Measuring the "impact" in impact investing



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This report was developed as part of an independent project through the Harvard Business School Social Enterprise Initiative in fall 2014, under the supervision of Alnoor Ebrahim. We welcome comments, feedback, and thoughts on this report. Please feel free to contact us: Ivy So (iso@mba2015.hbs.edu) and/or Alina Staskevicius (astaskevicius@mba2015.hbs.edu).

Executive Summary

Introduction

The growth of impact investing has led to an unprecedented focus on impact measurement, with the aim of understanding both financial and social return on these investments. However, impact measurement is complex in practice, and varies in approach and rigor, with a number of methodologies and practices emerging from different organizations. This carries a risk for the emerging field of impact investing; if a certain level of rigor in impact measurement is not established across the industry, the label "impact investing" runs the risk of becoming diluted and used merely as a marketing tool for commercial investors.

The aim of this study was to deepen the understanding of the specific practices and methodologies that established impact investors are using to measure the social impact generated by their investments, and to analyze the conditions under which each measurement method is most relevant. The intended audience for our analysis is impact investors themselves, as well as social sector organizations, traditional funders, and evaluators.

As a part of our research, we conducted over 20 interviews with practitioners across a wide range of domestic and international organizations in the private, social, and public sectors. Recognizing that the nascent impact investing field may benefit from examining the practices used by more traditional funders, our interviews also included foundations, venture philanthropists, and other relevant organizations. A full list of our interviews can be found in Appendix A.

From these interviews and review of relevant reports and literature, we gathered information on the methods currently used by impact investors and other funders. We synthesized these findings to identify common objectives behind impact measurement and to develop categories of measurement methods. We analyzed the advantages and disadvantages of each category and developed recommendations for effective adoption as well as advancement for the sector. We also developed recommendations for two cross cutting themes – incentives and additionality. Finally, we recommend an integrated model of impact measurement that provides a comprehensive approach throughout the investment life cycle.

Findings and Analysis

Impact measurement efforts serve a number of different objectives throughout the investment cycle. We found that measurement efforts can be logically grouped into four key measurement objectives:

1. Estimating impact: Conducting due diligence pre-investment
2. Planning impact: Deriving metrics and data collection methods to monitor impact
3. Monitoring impact: Measuring and analyzing impact to ensure mission alignment and performance
4. Evaluating impact: Understanding post-investment social impact of an intervention or investment

These objectives feed into one another, as described below:



Figure 0.1 *Continuous Cycle of Measurement Objectives*

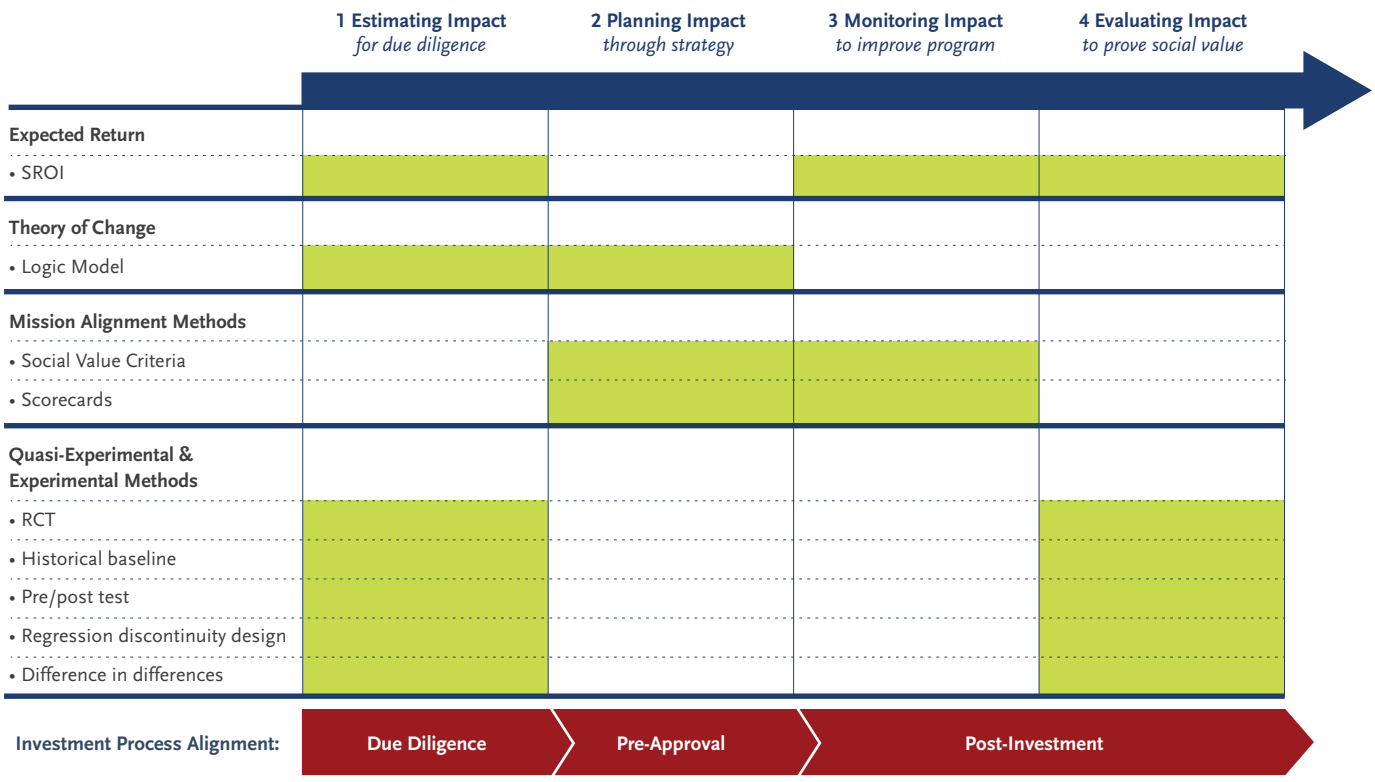
In addition to the four objectives mentioned above, impact measurement can also be used to report impact and communicate with various audiences.

Impact investors employ a number of methods to pursue the objectives outlined above. By identifying patterns that we found in our research, we have categorized four impact measurement methods:

1. Expected return takes into account the anticipated social benefits of an investment against its costs, discounted to the value of today's value. This expected return metric can take various forms; examples include Social Return on Investment (SROI), Benefit Cost Ratio (BCR), and Economic Rate of Return (ERR).
2. Theory of change and logic model explain the process of intended social impact. Specifically, logic model is a common tool used to map a theory of change of an organization, intervention, or program by outlining the linkage from input, to activities, to output, to outcomes, and ultimately to impact.
3. Mission alignment methods measure the execution of strategy against mission and end goals over time; examples include social value criteria and scorecards used to monitor and manage key performance metrics.
4. Experimental & quasi-experimental methods are after-the-fact evaluations that use a randomized control trial or other counterfactual to determine the impact of the intervention compared to the status quo.

Impact measurement methods generally serve specific objectives in the investment cycle. Mapping the methods against the objectives provides a view of how each of these methods can accomplish the different objectives. The following graphic illustrates how such methods have been applied to the various phases of impact measurement.

Figure 0.2 *Map of Measurement Methodologies to Measurement Objectives*



Each measurement method carries advantages and disadvantages. An overview of this analysis is included in the table below.

Figure 0.3 *Summary of Measurement Method Analysis*

Method	Common applications	Advantages	Disadvantages
Expected Return	• To estimate expected social return in assessing potential investments • To monitor and evaluate the social performance of investments	• Can provide a disciplined approach for decision making • Offers opportunity for organization to speak a common language • Similarity with return on investment can help gain private sector trust	• May unfairly penalize interventions working with the most challenging problems and populations • Can be perceived as inexact and constantly changing • Expected return calculations are only as strong as the data that feeds them • Risk of temptation in using expected return figure as standalone metric for funding decisions • Not applicable to interventions without quantifiable benefits • Does not take into account catalytic effects
Theory of change and logic model	• To understand path to intended impact as part of due diligence • To provide a framework for goal setting • To track and monitor progress of investment • To provide targets for incentive schemes • To provide a framework for illustrating impact logic in reporting	• Provides an easy to understand framework that is familiar in the social sector • Is a versatile tool that can serve multiple purposes • Allows investors to overlay dimensions that are important to mission • Allows investors to identify underlying impact assumptions for further review as necessary	• Identifying indicators to assess outcomes can be challenging • Lends itself to risk of reducing social change to a linear process
Mission alignment methods	• To monitor impact investor's portfolio against its mission • To monitor impact of investee against its mission	• Surveys and screens are inexpensive, straightforward ways to monitor mission alignment • Scorecards may resonate with investors due to familiarity with balanced scorecard in business	• Survey results or scorecards are only as meaningful as the data collection methods or KPI metrics that they capture • Scorecards may not allow for direct comparisons across different investments

Figure 0.3, continued *Summary of Measurement Method Analysis*

Method	Common applications	Advantages	Disadvantages
Experimental & quasi-experimental methods	• To assess outcome for payments in Social Impact Bonds and other impact investments • To test hypothesis of an investor's theory of change • To assess impact risk of a potential investment	• Experimental methods allow for robust cause-and-effect attribution • Quasi-experimental methods can provide some attribution evidence with more flexibility and lowest cost • Both of these methods can help to demonstrate additionality of impact	• Experimental methods can be expensive and resource intensive • Experimental methods not suitable in many situations, e.g. environments that cannot be controlled, interventions that are insufficient to drive outcomes on their own, situations where randomizing beneficiaries may be unethical • Quasi-experimental methods may be limited in their ability to rule out exogenous factors

Additional Findings

While impact measurement offers benefits for multiple stakeholders in an impact investment, there is a need for greater alignment for incentives to devote resources to measuring impact. Factors that contribute to low incentive to measure impact include:

- Perception of low value in impact measurement by entrepreneur
- Survey fatigue of beneficiaries
- Low fund investor appetite for robust measurement
- Limited incentive structures for delivery of social impact

We believe that addressing these factors are critical in making progress in measuring impact in this industry.

Additionality is an important consideration in thinking about impact. Additionality refers to whether the target social outcomes would have occurred without the investment. *Investor-level additionality* is the additional impact the investor is creating on the enterprise; *enterprise level additionality* is the additional impact that the enterprise has on society. As additionality is an important concept in understanding the actual difference that an impact investment is making, it should be an important consideration that cuts across many of the methods mentioned above.

Recommendations

Our recommendations consist of three components: a proposed integrated model of impact measurement, recommendations for investors and/or the sector on each of the measurement methods, and recommendations related to the cross-cutting themes of incentives and additionality.

Putting it together: Integrated model of impact measurement

Recognizing that investors vary in their level of maturity and resources – and that their investees may also vary in level of impact measurement sophistication – we propose a framework that caters different integrated measurement models to each stage of investor and investee.

Our "best practices integrated model" is most appropriate for a mature impact investor who is working with a sophisticated investee. In this model, we envision that the **pre-investment process** involves a number of tools to screen candidates and conduct due diligence, including:

- Using an **SROI calculation** to compare the impact of potential investments
- Mapping out the potential investee's **theory of change** to understand how the investment will convert theory to action and to identify causal links

- Drawing upon **existing experimental or quasi-experimental studies** to test the hypothesis underlying the causal links

After due diligence, the investor works with the investee in:

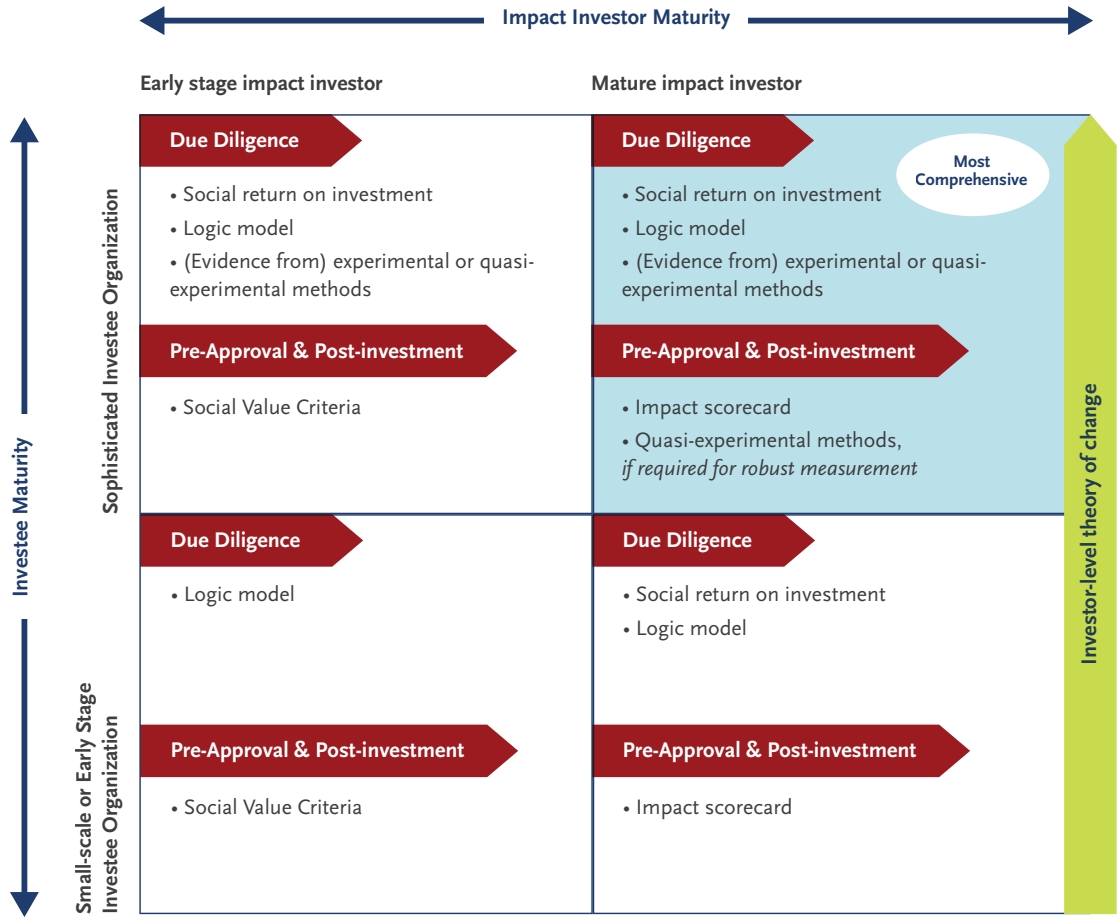
- Determining **key performance indicators (KPIs)** to track on the monitoring **scorecard**.
- Gathering and analyzing data on the KPIs post investment to monitor the social impact performance of the investee.
- If required, using a **quasi-experimental method evaluation in the evaluation stage**.

We encourage impact investors to **map their own theory of change** to understand how their investments translate into intended impact, and to conduct necessary research or evaluations to validate assumption.

The simpler adaptation

Our framework also proposes a simpler version for those that are just starting out. As a first step, we encourage investors to work with entrepreneurs to develop a **logic model** to map their venture's theory of change so the investor can understand and evaluate its path to impact. In the pre-approval stage, we suggest adopting **social value criteria** to rate investments, and to monitor the investee's progress post-investment.

Figure 0.4 *Integrated Model of Impact Measurement*



Note: Investee maturity should be determined by the impact investor based on the investee's size, reach, budget, or years in existence

Recommendations related to measurement methods

We have developed recommendations related to each of the measurement methods. While some recommendations are for investors, many are applicable at a sector level and concern what the impact investing field can do to advance the effective adoption of these methods.

Expected return

1. We believe that building a **clearinghouse of expected return figures and underlying assumptions** – or partnering with existing clearinghouses – would enable less established impact investors to gain access to data and evaluate their own ventures by comparison.

Theory of change and logic model

1. Similar to the standardization of output metrics, we believe that there is value in **knowledge sharing among organizations** to learn from each other's approaches and best practices on **leading indicators for outcomes.** There may also be opportunity to propose a common set of indicators for specific outcomes by funders or a collective of organizations.
2. Impact investors should consider applying the logic model to **map out their own theory of change** at the portfolio level to articulate their own path to driving impact and to identify its underlying assumptions.

Mission alignment methods

1. Impact investors can **adopt scorecards** that align with their theory of change to identify and track key performance metrics for their investments; this can also be aggregated into a portfolio view for high level analysis and reporting.
2. We believe that there is opportunity to increase the adoption of scorecards to effectively measure impact through forums and other educational events where established impact **investors showcase their scorecard templates and exchange ideas.**

Experimental and quasi-experimental methods

1. We believe that **drawing from and adding to "what works" databases** of evidence from previous experimental studies can add tremendous value to the community practices around a social issue.
2. Drawing from **principles of low cost RCT's** can reduce the cost and efforts related to conducting experimental and quasi-experimental evaluations.

Recommendations related to incentives to measure impact

Given the need for greater incentives to measure impact we recommend multiple angles:

1. **Take a survey respondent-centric approach**. A respondent-centric approach can mitigate some of the challenges related to both perception of limited value in impact measurement by the entrepreneur and survey fatigue of beneficiaries.
2. **Design innovative incentive structures**. Explore incentive structures such as a social impact carry, where portfolio managers are rewarded based on results related to measured social impact from investments under their management.
3. **Embed the impact measurement role.** Instead of assigning the work of impact measurement to a dedicated resource outside of the core investment process, impact investors should consider integrating their impact measurement work closely with their investment and portfolio management work.

Recommendations related to additionality considerations

Impact investors should encourage investees to **articulate and measure the additionality of impact** created by their ventures. Further, impact investors should actively incorporate the additionality of their investor-level impact in their measurement practices. More widespread communication about additionality by those impact investors who use it already will help LP's and other funders in the ecosystem understand the concept and push for it to be included in the impact reports that they receive.