The challenge for impact investing is management, not measurement

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It feels like we're at an important point in the evolution of impact investing. While the field has shown tremendous growth over the past few years, there are far more asset owners still sitting on the sidelines – interested in impact, but not yet investing. So why is it that – to quote the famous impact investor Bono – "they still haven't found what they are looking for"?

There are a number of reasons why interest continues to outstrip activity. The most obvious is the lack of scaled investment products. But perhaps the most important is that we still haven't clearly defined what we mean when we talk about impact.

There's been a lot of progress made over the last decade on the question of impact *measurement*. But I would argue that the challenge is more about impact *management*.

Impact management is how asset owners articulate their impact objectives: where they want to invest, who they want to reach, what problems they want to solve, what risks they want to take. These preferences need to be translated into investment decisions and expectations about what impact information they expect to have reported.

To take an example from our own portfolio:

Our first investment in the United States, Springboard Education, offers high-quality after-school enrichment programs in more than 88 schools in 13 states, serving nearly 5,000 children and their families. These programs are good for parents, who can relax knowing their children are in safe hands. They're good for school administrators, who are used to seeing good kids do bad things when left to their own devices. And they're a good way to narrow the achievement gap between lower and higher income kids (since the latter typically have more access to these programs).

When we at Bridges think about the impact of SpringBoard, we ask questions like: how many students does it serve? What is their socio-economic background? Do they perform better in school? And are we closing the achievement gap?

This data flows from the student and his family, to the superintendent and her school, through the company, Springboard, to the team at Bridges, to the investors in our fund.

Our investors will then evaluate this impact report we provide – both against their original expectations when they invested in Bridges, and in the context of every other impact investment in their portfolio. Some like that we are working in education. Some like that we are serving the educational needs of low-income students. And some care about the jobs we have created – which is great, but not really why we made that particular investment.

In other words, even in this relatively small field, many of the players are thinking and talking about impact in very different ways. So finding some common ground – a common language for articulating our goals, and a common framework to measure our success against those goals – remains a huge challenge for the sector. And that can be off-putting and frustrating for investors looking to enter this field.

The capital markets work, in part, because investment decisions are guided by a shared understanding of risk and return. If an investor meets with a financial advisor and asks them how to invest $1 million dollars, the advisor (whether it is USAA, Charles Schwab or UBS Private Bank) will ask a similar set of questions about the investor's risk tolerance, time horizon, liquidity needs, and other investments.

If the investor asks that same advisor how to have impact, they're more likely to get a blank stare, an admonition that they're asking the impossible, or at best, a hundred different suggestions ranging from screened equity funds to microfinance to wind farms.

That's why a broad group of industry stakeholders – from investors like us, to asset managers like BlackRock, USB, PGGM, to foundations like Ford and Omidyar, to policy makers like DfID – have come together to try and change this. We're working to develop a common convention for impact management; one that that will enable investors to clearly articulate and share their expectations around outcomes, demographics, materiality and risk.

If successful, the convention will lead to widespread adoption of three things:

- First, the concept of impact fidelity. In traditional asset management, fiduciary duty is a powerful way to bind actors across the chain of capital, ensuring that decisions are made that maximize the financial return of asset owners. Impact fidelity can serve an equivalent purpose within impact management, ensuring that investment decisions properly reflect the asset owner's original impact objectives.
- Second, common standards for reporting. We take great pride in the quality of our impact reports at Bridges. But our investors would never accept self-reported financial statements in a customized format – which is essentially how impact reporting tends to work. For the sector to scale, we need more consistent standards and expectations around impact reporting (including the possibility of independent verification).
- Third, we might have to stop treating impact in isolation. Unless and until we link impact to investment allocation decisions, and possibly even to a fund's carry and return waterfalls, impact may continue to play second fiddle to financial returns.

Once we live in a world where impact fidelity is as powerful as fiduciary duty, where impact reports are as consistent and clear as financial reports, and where a proven impact track record matters as much as a proven financial track record when raising a fund, that's when those investors currently sitting on the sidelines will join the impact investing game.

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Notes:

- *This blog post is based on the authors' paper* Impact Investing: A Brief History , in Capitalism & Society, Vol. 11, Issue. 2, Article 4, 2016
- *The post gives the views of its author, not the position of LSE Business Review or the London School of Economics.*
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