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IMPACT BUSINESS: WHAT IS YOUR SIGNATURE?

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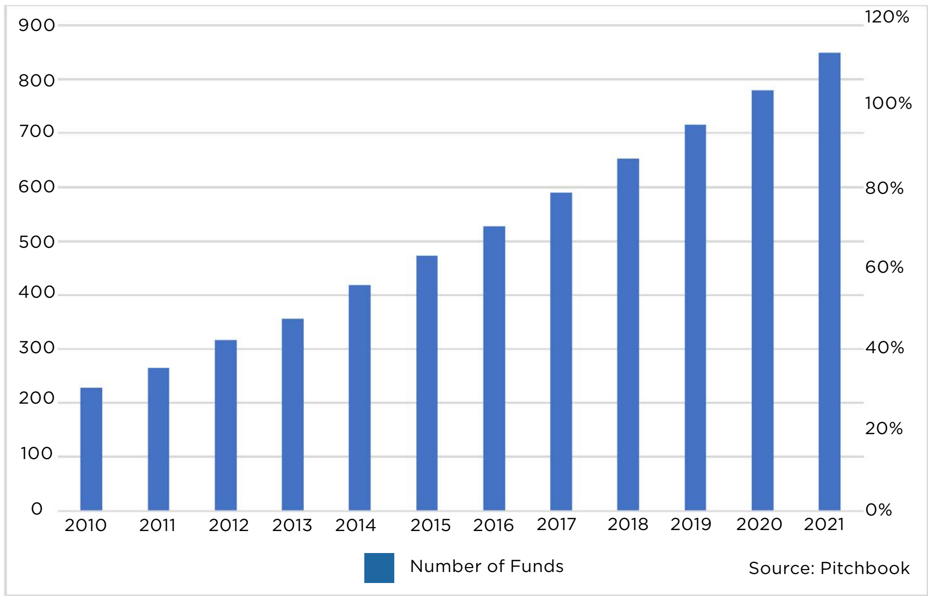
ABSTRACT

Impact—the difference that business makes in making the world a better place—is the buzzword of the day. But what does "impact" mean in practice? The genuine impact should be the positive, intentional, and measurable contribution a business makes to society over and above the generation of profit. Impact underwriting has become a real challenge for businesses and investors alike due to the multiplicity of approaches and measurement issues. In this article, we help your entrepreneurs navigate impact measurement approaches and provide principles and solutions to identify the specific and sometimes unique positive change achieved by a business that we define as signature impact.

INTRODUCTION

Impact investing is gaining ground, attracting more capital than ever. As of the end of 2021, the 848 impact funds globally in operation reported $265 billion of assets under management, with an average annual growth rate of 14% over the past decade (see Figure 1 and 2). Once considered a niche for philanthropic investors and multilateral donors engaged in development cooperation, impact investment is spreading fast in the investment community and is headed to become mainstream for private- and state-sponsored institutional investors alike. Indeed, in the face of a looming recession, geopolitical crises, and increased market volatility, investors are more comfortable considering new investment approaches and new ways to diversify. Furthermore, they had their fingers burned by some blatant greenwashing scandals and are reconsidering environmental, social, and governance (ESG) strategies and embracing impact investment with the intention to genuinely contribute to sustainable development in the years to come (Bortolotti, B. 2022. Mind the (investment) gap: fostering the

FIGURE 1: The Global Impact Funds Industry



transition from ESG to Impact, Localizing Sustainability for Emerging Markets).

The promise of impact investing, making a positive contribution to society over and above financial returns, rests on the measurability of impact. Yet, as impact investing grows, quality data collection on social performance remains the exception rather than the norm. While nearly all impact investors—about 95%—say that they measure and report on impact, current practice is, on the whole, limited to output measures of scale: number of people reached, number of jobs created, etc. While this is disappointing, it is also understandable. The prevailing wisdom within the sector is that collecting data about social performance is burdensome and expensive, and some impact investors and social entrepreneurs would assert that it is a distraction from the "core" work of building a financially sustainable social enterprise. Last but not least, there is no unanimous consensus about how impact should be measured and assessed, so businesses are confused by a variety of approaches and tools and a lack of standardization. Unfortunately, this distraction is a deadly one, as measurement is a quintessential feature of the impact business.

Against this background of complexity, the aim of this article is to provide some guidance to entrepreneurs and investors about the challenges to be faced in impact measurement and how they can be addressed in a pragmatic way.

BACK TO BASICS: WHAT IS IMPACT?

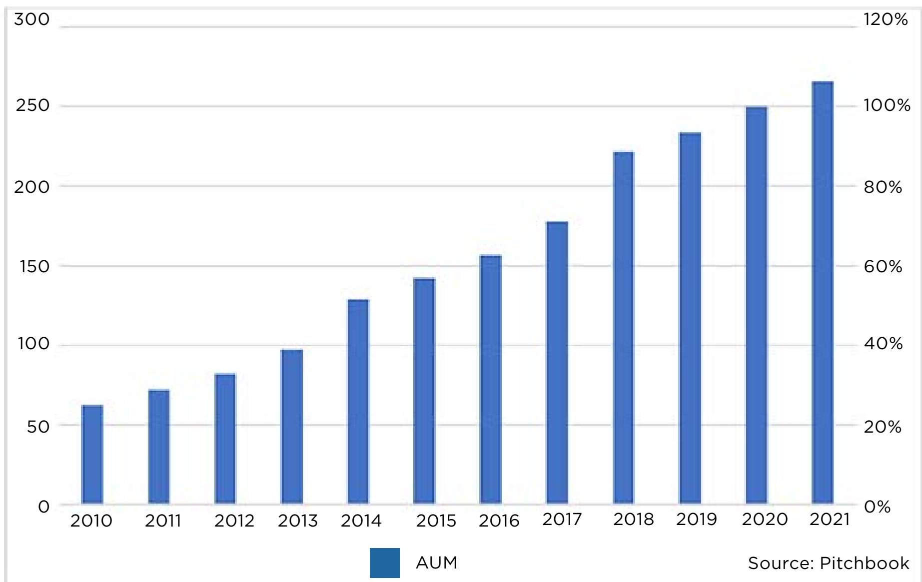
The term "impact" is a tricky one, as it often means different things to different people. But within the impact evaluation profession, to state that an investment has "impact" requires proving that it intentionally produced a measurable, positive change in

the target communities or social systems affected by the intervention. Starting from this agreed-upon definition, a customary methodological framework for impact assessment is the theory of change, namely the identification of the causal linkages according to input, activities, output, outcomes, and, ultimately, impact.

While inputs, activities, and output are straightforward and clearly referred to as the internally planned and executed work of the business, the distinction between outcome and impact is subtler and more intensely debated, especially in project evaluation in development cooperation. Two approaches are becoming standards (Scheck, B. 2021. Impact Assessment in Social Finance, State of Play Report, European Center for Social Science). The Organisation for Economic Co-operation and Development (OECD)'s Development Assistance Committee defines "outcomes as the likely or achieved short-term and medium-term effects of an intervention's outputs" while "impact as the extent to which an intervention has generated or is expected to generate significant positive or negative, intended or unintended, higher-level effects" (OECD-DAC. 2019. Better Criteria for Better Evaluation. Revised Evaluation Criteria Definitions and Principles for Use). The critical distinction is thus in the temporal dimension of the effect of the intervention on the target group, with impact outliving the lifetime of the project.

The second definition has been set forth by the European Commission (European Commission. 2014. Proposed Approaches to Social Impact Measurement in European Commission Legislation and Practice Relating to EuSEFs and the EaSI, GECES Sub-Group on Impact Measurement). Outcomes refer to the effect (change), both long term and short term, achieved for the target population as a result of the activity undertaken, while net impacts

FIGURE 2. Impact Funds Industry Size



are the reflection of social outcomes as measurements on the target group level, both long term and short term, adjusted for the effects achieved by others (alternative attribution), for effects that would have happened anyway (deadweight), for negative consequences (displacement), and for effects declining over time (drop-off).

The European Commission thus sets a higher bar for impact businesses. Applying this definition, aiming for mathematical accuracy, would be a daunting challenge for most industry players, even the most sophisticated ones. We believe, however, that the only way to credibly attribute higher-level, societal effects is to gauge them against a relevant control group. Absent a counterfactual (i.e., what would have happened anyway without the intervention), the genuine impact of an intervention cannot be measured or monitored, let alone convincingly reported.

TESTING ADDITIONALITY

This consideration is closely related to additionality, a concept referring to whether the target outcomes would have occurred anyway. In the impact finance literature, two main channels of additionality are usually identified. Investor-level additionality refers to the provision of capital that was not available before or other nonfinancial benefits (such as capabilities, incentives, technical assistance, connections, etc.) that allow the business to better achieve its social goals.

Enterprise-level additionality, on the other hand, refers to the positive net benefit to society created by the enterprise and can be broken down in two ways. First is product impact, which refers to the impact of the goods or services produced by the enterprise (e.g., providing clean water). The second is operational impact, concerned with the effects of the enterprise's inputs and management practices on the environment and community (e.g., employees, intermediate goods and services, etc.). Given our focus on businesses, in what follows, we will consider only additionality at the enterprise level, leaving the important topic of investor-level contributions to follow.

Businesses of all stripes should familiarize themselves with empirical methods that were originally used in development economics to evaluate the social impact of programs or policies. These analytical tools are often referred to as experimental and quasi-experimental methods of program evaluation, or measurement of impact after the fact. A key component of these methods is a counterfactual analysis: a group given the treatment is compared to a similar group that is isolated from the intervention. This enables the evaluator to answer the cause-and-effect question: "What are the changes in outcome directly attributable to the implemented intervention or program?"

Experimental methods are those that involve a randomized controlled trial (RCT) and use a randomized control group as the counterfactual. Quasi-experimental methods do not involve a random assignment to treatment or control, but usually use another type of counterfactual, such as a historical baseline. While RCTs are considered the gold standard in impact assessment, they are analytically challenging and, in most cases, too expensive to implement, especially for small businesses.

Quasi-experimental methods, however, are less demanding and can be applied with an acceptable level of accuracy at a relatively low cost. Within this set of tools, the so-called "difference-in-differences" approach—popularized in the design of

social impact bonds (SIBs)—sticks out as particularly promising. A comparison is made with a similar population, namely one that is not offered the new intervention but is receiving “treatment as usual”. Both groups receive pre- and post-assessments, and the difference between those assessments is used to determine the impact of the new intervention.

Instead of comparing outcomes between the treatment and comparison groups after the intervention, the difference-in-differences method compares trends between the treatment and comparison groups. The trend for an individual is the difference in outcome for that individual before and after the program. By subtracting the before-outcome situation from the after-outcome situation, we cancel out the effect of all of the characteristics that are unique to that individual and that do not change over time. Importantly, we are canceling out (or controlling for) not only the effect of observed time-invariant characteristics but also the effect of unobserved time-invariant characteristics.

An oft-cited example of this approach is the program at HMP Peterborough, the site of the world’s first SIB, aimed at reducing reoffending rates among short-sentenced prisoners leaving the prison. An independent evaluator developed a control group of prisoners and compared the pre-post change in reconviction rates in Peterborough (the treatment) with the same change in the control group. SIB payments were made if the difference-in-differences change was larger than a given contractually-defined threshold (Disley, E., Giacomantonio, C., etc. The Payment by Results Social Impact Bond Pilot at HMP Peterborough: Final Process Evaluation Report, 2015, https://www.rand.org/pubs/research_reports/RR1212.html).

A caveat is in order. Although difference-in-differences allows us to take care of differences between the treatment and comparison groups that are constant over time, it will not help us eliminate the differences between the treatment and comparison groups that change over time. Put differently, in the absence of the program, the differences in outcomes between the treatment and comparison groups would need to move in tandem. The underlying assumption required for unbiased estimation of impact is that outcomes display equal trends in the absence of treatment, and can be empirically verified with a reasonable approximation by studying the historical (pre-treatment) observations of the outcome for the two groups.

FINDING YOUR IMPACT SIGNATURE

Let us recap our argument so far. As the market rejects greenwashing and demands greater rigor in impact assessment and delivery, entrepreneurs will have the incentive to differentiate their businesses with a solid measurement framework aimed at proving enterprise additionality. With the spread of ESG frameworks, all companies will soon be expected to demonstrate “good hygiene” in metrics such as gender pay equality and board diversity. To differentiate, entrepreneurs will have to demonstrate how they are delivering a unique impact beyond these new benchmarks of good corporate practice. We call this “signature impact”.

I set forth a tentative, four-step preliminary approach to establish the signature impact of a business.

1. Lay out your theory of change: identify the causal chain linking inputs, activities, outputs, and ultimately, impact, the social

goal that the business aims to contribute to.

2. Search your case in the "what works" literature: draw from existing clearinghouses, previous examples, case studies, and experiments to provide supporting evidence for your theory of change.
3. Collect data: derive data collection methods and metrics to quantitatively measure the social goal of your business.
4. Measure your impact: run statistical analyses (possibly using a quasi-experimental approach) using the previously collected data to prove the additional contribution of your business in delivering the stated social goals.

The full-fledged implementation of the recommended procedure could be challenging for small businesses. However, the commitment to genuine impact measurement and management would provide credibility, unlock business, and unlock funding opportunities. While I strongly suggest that companies insource impact management and make it an integral part of their strategy and reporting activities, they could collaborate with external parties, especially research institutions, in fostering the soundness and credibility of their signature impact assessments.

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