NAVIGATING IMPACT INVESTING

The opportunity in impact classes

A Tideline working paper with Cathy Clark, Duke University

July 2016

ABOUT THE NAVIGATING IMPACT INVESTING PROJECT

The Navigating Impact Investing project began in September 2015 as an effort to bring greater clarity to the field of impact investing. The initiative was conceived and is supported by Omidyar Network, which has provided leadership and thought partnership throughout the project.

The project also includes a dedicated Advisory Group, to which Tideline and Omidyar Network extend our thanks. The members of the Advisory Group are named in the Appendix, along with the other leading practitioners who participated in a capstone project convening on February 10, 2016 at BlackRock in New York.

ABOUT TIDELINE

Tideline is a consulting firm that provides tailored advice to clients developing impact investment strategies, products, and solutions. Tideline's mission is to help clients excel in realizing financial and societal value.

Tideline project team

Ben Thornley
Cathy Clark (Duke University)
Christina Leijonhufvud
Aaron Arnoldy
Bryan Locascio
Anisa Dougherty

ABOUT OMIDYAR NETWORK

Omidyar Network is a philanthropic investment firm dedicated to harnessing the power of markets to create opportunity for people to improve their lives. Established in 2004 by eBay founder Pierre Omidyar and his wife Pam, the organization invests in and helps scale innovative organizations to catalyze economic and social change. Omidyar Network has committed more than $969 million to for-profit companies and nonprofit organizations that foster economic advancement and encourage individual participation across multiple initiatives, including Consumer Internet & Mobile, Education, Financial Inclusion, Governance & Citizen Engagement, and Property Rights.

Omidyar Network project team

Mike Kubzansky
Paula Goldman
Sonny Bardhan
Lauren Booker Allen
Robynn Steffen

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EXECUTIVE SUMMARY

The rapid growth of impact investing presents an unprecedented opportunity to harness the power of capital markets in service of addressing social and environmental challenges. However, along with this growth has come greater diversity and complexity, and with it, an acute need for clarity and common understanding. Addressing this need will be a critical next step in the market's evolution and maturation.

Challenges and objectives

Even as the field of impact investing has made progress on multiple fronts, market observers and participants still face challenges in comprehending and navigating the market, in part due to the lack of shared knowledge and frameworks. This can create frictions for investors and investment managers:

- **Misunderstanding -** Practitioners agree the lack of common ways to talk about impact investing remains a key challenge for the field,[1] contributing to confusion and uncertainty.
- **Inefficiency -** Investors and investment managers lament the bespoke, drawn-out effort required to identify appropriate counterparties that are aligned on financial and impact objectives.
- **Misalignment -** Practitioners also worry that investors will turn their backs if financial or impact expectations are misaligned or unmet, in the absence of more universally understood frames that can better establish appropriate objectives.

The Navigating Impact Investing project was created in Fall 2015 to explore these challenges, how they are currently managed by practitioners, and what may be needed to help optimize the process of matching an investor's unique risk, return, and impact preferences with the right impact investment opportunities.

Findings

Research and practitioner insights indicate the crux of the problem is the difficulty articulating, analyzing, and differentiating the *impact* in impact investing. Whereas the tools exist to understand investments on the basis of financial characteristics, the same cannot be said of impact characteristics. Proven methods for *evaluating* impact are becoming more widely adopted, but the project surfaced a need for additional clarity on impact at a more basic level, earlier in the investment process.

In traditional and impact investing, asset classes provide tremendous benefits as a frame for grouping investments with similar financial characteristics. Unfortunately, there is no equivalent shorthand for the *impact* in impact investing – i.e., no limited, agreed set of objective categories of investments that share similar impact characteristics and can therefore be more readily compared and contrasted. The research team has posited that an analogous set of "impact classes" could be an important additional grouping of the market, alongside other established tools and frameworks. The project has taken an inclusive approach, looking at the impact dimension of investments across asset classes, across sectors, and consequently, across a portfolio.

There is broad support for this hypothesis. In a post-event survey following a convening of 40 members of a dedicated project advisory group in February 2016, **81 percent of the 27 respondents agreed "the field of impact investing needs a broadly accepted and applied framework for categorizing the many ways in which funds/intermediaries create impact through investment."**

[1] Global Impact Investing Network. (2016). *2016 Annual Impact Investor Survey*.

As indicated in the same post-event survey, if successfully developed, impact classes could:

- Make it easier for **asset owners and their advisers** to filter down the range of impact investing opportunities to find the cluster or clusters that are most appropriate for an asset owner's preferences (76 percent agreed)
- Encourage **investment managers** to provide information on approaches to impact that is more consistent and/or standardized, providing efficiency benefits for asset owners and their advisers (77 percent agreed)
- Help **networks, academics, and others** to research and analyze the market by providing a necessary system of classification (76 percent agreed)

Designing impact classes

Translating the impact class concept into a practical framework that can be broadly adopted requires careful consideration and diverse input from the market. Practitioners emphasized a number of design characteristics. Impact classes should be:

- **Simple**
  - Straightforward and compelling: Impact classes that can be easily understood will likely have wider adoption and be more useful as a result.
  - Limited in number: The fewer the number of impact classes, the more likely they are to yield efficiency benefits.
- **Objective**
  - Meaningful, but objective: Impact classes need to offer product providers the opportunity to distinguish their work, but retain the possibility of third-party verification.
  - Neutral on the degree or quality of impact: Impact classes need to be descriptive without making value judgments.
- **Universal**
  - Inclusive, cutting across asset classes, sectors, and public and private markets: One of the most promising opportunities for impact classes is to be able to compare the impact dimension of investments across asset classes, across sectors, and consequently, across a portfolio.
  - Categorical and exhaustive: Impact classes should capture and distinguish the depth and breadth of activity in impact investing, but also not stifle further innovation.

A number of intriguing variables have surfaced during the course of the research, with the potential to distinguish approaches to impact investing in a way that is consistent with the design requirements above. The three that emerged as most promising include:

- **Role of impact investing capital:** The role of capital in influencing the formation, growth, or behavior of an investee and its impacts can be readily categorized.
- **Type of impact evidence:** The nature and depth of impact evidence provided by investment managers and required by investors can be objectively distinguished by a limited set of classifications.

- **Market and beneficiary characteristics:** The characteristics most commonly referenced in our interviews for distinguishing impact investments include the stage of development of the target market, the level of vulnerability of beneficiaries, and the extent to which the capital provided is essential.

The challenge is to consider how these or other variables can be brought together into a single framework that, if and when implemented, brings about broad, practical benefits to the market. Impact classes should not remain a theoretical concept or just another framework – the goal is that over time and with further consideration they become an actionable tool grounded in practical applications.

Next steps

Impact classes remain a concept under development. Further research and market engagement will help to inform the key next steps: further clarifying purposes and audiences, defining the right variables that underlie impact classes, and determining the means of achieving broad adoption, if basis for exploring the potential relationship between impact and financial performance.

It is clear the prospective, broadly agreed benefits of impact classes merit the close attention of practitioners. This research shows that many diverse stakeholders in impact investing concur: There is a need to segment impact investing more definitively, around the approach that investors take to delivering impact, and in a way that can cut across asset classes.

INTRODUCTION AND BACKGROUND

Origins of the project

The impressive growth of sustainable, responsible, and impact investing is well-documented, and almost every indicator points to this trend continuing. But is the market ready for that growth? In what ways could the growth of the market outpace its development? What risks or challenges may emerge or become more pronounced over time?

We have already seen examples of the market's growing pains – most notably in the overheating of the microfinance market in India and the controversial implications of the market's early IPOs.[2, 3]

These challenges have complex causes and consequences, but with thoughtful, collective effort, there is an opportunity to both address the risks of similar problems before they hinder progress and to capitalize on the opportunity of growing interest in impact investing in a way that can articulate and drive real impact instead of "putting impact in the appendix."[4]

As part of its field-building work, Omidyar Network set out to explore one such potential challenge, described in a recent *Stanford Social Innovation Review* article from Paula Goldman and Lauren Booker Allen:[5]

> "When industry leaders coined the term impact investing eight years ago, they used a 'big tent' approach to unite diverse players around a shared purpose. The movement aimed to develop a common language for diverse sets of investors … as well as to attract new capital to the space … This big tent approach has yielded tremendous benefits – as evidenced by all of the recent momentum."

The article goes on to posit that, in light of the increasing diversity and complexity of impact investing, the market needs to be parsed to define "the tables under the big tent." Without an improved classification, the market risks increased misunderstanding, inefficiencies, and misalignment that will impede its development.

With Omidyar Network's support and ongoing input, Tideline created the Navigating Impact Investing project in Fall 2015 to explore the need for enhanced classification in impact investing, with the foundational goal of optimizing the process of matching an investor's unique risk, return, and impact preferences with the right investment opportunities. The concept of "impact classes" emerged from this work as a way of sorting the impact investment market and is discussed in more detail in later sections.

Research approach

Over the last six months, Tideline has led a broad research effort designed to be driven by practitioner input and current market practices. The research has included:

- Literature review and desk research – of over 200 sources including from field-level impact investing reports and literature on impact performance and evaluation, SRI and ESG, philanthropy and public sector, and portfolio construction
- Extensive market outreach – including over 1,000 pages of transcripts from 45 expert interviews

[2] The Economist. (2010). *Discredited: A string of suicides puts microlending under the spotlight.*
[3] Consultative Group to Assist the Poor. (2007). *CGAP Reflections on the Compartamos Initial Public Offering: A case study on microfinance interest rates and profits.*
[4] Quote from Tideline Navigating Impact Investing project interview with an impact investment manager.
[5] Goldman, P. and Booker, L. (2015). *Parsing Impact Investing's Big Tent.* Stanford Social Innovation Review.

- Convening – of over 30 practitioners at SOCAP and two project Advisory Group meetings, culminating in an in-person meeting in February with over 40 participants, hosted by BlackRock in New York

The goal of the research and outreach has been to translate the findings into prospective solutions, including for accelerating the process of matching asset owner and investment manager expectations, helping asset owners deploy capital more efficiently, and setting up the market to aggregate data in a way that allows for more useful in-depth analysis over time.

Assessing market needs

According to recent research from Barclays, investors express significant interest in impact investing (two-thirds of high-net-worth clients report being at least moderately interested) but lack the "knowledge, guidelines, or frameworks" to act on.[6] Many established, specialized players are able to successfully manage this confusion, with some seeing a competitive advantage in being able to navigate the field effectively. "The lack of clarity hasn't been a barrier to us. It gives us an advantage," one interviewee told Tideline. But the confusion has created real barriers for new investors who want to invest for impact, but find the field difficult to parse (see "Hypothetical consequences of real-world confusion" below).

Less clarity also means less efficiency. Investors and investment managers lament the bespoke, drawn-out effort required to determine which counterparties are aligned on key impact considerations. While the "big tent" approach to describing impact investing has helped "dissolve the age-old thinking that doing good and doing well are separate domains," it is becoming increasingly difficult to find the right peers and partners.[7] "Everyone is speaking the same language but meaning different things," explained another project interviewee, a point reinforced by J.P. Morgan and GIIN's 2015 survey of the market: Two-thirds of practitioners agreed the lack of a common way to talk about impact investing remains a key challenge for the field.[8]

Moreover, the challenge identified as *most limiting* to the growth of impact investing both in the GIIN's 2015 survey and again in 2016 is the "lack of appropriate capital across the risk/return spectrum." J.P. Morgan and GIIN explain: "Several respondents highlighted the wide variety of opportunities in impact investing that cut across the risk-return spectrum, and noted that greater transparency about this diversity would be beneficial to the market as a whole."[9] In particular, the surveys indicated capital for seed, early, and venture-stage enterprises is lacking, as well as "risk-willing capital that would accept higher impact in lieu of higher financial returns."[10] With more visibility into the market, investors will better understand where their capital is most needed and the many different ways to achieve their impact objectives throughout the risk-return spectrum. In "*Parsing Impact Investing's Big Tent,*" Goldman and Booker Allen articulate the same priority, and identify the lack of an accepted taxonomy as a primary root of the challenge: "For one, helping investors better understand the space would accelerate their

> Interviews with practitioners yielded similar themes:
>
> - "This space is ***dying to be organized***. We're all interested in doing more good deals and we need partners." (asset owner)
> - "How do we help to build an industry nomenclature that helps to ***drive the kind of aligned capital that we need*** in the space … around blended capital, true cost, and the true impact that we're trying to get?" (investment manager)

[6] Barclays. (2015). *The Value of Being Human: A Behavioural Framework for Impact Investing and Philanthropy.*
[7] Goldman, P. and Booker, L. (2015). *Parsing Impact Investing's Big Tent.* Stanford Social Innovation Review.
[8] J.P. Morgan Social Finance and Global Impact Investing Network. (2015). *Eyes on the Horizon, the Impact Investor Survey.*
[9] Ibid.
[10] Global Impact Investing Network. (2016). *2016 Annual Impact Investor Survey*.

assessment of where they can 'play,' leading to more efficient, optimized capital allocation aligned with varying investor risk, return, and impact expectations."

The categorization of the market into "financial-first" and "impact-first" investors and "market-rate" and "concessionary" investments (see the box below titled "The financial/impact return tradeoff") has had the unintended effect of highlighting dichotomies where there actually *is* a rich spectrum of investments with different interplays between financial and impact return. Many impact investors are not seeking market-rate returns (41 percent are principally targeting below-market rate returns, according to the GIIN's 2016 Annual Impact Investor Survey[11]), and many of those targeting market-rate returns are also interested in a better articulation of the difference in the impacts of different investments.

As one member of the project's advisory group (an investment manager) described the problem at the February 10, 2016, meeting: "Investors are not sure which investment managers are peers, and it sometimes ***feels like impact is a binary conversation*** – that impact is a yes or no question. The supply of capital dedicated to impact investing is ***growing but still not filled out***: That is, there has been less progress on a full spectrum of capital, which could hamper new market development going forward. We run the risk of paying attention to the impact investing markets that are more mainstream, and not doing the work to help create new markets. If we could ***all see the impact piece through a similar lens***, it would make those conversations easier."

Finally, alignment of motivations and expectations among impact investors and investment managers remains a critical issue for the field. Conflicts often arise when motivations and expectations are different and not clearly understood or articulated.

Hypothetical consequences of real-world confusion

An investor with limited access to specialist advisory services is considering making her first impact investment with the goal of providing access to health care in Africa. The investor is weighing four different investment managers, but is confused by how each differs. One manager calls its strategy high impact but financially concessionary, another insists that what they do is highly impactful, but not intentionally "impact investing" at all, another talks about bridging the "pioneer gap," and the last emphasizes an impact thesis grounded in new health care "paradigms." The investor is open to a range of risk/return scenarios, but quickly decides that the time and expense of getting up to speed on the language of impact investing, and finding alignment on a specific opportunity, is likely to be prohibitive. Instead she opts to invest in a generalist Africa mutual fund, hoping some of her capital will flow to the right places and sectors.

Core hypothesis

Building on the role asset classes play in traditional markets, the Navigating Impact Investing project zeroed in on the concept of "impact classes:" a clustering of investments on the basis of their impact characteristics, intended to capture the full breadth of impact investing activity across asset classes, sectors, and public and private markets.

This working paper posits that a limited, agreed set of "classes" could bring tremendous efficiency benefits, particularly when making product selection and portfolio allocation decisions – a perspective validated by early outreach. In a recent survey of 27 leading practitioners introduced to the impact class concept, including members of a dedicated project advisory group (see Appendix for the full list), **76 percent strongly agreed or agreed that impact classes will "help asset owners and advisors**

[11] Ibid.

filter down the range of impact investing opportunities to find those appropriate for an asset owner's preferences to aid in individual investment and portfolio allocation decisions."

There is broader support still for the overarching hypothesis. Eighty-one percent of respondents agreed that "the field of impact investing needs a broadly accepted (and applied) framework for categorizing the many ways in which funds/intermediaries create impact through investment."

At the highest level, the Navigating Impact Investing project is an exercise in thought leadership. The audience for the work is the impact investing market writ large. However, in the process of attempting to build a real, actionable impact class framework that works for investors across all asset classes, it has become clear that, for some actors in the market, the challenges of allocating capital on the basis of impact are more acute. Those looking to match investor preferences with investment opportunities – namely asset owners and their advisers – have expressed the most interest in and are likely to benefit most directly from the introduction of impact classes, even as efficiency improvements at that level flow to the field as a whole.

Goal of the working paper

This working paper is intended to provide an overview of findings to date from the Navigating Impact Investing project and introduce the impact class concept. Further work is needed to develop the impact class concept into an actionable tool that is ready for broad adoption. This paper is intended to be an intermediate step in the process of arriving at a fully formed framework, providing an opportunity to share the latest thinking on the development of impact classes, to highlight related work from others in the field, and to synthesize the input and feedback received thus far from practitioners.

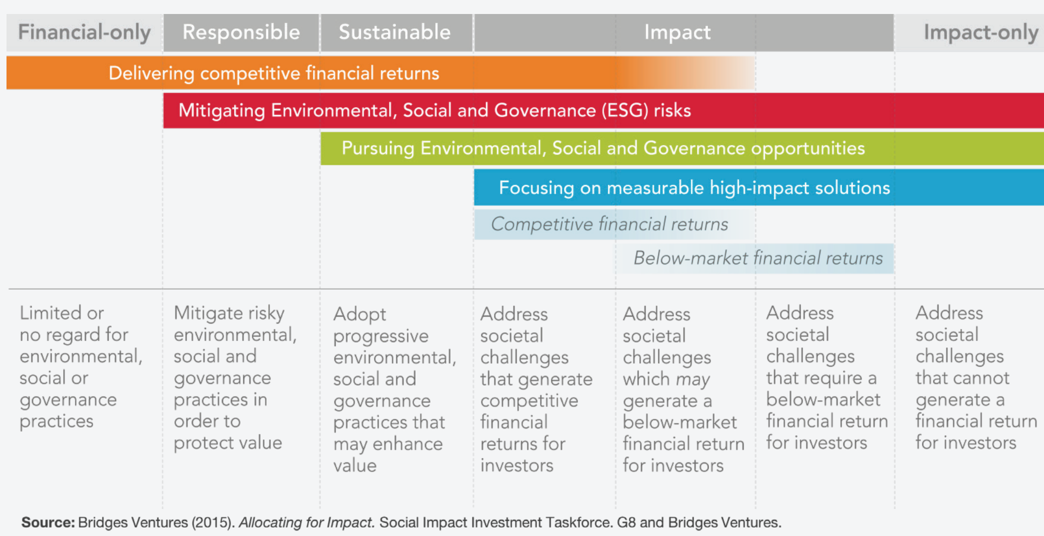
There are a number of key issues that lie ahead, including further engaging the market to inform and test the design of impact classes, determining the best means for encouraging adoption, and creating related materials for dissemination and education. We welcome the input and engagement of readers.

The financial/impact return tradeoff

The idea of a spectrum between pure financial return and pure social or environmental return has long been at the root of attempts to categorize the impact investing market. While impact investing is situated between traditional finance and philanthropy in these conceptions, in practice, investment managers found themselves being pushed toward one end of the spectrum or the other (toward "impact-first" or "financial-first"), in part because asset owners were generally more accustomed to *either* investing or philanthropy, and in part because the market lacked the shared language to easily talk about impact and financial return occurring together.

More recent frameworks have been developed that introduce the idea of financial and impact returns occurring in "lockstep," or attempt to better demonstrate the diversity of the field. In these depictions, impact investing is often placed among a range of related approaches to investing *with* impact,[12] including through responsible and sustainable investing, such as in the Bridges Spectrum of Capital below.

Figure 1: The Bridges Spectrum of Capital



Source: Bridges Ventures (2015). *Allocating for Impact.* Social Impact Investment Taskforce. G8 and Bridges Ventures.

Nonetheless, the stigma of a necessary financial/impact tradeoff persists and has discouraged some practitioners from identifying as impact investors at all. As one practitioner from a development finance institution noted in a project interview: "[The impact investing field] is too broad for us to get comfortable aligning with it without confusion. Our core business is to make good investments that have a positive impact but generate market return. We do not want to be confused with an impact investor who is willing to compromise [on returns]."

Although recent research from Cambridge Associates and the GIIN,[13] as well as the Wharton Social Impact Initiative,[14] has dispelled the inevitability of the financial/impact tradeoff (by demonstrating that impact investing private equity funds seeking market-rate returns perform competitively), this too has inadvertently reinforced the outdated "impact-first" and "financial-first" dichotomy,[15] together with the new shorthand that has arisen in its place, categorizing impact investments as either "market-rate" or "concessionary."[16] In practice, all impact investors – including the 41 percent not seeking market-rate returns according to the 2016 GIIN survey[17] – have diverse and complicated financial expectations, which often relate directly to the impact goals being pursued. This implies that a more nuanced understanding of the intersection of impact and financial performance is needed.

[12] Morgan Stanley. (2016). *Investing with Impact: Creating economic, social, and environmental value.*
[13] Cambridge Associates and the Global Impact Investing Network. (2015). *Introducing the Impact Investing Benchmark.*
[14] Wharton Social Impact Initiative. (2015). *Great Expectations: Mission preservation and financial performance in impact investing.*
[15] Fulton, K. and De Bruin, C. (2013). *Let the scaffolding fall.* Monitor Institute.
[16] Foley, S. (2015). *Impact investing must be more than a buzzword.* Financial Times.
[17] Global Impact Investing Network. (2016). *2016 Annual Impact Investor Survey.*

The Navigating Impact Investing project builds on and benefits from many attempts to parse impact investing's "big tent." The following analysis presents an overview of the impact investing process, focused primarily on the *impact* dimension. At each step in the process, key considerations are highlighted, along with sample existing frameworks and tools that provide clarity on each of these respective considerations. Taken together, the considerations and tools provide a summary of notable current market practices, as well as an opportunity to introduce the unique role of impact classes within this context.

The investment process overview is presented below in Figure 2.

Figure 2: Impact investing process: impact considerations and tools

STEPS	1. Define vision and motivations	2. Develop strategy and narrow investments	3. Execute strategy	4. Evaluate performance*
ACTIVITIES	• Clarify motivations and intentions • Define high-level impact goals	• Develop portfolio construction approach • Narrow the set of prospective investments to meet goals and preferences	• Perform due diligence • Allocate capital consistent with strategy	• Monitor financial and impact performance • Adjust strategy and portfolio as needed
SAMPLE CONSIDERATIONS AND TOOLS	**GOALS & PREFERENCES** Investor questionnaires **INTENTIONS & MOTIVATIONS** Barclays behavioral tool	**GEOGRAPHY & SECTOR** RPA Landscape CAPROCK iPAR tool **IMPACT APPROACH & EVIDENCE** Impact classes KLF impact assurance framework **IMPACT THESIS** Place, process, planet, product, paradigms**	**DIMENSIONS OF IMPACT PERFORMANCE** Bridges Impact Radar Vital Capital Diamond **STANDARDIZED AND CUSTOM METRICS** IRIS & GIIRS Proprietary frameworks	(spans steps 3 and 4)

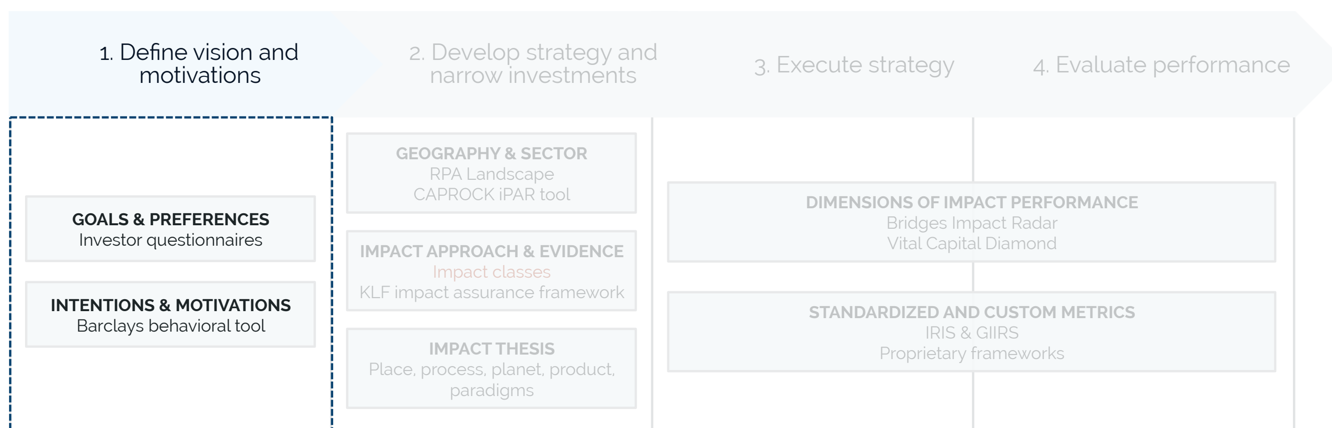
Sources:
* Process adapted in part from: World Economic Forum. (2014). *Impact investing: A primer for family offices*.
** Trelstad, B. (2016). *Making Sense of the Many Kinds of Impact Investing*. Harvard Business Review.

The considerations highlighted above are not intended to be exhaustive. Investors may incorporate a variety of impact-related factors in their investment processes beyond those included here, or may differ on the importance they place on each.

In the subsections that follow, the impact investing process diagram will provide a basis for exploring a sample of tools currently used in the market. For the sake of clarity and simplicity, we have placed each of these tools within a particular step in the process, along with the considerations they most directly address. However, it should be noted that many of these tools could be used at different points in the investment process, according to the particular needs and interests of investors. Furthermore, the investment process is often less linear and more iterative or cyclical than this schematic implies. For example, investors have developed sophisticated tools that apply at the execution and evaluation stages, which are also useful for goal- and strategy-setting. This more dynamic and iterative process, known as *impact management*, is the subject of a report due to be released in the summer/fall of 2016 by Bridges Ventures.

Step 1: Define vision and motivations

The impact investment process begins with an asset owner focusing on their overarching vision and goals for impact, shaped by one's unique motivations, values, and intentions.



Goals and preferences

As with traditional investments, an investor questionnaire is often used to help surface some of the goals and preferences of investors, both financial and impact-related. For financial considerations, these questionnaires typically cover questions related to risk tolerance, liquidity needs, time horizon, and financial objectives. To address the impact dimension, example issues include impact themes of interest, degree of impact sought, willingness to take risks to achieve impact, and geographic preferences.

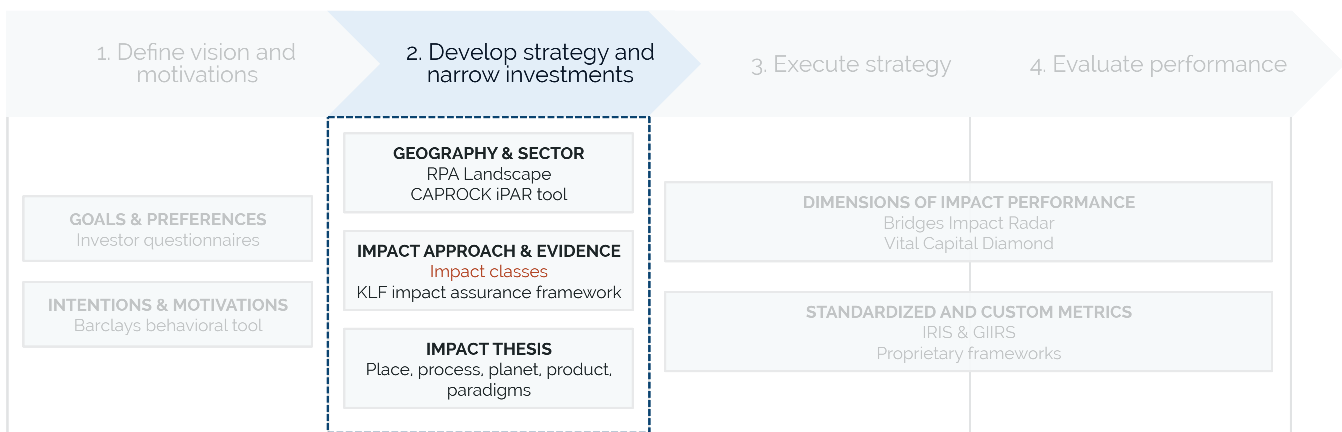
Intentions and motivations

As one example of a recent effort to bring clarity at this stage in the process, in 2015 Barclays announced an investor questionnaire tool[18] and published a report[19] that bring a behavioral finance lens to discerning an investor's impact objectives. The tool consists of 24 questions that advisers can use with their clients to draw out how strongly they feel about particular impact goals. Beyond this tool, the Barclays report presents a framework for impact investing and philanthropy they call a "social budget," which is intended to help investors determine their motivations for seeking socially beneficial outcomes and making high-level decisions about how to allocate their capital.

Step 2: Develop strategy and narrow investments

With the vision and goals defined, these fundamental considerations must be translated into a strategy and corresponding set of prospective investments.

[18] ThinkAdvisor. (2015). *What do impact investors really want? New Barclays tool helps advisors find out.*
[19] Barclays. (2015). *The Value of Being Human: A Behavioural Framework for Impact Investing and Philanthropy*.



Geography and sector

At the highest level, investors often begin by considering the geographic focus and sectors (or themes) that best align with their impact goals. Rockefeller Philanthropy Advisors' (RPA's) 2009 overview of the impact investing market is perhaps the most commonly used visual (see Figure 3) at this early stage in the process. Its axes reflect the dimensions most commonly discussed in financial advisers' initial conversations with clients and used by institutional asset owners when they allocate capital: theme/sector and asset class.

Figure 3: Mapping impact investments by theme/sector and asset class

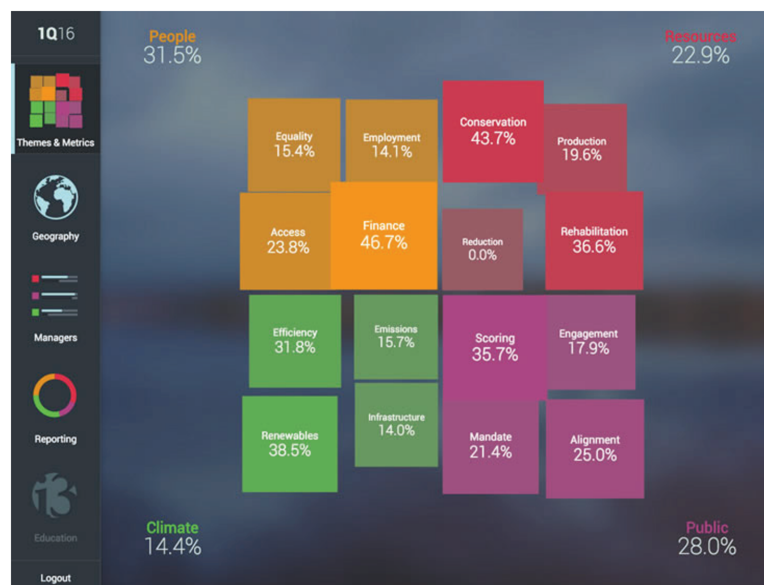
	LIQUIDITY	INCOME & WEALTH PRESERVATION			CAPITAL APPRECIATION & WEALTH GROWTH			INFLATION PROTECTION	
	Cash / cash alternatives	Notes / other debt obligations	Bonds	Absolute returns / low equity correlations	Public equity	Equity long / short	Private equity	Real estate	Commodities & other real assets
CLIMATE CHANGE	Green Deposit Bank		Tax-Exempt Green Bonds	Carbon Trading	Positive & Negative Screening		Clean Tech Venture Capital	Green REITs	
ENERGY			Screen Corporate Bonds	Alternative Energy Project Finance	Exchange Traded Funds	Renewable Energy	Energy Efficient Venture Capital		Sustainable Feedstocks
WATER			Corporate Infrastructure Bonds	Water Treatment Project Finance	Unit Investment Trust, Closed End Funds	Water Funds	Water Technology Venture Capital		
COMMUNITY DEVELOPMENT	Community Bank CDs	Foreclosure Repair		Microfinance Institutions Debt	Shareholder Proxy Voting		Community Development Venture Capital	Transportation Smart Dev. Funds	
SOCIAL ENTERPRISES		Social Enterprise Credit			Micro-Cap Listed Social Companies		Small & Medium Enterprise	Conservation / Eco-tourism	
HEALTH & WELLNESS		Bridge Financing		Structured Public Note			Consumer Product Venture Capital	Organic Farming	
SUSTAINABLE DEVELOPMENT	Trade Finance Guarantee / Deposit		Smart Growth Municipal Boards	Blended Debt Equity Hybrid Structures	Thematic Screening			Ranchland, Agriculture	Sustainable Timber
EDUCATION	Linked Deposit / Guarantee		Charter School Bonds				Education Private Equity	University Green Building	

Source: Rockefeller Philanthropy Advisors. (2009). *Solutions for Impact Investors: From strategy to implementation.*
This version: Arabella Advisors, Exponent Philanthropy, and Mission Investors Exchange. (2015). *Essentials of Impact Investing: A guide for small-staffed foundations.*

Individuals and organizations have been able to use RPA's graphic to identify what products exist across sector interests broadly, and where to look for them by asset class. By grouping impact investments by asset classes according to their role-in-portfolio exposures (i.e., Liquidity, Income & Wealth Preservation, Capital Appreciation & Wealth Growth, and Inflation Protection), the graphic helps provide a proxy for expected financial risk and return for various impact investment products. Similarly, impact sector/theme acts as a short-hand for characterizing the type of impact created by various investment products.

The CAPROCK Group has recently developed a tool called iPAR (Impact Portfolio Allocation Review) aimed at helping clients allocate capital according to theme and geography, among other considerations. As seen in Figure 4, the tool allows investors to see how their portfolio is allocated across a range of interest areas. The effort intends to create a comprehensive set of themes that can apply across asset classes, allowing an investor to see and evaluate thematic alignment. A similar visual component maps investment allocation according to geography as well.

Figure 4: Mapping impact themes



Source: iPAR website. CAPROCK. https://iparimpact.com.

While the RPA framework limits its characterization of impact to theme/sector and does not address intentionality or impact outcomes, other organizations (including CAPROCK) have built proprietary frameworks to highlight different impacts that investments are having. However, there is no widely accepted framework or vocabulary. As a result, the conversation with clients and prospects about approaches to impact often falls by the wayside – at least at an early stage in the investment process, before detailed due diligence homes in on a range of specific impact theses.

Impact approach and evidence

Along with the high-level considerations of sector and geography, the approach to impact and type of evidence required to demonstrate impact performance (to the satisfaction of investors) can be important considerations for investors and a means of further narrowing the set of aligned prospective investments.

Research and feedback from the market has indicated that these factors have been relatively under-addressed by existing frameworks – and yet can be fundamental to defining the nature of an impact investment opportunity, and to identifying alignment with an investor's goals and strategy.

Impact classes are proposed as one solution to this gap, providing a unique layer of information otherwise lacking in the investment process. The purpose of impact classes at this stage is to provide an additional, high-level lens through which to more efficiently sort investments on the basis of impact in order to identify those that are most appropriate. The nature and composition of impact classes will be explored in detail later in this report.

An example framework that relates to the "type of impact evidence" is seen in Figure 5 below, from New Philanthropy Capital (NPC), working with K.L. Felicitas Foundation (KLF). The framework introduces the concept of impact assurance, which refers to the degree of certainty that an impact being sought will be achieved, based on the impact practices and data of investees. The level of impact assurance is categorized within the Impact Assurance Classification stages seen in Figure 5.

The NPC framework encompasses the diversity of potential impact practices among investees, while acknowledging that no single aspect of impact practice is determinative in distinguishing between the classifications. A comprehensive range of variables related to various types and degrees of evidence of impact are evaluated collectively to create a standardized metric (the "Stages" indicated in Figure 5). The metric is designed to meet KLF's needs, indicating the anticipated strength of the connection between the outputs collected and the actual impacts created (i.e., the impact assurance). The concept of impact assurance helps asset owners determine a level of impact evidence and rigor of investee impact practices that meets their preferences or requirements.

Figure 5: NPC and KLF's Impact Assurance Classification stages

Source: New Philanthropy Capital and KL Felicitas Foundation. (2015). *Investing for Impact: Practical Tools, Lessons, and Results.*

Impact thesis

Recent work from The ImPact (Figure 6) brings together many key components of an investor's potential intended impact goals into one framework, including an "Impact Strategy," which characterizes various types of impact on the basis of business model (Product-Based, People-Based, Place-Based, etc.). Brian Trelstad of Bridges Ventures outlined a similar approach in the *Harvard Business Review*, laying out five types of impact (Place, Process, Planet, Product, and Paradigms).[20] B Lab's Global Impact Investing Rating System (GIIRS) uses its Impact Business Models in a similar way, to emphasize the different ways an enterprise can have impact as a key component of the ratings approach. B Lab categorizes impact enterprises by the way they create impact, whether it is because

[20] Trelstad, B. *Making Sense of the Many Kinds of Impact Investing* (2016). Harvard Business Review.

an enterprise uses a microfranchise model, for example, or is worker-owned and operated, or produces environmentally oriented products and services.[21]

These characterizations are useful for investors that know what type of impact they want to have (i.e., they specifically want to support new products or help revitalize a particular region). However, using types of impact or impact business models as a sole filter for categorizing impact investments (even within a given asset class) still yields a considerable diversity of potential investments, each appropriate for a different kind of investor. A simple, agreed-upon categorization of impact is still absent from the conversation.

Figure 6: Example of The ImPact's approach to categorizing impact investments

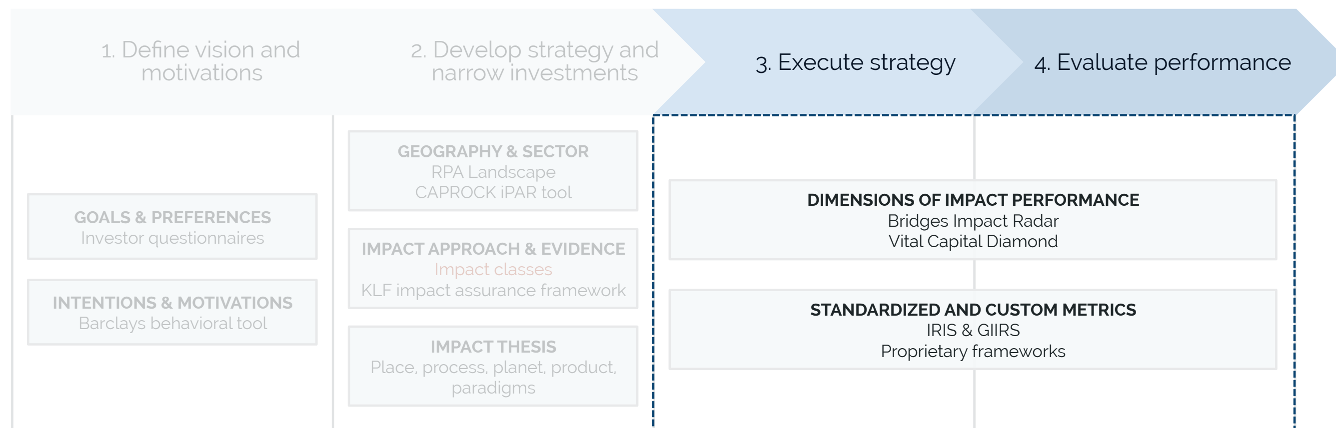
VOX CAPITAL

ASSET CLASS	SECTOR	GEOGRAPHY	IMPACT STRATEGY	RETURN PROFILE
Public Equity	Education	Sub-Saharan Africa	**Product-Based**	**Market-Rate**
Fixed Income	Environmental Conservation	Middle East & North Africa	**People-Based**	Concessionary
Private Equity	Sustainable Consumer	**Central & South America**	Place-Based	Off-Market
Venture Capital	Products	Asia & Oceania	Process-Based	
Real Assets	Housing & Community Development	Eastern Europe & Russia	Behavior-Based	
Hedge Funds	Agriculture & Food	Western Europe	Model-Based	
Social Impact Bonds	Energy & Resource Efficiency	North America	ESG-Screened	
Cash	Safety & Security	Emerging Markets	SRI-Screened	
	Healthcare & Wellness	Developed Markets		
	Access to Finance	Global		
	Employment & Empowerment			
	Base of Pyramid Services			
	Sustainable Infrastructure			
	Sustainable Banking			

Source: The ImPact. (2016). *Impact Investing: Frameworks for Families.*

Steps 3 and 4: Execute strategy and evaluate performance

The considerations in the execution phase are often relevant in the evaluation phase as well, as the same impact-related criteria that informs impact expectations and goals in due diligence may be used throughout the monitoring and evaluation processes to account for and evaluate impact. Therefore, for purposes of this analysis, the two steps are combined.



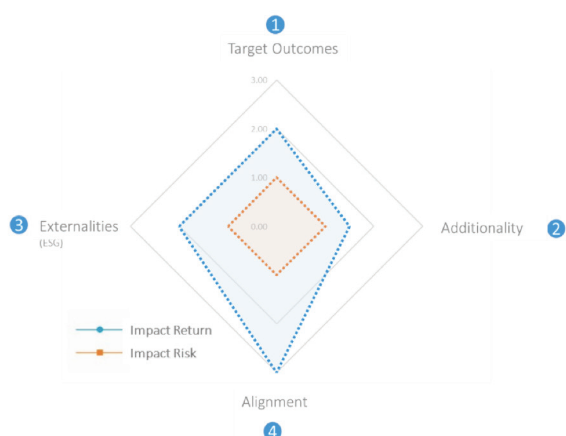
[21] B Lab. *Impact Business Models.* B Analytics website: http://b-analytics.net/articles/impact-business-models.

Dimensions of impact performance

At this step in the process, investors are now able to examine the impact characteristics of investments in a deeper, more nuanced fashion, including on factors related to the nature and depth of impact expected from an investment.

Some asset owners and investment managers, particularly those with portfolios composed entirely of impact investments, have developed proprietary frameworks that describe their impact preferences and act as a tool for evaluating investments on that basis. Bridges Ventures has identified four variables (Target Outcomes, Externalities,[22] Additionality, and Alignment) as being indicative of the potential for positive change for each of its investments. Bridges' Impact Radar summarizes their analysis of "impact return" (achievement if performance is as expected) and "impact risk" (the probability that impact performance will be different than expected). In Figure 7 below, an illustrative example of the Impact Radar is presented along with a summary of the underlying questions that determine the levels of impact risk and return among the four variables.

Figure 7: Bridges Ventures' Impact Radar



Variable	Analysis
I. TARGET OUTCOMES	**RETURN ANALYSIS:** Does the investment **create depth and/or scale** of impact? Does the investment benefit **an underserved beneficiary group or society at large**? What **systemic or wider impact** will occur from the investment?
	RISK ANALYSIS: How well-tested are the causal links in the logic model?
II. ADDITIONALITY	**RETURN ANALYSIS**: Is Bridges integral to the development/performance of the investment?
	RISK ANALYSIS: Does the investment lead to outcomes that would not otherwise occur?
III. EXTERNALITIES	**RETURN ANALYSIS:** Does the investment generate positive externalities?
	RISK ANALYSIS: Can risk of negative externalities be mitigated?
IV. ALIGNMENT	**RETURN ANALYSIS:** Does the investment optimize performance against both its impact goals and financial goals?
	RISK ANALYSIS: How aligned is the business model of the investee with its generation of impact?

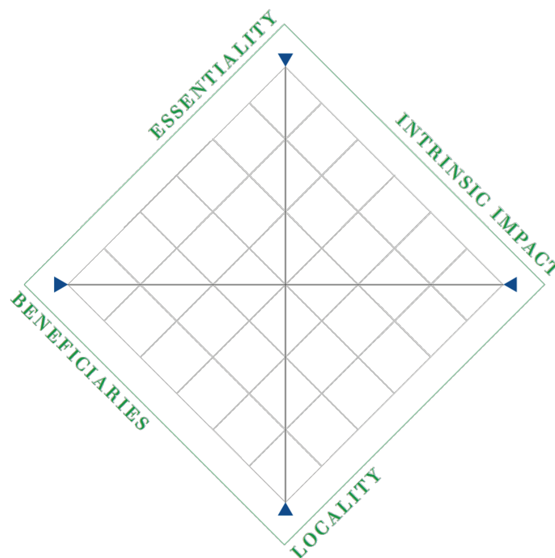
Source: Bridges Ventures

[22] Note: Bridges uses the terms 'ESG' (Environmental, Social and Governance factors) and 'Externalities' interchangeably on their Radar, since the traditional investment community is accustomed to the term ESG.

Another notable example of a due diligence tool is Vital Capital's Impact Diamond. The framework incorporates four "dimensions" by which investments are rated 0-3 to devise the impact profile. The dimensions are:

- **Essentiality:** Considers the need for the service or product as well as the necessity of Vital's involvement as the generator of impact. Need is contextualized by the existence, availability, and affordability of alternatives.
- **Beneficiaries:** Considers the segment of beneficiaries targeted by the investment as well as the reach and magnitude of the intended impact. Local and multinational impacts are treated differently.
- **Locality:** The locality dimension considers the ways in which an investment provides local empowerment, including through the creation of local jobs, a focus on local target market, and targeting pressing local needs.
- **Intrinsic Impact:** Investments where there is an inherent positive correlation between the financial and impact drivers.[23]

Figure 8: Vital Capital's Impact Diamond



Source: Vital Capital. (2015). *Crafting Impact: Presenting Vital Capital's approach to impact investing.*

Comparing evaluation tools to impact classes

While tools like the Impact Radar and Impact Diamond may seem to play a similar role to impact classes and share similar characteristics, there are important distinctions. Most notably, the types of considerations that these tools address can only be evaluated with relatively in-depth analysis, most likely through detailed diligence. This is primarily because some of the variables examined under these frameworks are quite complex to assess and can be difficult to rate objectively, requiring careful analysis. Furthermore, many evaluation tools, including the two highlighted herein, are tailored to an investment manager's unique approach and preferences. By contrast, impact classes are meant to be descriptive of investments (rather than making value judgments) using a limited set of universal, objective variables, and are intended to be used earlier in the investment process, without the need for exhaustive analysis, as a "higher level" filter through which to sort investments.

Standardized and custom metrics

While efforts to help investors more efficiently *allocate* impact capital are nascent, work to *evaluate* and *account* for impact[24] at the investment and portfolio level is well-developed. This is due in part to the increasing use of the GIIN's Impact Reporting and Investment Standards (IRIS) for quantifying and standardizing social and environmental impact outputs, as well as B Lab's Global Impact Investing Rating System (GIIRS), which provides an "Impact Rating" of the impact performance of funds and companies. GIIRS is an online self-assessment tool that assesses impact data and performance in a

[23] Vital Capital. (2015). *Crafting Impact: Presenting Vital Capital's approach to impact investing.*
[24] Based on language used by Bridges Ventures to describe the impact investing process.

more holistic fashion that is aimed at allowing for comparability, and has been used by more than 6,000 companies to date.[25]

Of 158 respondents to the 2016 GIIN survey of impact investors, 65 percent indicated they use metrics that are aligned with IRIS and 37 percent (many likely overlap) measure impact using standard frameworks and assessments such as GIIRS, the Global Reporting Initiative (GRI), and others.[26] The G8 Impact Measurement Working Group characterized these frameworks as having moved past the point of development and alignment across organizations to a point of standardization that continues to gain traction.[27]

Increasingly, private and public investors are utilizing standardized metrics to compare impact performance across investments – and in some cases use of these systems is required. For example, when the U.S. Small Business Administration's (SBA's) Small Business Investment Company (SBIC) Program expanded its Impact Fund in 2014, it required that funds certified as "Impact SBICs" utilize IRIS and GIIRS for a fund-level impact assessment and perform a portfolio company impact assessment using the standards of IRIS, GRI, or the Sustainable Accounting Standards Board (SASB) in order to qualify for commitments.[28]

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[25] GIIRS website. http://giirs.nonprofitsoapbox.com/.
[26] Global Impact Investing Network. (2016). *2016 Annual Impact Investor Survey.*
[27] Impact Measurement Working Group. (2014). *Measuring Impact*. Social Impact Investment Taskforce established under the UK's Presidency of the G8.
[28] US Small Business Administration. https://www.sba.gov/sbic/general-information/key-initiatives/impact-investment-fund/new-2014-expanding-sbas-impact-fund.

BUILDING IMPACT CLASSES

In the same way asset classes cluster investments by the way they deliver financial return, impact classes are intended to cluster investments by the approach they take to delivering impact, providing a useful, intuitive method for quickly sorting through a fast-growing universe of investment opportunities, across asset classes and in both private and public markets.

As illustrated by the diversity of useful frameworks in the section above, impact classes cannot and are not intended to provide a comprehensive depiction of the impact in impact investments. Impact classes are instead a high-level categorization, used early in the investment process, to narrow the universe of potential investments to a set that is more aligned with an investor's preferences.

Key characteristics of impact classes

Given the need identified for a broad, encompassing, and high-level categorization; it has become clear from research, interviews, and group discussion that impact classes should be:

- **Simple**
    - Straightforward and compelling: Impact classes that can be easily understood will likely have wider adoption and be more useful as a result.
    - Limited in number: The fewer the number of impact classes, the more likely they are to yield efficiency benefits.
- **Objective**
    - Meaningful, but objective: Impact classes need to offer product providers the opportunity to distinguish their work, but retain the possibility of third-party verification.
    - Neutral on the degree or quality of impact: Impact classes need to be descriptive without making value judgments.
- **Universal**
    - Inclusive, cutting across asset classes, sectors, and public and private markets: One of the most promising opportunities for impact classes is to be able to compare the impact dimension of investments across asset classes, across sectors, and consequently, across a portfolio.
    - Categorical and exhaustive: Impact classes should capture and distinguish the depth and breadth of activity in impact investing, but also not stifle further innovation.

Component variables of impact classes

Impact ratings and certifications consist of literally hundreds of variables. For impact classes to serve the simple purpose for which they are intended and align with the characteristics listed above, some limited set of variables must be selected as core elements.

Impact investments are "investments made into companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside a financial return," according to the definition used by the GIIN. Following from this definition, three key components of impact investing are intentionality, approach, and measurability/accountability.

BUILDING IMPACT CLASSES

As the Navigating Impact Investing project focused on these components, it became clear that “intentionality” defies easy categorization. Though intentionality is an essential component of the commonly accepted definition of impact investing, both the ways investors intend to have social and/or environmental impact, and the types of impact targeted by investees are innumerable and idiosyncratic. Even with broad categories like those laid out in IRIS’s impact objectives, a significant number are required to capture the breadth of activity in impact investing (Figure 9). The project instead focused on variables that distinguish between approaches and measurability/accountability practices. There are a number of variables impact investors and investment managers use that address these components of impact investing. The project was an attempt to identify or create those that are as objective, simple, and universal as possible.

Figure 9: IRIS impact objectives

Social objectives	Environmental objectives
• Access to clean water and sanitation • Access to education • Access to energy • Access to financial services • Access to information • Affordable housing • Agricultural productivity • Capacity building • Community development • Conflict resolution • Disease-specific prevention and mitigation • Employment generation • Equality and empowerment • Food security • Generate funds for charitable giving • Health improvement • Human rights protection or expansion • Income/productivity growth	• Biodiversity conservation • Energy and fuel efficiency • Natural resources conservation • Pollution prevention & waste management • Sustainable energy • Sustainable land use • Water resources management

Source: IRIS website. GIIN. https://www.iris.thegiin.org.

Tideline evaluated dozens of potential variables utilized by investment managers and narrowed in on three that offer the potential to distinguish investment managers’ impact practices at a high level: (1) the **role of impact investing capital**; (2) the **type of impact evidence**; and (3) **market and beneficiary characteristics**.

Potential variable 1: Role of impact capital

There are a discrete number of reasons why impact capital might be needed in a market and a discrete number of broad strategies for creating impact using capital. For example, an investor may prefer to invest primarily in pioneering efforts that develop new and untested business models, or alternatively in scaling proven, impactful solutions in more mature markets – each of which are valid and compelling purposes.

Figure 10: Segmenting by role of capital

Source: BlackRock

These examples speak to the role of impact investing capital. While the role of impact investing capital is often closely related to a business model’s stage of development, it also draws in other considerations such as the nature of the beneficiaries being targeted or the maturity or inefficiencies of the market in which an investment manager operates.

This variable has already been put to use in segmenting investments, including by BlackRock. In describing the types of “sustainable” investments offered through its platform (Figure 10), BlackRock highlights three

roles for an investor's capital: *preventing* negative impacts, through exclusionary screens; *promoting* positive impacts, through investments in companies furthering ESG factors; and *advancing* social/environment objectives, through investments with impact targets.

Impact classes could similarly use "role of capital" as a variable to provide further definition, characterizing different impact investments by *how* they advance both social and financial objectives.

BlackRock's approach to segmentation is consistent with many frameworks used to describe the impact investing market, including the Bridges spectrum of capital presented above. What is unique in this case is the role of capital is not just descriptive, but is framed as an objective which investors may choose to pursue alongside other goals and preferences, both impact and financial.

Figure 11 draws on the literature, including BlackRock's work and the categories Omidyar Network described in its 2012 "Priming the Pump" report,[29] to highlight one way impact investments could be categorized by the role of impact capital. Investment managers would not necessarily be confined to the opportunity to provide additional detail later in the investment process.

Figure 11: Proposed variable 1 – Role of impact capital

ROLE OF IMPACT CAPITAL		
INFLUENCING PROMPTING the impactful actions of mature businesses	**SCALING** GROWING proven, impactful business models or sectors	**PIONEERING** SEEDING new or early-stage impactful business models and financial innovations

Source: Tideline

Potential variable 2: Type of impact evidence

The type of impact evidence collected by impact investment managers ranges from the assessment that an investment's practices and activities are broadly consistent with a targeted impact, to high-quality data on beneficiary outcomes that is sufficient to allow for a determination of the cost-effectiveness of an intervention.

The impact evidence variable (similar to the "impact assurance" variable in the report by K.L. Felicitas and NPC in the section above) is a compelling way to segment the impact investing market for a number of reasons:

- The kind of evidence an investment manager collects *already* plays an important role in an investor's decision to allocate capital, since many investors have requirements or preferences for how impact is demonstrated. For example, when foundations make Program-Related Investments, they need to justify their charitable purpose and have specific requirements for how impact is measured. They may want high-quality data on outputs of the business (such as how many borrowers repay their loans) or even data that relates to changes, or outcomes, for specific beneficiaries (such as how many farmers experience an increase in their income after

[29] Bannick, M. and Goldman, P. (2012). *Priming the Pump: The Case for a Sector-Based Approach to Impact Investing*. Omidyar Network.

the purchase of a new seed or tool). Governments often want even more evidence, such as data demonstrating the cost-effectiveness of their investments compared to other means of achieving similar outcomes (pay-for-success contracts are a good example). For other impact investors, the alignment of an investment manager's practices and activities with a specific area of impact is satisfactory, and they express no need for the collection of specific impact data. Others may look for a clearly defined impact thesis, efficient measurement of related outputs relevant to this thesis, and a handful of anecdotes that demonstrate the process of creating impact as their ideal.

- The variable is relatively objective, is nonjudgmental, and can be determined without extensive due diligence.

- The variable also serves as a proxy for the specificity of the impact being targeted. For an investor with very focused social or environmental goals, more evidence might be required to gain assurance on progress toward these goals. For broader or more systemic social or environmental goals, progress might be too difficult or inefficient to measure conclusively, making strategic collection of less data preferable.

Despite the need, there is not currently a clear, universal way of discussing types of impact evidence. Figure 12 highlights one potential way of categorizing, building upon the elements of the logic model commonly used in the non-profit sector.

Figure 12: Proposed variable 2 – Type of impact evidence

TYPE OF IMPACT EVIDENCE			
THESIS-ALIGNED Have investment practices aligned with impact intentions, and report high-level data on investee PRACTICES & ACTIVITIES	**STRATEGIC OUTPUTS** Report a selection of relevant investee OUTPUTS CONSISTENT WITH IMPACT GOALS	**OUTCOME DATA** Track output and outcome data on an ongoing basis, and can provide DATA DEMONSTRATING POSITIVE CHANGE for target beneficiaries	**IMPACT DATA** Can provide data that explicitly informs assessment of ADDITIONALITY AND/ OR COST-EFFECTIVENESS

Source: Tideline, adapted from *Impact Evidence Cheat Sheet*. Smart Impact Capital. Duke University, CASE i3. Cathy Clark. 2015.

It is important to note the impact evidence variable is not intended to imply that investment managers should *only* meet the evidence requirements of their prospective investors, or to otherwise curtail the effort to gather deeper impact data. In fact, there are many reasons why investment managers may go beyond the requirements of investors, including because exploring their impact more deeply may provide insights that enhance performance, or as part of an investment manager's overarching commitment to impact.

Potential variable 3: Market and beneficiary characteristics

Some investment managers are hesitant to be boxed in to high-level categories. In reality there are many nuanced factors that bring greater definition to an investment manager's unique impact investing approach.

Three factors arose repeatedly in conversations with practitioners:

- **Beneficiary** - the extent to which the people, places, or systems being targeted are disadvantaged, under threat, and/or lack access to resources and opportunity;
- **Market** - the extent to which the market in question is relatively new, emerging, or subject to systemic challenges; and
- **Capital need** - the extent to which the capital being provided to an investee plays an essential role in making the impact possible.

Figure 13 below illustrates one method for categorizing investments by these characteristics, using a dichotomous approach for each factor:

Figure 13: Illustrative categorization according to market and beneficiary characteristics

FACTORS	CATEGORIES	
Beneficiary	**Vulnerable:** Benefits are primarily targeted to people, places, or systems that are disadvantaged, under threat, and/or lack access to resources and opportunity.	**Undefined:** Benefits are primarily broad-based and are not explicitly targeted towards people, places, or systems that are demonstrably vulnerable.
Market	**Underdeveloped:** The investment's market is relatively new, emerging, or subject to systemic challenges.	**Established:** The investment's market is relatively proven, efficient, and well-functioning.
Capital need	**Critical:** Limited opportunities are available for the investee to access capital, implying that capital provided plays an essential role in making the impact possible.	**Supplemental:** Access to capital is generally available in the investee's market. Additional capital provided is of a supplemental nature.

Source: Tideline

Further research is needed to explore how these characteristics might best be incorporated into a prospective impact class framework.

Testing impact classes

Combining the *role of impact capital* and *type of impact evidence* variables described above could yield a matrix like the one pictured in Figure 14. This framework allows investment managers to find an appropriate cluster along two dimensions that describe why impact investing is needed (*role of impact capital*) and how the resulting impact is demonstrated (*type of impact evidence*).

“Impact classes,” in this case, could be each of the individual cells of the 3x4 matrix below, or could be groups of cells with overarching characteristics in common (i.e., A, B, and C in the matrix). Impact class “A” would include investment managers focused on influencing or scaling the impacts of generally more mature investees and providing evidence of these impacts by pointing to consistent investment practices or the resulting investee outputs. Impact class “B” would contain investment managers with a demonstrated practice of seeding or growing impactful businesses, or closely tracking the social or environmental outputs or outcomes of established businesses they influence or scale. Impact class “C”

would include investment managers who seek to seed or scale business models that typically seek highly specific outcomes or proven impacts.

Figure 14: Illustrative potential impact class framework

ROLE OF IMPACT CAPITAL	TYPE OF IMPACT EVIDENCE			
	THESIS-ALIGNED Have investment practices aligned with impact intentions, and report high-level data on investee PRACTICES & ACTIVITIES	**STRATEGIC OUTPUTS** Report a selection of relevant investee OUTPUTS CONSISTENT WITH IMPACT GOALS	**OUTCOME DATA** Track output and outcome data on an ongoing basis, and can provide DATA DEMONSTRATING POSITIVE CHANGE for target beneficiaries	**IMPACT DATA** Can provide data that explicitly informs assessment of ADDITIONALITY AND/OR COST-EFFECTIVENESS
INFLUENCING PROMPTING the impactful actions of mature businesses	A	A	B	-
SCALING GROWING proven, impactful business models or sectors	A	B	B	C
PIONEERING SEEDING new or early-stage impactful business models and financial innovations	B	B	C	C

Source: Tideline

The framework is but one example. Impact classes could take other forms, or may be comprised of different variables; but elements of this framework resonate with the envisioned characteristics of impact classes listed above. The framework provides categories that are descriptive and nonjudgmental, allowing investments to be placed with clarity and consistency, and the push for objectivity facilitates external validation. While investment managers may self-identify, as a first step, clearly defined criteria for each cell can help investors and the market determine whether an investment manager has self-categorized appropriately.

Additional uses of impact classes

In addition to the role of impact classes in the investment process, there are a number of other prospective uses:

- **Research** – Impact classes have the potential to be the basis for research on impact risks/returns, as well as a nexus for linking impact and financial risks/returns.
- **Communication, education, and marketing** – Having a common language and understanding could make it easier to communicate about impact in a variety of settings, including in describing what impact investing is, educating newcomers on the approaches to impact investing, and as part of marketing investment opportunities based on their impact approach.
- **Portfolio construction** – For some investors, impact classes may provide an additional dimension by which to diversify portfolios.
- **Comparison and benchmarking** – Defining and agreeing upon high-level categories allows for more ready comparison of impact investment managers on both financial outcomes and impact outcomes. Benchmarks for what level of financial and impact performance can be expected for a given impact class and asset class within a given sector and geography could help set investors' expectations.
- **Standardization** – Since impact classes are intended to help better align expectations between investors and investment managers before an investment is made, investment managers may benefit from being able to provide a more standardized set of reporting to investors. Similarly, as a framework for impact classes becomes more widely adopted, practices and principles that help define the boundaries of an impact class will emerge, standardizing categorizations for the field and allowing an investment manager to more easily self-categorize and determine what information to provide for the rest of the market to verify the categorization.

Impact classes in practice: A real-world investor-fund manager interaction

Following the meeting of the project Advisory Group, February 10, 2016, two participants – an investor and a fund manager – held a brief conversation exploring a potential fund investment. In discussing if the investor and fund might be a good fit for one another, the two referenced the framework presented above and, by placing themselves within that proposed clustering, quickly realized they were well-aligned in terms of the approach to generating impact and the type of impact evidence that would be desired/delivered. The investor and fund manager later told Tideline they were able to establish an initial understanding within minutes that might have taken much longer without the framework.

Impact classes in practice: Categorizing hypothetical investments

The following example illustrates how impact classes could help diverse investors match their specific preferences to suitable investments.

A government enters into a pay-for-success contract that encourages private investors to provide the initial funding for an intervention aimed at reducing recidivism.

Sector / impact theme	Prisoner rehabilitation
Asset class	Pay-for success contract
Geography	United Kingdom
Impact class	*PIONEERING – IMPACT DATA*

A foundation makes a program-related investment into a fund that provides financing for community clinics.

Sector / impact theme	Health care delivery
Asset class	Fixed income
Geography	United States
Impact class	*SCALING – STRATEGIC OUTPUTS*

A high-net-worth investor invests in a mutual fund that invests in public equities and files shareholder resolutions or engages with public companies on environmental issues.

Sector / impact theme	Environment
Asset class	Public equity
Geography	International
Impact class	*INFLUENCING – THESIS-ALIGNED*

Links to financial risk/return

The field of impact investing longs for more information about the correlations between impact and financial risk and return. Common frameworks that articulate and categorize the impact characteristics of investments could provide a basis for collecting and analyzing data in order to explore these relationships.

Even in traditional markets, categorizations that complement and supplement the core focus on asset classes are critical. Within the realm of alternative investments, for example, hedge funds and private equity both invest primarily through “equity” as an asset class, but they generate their returns in different ways depending on strategy: For hedge funds, this could be long/short equity, market neutral, event-driven, or global macro (among others); and for private equity may include venture, growth, buyout, or special situations.

These kinds of categories help bucket investment managers looking for similar types of investments with similar approaches to deriving value and comparable risk profiles. The bucketing facilitates benchmarking, which is essential for investors in determining the appropriate financial returns relative to risks.

In impact investing, the same type of clustering on the basis of impact characteristics and practices can provide similar benefits for comparing investments. For example, clustering could help distinguish managers supporting untested business models in new markets from those working with large,

established companies. In addition, some managers put significant resources into measuring and managing for impact, others have chosen not to, do not need to, or cannot. Impact classes could add a layer of information that helps more clearly distinguish the different buckets within which like investments can be compared.

The exploration of these elements of impact practice alone is important for some impact investors in their investment decisions. Many investors, though, will also want to know the correlation between an investee's impact goals and their financial goals: a concept Bridges Ventures refers to as "alignment."

Like the hedge fund and private equity strategies above, impact classes would not, a priori, be assumed to have a specific financial risk/return profile, but rather these correlations would emerge over time and likely surface different conclusions in different impact sectors and geographies.

For example, a microfinance institution that shifts resources to emphasize impact measurement relatively more than its peers may underperform those peers in a given year. Over time, though, the organization may prove better at creating long-term value and demonstrate better financial performance and/or less risk, given the potential benefits of having invested in its measurement practices (again, only time and data would tell).

In other geographies, sectors, or stages of market or company development, over-investment in impact practices may create a drag on financial returns. Whether this drag is an acceptable "tradeoff" for the level of impact return and/or level of evidence of impact is a choice each investor will need to make, but currently has difficulty making, arguably because the impact element of the impact/financial correlation equation remains vague and poorly defined.

Ultimately, impact classes may only have a loose connection to financial returns, especially if they span asset classes, geographies, and sectors. It may be possible to surmise that certain investments with particular impact goals and standards for impact evidence are likely to have a wider range of potential deviations from "market-rate" returns. However, a better categorization of investee and investment manager impact practices is needed to lay a clearer path for this exploration of the relationship between financial return and impact.

RESPONSES TO THE IMPACT CLASS CONCEPT

The impact class concept was introduced in detail and vetted at the in-person meeting of the project's Advisory Group on February 10, 2016. The following section includes highlights of that discussion, as well as the feedback received from 27 of the 40 participants in the meeting through a subsequent survey.

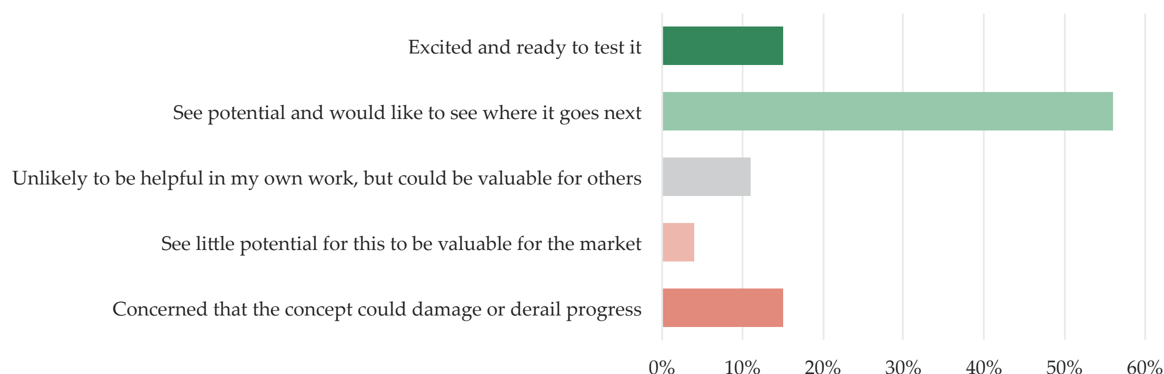
It is important to note the survey's sample size of 27 is not large enough to be considered representative of the market at large, though the Advisory Group was convened to represent the diversity in impact investing, including by role, asset class, geography, focus, and other considerations.

Support for impact classes

As mentioned above, support for the *concept* of a categorization framework was decidedly positive. Eighty-one percent of the 27 respondents agreed "the field of impact investing needs a broadly accepted and applied framework for categorizing the many ways in which funds / intermediaries create impact through investment."

Figure 15 below shows the idea of "impact classes" specifically also had broad support, with 15 percent of respondents ready to test the frameworks as presented, and another 67 percent seeing potential for impact classes, either in their own work or for the market.

Figure 15: Support for impact classes, indicated in the Advisory Group meeting participants survey (n=27)



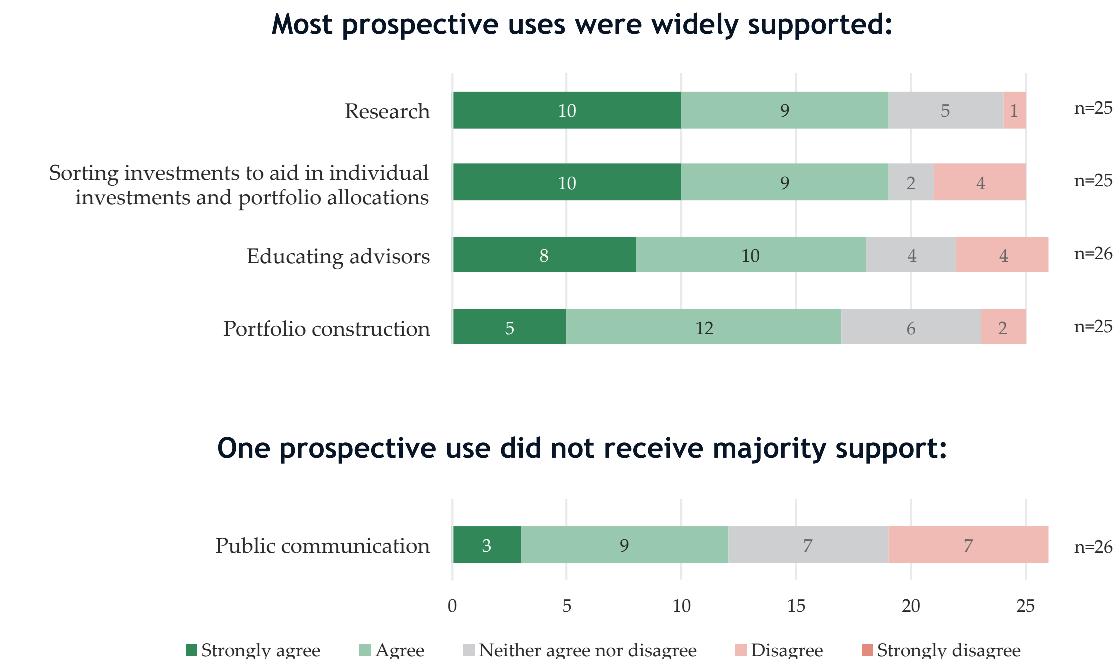
Source: Tideline

Some participants were also enthusiastic about the specific variables and frameworks presented in this paper, but there is more work to be done to determine if the variables identified are appropriate, and whether they are being categorized and assembled in a way that will be useful to the market.

Prospective uses of impact classes

Participants in the February Advisory Group meeting were also surveyed on prospective uses for impact classes. In general, the responses were positive across various uses, with only one receiving less than majority support. Those that received the most support were: research, sorting investments, educating advisers, and portfolio construction. Public communication was viewed as the least promising use.

Figure 16: Prospective uses of impact classes, per Advisory Group survey



Source: Tideline

Regarding research uses for impact classes, one participant in the February meeting observed: "It may be helpful to have some sort of apples-to-apples comparison on the impact dimension. All these funds will be compared to one another, whether we decide what those groups are or not. Someone will put things into groups, and then someone will test the market based on that. It will make more sense if [this grouping] is based on input from practitioners, not just coming straight out of academia."

On impact classes' role in sorting investments, another noted: "Every year I come across [a new] investor and realize: You guys think about this the way we think about this … This clustering methodology enables us to say, here's what I mean by that."

Feedback: Common themes

Advisory Group members, project interviewees, and other market practitioners have been encouraged to provide input and feedback over the course of the project, including on February 10.

This feedback has reflected the particular perspectives in the market of practitioners, with accordingly varied levels of interest, support, and/or perceived value. The prospective impact class framework – like any other framework – applies more directly to the circumstances of some actors than others. In general, asset owners have been the most supportive of the impact class framework. Advisers have been relatively supportive. Investment managers have been mixed in their support, with those that emphasize impact in their work being the most enthusiastic.

RESPONSES TO THE IMPACT CLASS CONCEPT

The input can generally be grouped into the following common themes:

- **Practicality and market uptake are key:** Designing the impact classes for practical application will be essential to ensuring widespread use. One commenter noted that impact classes could be “a tremendous breakthrough” provided there is buy-in from asset owners and fund managers.
- **Simplicity and clarity are paramount:** Some commenters re-emphasized that the framework must be simple in order to avoid misinterpretation, misuse, and confusion.
- **Questions about implementation:** A few commenters observed that it will be important to consider how investment managers will be placed into impact classes – either through self-classification or by an empowered third party.
- **Need for education:** It may be difficult for some who are new to the space, including some advisers and their asset owner clients, to be able to immediately understand and adopt a new framework: Education would be required.
- **Contribution to understanding of financial return:** Some commenters noted that a framework focused exclusively on the impact dimension would not be useful to them unless it also contributed to a better understanding of financial risk and return.

Key risks to impact classes

Impact classes are not without risks. Informed by feedback from interviewees and Advisory Group participants, the following risks are among the most significant:

- **Maintaining integrity and preventing abuse:** Impact classes are intended to be nonjudgmental and straightforward to verify, ideally allowing investment managers to appropriately self-identify without the need for a third-party arbiter. There is a risk the impact class framework becomes murky and less usable if managers do not self-categorize accurately. Guidelines or principles for placing oneself into the correct categories may mitigate this risk.
- **Maintaining impartiality and resisting distortion:** Impact classes are not intended to indicate what products or investment managers are “more impactful.” Any variables that undergird impact classes should showcase a spectrum of viable impact practices, each potentially appropriate for different kinds of investors and investment managers. If this impartiality is not achieved or is lost during implementation, there is a concern that investment managers will manage to and message to what is measured, to the detriment of operational efficiency and clarity.
- **Classification may limit innovation:** One risk raised by practitioners is that placing investments into categories may inadvertently discourage innovation, by influencing the market to stay within those confines. Impact classes, though they do attempt to categorize and cluster, are not intended to exclude or limit new potential innovations. Care should be taken that impact classes do not become restrictive or determinative with regard to which investment managers receive funding and whether new models are able to gain traction.

In spite of the risks and the difficulty of adopting another new framework, 77 percent of February 10 meeting participants described the meeting as value-adding for the field and 100 percent indicated they would like to remain involved going forward either directly (85 percent) or peripherally (15 percent).

THE WAY FORWARD

Meeting participants also emphasized the importance of continuing the effort. As one survey respondent wrote: "I think that issues around abuse/error and being reductionist are concerns but that net-net it's still worth attempting." Another commented: "I'm not concerned about a wasted effort among the advisory group. This is an issue that needs to be addressed."

There are several ongoing questions and challenges that will need to be addressed as this work evolves. These include:

- **Clarifying purposes and audiences:** For a new system of impact classes to be effective as a tool to help the field, it must ultimately be accepted and adopted by multiple parties in the impact investing ecosystem, including asset owners and managers, advisers, investment managers, standards and network organizations, and ultimately entrepreneurs. Broad adoption is the endgame – although engaging all stakeholders at once is unlikely to be successful. Actors in impact investing have different goals, different political economies, different stakeholders, and different identities in the marketplace. Now that the concept of impact classes has been introduced, the optimal approach is likely working through smaller groups to allow different players to give feedback with their peers – beginning with asset owners, advisers, and investment managers, and expanding from there.

- **Determining the right variables:** While a key decision emerging from the February meeting was the general acknowledgement the concept of impact classes could fill a gap in the marketplace, attendees did not agree on the exact framework that will define impact classes. Identifying boundaries between each impact class, as established by *the core variables* that are universal and create differentiation, will be essential. The prototypes presented and tested in February 2016 will need to be further iterated.

- **Weighing the benefits of one or more frameworks**: One hypothesis is that impact classes would be most effective as *one* universally accepted framework that allows many different parties to identify their impact class and those of others. However, this assumption will need to be tested further. More than one major classification may be needed.

- **Balancing the pursuit of consensus with moving to action:** It will be important to have a threshold level of support for any prospective impact class framework before taking it to the market at large, in order to ensure broad adoption. As impact classes continue to develop, there may be a tension between building additional support and moving to action. Full consensus is surely beyond reach, and thus a balance must be struck in determining the appropriate timing for broad dissemination and adoption, once sufficient support has been indicated through testing.

- **Governance, and finding the right home in order to drive adoption**: As of writing, the research is led by a purpose-built project team. For the longer term, it will be important to consider the best home for this effort, which could form part of another organization's work. To be sure, there will need to be a sufficiently robust governance process in place to engage natural constituents in the process of refining the impact classes over time, to provide a level of transparency that will evince credibility in the effort, and to empower an entity to be responsible for improvements. Prior work on standards shows there are a number of choices of structure that should be considered carefully.

Conclusion

The market is at a unique and critical moment in its development, where thanks to the efforts of many pioneers and leaders, the type of scale and impact that many envisioned is beginning to be realized. With that progress comes new challenges. Impact classes are but one potential contribution to the market's development, aimed at moving the needle on some of these important challenges.

While impact classes are not a silver bullet and more work remains, research and outreach have made it clear there is an opportunity in impact classes. Now is the time for building a more navigable roadmap for impact investing, and a stronger market as a result.

APPENDIX

The Navigating Impact Investing project Advisory Group members are listed below.
Please note that inclusion in this list does not constitute an endorsement of the Navigating Impact Investing project, nor of the project's preliminary findings. The Advisory Group was designed to bring together representatives from the many different perspectives in the field today: from foundations to investment managers, institutional investors, financial institutions, family offices, academics, field builders, and others.

**Indicates Advisory Group members that attended the meeting in New York on February 10, 2016 (either in-person or by videoconference).*

Advisory group

Ali El Idrissi, J.P. Morgan*
Amit Bhatia, Impact Investors Council
Amit Bouri, Global Impact Investing Network
Brian Trelstad, Bridges Ventures*
Caroline Mason, Esmee Fairbairn Foundation*
Christine Looney, Ford Foundation*
Clara Barby, Bridges Ventures*
Daniel Izzo, Vox Capital*
Deborah Winshel, BlackRock
Debra Schwartz, MacArthur Foundation*
Elizabeth Boggs Davidsen, Inter-American Development Bank*
Fran Seegull, ImpactAssets*
Gil Crawford, MicroVest*
Gurmeet Kaur, CDC Group
Henry Gonzalez, ResponsAbility*
Hilary Irby, Morgan Stanley*
Jackie VanderBrug, US Trust*
Jacob Gray, Wharton Social Impact Initiative*
Jessica Matthews, Cambridge Associates*
John McKinley, BlackRock*
Lisa Hagerman, DBL Partners*
Lisa Hall, Anthos Asset Management*
Lisa Hehenberger, European Venture Philanthropy Association*
Lisa Woll, US SIF*
Manuel Lewin, Zurich Insurance Company*
Matthew Weatherley-White, CAPROCK Group*
Mildred Callear, OPIC*
Monica Brand Engel, Quona Capital*
Nancy Pfund, DBL Partners*
Nick O'Donohoe, Bill and Melinda Gates Foundation
Patricia Dinneen, EMPEA*
Rekha Unnithan, TIAA-CREF*
Robert Kraybill, IIX*
Sasha Dichter, Acumen*
Terri Ludwig, Enterprise Community Partners
Tim Macready, Christian Super*
Tom Speechley, Abraaj Group
Tracy Washington, International Finance Corporation*

Vishal Mehta, Lok Capital*

Guest attendees at February 10th meeting

Brian Milder, Root Capital
Graham Macmillan, Ford Foundation
Irina Ivan, Porticus
Julia Shin, Enterprise Community Partners
Julie Katzman, Inter-American Development Bank
Lisa Jordan, Porticus
Sapna Shah, Global Impact Investing Network
Thomas Hyland, Aspada Investments

QUESTIONS AND COMMENTS

Please contact Tideline at info@tideline.com with any questions or comments about this working paper.