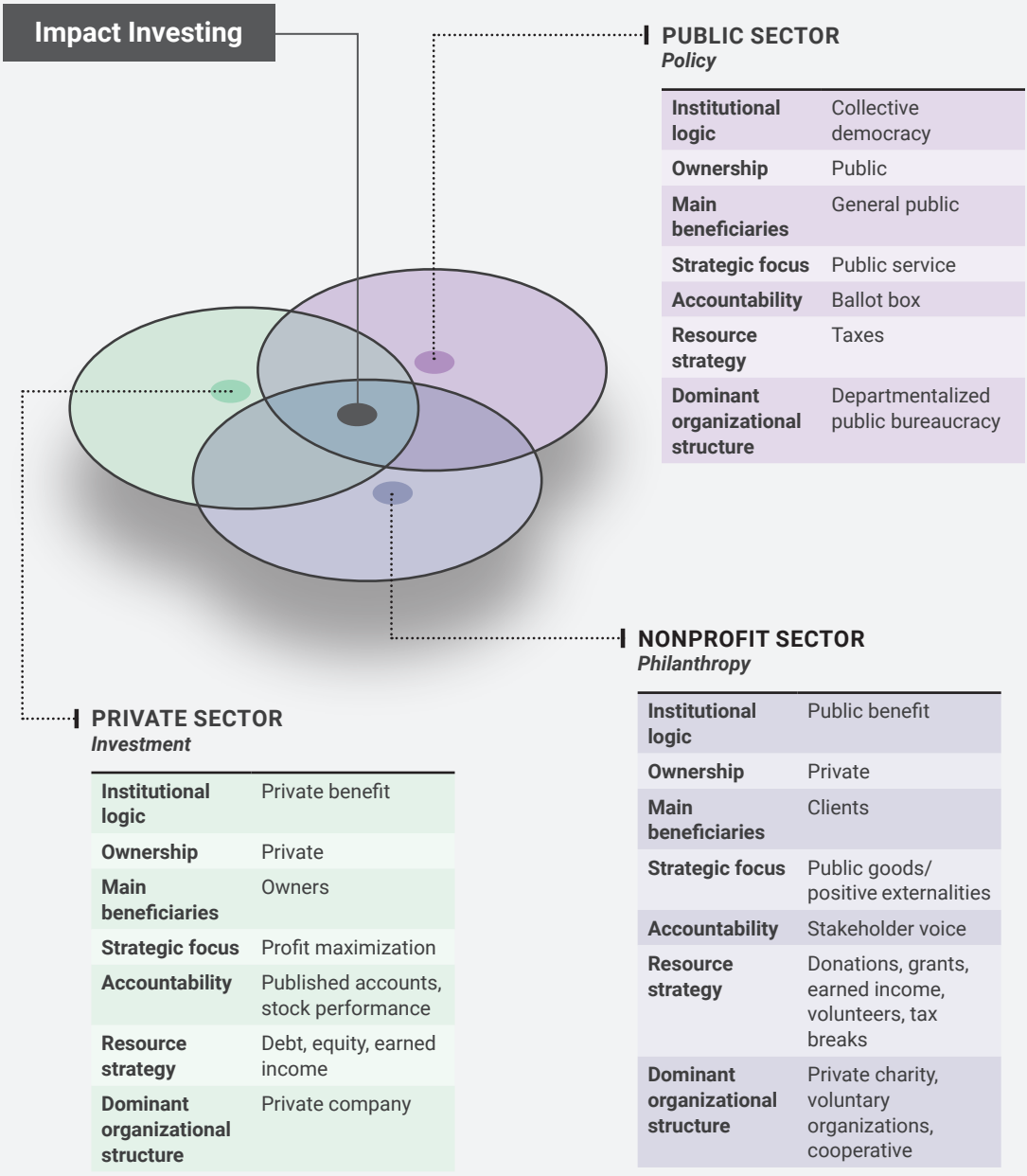
While philanthropy can build the field and policy can support and enable the proliferation of impact investing, the capital markets can be used as a new lever to create impact. Sitting at the nexus of investment, philanthropy, and policy (Exhibit 1-7), impact investing combines the distinct institutional elements of these sectors. For example, an affordable-housing impact investment may draw upon public-sector tax incentives, nonprofit-housing developers, and commercial investors to achieve its social, environmental, and investment goals

The interaction of policy, philanthropy, and investment is not new, but understanding the distinct attributes of these sectors is essential for the structuring of effective impact investments. Private, public, and nonprofit sectors have distinct and sometimes conflicting ownerships, organizational structures, accountability, goals, and resource strategies. This has led to activities remaining within their distinct silos. Nonprofits in the social sector need to raise their support from donors who may not have the same incentives as the beneficiaries and other stakeholders that the nonprofit seeks to help. Public-sector agencies must serve the general public and are accountable through elected officials and election cycles. This can make working with the private sector challenging. The private sector's clear alignment of ownership, beneficiaries, and legal structure has led to growth and scale, but can also lead to companies not being held responsible for all of the negative externalities that they may create. Cross-sector activities such as impact investing require clear expectations and incentives for collaboration.

To achieve its full potential, impact investing brings together the tools and disciplines of investment, public policy, and the nonprofit sector (Exhibit 1-8). The case for impact investing is built on the assumption that combining investment capital with impact goals creates more environmental and social benefits than would be created if these individual tools were not combined. Both the nonprofit sector and impact investing consider externalities and seek to create public goods that do something positive for stakeholders as well as the investors.

EXHIBIT 1-7

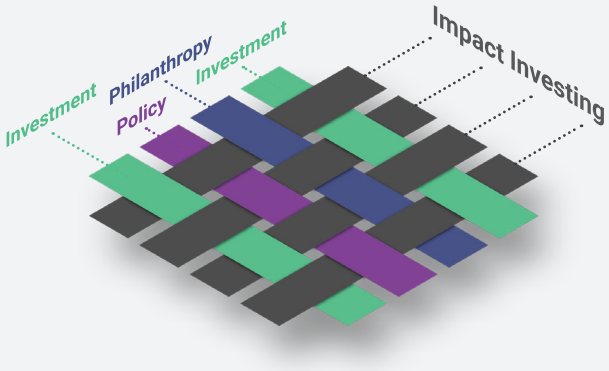
The Intersection of Investment, Philanthropy, and Policy



Source: Adapted from Alex Nicholls, "The Institutionalization of Social Investment: The Interplay of Investment Logics and Investor Rationalities," Journal of Social Entrepreneurship, 1:1 (2010), page 73.

EXHIBIT 1-8

Impact Investing Weaves Together the Distinct Strands of Policy, Philanthropy, and Investment



Silos Matter, Overlapping Approaches

As we move to the *Who* and then explain the distinct reasons *Why* investors seek to create impact, it is important to note that diverse approaches and stakeholders will continue to coexist. Although the connections between the silos are growing, philanthropy, policy, and investment will likely continue as distinct disciplines. As new issues emerge from social and environmental movements, we expect to increasingly see impact investing as a tool that can successfully weave them together.

Our hope is that if impact investments are constructed appropriately, they can accomplish goals that cannot be achieved through the separate strands of policy, philanthropy, or investment.

FRAMING QUESTIONS

- Are you currently operating within individual disciplines and silos? Is this the most effective framework for achieving your goals now and in the future?
- Given the definition of impact investing, which approaches do you find most compelling? Which elements or considerations will be critical for your implementation of an impact investment strategy?
- Do you want to use your assets to drive specific system changes, or do you want to have your values and mission reflected in how your assets are deployed? Or do you want both?
- Have you looked at your existing assets and considered the current positive and negative impacts?
- How might this impact approach be different from what you are currently doing?

Practitioner Exercise and Sophia Example

What: Resource Inventory

Exercise Overview

The first step in preparing for your impact investing journey is to understand what resources you can activate. While most practitioners will use this handbook with a focus on financial assets, we suggest getting a full picture of all resources you might use and then focusing attention from there. The practitioner's exercise for this chapter is a resource inventory to get a sense of your starting place: your assets, your human or organizational capital, and your relationships. Once you have completed the inventory, make an initial estimate of which assets could be activated toward implementing your impact investing goals. We encourage you to consider how these distinct resources can work together to compound progress toward your goals. A detailed understanding of your networks and relationships will inform the next chapter's exercise: your stakeholder map.

Sophia's Story

We have developed a hypothetical asset owner, Sophia [she, her, hers], to bring each chapter and exercise to life. Before diving into Sophia's resource inventory, we will share a bit of her story.

Sophia grew up in a middle-class family in Florida, where she studied at a state university and majored in finance and marketing. After a stint at a large fashion house in New York, where she expanded a new line of fast fashion, Sophia moved back to Miami and launched her own business. The brand gained traction quickly and grew steadily until being acquired by a large European fashion house for $450 million, bringing her and her husband's combined assets to $500 million.

Sophia, now forty-five years old, has shifted her attention to an environmental issue that had bothered her about the fashion industry: its heavy water usage. To help tackle this issue, Sophia and her husband established a $40 million family foundation. They had also previously established a $5 million donor-advised fund (DAF) through their local community foundation, focused on their joint interest in Miami community development.

Sophia has learned much about water issues and has made a number of satisfying grants. However, she has become increasingly frustrated by the scale of impact from grantmaking alone and now wants to use more of her assets to bring about change. She first heard of impact investing through a prominent financial article, then she began researching impact investing and attending a few conferences. Though supportive, her husband's initial response has been tempered by a more traditional view of the role of investments and philanthropy. Excited about the increased scale of impact investing, Sophia now wants to investigate shifting her investment portfolio to reflect her values.

Sophia's Resource Inventory

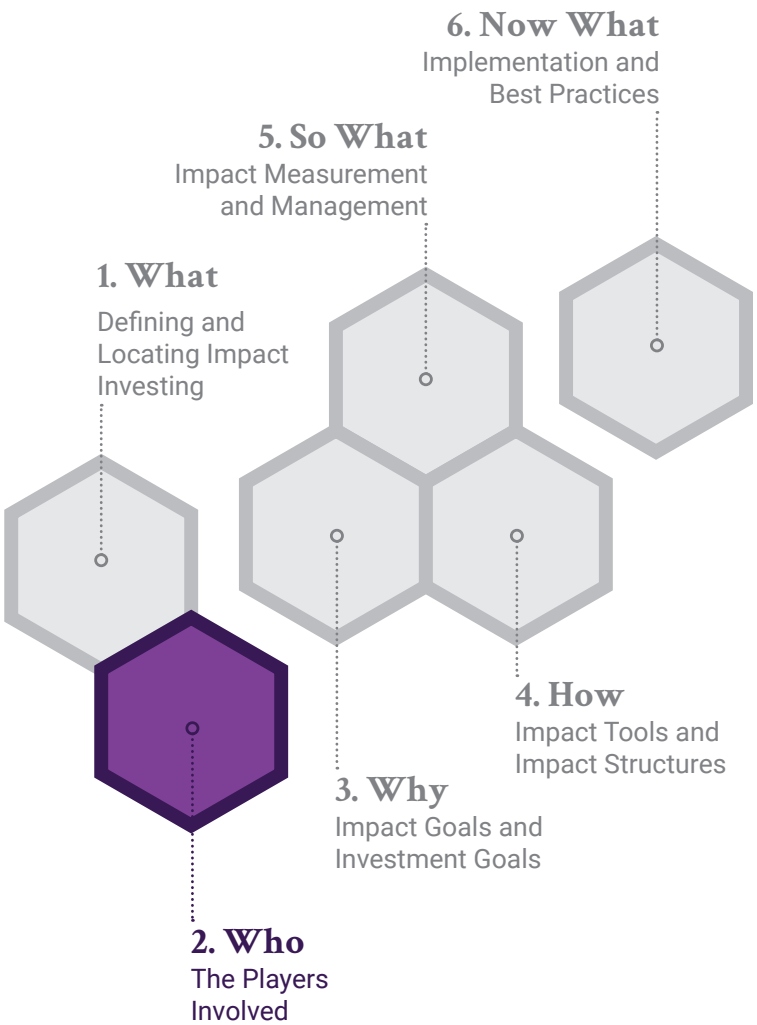
Considering all of her resources, Sophia developed the following list to include her assets, expertise, passion, and networks. She then reflected on which categories she would like to prioritize to implement her impact investing goals. At this point, she has chosen to focus on the priorities in the column on the right. In later chapters, we will focus on the financial assets: the couple's entire investment portfolio ($500 million), including Sophia's foundation's endowment ($40 million), its annual payout ($2 million), and the annual spend of her donor advised fund ($1 million).

Resource Category		Sophia's Priorities
Assets	• Investment Assets • Charitable Assets • Retirement Assets • Property	• $500M investment portfolio • $40M foundation endowment with $2M annual payout • $5M donor advised fund with $1M annual spend
Human (Organizational) Capital	• Professional: Skills, Knowledge, Experience • Personal Background • Values and Passions • Time and Energy	• Business acumen • Fashion industry experience • Passion for water-related impact • Devoting 50% of time/energy
Relational Capital	• Relational Capital • Networks and Affiliations • Professional Relationships • Personal Relationships • Political Influence	• Business relationships • Water-related charity relationships • Relationship with trusted family attorney

CHAPTER 2

Who

The Players Involved



Who Starts with You

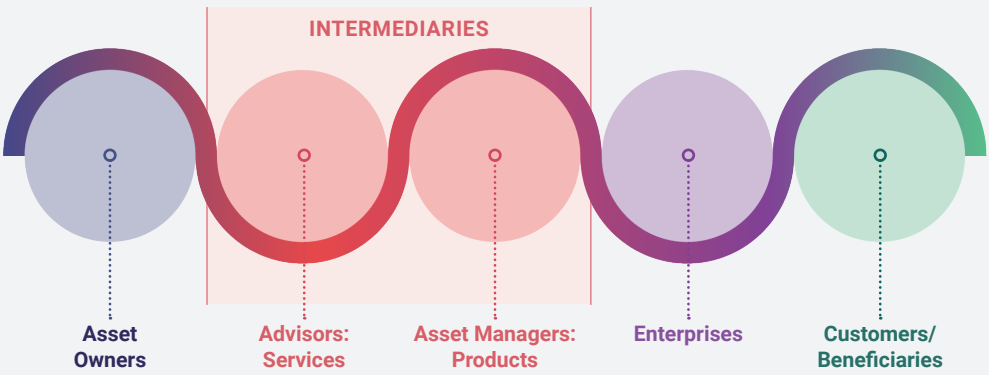
Understanding *Who* you are as an asset owner is a critical first step in establishing your impact investing strategy. From individuals to large institutions, a broad range of asset owners exist—each with distinct capabilities and resources, which will guide their practices. Your *Who* will direct your engagement with other market participants and stakeholders, drive your *Why* through a theory of change, and govern *How* you will ultimately deploy capital.

Moving Impact Across the Capital Chain

Understanding the impact capital chain (see Exhibit 2-1) is particularly important, since you want your investments to create positive environmental and social impacts in addition to a financial return. In order to successfully create impact, you will need to navigate a network of stakeholder relationships that are part of the flow of capital. As a supplier of capital, you will need to assess and understand the ultimate users of your capital as well as the intermediaries. Decisions about how much time, energy, and resources you want to spend will drive how you approach the intermediaries, such as the asset managers, who sit between you and the entities that create impact. While intermediaries are the bridge between your assets and impact creation, they can also create barriers. The expertise and willingness of an advisor to work with you on the creation and evolution of your impact strategy can be critical for its success.

To better understand these actors, we discuss them here individually.

EXHIBIT 2-1
Impact Capital Chain



Godeke & Briaud

Asset Owners

As an asset owner, you hold the capital and should make the ultimate allocation decisions along the impact capital chain, establishing the impact orientation of the capital. Asset owners can range from retail investors to endowments of institutions, such as private foundations, to sovereign wealth funds.

Intermediaries: Advisors and Asset Managers

An intermediary is an entity that acts as a bridge between two parties in a financial transaction, such as commercial banks, investment banks, and investment funds. One emerging trend is the advancement of technology, like robo-advisors, that may replace certain financial intermediaries. Your choices about working through intermediaries should align with your own capacity and resources, which may also affect your cost of doing impact investing. Two distinct types of intermediaries are advisors and asset managers.

Advisors: Advisors provide services to asset owners on how to deploy their assets in exchange for fees—and may or may not offer their own investment products. Most asset owners prioritize advisors who are independent and objective. Some advisors may be given the discretion to make investment decisions on the behalf of their asset owners, while other advisors need to have the asset owner's approval to execute investment decisions.[29] Investment advisors often work with asset owners to select asset managers. Advisors also include investment consultants and Outsourced Chief Investment Officers (OCIOs). For a description of the specific types of advisors and how to find the appropriate advisor, see Chapter 6.

Asset Managers: Asset managers construct products on behalf of others to meet specific investment goals. These asset managers may be institutions or private investors, and they may invest directly or through aggregated structures such as mutual funds. Asset managers offer a wide range of products across asset classes and risk profiles. These products, sometimes also known as strategies, serve as the building blocks of portfolios.

An important, often misunderstood, consideration in the relationship between asset owners, advisors, and asset managers is the role of fiduciary duty. See Exhibit 2-2 and a summary video[30] regarding the consideration of fiduciary duty in the 21st century.

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29 In the United States, The Investment Advisers Act of 1940 defines investment advisor as any person or group that makes investment recommendations or conducts securities analysis in return for a fee. An investment advisor who has sufficient assets to be registered with the Securities and Exchange Commission is known as a Registered Investment Advisor (RIA).

30 Al Gore, *Fiduciary Duty in the 21st Century*, https://youtu.be/PKRIW2yc5WA.

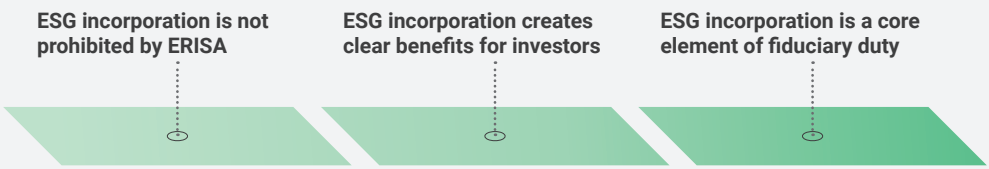
EXHIBIT 2-2

Evolution of Fiduciary Duty Regarding ESG Integration

The impact capital chain includes the intermediaries that connect capital owners with investments. Some of these intermediaries are fiduciaries, who have a legal duty to act with reasonable care, good faith, trust, and appropriate prudence on behalf of charitable capital owners in the management of their assets. Fiduciary duty is the highest legal duty of one party to another, and it also involves being bound ethically to act in the others' best interests.

A potential conflict of interest in the form of an agency problem can exist in any relationship where one party (the agent) is expected to act in the best interests of another (the principal). For example, an agency problem can exist between pension-plan sponsors as fiduciaries and plan beneficiaries or between asset managers and asset owners.

Fiduciary duty in the context of impact investing has evolved as environmental and social considerations are increasingly integrated into the investment process, and there is recognition that depending on the situation these factors can and sometimes should be incorporated into the fiduciary analysis. The approach has evolved from fiduciaries thinking that considering impact violates their fiduciary duty because it does not maximize risk-adjusted return, to an understanding that asset owners receive clear benefits from integrating impact.



Source: "Untangling Stakeholders for Broader Impact: ERISA Plans and ESG Incorporation," Principles for Responsible Investment and Godeke Consulting, 2018, page 7.

Enterprises

Capital is ultimately put to use by the entities that generate the impact and financial return. This point in the capital chain is critical to achieving an asset owner's social and financial goals. These enterprises can take on a range of corporate forms, including nonprofits, for-profits, and hybrid structures (such as benefit corporations).

Customers/Beneficiaries

Finally, the enterprise creates a positive or negative change for the customers and beneficiaries. Some categories of beneficiaries are intuitive, such as the residents of a city where electric vehicles are reducing air pollution. Other beneficiaries are just as important but perhaps less easily identified, such as employees or communities along a company's

supply chain. The asset owner does well to pay close attention to the impact of an investment on these diverse stakeholder groups. Ideally, representatives of this group are invited into the asset owner's strategic decisions and impact evaluation.

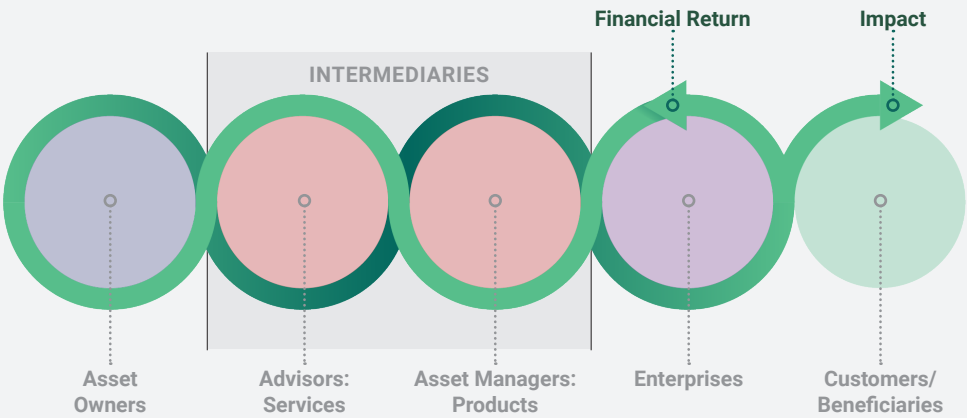
As all of these actors work in concert, the impact market system creates impact as well as a financial return. The impact market system (Exhibit 2-3) is a feedback loop of impact investments generating financial return along with impact. This feedback loop distinguishes impact investing from philanthropy and traditional investing.

Supply and Demand

What is the most significant bottleneck in growing the impact investing market? Capital raisers claim that not enough capital is available, while investors see a shortage of investable opportunities. The answer depends much more on the specific goals and approaches of an investor as well as the specific tools being used. For example, many more opportunities exist to shift a portfolio toward climate concerns, while an emerging new focus among impact investors is the creative economy. In addition to risk and return, disagreements regarding the relative impact of specific investments also affect the flow of impact capital. Your specific opportunity set of investments will depend upon your time, energy, and willingness to commit capital. We will explore this further in the "How" chapter's product matrix.

EXHIBIT 2-3

Impact Market System



Rockefeller Philanthropy Advisors

Enabling Environment

In addition to the direct links in the impact capital chain, other stakeholders are integral to impact creation, such as regulators and policy makers. Many impact investments may directly affect communities in ways that are similar to philanthropy and public policy. The lack of a direct transaction or contract between impact investors and the beneficiaries of their investments creates the need to complete stakeholder analysis as part of the due diligence process. This distinction can also raise the question of what legitimacy market participants have in addressing impact issues. In addition to regulators and policy makers, accelerators and incubators can also help the field by mitigating risk and expanding the pipeline of investable opportunities.

Partnering, Cross-Sector Engagement, and Collective Action

Given that impact investors are seeking to drive social and environmental change, and the complexity of the systems impact investors are trying to shift, the role of partnering and collaboration is critical. For example, impact investors focused on education technology need to make sure that the companies they invest in engage with public officials and understand classroom dynamics to successfully scale their investments. This is different from traditional investing that does not typically require engaging with cross-sector partners. As we discussed in Chapter 1, coinvesting with public sector or philanthropic capital can raise issues such as philanthropy subsidizing or crowding out private capital. Many issues investors seek to address through impact investing require collective action in order to generate impact. For example, shareholder engagement on social and environmental issues with corporate management may only be effective when it is done through a network of asset owners who have the ability to garner the attention of corporate management. Many traditional investments are valued based on proprietary products or services, which may be at odds with the collaborative impact goals of investors.

Considerations of diversity, equity, and inclusion are central elements of the *Who*. These criteria can be applied to the impact beneficiaries as well as to all of the players and stakeholders across the capital chain. Mission Investors Exchange and *Stanford Social Innovation Review* explored racial equity and impact investing through the series Impact Investing and Racial Equity: Foundations Leading the Way,[31] which framed the following questions that impact investors can use to drive this work:

31 Matt Onek, Impact Investing and Racial Equity: Foundations Leading the Way, *Stanford Social Innovation Review* (2019).

- Who allocates capital?
- Who receives investments?
- Who is the beneficiary or end user?

Given impact investing's potential role in addressing racial and gender equity, some investors and advisors have begun to apply a racial and gender equity lens to their entire strategy.[32] Confluence Philanthropy has launched a racial equity initiative calling for action to address the lack of diversity in the field of impact investing.[33] We will explore this more deeply in the "Why" chapter, as part of the development of impact themes and lenses.

Stakeholder Map and Power Analysis

Impact investing works in one field of influence, such as investment markets, yet other ways to influence or exercise power include democratic process, advocacy, and movement building. Which key stakeholders need to be involved for a successful impact investment? Initially, some impact investing advocates viewed their investments as simply leveraging the power of private markets to drive social and environmental change. The effectiveness of this narrow approach was limited. For example, investing in microfinance institutions often generates significant additional positive outcomes for clients; however, the investment per se is not always positive for borrowers if it leads to over indebtedness. Acknowledging and assessing the relative effects of these positive and negative impacts is an important element of impact investing. We need to understand that institutions that can best support social and environmental change may not be the best investments. Impact investing approaches that do not acknowledge the need to understand their power and policy contexts will not be effective.

At this stage, we recommend creating a stakeholder map (Exhibit 2-4) that shows the relationship between you, as the asset owner, and other key actors—including peers, board members, legal counsel, regulators, affinity groups, and all relevant actors—in the capital chain described above. Once you have completed this mapping exercise, consider the following power analysis, which classifies each stakeholder into four categories across a two-by-two matrix comparing the power and interest of each party.

When completing this power analysis, be clear on the intended goal. In other words, to what end does each stakeholder have power or influence? For example, a disengaged board member may have significant power to influence an impact portfolio but may also have little interest in the topic, so you should focus on keeping that individual satisfied. We will further develop this concept in the "Now What" chapter, as we share specific guidance and best practices on how to build consensus with a diverse set of stakeholders.

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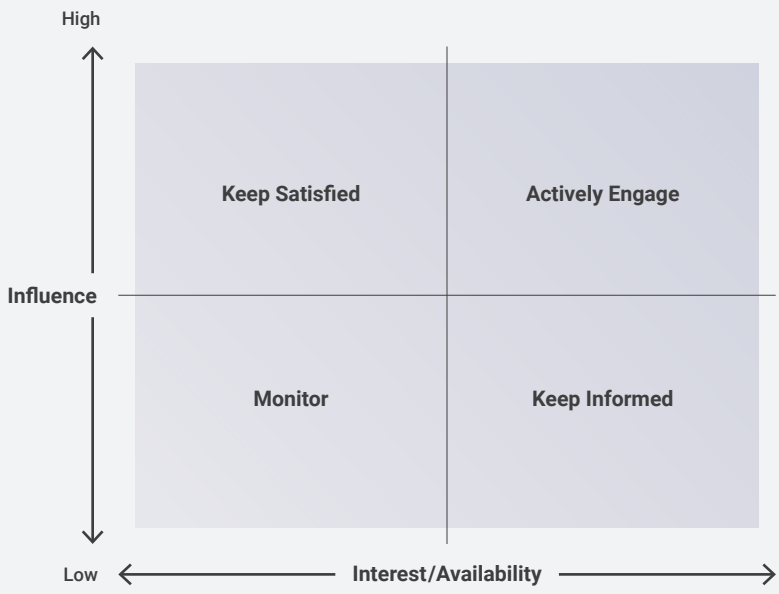
32 *Social Equity Investing: Righting Institutional Wrongs*, Cambridge Associates (2018).

33 *It's About Time: A Call to Advance Racial Equity in the Investment Industry*, Confluence Philanthropy (2019).

EXHIBIT 2-4

Power Analysis



Source: Adapted from A.L. Mendelow "Environmental Scanning—The Impact of the Stakeholder Concept," ICIS 1981 Proceedings (1981), page 20.

FRAMING QUESTIONS

- Who are the key stakeholders you need to know? Who do you respect/trust?
- Who are the key intermediaries and fiduciaries involved in your assets?
- Do you understand your fiduciary rights and duties in the management of your assets?
- Where do you want to work across the capital chain? What is your desired level of engagement?
- Do you want to make direct investments or work through advisors or intermediaries?
- Who do you need to keep satisfied, encourage/influence, monitor, and keep informed?

Practitioner Exercise and Sophia Example

Who: Stakeholder Map and Power Analysis

Exercise Overview

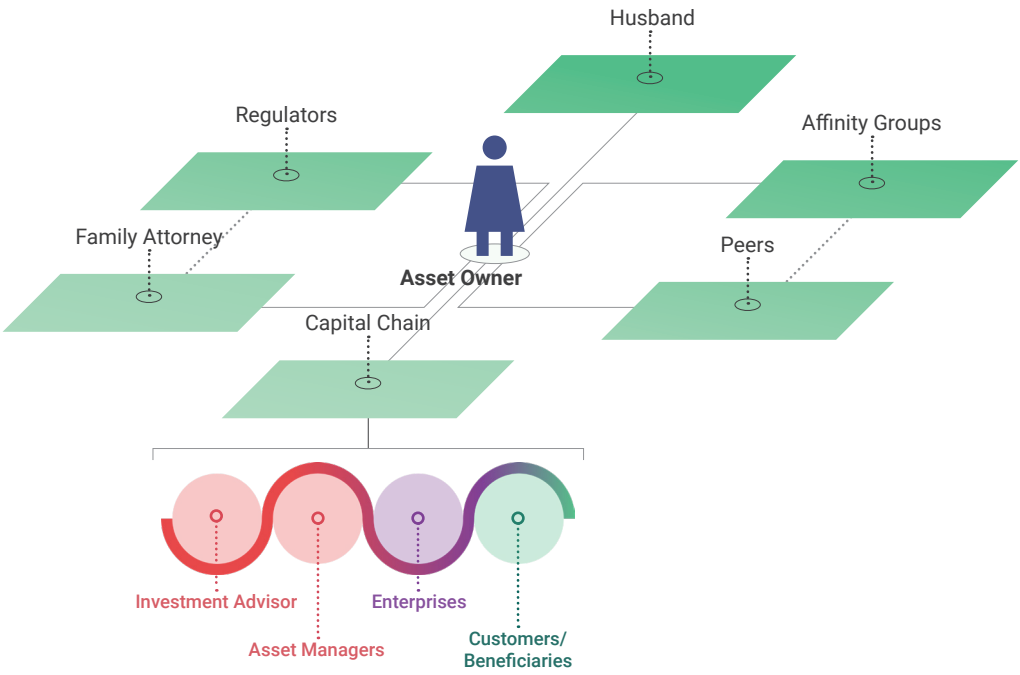
We now suggest taking a deeper look into your relationships and networks by completing a stakeholder map, laying out the key players who may influence your impact investing strategy. Similar to your resource inventory, begin with the broadest set of stakeholders, then focus on those you deem most relevant. The stakeholder map shows the relationship between you, as the asset owner, and other key actors—including peers, board members, legal counsel, regulators, affinity groups, and all relevant actors in the capital chain described above.

Once you have completed the stakeholder map, consider how power and influence is distributed among these stakeholders by completing the power analysis grid introduced above. Starting with your goal of shifting toward an impact portfolio, this grid will help you eventually engage each stakeholder to further your strategy.

Sophia's Stakeholder Map

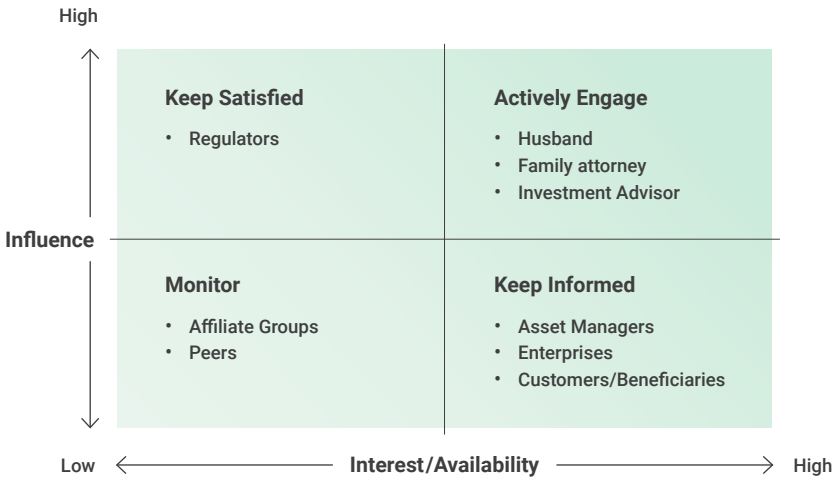
Reviewing the key stakeholders around her, Sophia created the map that follows. The primary stakeholder is her husband. While he is generally supportive, his traditional investment background has him worried that any impact consideration will require a trade-off of financial returns. He is skeptical of impact investing and believes they should focus on creating impact through grantmaking. Sophia is also mindful that impact investing could diminish their capacity to support their philanthropic grantees. One key advisor is their longtime family attorney with whom she and her husband have a strong relationship. Their attorney will advise them on investment and charitable regulations to be sure any impact investing strategy fits within the legal limits. Sophia has also been influenced by peers she has met through affinity groups and conferences.

As for elements of the capital chain, Sophia has an existing investment advisor, part of the private-wealth team in a big bank, who is not an impact investing expert but is open to it. Through this advisor, she has identified a few potentially aligned asset managers and hopes to pursue a few direct investments. Sophia has learned a lot from water-focused nonprofits, including serving on a board. During her travels, Sophia has also seen the communities and people who are facing the water crisis while trying to survive economically. Though she no longer works in the fashion industry, she is active in an industry initiative on sustainable fashion that brings her into contact with industry leaders.



Sophia's Power-and-Influence Analysis

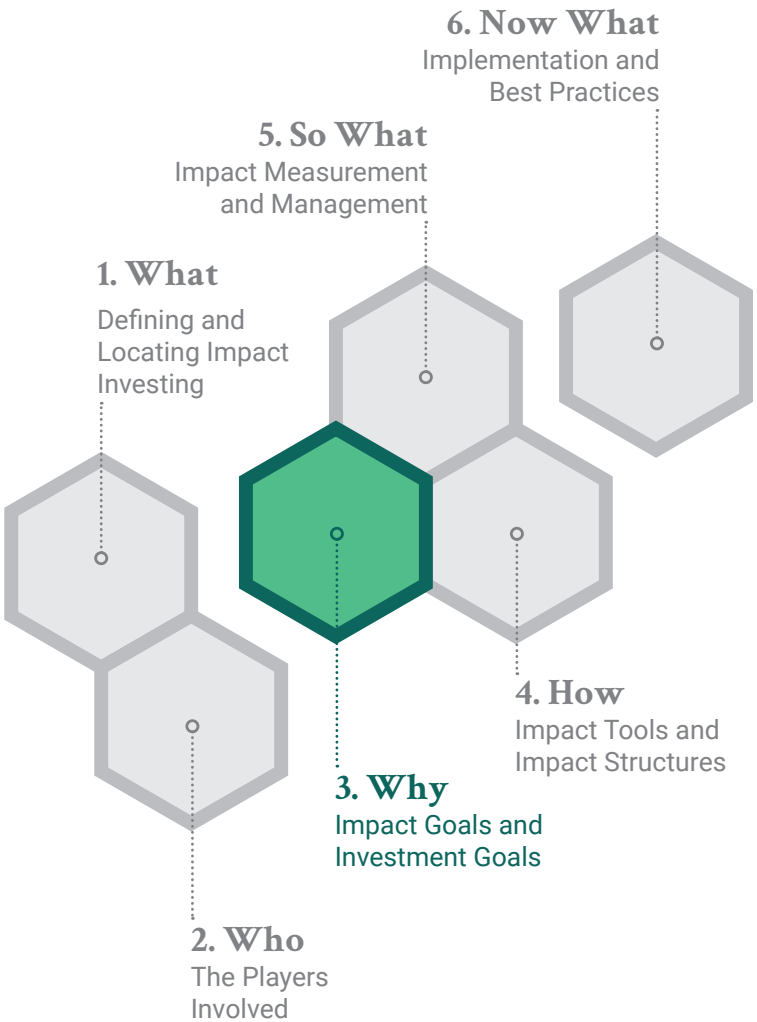
Now, placing key stakeholders within the power-and-influence matrix, each quadrant shows the parties as well as how Sophia might go about engaging them in her impact investing strategy based on their power and interest. The most attention will be paid to the three in the top right quadrant: her husband, the family attorney, and her investment advisor.



CHAPTER 3

Why

Impact Goals and Investment Goals



Anchoring Impact Investing in Why

> "He who has a why to live can bear almost any how."[34]
> *– Friedrich Nietzsche*

You now have a working definition of impact investing and an understanding of the landscape of players you will need to engage. You are ready to identify your specific impact investment goals—the *Why*—that will drive your strategy toward implementation. We will help you identify your impact goals, which, when integrated with your investment goals, will inform your impact investing goals, including priority impact themes and lenses. This chapter concludes with an introduction to the theory of change that will serve as a strategic framework from which you will choose impact tools and structures in the "How" chapter, creating the basis for evaluating success in the "So What" chapter.

Articulating the *Why* is the essential—and often underappreciated—step toward making an impact investment. It is important to be anchored in the *Why* before moving to the *How*. The *Why* establishes the values, goals, and parameters that you will test as you move through the implementation process. Skipping this step may be tempting, but investing the time up front often leads to a more thoughtful and consistent strategy.

> "If I had an hour to solve a problem, I'd spend fifty-five minutes thinking about the problem and five minutes thinking about solutions."
> *– Albert Einstein*

As you develop this strategic framework, do not confuse the *Why* with creating impact. Just as in philanthropy or policy, deploying capital may not create the intended impacts. By establishing the *Why*, you are putting down the markers of intention, measurement, and contribution that will hold you accountable throughout your investment.

Building on the metaphor that we introduced in Chapter 1 of your impact investing assets being similar to a house, *Why* forms the foundation of the house and will serve to define its structure and ground its stability as shown in Exhibit 3-1.

Investors come to impact investing with a wide range of motivations. Some learn about this new approach through financial publications or their wealth advisor. Others are introduced to impact investing from next generation family members. You may simply be dissatisfied with your level of impact as compared with the pressing needs of our planet and its communities. We will help you identify your specific impact goals and then merge them with your investment goals to arrive at your theory of change. Exhibit 3-2 outlines the flow of this process.

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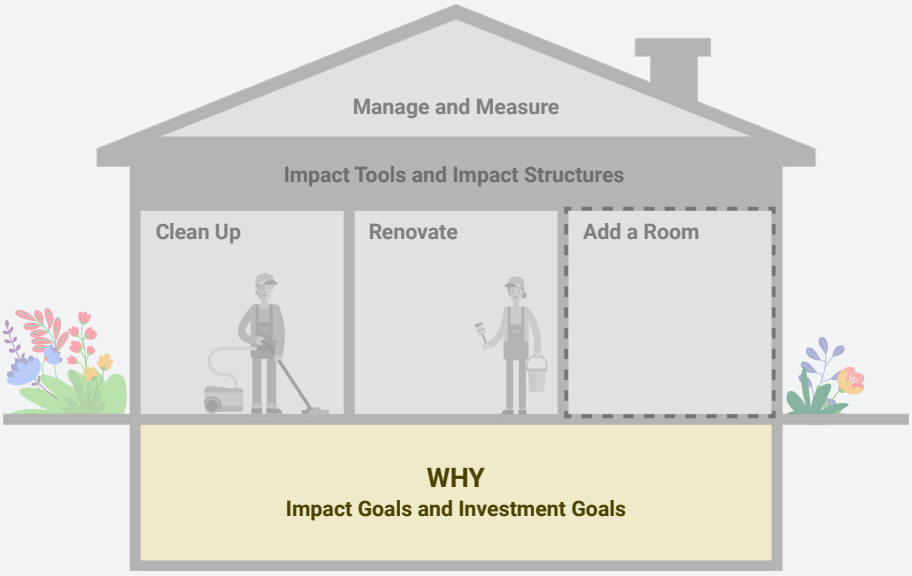
34 *Twilight of the Idols*, "Maxims and Arrows," §12.

EXHIBIT 3-1
Foundation of Your Impact Strategy Is the Why



Investment Goals

Most asset owners (and their advisors) have a solid grasp of their "investment why," which shapes their specific investment goals. Individuals and families may have a desire to retire at a certain age or maintain a certain standard of living. For many foundations, the goal may be to match or exceed the payout requirements (for example, 5% plus inflation) in order to support their grantees in perpetuity. Educational and religious endowments need to balance the need for immediate operating support and the long-term viability of their institutions. For a family office, the goal is often to sustain and grow the family's wealth and legacy by maximizing risk-adjusted returns. Other investment goals may include liquidity needs, diversification, and tax minimization. With a traditional investment approach, investors use these goals to construct a portfolio—selecting investments from a broad universe of opportunities and assembling their portfolios based on characteristics such as risk and return as well as liquidity and time horizon. These investment goals are most often built on established principles, including modern portfolio theory and the capital asset pricing model (CAPM). These elements also remain in place for impact investors.

However, one of the distinct characteristics of impact investing is to outline impact goals alongside the traditional investment practice. This is an extra perspective for examining your current assets and potential future investments. Having a solid grasp of your impact goals is critical to impact investing, yet establishing your impact goals can seem overwhelming given the range of challenges and opportunities that the world faces. Some impact goals are similar to philanthropic and policy goals, while others are specific to investing. For individuals with established values, as well as organizations with a clear mission, impact goals will likely emerge more quickly. For others, this process will involve more reflection and facilitation.

Impact Goals

Impact goals may be driven by an asset owner's heritage, family, faith, legacy, or experience. These goals can aim to leverage specific approaches, including innovation, awareness raising, and direct service. Many family impact investors also pursue impact goals as a means to engage the next generation. For an exploration of how donors develop impact goals, please refer to "Your Philanthropy Roadmap."[35] In order to arrive at these goals, some impact investing advisors have developed impact diagnostics tools—ranging from a simple series of questions to more complex surveys—that can help you determine the impact goals most important to you. Once your broad impact goals are established, you can translate these into a clear theory of change that will inform how you frame, evaluate, and review the impact performance of your investments.

Some of the most common reasons investors pursue impact investing follow. As you review them, consider which resonate most with you or your institution. Please keep in mind that your impact goals are distinct from the impact tools and structures that you will use to select specific investments.

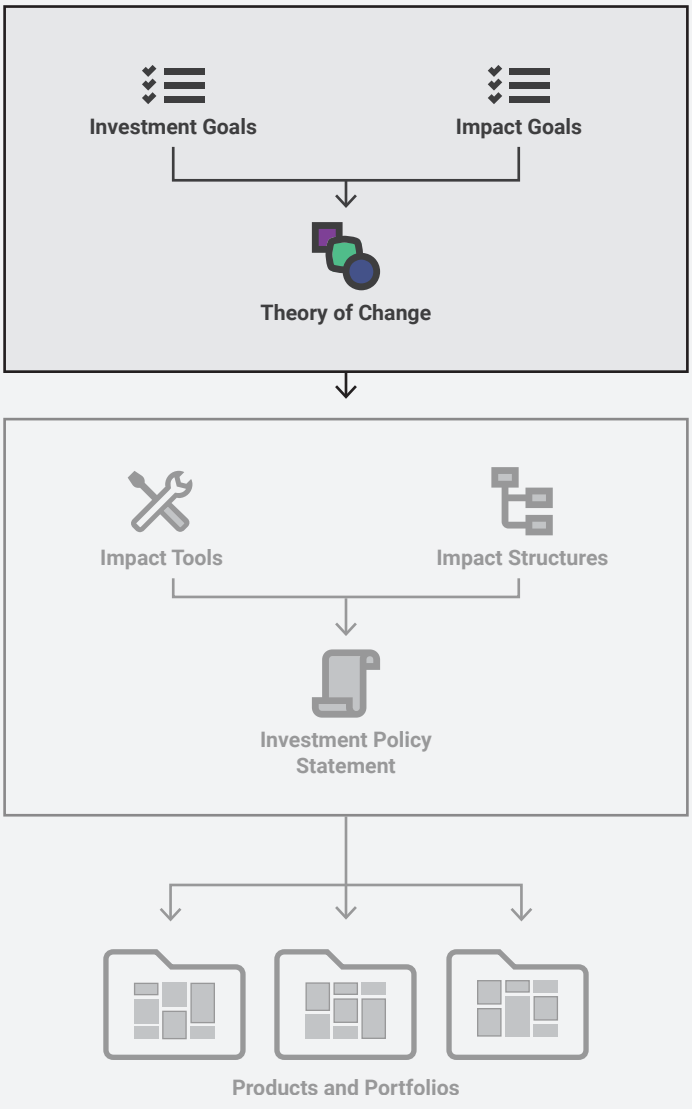
Engaged Ownership

The goal of engaged ownership is to align all of your assets for social and environmental impact. This goal aims to overcome the separation of the traditional silos of investment and impact in order to bridge gaps and reduce dissonance. As described in the "What" chapter, thoughtful impact investing can provide us with the ability to be accountable for all the positive and negative impacts of our assets by intentionally using them to make a positive difference. Our decisions as consumers, investors, philanthropists, and citizens have positive and negative effects. We have the ability to make these decisions align with our personal values or organizational mission. Our ability to have our values articulated through our assets has expanded as we have access to better data and higher transparency.

35 https://www.rockpa.org/guide/your-philanthropy-roadmap.

EXHIBIT 3-2

Construction of Impact Investing Theory of Change



Shifting a Discrete System

As explored in the "What" chapter, this goal aims to influence the interconnected set of elements that govern a topic or sector. An asset owner with this goal is not satisfied with incremental change and seeks to address the root causes of social and environmental problems—often complex and embedded in networks of cause and effect. It is an intentional process designed to fundamentally alter the components and structures that cause the system to behave in a certain way. Although changing systems is typically viewed as the realm of policy makers and philanthropists, impact investing introduces investment capital as an additional tool to change systems. See Exhibit 3-3 for an overview of systems theory and its application to impact investing.

The Whole System Approach

While some impact investors will focus on specific interventions, such as reducing carbon in a supply chain or increasing educational achievement in a specific city, other impact investors have the broader goal of using impact investing to reconfigure and reinvent our current economic system. Impact investing offers an opportunity to realign investment broadly, so it delivers a healthy future for people and the planet—a vision that is expressed in shared global frameworks like the UN Sustainable Development Goals (SDGs).

As impact investment has broadened and diversified, many investors are now looking at how to leverage the power of commercial markets. In the United States, the size of philanthropy is $428 billion,[36] while government spending is $4.1 trillion,[37] and the capital markets (all public debt and equity investments) are $69 trillion.[38] Shifting from philanthropy to the public sector to the private sector, the funding pool grows by a factor of ten each time. In fact, this disparity was a major driver in the launch of the impact investing industry ten years ago.[39] Impact investors with this goal seek to drive social and environmental change by shifting the economic system, including shifting corporate behavior, changing Wall Street incentives, or adding regulation to drive corporate responsibility.

Some investors seek to address market inefficiencies or failures by reducing negative externalities and increase positive externalities in order to maximize net-positive impact. With a catalytic mindset, this goal leads to closing the capital gap in order to deploy capital where traditional capital is scarce, provide a pipeline of investable opportunities, or engage underserved populations. Those who pursue this goal often consider the influence of behavioral finance tools. When seeking to disrupt and transform the economic system, impact investors may look to whole-system frameworks, such as The Just Transition Framework (see Exhibit 3-4), to inform their strategy and approach.

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36 "Giving USA 2019."

37 https://www.cbo.gov/publication/55342.

38 SIFMA ($37T value of outstanding bonds + $32T stock market capitalization).

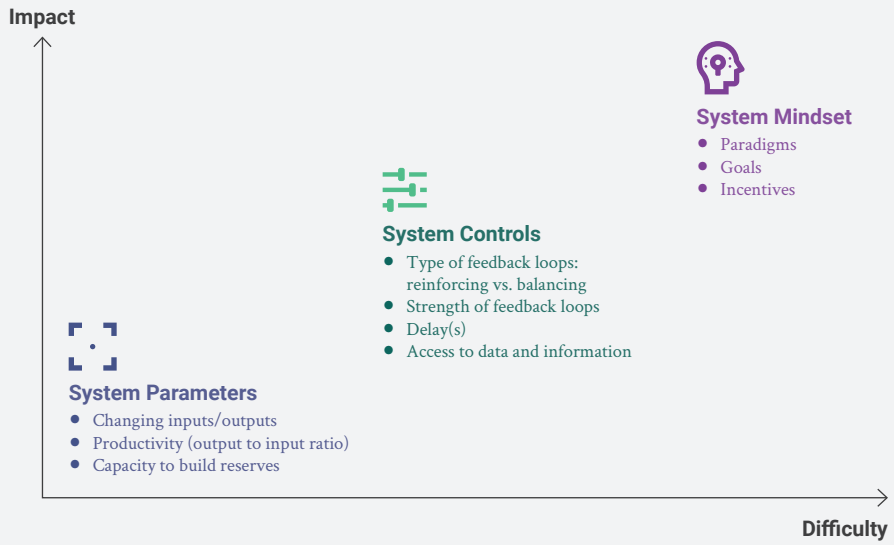
39 See *Investing for Environmental and Social Impact*, Monitor Institute (2009).

EXHIBIT 3-3

What Is Systems Change?

There are many definitions of systems change. In this handbook, we use one that conceives of a system as an interconnected set of elements that are organized in a way that achieves specific outcomes. All systems have elements, interconnections, and a function or purpose. Systems thinking places importance on a number of approaches to learning and doing: seeing the parts, not just the whole, and their interrelationships; seeing things from multiple and diverse perspectives; understanding the importance of resources and power and how they are distributed; embracing complexity; focusing on what is emergent; and paying attention to unintended consequences. One result is that system thinkers see the world as a collection of "feedback processes." Thinking in systems can help us understand root causes, identify leverage points, and take effective action.

Those who want to shift or disrupt at a systems level seek to find leverage points that can have a big impact, which can link to specific issues they care about. Leverage points range from shallow parameters that are more mechanistic to system design features, such as social structures, rules, and policies, and finally to the deepest leverage points—people's mental models, beliefs, values, and assumptions—which, in turn, shape structures and patterns in society.



Source: Donella Meadow, Thinking in Systems: A Primer, 2009.

Applying Systems Theory to Impact Investing: The Impact Market System (see Exhibit 2-3, "Impact Market System") can be seen as reinforcing feedback loops for capital and impact, with the beneficiaries of impact not controlling the ongoing deployment of the capital. In other words, the closed-feedback loop of traditional investing needs to be expanded to include the feedback loop of impact generation. In fact, impact investing may reflect the multiple feedback loops of real systems better than the simplified version used in traditional investing. Multiple feedback loops tend to make for more stable and resilience processes.

Advancing a Particular Cause

Many impact investors will want to focus on a specific place, people, or institution. Asset owners who focus here often start with and build from their philanthropic goals. They may see impact investing as a better means to scale solutions toward the outcomes they are seeking.

Place: Many impact investors support a specific geography or community, including place-based investing. Institutions with region-specific missions, such as community foundations, tend to adopt this goal and focus on specific geographic areas. See Exhibit 3-5 for Incourage and the Wisconsin Impact Investing Collaborative's place-based impact investing work.

People: Impact investors may focus on improving the conditions of a specific population, including considerations of ethnicity, race, age, and income.

Institution: Some impact investors target a specific institution or specific types of institutions, including startups, community colleges, public companies, or nonprofits.

EXHIBIT 3-4

The Just Transition Framework

Just Transition is a framework that was developed by the labor movement and is embraced by other civil society organizations to encompass a range of social interventions needed to secure workers' jobs and livelihoods as economies shift to sustainable production, primarily to avoid climate change and protect biodiversity.

Climate goals set standards for a clean economy. In the process, sectors including energy, manufacturing, agriculture, and forestry, which employ millions of workers, must restructure. Concerns exist regarding periods of economic restructuring in the past that left ordinary workers, their families, and communities to bear the costs of the transition to new ways of producing wealth, which led to unemployment, poverty, and exclusion for the working class, as opposed to business owners, who were able to afford the transition. Just Transition addresses this concern by promoting sustainable actions that help workers.

Just Transition has been endorsed internationally by governments in different arenas, including the International Labour Organization (ILO) which adopted conclusions on this matter in 2013 and the tripartite (union-employer-government) "Guidelines on a Just Transition" toward environmentally sustainable economies and societies for all in 2015. The Paris Climate Agreement also contains references to a Just Transition, where governments commit to ensuring that workers are accompanied in the transformation through the creation of decent work opportunities.

Exhibit continued on next page

EXHIBIT 3-4 (CONTINUED)

Source: Movement Generation

EXHIBIT 3-5

Wisconsin Impact Investing Collaborative and Place-Based Shareholder Engagement

Incourage Community Foundation and Avivar Capital

The Wisconsin Impact Investing Collaborative is an initiative led by a group of Wisconsin foundations committed to leveraging their assets to build inclusive, vibrant, and environmentally sustainable communities across Wisconsin's urban, rural, and tribal areas. These foundations are among a range of Wisconsin trailblazers in impact investing that also include faith-based, corporate, and socially motivated funds and individual investors. These actors share a commitment to community investing—ensuring that capital is available on fair and affordable terms to meet the financing needs of local small businesses, nonprofit organizations, and families. The beneficiaries are typically those who qualify for financing but face barriers to access conventional financing sources.

The collaborative seeks to increase the practice of regional impact investing through shared learning, investment-support services, and coinvestment. The goal is to make it easier for all types of investors to target a portion of their investments to create systemic, lasting, positive changes for the people and environment of Wisconsin.

The Wisconsin Impact Investing Collaborative has created a website and guide.[40] These resources serve as a primer on impact investing, as told through the lens of the Wisconsin investors whose goal is to build interest among like-minded investors.

The Incourage Community Foundation is one collaborative member that has committed to aligning 100% of its assets with this mission. Its public-equities allocation includes advancing the concept of Corporate Community Stewardship (CCS) and Place-Based Shareholder Engagement (PBSE). The website Engageforplace.org sets out these concepts, aligning corporations and communities toward inclusive, prosperous, and sustainable neighborhoods. With backing from The Nathan Cummings Foundation, Incourage and Avivar Capital are helping advance CCS and PBSE as a national movement with a coalition of aligned practitioners.

Impact Intensity and Risk

Two additional variables that describe your impact goals are impact intensity and impact risk.

Impact Intensity: One consideration for establishing your impact goals includes your impact intensity—how influential you want your impact goals to be in shaping your investment decisions. Intensity may drive your willingness to target deeper, more system-level goals, take on more investment risk, and use nontraditional investment tools.

Impact Risk: In addition to investment risk, impact risk describes how comfortable you are with the possibility that your investment will fail to create the targeted impact. The Impact Management Project has identified nine types of impact risk, including evidence risk (lack of high-quality data), drop-off risk (that positive impacts do not endure), and unexpected impact risk (significant unexpected positive or negative impacts occur).

40 *Wisconsin Guide to Impact Investing*, https://www.wi3c.org.

Impact Themes and Lenses

Impact themes and lenses are the means through which you can sort and organize the deployment of your investment capital in alignment with your impact goals. These two categories tend to cluster around specific issue areas and impact goals. For example, the impact theme of financial inclusion may align with the impact goals of empowering women, economic equality, and community development.

Theme: An impact theme can be a specific industry sector, such as energy or health, or can focus on a specific issue, such as community development or social justice. Sometimes these themes may be divided into subthemes.

Lens: An impact lens is a specific view or perspective applied across all of an impact investor's assets. For example, a foundation may apply a racial-equity lens to all its investments. This means that the foundation will consider how the investments affect the underlying conditions of racial equity.

These themes and lenses are not mutually exclusive and can evolve over time. Examples of impact themes and lenses are presented in Exhibit 3-6.

EXHIBIT 3-6

Examples of Impact Themes and Lenses

Examples of Impact Themes	Examples of Impact Lenses
Climate Change	Climate
Community Development	Creative Economy
Education	Inequality
Energy and Resources	Gender
Health and Wellness	Racial Equity
Social Enterprises	
Sustainable Development and Agriculture	
Water	

EXHIBIT 3-7

Gender Lens Investing

Suzanne Biegel, Catalyst at Large

Gender lens investors use gender as a tool to identify risks and opportunities in order to achieve better financial, social, or environmental outcomes. An investor focused on the theme of women and girls might choose to invest its capital in women-owned businesses or women-focused products. An investor focused on a gender lens would take a broader "viewfinder for opportunity or risk" in all of its investments, whether they explicitly address gender or not.

Gender can be a factor across all investments, explicit or not. Recognizing and responding to gender opportunities and risks in every business or investment vehicle can equip us to build better ventures and achieve greater impact. This is true whether investing in sectors traditionally associated with more women impact, such as health-care or consumer products; seemingly gender-neutral arenas, such as IT or financial services; or traditionally male-dominated sectors, such as energy or construction.

In practice, gender lens investors examine the role of gender across the entire value chain, including:

- Leadership and board gender balance;
- Employee composition, policies and practices such as recruitment promotion, advancement, pay equity, parental leave and flexible working, and sexual harassment policies;
- Supply chains; and
- Products and services.

The question should be posed as to if and how a venture addresses the needs of women and men (and all genders) appropriately, and how using a gender lens might change the way a product is designed or delivered. We ask where and how supply chains include women and in what ways. We question whether the capital available from investors is really right for the needs in the market and where it is gendered. We ask how not paying attention to gender might put a venture at risk for not achieving its financial or impact objectives. If you're building a new transport system, for example, it's smart to pay attention to how and when women will use it rather than assuming men's use is the default. And we look at intersectionality beyond gender to racial and ethnic diversity.

Gender lens investors might deploy capital explicitly to women-owned or led (or gender-balanced) companies. They might prioritize investments that challenge harmful gender roles or solve problems which disproportionately impact women and girls—whether that might be gender-based violence, lack of access to family planning, or a deficiency of women's voices and ownership in the media.

Investing in women is an idea with a long and storied history. Indigenous women's lending circles go back centuries, and the microfinance loans pioneered by Muhammad Yunus in the 1970s were primarily employed by women. But what we currently understand as "gender lens investing" was named and framed in 2009, as the Criterion Institute, Calvert Foundation, and other early leaders began to push for a deeper understanding of the role that investors could play in this arena, along with a greater recognition of the importance of gender within the field of impact investing.

Exhibit continued on next page

EXHIBIT 3-7 (CONTINUED)

Throughout the last decade, the market has exploded. More than 50 structured vehicles with a gender mandate are currently available in the public markets, as well as in more than 145 private funds and vehicles. Nonetheless, the International Finance Corporation (IFC) estimates a shortfall of $320 billion in emerging markets alone, just among women-founded companies—and in North America only a mere 3% of venture capital goes to women, with less than 0.2% to companies led by women of color. The understanding among investors for how to apply a gender lens in investment is still quite limited.

One key entry point that has become increasingly salient for investors is to ask: Who is managing investment decisions? Where are women in the picture? Where is gender balance? It is not just what we are investing in but how and by whom.

If you want to start investing with a gender lens, the place to start is by looking at your own portfolio. How do the vehicles you're investing in perform when it comes to gender equity? Where can they do better? Who is managing your money? And, what opportunities are they—and you—missing out on by not paying more attention?

The creation and articulation of impact goals, themes, and lenses can emerge from a wide range of sources. For families and individuals, reflection and facilitation may lead to specific areas of interest. For institutions with a clear mission, this will inform your selection. An upfront grounding and education in the range of possibilities can also trigger your specific interest in a theme. A deep interest in a specific area should be tested against social science and how change happens in the sector. Some lenses, including climate, touch such a wide range of sectors that they can be applied in multiple ways. As shown in Exhibit 3-7, gender lens investing uses gender as a tool to assess investment risks and opportunities. While some may have detailed interests, others may have a broader, less focused, goal that you will need to further develop. Many advisors have structured tools and processes to use with clients to help them develop these personal and institutional goals both individually and as a group. We will explore how these impact goals and themes will be used to construct your portfolio in the "How" chapter. For now, articulating your goals is key without jumping to the specific investment tools that you will use to achieve these goals.

Field Level Impact Themes and Lenses

At the field level a range of frameworks, such as the United Nations Sustainable Development Goals (SDGs) shown in Exhibit 3-8, have emerged to promote and target investment in themes to better align economic, environmental, and social systems that support both people and the planet. While the SDGs are not an all-encompassing list of impact investing themes, impact investors are coalescing around them. This is in large part due to the normative framework organized into a typology of seventeen goals and associated targets that helps potential investment partners find each other. The SDGs demonstrate that collective action matters, while different investors can choose to focus on distinct goals. Some SDG goals lend themselves better to investing than others. For example, Goal 7, Affordable and Clean Energy, aligns well to a climate-focused investment goal, while Goal 17, Partnerships for the Goals, is more challenging to translate into an investment portfolio.

The concept of Doughnut Economics in Exhibit 3-9 is another useful framework based on the need to set our economic and social activities within the ecological capacity of the planet. This framework summarizes the social foundations needed by humanity and the ecological planetary boundaries between which a safe and just space for humanity can exist. Many of the fundamental societal issues, such as health, gender equality, and energy, can serve as impact themes: while investments in areas that threaten to push past our planetary boundaries, such as fossil fuel–based energy projects, would be avoided. The ecological ceiling can inform how investors can consider environmental themes. For an example of how this can be applied practically, see the work of the Science Based Targets Networks.[41]

41 http://sciencebasedtargetsnetwork.org.

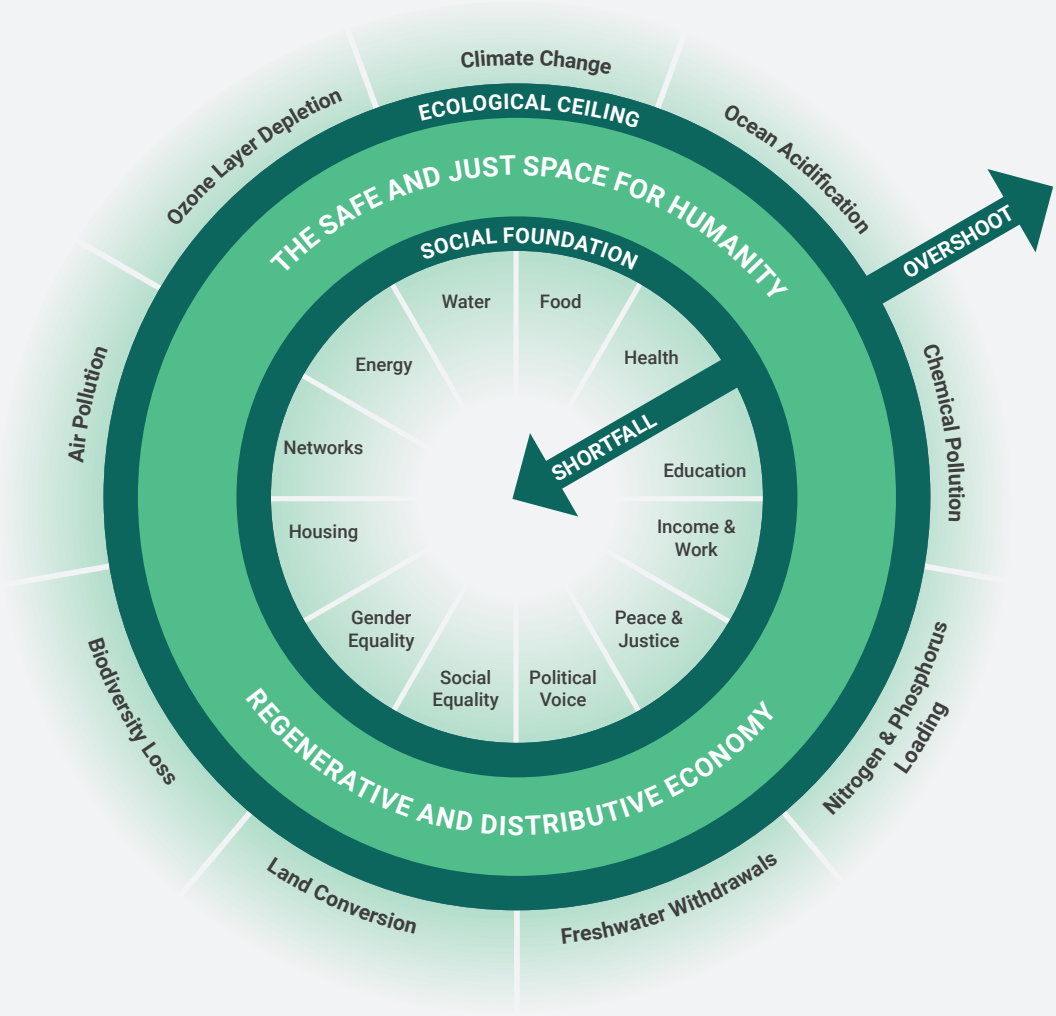
EXHIBIT 3-8

The United Nations Sustainable Development Goals

Source: The United Nations Department of Economic and Social Affairs.

EXHIBIT 3-9

Doughnut Economics



Source: Kate Raworth, Doughnut Economics: Seven Ways to Think Like a 21st-Century Economist, 2017.

Emergence of New Themes and Lenses

In addition to broad impact themes and lenses, impact investors have begun to focus on more specific subthemes such as early-childhood development or carbon-mitigation technologies. As new social and environmental movements emerge, entirely new impact themes and lenses will also be created. For example, Exhibit 3-10 highlights Upstart Co-Lab, launched in 2016 to create a new impact lens on the creative economy.

Coordination Versus Customization

The impact investing field must balance the goals of establishing exhaustive lists of themes and lenses, so that investors can focus and coordinate their investments with the desire of other asset owners to customize their impact themes in order to reflect their individual preferences. To drive real change on themes such as climate and education, investors will need to work together. Clearly defined themes also allow asset managers to build impact investing products at scale. However, asset owners will continue to create new themes as social and environmental movements emerge. Some impact lenses will cut across themes since social and environmental topics can be so closely interrelated.

EXHIBIT 3-10

A Creativity Lens for Impact Investing

Laura Callanan, Upstart Co-Lab

The Global Impact Investing Network (GIIN) reports annually on how its members are investing by theme, and every year a category labeled "arts and culture" appears as 0%. And yet, the rapidly growing creative economy is more than 4.5% of U.S. Gross Domestic Product (GDP) and more than 3% of global GDP. Borrowing from the lessons of gender lens investing, Upstart Co-Lab has introduced a "creativity lens" to help impact investors see enterprise and real estate opportunities connected to art, design, culture, heritage, and creativity.

The first step was to move away from "arts and culture" and toward the framework used by the United Nations and many global development leaders: the "creative economy." Defined by John Howkins in 2001, the "creative economy" is a new way of thinking and doing that revitalizes the manufacturing, services, retailing, and entertainment industries with a focus on individual talent or skill, as well as on art, culture, design, and innovation.

Exhibit continued on next page

EXHIBIT 3-10 (CONTINUED)

A unique set of industries defines each local creative economy, reflecting the traditions and heritage of that place. Based on industry research, Upstart Co-Lab identified 145 industries that comprise the creative economy,[42] including businesses engaged in the inputs, production, and distribution of creative products. These businesses can be summarized in five creative economy categories.

1. **Ethical Fashion:** Companies producing clothes, shoes, jewelry, and accessories that proactively address industry challenges related to labor, environmental impact, governance, and/or preservation of cultural heritage.
2. **Sustainable Food:** Producers and providers of food and beverage products and experiences that proactively address and raise consumer awareness of resource conservation, preservation of cultural heritage, and/or access to healthy food.
3. **Social-Impact Media:** Companies that leverage the power of communication, storytelling, and technology to drive positive social outcomes at scale, give a platform to underrepresented voices and/or build a diverse workforce.
4. **Other Creative Businesses:** Other facility, input, production, and distribution businesses in arts, design, culture, and heritage industries that are run sustainably, provide quality jobs, and have a social impact.
5. **Creative Places:** Real estate projects that are affordable, target creatives or businesses in the creative economy, and benefit their neighbors.

Investment opportunities in the creative economy may be best suited for the $58 billion sitting in the endowments of museums, performing arts centers, libraries, art schools, and artist-endowed foundations. However, three reasons should encourage all impact investors to embrace a creativity lens.

- **More prospective investment opportunities and portfolio diversification:** As impact investing goes mainstream, more quality opportunities are needed to absorb the additional capital. The creative economy puts new high-potential companies in scope and offers impact diversification, bringing cognitive diversity by including creatives as problem solvers and getting more eyeballs on the issues.
- **More ways to get social impact. Investors can further their current impact goals by including creative businesses in their portfolios:** Businesses in creative industries are delivering impact for the environment, health, and education—among other priorities. Investors aligning with sustainable-development goals will find synergy with the creative economy. And, the impact that creativity and culture contribute to low-income communities has already been well documented.

Build a sustainable creative economy now; no need to fix it later: The presence of capital that values inclusion, equity, and sustainability can ensure that companies in the creative economy are providing quality jobs, acting positively for the environment, and strengthening their communities. Entrepreneurs leading companies in creative industries want to deliver impact and need impact investors to stand with them. The creative economy is growing and impact investors have an opportunity to shape the creative economy so it grows the right way.

42 Using the North American Industry Classification System (NAICS).

Developing a Theory of Change

Now that we have helped you zero in on your goals and establish your priority themes and lenses, we will introduce the theory of change. This tool will serve as the articulation of your intended objectives, how you think they will be achieved, and why you believe it to be so: *If we provide X support, we believe Y and Z will happen*. A theory of change articulates the intended changes for people, issues, and systems. It helps make explicit the connections and logic between activities (what you will do in terms of deploying financial and non-financial contributions), outputs (the short-term, direct results), and outcomes and impacts (the longer-term shifts that occur for issues and contexts, either directly or indirectly).

Your theory of change is typically constructed by first identifying the desired long-term goals and then working backward from these to identify all the intermediary effects, or outcomes, that are intended to occur to demonstrate progress. The theory of change includes the influence of the context you are working in, as well as the assumptions and evidence you are relying on. It is usually depicted as a visual map displaying the space between what impact investments do and how these directly or indirectly advance or realize the desired impact goals being achieved. This can be demonstrated at the enterprise, fund, or portfolio levels.

A theory of change can be useful for your impact investing strategy in several ways.[43] First, it can help describe and interpret—for you, your advisors and partners, and other stakeholders—what you are seeking to achieve and why. In this way, a theory of change can serve as a communications tool to align and manage expectations. Working through a portfolio-level theory of change can inform portfolio construction in terms of themes, instruments, and partnerships. It can also identify gaps and issues that require further validation, as you prioritize how you seek additional research and evidence. A theory of change should also inform the selection of methods, indicators, and standards that you can use to measure and evaluate success, while aligning short- and long-term measurement efforts.

43 For more examples of how theory of change has been applied in impact investing, see the open access article by Edward T. Jackson, "Interrogating the Theory of Change: Evaluating Impact Investing Where It Matters Most," *Journal of Sustainable Finance & Investment* (2013).

Components of a Theory of Change

As a first step in developing and constructing a theory of change, the logic model framework shown in Exhibit 3-11 may be useful. This linear logical model explores the basic components that will eventually become a nonlinear theory of change. While a standard format for a theory of change does not exist, we present this as a template or possible way forward. You can review a few specific examples later in this chapter, then utilize what is relevant and develop your own. Here we highlight common components:

Inputs: The financial and nonfinancial resources you bring. Examples include the amount and type of capital, instruments used, networks, time, and passion.

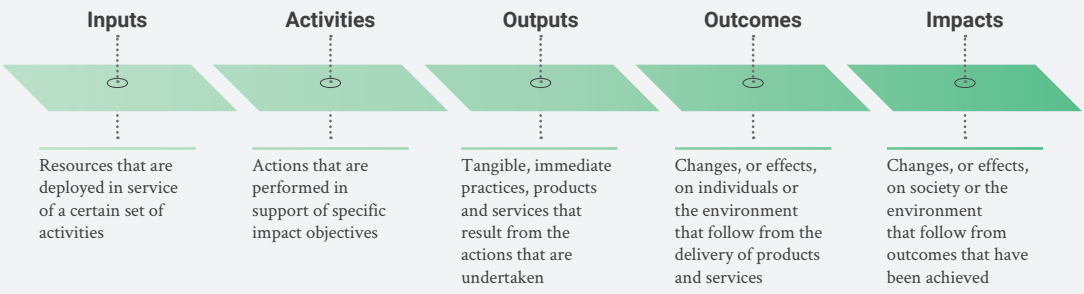
Outputs: The immediate, direct results from these investments–including what is delivered, to whom, when, and how. Examples include the number of units or products sold, the number of users reached, or the demographic characteristics of your direct beneficiaries.

Outcomes: The short-term and medium-term results attained or effects for individuals, groups, or issues. They can be both directly and indirectly related to the investments. Examples include improvements in targeted health behaviors for individuals or groups, or reduction in localized household-level economic poverty.

Impact: The long-term changes achieved for populations, issues, or systems. Impacts usually also specify the nature of contribution from investments relative to other inputs and influential factors. Examples include the shifts in behaviours or patterns for multiple population groups, or reductions in regional or national poverty levels.

Assumptions: Description of what you believe to be true in the context of the intended changes. They describe the basis of evidence or experience you are using, and should identify possible influential factors across the various levels from inputs to impacts.

EXHIBIT 3-11
Logic Model Overview

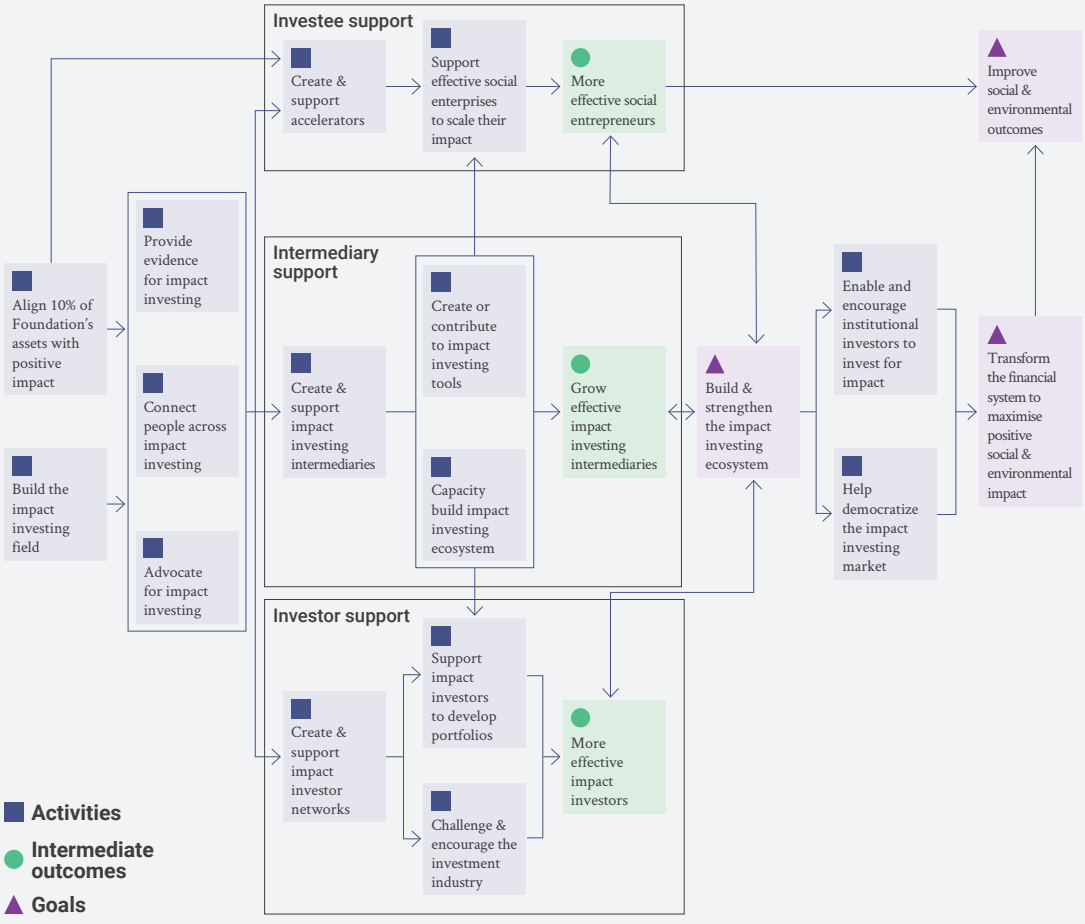


Source: Adapted from Logic Model of Measuring Impact, Impact Measurement Working Group of the G8 Social Impact Investment Taskforce, 2014.

EXHIBIT 3-12

KL Felicitas Foundation's Institution-level Theory of Change

The mission of the KL Felicitas Foundation, a private family foundation created by Lisa and Charly Kleissner in 2000, is to enable social entrepreneurs and enterprises worldwide to develop and grow sustainably. The foundation also actively advocates its impact investing strategy. KL Felicitas has pursued its impact goal of engaged ownership by creating a 100% mission-aligned portfolio and is working to shift the discrete system of the impact investing industry. We will revisit KL Felicitas in the impact measurement and management chapter. The foundation's impact investing strategy works to match the entrepreneurial spirit and business discipline of social enterprise with the significant capital made available through a growing network of impact investors. The Kleissners' personal values, along with their conviction regarding the potential of social enterprises and social entrepreneurs, help inform how they make investments and how they identify the most promising innovations for positive social and environmental change in the world. KL Felicitas's theory of change illustrates how the various strands of the foundation's work contribute toward their overarching goal of transforming the global financial system to maximize positive social and environmental impact.



Source: Plum Lomax, Anoushka Kenley, Abigail Rotheroe, and Sarah Denselow, "In Pursuit of Deep Impact and Market-Rate Returns: KL Felicitas Foundation's Journey," KL Felicitas Foundation and Sonen Capital, 2018.

Tips for Developing Your Theory of Change

Developing theories of change can be daunting. As part of our research, we spoke with a group of impact investment advisors about how they work with clients to develop and articulate impact themes, create theories of change, and ultimately construct portfolios that reflect these impact goals. The differences among individuals, families, and institutions are significant—reflecting the distinct approaches that are used to develop theories of change. These advisors emphasized the importance of shepherding clients through this process before heading into portfolio construction.

Here are some highlights:

- A shift from themes to theories of change means a shift from sectors to actions, resulting—for example—in looking at poverty alleviation rather than the financial-inclusion sector;
- By going deep on specific outcomes, understanding your priorities becomes critical and real-life examples are key in testing and setting these priorities;
- Take an expansive rather than a narrow perspective when developing your theory of change, as many impact goals and themes are interconnected. Multiple pathways exist for creating impact, rather than just one "magic bullet";
- Developing a theory of change is a repetitive process that requires data in order to be effective—be both courageous and iterative;
- The ability of an advisor to work with you to develop a theory of change has become an essential part of impact investing services;
- Organizations may distinguish between their organizational mission and their impact theory of change; and
- Impact theories of change will not deliver clear black-and-white answers and need to be informed by social science and research that may not align with your interests and passions.

The Limits of Theory of Change

To be clear, some funding decisions and portfolios lend themselves to using a theory of change better than others, and the pathways of change can be short and straightforward or long and complex. When supporting areas that require shifts in people's beliefs, mindsets, and culture (for example, social justice), investors need to understand that progress may take far longer and be more difficult to measure. Other interventions, such as incremental steps toward adopting new solar-energy technologies, may be much quicker and easier to track. Ultimately, a theory of change is just that—a theory you will progressively test, validate, and iterate through your investment decisions and feedback loops. A sound theory of change is important, but it is only one tool in your impact investing journey. We will provide more guidance in the "Now What" chapter.

Theories of Change Across Organizations and Approaches

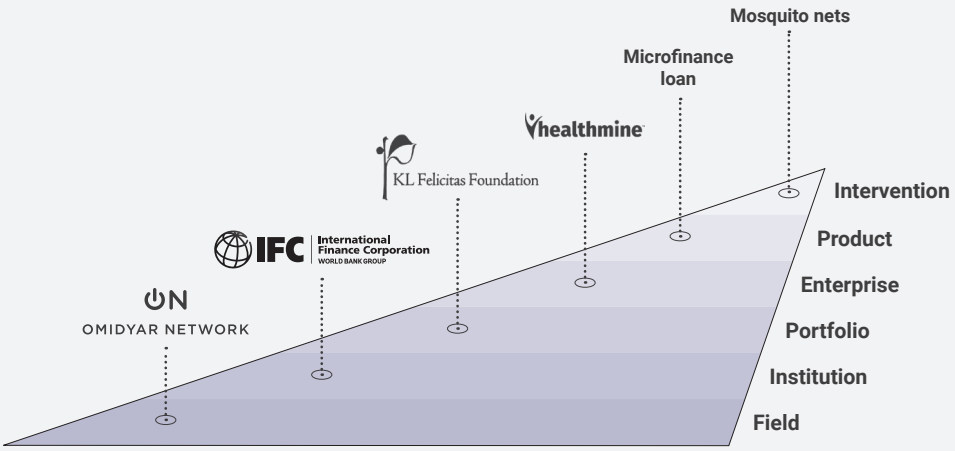
As you begin to construct your impact investing theory of change, it is helpful to understand that a theory of change can operate at different units of analysis. For example, there could be a theory of change for an asset owner (an individual, a family, or an institution), a portfolio, a fund, an asset class, or a specific investment or enterprise. In Exhibit 3-13, we have outlined the various units of analysis that a theory of change can use. We have also included a specific theory of change from HealthMine (Exhibit 3-14), a for-profit enterprise in which the W.K. Kellogg Foundation has made an impact investment.

Aligning Impact Intention and Impact Measurement and Management

While we will address impact measurement and management in more detail in the "So What" chapter, the theory of change can inform how impact considerations are integrated at various stages of the investment process. At the highest level, your theory of change informs the design of your overall impact portfolio. One level down, it can be applied at the thematic level, and subsequently at the transaction level. At these stages, you are beginning to convert specific aspects of your theory of change into "impact criteria and considerations" that will be integrated within due diligence processes—also known as impact due diligence. This integration helps to align and screen for impact considerations

EXHIBIT 3-13

Theories of Change: From Broad Fields to Specific Interventions



Rockefeller Philanthropy Advisors

EXHIBIT 3-14

HealthMine's Enterprise-level Theory of Change

As a service company that continuously empowers and incentivizes individuals to take action and improve their health, HealthMine drives health action while enabling health plans and organizations to increase profitability. Originally built inside a value-based insurance design health plan, HealthMine's services have been leveraged by health plans since 2008, targeting and engaging individuals to take clinically informed health actions that improve quality measures and clinical outcomes while decreasing total cost of care. The Kellogg Foundation has invested in HealthMine, based on the company's theory of change.

HealthMine's Theory of Change: As a health-care technology provider, HealthMine's impact is concentrated on the members who register on the platform and change their behavior as a result of registration. Kellogg assessed the impact of HealthMine on members in four key impact areas: use of the platform, compliance with the recommended health actions, management of chronic conditions, and health-care expenditures.

Source: W.K. Kellogg Foundation and KKS Advisors, Mission Aligned Framework for Investing, 2019.

before making an investment, guides the terms of that investment, and informs post-investment monitoring and review of impact performance. This process helps you make more informed investment decisions, increases the chances of impact occurring, and protects against the risks of negative impacts on suboptimal results.[44]

One framework that can be helpful for both your theory of change and its translation into impact due diligence criteria is the "Impact Management Project's (IMP) Five Dimensions of Impact" (Exhibit 3-15). These dimensions provide defined categories as a shorthand—What, Who, How Much, Contribution, and Risk. On one hand, it can be helpful to review your theory of change against these dimensions to ensure that you have the appropriate level of clarity for each dimension—and that you have a holistic understanding across these dimensions. On the other hand, you can integrate these dimensions (and their subcategories and data fields) into your impact due diligence processes, including post-investment monitoring and reporting. To put it simply: The IMP five dimensions can act as a checklist to ensure that you have a targeted understanding of your intended impacts in relation to your impact investment strategy.

In the next chapter, we will build from the theory of change and move to the *How*, considering the impact tools and structures available for impact investors. These will guide your selection of products for your portfolio, bringing more detail to your theory of change and shaping your governance documents.

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44 For a further exploration of impact due diligence, see *Impact Due Diligence Guide*, Pacific Community Ventures (2019).

EXHIBIT 3-15

Impact Management Project's Five Dimensions of Impact

What	Who	How Much	Contribution	Risk
What outcome(s) do enterprise activities drive? How important are the outcomes to the people (or plant) experiencing them?	Who experiences the outcome? How underserved are they in relation to the outcome?	How much of the outcome occurs? Does it happen at scale? Does the effect drive the outcome? Does it last for a long time?	What is the enterprise contribution to what would likely happen anyway?	What is the risk to people and the planet that the impact does not occur as expected?

Source: Impact Management Project

FRAMING QUESTIONS

- What are your impact goals, and how will you express them?
- What impact themes and lenses are most relevant to achieve these goals?
- How will you learn about the underlying research and policy landscape for the themes and lenses?
- How will you develop your theory of change? What support do you need?
- What aspects of your theory of change are you most comfortable with? What areas require additional work?
- How will you ensure that your theory of change reflects your latest thinking, experience, and learning? How will it be updated and used regularly?
- How do your impact goals and theory of change relate to your investment goals? Do they feel strongly aligned, or what additional exploration is required?

Practitioner Exercise and Sophia Example

Why: Initial Theory of Change

Exercise Overview

As you explore your impact investing goals, prioritize those that resonate with you. You will likely not be able to achieve all your goals, especially not in the shorter term. The good news is that the *Why* will be iterative as you look at possible impact tools and structures. Learning goals—not just impact and investment goals—are also critical. So, don't feel locked into your choices at this point. We begin with a simple theory of change and will build from there.

Steps to Creating Your Theory of Change

1. Revisit your resource inventory and add each element as an input along the logic model.
2. For each row, fill out the desired activities for each of the inputs. You can include both what you are providing today and what you hope to provide or leverage over time.
3. For each row, fill out a first attempt at the overall impact you hope to achieve for each activity. Keep this at a relatively high level and focus on the big picture markers of progress for individuals, organizations, or issue areas. If you're feeling ambitious, you can divide the work into outputs, outcomes, and impact.

Additional Steps to Adding Detail to Your Theory of Change

4. Narrow your focus to financial assets, and segment your assets into priority categories.
5. For each category, add specific impact goals and investment goals discussed in this chapter.

Sophia's Theory of Change

Sophia's primary impact goal is to align as much of her portfolio with her values as possible. Realizing that all investments have impact, she has an overarching goal of knowing what she currently owns, shifting it toward positive net impact, and doing as little harm as possible. She wants to be accountable for the impact of her assets. She continues to talk with her husband, while looking at the enterprises they own as a first step to seeing what might be out of alignment with both of their values.

Specifically, Sophia would like to prioritize the following impact themes: Water, Climate, and the Arts, in that order. Where possible, she would also like to overlay a gender lens. Sophia has followed the guidance above and filled out the following table to create her initial theory of change. Sophia has set the overall investment goal of her foundation at a risk-adjusted rate of return of a 5% payout plus inflation. She is seeking a diversified portfolio with an allocation to less liquid, impact-aligned opportunities.

Resource	Activity	Impact
Financial Assets	• Commit the entire endowment toward impact with a primary goal to do no harm and integrate values where possible • Explore high-impact investments with foundation payout • Focus donor-advised fund on water grantmaking	• To not contribute to negative corporate impacts • Prove new models toward water access • Empower women through gender lens • Learn about overlap with fashion industry
Human (Organizational) Capital	• Play a significant role in private investments given business experience and interest, considering art/fashion investments • Leverage passion for water-related causes • Devoting 50% of time/energy to align portfolio, considering consultant as needed	• Become better versed in impact investing best practice • Expand water interest to use business models and capital markets for impact • Explore how fashion can be leveraged for good
Relational Capital	• Focus relationship building on learning from one peer asset owner for inspiration and guidance • Consider a consultant to support strategy development • Stay close with family attorney to review portfolio shifts and influence on broader family	• Be guided/inspired by experts • Begin to shift family's perspective in impact investing

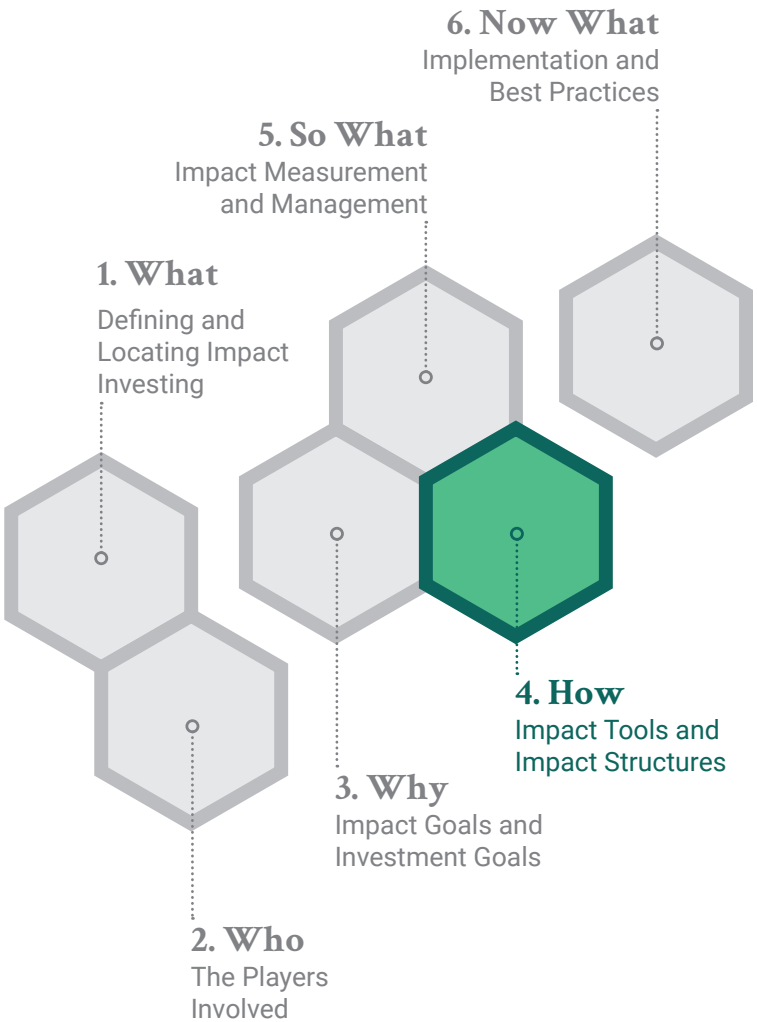
Sophia decides to take her theory of change to one more layer of distinction, focusing on specific financial assets and integrating specific impact goals and investment goals. This will serve as the foundation to build her portfolio.

Resource	Impact Goal: Impact Theme	Impact Goal: Impact Intensity	Impact Goal: Lens	Investment Goal: Risk/Return Target
Entire Portfolio ($500M)	Do no harm	Low	N/A	Maximized financial risk/return
Foundation Endowment ($40M)	1. Water, where possible 2. Climate, where possible	Low to medium	Gender	Payout plus inflation
Foundation Payout for PRIs ($2M)	1. Water 2. Arts, where possible	High	Gender	80% return of capital

CHAPTER 4

How

Impact Tools and Impact Structures



Bridging Theory of Change and Portfolio Construction

Once you have established your impact goals and developed a theory of change, you are ready to apply your theory of change to the construction of your portfolio. In this chapter, we will focus on the impact tools and impact structures available to express your theory of change. Impact tools are actions, such as screening, shareholder engagement, ESG integration, thematic investment, catalytic concessionary capital, and setting a time horizon. Impact structures are the investor, intermediary, and enterprise vehicles you can select to optimize impact. Transaction structures, such as pay for success, responsible exits, and covenants, can also drive specific outcomes. While these impact tools and impact structures can affect investment risk and return, we will focus on how they can be used to drive impact. We will then discuss specific product types and concrete suggestions about constructing your impact investing portfolio. To begin, we will introduce asset classes and review the key governing documents, such as the investment policy statement, that establish the ground rules for deploying your impact investing portfolio.

Investment Governance Documents

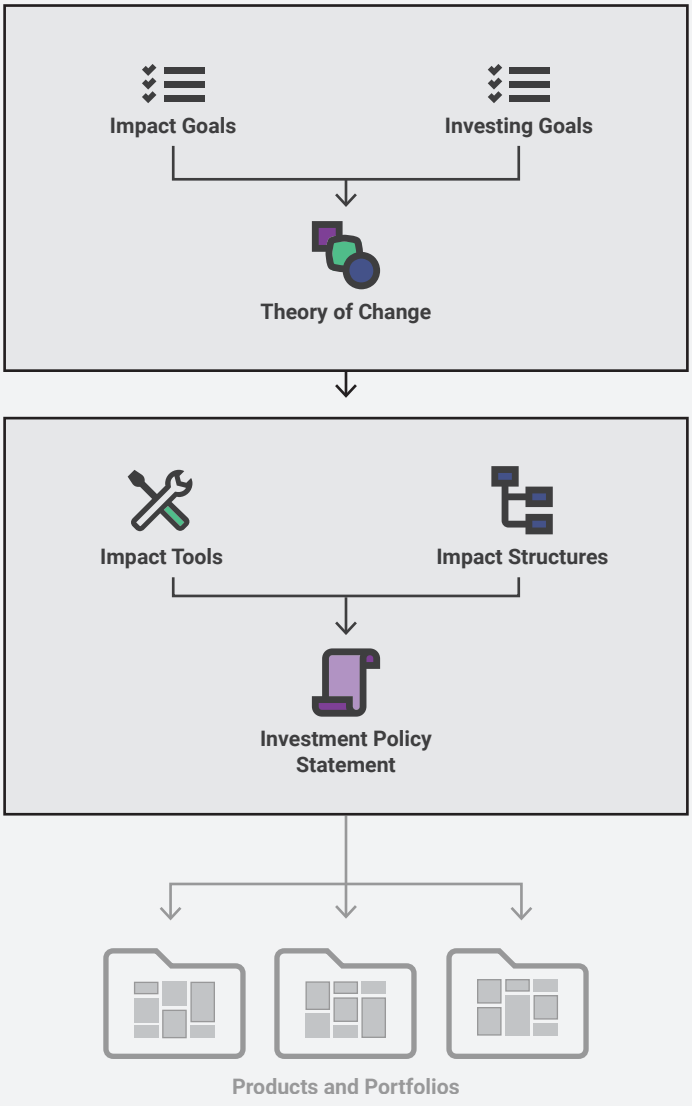
The two categories of governing documents for an impact investing portfolio are the impact investment statement (IIS) and investment policy statement (IPS). The IPS has traditionally focused on investment goals and parameters that drive portfolio construction. Along with the IPS, the IIS codifies your theory of change as driven by your impact goals. The IIS is a guiding tool for both internal and external stakeholders, which provides clarity of mission, principles, and impact strategy. Some asset owners choose to create one document that integrates elements of both statements, while others choose to create two separate documents. The IIS can serve as the guiding principles for the family or board and can then be used to drive the execution of the strategy through the IPS. In the practitioner's exercise at the end of this chapter, we will help you develop your version of these two documents.

Your impact investment statement may contain the following elements:

- Mission, vision, and values;
- Views on fiduciary duty;
- Definition and boundaries of impact investing;
- Role of impact investing;
- Impact investing approaches;
- Theory of change;
- Impact goals;
- Impact tools and structures;
- Product examples, if desired; and
- Approach to Impact Evaluation (read more about this in the "So What" chapter).

EXHIBIT 4-1

Impact Investing Process



Your investment policy statement likely includes:

- Roles and responsibilities of the board, family, and investment committee;
- Role of advisors, including level of discretion;
- Overall investment goals and objectives;
- Risk appetite;
- Liquidity requirements;
- Diversification goals;
- Investment limitations, including specific assets and transactions;
- Tax considerations, as applicable;
- Asset-allocation strategy;
- Time horizon;
- New cash investment guidelines; and
- Financial reporting.

As one example of these governing documents in practice (Exhibit 4-2), the Rockefeller Brothers Fund (RBF) has developed an investment policy statement[45] as well as a mission-aligned investment statement.[46] The RBF's investment policy statement intentionally addresses the roles and responsibilities of the board of trustees, the Investment Committee, staff, and the foundation's Outsourced Chief Investment Office (OCIO). As we elaborate in the "Now What" chapter, the clear delegation of these responsibilities is a critical element of an investment policy statement. The document also establishes return, risk, and liquidity targets for specific asset classes and the overall portfolio.

Asset Classes

The key building block of any portfolio is the asset class, each categorized with unique risk/return characteristics. Debt and equity are broad asset classes, and each is distinguished by the asset owner's relationship to the investment: Debt investors are creditors (lenders) and equity holders have an ownership stake. Debt is also known as fixed income, as the lender is typically paid a fixed rate of interest. The equity owner is not assured a fixed return and is compensated by the company's growth, expressed in an increase (or decrease) in the value of the ownership interest. An equity investor can receive dividends from the company or sell the equity stake in order to realize a return. Asset classes generally range from very liquid and low risk/return, such as cash, to illiquid and high risk/return, such as private investments and real assets. Debt and equity are available in both public and private markets. While there are different ways of segmenting asset classes, we will use the categories specified in Exhibit 4-3 going forward as we discuss impact investing portfolios.

45 https://www.rbf.org/sites/default/files/rbf_investment-policy-statement_6-23-16.pdf.

46 https://www.rbf.org/sites/default/files/mission_aligned_investment_efforts_2017-03.pdf.

EXHIBIT 4-2

The Rockefeller Brothers Fund's Approach to Impact Investing Governance

Gerry Watson

RBF has embarked on an effort to achieve greater alignment of its investments with its philanthropic mission while maintaining the overall goal of preserving the purchasing power of the endowment over time. This has evolved into a dual-pronged approach to investing, which ensures all investment allocations across the entirety of the endowment reflect mission-aligned investing objectives:

1. At the highest level, RBF has increased the degree of alignment between its portfolio and its mission. The clearest way to do this was to commit to divest from investments in fossil fuels.
2. At the same time, where practical, RBF seeks to advance its mission and program initiatives through impact investing.

MISSION-ALIGNED INVESTING

The Rockefeller Brothers Fund has worked throughout the last decade to align its financial portfolio with its programmatic interests in democratic practice, peacebuilding, and sustainable development. The fund's mission-aligned investment efforts include divestment from fossil fuels; impact investments; investing using environmental, social, and governance (ESG) criteria; and leveraging shareholder voting rights.

99% Fossil Fuel Free

Impact Investments

Market-rate investments in primary capital (e.g., private equity and debt, and real assets such as real estate and infrastructure) with meaningful and measurable impact advancing the RBF's mission and program initiatives.

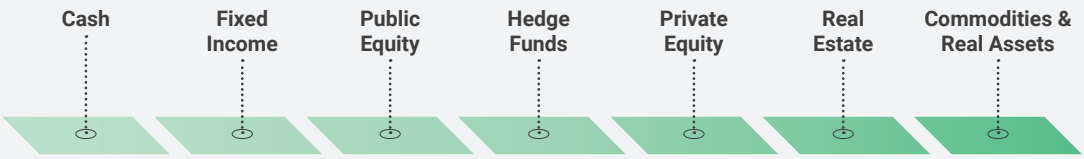
ESG Investments

Investments proactively screened for environmental, social, and governance criteria. While ESG criteria may differ, they can include factors such as carbon emissions, land use, labor management, health risk, board diversity, and financial transparency.

Remaining Fossil Fuel Exposure

Source: Rockefeller Brothers Fund

EXHIBIT 4-3
Spectrum of Asset Classes



Though asset classes are not directly linked to specific impact tools or structures, impact characteristics and considerations do vary across asset classes. For example, a municipal bond might have more information about intended community impacts, while private equity could raise impact questions about how to responsibly exit the investment. The impact characteristics of specific asset classes will be explored further when we look at portfolio construction later in this chapter.

Impact Tools and Impact Structures

Extending our house metaphor, the *How* will begin to build the structure of your portfolio on top of the foundation of your *Why* or theory of change. Expanding on the approaches we introduced in Chapter 1, the impact tools and impact structures in Exhibit 4-4 can also be clustered within the following broad approaches. You will use impact tools and impact structures to lay out the rooms and walls before selecting the specific investment products you will use to construct your impact portfolio.

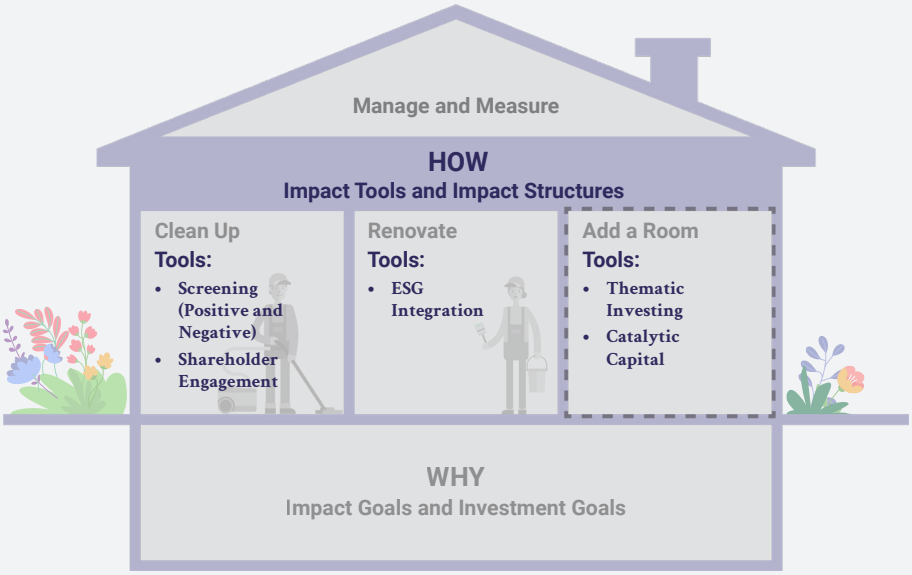
Impact Tools

Impact tools can be combined or used separately within your portfolio. Screening can be applied to reflect your specific preferences about what investments you want to hold, while shareholder engagement is about influencing the corporate practices of the companies in your portfolio. Environmental, social, and governance (ESG) integration uses data and methodologies to include ESG factors into your financial analysis and investment selection. Thematic investment is an impact tool that drives the creation or expansion of specific outcomes, while catalytic concessionary investments generate (catalyze) positive impact and enable investments that would not otherwise be deployed.

We will now explore each of the impact tools and impact structures individually.

EXHIBIT 4-4

Impact Tools & Impact Structures



Screening

The earliest examples of impact investing use the tool of screening: the inclusion or exclusion of companies or sectors due to alignment with specific values. As many impact themes emerge from social and environmental movements, investors see screening as a way to align assets with their values and drive change. For some investors, entire industries, such as private prisons, tobacco, or contraception, are excluded from their investment holdings. While the link between screening and contribution is not as clear as with other impact investing approaches, many impact investors see screening as a central part of their active ownership.

Shareholder Engagement

Shareholder engagement involves the identification of material factors where shareholders can influence corporate practice—either by engaging with corporate management or voting as a shareholder. While most shareholder engagement occurs in public equities, private-equity investors and debt holders can also engage with management (for example, by taking a board seat). Through direct results and broader influence, this approach feeds back into future investment analysis and decision-making. While this approach has historically involved a significant investment of time and resources, recent advances have improved its popularity. Exhibit 4-5 highlights the U.S. Dominican Sisters' evolving approach throughout several decades, showing the importance of long-term commitments and collaboration to influence corporate change.

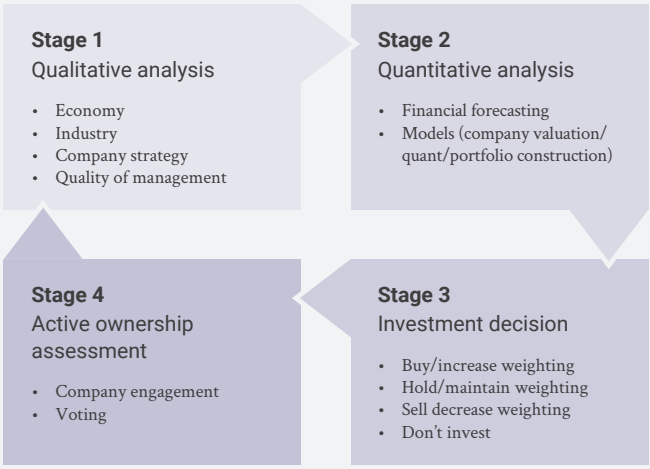
EXHIBIT 4-5

Shareholder Engagement and Impact Investing

U.S. Dominican Sisters

Dominican Sisters in the United States has been working on a range of shareholder engagement activities through the Interfaith Center on Corporate Responsibility (ICCR) since the 1970s. In 1990, its first climate-related resolution was to utilities in its portfolios on energy efficiency. This one resolution evolved into various requests to companies in almost every sector related to Greenhouse Gas (GHG) emissions disclosure, the funding of climate deniers, investment in renewable energy and energy-efficient products, and the climate risk inherent within corporate business models. In 2015, as part of a theological reflection on what would be needed to transition to a post-carbon economy, with concern for marginalized communities, Dominican Sisters decided to invest proactively in climate solutions that are integrated with the UN's SDGs. In its view, the climate crisis will require more than shareholder engagement, so proactive thematic investment is the next step. This bottom-up approach is how the Dominican Sisters see the movement growing. The Sisters discovered a lack of product offerings, and after meeting with more than two dozen Wall Street investors found a partner in Graystone Consulting/Morgan Stanley. This group was willing to develop new products with a mix of public and private investments across asset classes. Dominican Sisters sees shareholder engagement as a key approach to effecting change on a host of social and ecological issues, along with advocacy, education, and impact investing. "We find that companies pay attention to shareholder engagement initiated by ICCR members, because it is an early-warning system for risks—you can see that through a recent example such as human trafficking," said Sister Patricia Daly, OP. Working within the broader interfaith community is critical to achieving its goals.

EXHIBIT 4-6
ESG Integration Process



Source: Principles for Responsible Investment, https://www.unpri.org/listed-equity/a-practical-guide-to-esg-integration-for-equity-investing/10.article.

ESG Integration

The widely used impact tool of environmental, social, and governance (ESG) integration is the systematic and explicit inclusion of ESG factors into financial analysis and investment selection. Investment institutions complement traditional quantitative risk/return analysis with consideration of ESG policies, performance, practices, and impact.[47] When applying this approach to investment selection or weighting, it may also be known as an ESG tilt or best-in-class screening. Asset managers and asset owners can incorporate ESG issues into the investment process in a variety of ways. Some investors include companies that have stronger ESG policies and practices, while others exclude or avoid companies with poor ESG track records. Still, others incorporate ESG factors through peer benchmarking or as part of a wider evaluation of risk and return. The Principles for Responsible Investment has developed a four-stage process (Exhibit 4-6) describing how investors can integrate ESG.

47 US SIF: The Forum for Sustainable and Responsible Investment, https://www.ussif.org.

The availability of ESG data and data providers has proliferated, although consistency does not yet exist across approaches. ESG data services range from fundamental providers of public data such as Bloomberg and Refinitiv to comprehensive ESG ratings providers like ISS, MSCI, RepRisk, Sustainalytics, and Vigeo Eiris to specialists focused on specific themes such as the nonprofit Carbon Disclosure Project (CDP) and Equileap, which provides gender-equality data. Asset owners use ESG data as one input for their investment decisions as part of their due diligence and portfolio monitoring. Given the growth in ESG data sources, ESG is no longer limited to corporate disclosures as data providers track information from non-governmental organizations (NGOs), governments, and other stakeholders to find insights. As data proliferates, the field is moving from data gathering to better understanding the patterns and signals in the data, through machine learning, natural language processing, and artificial intelligence. Truvalue Labs (Exhibit 4-7) has developed a helpful framework to understand how ESG research has moved from data scarcity to abundance and now superabundance with artificial intelligence.

EXHIBIT 4-7

The Evolution of ESG Research

	Scarcity What can I discover about the ESG record of a company?	**Abundance** What does all the data mean? How do I differentiate companies?	**Superabundance** How do I find ESG signals in unstructured data?
Data	Stuctured > Unstructured	Stuctured > Unstructured	Unstuctured > Structured
Technology	Print media & databases	Internet search engines	AI→NLP & ML
Framework	Values alignment	Materiality & risk	Intangible value & risk
Product	Reports	Ratings	Stakeholder sentiment analysis
Frequency	Annual	Annual	Daily
Primary Use Case	Screening	Static peer ranking	Dynamic peer analysis & trends
	1970s	**2000s**	**2010s**

Source: Truvalue Labs 2019

Thematic Investment

Thematic investment is an impact tool that drives the creation or expansion of specific outcomes. Different from the tools mentioned thus far, this tool focuses on investments that address one particular impact theme. For example, an investment in an early-stage educational-technology company would be a thematic investment focused on the theme of education. This approach can be applied across asset classes and themes, although individual projects and early-stage enterprises may more easily demonstrate outcomes. Given that an investor can exercise more direct control over a project or private-market investment, many thematic investments are in these asset classes.

In the article, "Why and How Investors use ESG Information: Evidence from a Global Survey," Amir Amel-Zadeh and George Serafeim lay out the broad range of impact investing approaches and reasoning of global money managers responding to the survey.[48] For their research, they distinguished between the following impact tools commonly used in practice:

- Engagement/active ownership is the use of shareholder power to influence corporate behavior through direct corporate engagement, such as communicating with senior management and/or boards of companies, filing or co-filing shareholder proposals, and proxy voting that is directed by ESG guidelines.
- Full integration into individual stock valuation is the explicit inclusion of ESG factors into traditional financial analysis of individual stocks, for example as inputs into cash-flow forecasts and/or cost-of-capital estimates.
- Negative screening is the exclusion of certain sectors, companies, or practices from a fund or portfolio on the basis of specific ESG criteria.
- Positive screening is the inclusion of certain sectors, companies, or practices in a fund or portfolio on the basis of specific minimum ESG criteria.
- Relative/best-in-class screening is the investment in sectors, companies, or projects selected for ESG performance relative to industry peers.
- Overlay/portfolio tilt is the use of certain investment strategies or products to change specific aggregate ESG characteristics of a fund or investment portfolio to a desired level, such as aligning an investment portfolio toward a desired carbon footprint.
- Thematic investment is investment in themes or assets specifically related to ESG factors, such as clean energy, green technology, or sustainable agriculture.
- Risk factor/risk premium investing is the inclusion of ESG information in the analysis of systematic risks as, for example, in smart-beta and factor-investment strategies—similar to size, value, momentum, and growth strategies.

Based on the survey, the primary reason asset owners use ESG information is to assess investment performance and form an active ownership/shareholder engagement strategy. The major impediment was found to be the lack of comparability across the ESG reporting of companies.

48 *Financial Analysts Journal*, vol. 74, no. 3, CFA Institute (2018): 87-103.

EXHIBIT 4-8

Net Contribution of Enterprises Drives Conscious Portfolio Construction

Heron Foundation

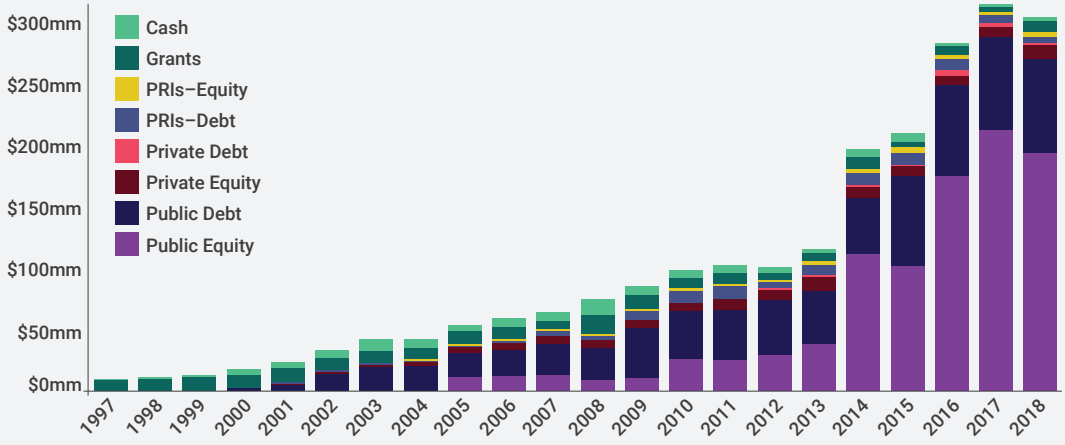
After the Heron Foundation's board and staff committed to aligning their entire portfolio with their mission of helping people help themselves out of poverty, they also acknowledged that all their current investments had impact both positive and negative. They originally believed that they could simply shift current investments to enterprises that provided better family-sustaining jobs. However, when they began examining every underlying enterprise across their current portfolio, they realized that some of the enterprises that provided "good jobs," such as private prisons, were not good, on the whole, for the people and communities they wanted to help.

Over time, they recognized they would first need to look at their investments with "a view toward overall impact"—an approach they now refer to as "net contribution." This point of view developed into a focus on enterprises that have a net-positive impact on society—and only then do they layer on their specific mission. The net-contribution lens examines the aggregate effect of an enterprise on the world and helps analyze the way in which enterprises consume and generate different types of capital: human capital, natural capital, civic capital, and financial capital.

- **Human Capital** comprises an enterprise's interactions with individual people with whom it has a direct relationship, including but not limited to its employees.
- **Natural Capital** includes how an enterprise makes use of resources, such as energy and raw materials, how it handles waste products, and its effects on the natural environment.
- **Civic Capital** looks at an enterprise's interactions with communities, including customers, neighbors, and governmental actors such as regulators. One such interaction might be how a company approaches its taxes.
- **Financial Capital** looks at an enterprise's interactions with the economic and financial landscape in which it operates, including most directly its effects on capital providers through governance practices and capital-outlay decisions.

Because Heron believes every investment has impact, it does not limit its investment universe to just a few asset classes or types of enterprise. By using an array of financial tools, it invests in a diverse group of enterprises, including nonprofits, for-profits, and government entities. This helps Heron minimize risk, optimize liquidity, manage transaction costs, and maintain the flexibility required to provide communities with the types of capital they identify as most helpful.

Impact Assets Over Time



Source: Heron Foundation, https://www.heron.org/conscious-portfolio-construction-1.

Catalytic Concessionary Capital

Catalytic concessionary investments are structured to generate (catalyze) positive impact and enable investment that would not otherwise be deployed. Catalytic capital achieves this goal by accepting disproportionate risk and/or concessionary returns relative to investment-seeking, risk-adjusted, market-rate returns. This "but for" consideration is critical to the success of catalytic investments.[49] While some types of catalytic capital can focus specifically on debt, it can also include private-equity investments. The subsidy or concession that is an essential element of catalytic capital can take several forms. Debra Schwartz, of the MacArthur Foundation, first described these concessions as the Five Ps in 2013.[50]

Price: This approach accepts an expected rate of return that is below market, relative to the expected risk. This would include structures such as program-related investments (PRIs), recoverable grants, and any investment in which a subsidy is embedded in the return.

Pledge: This approach provides credit enhancement in the form of a guarantee, allowing impact investors to support an enterprise without deploying capital. The guarantee is a contingent obligation of the investor—for example, it is used only if the enterprise does not meet its obligations. Given that some foundations have endowments that are being managed for perpetuity, a guarantee issued by the foundation can create impact without the need to liquidate or reduce securities holdings in the endowment. The lender looks to the guarantee as collateral for the loan. Exhibit 4-9 shows how MCE Social Capital leverages the guarantees of loans to individuals in order to generate impact. Prioritizing this tool, The Kresge Foundation has commissioned studies, created helpful instructional videos, and founded an innovative guarantee collaborative, the Community Investment Guarantee Pool.

Position: This approach provides credit enhancement by taking a subordinated/junior position in a "capital stack," while other investors take a senior position. Roughly defined, the capital stack determines who has the rights—and in what order—to the income and profits generated. In this structure, the impact investor might bear the "first-loss" risk—for example, the subordinated investors get paid after the senior investors in the case of a shortfall. Many complex debt and project finance structures may invite impact investors to take subordinated positions in order to attract senior commercial capital into the project. Unlike a guarantee, these investments are funded with capital and not on a stand-by basis.

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49 *Catalytic Capital: Unlocking More Investment and Impact*, Tideline Report, MacArthur Foundation (2019): 2.

50 Paul Brest and Kelly Born "Unpacking the Impact in Impact Investing," *Stanford Social Innovation Review*, (2013), https://ssir.org/articles/entry/unpacking_the_impact_in_impact_investing#.

EXHIBIT 4-9

Guarantees (Pledges) for Impact Generation
MCE Social Capital

MCE Social Capital is a nonprofit impact investing firm that uses a pioneering loan guarantee model to generate economic opportunities for millions of people, particularly women, in more than 35 countries. MCE funds its microfinance institutions and small- and growing-businesses lending by collecting philanthropic pledges from foundations and individuals (its guarantors) to make tax-deductible contributions if—and only if—one of its borrowers fail to repay a loan from MCE. The firm pools these pledges—currently $135 million from more than 100 guarantors—and uses them as collateral to borrow capital from U.S. and European financial institutions.

Source: MCE Social Capital, https://www.mcesocap.org.

Patience: This approach accepts a longer, or less-certain, time horizon for repayment than other commercial investors. In the case of an equity investment, the investment may come with no set repayment schedule, while debt investors have a set repayment timeline. Patient capital may also be a tranche of debt that is not repaid until other investors have been repaid. In certain cases, the repayment is based on a portion of the investee's operating revenue rather than a set repayment schedule. Impact investors using this approach are willing to defer repayment in order to prove a case for investment in a new company, impact theme, or geography.

Purpose: This approach accepts nontraditional/non-market terms to meet the needs of the enterprise, including no collateral, smaller investment size, higher transaction costs, or more flexible use of proceeds. This tool becomes particularly important when investing in an innovative structure that requires additional research and development before it can attract commercial capital. The investor should be mindful that nontraditional structures may face challenges when they try to scale.

As defined in Exhibit 4-10, many foundations use PRIs as catalytic investments. In Exhibit 4-11, the Michael & Susan Dell Foundation's (MSDF) MISSION Framework is shared as a tool for analyzing these opportunities. MSDF, in conjunction with NYU Wagner, developed its MISSION framework with the following dimensions: Market, Impact, Scale, Sustainability, Incrementality, Organization, and Next. This framework address questions of how a specific opportunity aligns with MSDF's programmatic strategies.

The Limits of Concessionary Capital

Some impact investors may see the use of concessionary capital as the key driver of their impact investing strategy. Others, however, argue that catalytic capital can provide subsidies that interfere with important market forces and should not be used, while still other impact investors will use both catalytic concessionary capital and non-concessionary tools in the

EXHIBIT 4-10

Program-Related Investments: A Catalytic Capital Tool for Private Foundations

An important structural distinction for private foundations deploying catalytic capital is the difference between a program-related investment (PRI) and a mission-related investment (MRI). A PRI is a statutorily defined type of charitable investment that arises in the context of the general prohibition on jeopardizing investments under Section 4944 of the Internal Revenue Code. A PRI is treated like a grant for many regulatory purposes, including qualifying toward a foundation's 5% minimum distribution requirement. Section 4944(c) and the Treasury Regulations articulate a three-part test for an investment to qualify as a PRI: (1) The primary purpose of the investment is to accomplish one or more charitable purposes; (2) No significant purpose of the investment is the production of income or the appreciation of property; and (3) No purpose of the investment is to lobby or engage in political campaign intervention. In contrast, an MRI is not a legal term but describes an investment that integrates mission alignment into the investment decision-making process. These investments are a component of the foundation's overall endowment and investment strategy and must comply with the state and federal prudence requirements applicable to a foundation's investing activities generally. They are unique in that the degree of mission alignment becomes an essential factor in the prudence analysis, allowing for, in some cases, a lower financial return objective than for a non–mission aligned endowment investment. In many cases, mission-related investments in a foundation portfolio will look exactly like investments you would find in any portfolio, however the diligence in choosing those investments will have an additional impact lens.

See more details in the legal section of the "Now What" chapter.

construction of their portfolios. As you consider this tool, remember that some theories of change are advanced by these concessionary tools and some may not be. The use of concessionary capital will be driven by your theory of change and the type of investor you are.

Setting a Time Horizon

Your time horizon has implications on investment decisions. Impact investors seek to align investment timelines with the requirements of social and environmental challenges. This can come into conflict with some traditional investors who may focus solely on short-term results, such as quarterly earnings. It is important to balance the time horizon of desired financial results with desired social outcomes.

EXHIBIT 4-11

MISSION Framework for Analyzing Program Related Investments

Michael & Susan Dell Foundation and NYU Wagner

M	**Market** Ability to create new markets, test innovative products and services, or serve new demographics through the use of patient capital and/or fund investments. Objective is to prove business model's long-term financial sustainability and demonstrated demand (aka product/market fit) in order to attract traditional capital and spur competition.
I	**Impact** Use of a PRI may induce organizational growth, programmatic scale, or similar effects that can lead to widespread, demonstrable outcomes in a relatively short time. The investee should be able to produce measurable outcomes that are clearly connected to programmatic strategies.
S	**Scale** Investment can scale a nascent market to serve low-income customers or move an existing market to have a higher proportion of low-income customers.
S	**Sustainable** Long-term financial health increases the likelihood of an investee's success and the achievement of social impact at scale. A deep understanding of organizational risk factors, operational metrics, exit path strategies, and scenario planning helps to mitigate firm-level risk. Relationships with top management and other investors, along with ongoing data collection and analysis, are additional tools for ensuring sustainability.
I	**Incrementality** The investment adds value and is an opportunity beyond the scope of, not a replacement of, mainstream capital.
O	**Organization** The entrepreneur/promoter and other capital providers need to be committed to both the market and charitable objectives of the investment and be open and supportive of the philanthropic investors' role, including board representation, reporting requirements, and operational target analysis.
N	**Next** The investment has a logical path to scale market sustainability through a capital strategy or recycling of capital. The inherent sustainability of the model should enable it to attract new forms of capital to allow significant scale up of the outreach and impact. There is a steadfast commitment to accountability by the investee, driven by expectations of capital recovery.

Source: NYU Wagner and the Michael and Susan Dell Foundation, "Mission Investing: A Framework for Family Foundations," 2018.

Beyond the time component for investment performance, a consideration specific to foundations and other charitable vehicles is an institution's time horizon, ranging from perpetuity to spend down. More and more foundations are choosing to spend down, or sunset, their endowment in order to have the most impact on the most urgent needs. For more information, see Rockefeller Philanthropy Advisors' guide *Setting a Time Horizon*.[51]

If you are considering spending down, here are some key investment considerations:

- Priority is placed on fixed income and cash, given the defined timeline for liquidity and exit;
- Risk tolerance ranges from quite low, in order to meet grant payouts, to quite high, in order to make a significant impact in a short time;
- Coinvestment opportunities can be compelling to align the short time horizon of one investment with the longer time horizon of others. However, challenges of coinvesting can occur with asset owners who have a different time horizon;
- Care should be taken when selecting managers given the need for time alignment;
- One option is spinning out high-performing investments at the end of sunset; and
- Investment talent should be carefully considered to properly incentivize performance and transition in the final years.

Exhibit 4-12 shows how the Grove Foundation integrates impact investing into its spend down strategy.

51 https://www.rockpa.org/wp-content/uploads/2017/08/Setting-a-Time-Horizon.pdf.

EXHIBIT 4-12

Spend Down and Impact Investing

Rebekah Saul Butler, The Grove Foundation

The Grove Foundation, founded in 1986 by former Intel CEO Andy Grove and his wife, Eva, was never intended to last forever. From the beginning, the Groves said it should be closed within twenty-five years of the death of the second founder, a reflection of the Groves' shared commitment to address today's problems today. When Andy passed away in 2016, his daughter Karen became chair of the foundation. Eva and Karen's sense of urgency became even more acute as they witnessed the deterioration of many of the things the foundation sought to protect. As a result, they decided to (1) further accelerate their spending toward complete spend down within the next ten to twenty years, (2) start a sister 501(c)4 to engage important policy issues, and (3) adopt an investment policy that committed to aligning *all* of the organization's assets with its mission.

The organization has learned firsthand how impact investing interacts with spending down in helpful and challenging ways:

Freedom from returns-focused constraints. Spending down frees a philanthropy from rigid investment targets aimed at perpetuating and growing the institution. Instead, The Grove Foundation's team is able to consider all of its funds and ask, "What can we do with these resources to make the biggest impact possible?" This opens up an entire continuum of capital—from grants to recoverable grants to multidimensional private and public investments—and creates a kind of agnosticism on the format of spending (within the constraints of private foundation law and fiduciary responsibility, of course).

The Grove Foundation's theory of change requires most funding to go to grants; as a result, it still maintains somewhat traditional investment-allocation targets (currently 60% fixed income, 20% public equity, 15% cash, and 5% private equity/other). Within these allocations, however, ESG factors are considered first and "tracking errors" are accepted. Managers and funds are selected based on their track record, leadership, alignment with Grove goals, and potential to build the mission-investing field. Individual bonds are carefully evaluated and many of them are certified green; equities are screened, tilted, and paired with shareholder activism.

In addition to these allocations, The Grove Foundation has committed $10 million to investments that are deeply aligned with its programmatic objectives and may involve significant risk. There is a scarcity of this kind of structurally focused, flexible capital, so small amounts of it can be quite catalytic. As a result, this deep mission carve out, which is managed in close collaboration with the program team, is a particularly exciting part of the foundation's impact portfolio.

Avoidance of incrementalism. Planning for a limited organizational life nurtures a bias toward action now. While many foundations take a slow, phased approach to impact investing, The Grove Foundation moved quickly in the wake of the board decision. It adopted a new investment policy within six months and executed most implementation within eighteen months. In addition, with the climate crisis rapidly escalating, The Grove Foundation decided to immediately divest from fossil fuels, unless a compelling argument was made to own a company for engagement. Moreover, creative climate solutions are a particular focus of the organization's risk tolerant and relatively nimble carve out; several carve-out investments have been "first-in" dollars, consistent with the organization's goal to make a difference now.

Exhibit continued on next page

EXHIBIT 4-12 (CONTINUED)

Investment Horizon Limits. A key investment-policy goal is to ensure assets are available to support grantmaking in a consistent way throughout the life of the foundation. This, combined with a limited time horizon, poses a significant challenge in terms of investment opportunity in that it skews asset class choices toward liquidity and cash. For example, Grove now constrains its investment timeframe to seven to nine years at most, ruling out most early-equity/venture-type investment and longer-term/patient-alternative investments, which are commonly needed by mission-focused companies. On the other end of the spectrum, truly mission-focused investments that are safe and liquid enough to support significant cash needs can be difficult to find. However, cash-like offerings in this space are increasing, and moving to a mission-aligned commercial bank allowed the foundation to achieve several objectives at once.

In sum, being a mission-aligned investor that is spending down simultaneously frees the foundation from returns-objectives constraints and reduces procrastinating action until tomorrow. At the same time, it creates constraints and challenges in asset classes/time horizons. These forces are in some ways crosscurrents in terms of the organization's ability to achieve maximum impact with all of its capital. Net-net, however, The Grove Foundation believes being a spend down boosts impact rather than mitigating it. As Eva Grove said in 2016 as the board decided on these changes, "This is no time to hold back."

Source: The Grove Foundation

Impact Structures

When constructing an impact portfolio, impact investors need to understand how to select the optimal investor, aggregation, and enterprise vehicles across asset classes. The goal is to select investment vehicles that can optimize impact while operating within the appropriate portfolio construction and management frameworks. As outlined in Exhibit 4-13, the structure of the investor, intermediary, and enterprise can have differing impact characteristics and challenges.

EXHIBIT 4-13

Examples of Investor, Intermediary, and Enterprise Structures

Investor Structures	Intermediary Structures	Enterprise Structures
Partnership	Mutual Fund	Public Corporation
Limited Liability Company (LLC)	Separately Managed Account	Private Corporation
Holding Company	Limited Partnership	Benefit Corporation (B Corp Certification)
Public Charity	Exchange Traded Fund (ETF)	Limited Liability Company (LLC)
Donor Advised Fund (DAF)	Fund of Funds	Low-Profit Limited Liability Company (L3C)
Private Foundation	Loan Funds	Cooperative
Community Foundation	Coinvestment	Public Charity (NGO)
	Crowdsourcing	Unincorporated Project

Investor Structure

Asset owners can organize around a wide variety of forms in order to drive impact creation. These different corporate forms allow for different tax benefits, expenses, anonymity, and flexibility. Traditionally, asset owners had their investment portfolio and a private foundation to carry out their social-impact goals. Along with a number of other options, the two structures with the most momentum are Limited Liability Companies (LLCs) and donor-advised funds (DAFs). LLCs were first championed by early adopters, such as the Omidyar Network and Emerson Collective, and they continue in popularity with others such as the Chan Zuckerberg Initiative and Arnold Ventures. These asset owners prioritize flexibility over tax benefits, sometimes forgoing millions of dollars in tax savings. In addition, investors may have more control if they make direct investments or hold partnership stakes rather than holding the debt or equity of a publicly traded company. In another significant trend, Exhibit 4-14 highlights one example of DAFs being used for impact investing.

EXHIBIT 4-14

Impact Investing Through Donor-Advised Funds

ImpactAssets

With more than $121 billion in charitable assets at year-end 2018, DAFs are the fastest growing philanthropic vehicle, offering donors a tax-smart way to give that enables an individual to make a donation and then contribute to causes over time.

As they grow in size, DAFs also have greater potential to turbocharge impact by investing charitable assets right away to tackle climate change, growing inequality, and other critical societal issues.

That is the focus of ImpactAssets, a nonprofit financial services firm with a $1 billion donor-advised fund that is mobilizing philanthropic capital into strategic and catalytic impact investments. Launched in 2010, ImpactAssets has a 100% impact investing platform with a wide range of high-impact investment options—from private debt and equity funds to blended portfolios and strategies—that enable donors to transform their charitable dollars into a source of risk-tolerant catalytic capital for social enterprises tackling the world's most pressing problems. It was among the first institutions to bring low-minimum investment opportunities in private-debt and equity-impact deals by pooling commitments from individual donors into a single investment.

In an industry first, ImpactAssets tapped the passions and expertise of individual donors to create a dynamic "Custom Investments" program. Donors can source and recommend direct investments, at a $25,000 minimum, in private mission-driven businesses, impact funds, and nonprofit organizations that are committed to measuring and reporting on their social and environmental impact as well as financial returns.

Successful custom investments have led to significant philanthropic windfalls. For example, in 2013 two ImpactAssets clients made seed investments in Beyond Meat and saw significant returns when the plant-based meat company launched its successful initial public offering in May 2019. That money is now being reinvested into a new slate of impact-driven businesses and causes.

The ImpactAssets approach enables donors to maximize their impact by aligning social-enterprise investments with charitable giving. Donors are finding that they can "double down" by investing charitable assets in a social enterprise that is working in parallel with a nonprofit that they support with granting. The firm has also found that donors are often more willing to take greater risks and invest in early-stage ventures when using donated dollars. Closing the funding gap with this charitable-catalytic capital can lead to breakthroughs in science—or help address an annual $2.5 trillion investment gap critical to realizing the UN's Sustainable Development Goals (SDGs) by 2030.

The challenge for donors and all DAFs is to act with increased urgency in responding to the climate and social challenges globally. Although DAFs are not subject to the 5% minimum distribution requirement of foundations, charitable assets in DAFs can and should be a catalytic resource that enables donors to move fast and fearlessly to create impact. By activating the vast pool of philanthropic capital already set aside to do good, donors and DAFs have the potential to accelerate transformative change.

Source: ImpactAssets

Intermediary Structure

An intermediary is the bridge between asset owners and investable enterprises. The most common structure is a fund, a supply of capital belonging to numerous investors used to collectively purchase securities while investors retain ownership and control of their shares. An investment fund provides a broader selection of investment opportunities, greater management expertise, and lower investment fees than investors might be able to obtain on their own. Types of investment funds include mutual funds, exchange-traded funds, money-market funds, and hedge funds. Some of these aggregation structures, such as separately managed accounts (SMAs), may allow more control or flexibility in investment selection, which can be important if the investor wants customized screening. Innovative fund structures such as Benefit Chicago (Exhibit 4-15) demonstrate how institutional, retail, and philanthropic investors can coinvest at scale.

Enterprise Structure

An enterprise is the ultimate creator of financial and social value, including for-profit, nonprofit, and hybrid-corporate forms as well as public and private companies. One such innovative structure that has seen significant growth is the benefit corporation, which embeds social and environmental values into its governing documents. Cooperatives are another collaborative model with collective ownership and coordinated decision-making.

EXHIBIT 4-15
Benefit Chicago Fund Structure

Benefit Chicago, a collaboration of The Chicago Community Trust (the "Trust"), Calvert Impact Capital ("Calvert"), and the MacArthur Foundation, launched in 2016 to mobilize up to $100 million in impact investments for hard-to-reach communities and populations within the six-county region of Chicago. The structure allows individuals, corporations, philanthropies, and other investors to purchase from Calvert fixed-income notes targeted to Benefit Chicago in amounts ranging from $20 online or $1,000 through a brokerage account to $2 million or more—with the interest rate payable by Calvert, dependent on the duration of the notes purchased. Loans and investments focus primarily on three impact themes: create wealth in or for a community—including through economic revitalization, growth in community assets, or support of community-based entrepreneurs; and/or create jobs accessible to community residents for whom access to employment may be a challenge; and/or enhance job readiness through training programs and other mechanisms that provide people with the skills necessary to find, maintain, and advance in employment.

Source: MacArthur Foundation

Investment Structures to Drive Impact

Some innovative impact transaction structures are designed to create specific impact outcomes, including pay-for-success (see Exhibit 4-16), blockchain, responsible exits, or impact covenants. When negotiating the terms of your impact investment, you can embed specific provisions into the transaction that targets the creation of specific impacts. For example, impact covenants can require that a loan be deployed in particular locations or used to support specific beneficiaries. Affordable housing loans may be targeted to residents who earn less than a community's median income. The use of loan proceeds can be tied to a set purpose, such as small business enterprises, or sector, such as retrofitting homes with solar. Pay-for-success structures are contractual agreements that link the repayment of capital to specific impact outcomes. They have, for example, been used to test and scale the delivery of social services. By requiring your consent to the sale of an investment, you can increase the likelihood that the enterprise will retain its impact focus through a responsible exit.

EXHIBIT 4-16

Pay-for-Success Finance in Germany
Bertelsmann Stiftung, PHINEO, and BASF SE

Improving Educational Opportunities for Children, Social-Impact Investment in Germany

Currently, children with a migrant background are particularly disadvantaged in Germany due to poor language and learning skills as well as often a more disadvantaged social background. This is reflected by their school performance in core subjects, such as German and mathematics, and their recommendations for entry to university-track schools (Gymnasium). PHINEO has supported the City of Mannheim to develop a pay-for-success (PFS) structure/social-impact bond (SIB) to finance a program that provides additional educational support to immigrant children through the public school system.

PFS structures/SIBs are partnerships between public authorities, social investors, and social-service providers with the goal of financing innovative prevention programs. In this pilot project, the partners are the City of Mannheim as project sponsor (outcomes payor), the Pestalozzi School as the selected location for implementing the program, BASF SE as a social investor, and PHINEO as project coordinator. Bertelsmann Stiftung, a private foundation, has supported the development of the financing structure.

SIBs mitigate the risk of failure for public authorities by bringing in social investors that provide flexible multiyear funding. They link financial success to the delivery of measured social outcomes. If and only if the predefined-outcome goals of the program have been attained, the City of Mannheim will return the invested capital to the social investor BASF SE. Outcomes goals include an increasing number of recommendations for Gymnasium for children with a migrant background as well as overall improved cognitive skills for these children. The program will run through 2023 and will be scientifically evaluated, with results published afterward.

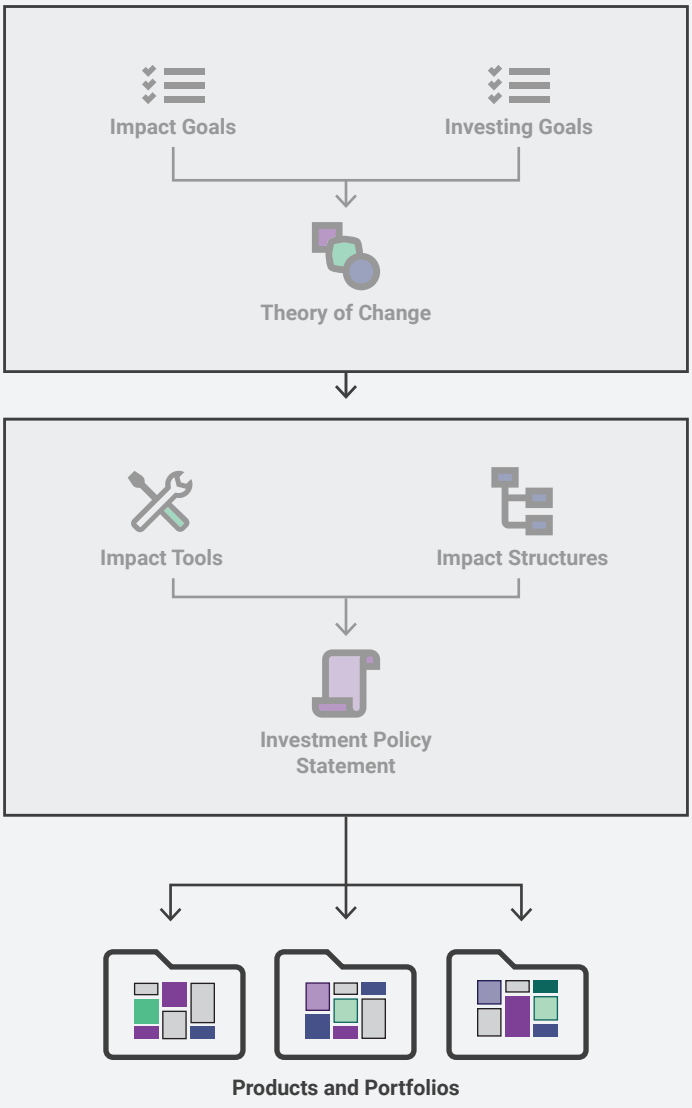
Product Selection and Portfolio Construction

Now that we have presented the categories of impact structures and impact tools, you are ready to begin selecting the impact investing products that will comprise your portfolio (see Exhibit 4-17). These products will have the impact attributes that support your theory of change and incorporate impact tools and impact structures. As you (and your advisor) begin to construct your impact portfolio, you will want to have it reflect your governance documents, such as your impact investment statement and your investment policy statement. As all of your assets have impact, you will want to select products that best represent your impact goals. You will want to consider the impact characteristics of each product and how it relates to asset classes. This process may unfold through conversations with your advisor and should also consider how you will measure and manage impact in your portfolio. The following list describes common considerations specific to certain asset classes.

- **Cash** is a low-risk asset class that can be deployed into impact vehicles, such as certificates of deposits in community banks.
- **Fixed income** provides the opportunity for you to direct debt capital to specific purposes, such as municipal and corporate bonds that focus on targeting specific locations or activities, green bonds, etc.
- **Public equity** is very liquid with broad ownership and disclosure of data, providing opportunities to engage with management or to integrate ESG data into your selection process.
- **Hedge funds** and other alternative investments may have specific thematic strategies but may not be transparent in their holdings and strategies.
- **Private equity** and other early-stage investments can create impact through innovative and high-growth business models in specific impact themes, and investors may use board seats to direct impact-integrated corporate strategies.
- **Real estate** creates impact through its environmental footprint as well as through the important role it can play in housing, community building, and enterprise development.
- **Commodities** and real assets, such as timber, environmental finance, water, and renewable energy, provide targeted impacts leveraging tangible resources.

EXHIBIT 4-17

Product Selection Process



Impact Product Matrix

An investment product, as we use the term here, is a specific vehicle that expresses your impact goals using the impact tools and impact structures introduced throughout this chapter. One approach to portfolio construction is introducing these products at the intersection of the two key variables of asset class and impact theme. Exhibit 4-18 provides an illustrative impact-product matrix, with impact themes in each row and asset classes in each column. This matrix was first developed for Rockefeller Philanthropy Advisor's *Solutions for Impact Investors: From Strategy to Implementation* in 2009,[52] and updated by Sonen Capital. For each product, a corresponding theme and asset class exists. Specific products should reflect the impact goals and impact structures aligned to your theory of change. When reviewing the matrix, you should note that each box represents not only a distinct risk/reward characteristic, but also varying degrees of impact for the particular theme. This matrix, of course, does not capture all impact themes and products currently available to impact investors.

Concrete Steps to Portfolio Construction

Although many possible steps and sequences exist for constructing an impact investing portfolio, we have included some concrete actions you can take. While each asset owner will have a different approach, we recommend starting with the parts of the portfolio with which you are most familiar—from an impact or a financial perspective. For example, a foundation's impact goals may lead to tools such as PRIs and ESG screens. If you are very familiar with your grantees and outsource your investment management, consider starting with a loan to a familiar grantee and building a portfolio of PRIs. On the other hand, if you have an active investment committee and aligned CIO, you may be most familiar with public equities and start with the ESG screens through familiar fund managers. In general, the following four approaches can be taken to shift or build an impact investing portfolio.

First Step: Know What You Own. A common first step is to know what you own—for both financial and social purposes. This is the corollary to "all assets have impact." While you likely have a good sense of your portfolio's investment composition, get to know your portfolio's existing impact. For example, take a look at underlying holdings of your mutual funds in order to assess mission alignment. You may find objectionable holdings and proceed with a disciplined approach to removing them from your portfolio.

Mission-Driven: Create Your Impact Portfolio. The approach starts from the ground up in order to create a theory of change, then incorporate your investment and impact goals into your portfolio. This approach has been our focus in this guide, as it is the most comprehensive and challenging. Most asset owners will not begin impact investing with a blank slate but rather will have legacy assets that will need to be transitioned.

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52 Steven Godeke and Raúl Pomares, *Solutions for Impact Investors: From Strategy to Implementation*, Rockefeller Philanthropy Advisors (2009): 64.

EXHIBIT 4-18

Illustrative Impact Product Matrix

Goals *Asset Class*	**Liquidity** *Cash and Alternatives*	**Income and Wealth Preservation** *Fixed Income*	**Capital Appreciation** *Public Equity*	**Capital Appreciation** *Hedge Funds*	**Capital Appreciation** *Private Equity*	**Inflation Protection** *Real Estate*	**Inflation Protection** *Commodities and Real Assets*
Community Development	Community Bank CDs	Foreclosure Repair	Thematic Focus and Proxy Voting	Microfinance Debt/Equity	Community Venture Capital	Transit Oriented Development	Ethical Mining
Climate Change	Green Bank Deposit	Tax Exempt Green Bonds	Actively Managed Sustainability Funds	Green Long/ Short	Clean Tech Venture Capital	Green REITs	Land-Based CO2
Energy and Resources	Green Bank Deposit	Screened Corporate Bond	Exchange Traded Funds	Renewable Energy	Clean Energy	Power Infrastructure	Sustainable Feedstock
Water	Green Bank Deposit	Corporate Infrastructure Bonds	Unit Investment Trusts, Closed End Funds	Water Funds	Water Technology Venture Capital	Wetlands	Water Rights
Social Enterprise	Short Term Loan Funds	Social Enterprise Credit	Micro-Cap Listed Companies	SME Blended Debt/Equity Structures	Small and Medium Enterprises	Conservation/ Ecotourism	Agro-forestry
Education	Linked Deposit/ Guarantee	Charter School and Tax-Exempt Bonds	Thematic Screens	Tuition Financing Strategies	Ed Tech and Education Delivery	School Green Building and Charter Facilities Finance	N/A
Health and Wellness	Receivables Factoring	Global Development Bonds	Healthcare Equity	Structured Public Notes	Consumer Project Venture Capital	Organic Farmland	Agriculture/ Food Systems
Sustainable Development and Agriculture	Trade Finance Guarantee/ Deposit	Social Growth Municipal Bonds	Thematic Screening	Blended Debt/Equity Hybrid Structures	Sustainable Growth Equity	Ranch Land Agriculture	Sustainable Timber

Source: Sonen Capital

Portfolio-Driven: Transition Existing Portfolio. This approach keeps the existing investment philosophy and asset allocation while layering in the impact considerations. Often this method starts with the "do no harm" mentality and builds in other impact considerations, which frequently requires less time and resources compared to rebuilding the portfolio. In some cases, legacy positions may be locked up for a certain time before they can incorporate impact.

Blend: Carve Out or Use of Specific Tool. This approach is a combination of the first two approaches since it has high-impact intentionality yet only engages a subset of the portfolio. This can be an important first step or testing ground for broader implementation. One downside to this approach is the possible artificial ceiling of total portfolio activation. Many investors use this strategy as a starting point, not an ending point, which can complement a portfolio-driven approach. Be mindful with this approach that different parts of your portfolio may be working against each other.

Current Approaches to Portfolio Construction

The ability to translate your goals and theory of change into investable opportunities is critical to the success of your impact investing strategy. In our conversations with advisors, it was clear that they draw upon similar tools and structures when building impact portfolios; however, the process varied depending on client goals as well as the advisor's expertise and business model.

Some of the approaches proposed by the advisors include:

- Constructing a **top-down strategic asset allocation** based on the advisor's macro views and then applying it to a tactical asset allocation for each client that seeks to incorporate specific impact themes. In some cases, major themes—such as climate—are being used to reengineer the strategic asset allocations for some investors with specific impact tools and structures used at the security-selection level.
- Incorporating impact into **goals-based portfolio construction tools** by drawing out a client's impact goals, including values, risk, and time horizon. The advisor then sets goals with clients, such as catalytic, growth, stability, and risk, for parts of the portfolio. Once the goals and priorities are established, specific impact themes are then applied across the asset classes using fund managers or direct investments.
- Following a **research-driven approach that targets specific impact sectors**, with the advisor finding opportunities that combine high investment and impact performance. This deep, thematic-research approach identifies market-rate impact opportunities but may not be customized for specific clients.
- Some advisors will go deep into specific themes with clients as they seek to **create transformation rather than simply complete transactions**. This may lead to specific thematic investments or place-based approaches.

- **Standardization and simplification of impact products** is also a key driver as both clients and advisors seek out competitively priced funds that can deliver intentional and measurable impact to a wide range of clients.
- Seeking to **balance the depth and breadth of their portfolios**, investors realize that targeted investments can lead to concentration risk while less-direct investments may dilute the contribution of their investments or limit their influence and control. While this trade-off is not linear, balancing concentration risk against impact intensity needs to be considered in portfolio construction.

Regardless of the approach, transitioning a portfolio toward impact is a highly consultative and iterative process between you and your advisors. Many advisors see their ability to create a sound and meaningful client experience during this transition as a central part of their value add. Advisors typically begin this process with an assessment of the current portfolio and a survey of the investor's goals. Given that advisors cannot be deep experts in every possible impact theme, some are building out their expertise within clusters, such as climate, social justice, and community development. Ongoing education and engagement with clients is critical.

From Product Scarcity to Quality Control

As impact investing products proliferate, quality control is critical if you want to further your theory of change. The current environment has changed dramatically since the early days of impact investing when the goal was to simply support the idea that investment products could exist across impact themes and asset classes. Now, the challenge is not product creation but rather quality control. The institutional investment industry will fill this vacuum with impact products, but impact investors need to come to the table with a clearly articulated vision of the impact investing goals they are trying to achieve.

Traditional Investment Practice Is Not Static

As impact investors seek to have impact goals expressed alongside traditional investment goals, we should note that traditional investment practices are also evolving to incorporate new disciplines, such as behavioral finance. All investors are seeking to use models and heuristics to inform their capital deployment in the future. Remember past performance is not an indicator of future results. Investments made in the future will exist in a future world that is not the same as the past. We must create investment philosophies and strategies to match these changes. We see impact investing as one of these strategies rather than an entirely new discipline.

Portfolio construction is an iterative process as you align your investments with your theory of change. In the next chapter, we will explore how you can maintain and monitor your impact portfolio using the tools of impact measurement and management.

FRAMING QUESTIONS

- How will you construct your impact portfolio?
- What impact structures and impact tools could enhance the impact of your investments, such as catalytic capital, ESG integration, or time horizon?
- What are the best products, asset classes, and legal structures to achieve your impact goals?
- How will you source opportunities and complete due diligence?
- How will you configure your impact investment statement?
- How do you create an investment policy statement with clear roles, responsibilities, and governance?

Practitioner Exercise and Sophia Example

How: Investment Policy Statement

Exercise Overview

In order to arrive at your investment policy statement (IPS) and impact investment statement (IIS), we propose that you start by expanding the detail of your theory of change from the "Why" chapter, adding impact tools and impact structures from this chapter, as mapped onto the goals you laid out in your theory of change. This added level of detail will inform your approach to portfolio construction.

Sophia's Investment Policy Statement

Sophia has an existing IPS, which guides the family's overall investment portfolio. She now wants to integrate impact considerations. Starting from her theory of change at the end of the "Why" chapter, Sophia now adds specific impact tools and impact structures aligned to her goals and applied uniquely to her three categories of financial assets. She then reviews the tool matrix and identifies products that might express these tools and structures.

Using these inputs, Sophia and her advisors decide to keep her existing IPS and add an IIS to codify her priorities, objectives, and goals for aligning her investments with her mission. To arrive at this IIS, Sophia has reviewed the core components and approaches to governing documents and chooses the following components to prioritize.

Sophia's Impact Investment Statement will contain the following components.

- **Definitions:** Impact investing is not a choice but a responsibility to know what one's investments are doing in the world and to shift them to do the most good possible.
- **Levels:** The family's approach to integrating impact will happen at three levels, described in the table that follows—entire portfolio, foundation endowment, and foundation payout.
- **New cash strategy:** All new cash into the portfolio will be put into community banks
- **Theory of change:** For each level, the table above also indicates relevant investment goals, impact goals, impact tools, and impact structures.
- **Roles:** Sophia will lead strategy and investment decisions; her husband and their attorney will sit on an informal investment committee, along with a former colleague from her firm and a community representative from Miami; the existing investment advisor does not initially have the discretion to make impact-oriented investment changes—the discretion decision will be reconsidered after year one.
- **Time horizon:** At this point, the goal is for the entire investment portfolio and the foundation to continue to grow and exist in perpetuity. The family donor-advised fund will spend down in the next five years to consolidate all charitable activity within the private foundation. More aggressive spending down will be considered after year five.

Resource	Impact Goal: Impact Theme	Impact Goal: Impact Intensity	Impact Goal: Lens	Investment Goal: Risk/ Return Target	Tools and Structures	Products
Entire Portfolio ($500M)	Do no harm	Low	N/A	Maximized financial risk/return	Possible screening and ESG integration	TBD working with husband and advisor on product options
Foundation Endowment ($40M)	1. Water, where possible 2. Climate, where possible	Low to medium	Gender	Payout (5%) plus inflation	Filter diversified portfolio through ESG screens while prioritizing water and climate considerations With cash, increase loan capital to underserved populations	Corporate infrastructure bonds ESG tilted public equities Water-technology venture capital Water rights as commodities Cash in community bank deposits
Foundation Payout for PRIs ($2M)	1. Water 2. Arts, where possible	High	Gender	80% return of capital	Provide equity and debt capital to promising water and arts social enterprises	Loans to water charities Equity to creative economy startups

For full IPS and IIS examples, we invite you to review other examples from the field.

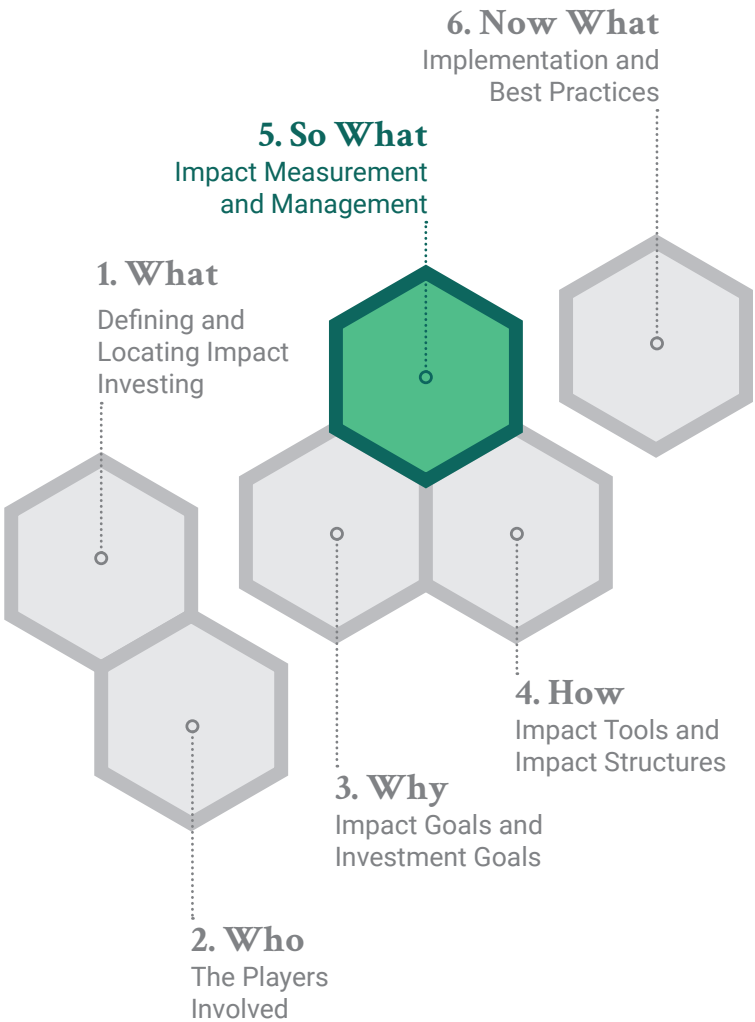
Examples of Investment Policy Statements

- Learning from Peers: A Collection of Impact Investing Strategies from Mission Investors Exchange: https://missioninvestors.org/resources/learning-peers-collection-impact-investing-strategies.
- Establishment Investment Policy from Intentional Endowments Network: https://www.intentionalendowments.org/investment_policy.

CHAPTER 5

So What

Impact Measurement and Management



Godeke & Briaud

Impact Measurement and Management

We now turn to how you can measure the success of your impact investing portfolio over time—and how you might use this information for future decisions. The foundation for success is laid out in the theory of change that you developed in the "Why" chapter. The theory of change is the bridge connecting your impact goals to the investment products you selected in the "How" chapter. Impact measurement and management (IMM) will provide you with a framework to test whether your portfolio of investments is achieving those impact goals. For most impact investors, the portfolio will be the focus of the impact measurement and management system. Depending on impact tool and asset class, varying levels and specificity of impact information will be available.

IMM is the process by which impact investors can understand the effects of their investments on people and the planet (measurement) and then take action to adapt processes and improve outcomes (management). IMM has evolved through many decades of social science and philanthropic research. During that time, IMM has had various labels, such as monitoring and evaluation (M&E) and social-impact measurement (SIM). IMM as a term has been popularized through the Impact Management Project and the Global Impact Investing Network—and has been increasingly adopted by investors. IMM uses some of the evaluation methods of M&E, along with the tools of financial accounting and reporting such as the use of ratings, key performance indicators (KPIs), and disclosures.

IMM is relatively young and still somewhat fragmented but, encouragingly, growing in scope and sophistication.[53] In this chapter, we provide some starting points and initial tools with the expectation that these will be improved as the field matures. We also provide guidance based on current practices and emerging trends. Impact investors have tended to default to output-level metrics as a proxy for long-term outcomes and impacts. For example, investors may measure the amount of capital deployed or number of housing units constructed, which may not tell you much about the quality of housing, the changes for resident families, or the effect on neighborhoods. As we noted earlier, a robust theory of change can help distinguish between and link these different levels. Although the trend is to concentrate on quantitative measures, qualitative data can also be collected and analyzed in a robust manner to help you understand what types of impact have occurred—and why—and what has yet to happen.

Three core characteristics are critical: a consistent and disciplined approach, transparency in impact due diligence and reporting, and the use of appropriate approaches and tools. No one line of inquiry and evidence is going to tell you everything. IMM should help you "manage forward" to improve your impact over time, rather than just look back at what impact has occurred. IMM can be daunting and the risk of analysis paralysis exists, but remember the importance of beginning thoughtfully and taking one step at a time. Regardless of where you start, IMM is an iterative process that will grow and evolve.

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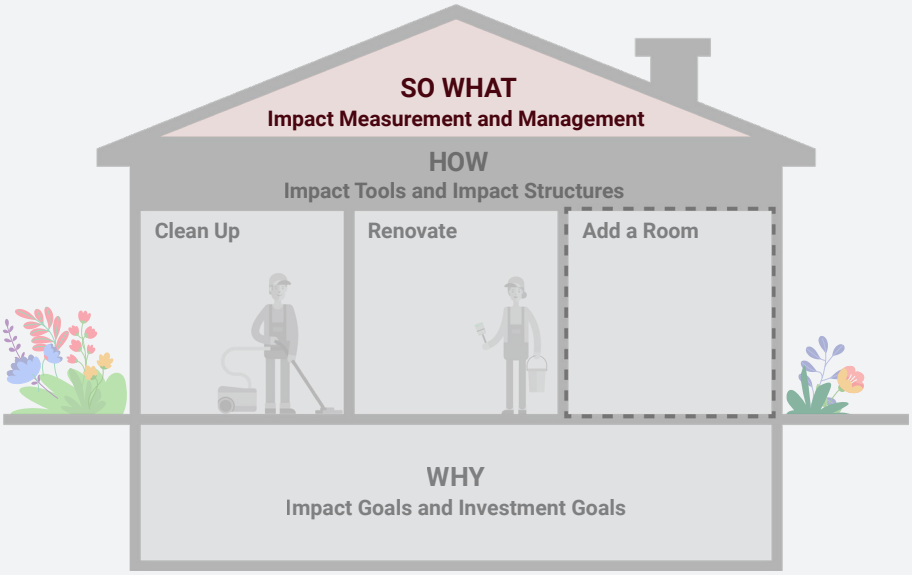
53 Rachel Bass, Hannah Dithrich, Sophia Sunderji, and Noshin Nova, *The State of Impact Measurement and Management Practice*, Second Edition, Global Impact Investing Network (2020).

EXHIBIT 5-1
So What: Measuring Success



Core IMM Questions: Why, What, How

Now, we move on to the overarching questions you can use to construct your impact measurement and management system. These questions will build on each other throughout this chapter: why measure, what to measure, and how to measure it.

Why Are You Measuring?

In Chapter 3, we started with the *Why* of your overall impact investing strategy. Similarly, we encourage you to start here with the *Why* of impact measurement. You are setting out to measure the success of the strategy you have developed, but to what end? We suggest that you explore at least three aspects of your *Why*.

Prove

The most common reason is to understand whether the short-term changes and long-term effects are occurring in ways that you anticipated, while also accounting for unexpected developments that may cause you to outperform or underperform on impact.

Improve

Impact investors are not only trying to "prove" impact but, like financial performance, are interested in improving it over time. Similarly, IMM should help inform how you get more impact at any level—from a specific deal to the overall portfolio.

Learn

We encourage you to also include specific learning goals for your own approach, to inform your future portfolio. Consider how you might also help existing and aspiring impact investors who are working in your relevant impact themes. Your learning can support the maturing field of IMM.

Building a Portfolio from Your Theory of Change

This is a good moment to return to your theory of change, your guide and starting point for IMM. Once you have articulated your overall objectives, you want to ensure that your portfolio and transactions are aligned with these goals—recognizing that each individual investment may have stronger or weaker alignment. Depending upon your impact approaches and structures as well as your investment products, your assets will generate different types of impact data that will affect your ability to measure and manage that data. For example, impact data from disclosures of a publicly traded corporation will be different from the data from early-stage enterprises focused on research and development. The impact generated through a direct investment is quite different from the impact you have by investing through a fund structure. Again, the goal is for your overall portfolio to reflect your theory of change. As developed in Chapter 3 (Exhibit 3-13, "Theories of Change: From Broad Fields to Specific Interventions"), impact can be measured at a number of levels. Similar to rolling up financial performance from the deal to portfolio level, you may also want to roll impact measurement up to the portfolio level.

What Are You Measuring?

Based on your *Why*, you can now determine *What* you want to measure and the principles, frameworks, and standards you can use to drive the gathering of the relevant impact data.

The practice of IMM has developed out of several distinct disciplines, and different ways to organize the various components exist. For this handbook, we have simplified these components into three categories: Principles, Frameworks, and Standards (see Exhibit 5-2). Each category has a wide array of approaches, which can be applied at different units of analysis—industry, portfolio, asset class, investment, or intervention. While IMM approaches are still somewhat fragmented, efforts are underway to link some of them in order to promote efficiency and broaden their applicability. In the following sections, we will explore one example for each in more detail, namely the International Finance Corporation (IFC) Operating Principles for Impact Management, the Impact Management Project's five dimensions of impact framework, and the IRIS+ standards. In addition to being some of the most prominent IMM approaches, they are also linked to other principles, frameworks, and standards that you may want to explore or adopt. Impact investors can use these to guide and evaluate their portfolios of investments.

EXHIBIT 5-2

Organizing Impact Measurement and Management Principles, Frameworks, and Standards

	Principles	Frameworks	Standards
Purpose	Rules and best practice to ensure overall integrity of processes and behaviors	Methodologies and conceptual frames to organize IMM	Taxonomy and metrics applied to specific industries, themes, and interventions
Scope	General	General	Industry
Examples	• IFC Impact Investing Principles • UN PRI • EVPA Principles	• SDGs • IMP's Five Dimensions • Standards of Evidence • Lean Data • G8 Impact Measurement Working Group Report	• B Lab • IRIS+ • SASB • UNDP SDG Impact Practice Assurance Standards

Selecting and applying specific impact principles, frameworks, and standards to your investment will provide useful information to drive your future decision-making. For example, the Sustainable Accounting Standards Board (SASB) is a standard that generates industry-specific impact data. SASB is appropriate to compare industry peers but would not be appropriate for assessing an early-stage social enterprise. Particular investments and asset classes in your portfolio will have varying levels of impact and may require distinct measurement tools. At the end of this chapter, we will apply these to create your IMM framework.

Principles

Principles are broad rules and best practices that ensure the overall integrity of processes and behaviors. They are not typically industry specific but set the rules of the road. Principles often come in the form of a public commitment to certain practices, transparency, measurement, and accountability. Principles differ from frameworks and standards in that they communicate intention rather than specific measurement techniques. Examples relevant for impact investing include the IFC Operating Principles for Impact Management, the Principles for Responsible Investment (PRI), and the European Venture Philanthropy Association's (EVPA) Impact Management Principles.

IFC Operating Principles for Impact Management

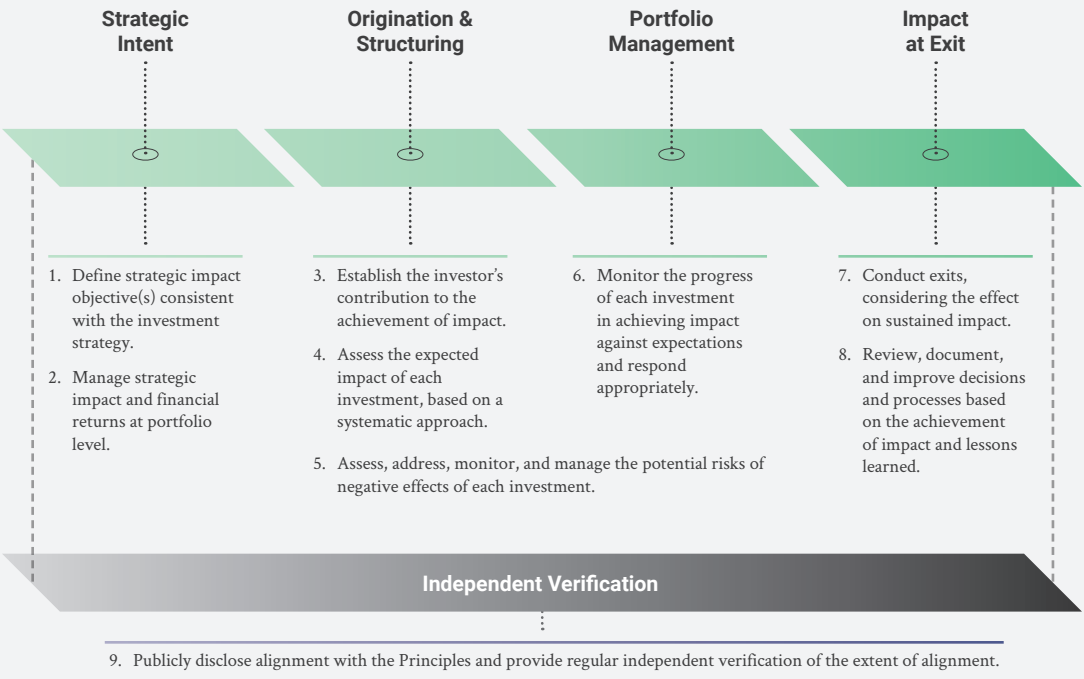
The IFC has developed operating principles (Exhibit 5-3) as a guide to help investors with the design and implementation of their impact management systems, ensuring that impact considerations are integrated throughout the investment lifecycle. You can work through each principle systematically to describe how you are interpreting and applying it within your own portfolio. Across all categories, Principle 9 calls for public disclosure of alignment with these principles through independent verification, which can function as a review of areas of good practice, possible gaps, and room for improvement.

Frameworks

Frameworks are specific methodologies and conceptual frames to organize IMM. This category organizes your IMM strategy alongside an established framing tool. Frameworks take the intention of principles and put them into practice. They exist at a general, strategic level that is then put into practice by more tactical standards. Examples include the United Nations Sustainable Development Goals (UN SDGs) and the Impact Management Project's (IMP) five dimensions of impact.

EXHIBIT 5-3

IFC Impact Investing Operating Principles



Source: Operating Principles for Impact Management, https://www.impactprinciples.org/principles.

As introduced in the "Why" chapter, IMP's ABC framework illustrates how investors may contribute to impact through their investments as part of a portfolio. In this ABC framework, investors can contribute to impact by:

A. **Acting to avoid harm**,

B. **Benefiting stakeholders**, and

C. **Contributing to solutions**.

Building on this framework is IMP's Five Dimensions of Impact (Exhibit 5-4). It recognizes that all investments have effects on people and the planet, positive and negative, intended and unintended. Using the five dimensions of impact (and their respective subcategories), investors and investees can identify which effects matter and assess the performance of those effects. You can work through each of these data categories to inform what type of data (and level of specificity) you would seek to collect across your entire portfolio, or for certain parts of your portfolio, depending on the type of capital and instrument.

EXHIBIT 5-4

Impact Management Project's Five Dimensions of Impact

Impact dimension	Impact data category	Description
What	1. Outcome level in period	The level of outcome experienced by the stakeholder when engaging with the enterprise. The outcome can be positive or negative, intended or unintended.
	2. Outcome threshold	The level of outcome that the stakeholder considers to be a positive outcome. Anything below this level is considered a negative outcome. The outcome threshold can be a nationally or internationally agreed standard.
	3. Importance of outcome to stakeholder	The stakeholder's view of whether the outcome they experience is important (relevant to other outcomes). Where possible, the people experiencing the outcome provides this data, although third-party research may also be considered. For the environment, scientific research provides this view.
	4. SDG or other global goal	The Sustainable Development Goal target or other global goal that the outcome relates to. An outcome might relate to more than one goal.
Who	5. Stakeholder	The type of stakeholder experiencing the outcome.
	6. Geographical boundary	The geographical location where the stakeholder experiences the social and/or environmental outcome.
	7. Outcome level at baseline	The level of outcome being experienced by the stakeholder prior to engaging with, or otherwise being affected by, the enterprise.
	8. Stakeholder characteristics	Socio-demographic and/or behavioural characteristics and/or ecosystem characteristics of the stakeholder to enable segmentation.
How Much	9. Scale	The number of individuals experiencing the outcome. When the planet is the stakeholder, this category is not relevant.
	10. Depth	The degree of change experienced by the stakeholder. Depth is calculated by analysing the change that has occured between the "Outcome level at baseline" (Who) and the "Outcome level in period" (What).
	11. Duration	The time period for which the stakeholder experiences the outcome.
Contribution	12. Depth counterfactual	The estimated degree of change that would have happened anyway—without engaging with, or being affected by, the enterprise. Performance of peer enterprises, industry or local benchmarks, and/or stakeholder feedback are examples of counterfactuals that can be used to estimate the degree of change likely to occur anyway for the stakeholder
	13. Duration counterfactual	The estimated time period that the outcome would have lasted for anyway—without engaging with, or being affected by, the enterprise. Performance of peer enterprises, industry or local benchmarks, and/or stakeholder feedback are examples of counterfactuals that can be used to estimate the degree of change likely to occur anyway for the stakeholder.
Risk	14. Risk type	The type of risk that may undermine the delivery of the expected impact for people and/or the planet. There are nine types of impact risk.
	15. Risk level	The level of risk, assessed by combining the likelihood of the risk occuring, and the severity of the consequences for people and/or the planet if it does.

Source: How Enterprises Manage Impact, Impact Management Project, https://impactmanagementproject.com/impact-management/how-enterprises-manage-impact/.

Standards

Standards are taxonomies and core metrics applied to specific industries, sectors, and themes. This is the most specific category, which arrives at the "nuts and bolts" of measurement. With standards, you choose how you define a particular term (for example, a "job" may or may not include minimum wage) and specific metrics to indicate impact progress. Examples of standards include SASB, B Lab, and IRIS+ (Exhibit 5-5).

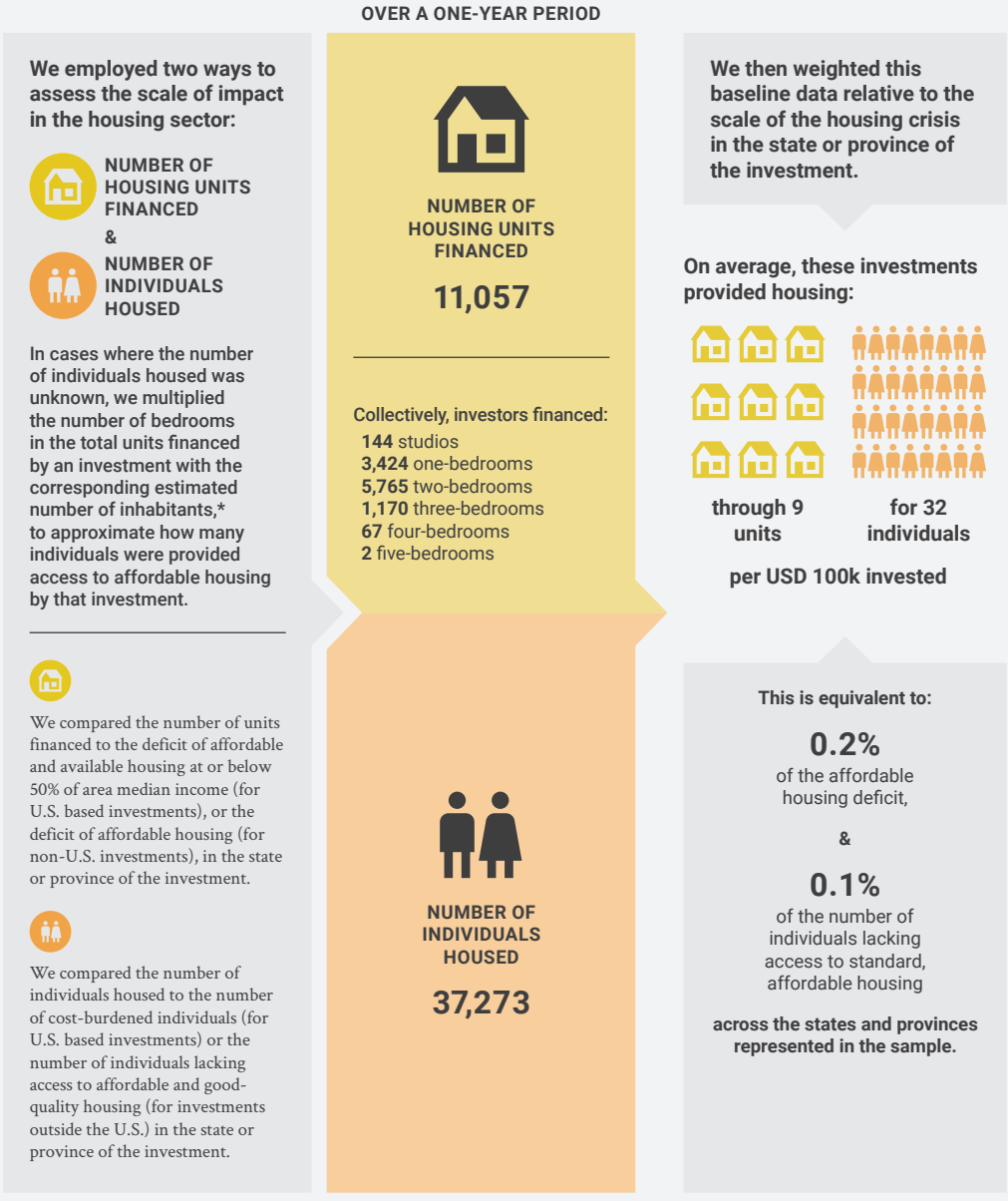
IRIS+ and Housing Subtheme Standards

The Global Impact Investing Network (GIIN) launched IRIS+ as a generally accepted standard for impact measurement, which identifies performance indicators by impact theme or category. The system is aligned to the SDGs, the IMP's five dimensions, and more than fifty other conventions. It allows impact investors to efficiently identify and select appropriate metrics from a comprehensive open list and offers guidance to standardize data collection and reporting. IRIS+ standards have been developed for broader themes and subthemes, which often correspond to the thematic focus and outcome levels of a theory of change—though most of the metrics are output-level measures. Over time, this should enable more standardized and comparable impact reporting, as shown in the following example of the IRIS+ standards for the housing sector.

EXHIBIT 5-5

Housing Subtheme IRIS+ Standards

GIIN used two ways to assess the scale of impact in the affordable housing sector: Number of Housing Units Financed and Number of Individuals Housed. It then assessed the risk of creating impact in this sector as well as the contribution to impact.



* Per the U.S. Department of Housing and Urban Development's bedroom occupancy standards.

Source: GIIN, Evaluating Impact Performance: Housing Investments, 2019.

Godeke & Briaud

How Are You Measuring?

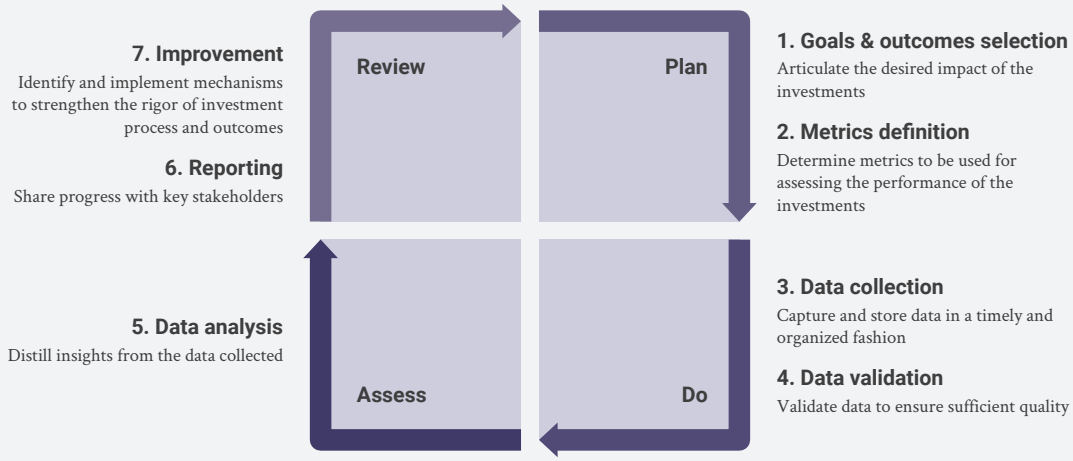
Now that you have established the *Why* and *What* of your IMM strategy, you can now construct the process of your IMM activities.

IMM Life Cycle

IMM is an iterative process starting with goal setting, through data collection and approach, to analysis and validation, and ultimately leading to better judgments and decisions for the future. This cycle of designing, collecting, assessing, and then acting should drive your impact investing strategy and implementation. You can adapt this life cycle to meet your specific approach.

The Impact Measurement Working Group of the G8 Social Impact Investment Task Force created the four-phase framework seen in Exhibit 5-6.

EXHIBIT 5-6
IMM Program Structure



Source: Impact Measurement Working Group of the G8 Social Impact Investment Task Force

Impact Due Diligence

Impact due diligence is a key part of the IMM cycle. A number of distinct approaches to impact due diligence can be made—from qualitative storytelling to more technical and quantitative data. Narratives are common starting points for understanding how change is occurring and what implications result from that change. These are sometimes expressed as a narrative form of the theory of change and are used to indicate broad alignment with a theory of change. However, impact investors often need to go further when making investments. We recommend incorporating a combination of qualitative and quantitative approaches.

A starting point is to use impact due diligence questionnaires as initial screens for alignment to your theory of change. A well-designed set of questions can identify linkages with the components of the theory of change and also identify areas of potential misalignment. A follow-up step is to design a quantitative tool that provides nuanced translation of the theory of change into weighted criteria, to provide a degree of specificity that can inform targeted actions during due diligence and post investment. As seen in Exhibit 5-7, each approach has merits and should be calibrated to the capacity and goals of the impact investor.

EXHIBIT 5-7
PCV Impact Due Diligence

Approach	This approach is best for investors who...
Narratives of expected impact	• Want to adopt a consistent approach to impact due diligence and document expected impact • Lack the capacity to build or implement a due diligence questionnaire or a quantitative tool
Impact-focused due diligence questionnaire	• Are interested in developing a deeper, more systematic approach to understanding anticipated impact • Have the capacity to ask each investee a standard list of questions, and revise their questions accordingly to assess impact • Have sufficient organizational buy-in to use the responses to inform decision-making
Quantitative impact due diligence tool	• Are interested in systematically comparing quantitative assessments of anticipated impact across a portfolio • Manage, or expect to manage, a portfolio of at least twenty investments • Have the capacity to thoughtfully develop, methodically test, systematically implement, and continuously refine their tool • Have a project lead who can dedicate at least five hours weekly for four to twelve months to the design and implementation of the tool • Have sufficient organizational buy-in to use the scores produced by their tool to inform decision-making • Would like to understand their portfolio's aggregate level of anticipated impact over time

Source: Pacific Community Ventures, The Impact Due Diligence Guide: Practical Guidance for Investors Seeking to Systematically Assess Investments' Anticipated Impact, October 2019.

Impact Management Considerations

A disciplined approach to designing, implementing, and using IMM is both possible and necessary for impact investors. Various approaches can help you go deeper in terms of understanding whether outcomes and impacts have occurred.

IMM at the Portfolio Level

One challenge is how to aggregate across the portfolio, especially if you are involved in different sectors and instruments. The IMM field does not yet have the maturity of frameworks and platforms to do this across all portfolios, but the two examples we have highlighted, IMP and IRIS+, are facilitating aggregation through their standardized language and structures.

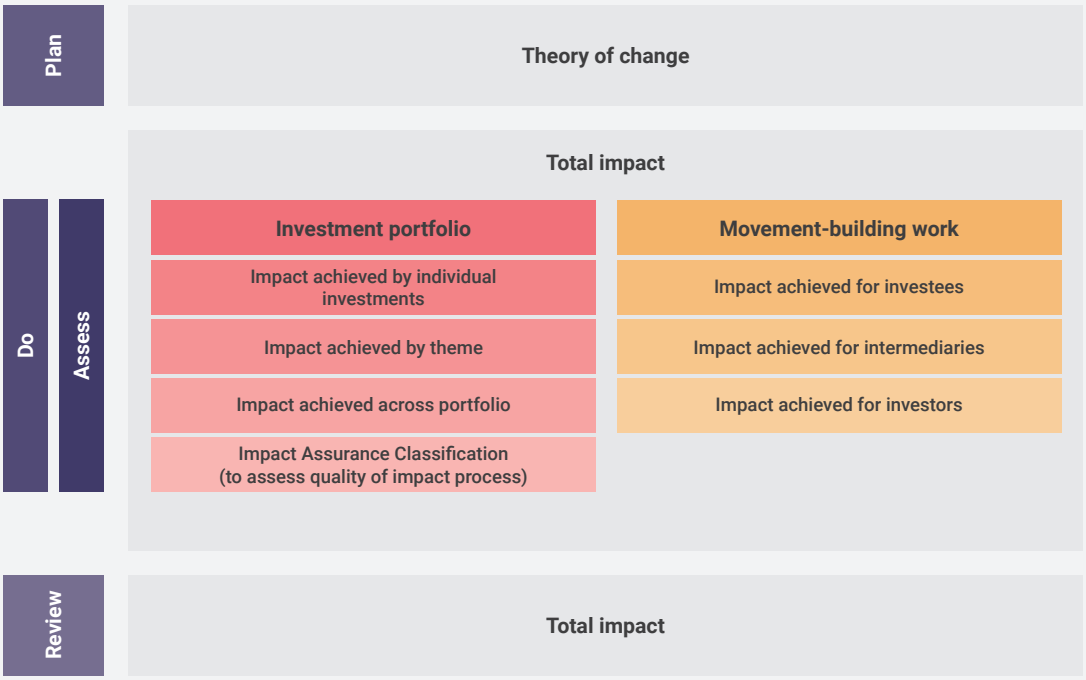
Your IMM framework will also reflect the impact characteristics of the specific asset classes in your portfolio and how you hold those investments. For example, some fund managers will have their own IMM frameworks for their funds while direct investments may require the creation of customized approaches. The distinctions between debt and equity, and public versus private investments, also need to be considered in constructing an IMM framework.

The KL Felicitas Foundation has developed a multilayered approach that integrates the elements we have described earlier. The foundation has publicly reported on its impact performance and learning across its portfolio and transactions.[54] This impact management approach builds upon the foundation's theory of change presented in Exhibit 3-12, "KL Felicitas Foundation's Institutional-level Theory of Change." We provide two excerpts from the foundation's most recent impact performance report. The first (Exhibit 5-8) describes a portfolio-level view that integrates the theory of change, various thematic and instrument segments, and alignment with the Impact Measurement Working Group Principles. The second (Exhibit 5-9) describes an individual fund's performance, integrating IMP and SDG frameworks, as well as IRIS+ and the KL Felicitas's customized Impact Risk Classification (IRC) standards. This scorecard contains both quantitative and qualitative data as context for impact alignment and reporting. As you review these examples, remember that this is one of many interpretations. Consider how elements of these examples might inspire your own approach.

54 Plum Lomax, Abigail Rotheroe, and Anoushka Kenley, "Impact Risk Classification (IRC) Assessing the Impact Practice of Impact Investments," KL Felicitas (2018).

EXHIBIT 5-8

KL Felicitas Foundation Impact Management at Portfolio Level



Source: Plum Lomax, Abigail Rotheroe, and Peter Harrison-Evans, "Investing for Impact: Practical Tools, Lessons and Results," NPC, 2015, page 18.

IMM from the Beneficiary Perspective

Unsurprisingly, a tendency exists in impact investing to favor numbers when describing impact. These provide comparability and standardized reporting, which can be an efficient solution when dealing with complex challenges. At the same time, these numbers may not account for the context and, in particular, the perspectives of those who are most affected by impact investments. It is critical to consider and design for the ultimate beneficiary.

One relevant approach is Lean Data, which was incubated at Acumen and now operates independently as 60 Decibels. Lean Data seeks to efficiently integrate beneficiary voices directly into IMM through the use of technology. By blending quantitative measures and

EXHIBIT 5-9

KL Felicitas Foundation Impact Management at Product (Fund) Level

Who

Well served — Underserved

Lyme is focusing on the planet

Lyme Forest Fund III targets high conservation priority forestlands. The Fund aims to protect native flora and fauna, and to support people and companies working on the land in a sustainable way.

How Much

Marginal effect — Deep effect

More than 50% of Lyme's land permanently protected

For few — For many

For the planet

Short-term — Long-term

Permanent protection

Slowly — Quickly

Effects (like tree planting) take time

Contribution

Likely worse — Likely better

Much better than without protection

Impact metrics	2014	2015	2016
Sustainably Managed Land Area (acres) OI6912	223,247	170,169	169,153
Permanently Protected Land Area (acres) PI3924	1,927	46,189	8,907
Fresh Water Bodies Present (acres) PI7170	42,396	37,251	37,251

What

Important negative — Important positive

6 CLEAN WATER AND SANITATION

15 LIFE ON LAND

Lyme contributes toward two of the UN Sustainable Development Goals

The fund invests in US timberland and rural real estate with important conservation attributes. Central to Lyme's strategy is to sell conservation easements, which permanently restrict land development but still allow Lyme to generate income. The fund invests in mitigation banks and sells credits to project developers who need to mitigate their impacts.

Risk

Impact Risk Classification (IRC): Stage 4

Principles	Purpose	Outputs	Outcomes	Impact
✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓

Clear focus and purpose, and business model fully aligned with impact goals. Good output data and some outcomes with case studies and year-on-year comparison. Land preservation means outcomes likely to be sustained.

Source: Plum Lomax, Abigail Rotheroe and Anoushka Kenley, Impact Risk Classification (IRC): Assessing the Impact Practice of Impact Investments, KL Felicitas, 2018.

qualitative insights across large samples, it can identify emerging patterns for expected and unexpected effects and triangulates various data points over time. One key goal is to promote a culture of stakeholder accountability by sharing results with targeted users, beneficiaries, and communities.

Self-reported Surveys

Exhibit 5-10 details several approaches that can be used to collect new data. Each provides varying degrees of certainty, and some are more appropriate and effective in different contexts than others. Self-reported data through surveys is particularly valuable when beginning to measure the impact of an enterprise. This approach complements the quantitative and standardized approaches, such as IRIS+ and IMP, and can be particularly important for investors who want to amplify beneficiary voices within community-based initiatives. It is important to recognize that none of these data types are necessarily better or more rigorous than any other. Each has relative strengths and weaknesses. The best option will depend on the type of impact or business model in question.

Impact Preservation

One common shortfall when measuring the effectiveness of an impact investment is not paying attention to its influence beyond the initial investment selection. As impact investments begin to scale, the asset owner does well to estimate and track the preservation of impact. If not, an investment may grow in market share or returns, while impact erodes. Some impact investors are attempting to explicitly connect their impact

EXHIBIT 5-10
Types of Self-Reported Data

Subjective self-reported data	Objective self-reported data	Objective non-self-reported data
"I know more than I did before the course"	"I was offered a job shortly after completing the course"	Student completed and passed the course with a mark of 80%
"I am coughing less this month"	90% of customers substituted the kerosene lantern for the solar lamp	500 solar lamps purchased
"I feel better this year compared to last year"	"I went to a doctor three times last year, compared to 15 times the year before"	Patient blood pressure: **2017:** 150/90 **2018:** 125/80

Source: Impact Management Project and 60 Decibels "Using Self-reported Data for Impact Measurement: How to Use Stakeholder Surveys to Improve Impact Performance," 2019.

measurement to their financial measurement, so they have a holistic view of how their investments are performing positively and negatively over time (Exhibit 5-11). This leads to an understanding that investments can underperform or over perform along either side of the impact or financial scale.

EXHIBIT 5-11

Approach to Enterprise Impact Measurement
Skoll Foundation

The Skoll Foundation focuses on social entrepreneurship—defined as both nonprofits and for-profits. As more for-profits enter the foundation's pipeline, Skoll adapted its due diligence for the Skoll Award for Social Entrepreneurship to clarify the impact motive and pathways for impact preservation.

As part of initial investment criteria, the investment team has a list of criteria that for-profits must meet in order to be considered. These include questions about other investors (mission alignment, return expectation, and timeline), governance (board makeup and role), and measurement (metrics tracked and reporting frequency). These questions set the stage for determining the degree to which impact is "baked" into the core business model and include the organizations' commitment to social impact, mission statement, external impact communication, and track record.

One example within the Skoll Foundation portfolio is Babban Gona (BG), the winner of the Skoll Award for Social Entrepreneurship in 2017. BG is an investor-owned social enterprise that works to revitalize the Nigerian smallholder agricultural sector with end-to-end services for smallholder farmers, a series of risk-mitigation tactics, and an ability to scale. Members receive training, credit, agricultural inputs, marketing support, and other key services. One of the strategies keeping impact at the center of its operations is that each smallholder farmer is also a partial owner of the larger enterprise. Inspired by cooperatives in the U.S., BG's model is anchored in trust groups of roughly four smallholder farmers. Farmers have board representation and can vote on all matters, including those particularly pertinent to their productivity and profitability. In that way, BG has ensured that it is directly accountable to its end users as shareholders. This proximity allows strategy to evolve in lockstep with changing farmer needs and aspirations.

To best support this inherent impact, the Skoll Foundation believes that a key driver for preserving and strengthening impact is appropriate investment terms and incentives. A Skoll investment of $1.25 million in subordinated debt came early in BG's history and aimed to reduce the perceived risk of the then-young business model, making it relatively easy to unlock senior debt. For every $1 in subordinated debt raised, BG has been able to raise an additional $3 million of senior debt for the expansion of its agricultural-franchise model. An urgent need exists for a common standard on deal structures and terms within the impact investing sector. With this goal in mind, Skoll Foundation has also supported the development of Toniic's Impact Terms Platform. The platform is a repository of deal structure, investment terms, and standardized documents with a critical goal of keeping impact at the center.

Source: Skoll Foundation

Monetizing Impact

A long debate continues to focus on how to monetize impact when comparing impact investing across themes. One widely used approach to monetizing impact is cost-benefit analysis. While some investors, philanthropists, and policy makers pursue this method, it requires them to select one specific variable that can be captured in monetary terms. For example, the Robin Hood Foundation has pursued a strategy of monetization to evaluate which interventions can most increase the economic well-being of poor New Yorkers. This plan is useful to assess the impact of a preschool program relative to a job-training program. This approach is more challenging for an impact investor who is deciding whether to save human lives or save acres of rainforest. Once an investor is constructing an entire portfolio, the challenges of monetization increase further. The Impact-Weighted Accounts initiative (Exhibit 5-12) is exploring how monetized-impact estimates can be integrated into financial statements.

EXHIBIT 5-12

Impact-Weighted Accounts

A potential development for increasing comparability between investments and weighing the trade-offs is the development of monetized impact estimates, also called impact-weighted accounts. Impact-weighted accounts are monetary line items on a financial statement, such as an income statement or a balance sheet, that are added to supplement the statement of financial health and performance by reflecting a company's positive and negative impacts on employees, customers, the environment, and the broader society. The aspiration is an integrated view of performance, which allows investors and managers to make informed decisions based not only on monetized private gains or losses but also on the broader impact a company has on society and the environment. Converting impact metrics into dollars or other monetary equivalent helps managers place impact into the greater business context seamlessly. Additionally, the impact represented by nonfinancial metrics is either of inherent value—for example, a number of acres of preserved wilderness—or is of instrumental value for something less familiar or intangible, such as an amount of carbon emissions avoided that are instrumental in stemming climate change. Either way, it is simply harder for people to wrap their minds around the value of something nonfinancial.

Source: George Serafeim, T. Robert Zochowski, and Jen Downing, "Impact-Weighted Financial Accounts: The Missing Piece for an Impact Economy," Harvard Business School, 2020.

Progress in the IMM Field

The field of impact measurement and management has made substantial progress in the development of principles, frameworks, and standards. The more than 150 tools, resources, and methods claiming to support IMM can be difficult to navigate or clarify what constitutes best practice versus what is noise. Impact performance remains largely self-reported and is not audited, and a lack of transparency exists on impact performance across the industry. More broadly, IMM is still seemingly focused on a "reporting and disclosure" mindset, which incentivizes investors to focus mostly on positive, measurable, standardized metrics—which may not tell the full story and, worse, promote an inaccurate one.

As the practice of IMM continues to grow, choices and trade-offs will need to be considered based on costs, approaches, and uses. The inherent limitations of each customized approach will remain; however, encouraging progress has been made on aligning various frameworks and standards. Early efforts are obtaining the benchmarked impact data that investors seek, such as GIIN's recent surveys in clean-energy access and housing.[55] A strong interest exists for integrating beneficiary and user perspectives and finding an appropriate balance of numbers and narrative. Investors are testing integrated approaches that combine financial and impact data in an effort to understand the relationships between them and report them more efficiently.

A general rule of thumb to remember: The more sophisticated the measurement approach, the more resources will be required. At the same time, you would not just spend additional money to get a more precise evaluation without considering if and how it would influence your decision-making. One pertinent example is the allure of randomized control trials (RCTs) that have been promoted as a "gold standard" for measurement. In reality, they are well suited to provide specific answers to narrow questions and not necessarily applicable to other contexts. Given the significant investment of time and money they require, alternative approaches may be a better fit. Regardless of the approaches you use or test, it is important to describe your views on why, what, and how to measure.

55 "Evaluating Impact Performance," GIIN, https://thegiin.org/research/publication/evaluating-impact-performance.

EXHIBIT 5-13

Making Choices in IMM

Karim Harji, Saïd Business School, University of Oxford

Many impact investors still struggle with impact measurement. But keep in mind that the financial-accounting standards that we take for granted today are the product of decades of iterative development, review, and negotiation. We are still in the early days for the analogous journey in social- and environmental-impact accounting. In this chapter, some starting points were provided which allow you to design your IMM approach in a pragmatic manner.

Regardless of where you are in your IMM journey, you will always have choices to make. You may be asking yourself: How much measurement is enough? How precise can we be? How much should it cost? There are no hard and fast answers—yet. However, here are a few principles that you can use to inform how you make these choices in practice.

- **Coherence:** Ensure that impact considerations are integrated at each step of your investment process—at the transaction and portfolio levels—and communicate the expectations with your colleagues, advisors, product issuers, and coinvestors.
- **Triangulation:** Think about the balance of numbers and the narrative that are required to not only understand what is happening (for example, who the investments are reaching) but also why and how it matters (for example, who is not being reached, why not, and does it matter?).
- **Decision Utility:** Work with your colleagues and advisors to probe how you can use the existing impact data to inform your current investment mix and future investment decisions, and regularly review which evidence you consider most useful or necessary.
- **Proportionality:** As you expand the scope of your investment and IMM activities, consider how your expectations on IMM are aligned with the capacity of the investee, your investment allocation, and the precision and quality you require for decisions.
- **Transparency:** Foundations have an important role to play in field building to promote better practice in IMM as a public good; work collaboratively with your peers, investees, and advisors to explore how you can share your approach, performance, and lessons.

Over time, commit to evolving your IMM approach as you learn more from your own experience and that of others, as you listen to feedback from your users and stakeholders, and as the field of IMM matures. And find a healthy balance in the goals of proving impact, improving impact, and generating learning.

FRAMING QUESTIONS

- Why will you undertake impact measurement and management? What are your goals for proving impact, improving impact, and learning?
- How does your theory of change map to your IMM approach? What areas are you most clear or confident in? What aspects require additional work?
- How does your IMM relate to the different products and asset classes in your portfolio? How do you frame impact across the portfolio as compared to specific segments?
- What are your challenges for measuring impact—in terms of data collection, analysis, reporting, and decision-making? How can you address these in practice?
- What is the most appropriate impact measurement and management strategy for you? What are your starting points, and which areas do you need to explore further?
- How will you harness your internal (staff, experience, systems) and external (advisors, peers, managers) capabilities to manage for impact on an ongoing basis?
- How can you share your IMM approach, emerging lessons, and impact performance with your internal and external stakeholders to contribute to field-level learning?

Practitioner Exercise and Sophia Example

So What: Impact Measurement and Management Plan

Exercise Overview

The good news is that you've started your IMM framework with your theory of change from previous chapters. Using the content of this chapter, we invite you to follow the three-part process to build your approach to IMM: Why are you measuring?; What are you measuring?; and How are you measuring? First, we suggest deciding on which parts of the portfolio you plan to evaluate, and create a row for each segment. Then, answer the three questions for each segment.

Sophia's IMM Plan

Consistent with her theory of change as described in previous chapters, Sophia has chosen to start by identifying one key goal for each of three capital sources she plans to deploy. Her broadest goal is applied to all assets: to increase her confidence in "doing no harm," particularly relevant after coming to understand that all investments have an impact on people and planet. Narrowing in on her foundation's endowment, she is choosing to prioritize a gender lens goal to see how much of these assets can apply gender-specific considerations, aligned with SDG 5 (Gender Equality). For the "catalytic" bucket, her foundation's PRIs will allow her to understand the ways in which water-focused enterprises are scaling by evaluating qualitative and quantitative measures. For more specifics, see the full table.[56]

One key assumption to this approach is her advisor's ability to adequately support her. She will be assessing this external support as well as the need to begin hiring an internal team to support the work. To be sure she is on the right track, she plans to first seek input on this overall framework from peers and experts including similar asset owners, sector experts, and potential investees. She will work through the initial steps of implementing this framework, while identifying gaps and areas for improvement. She intends to annually review impact performance and lessons-learned alongside her husband and family attorney, as well as two respected peers. After this initial review, she expects to refine her approach for the following year.

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56 These examples, such as Sustainable Development Goals (SDGs), International Finance Corporation (IFC) principles, IRIS+ standards, and Impact Management Project's (IMP) ABC framework to avoid harm, benefit stakeholders, and contribute to solutions, have been defined and explored in this chapter as well as earlier in the guide.

Resources	Why Are You Measuring? *Prove, Improve, Learn*	What Are You Measuring? *Principles, Frameworks, Standards*	How Are You Measuring? *Plan, Do, Assess, Review*
Entire Portfolio ($500M)	**Prove:** Feel confident in "doing no harm" while assessing her investment advisor's ability to provide support.	Percent of assets screened using negative and positive ESG criteria Categorize investments according to the IMP's ABC Framework Describe alignment with IFC's Operating Principles	Initially, work with advisor to assess baseline for each area of measurement (ESG Criteria, IMP Framework and IFC Principles), and identify strength and weakness to prioritize Conduct annual review to improve each area, to arrive at holistic "do no harm" judgment by end of Year 3
Foundation Endowment ($40M)	**Learn:** Explore the various ways to apply a gender lens across the portfolio, including investment processes, data collection and reporting.	Portfolio alignment with SDG 5, and how investments can report against relevant targets[57] The extent to which metrics can be disaggregated by gender, drawing on IRIS+ and 2X Criteria[58] Benchmarking and progress on worker health and safety, pay equity, and board diversity	With advisor's or external support, review leading gender-lens research, in order integrate across all asset classes and investment processes Review gender disaggregated data annually with asset managers Create scorecard with custom metrics to track progress over time, and work with peers for collective action and learning
Foundation Payout [PRIs] ($2M)	**Improve:** Seek to scale water-related enterprises and community-level outcomes through deployment of catalytic capital.	Establish initial combination of capital and non-capital supports required for various scaling strategies Portfolio alignment with SDG 6[59] (Clean Water and Sanitation) and related IRIS+ criteria Assess qualitatively how investees target underserved populations, and how access to water enables household and community-level outcomes	Seek out peers who focus on water issues to learn and refine approach to selecting and supporting investees, while testing ideal characteristics for scale Support investees to apply the Lean Data methodology, use baseline and follow up surveys to gather longitudinal qualitative and quantitative data

57 https://sustainabledevelopment.un.org/sdg5.

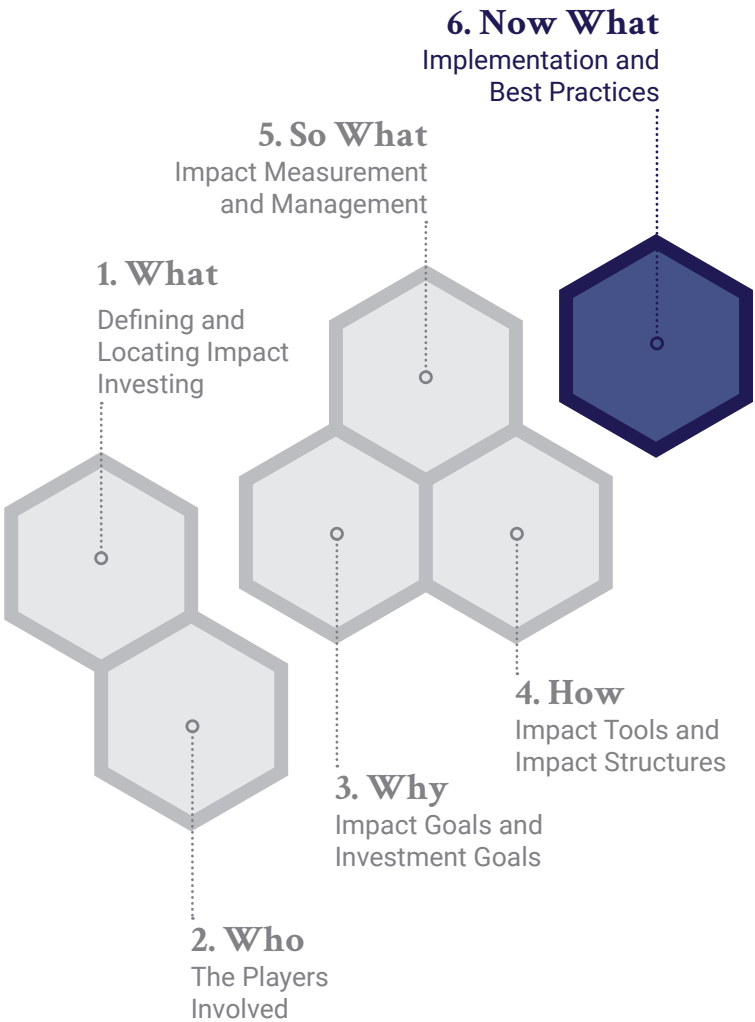
58 CDC Group, How to Measure the Gender Impact of Investments (2020), https://assets.cdcgroup.com/wp-content/uploads/2020/03/16111901/How-to-measure-the-gender-impact-of-investments.pdf.

59 https://sustainabledevelopment.un.org/sdg6.

CHAPTER 6

Now What

Implementation and Best Practices



Organizing Frameworks for Impact Investing

The preceding chapters and each resulting exercise have prepared you to develop your implementation plan and act. The time has come for you to start building your impact portfolio. Although impact investors often consider themselves one of a kind, common organizing frameworks can help shape an implementation plan. Your organizing framework for impact investing will depend on what type of asset owner you are. If you are an individual or a family, your operating model will reflect that you are investing your own assets. Those who are responsible for investing the assets of institutions, such as foundations and endowments, will have a different model that addresses their role as fiduciaries of assets rather than direct owners.

In this chapter, we will share ideas and best practices for a range of frameworks. Exhibit 6-1 shows an example of a plan for philanthropy, applying Peter Drucker's "The Theory of the Business"[60] to the foundation context. This framework may be useful to impact investors as they build out their implementation plans. We will also provide a more detailed overview of legal issues relevant to institutional philanthropy and other fiduciaries. But regardless of your structure, having an operating model that fits your needs will make your implementation plan more effective, provide concrete steps for you to take, and set you up for success.

The Philanthropy Framework[61] aims to help foundations examine how they make decisions, interact with society, and marshal resources and capabilities. This tool, which includes the concepts of charter, social compact, and operating model, can be used as a guide to help foundations align all of their resources for maximum impact. The charter, shaped by a founder's vision, defines a foundation's intended scope, culture, and values. The social compact refers to the foundation's implicit or explicit agreement with stakeholders about the value it creates in society, defined in part by to whom the foundation is accountable and how independent or interconnected it is with other institutions. The operating model includes the resources, structures, and systems that enable a foundation to deliver on its goals. This includes how it carries out its funding and decision-making, what resources it uses to execute its work, and the way it functions internally and with grantees or partners. When foundations are internally aligned on their framework and able to articulate their values, culture, approach, and ecosystem of stakeholders, they are able to better fulfill their mission and goals.

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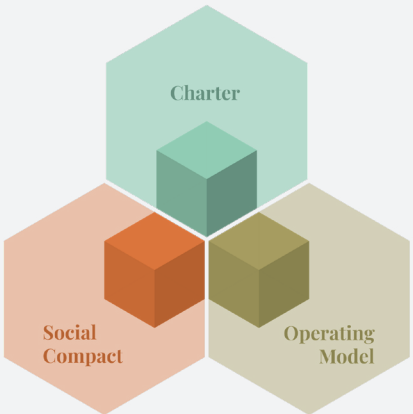
60 Peter Drucker, "The Theory of the Business," *Harvard Business Review* (1994).

61 *The Philanthropy Framework*, https://www.rockpa.org/wp-content/uploads/2019/02/The-Philanthropy-Framework-1.pdf.

EXHIBIT 6-1
Rockefeller Philanthropy Advisors' Philanthropy Framework



Source: Rockefeller Philanthropy Advisors, The Philanthropy Framework, 2019.

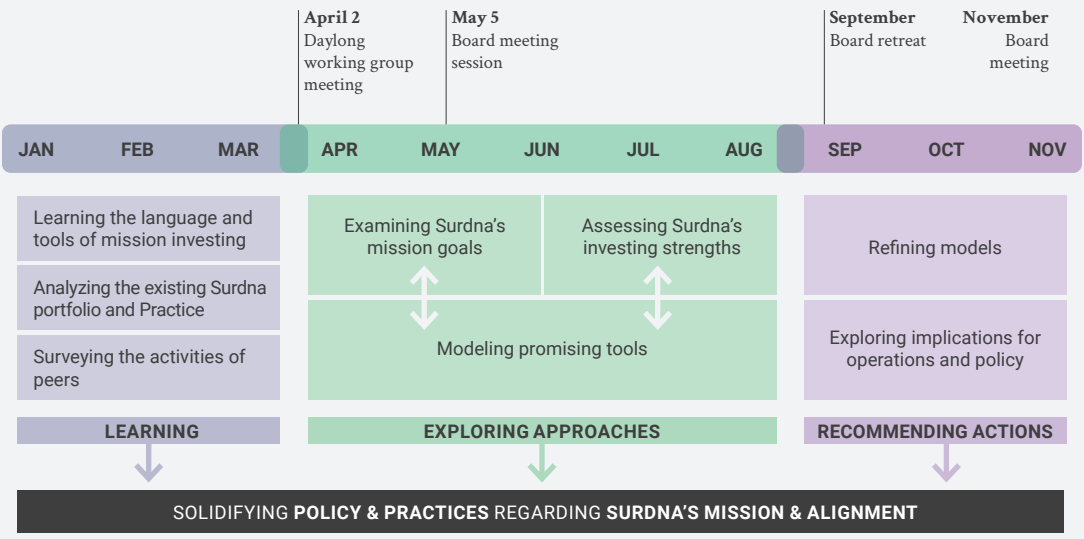
Investor Readiness

We encourage you to reflect on whether you have the necessary building blocks for a successful implementation plan. "Investor readiness" denotes the extent to which an asset owner has the core components in place to build an impact portfolio. To be clear, each component will always be a work in progress, needing to be refined by iteration. The key is to develop a baseline of competency in each category. Exhibit 6-2 shows how the Surdna Foundation went through a nine-month process to learn, explore approaches, and finally recommend next steps in its impact investing journey.

Categories of investor readiness include:

- Clearly defined implementation goals and strategies, including a relevant timeline;
- Consensus with key stakeholders, such as family, board, staff, and others;
- Relevant experience and expertise, internally from staff or externally from advisors;
- Organizational momentum and capacity, such as processes and systems; and
- Intentional approach to building the portfolio and finding investment opportunities.

EXHIBIT 6-2
Surdna Foundation's Impact Investing Exploration



Source: Jan Jaffe, "Mapping the Journey to Impact Investing," Surdna Foundation, 2017.

Implementation Goals

Similar to your impact and investment goals described in the "Why" chapter, take a moment to set a target for success in implementation. For example, if your organization is new to impact investing and you have a skeptical board or family members, perhaps the goal is to achieve incremental early successes. For another investor, it may be to test internal expertise alongside a consultant in order to gauge the need for future team resources. Other asset owners may want to simply start screening their existing portfolios.

To begin this process, we suggest you first review any strategic or governing documents that might influence your implementation process. You can also review and incorporate the documents you have developed through the exercises in the previous chapters. Governing documents specifically for impact investing would include an investment policy statement, an impact investment statement, and any other board-approved statement or policy to address roles and responsibilities for your organization's investing function.

Consensus Building

Unless you are acting alone, impact investing can be as much about organizational change or interpersonal dynamics as it is about investment. Beginning with the stakeholder and power map you created in the "Who" chapter, determine the highest-priority stakeholders and their opinion of impact investing as well as any worst-case scenarios. For example, investment committee members may be more likely to think about added risk or lower returns. Impact-oriented stakeholders, on the other hand, may be more concerned about unintended consequences or dilution of impact. Varying views on cost structures and the relative merit of different investment approaches will be likely.

With your priorities in mind, approach each group or individual with a collaborative tone in order to listen to their points of view. In other words, do not start with a hard sell. From that initial interaction, develop an engagement plan for each person or group—keeping them updated along the way. Strategies to keep in mind:

1. Tailor your approach and language to your audience and meet them where they are, looking for easy wins.
2. Root your engagement in your goals, and show how impact investing is one of many tools to achieve those goals.
3. Leverage advocates, partners, stories, and data to support your case.
4. Consider how to merge the often-separated finance and impact considerations, aligning impact goals with financial ones.
5. Use an exploration of your existing investments to trigger a conversation with your other stakeholders about what you own. This can establish a common knowledge base without any incremental cost or risk.
6. Start from a place of strength: Consider a loan to an existing organization that you know well or look at an environmental, social, and governance (ESG) screen for the next investment in an already familiar sector or asset class.

As you begin building consensus, recognize that this will be an ongoing process of informing, educating, and responding to key stakeholders. This is also true for seasoned impact investors. The Michael & Susan Dell Foundation (MSDF), for example, has been a leading impact investor in India for more than ten years. In recent efforts to apply this tool to its U.S. education work, MSDF has taken thoughtful education and communication from program officers and impact investing staff to begin implementation. In Exhibit 6-3, we share The Nathan Cummings Foundation's journey of investor readiness on its way to committing its entire endowment to impact investing.

EXHIBIT 6-3

The Nathan Cummings Foundation: Investor Readiness and Consensus Building

Sonen Capital

The Nathan Cummings Foundation (NCF) works to create a more just, vibrant, sustainable, and democratic society. NCF's funding focuses on finding solutions to some of the most challenging problems of our time—the climate crisis and growing inequality. NCF aims to transform the systems and mindsets that hinder progress toward a more sustainable and equitable future for all people, particularly women and people of color. The foundation has long been active in filing shareholder proposals and catalyzing meaningful change among the public companies in which it invests.

In early 2017, NCF trustees and staff agreed that this was no time for "business as usual," given the urgency and magnitude of the issues it was trying to address. Realizing that these issues required market-based solutions in addition to grantmaking, NCF considered how to use its endowment as a critical tool.

The NCF team embarked on a journey to examine its values, test its courage, and understand the foundation's commitment to catalyzing change. At the onset, there was no certainty of consensus from the foundation's decision-makers. Skeptics on the team did not think this approach aligned with the foundation's best interest, while others resisted the disruption of the existing separation between financial and programmatic work.

Throughout the next year, the board, investment committee, and staff went through a deliberative educational process to bring the entire foundation into alignment in order to decide on if, and how, to proceed with impact investing. NCF was clear from the beginning that it wanted a broad group of stakeholders involved in the education process, including board members, staff and program officers, investment-committee members, and members of its outsourced chief investment officer (CIO). This process included guest speakers, examples from other foundations, empirical data about financial returns from various impact investment approaches, and investment managers focusing on sustainable and impact investment strategies.

Through NCF's journey, the following elements emerged as critical components to its successful consensus-building process.

1. **Level Setting:** The first step was to assess and calibrate the level of understanding, expectations, and biases that were already present within the organization (at board and staff levels) and to create an intentional process of learning and decision-making, along with shared agreements on terminology.
2. **Understanding Why:** The key stakeholders needed to understand why they were heading down this path. Decisions about impact investing can only be made when clarity exists about the decisions being made in the first place.
3. **Aligning Values:** Fundamentally, the team needed to determine if it believed that investment capital can be an instrument for change. Are capital markets intricately connected to the challenges and opportunities it sought to address through programming? If so, it can be illuminating to examine the relationship between financial return, risk, liquidity, and impact, and optimize that relationship in a way that enhances the institution's overall impact mission.
4. **Picking the Players:** Who should have a seat at the table for conversations and decision-making? NCF felt strongly about bringing in a multitude of stakeholders and voices to create long-lasting acceptance and change, and involve people who had a commitment to diversity, equity, and inclusion.

Exhibit continued on next page

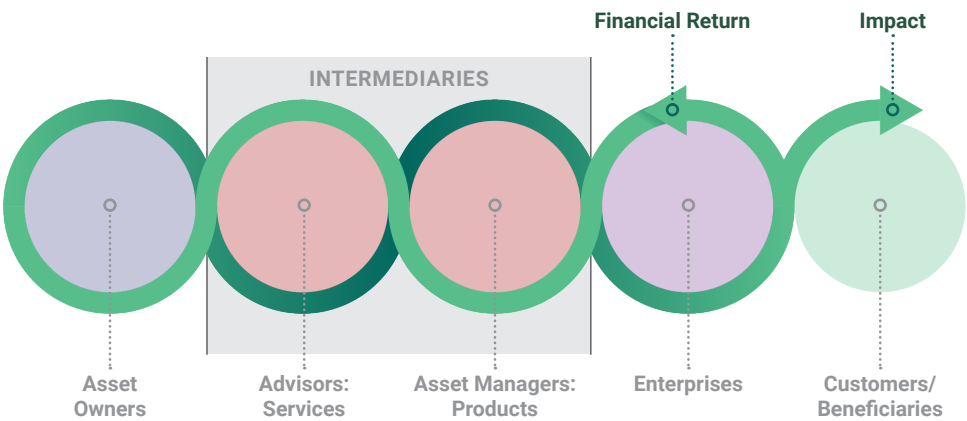
EXHIBIT 6-3 (CONTINUED)

5. **Getting to the How:** A critical starting point was to acknowledge that all investments have an impact. Finding the right approach for the foundation required self-examination, education, and expert advice. However, NCF agreed that it would not let the perfect be the enemy of the good. The foundation understood that it wouldn't have all the answers at the start and that it could move slowly and incrementally.

The result of this process was a 100% endowment commitment toward impact investing. NCF's choice to use its endowment to its fullest capacity in pursuit of its mission was the result of a steady, deliberative approach among all of the foundation's stakeholders during the course of a year. The consensus-building approach included voices from board members, staff and program officers, investment-committee members, and professional-investment managers. With a clear view of the foundation's goals, and now with the backing of its full endowment, NCF believes it is better equipped to build a more equitable future for all people.

Finding and Evaluating External Support

As part of a buy-versus-build analysis, asset owners can assess when they will build internal resources and when they will buy external support. External advisors may bring specific expertise in areas including tax and accounting, legal and investment management, or support to your organization as you explore a new area such as impact investing.



As described in the "Who" chapter, an investment advisor is an intermediary that sits between you and the investments you are making. Understanding the nature of this relationship is critical to your success. An investment firm has "discretion" if it has the authority to decide which securities to purchase and sell for the client. A firm also has discretionary authority if it has the authority to decide which investment managers to retain on behalf of the client.

Here are a few guiding principles for choosing an appropriate investment advisor for you:

- Do they have expertise at the intersection of your impact and investment goals? And do they have specific examples of their experience and the role they played in desired strategies and investments?
- Do they have credentials to satisfy the work requirement and satisfy your key stakeholders?
- Do they have experience working with organizations and governance structures like yours? For example, do they operate on a discretionary or nondiscretionary basis?
- Can they speak your language and help you reach your specific goals? Do they exhibit values alignment with you on how they operate as an organization?
- Are they able to measure impact in line with your goals?
- What are their business strengths and weaknesses: customer service, reporting capabilities, customization, fees, etc.?

Investment Advisor Search Process

When searching for an investment advisor, it is critical to have a clear understanding of your goals and objectives. By being certain about what you want to achieve, you can better target your search for an impact investment advisor who will work best for you. Some advisors specialize in impact investing while it is ancillary to a broader investment practice for others. In order to prioritize potential candidates, you should understand all of the services you will need from an advisor. Once you have developed your key selection criteria, you may want to have preliminary screening conversations with candidate firms and then send out a more detailed request for proposals (RFP) to a few select firms. In-person interviews are the final step in the process. You may consider hiring a search consultant, who can work with you, your board, and your investment committee on this process. Exhibit 6-4 outlines the Jessie Smith Noyes Foundation's advisor search, emphasizing the advisor's understanding of social justice.

While formal consulting helps bring focused attention to your specific needs, many investors supplement this support with key peer relationships—another asset owner on a similar path, who can support you along the way. To find these peers, we recommend joining an aligned affiliate group or attending relevant conferences, including the Asian Venture Philanthropy Network, Confluence Philanthropy, European Venture Philanthropy Association (EVPA), Global Impact Investing Network (GIIN), Global Steering Group for Impact Investing (GSG), The ImPact, Mission Investors Exchange, Principles for Responsible Investment (PRI), Skoll World Forum, Social Capital Markets (SOCAP), and Toniic.

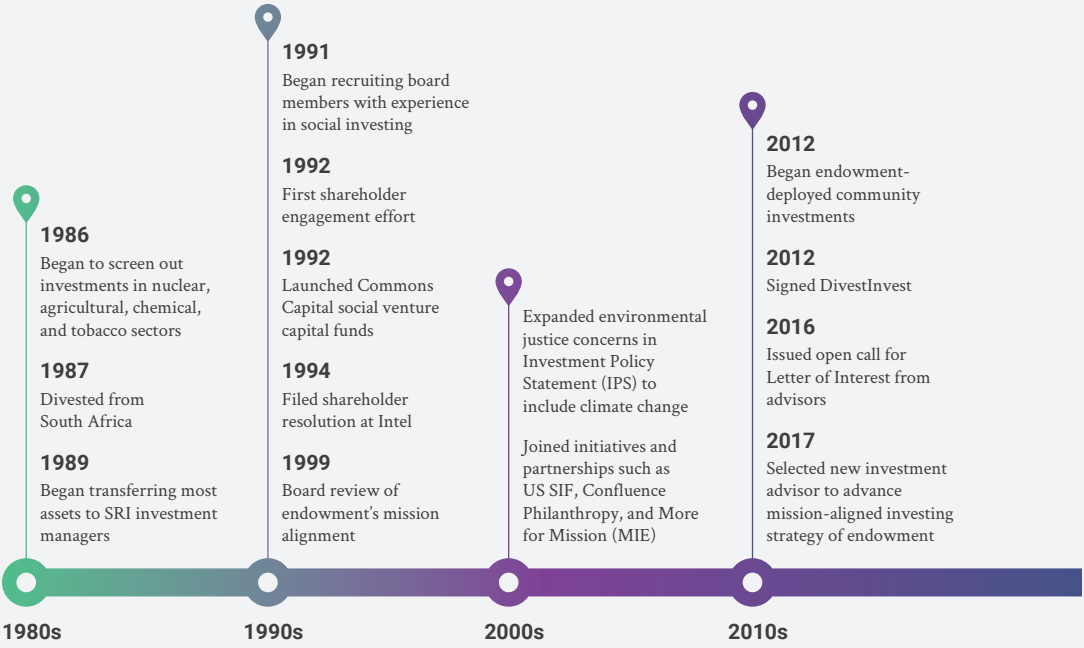
EXHIBIT 6-4

Investment Advisor Search Process at a Social Justice Foundation

Jessie Smith Noyes Foundation

For the past thirty years, the Jessie Smith Noyes Foundation has worked to closely align the management of its endowment with its grantmaking activities. As a medium-size family foundation at the forefront of social change, Noyes is determined to make every dollar work toward its mission of promoting social justice.

Timeline: Noyes's Evolving Investment Approach



This path toward mission alignment has yielded several lessons: First, it has required effort on several fronts—sometimes more than the foundation had imagined. The board is engaged with the investment portfolio beyond risk and return. Leadership has a broader perspective on strategies for accomplishing its mission. Staff engages with grantees on an array of possible activities, including impact investing and shareholder activism. Second, Noyes has broadened its universe of partners and now collaborates with others on ESG and impact-investment strategies beyond grantmaking. In doing so, Noyes considers a wider range of options for vendors and asset management.

In 2017, Noyes determined that selecting a new investment advisor was critical to its success. Though the foundation's investment performance had been quite competitive, it wanted to explore whether a new advisor could shape a strategy to further reflect its values by utilizing the increasing number of options for impact investing. The board determined that the right kind of partnership—with the right kind of investment advisor—would amplify the foundation's "voice" to reach new sources of demand for mission-aligned activities and shareholder advocacy.

Exhibit continued on next page

EXHIBIT 6-4 (CONTINUED)

The foundation used an open, crowd-sourced search process to generate investment-advisor candidates. By using this open search process, Noyes sought to demonstrate demand for impact advisors and trigger a broader awareness of social-justice investing in the advisor industry. This search for an investment advisor integrated specific questions for the field of advisors on the intersection of social justice and investing in order to:

- Highlight innovations that support impact investors focused on social justice;
- Identify advisors who address the needs of historically underserved impact investors that sit between the large-institutional investors and the small-endowment and private-wealth segments typically served by Registered Investment Advisors (RIAs); and
- Demonstrate demand for viable investment strategies that generate competitive returns while addressing critical social and environmental challenges, particularly around the emerging field of social-justice investing.

The thirty-four investment firms that responded to the request for letters of interest demonstrated that they could deliver a range of impact products and were actively building dedicated impact-investing teams. However, the depth of some of the product offerings was limited and Noyes struggled to find diverse teams and fund managers in the pool of responses. Noyes has learned that ongoing engagement with advisors and consultants is essential to drive mission alignment across its endowment as the field expands and evolves.

Source: "Building Power Across the Impact Investment Field: Key Takeaways from Our Investment Advisor Search," Jessie Smith Noyes Foundation, 2018.

Whole Team Approach

Both financial and impact expertise are needed to implement thoughtful impact investing. However, most asset owners have established two operational silos for investment and impact functions. In institutions this divide may be reflected in separate departments and staffing, while individuals and families may be working with separate external advisors who are not coordinated. When these two approaches are merged into one—even in a subset of assets—pressure will be put on the traditional organizational design. This may trigger the need for additional talent and integration related to interactions, communications, processes, and systems. While such a change may seem daunting, remember it is possible to take one step at a time and only make changes specific to your desired approach. For example, if you plan to consider loans, invite one credit analyst from the investment team to sit on your impact due diligence committee. See how that goes and iterate.

Building a Team

As you recall from the "Who" chapter, investment is a nuanced, broad field. Social impact and philanthropy are also nuanced, broad fields. Selecting expertise at the intersection of these fields can be complex. To take your first steps, think of supply and demand. What supply of existing talent do you have that matches the demand of the strategies resulting from your theory of change. When considering talent resources, pay attention to key quasi-staff roles like your board, investment committee, and existing advisors/consultants.

Again, start slowly with your goal in mind and assess gaps as they develop. If screening public equities for ESG factors, do your analysts/advisors have a good grasp of the different screening options and approaches? As you find gaps in experience or expertise, first consider a consultant or advisor then begin to build or reshape your team to ensure it has the necessary skills. As the field of impact investing matures, an increasing pool of talent with the appropriate mix of investment, policy, and philanthropic experience exists.

In addition to staff and consultants or advisors, one compelling option is an investment-advisory committee, a group of experts who share their knowledge about the investment process and are committed to your mission. The group is often made up of both internal and external parties with an understanding of your organization and/or the issues and structures of the impact investing strategy. See Exhibit 6-5 for how the Catalyst Fund has used an advisory board to execute its strategy.

EXHIBIT 6-5

The Power of an Investment Advisory Committee

Maelis Carraro, Catalyst Fund

Catalyst Fund is an accelerator for inclusive fintech startups in emerging markets that are building affordable, accessible, and appropriate solutions for underserved communities. Catalyst Fund is supported by the U.K.'s Department for International Development (DFID) and JPMorgan Chase & Co., managed by BFA Global and fiscally sponsored by Rockefeller Philanthropy Advisors. Between 2016 and 2019, Catalyst Fund accelerated twenty-five fintech startups that went on to raise nearly $50 million in follow-on funding and reaching more than two million customers.

The Catalyst Fund offering combines bespoke venture-building support from fintech- and emerging-markets experts, patient capital in the form of flexible grants, and curated connections with investors. Startups are offered support at the critical stage of testing product-market fit. Many startups experience a "valley of death" at this stage, running out of capital before they can refine their product and reach a sufficient number of customers. Catalyst Fund fills this financing-and-support gap during this testing phase, bringing startups to the point where they are investment ready.

Exhibit continued on next page

EXHIBIT 6-5 (CONTINUED)

Catalyst Fund finds companies through an Investor Advisory Committee (IAC) comprised of leading investors in fintech and emerging markets: Accion Venture Lab, 500 Startups, Gray Ghost Ventures, Omidyar Network, Quona Capital, and Anthemis. Each member of IAC is asked to recommend promising startups that match the fund's criteria. This group of experts then vets and mentors the recommended startups through the duration of the program. By the end of the acceleration process, the benefit to IAC members is deep familiarity with investment-ready companies.

This process ensures that high-quality startups are selected by professional investors who are uniquely qualified to find and recognize high-potential, scalable investment opportunities. The investors review the companies based on Catalyst Fund's criteria, combined with their own acumen and experience conducting due diligence on fintech companies across emerging markets.

This method also ensures that investors act as partners to accelerate the inclusive fintech ecosystem and do not merely become an exit strategy for the startups. It gives investors a chance to engage with companies at an early stage and follow their progress until they reach the proof points that investors are seeking. As an IAC member from the Omidyar Network said, "Catalyst Fund provides an opportunity to stay close to early-stage innovators to determine which are investor ready over time."

Roles and Responsibilities

When developing a team, be clear about roles and responsibilities, since impact experts can step on the toes of finance experts and vice versa. A few questions to ask are:

- How deeply does each party need/want to engage?
- If there is more than one team or person, how is the due-diligence process being shared?
- What is the right frequency of meetings between investment-oriented and impact-oriented team members?
- How can more intentional communication be encouraged between investment and impact personnel?
- How do roles change from strategy through individual investment selection?
- How do roles change throughout the investment process from sourcing to due diligence, selection, monitoring, and exit?

While determining roles and responsibilities, be mindful of the overall culture change that will likely need to take place across your organization.

Investment Decision-making

An effective investment policy statement ensures that the roles and responsibilities of all parties are not only clearly defined, but also appropriately delegated to the investment committee, staff, investment advisors, and asset managers. These roles and responsibilities will vary depending on your governance structure and operating model. But regardless of where specific responsibilities are located in your organization (see Exhibit 6-6), you should consider the following questions:

- Who has the responsibility to vote on/approve issues, such as asset allocation or hiring an asset manager?
- Who provides advice or formal recommendations?
- Who reviews and provides oversight on the decision?
- Who implements the decision?
- Who is notified as an interested party?

Processes and Systems

In a way similar to how you assessed your team resources, consider the processes and systems that need to be created or changed to implement an impact investing strategy.

Categories of procedural changes within foundations include:

- **Governance:** Board and investment committee review, sign off, and reporting for impact investments;
- **Legal:** Professional review of any new impact investments and related documentation, particularly relevant for direct investing;
- **Administration:** Grants personnel executing expenditure responsibility for any charitable investment, including relevant reporting;
- **Accounting:** Finance teams tracking repayments and accounting for impact investments on financial statements and tax returns, such as Form 990-PF; and
- **Reporting:** Combined impact and financial metrics and reporting process to key internal and external stakeholders.

Categories of changes in organizational systems may include:

- Grants management or portfolio management software to track investments;
- Customer-relationship management (CRM) system;
- Project-management system; and
- Document-management system.

Other asset owners, such as family offices, high net–worth individuals, and institutions, will have their own ways of addressing these changes in procedures and systems.

EXHIBIT 6-6

The Investment Decision-making Pyramid

Source: Godeke Consulting

EXHIBIT 6-7

Organizing for Impact
Alabama Power Foundation

The Alabama Power Foundation deployed its first social-impact investment in April 2019. The foundation issued a loan to a Birmingham-based health-tech company, so it could develop a behavior-coaching program to reduce opioid dependence and addiction. For the corporate foundation of Alabama's largest public utility, this was not business as usual. The Program Related Investment (PRI) was the result of more than a year of work aligning social-impact ventures with core business strengths, developing a pipeline to identify investment opportunities and advising the foundation's board of directors on the value and opportunity of social-impact investing. This was the first of six PRIs the foundation made in 2019.

April 2019 marked the culmination of an impact investing journey that began with a challenge in 2017 by foundation leadership: partner with Alabama Power's economic-development team to develop charitable strategies that grow the tech sector's workforce pipelines to meet the needs of business and industry. That initial challenge sparked a transformative initiative to align the foundation's social-impact aims with the utility's core knowledge of community needs, economic development and local leadership. Alabama Power's founders believed that nothing could be good for Alabama Power unless it was good for Alabama. That belief continues at the company today—and at the Alabama Power Foundation, where improving Alabama is key to its mission.

In 2018, the foundation's board of directors approved efforts to align a portion of the foundation's giving with social-impact investment. An internal advisory committee representing key partners in the company was formalized to help source projects, provide due diligence, and develop procedures for the impact investing program.

Leveraging the company's grassroots connections and economic development expertise to source projects, the team executed its first coinvestment project—attracting an additional $500,000 in partner investments from corporate and private foundations, as well as state-agency partners, to fund a high-risk, for-profit corporate venture aimed at improving continued enrollment and graduation rates among at-risk higher-education students. It facilitated the development of a prospectus for a hyper-local Opportunity Zone fund through below-market debt that includes an equity option should the fund be capitalized. It has also engaged stakeholders throughout Alabama regarding the value of benefit corporations and social-innovation and entrepreneurship incentives.

Today, the Alabama Power Foundation is opening its social-impact investment pipeline to local peers and new national partners—using impact investment to incentivize nonprofits to think about revenue more like businesses do and to help businesses offset the potential risks associated with prioritizing social impact.

The Alabama Power Foundation hopes to expand coinvestment opportunities and grow Alabama's impact investing network—both building within its organization and attracting external thought leaders. It is working to educate and engage Alabama stakeholders about the benefits of cultivating a friendly impact investing market through incentives for social innovation and social entrepreneurship. The foundation is building networks among agencies, nonprofits, for-profits, and the communities it serves to bring resources to bear in new ways that meet local needs with sustainable solutions.

Legal Considerations

Three broad categories of legal considerations exist for impact investing: fiduciary, charitable, and securities law. We will focus on the first two, since most securities-law considerations are not unique to impact investing. These legal considerations are most directly applicable to charitable organizations and private foundations, in particular, and build on Exhibit 2-2 in the "Who" chapter. Please keep in mind that we are presenting certain general and high-level legal considerations—not legal advice or opinion—for impact investing.

Although we will present detailed reflections on a range of legal issues, our key message is this: Impact investing does not conflict with the duties, rules, and responsibilities assigned to asset owners. In fact, for mission-driven organizations, impact investing can increase the ability to achieve their purpose.

Fiduciary Duty Satisfied

A fiduciary, in the investment context, is a person or an organization that acts on behalf of another entity/person to manage assets or those individuals who oversee the management of the institution's charitable assets. Essentially, a fiduciary owes the charitable institution the duties of good faith and trust. A fiduciary is bound ethically to act in the institution's best interests—it is the highest legal duty of one party to another.

A fiduciary's responsibilities or duties are both ethical and legal. When a party knowingly accepts the fiduciary duty on behalf of another party, that party is required to act with reasonable prudence and care and in the best interest of the institution whose assets the fiduciary is managing. This is known as a "prudent person standard of care."

The prudent-investment rule requires that a fiduciary invest institutional assets as if they were the fiduciary's own. Under this rule, the fiduciary should consider the needs of the institution and avoid investments that are excessively risky or inappropriate.

Fiduciaries of charitable institutions have three basic responsibilities.

Duty of Care: Perform duties in good faith and with the care that an ordinarily prudent person would exercise in a similar position under similar circumstances. Be diligent and informed, and exercise honest and unbiased business judgment when making decisions on behalf of the charity.

Duty of Loyalty: Make decisions for the benefit of the charity with undivided commitment to the charity and without regard to personal concern. Relevant issues include conflicts of interest, confidentiality, and corporate opportunity, such as diverting a corporate business opportunity for personal gain.

Duty of Obedience: Act with fidelity to the charity's mission; its governing rules, documents, and policies; the duly adopted acts of the board and applicable laws; and avoid any acts beyond your legal authority.

Charitable Purpose and Impact Considerations

The exempt purposes set forth in Internal Revenue Code section 501(c)(3) are charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and the prevention of cruelty to children or animals. The term charitable is used in its generally accepted legal sense and includes relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; protecting and preserving the natural environment; and combating community deterioration and juvenile delinquency.

The Uniform Prudent Management of Institutional Funds Act (UPMIFA) provides guidance and authority to charitable organizations concerning the management and investment of their institutional funds, among other things. UPMIFA describes the factors that a charity should consider when making investment decisions, including a modern prudence standard. It also requires a charity—and those who manage and invest its funds—to act in good faith, with the care an ordinarily prudent person would exercise, and in general develop an appropriate investment strategy.

Under UPMIFA, a charity is required to make decisions about each asset in the context of the entire portfolio of investments, as part of an overall investment strategy. This means that an asset, which in isolation might seem imprudent for a charitable organization to hold because of its risk profile, may nevertheless be retained by the charity if it fits into a diversified portfolio comprised of various asset classes. Indeed, another general UPMIFA investment directive is to diversify investments.

UPMIFA allows for mission considerations when assessing fiduciary duty and carves out investment assets that have a primary program or mission purpose, as opposed to an investment purpose from the traditional investment-prudence analysis. In addition, as an element of its prudence analysis, UPMIFA invokes the consideration of "an asset's special relationship or special value, if any, to the charitable purposes of the institution."[62]

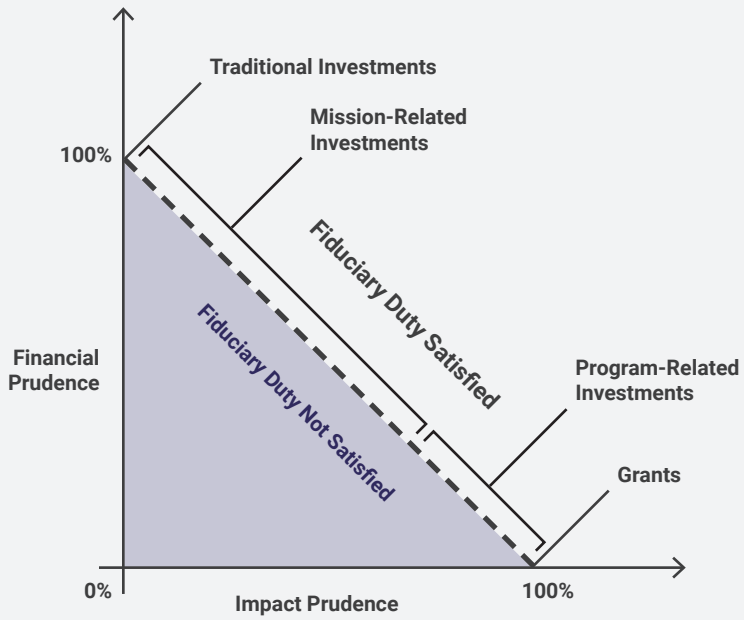
Prudence and Charitability to Satisfy Fiduciary Duty

Taking these considerations together, the following continuum chart (Exhibit 6-8) shows how the blending of prudence and impact (or mission alignment) inform fiduciary duty. On the far left, you have pure financial prudence as with traditional investing. As you move to the right, less financial prudence and more impact are exhibited. Here, both the financial issues and the special relationship of an investment to the charitable mission/purposes of the institution are considered. As you move further to the right, you demonstrate more and more impact prudence, which applies UPMIFA's mission considerations and blends in prudence from an impact perspective such as whether sufficient relatedness to an

62 "Uniform Prudent Management of Institutional Funds Act," https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=d7b95667-ae72-0a3f-c293-cd8621ad1e44&forceDialog=0.

EXHIBIT 6-8

Fiduciary Duty Satisfied by the Combination of Financial and Impact Prudence



institution's exempt purposes warrants engaging in the activity. To be sure, if an investment is not adequately prudent from a mission or impact perspective, the investment should not be made.

To simplify the key point, a private foundation considers an investment in the middle of this spectrum—the prudence of which is determined by a mix of investment prudence (say 70%) and impact prudence (say 30%). Though it may be riskier or have a lower expected return than a comparable investment with no impact component, the foundation believes that it is still a prudent investment and fiduciary duty is satisfied if the investment has the sufficient alignment with the foundation's mission to offset the lower expected return than a pure financial investment. In other words, the investment combines 70% investment prudence with 30% impact prudence, leading to 100% fiduciary duty satisfied.

The following section continues to focus on private foundations yet has analogous considerations for other charitable organizations. For example, although public charities are not subject to the PRI rules, many now seek to make PRI-like investments. While PRIs provide no additional benefit to noncharitable institutions, other organizations such as endowments are choosing to use PRI-like instruments as part of their investment practice.

As a reminder from the "How" chapter, an important structural distinction for private foundations is the difference between a program-related investment (PRI) and a mission-related investment (MRI). A PRI is a specific and statutorily defined type of charitable investment—treated like a grant for many regulatory purposes, including qualifying toward a foundation's 5% minimum distribution requirement—that arises in the context of the general prohibition on jeopardizing investments under Section 4944 of the Internal Revenue Code. Section 4944(c) and the Treasury Regulations articulate a three-part test for an investment to qualify as a PRI: (1) The primary purpose of the investment is to accomplish one or more charitable purposes; (2) no significant purpose of the investment is the production of income or the appreciation of property; and (3) no purpose of the investment is to lobby or engage in political campaign intervention. In contrast, an MRI is not a legal term but describes an investment that integrates mission alignment into the investment

EXHIBIT 6-9

How Fiduciary Duty Is Satisfied by Investment Category

Category	Source	Financially Prudent?	Mission Aligned?	Financial Return as a Significant Purpose	Fiduciary Duty Satisfied?
Tradition Investment	Endowment	**Yes**	**No**	**Yes**	**Yes**, by pure financial prudence
MRI* (At or Below Market Rate)	Endowment	**Yes**, to varying degrees	**Yes**, to varying degrees	**Yes**	**Yes**, by combination of financial and impact prudence
PRI (Below Market Rate)	Distribution	**No**	**Yes**, by meeting charitable standards	**No**	**Yes**, by pure impact prudence
Grant	Distribution	**No**	**Yes**, by meeting charitable standards	**No**	**Yes**, by pure impact prudence

**This analysis of the distinction between a "traditional" investment and a market-rate MRI is relevant to private foundations. For other impact investors, the difference is simply whether they make an investment with impact intention or not.*

Godeke & Briaud

decision-making process. These investments are a component of the foundation's overall endowment and investment strategy and must comply with the state and federal prudence requirements applicable to a foundation's investing activities. They are unique in that the degree of mission alignment becomes an essential factor in the prudence analysis, in some cases allowing for a lower financial-return objective than for a non–mission aligned endowment investment. See Exhibit 6-9 for how to test an investment for prudence and fiduciary duty.

Jeopardizing Investment Rule Section 4944 of the Internal Revenue Code

Jeopardizing investments are generally investments by private foundations that show a lack of reasonable business care and prudence in providing for the long- and short-term financial needs of the foundation in carrying out its exempt function. No single factor determines a jeopardizing investment, but certain investments bring extra scrutiny. An excise tax will be imposed on any jeopardizing investments. This rule imposes a federal-level prudence requirement on the investment activities of private foundations. The IRS recently harmonized the application of the jeopardizing-investment rules with the state-level prudence analysis,[63] acknowledging that, in essence, if you satisfy prudency on the state level, you satisfy it federally.

Other Legal Considerations

Related to and beyond the key consideration of fiduciary duty, the following section describes additional legal elements to keep in mind.

Expenditure Responsibility

Expenditure responsibility[64] relates to certain heightened grantmaking and reporting procedures required in connection with any grant to or PRI in an entity that is not a Section 501(c)(3) public charity (or foreign equivalent), governmental entity, or a designated international organization. Failure to exercise expenditure responsibility when required will result in excise taxes.

Expenditure responsibility means that the foundation exerts all reasonable efforts and establishes adequate procedures to:

1. See that the grant is spent only for the purpose for which it is made,
2. Obtain full and complete reports from the grantee organization on how the funds are spent, and
3. Make full and detailed reports on the expenditures to the IRS.

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63 Notice 2015-62, "Investments Made for Charitable Purposes," https://www.irs.gov/pub/irs-drop/n-15-62.pdf.

64 IRC Section 4945(h)—Expenditure Responsibility, https://www.irs.gov/charities-non-profits/irc-section-4945h-expenditure-responsibility.

Self-dealing

The self-dealing rules[65] prohibit almost all business and financial transactions between a private foundation and its "disqualified persons"—a broad category of foundation insiders that includes substantial contributors to the foundation, its trustees and managers, certain family members and businesses owned by disqualified persons, and certain government officials. It also includes transactions where the income or assets of the private foundation are used to benefit a disqualified person.[66]

Beyond the important grantmaking considerations for any foundation, self-dealing becomes particularly relevant for impact investing activity related to coinvestment. For example, if a disqualified person's investment in Company A benefits from the foundation's investment in the same company, self-dealing may be triggered. The IRS imposes an excise tax on each act of self-dealing between a private foundation and disqualified persons.

Intermediate Sanctions: Excess Benefit Transactions

Under the so-called intermediate-sanctions rules[67] applicable to Section 501(c)(3) public charities and Section 501(c)(4) social-welfare organizations, an excess-benefit transaction is a transaction in which an economic benefit is provided by an applicable tax-exempt organization, directly or indirectly, to or for the use of a disqualified person—and the value of the economic benefit provided by the organization exceeds the value of the consideration received by the organization.

The excess benefit rules are the public charity analog to self-dealing and allow for arms-length transactions, which are generally not permitted in the private foundation context.

Tax and Accounting Considerations for Program-Related Investments

As an IRS defined category, a PRI counts toward the 5% required charitable distribution in the year the PRI is disbursed. PRI principal repayments (not including capital gains, dividends, or interest) count as a "negative distribution" against payout requirements to be applied to the tax year in which the repayment is received. PRIs are also excluded from the foundation's assets on which the 5% required distribution is calculated. Interest, dividends, and capital appreciation count as regular income to be included in the calculation of Excise Tax on Net Investment Income, and PRIs generally are not subject to the Unrelated Business

65 Acts of Self-dealing by Private Foundation, https://www.irs.gov/charities-non-profits/private-foundations/acts-of-self-dealing-by-private-foundation.

66 "Avoiding Conflicts of Interest and Self-Dealing for Family Foundation Boards," https://www.ncfp.org/wp-content/uploads/2018/09/Avoiding-Conflicts-and-Self-Dealing-for-Family-Foundation-Boards-NCFP-2013-avoiding-conflicts-of-interest-and-self-dealing-for-family-foundation-boards.pdf.

67 "Intermediate Sanctions—Excess Benefit Transactions," https://www.irs.gov/charities-non-profits/charitable-organizations/intermediate-sanctions-excess-benefit-transactions.

Income Tax (UBIT) by being "substantially related" to a foundation's exempt purposes. For details on how to report PRI income, appreciation, and asset value on the annually required tax form 990-PF, refer to the IRS's Instructions for Form 990-PF[68] and search "program-related investment." To get a quick summary of a private foundation's PRI activity, look for Part IX-B on the 990-PF.

Legal Process and Investment Lifecycle

Building on these legal and accounting considerations, best practices should be followed by different actors at different points in the investment process. Specific actors will have distinct tools, goals, and requirements—in some cases for the same investment. Overall, it is useful to ask the following sequence of questions as you consider impact investing opportunities:

1. **Can I do this?**
2. **Should I do this?**
3. **How do I do this?**

Each stage of the investment lifecycle (Sourcing, Selection and Execution, Monitoring and Exit) can also bring up specific legal considerations.

- **Goal Setting:** Be clear about your goals for this investment, including prudence and charitability, along with any themes or lenses.
- **Decision-making:** During the initial phases, be clear about who will be making what decisions, including any investment-advisory committee and advisors. Be particularly mindful of any disqualified persons involved.
- **Write-up:** A summary write-up is recommended to memorialize the analysis on how this investment meets the goals previously set. This is particularly important for PRIs or other investments prioritizing social impact.
- **Investment Execution:** Be sure that these documents satisfy regulatory requirements for both prudence and charitability. Pay attention to securities law for this step.
- **Monitoring:** Regular reporting should be aligned to the investment's dual purpose as well as to the reporting requirements (for example, as a result of expenditure responsibility) for any charitable investment/PRI.
- **Exit Considerations:** Think about exit on the front end. Assess the reason for exit, including "Successful," "Unsuccessful," or "Violative" (for example, in violation of investment terms), and be clear on the terms of exit.

Consider how these are placed along the investment process in Exhibit 6-10.

68 Instructions for Form 990-PF, https://www.irs.gov/pub/irs-pdf/i990pf.pdf.

EXHIBIT 6-10
Considerations Along the Investment Life Cycle

Consideration	Sourcing	Selection and Execution	Monitoring	Exit
Goal Setting	✓			
Decision-making	✓	✓	✓	✓
Documentation	✓	✓	✓	✓
Regulatory Requirements		✓	✓	✓
Exit Considerations		✓	✓	✓

Coinvestment and Collaboration

Collaborating with other investors can bring a host of benefits from learning to expanding your influence to risk mitigation. As discussed in the "Who" chapter, given that impact investors are seeking to drive social and environmental change, along with the complexity of the systems impact investors are trying to shift, the role of partnering and collaboration is critical. Many impact strategies require collective action to be effective. See Exhibit 6-12 for the collaboration model between a community foundation and a family foundation in Texas. For your operating model, consider the role of peers and coinvestors. Approaches to coinvestment and collaboration include sharing due diligence, peer coaching, shared learning, and making the same investment at the same or different place on the capital stack.

EXHIBIT 6-11

Message to Impact Investors

Tomer Inbar, Patterson Belknap Webb & Tyler LLP

- Understand what you are trying to accomplish and how. Structure your investment approach consistently with those principles in mind.
- Focus on your goals and be clear about them.
- Ask, "What is the best vehicle to accomplish my objectives?" Be thoughtful in choosing your tools.
- Ask, "Does it matter and to whom?" Think about relevant internal and external stakeholders. Do we have organizational (cultural) buy-in?
- Ask, "Do we have the right people in place?" Focus on each stage of (1) Do, (2) Monitor, (3) Report, and (4) Exit.
- Find external advisors (legal counsel, accountants, and investment consultants) with specific impact investing experience, particularly to help with PRI compliance and to assist with fiduciary considerations generally.
- Consider establishing an investment-advisory committee to establish broader support and provide a focused approach to the program.
- Avoid and/or manage conflicts of interest (actual or perceived). Conflicts that are not managed appropriately can undermine your impact investing approach and lead to regulatory and compliance-enforcement issues, both at the state attorney general and IRS level. Have a good policy and process in place—consider specifically addressing impact investing/coinvesting conflicts of interest in a separate policy or as an addendum to your general policy. Clearly communicate internally about these issues.
- DOCUMENT. DOCUMENT. DOCUMENT. Document often and well. Be "on message" and memorialize the narrative of your Why and How. Include in board and committee minutes: internal memorandums, policies, and public descriptions (for example, website, presentations, and external communications). Extend this approach generally whenever you talk about your impact investing portfolio.

EXHIBIT 6-12

Coinvestment and Collaboration in Impact Investing

Austin Community Foundation and the Aragona Family Foundation

Throughout the past decade, Austin's economy and population have experienced substantial growth. For some, the growth has been overwhelmingly positive. However, data revealed that not everyone was thriving nor had the same access to opportunity. This fact led Austin Community Foundation (ACF) to start exploring place-based impact investments as a new approach to addressing the widening opportunity gap in Central Texas. At the time, only a few community foundations were embracing impact investing but the Austin Community Foundation recognized Central Texas as a ripe testing ground for exploring this tool.

In 2015, the foundation launched a dedicated impact investing fund, FundATX, and began making investments first through intermediaries and then directly to nonprofits. Investments were primarily concessionary and structured as low-cost debt. After a few years of gaining experience and comfort with these tools, the foundation shifted the focus of its impact investments to support economic security and affordable housing through local intermediaries in these spaces.

FundATX projects need patient capital and are structured as PRIs. Investments have primarily been directed to community-development financial institutions (CDFIs) and other intermediaries that play an important role in the place-based impact investing ecosystem in Central Texas. Current FundATX investment partners include PeopleFund, Grameen America, BCL of Texas, the Texas State Affordable Housing Corporation, and the Austin Housing Conservancy.

In 2019, the foundation invited current ACF donor-advised fundholders to directly coinvest—aligning their dollars with the foundation's. In response, nearly $1 million was raised in nine months. This early success demonstrated the funding community's hunger for a new philanthropic solution targeting Austin's most pressing challenges.

"By partnering with the private and philanthropic communities to identify an intermediary strategy, we see an opportunity to allocate additional capital to effective organizations that share our desire to quickly close the opportunity gap in Central Texas," said Mike Nellis, chief executive officer at Austin Community Foundation.

The foundation also facilitates impact investments recommended directly by donor-advised fundholders. This service allows sophisticated philanthropists the option to increase their impact by leveraging different vehicles. In particular, Austin Community Foundation and the Aragona Family Foundation (AFF) have collaborated on several impact deals that aligned with AFF's place-based mission. A private family foundation headquartered in Austin, Texas, AAF utilizes select impact investment strategies when opportunities align with its traditional funding areas.

"For a place-based family foundation like AFF, Mike and the ACF team's willingness to embrace impact investing is a really unique value add. It provides us with another pool of capital to meet our mission and provides access to interesting local deals we may not have found on our own. We are really fortunate to have our donor-advised fund at ACF so aligned with our private foundation," remarked Chris Earthman, AFF's executive director.

By working with Austin Community Foundation through a donor-advised fund, AFF has advised on debt and equity-impact investments that make up a diversified impact investment portfolio. AFF has also amplified investment returns by joining the community foundation's investment pool.

Impact Investing Field Building Through Grantmaking

Philanthropic grantmaking has an opportunity to continue to support and expand the field of impact investing. At a recent convening,[69] impact investing leaders proposed the following areas of focus for philanthropists to support impact investing.

- Narrative change, including common misconceptions (e.g., fiduciary duty);
- Impact principles, frameworks, and standards (e.g., Sustainability Accounting Standards Board [SASB]);
- Policy and regulation (e.g., U.S. Impact Investing Alliance and Opportunity Zones);
- New corporate forms to emerging markets (e.g., benefit corporations);
- Impact reporting (e.g., Impact Management Project);
- Asset-owner training (e.g., practitioner cohorts);
- Education and talent development (e.g., MBA faculty);
- Support field data and research (e.g., ESG effect on returns, Catalytic Capital Consortium);
- Map the field (e.g., Case Foundation);
- Networks and convenings (e.g., Confluence Philanthropy, Mission Investor Exchange, Global Impact Investing Network);
- Place-based ecosystems (e.g., community foundations);
- Pre-investment pipeline (e.g., grants to for profits, Catalyst Fund); and
- De-risk investments (e.g., technical assistance, loan guarantee bank).

If grantmaking is one of the tools you use to support impact investing, consider surveying existing efforts and joining where you find alignment with your goals and interests. You should consider some well-established pooled funds. See Exhibit 6-13 for how the Woodcock Foundation combined the use of grants and PRIs to drive change in a sector they want to support and grow.

69 *Building an Impact Economy: A Call to Action for the Philanthropy Sector*, https://impactalchemist.com/building-an-impact-economy-report.

EXHIBIT 6-13

Building the Impact Investing Field

Woodcock Foundation

The Woodcock Foundation is a family foundation that first began making PRIs alongside its grants more than a decade ago to expand the impact of its programs. Woodcock has a sustainable food-systems program, and in 2012 the foundation decided to explore the use of PRIs to advance sustainable fisheries.

Woodcock's board and staff had become aware of the depletion of fish stocks in different regions of the United States and understood that this posed a challenge for fishing livelihoods, fishery ecology, and quality seafood as a source of nutrition. After an initial exploration of U.S. fisheries projects, the foundation did not find any investment-ready deals that married the social outcomes (livelihoods and nutrition) with the environmental outcomes (increased fish stocks and restored ecology of fisheries) it sought. The foundation saw an opportunity to help build a pipeline by supporting research and development of investment opportunities.

Woodcock made a grant to The Nature Conservancy (TNC) in Maine for a project in partnership with an investment advisory firm to design a fund that would support fishing communities in Maine. New regulations had recently been instituted that imposed a limit on total catch from Maine fisheries, and fishers were required to have permits for their catch. Building on TNC's existing efforts, TNC and the advisors engaged the fishing community and other stakeholders to assess the viability of an expanded fund that bought permits and leased them to local fishers at affordable rates. Leases would be contingent upon their agreement to test and utilize sustainable equipment and practices in their fishing operations. Support from Woodcock and other funders enabled TNC to develop a set of recommendations and plans for a larger permit acquisition fund using an approach that blended philanthropy with investment. TNC moved ahead with quota acquisition in three Gulf of Maine states, accessing low-interest, long-term loan financing to acquire two New Hampshire–based permits.

As the TNC project was wrapping up, Woodcock joined the Mission Fish working group that had been launched by values-driven investor network Confluence Philanthropy. In 2015, the foundation made a grant in collaboration with other members to support a research project with the Gulf of Maine Research Institute to scan the New England fisheries' investment landscape and identify opportunities and gaps for improving sustainability. The resulting report verified that limited deal flow existed and identified Coastal Enterprises, Inc. (CEI) as a promising existing intermediary for making investments in fishery entrepreneurs. As a result, Confluence decided to turn the results over to CEI to inform its future fisheries investing initiatives, building on the expertise of an existing entity rather than launching an independent effort. The report also summarized opportunities to develop other vehicles for investment, which would require patient, flexible capital.

In 2017, informed by the field-building projects with TNC and Confluence, Woodcock approved its first PRI to support sustainable fisheries. The investment was in the Martha's Vineyard Fishermen's Preservation Trust for a scallop-permit acquisition transaction, structured by Catch Together. One of the cofounders of Catch Together had been part of the investment-advisory team that worked with TNC a few years earlier. Today, Catch Together provides an array of services to help fishers acquire quota and fishing assets, and it has completed eight transactions financing a total of $10.2 million of fishing assets in five communities across New England, the Gulf of Mexico, and Alaska.

Building an Implementation Plan

Your action plan will depend on your context, priorities, and sequencing. That said, the following list contains key characteristics of a robust implementation plan. Consider these components to be sure your plan is adequately detailed, nuanced, and actionable.

Key components for an implementation plan include:

- Clear goal and scope of the plan;
- Overall roles for internal and external resources;
- Activities in sequence;
- Activity roles, e.g. RACI (Responsible, Accountable, Consulted, Informed) framework;
- Timeline with milestones or deliverables;
- Budget and other resources required;
- Risks, assumptions, and contingencies along the way;
- Communication and stakeholder-management strategy; and
- Change-management plan (e.g., organizational culture change).

Now that you have the components of an implementation plan, we invite you to draft your plan. Though it may seem overwhelming for some, remember to take one activity at a time and build from one to the next. This will be an iterative journey with successes and challenges along the way.

EXHIBIT 6-14

An Impact Investing Journey

Kristin Hull, Nia Global Solutions

When Kristin Hull's family sold its business, she found herself in an unfamiliar situation: She was tapped to manage the family's foundation—both investments and grantmaking. Kristin had built a career as a public school teacher and had experience in her family's trading firm—both quite relevant to the challenge before her. How could she leverage the foundation's resources most effectively to improve the world around her? In 2007, Kristin attended a Global Philanthropy Forum session that encouraged foundations to pledge 2% of their endowment toward their mission. That intrigued her. *But why stop at 2%?*, she wondered to herself. *Why not 100%?* This seeded her interest in impact investing, which took shape in the following steps:

1. With the foundation's assets all in the stock of one corporation, her first move was to sell the stock and begin investing the resulting cash for good.
2. Kristin began working with Imprint Capital Advisors to research community banks, eventually choosing seven that could provide a modest return while benefiting communities in need.
3. Happy with the direct impact of helping these institutions improve financial literacy and serve entrepreneurs of color, Kristin set out to expand her own tool kit. She soon started doing her own due diligence and investing in deals without any help—even when more conservative investors might have paused. She explored options for fixed-income assets then moved on to private equity.
4. Eventually, Kristin decided to strike out on her own and continued to evolve as an investor. She started experimenting with PRIs, noting that their financial risk is inherently lower than the 100% financial loss represented by a grant.
5. She then considered the power of early timing in funding a promising new business, which might not otherwise get off the ground.
6. She expanded her investor mindset to include resources she can provide beyond money, including legal support to help with complicated documents, board member invitations, and introductions to relevant experts or partners.
7. Driven by the lack of investment in women- and minority-led businesses, Kristin launched her own investment vehicle, Nia Global Solutions, to allow investors to direct their money into the world they wanted to see by building a portfolio of exclusively solutions-driven companies.

Kristin's story is one of her own reinvention, continually learning and building to steward her place in the world.

Practitioner Exercise and Sophia Example

Now What: Implementation Plan

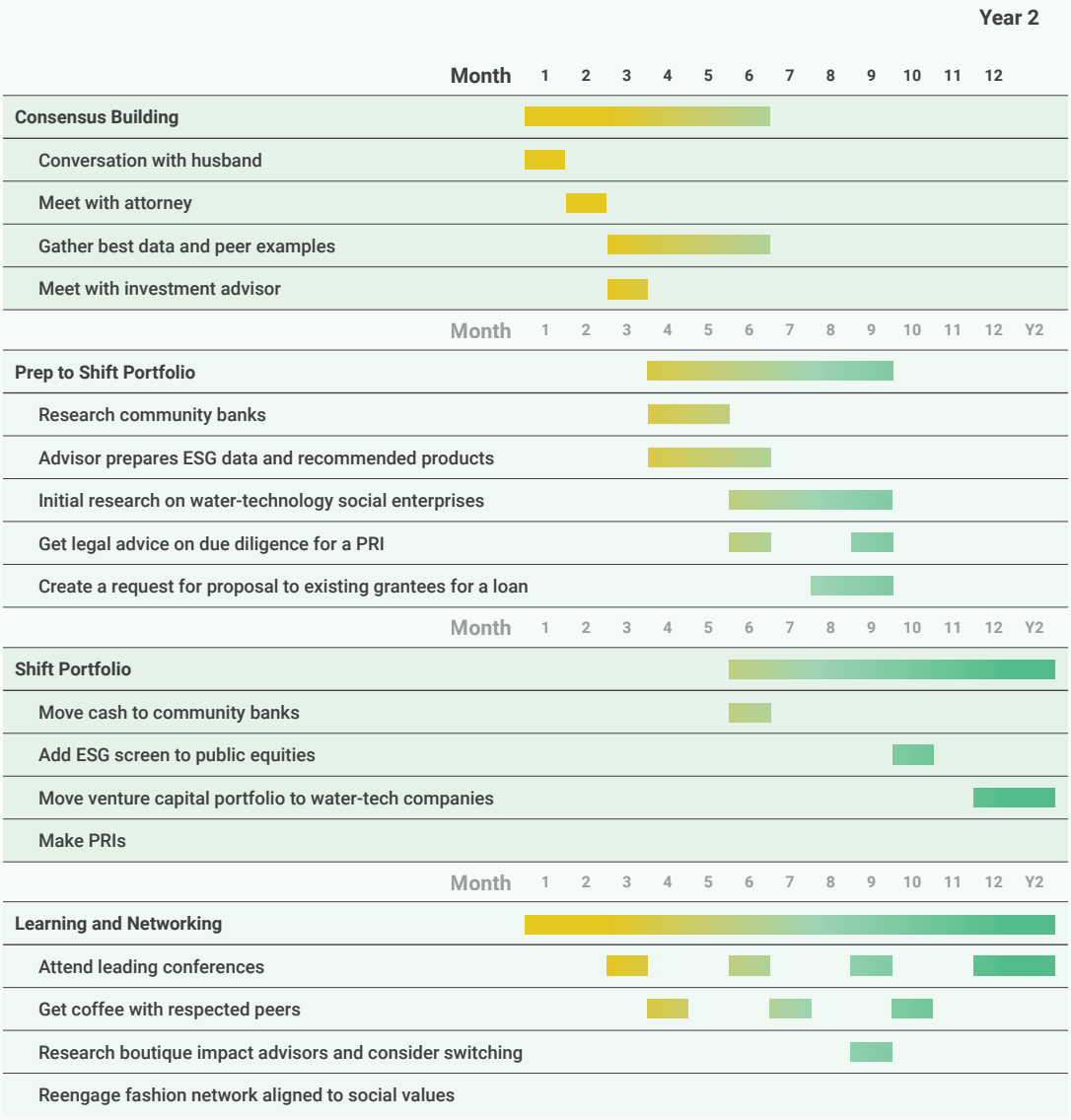
Exercise Overview

Your implementation plan will be customized for your circumstances, since key elements such as implementation goals, corporate structure, key stakeholders, and the state of your existing portfolio are quite distinct from other investors. To shape your particular plan, start by revisiting the practitioner exercise for each of the preceding chapters. These will give you a sense of the goals, key stakeholders, and approaches to inform your unique priorities. When you are ready to draft your plan, these key components for an implementation plan may be useful:

- Clear goal and scope of the plan;
- Overall roles for internal and external resources;
- Activities in sequence;
- Activity roles, such as RACI (Responsible, Accountable, Consulted, Informed) framework;
- Timeline with milestones or deliverables;
- Budget and other resources required;
- Risks, assumptions, and contingencies along the way;
- Communication and stakeholder-management strategy; and
- Change-management plan (for example, organizational culture change).

Sophia's Implementation Plan

Reviewing her previous exercises, Sophia decides to pay particular attention to her relationships and networks, her stakeholder map, and her detailed theory of change. She knows that successfully bringing her husband into the plan will be the most important and challenging step. Her plan to engage him includes data, peer examples, and his trust in the longtime family attorney. Given the lack of other influential stakeholders and her comfort with investment decisions, she sets an implementation goal to shift all assets in her private foundation toward impact within the next five years. Her existing investment advisor comes from a big bank with certain strengths, but she is not convinced that her advisor has what it takes. If she is not happy after the first year of the advisor's help implementing her impact investment portfolio, she will consider switching to a boutique impact advisor. As for the specific priorities, she will start with moving cash to her favorite community bank for her entire portfolio, add an ESG screen to her public equities in her foundation's endowment, then begin to carve out the endowment's venture capital allocation toward water technology. She will also assess which existing grantee could be best suited for a PRI loan. She plans to reengage with some of her fashion network to learn about opportunities in the arts and the broader creative economy.



Sophia Today

We are pleased to report that one year into Sophia's journey, she has made significant progress, along with learning from some setbacks. She and her husband have a more aligned commitment and approach to impact investing, as he is now exploring how to translate his passion for their local Miami community into impact investing tools and products. Given his concern for gun violence, they decided to divest from all gun and weapons manufacturers. Sophia's advisor has become an advocate for impact investing within her institution. Sophia continues to deepen her impact investing practice by collaborating with industry partners.

Conclusion

> All Investments have impact—both positive and negative.

> Impact investments are made with the intention to generate positive, measurable social, and environmental impact alongside a financial return.

This handbook is meant to inspire you to reimagine and redefine your relationship with your assets, while encouraging you to consider how your investments affect our world. Disruption and change are coming to investing. Impact investing requires organizational change and planning to make it happen. We hope that this handbook provides you with the tools and strategy you need to help you become an engaged asset owner who can be accountable for your assets.

Over the last decade, many investors who in the past dedicated just a portion of their assets to intentional, positive impact have now moved to 100% mission alignment. With expanding data, transparency, and measurement tools, you can now advance your impact investments and refine your approaches in a way that was unimaginable a few years ago. Investors are redefining themselves as stewards who are accountable for how their assets are in the world. Investing is shifting from extraction to accountability.

As the complexities of the challenges facing the world deepen each day, the need to apply impact to investing increases in urgency. Even prior to the current pandemic and its resulting economic dislocations, this decade was set to underscore the necessity to work together to address the climate emergency, inequality across the world, and the fragility of the environmental and social systems that sustain us.

This is a tall order for all investors.

To guide you through this journey, this handbook lays out a framework that translates these high aspirations into concrete action.

We live and invest in complex systems. Markets do not exist independently but are grounded in a social and environmental context. Using intention, measurement, and contribution, investors have the ability to step up to their role as system changers while working with policy and philanthropy when it is needed. Interconnection and collaboration will be key as traditional business models and investment approaches face increased stress.

In order to successfully create impact, investors will need to navigate a network of relationships that are part of the investment process. Understand where you sit in the impact capital chain and how you can drive change through it. Pick your advisors and managers with consideration of how they can help you achieve your intended impact goals. The intermediaries, who are the bridges between your assets and impact creation, can also be barriers. Remember, power matters; not just financial capital.

Your theory of change anchors your impact investing strategy. This is an essential element of impact investing. By identifying your impact goals, you can focus on the approach you want to pursue, be it engaged ownership or systems change. Once your broad impact goals are established, you can translate these into a clear theory of change that will inform how you frame, measure, and manage the impact of your investments. Whether you are seeking broad alignment of your assets and your values or are focused on a specific theme, establishing a clear theory of change is critical for your success.

The construction of your portfolio will reflect the impact tools and structures you select. You can focus on the impact tools and impact structures available to express your theory of change. Impact tools are actions, such as screening, shareholder engagement, ESG integration, thematic investment, catalytic concessionary capital, and setting a time horizon. Impact structures are the investor, intermediary, and enterprise vehicles you can select to optimize impact. Transaction structures, such as pay for success—and covenants—can also drive specific outcomes. Given the increasing range of impact products in the market, knowing your goals will help you select the appropriate impact tools and products.

Through impact measurement and management, you are developing a framework to measure the success of your impact investing portfolio over time—and how you might use this information for future decisions. This is directly tied to your theory of change and the investment products. It is important to ask *Why*, *What*, and *How* of your impact measurement and management framework.

Finally, remember to keep trying and learning as you move forward. We hope you will share your successes and challenges with us as we take this handbook and share it through other forms, such as digital and through trainings. Please send us your comments and questions, and let us know what worked for you.

Additional Resources

B Lab	bcorporation.net	A nonprofit organization focused on using business for good through its B Corporation certification, promoting new mission-aligned corporate forms, and providing analytics for measuring what matters.
Business Roundtable	businessroundtable.org	Business Roundtable is an association of chief executive officers of America's leading companies working to promote a thriving U.S. economy and expanded opportunity for all Americans through sound public policy.
Confluence Philanthropy	confluencephilanthropy.org	A nonprofit network of more than 200 foundations that builds capacity and provides technical assistance to enhance the ability to align the management of assets with organizational mission to promote environmental sustainability and social justice.
Global Impact Investing Network	thegiin.org	A network of impact investing professionals advancing the impact investing industry and offering information and resources to investors, including a global directory of impact investing funds (ImpactBase); a set of metrics to measure and describe social, environmental, and financial performance (IRIS); an annual survey of impact investing trends; and a rating system for impact investing funds using B Lab methodology (GIIRS).
Global Steering Group for Impact Investing	gsgii.org	An independent global steering group comprised of 32 countries, catalyzing impact investment and entrepreneurship to benefit people and planet, which was established in August 2015 as the successor to the Social Impact Investment Taskforce, under the U.K.'s presidency of the G8.
IFC Operating Principles for Impact Investing	impactprinciples.org	The IFC Impact Principles support the development of the impact investing industry by establishing a common discipline around the management of investments for impact.
ImpactAlpha	impactalpha.com	ImpactAlpha is a digital media company redefining business journalism around social and environmental value.
Impact Management Project	impactmanagementproject.com	The Impact Management Project (IMP) is a forum for building global consensus on how to measure, compare, and report ESG risks and positive impacts.
ImpactAssets	impactassets.org	A nonprofit financial-services firm dedicated to advancing the field of impact investing, publishing the ImpactAssets 50, an annual database of 50 experienced private-debt and equity-impact investment fund managers.

ImpactBase	impactbase.org	A searchable online database of impact investing funds and products, helping connect investors with investment opportunities.
Investors Circle	investorscircle.net	An early-stage impact investor network made up of individual angel investors, professional venture capitalists, foundation trustees, and officers and family office representatives.
IRIS+	iris.thegiin.org	IRIS+ is the generally accepted system for measuring, managing, and optimizing impact.
Mission Investors Exchange	missioninvestors.org	Network of foundations and mission investing organizations offering workshops, webinars, and a library of reports, guides, case studies, and investment policy templates—with the goal of sharing tools, ideas and experiences to improve the field.
RPA's Impact Investing Primer: Introduction	rockpa.org/guide/impact-investing-introduction	Impact investing primer guide, Part 1.
RPA's Impact Investing Primer: Strategy & Action	rockpa.org/guide/impact-investing-strategy-action	Impact investing primer guide, Part 2.
SASB	sasb.org	SASB connects businesses and investors on the financial impacts of sustainability.
Stanford Social Innovation Review	ssir.org	SSIR is a magazine and website that covers cross sector solutions to global problems.
The ImPact	theimpact.org (Knowledge Library: theimpact.org/library)	A network of families joined by a pact to improve the impact of their investments—providing education, inspiration, and tools to make more impact investments more effectively.
Toniic	toniic.com	An international impact investor network promoting a sustainable global economy and offering peer-to-peer opportunities to share, learn, and coinvest—including a searchable directory of impact investments, an impact portfolio tool, and multiyear studies of impact investing portfolios.
UN PRI	unpri.org	An international network seeking to understand the investment implications of environmental, social, and governance (ESG) factors and to support its investor signatories as they incorporate these factors into their investment and ownership decisions.
US SIF	ussif.org	The Forum for Sustainable and Responsible Investment is aimed at shifting investment practices toward sustainability across all asset classes.

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