Making the Case for Social Metrics and Impact Investing

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In volume 5, issue 2 of this journal, my colleagues Antony Bugg-Levine and John Goldstein describe the emergence of an industry the Rockefeller Foundation refers to as impact investing. Broadly defined, impact investing is that which helps solve social or environmental problems while generating financial returns. Impact investing encompasses a broad range of sectors and geographies, but U.S. community development finance is widely recognized as one of its most mature and vibrant areas of activity.

Bugg-Levine and Goldstein provide a compelling description of the investor interest and innovation that is emerging, but they also caution that the "ability of this new industry to deliver on its potential is not inevitable." They describe some of the public goods, private services, and collective action that must take place if this new industry is to realize that potential. They make the case that credible standards and tools for measuring social impact are vital for the industry's success.

As the designated "metrics person" on the Rockefeller Foundation's Impact Investing team, I am often asked to elaborate on this high-level claim about the importance of social metrics by providing a more detailed description of what is needed, and of the initiatives (including IRIS and GIIRS) that are taking place to meet those needs. For those who have an appetite for detailed conversations about metrics, an interesting dialogue generally ensues. For the majority, however, theirs is a limited attention span for topics such as the IFRS-like taxonomy needed to standardize impact-related terms, or the trade-offs implicit in developing the weights for a fund-level impact rating methodology. People, I find, believe that nonfinancial performance measurement is essential in principle, but they are eager to defer further conversation to the social metrics person at their institution.

Measuring social and environment impact is extremely complicated and is appropriately considered the purview of experts. However, metrics experts must engage, and receive support from, the broader industry community, given that:

- the success of impact investing may well hinge on our ability to meaningfully and credibly capture, track, report, and measure social and environmental impact; and
- establishing common reporting and performance standards requires wide-scale adoption.

Democratizing the arena of social metrics makes it incumbent upon those of us who do focus on it to find simpler, more accessible ways to describe some of its nuances. However, we also need to to convince industry participants of what is at stake and that they should engage in some of the details. Lisa Hagerman and Janneke Ratcliffe, also in volume 5, issue

2 of this journal, make a compelling argument for measuring social impact. Doing so, they argue, can help reveal the positive correlation between impact (or proxies for impact) and financial return. For some investors–particularly institutional investors such as pension funds–this may always be the most compelling rationale. However, this argument is not the only one, and it precludes investments that do not provide a market rate of financial return. I believe we can and should make a broader case.

Making that case can be challenging. Social scientists, for example, often express concern that standardized measurement tools risk omitting, or even worse, misrepresenting, important dimensions of social change. Some bristle at the misappropriation of the term "impact," which they argue requires detailed (and usually expensive!) information on outcomes and attribution. Nonprofit organizations or community groups may worry that an overreliance on quantitative measures will cannibalize interest and funding for activities that result in more qualitative outcomes. These concerns are valid, and should be considered when developing standards and tools. However, they are better addressed in a future publication given that they cannot be done justice here.

Struggling to keep the attention of a lay investor audience and often subject to suspicion from academics, impact investing metrics enthusiasts sometimes find it challenging to engage the breadth of people that must be invested in their success. It is imperative to find simpler, more accessible ways to describe some of the nuances of impact metrics. One option I have often found helpful is to describe a few "doomsday" scenarios in which appropriate and widespread standards for measuring impact do not materialize. These doomsday scenarios include:

Impact investing enables green-washing. In the absence of meaningful social and environmental performance standards, impact investing becomes too easy. Capital flows to companies and funds that produce annual reports or investment prospectuses with the most compelling photographs on their covers, rewarding (and creating incentives for) competencies in public relations rather than activities with real impact.

Apples cannot be distinguished from oranges. Standard definitions for impact-related terms do not take root across the industry, and individual companies and funds must use their own definitions and terms for reporting on impact. Investors cannot meaningfully compare one company or fund's performance against another. Industry benchmarks cannot develop, which deprive companies and funds of a meaningful management tool and deprive investors of critical information on which to base investments. Companies and funds that produce truly impactful activities and outputs are unable to distinguish themselves.

Impact investors must staff PhDs in program evaluation. If industry participants set a high bar for the integrity and accountability of their nonfinancial impact (as we hope they will) but third-party standards and tools do not develop, each will be required to internalize expensive measurement and evaluation functions for which they are generally not well suited. This will drive up costs for the few that choose to do it, and is likely to prove prohibitively expensive for the majority. In addition, bespoke measurement systems will lack comparability, as described above.

The right matchmaking does not take place. Impact investors are diverse in many ways, including in the relative priority they place on generating social or environmental value versus financial return. Those investors who are or may be "impact-first" (such as foundations making program-related investments, family offices, private clients, or even retail investors) may be willing to accept a lower rate of financial return if they have reasonable confidence in the investment's greater social or environmental impact. Other investors may necessarily prioritize risk-adjusted financial return and be content with moderate impact. Absent credible information to differentiate degrees (or even orders of magnitude) of impact, it is impossible to situate potential investment opportunities along any kind of continuum. Impact-first investors are unable to optimize their social impact, and "finance first" investors may find the market distorted by competition from concessionary capital.

Policymakers cannot serve as allies. An enabling policy environment for impact investing (through mechanisms such as preferential tax treatment, government guarantees, expanded or revised regulations) cannot develop because policymakers lack the ability to distinguish this category of investment from other investment activity. Sector-specific regulations such as the Community Reinvestment Act may continue to develop in silos but their reach and application will be limited.

Although it is easy to identify the shortcomings of any particular set of tools and standards, I think most of us would agree that not developing them presents a greater threat to the industry's success.

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