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Frameworks used to Measure the Societal Influences & Effectiveness of Impact Investing

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Societal Influences & Effectiveness of Impact Investing

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Abstract

The purpose of this thesis is to learn how capital generates positive returns for society through impact investing. I address the different forms of impact investments along the spectrum and examples of companies that are grouped into each category. Afterwards, I highlight the various pre-existing frameworks being used by the industry to properly measure their social returns and then provide insight into my personal experience working with Citigroup, Inc. Impact Fund. This paper includes an empirical study to address my hypothesis that companies who invest in producing social returns, receive a positive impact on their financials. It was concluded that social returns do not improve a company's financial position.

Keywords: impact investing, investments, investing, verticals, impact funds, financial returns, returns, social returns, Environmental Social Governance (ESG)

Frameworks used to Measure the

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Introduction

Impact investing refers to investments made into organizations, funds, or projects with the intention of generating measurable social impact alongside financial returns. Unlike other investment vehicles among socially responsible investments[1] and environmental, social, governance (ESG)[2] investing that mainly invests in publicly listed companies, impact investing primarily invests in impact-driven, unlisted companies in the form of private equity and/or debt (Brest and Born, 2013; Höchstädter and Scheck, 2015).

This thesis introduces the subject of impact investing and its significance in the financial services industry. Impact investments are important because the generated returns go beyond what is reflected on an entity's financial statements and creates tangible positive impact for underrepresented and underserved communities across the United States.

I will also provide insight into examples of different impact investments and who regulate such transactions. During my research and conversations with professionals involved with impact-first investing, I learned about the many audiences who review the social score reports and how they all may have different objectives, goals, and focuses. This hinders everyone's ability to view one report and each gain something from it. Viewers may include: employees, consumers, business partners, governments and regulatory agencies, civil society organizations, and investors (*Value-of-Social-Reporting.Pdf*, n.d.).

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[1] Socially Responsible Investment (SRI): "Investors use screening and exclusion, divestment, positive reinvestment and shareholder activism to achieve positive social or environmental outcomes. (*The Key Differences between SRI, ESG and Impact Investing*, n.d.)"
[2] Environmental, Social, and Governance (ESG): "ESG refers to a framework or set of criteria used to evaluate a company's environmental, social and governance risks and practices. (*The Key Differences between SRI, ESG and Impact Investing*, n.d.)"

Then, I will end with an empirical analysis on how firms who invest in creating social returns perform financially. Lastly, I will provide the results I received from my analysis and insight into my professional experience working an impact fund.

Overview of Impact Investing

Impact investing is a proactive investment style in enterprises whose mission is to create both social and commercial value, as defined by the coiners of the phrase, The Rockefeller Foundation (Agrawal & Hockerts, 2021). Beginning in the 1950s, the "spectrum of capital" and dynamic between the fiduciary and the philanthropic investors began to change. Investors driven by their fiduciary responsibility on one end of the spectrum invest capital[3] for a maximum financial gain with little regard to the environmental or social consequences of the investments. By contrast, those at the philanthropic end seek to donate capital for a maximum social and/or environmental benefit, with little to no consideration for the financial return.

During the 1970s and 1980s, program-related investment increased. Examples of program-related investment include affordable housing developments and financing, the funding of capital projects, bridge loans, or microfunds that extend credit to women and small businesses in emerging markets (Berliner, n.d.). Since the 2000s, 'impact investing' has emerged. Avid impact investors believe that investing capital in business models that target social and environmental challenges, such as the housing crisis or climate change, can generate market-rate financial returns while also providing measurable impact on the specific weakness of society (Trelstad, 2016). Their investments bring further influence to the power of a dollar.

Impact investing is important because these transactions assist our society in achieving the United Nations' Social Development Goals (SDGs) through financing the growth of social

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[3] Capital: wealth in the form of money or other assets owned by a person or organization or available or contributed for a particular purpose such as starting a company or investing

organizations (International Finance Corporation, 2019). The 17 Social Development Goals were established in 2015 as part of the 2030 Agenda for Sustainable Development adopted by all United Nations Member States. These goals recognize that ending poverty and other weaknesses of our society must positively correlate with the strategies being used to improve health and education, reduce financial and racial inequality, and spur economic growth – all while tackling climate change. In order for member states to achieve the agenda by 2030, $2.5 trillion U.S. Dollars must be directed toward this promising investment vehicle of impact investing (Financing the SDGs_Impact Investing in Action_Final Webfile.Pdf, n.d.). These investments also pump additional capital into the various economies that make up the United Nations Member States.

SDGs are often essential components found in the frameworks of impact funds both domestically and internationally. Examples of SDGs would include: responsible consumption and production, affordable and clean energy, and decent work and economic growth (Financing the SDGs_Impact Investing in Action_Final Webfile.Pdf, n.d.). A pressing challenge that institutions and individual investors face while approaching these goals is the lack of accessibility to capital for organizations based on creating social impact (Arena et al., 2018). The lack of access to the appropriate funding places a constraint on the respective companies' growth and the headway made to fulfill their commitment to society.

Impact investing addresses a breadth of societal challenges that fall within the four main categories of: workforce development, physical and social infrastructure, financial inclusion, and sustainability. For example, Citigroup, Inc. (Citi) is the most global financial institution in the world. In addition to their lines of business in capital markets, investment banking, and private banking and more, they also established an impact fund in 2020 valued at $200mm. The four verticals[4] of an impact fund are prominent in the Citigroup, Inc. Impact Fund and many of their peer's funds.

The first vertical of workforce development provides underserved communities with the resources to continue their education for lifelong development, connect people to meaningful job opportunities and/or entrepreneurial endeavors, promote workforce diversity at all levels, and career pathways for upward economic mobility. An impact fund then chooses to invest in start-ups that support the initiatives found under this vertical. The start-up sells goods or services to their targeted audience in an effort to drive workforce development for underrepresented and underserved communities within the United States.

The next vertical found within Citi's impact fund is physical and social infrastructure. These initiatives help mitigate the effects of the current housing crisis, help reduce traffic and the related pollution, reduce healthcare costs, among many other challenges that press our disadvantaged communities.

The third vertical is financial inclusion. This spans over the pressing demand to democratize access to financial services by correlating costs, and fees, and removing distribution barriers. The start-ups that fall within this vertical of an impact fund also strive to increase an individual's ability to improve their economic capability, enhance financial infrastructures, and develop the array of financial products being made available for low-to-middle income communities.

Lastly is the vertical of sustainability, which is responsible for promoting clean and safe energy sources, the development of products created from recyclable and reused materials, and the promotion of efficiency (*Citi | Communities | Citi Impact Fund*, n.d.).

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[4] Vertical market: "a group of companies focused on a specific niche. Companies in a vertical market provide targeted insight and specialized services" (*Vertical Market*, n.d.).

The impact investing space has exponentially grown over the decades and continues to do so with the support of financial institutions, passionate entrepreneurs, and investors that desire to create change. The Rockefeller Foundation is the true pioneer of the phrase 'impact investing.' In 2007, during a meeting at the Bellagio Center in Italy, business professionals met to discuss the intersection of philanthropy and developmental finance (Bugg-Levine & Emerson, 2011). Since then, impact investing has grown to be valued at $715 billion U.S. Dollars (USD) (*Impact Investments*, n.d.). The impact investing sector is predicted to grow to $500 billion USD by 2023, given how expansive and promising this sector is (*In Search of the Hybrid Ideal (SSIR)*, Summer 2012).

Over ten years ago, the Rockefeller Foundation and J.P. Morgan collaborated with the Global Impact Investing Network (GIIN) to publish a report forecasting that impact investing would reach between $400 billion and $1 trillion in assets under management by 2020 (*Impact Investments*, n.d.). This prediction greatly undermined the power of this emerging asset class and sheds light on how far this space can grow over the current decade. The size of the impact investment space may vary when addressing investments made by privately managed funds in private equity (PE) and impact assets owned by publicly owned financial institutions, like national/regional development banks. But across the broader market, together they make up about two percent of global assets under management (AUM) (Volk, 2021).

Impact investing is a niche market but progressively gathering increased interest. I believe this sector will continue to grow and positively influence the approach taken by investors on their financial decisions, especially when choosing to further prioritize the social, environmental, and financial impact their capital can have on underserved and underrepresented communities. As more public and private investments are made to address society's most pressing challenges, it is my hope that such issues will continue to grow smaller over time.

While the impact investment sector has grown, additional weaknesses have arisen. For example, private investments in start-ups that have surrounded their business model around generating social returns for society carry significant risk (*Impact Investing*, n.d.). It has been proven that 90% of companies that have received a venture capital investment will not make it past their 10-year mark (Dimov & De Clercq, 2006). There also is a lack of deal flow and strategies that fluently fit both the social and financial objectives of a company. Lastly, there is a shortage of professionals with expertise in market segmentation, and proven answers for impact investors to base their decisions around, given how new of an asset class this is.

The largest concern are the challenges that come along with measuring the social returns such impact investments are able to generate. Given how new this asset class is, there is a lack of knowledge that has been studied, proven, and accounted for which could lead to increased risk for the investors and investees (Agrawal & Hockerts, 2021). For example, impact investments can carry significant risk, there is a lack of deal flow of potential candidates for investment that address both the financial and social dimensions, and the small yet growing market segment of interested investors (*Impact Investing*, n.d.). There is not an industry standard on how to best measure the social returns made to the underserved- and underrepresented- communities, especially when considering how ambiguous the results may be across the verticals of impact investments.

Spectrum of Impact Investing

There are five different forms of impact investments that seek differing levels of social and/or environmental impact, and some expectation of a return on the invested capital. The examples I have provided represent both extremes and neutral positions of the spectrum, with Philanthropy and Mainstream Investing on both ends and Impact-First Investing in the middle.

Philanthropy

On the very-left of the spectrum is ‘philanthropy.’ Such groups provide suitable companies with grants in return for social and/or environmental impact with no expectation of receiving a return on their capital (*Impact Investing*, n.d.).

Example of a Philanthropic Investment Fund. An example of the ‘philanthropic’ form of impact investment is the philanthropic Mastercard Impact Fund. Since their founding in 2018, it has been their mission to advance equitable and sustainable economic growth and financial inclusion around the world. To date, the fund has disbursed more than $260mm in grants to 142 organizations in 89 countries that generate “actionable insights, impactful programs, and cross-sector partnerships” among the three areas of financial security, small business growth and improvement, and impact data science. I had the opportunity of gaining direct insight into the Senior Vice President of Social Impact, North America, at Mastercard, Marla Blow. She has experience launching and leading the philanthropic Mastercard Impact Fund through the Mastercard Center for Inclusive Growth. I valued speaking with her because as a former entrepreneur, founder of FS Card and the first African-American woman to raise $40mm in private capital, I resonated with the way she is able to positively influence society through such investments (*About Mastercard Center for Inclusive Growth*, n.d.).

Program-Related Investing (PRI)

Next is ‘Program-Related Investing’ (PRI), which has the main goal of receiving some or all return on their financial investments when striving to achieve a social and/or environmental return. It is common for a PRI to engage in thematic investing, where their investments are in related sectors that provide an explicit social and/or environmental benefit (*Impact Investing*, n.d.).

Impact-First Investing

The most neutral form of impact investment spectrum is 'impact-first-investing.' The impact funds that engage in these transactions are willing to accept a lesser financial outcome by taking greater risks among their portfolio or lower returns from the companies they have invested in -- in order to generate social and/or environmental impact. This form of sustainable investing utilizes a screening process to account for the ESG factors among the start-ups they have invested in, rather than just negative impact avoidance.

Example of Impact-First Investment Fund. Citigroup, Inc began an impact fund valued at $200mm that engages in 'impact first investing.' During this experience, I gained a deeper understanding of the screening- and decision- process that occurs when they are seeking and selecting rising start-ups for investment that make a social and/or environmental impact. When the respective professionals chose companies to invest in, they knowingly did so with the acceptance of a potential lesser financial outcome. Some of their portfolio investments have not met their milestones and some of the portfolio companies have done extremely well since having received their investment. The four verticals of their impact fund are workforce development, physical and social infrastructure, financial inclusion, and sustainability.

My research focuses on traditional 'impact first investments' through an impact fund.

Market-Rate Impact Investing

The fourth form of impact investment along the right side of the spectrum is 'market-rate impact investing.' Although niche among the growing asset class, they seek a full market-rate return, and some measurable social and/or environmental impact. Market-rate impact investing focuses on negative impact avoidance on society, but does not necessarily add to any positive results.

Mainstream Investing

On the most right of the spectrum is 'mainstream investing.' This is one of the most common forms of investing because investors have the expectation of receiving a full market-rate return with no consideration of beneficial social and/or environmental impact (*Fundamentals* | *Net Impact*, n.d.).

Example of Mainstream Investment. On the most right of the spectrum lies 'mainstream investing.' This form of investment reaches the most vast audience. An example would be an investment in the S&P 500 index that tracks diverse sectors and company sizes, domestically, while not taking any intentional consideration for if the indexed companies have an ESG focus.

Figure 1: Impact Investment Spectrum

Philanthropy	Program-Related Investments (PRI)	Impact-First Investments	Market Rate Investments	Mainstream Investments
[Most left]	→	→	→	[Most right]

Impact Fund Investments

In this section, I will address the actionable steps taken to address each vertical's respective challenges. Then, I will provide an example of a private start-up company, in Citi's Impact Fund portfolio, that reflects the respective vertical.

Workforce Development

These investments help to provide such underserved communities with the skills essential to meet the current and future needs of various industries and marketplaces. Investments in this vertical help to fund companies that provide programming, activities, and policies to retain a viable workforce (*What Is Workforce Development?*, 2010).

Examples of steps impact-first funds take to make actionable change through their investments are through network building, promoting diversity in an inclusive workplace, and promoting upward economic mobility through career opportunities. They also strive to foster continuous learning for lifelong career development and to connect professionals to meaningful job opportunities and entrepreneurial support (*Citi* | *Communities* | *Citi Impact Fund*, n.d.)."

An example of a start-up in the workforce development vertical of Citi's Impact Fund is The Mom Project, based in Chicago, Illinois. They are a female-founded and -led job marketplace for women to connect with companies that are committed to providing a better workplace environment for women. They strive to mitigate the gender-wage gap and gender-equality in the workplace through providing job opportunities and community of guidance for those that seek to integrate motherhood and their careers. Their current platform serves over 300,000 women that are actively seeking the resources essential to recruit, retain, and promote women. They also utilize an analytics platform called WerkLabs that evaluates flexible work arrangements and provides resources on best practices and processes for supporting women in the workplace (*Citi* | *Communities* | *Citi Impact Fund*, n.d.). It is their next milestone to connect their talent network of women "with over $1 billion in economic and professional development opportunities(*Citi* | *Communities* | *Citi Impact Fund*, n.d.)."

The Mom Project was one of the first start-up companies to join Citi's Impact Fund portfolio in 2020. As of October 6th, 2021, they have raised $115.6 million over four rounds of private investments from nineteen financial groups and investors that resonate with their mission (*The Mom Project - Funding, Financials, Valuation & Investors*, n.d.).

Physical & Social Infrastructure

This vertical addresses investments in assets that accommodate social services in markets with high barriers to entry, specifically in the housing, transportation, and healthcare industries. For example, housing equitability is a pressing challenge among our society, but with the respective capital, these investments are able to emphasize the equal rights everyone deserves to be judged fairly in the financing decisions related to housing. For example, financial technology lenders typically charge borrowers of color eight basis points higher interest rates than they charge white borrowers, and that is only one stage of the home-ownership process (Bartlett et al., 2017). It is very important that impact investors actively mitigate the risks of housing discrimination because of the disportionate effects it has historically had on underserved and underrepresented communities (*What Is Social Infrastructure?*, n.d.).

Such investments are transformed into actionable steps by helping to resolve the prolonged housing crisis, and to reduce the costs and time needed to build residential spaces. In regards to transportation, impact funds can play an active role in helping to reduce traffic and the associated pollution, as well as, invest in ways to make moving through metropolitan areas more efficient, especially for members of less privileged communities that rely on public modes of transportation. In the healthcare industry, impact investments can be directed towards reducing healthcare costs for vulnerable populations and to improve the quality of healthcare delivery (*Citi | Communities | Citi Impact Fund*, n.d.). These are examples of steps Citi's Impact Fund has taken to address such societal weaknesses among the housing, transportation, and healthcare industries.

In the housing market, an example of a private company invested in my Citi's Impact Fund is PadSplit, based in Atlanta, Georgia. It is their mission to provide affordable housing via a rental model with furnished rooms and all-inclusive utilities through weekly payments for lower income workers (*PadSplit*, n.d.). They are able to deliver such service by monetizing underutilized rooms in single-family homes while providing the property owners with an additional form of income. The weekly payment schedule allows their customers to save more of their income through lessening the burden of rent while providing them with the platform to work toward financial independence (*Citi | Communities | Citi Impact Fund*, n.d.).

PadSplit has raised $35.2 million in private investments from seventeen different parties since they first launched in 2017 (*PadSplit - Crunchbase Company Profile & Funding*, n.d.).

A rising start-up in the transportation industry that has received an investment from Citi's Impact Fund is Lacuna Technologies. They are based in Palo Alto, California. It is their mission to bring greater accessibility to cities and municipalities while streamlining transportation systems across the United States. Lacuna Technologies provides users with an open-source technology that gives cities a full and reliable picture of how their roads and airways are actively changing so that such communities can create and update their policies to address traffic congestion, pollution, and safety issues. This is very important given the various emerging forms of mobility that utilize the same public channels, like rideshare vehicles, delivery services, and drones (*Citi | Communities | Citi Impact Fund*, n.d.).

Lacuna Technologies has raised $16 million among a seed-stage and series A investment round, as of July 7th, 2021 (*Lacuna Technologies - Funding, Financials, Valuation & Investors*, n.d.).

The final industry to comprise the physical and social infrastructure vertical is the healthcare industry. An example of a company in this vertical of Citi's Impact Fund is MedHaul, based in Memphis, Tennessee. This is a Black- and female-founded start-up that "enables access to safe, quality, and inclusive transportation services for often overlooked populations.(*MedHaul | Home*, n.d.)" They provide a streamlined service that helps healthcare workers schedule non-emergency medical transportation (NEMT) for patients that may be of low-income and/or older patients with chronic conditions to help them get to their medical appointments via a cloud-based marketplace. They address a major downfall in the healthcare industry because, "appointments and ambulance abuse costs the healthcare system about $200 billion per year. (*Citi | Communities | Citi Impact Fund*, n.d.)" This ultimately offsets future medical risks and expenses for both the medical offices and their clients.

Financially, they have raised over $1.2 million in private dollars through multiple seed-stage rounds. Five investors have invested their resources and capital into their infrastructure, with Citi Impact Fund being one of the respective parties (*MedHaul - Crunchbase Company Profile & Funding*, n.d.).

Financial Capability

The third vertical of societal challenges is financial capability, which is the combination of education, skills, one's mindset, and the ability to practice self-efficacy that is needed to make smart money management decisions that are most suitable for one's lifestyle. Such decisions are only able to be made as a product of the appropriate financial services offered by one's local financial institutions (*What Is "Financial Capability?*, n.d.).

Perch Credit fulfills these weaknesses of our national financial system by providing unbanked and underbanked young adults with an innovative path to build credit history without having to take on additional debt, through earning positive credit for reporting one's monthly recurring payments, like rent and subscription services, to U.S. credit bureaus (*Citi | Communities | Citi Impact Fund*, n.d.). Perch Credit is actively contributing to a more inclusive and accessible financial system for younger or less educated borrowers that want to build a credit profile to qualify for riskier debt products in the future, like a residential mortgage.

Since December 21st, 2020, they have raised $2.6 million in private investments from seven diverse financial groups. Citi Impact Fund participated in a seed-stage round (*Perch - Crunchbase Company Profile & Funding*, n.d.). Citi has used their investment and mentorship role with Perch to increase access to financial services by decreasing costs and by increasing an individual's financial capability to improve their economic mobility (*Citi | Communities | Citi Impact Fund*, n.d.).

Environmental Sustainability

The steps taken to foster a more sustainable environment are to promote clean and safe energy resources, advance environmental justice, and to develop infrastructures that effectively recycle and reuse products (*Citi | Communities | Citi Impact Fund*, n.d.). Impact-first funds often align their environmental sustainability goals with the United Nation SDGs and the Paris Climate Accord. It is important for investors to avoid the risks of 'greenwashing[5],' because,

[5] Greenwashing:"the process of conveying a false impression or providing misleading information about how a company's products are more environmentally sound ((*Greenwashing*, n.d.)"

unfortunately, it is common for companies to market their products and services in a 'green-light' to appear more appealing and environmentally conscious to investors. The claims of these companies may not always stand true and can lead to serious consequences both financially and ethically, if they do not provide the environmental returns they committed themselves to prior (Netto et al., 2020). An example of a start-up company in the Citi Impact Fund portfolio that addresses this societal challenge is Recycle Track Systems (RTS), founded in New York, New York. According to the RTS mission, they "build partnerships with local, independent haulers and outfit vehicles with proprietary routing technology to streamline the collection routes and to keep in touch individual pickup sites. RTS helps businesses and communities manage waste more responsibly. (*About* | *RTS*, n.d.)" They utilize a software and analytics platform to track waste through the recycling and composting process, then relay such data to their partners (*Citi* | *Communities* | *Citi Impact Fund*, n.d.).

Since they were founded, RTS has raised $51.7 million across nine investors that resonate with their mission to optimize the waste-removal and management process (*Recycle Track Systems - Crunchbase Company Profile & Funding*, n.d.). The Citi Impact Fund began investing in this company during Series C on June 24th, 2021.

Metrics used to Measure Social Returns from Impact Funds

There are rating agencies and frameworks that have arisen from the financial services industry to measure social impact. Their ability to do so is very important because investors want to ensure that the capital they direct toward such entities are generating the social and/or environmental returns they initially committed to. It can be quite challenging because the results can be ambiguous and subjective. For example, it is much simpler to gauge the financial performance of a corporation by assessing their 10-k filing, than to measure how much the gender-wage gap has narrowed as a product of only utilizing 'The Mom Projects' services, per my example on page 15. Additional challenges experienced by individual and institutional impact investors are that they may all have different investment objectives, risk appetites, and visions for where or how they see the rising start-up progressing. The three frameworks I will address are the Institutional Shareholder Services (ISS), Global Impact Investing Network (GIIN): IRIS+, and the Bloomberg Environmental-Social (ES) score. These frameworks strive to standardize how we measure social impact through the creation of formalized reports. The factors that create the frameworks used by companies across the United States consistently align with the United Nations Sustainable Development Goals (SDGs). Then, I provide insight into who sets the industry standard for how to report a social score correctly.

Organizations that curate Social Score Frameworks

Institutional Shareholder Services (ISS). This ISS Environmental & Social (E&S) Disclosure Quality Score conducts research, screening, and analysis on a range of ESG topics with over 200 factors through the use of company disclosures ("E&S Disclosure QualityScore," n.d.)**.** This score allows the studied companies to identify their weaknesses in both environmental and social areas.

The Quality Score's rating scale is from the 1st to 10th decile, with their being an overall score and then one for each pillar or category that they choose to assess (Huber & Comstock, 2017). The social categories considered when measuring a company's social impact are: human rights, labor, health, and safety, stakeholder and society, and product safety, quality and brand ("E&S Disclosure QualityScore," n.d.).

Global Impact Investing Network: IRIS+. This system is an industry staple for optimizing, measuring, and managing impact. Their framework allows investors to understand impact performance under well-defined objectives that are generally-accepted. The breadth of social factors a company can include in their custom framework are: anti-discrimination policy, charitable practices, community services hours contributed, strikes and lockouts, and many more (*IRIS Catalog of Metrics | IRIS+ System*, n.d.)**.**

Bloomberg Environmental-Social Score. In Bloomberg's Terminal data center, they issue a breadth of ESG-based scores for corporations and investors to use when assessing the performance of a company while taking financial status, industry- and business- related factors and their activities into account. My focus has been placed on the ES Score, specially the social aspect. This system is particularly useful because it assists in standardizing how we perceive ESG performance ("Bloomberg Launches Proprietary ESG Scores | Press | Bloomberg LP," n.d.).

The Social (S) score is based on a scale of 0-10, with 10 being the best. They assess over 10,000 publicly-listed companies annually through the Bloomberg Equities and Intelligence Services division. When assessing the factors Bloomberg takes into account when evaluating the companies, they consider company diversity at the senior-level, community relations, human rights, and discrimination**.** These are a few of the 120 factors considered when generating ESG ratings (Huber & Comstock, 2017). In addition, they collect publicly-disclosed information through corporate social responsibility (CSR) reports found in the annual reports or investor relations websites.

Sets the Standards for Social Score Reporting

Global Reporting Initiative (GRI). The GRI Standards help organizations use the best practices for sustainability reporting to provide the highest degree of transparency for all involved parties, like investors, policymakers and regulators. They provide both universal standards and sector-specific reporting standards that provide stakeholders with transparency (*GRI - Standards*, n.d.). Users all follow the general universal standards in their reporting, their respective sector-standards, and then report specific information that pertains to a topic within their sector. For example, an organization in the oil industry generates a high level of environmental impact, so they would follow GRI 11 standards, then further specify with one or more of the 22 material topics for the oil and gas industry that are most relevant to the firm's activities and report in accordance with those standards (*ESG/Sustainability Reporting*, n.d.). Material topics for oil & gas include climate adaptation, resilience, air emissions, etc. Such standards ensure consistency, quality, and completeness among companies' reporting. Their modular system of standards helps organizations gain a better understanding of how their positive or negative contributions have affected their ability to achieve their ESG-related goals (*A-Short-Introduction-to-the-Gri-Standards.Pdf*, n.d.)**.**

International Financial Reporting Standards (IFRS): International Sustainability Standards Board. This organization oversees the International Sustainability Disclosure Standards Board (ISSB) and their framework on how a company should disclose ESG-related factors correctly when creating reports for their shareholders, in order to provide the highest-degree of transparency and to not hinder their ability to create future value. The Sustainability Disclosure Standards represent forward movement in providing investors with comparable and consistent reporting standards. ISSB sets both thematic and industry-based reporting requirements (*IFRS - ISSB: Frequently Asked Questions*, n.d.). This fulfills the growing demand for a more streamlined and standardized disclosure practice because it allows companies to make more accurate investment decisions and to spread comprehensive sustainability information into the financial markets (*IFRS - IFRS Foundation Announces International Sustainability Standards Board, Consolidation with CDSB and VRF, and Publication of Prototype Disclosure Requirements*, n.d.).

Empirical Analysis: Does Social Impact Affect Financial Performance?

In this section I form a hypothesis examining the effects of various social factors, that together create a social score framework, on the performance of publicly-listed companies in the United States. I empirically test my hypothesis with a quantitative evaluation over time and regression analysis.

Social impact positively influences a firm's financial performance because companies that are perceived as being socially-responsible have fewer-negative stock returns in comparison to their peers. In addition, when a company places a larger focus on ESG, it can help management reduce overhead costs and improve the firm's valuation (Serafeim, 2020).

I foresee a positive relationship between social impact and financial performance, because 21 empirical studies were conducted to address the identical research question and it was found that the majority of all 21 studies concluded that firms that are viewed as being socially responsible have either outperformed or performed just as well as firms that are not considered socially responsible (Pava & Krausz, 1996). When a company is intentional about generating a social impact, it causes better financial performance (Pava & Krausz, 1996). A similar empirical study conducted revealed that there is a positive relationship between corporate social responsibility and financial performance (Beurden & Gossling, n.d.)

This data leads me to hypothesize that social impact does improve financial performance.

Data and Methodology

Data

I conduct intensive research and analysis on the influence of social impact on financial performance, specifically firm's total assets, using a linear regression model. I collect financial data on 26,610 publicly-listed companies in the United States and how they scored in the MSCI ESG KLD StatsDatabase among seven social impact categories to ultimately curate a social score for each company within the framework I created.

Then, I sourced publicly-listed companies, and seven social impact factors from MSCI Database. The social impact factors include: Innovative Giving (COM_str_B), Support for Housing (COM_str_C), Support for Education (COM_str_D), Charitable Giving (COM_str_A), Community Engagement (COM_str_H), Ownership Strength (CGOV_str_C), and Women and Minority Contracting (DIV_str_E). I leveraged an academic journal on *Corporate Environmental Responsibility and Firm Risk* to gain a better understanding of the social factors I wanted to consider when measuring the listed companies social impact during the respective period (Cai et al., 2014). I selected the seven respective factors because I believe they are the most common social decisions and initiatives a company can make. It is key for a publicly-listed company to invest in their communities while uplifting the groups within them. For example, community engagement can include non-profit events hosted by a corporation and service hours invested, while women and minority contracting displays the intention behind creating professional opportunities for groups that may be utilized less than their counterparts.

Methodology

Using this data, I create a linear regression model to showcase the relationship between companies' social impact and their financial performance across time. I utilized each company's total assets and net incomes for each year within the given period to calculate Return on Assets (ROA). After selecting the seven social factors, I summed the scores across the seven social impact categories and then divided the total by the seven categories selected to find the average social score variable for each of the companies. If a company scored a one for each of the social factors, like Community Engagement (COM_str_H), then that represents their positive and impactful efforts that have been executed and recorded under this category. If a company scores a zero for any of the social factors, that means they do not generate social returns and create impact in that category.

I regress ROA, as the measure of financial performance and the dependent variable, against my measure of social impact, which is the independent variable. Because the size of the company may impact financial performance, I also control the size using total assets (AT). Additionally, the industry a company belongs to may influence performance. Therefore, I control the industry using the company's two digit SIC code. Specifically, I created industry dummy variables which take on a value of one if the company belongs to a particular industry, and zero if it does not. I estimate the following regression equation: $ROA = \alpha + \beta 1(social) + \beta 2(AT)$.

Results

This section provides an overview of my findings on how social impact influences a firm's financial performance, or more specifically, their total assets in the United States. After controlling the size of the company and its respective industry, social impact is related to lower financial performance. According to Figure 2, a higher social rating is related to a lower ROA. A one unit increase in a company's social impact score is associated with a 0.099 unit decrease in ROA. The t-value for the social score is statistically significant at -2.71, because the value exceeds the normal threshold of being considered statistically significant at a 95% confidence level of +/- 1.96. The size of total assets (AT) is not statistically significant in this model, because the t-value is 0.79. I have established these findings within the bounds of a standard normal distribution. As a firm invests more capital into initiatives that produce social returns, the lower the returns on their assets are, because they are placing more net income they generate into social impact rather than back into their revenue-generating business functions.

Therefore, my hypothesis that social impact improves financial performance has been proven false.

Figure 2: Regression Summary Output

Figure 2 represents an estimate for the equation: $ROA = \alpha + \beta 1(Social) + \beta 2(AT)$. The social variable captures the seven components that create the complete social score when assessing companies ability to produce social returns. The factors used to create the social variable come from the MSCI database. The total assets (AT) variable reflects all assets held by the companies used to run this regression between 2000 and 2018.

Parameter	Estimate	Standard Error	t-value	Pr > I t I
Intercept	0.01328576	0.10938612	0.12	0.9033
social	-0.09903037	0.03649570	-2.71	0.0067
AT	0.00000005	0.00000007	0.79	0.4313
R-Square	Coeff Var	Root MSE	roa Mean	--
0.103028	6963.641	0.914189	0.013128	--

Citi Impact Fund Personal Experience

In this section, I provide insight into my unique experience working with the professionals affiliated with Citigroup, Inc. Impact Fund and the other forms of socially-responsible investment vehicles and institutions, like Minority Depository Institutes (MDI) and Community Development Financial Institutions (CDFI), that generate social impact as well.

Personal Experience working with Citi Impact Fund

As the recipient of the 2020 Friedric I. McGhee Hillcrest Fellowship, I had the opportunity of shadowing the professionals within the Impact Fund at Citigroup, Inc. This $200mm private equity fund invests in society's most pressing challenges by providing capital to women- and minority-owned businesses that provide products or services whose solutions can be categorized into workforce development, physical and social infrastructure, environmental sustainability, and the accessibility of our financial system. Section three of my analysis will provide further details on what each vertical is composed of. The directors of the fund pursue investments as high as $10 million primarily in companies that have demonstrated proof of concept, built an existing customer base, secured prior rounds of funding and exhibited the potential for seed stage investments.

During my time in the ten-week Summer Analyst program, I conducted qualitative-based research on the various processes the Citi Impact Fund leverages when sourcing start-up companies. This was done through hosting weekly interviews with a Director and a Senior Vice President within the group. I also attended a meeting with the collective group where we heard from a prospective start-up owner on why their company would make a good addition to the fund's portfolio and then listened to the fund professionals conduct due diligence. In addition, I was able to meet with a member of the fund in their New York City office. This was an experience that I have always envisioned having for myself because I was able to gain hands-on experience, while observing what makes a successful impact fund, as an aspiring fund manager. This opportunity ultimately influenced my research experience and has exposed me to the breadth of knowledge found in this emerging market.

Minority Depository Institutes

A Minority Depository Institute (MDI) is a financial institution that is federally insured and meets the two requirements of at least 51% of the voting stock being owned by minority individuals[6] and that the board of directors is predominately minorities because the community they serve is also majority minority individuals (*FDIC: Minority Depository Institutions Program*, n.d.).

During my experience serving as a Summer Analyst at Citigroup during the Summer of 2021, I had the opportunity of speaking with professionals at the firm that worked directly with MDIs across the United States. Through those conversations, I was able to learn about the initiative Citigroup launched during 2021 to assist the MDIs during the COVID-19 pandemic by making sure they could withstand the volatility of the financial markets, because MDIs have historically experienced several bank closures during times of economic downturns. Citigroup set up a $50 million loan facility to purchase Paycheck Protection Program (PPP) loans from their partner MDIs balance sheets in order to free up capital for further investments in their communities. This step was crucial to implement because MDIs originate a greater share of residential mortgages for borrowers of color, as well as, small business loans secured by the Small Business Administration (SBA) to entrepreneurs of color (*2019 Minority Depository Institutions*, 2019). During the COVID-19 pandemic, MDIs issued over $10.7 billion in PPP loans to small businesses with a majority of the borrowers residing in predominantly Black neighborhoods (Howell et al., 2020). Therefore, Citi's decision to take $50 million worth of PPP loans from their partner MDIs balance sheets was crucial to supporting an equitable economic recovery and to the closing of the racial-wealth gap (*Minority-Depository-Institutions-Brochure.Pdf*, n.d.).

[6] Minority individuals in the United States identify as Black, Asian, Hispanic/Latinx, and/or Native American

Outside of the PPP loan initiative, Citigroup has made equity investments, created paths to revenue generating opportunities, and has invested in the promotion of growing the MDIs human capital. These initiatives significantly help the respective institutions expand banking and access to credit in Black communities. Examples of MDIs they have and are actively partnered with are: First Independence Bank, Liberty Bank, Industrial Bank, Citizens Trust Bank, and Unity National Bank of Houston. From 2008 to 2020, the number of MDIs in the United States has gone from 215 to 142, with only 14% being Black-owned (*MDI History_FourthQT2020.Xlsx*, n.d.). MDIs play an essential role in extending access to capital for minority communities, because for generations such communities have not had equitable access to the mainstream banking system and therefore, fewer opportunities to build generational wealth, compared to their peers.

Citigroup's engagement with the MDIs is an alternative way for them to achieve their goal of generating a social and financial return for society because they have the resources as a large institution to create a more capitalized impact.

Community Development Financial Institutions

A Community Development Financial Institution (CDFI) is a private financial institution that is fully committed to providing responsible and affordable lending through debt products for low-income, low-wealth, disadvantaged people, underserved and underbanked communities. CDFIs play an important role in allowing communities the opportunity to build generational wealth, through financially supporting small businesses, nonprofit organizations, affordable housing and more. These institutions are not seeking to maximize their profits and always place their communities first (*What Is a CDFI?*, 2013).

During my time at Citigroup, I spoke with a senior member of the Citi Foundation to gain insight into how their organization has supported CDFIs across the United States during the COVID-19 pandemic to further lessen the racial wealth gap. The Citi Foundation deployed $15 million, through a donation from Citigroup, Inc., as part of their $100 million COVID-19-related community relief efforts, especially considering the COVID-19 pandemic has only widened the racial-weath gap ("Wealth Matters," n.d.). For example, it has hindered Black communities ability to retire, increase home ownership, and access quality education ("Wealth Matters," n.d.). Minority communities that are underbanked by mainstream financial institutions have also experienced greater financial hardship when pursuing access to lending, causing them to rely on their savings to pay for their expenses (Bureau, n.d.).

Conclusions

Overall, a firm's ability and choice to produce social returns for society is at the expense of its financial returns. Despite the quantitative study proving my initial hypothesis wrong, it is ultimately up to the respective organizations on how they choose to prioritize serving underserved and underprivileged communities at the expense of their financial performance. The spectrum of impact investments highlights the contrasting objectives of investors and their appetite for financial and/or ESG-related risk. My analysis places a focus on impact-first investing, where these transactions are willing to accept a lesser financial outcome by taking greater risks among their portfolio of companies they have invested in, in order to generate social and/or environmental impact. My personal experience shadowing professionals affiliated with an impact-first fund exposed me to the decision process of selecting portfolio companies that fit their investment objectives and the ways impact investing can improve moving forward. The breadth of organizations that have arisen with the popularity of impact investing all seek to provide companies with ways to effectively measure and report social impact. Therefore, impact investments can create positive returns for society, if one is willing to accept the additional risks of not receiving market-rate returns.

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