INSTITUT DE LA FINANCE DURABLE
PARIS EUROPLACE

TASKFORCE ON IMPACT FINANCE

HOW CAN AN INVESTMENT FUND **MEASURE ITS IMPACT?**

SITUATION ANALYSIS AND RECOMMENDATIONS

January 2024

PRESENTATION

This document summarises the work completed by the working group on impact measurement.

This group, which was dedicated to measuring impact and its operationalisation, brought together companies, asset management firms, institutional investors, academics, consultants and representatives of civil society (a total of 140 registered participants). It was structured in an open manner, including for non-members of the Institut de la Finance Durable (Paris Sustainable Finance Institute) (*Institut de la Finance Durable* – IFD), thanks to the support of the **social solidarity economy and impact investment unit of the General Directorate of the French Treasury.**

The need to separate the two levels of impact measurement, i.e. company/underlying impact measurement and investment fund impact measurement, emerged from the initial preparation. During the first session, the working group's members divided themselves in equal proportions between these two subjects according to their perception (what most required input from the working group) and according to their skills and interests.

After preliminary work at the end of 2022, the working group, divided into two sub-groups, met six times during the first half of 2023 with the aim of presenting the content of the work during the plenary session of the Taskforce on Impact Finance on 29 June 2023.

This report summarises the work of the sub-group dedicated solely to measuring impact at the investment fund level. At the same time, another sub-working group focused on measuring impact at the underlying level.

Three operational leads were involved to coordinate this sub-group's work and the production of the report:

— **Mickaël Mangot** (2 Degrees Investing Initiative): main contributor to this report
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INTRODUCTION

Measuring the impact of investment funds is a key topic in impact finance in several respects.

— **Firstly, measurement is one of the generally recognised pillars of impact finance, in the same way as intentionality and additionality.** The definition adopted by the Taskforce on Impact Finance of Finance for Tomorrow[1] (which has since become the Institut de la Finance Durable (Paris Sustainable Finance Institute)) in 2021 enshrines these three principles. In fact, impact-driven funds[2] must measure (or, more broadly, evaluate) their real effects on the environment or society.

However, a fund's impact is not automatically deduced (by proportional attribution) from the impact of the underlying companies.

To be able to move from one to the other, the use of robust methods – whether quantitative or qualitative – is necessary.

— **Secondly, measuring a fund's impact can be a powerful tool in combating "impact washing"**, i.e. any misleading or excessive communication on the impact generated by investments through "impact-driven" funds. The observation of tangible outcomes (or a lack of outcomes) calls for consistency and proportionality in the communications by impact-driven funds. This forms part of a transparency approach[3].

— **Thirdly, monitoring a fund's impact makes it possible to ensure that the fund's impact strategy is effective,** thereby limiting the risk for its investors of not ultimately having an impact and, if not, redirecting the fund's strategy.

— **Fourthly, implementing methods for evaluating a fund's impact today also means anticipating possible future regulations[4]** or the rules set out by a possible Impact Label at the French or European level. In this respect, the Impact Potential Evaluation Grid[5] developed by the IFD's Taskforce on Impact Finance dedicates an entire section to outcomes in the sustainable transformation of funds (which evaluates both the evaluation procedures put in place and the outcomes obtained)[6], which represents a substantial portion of the total score (30%).

In addition to these practical aims for funds, the work presented in this document also aims to provide food for thoughts for the financial ecosystem, and in particular regulators and certifiers, on legitimate expectations in terms of impact evaluation or measurement for impact-driven funds.

1 Available here. https://institutdelafinancedurable.com/actualites/publications-groupe-de-place-impact/
2 and other financial or banking products that fall outside the scope of this working group
3 This transparency approach aims to prevent funds' confidentiality policies about their proprietary methods from concealing the absence of a truly formalised approach
4 See, for example, the UK regulator's proposals: FCA (2022), Sustainability Disclosure Requirements (SDR) and investment labels, Consultation Paper.
5 Available here. https://institutdelafinancedurable.com/actualites/publications-groupe-de-place-impact/
6 This represents 30% of the total score.

The scope of the working group, and therefore of this report, includes the various methods for attributing non-financial results of underlyings to funds (**attribution**), whether quantitative or not. In doing so, it addresses impact evaluation in general. It excludes methods for justifying additional actions by investors (**contribution**), a subject of equal importance that we believe should be the subject of a specific working group[7]. These two aspects are different but complementary within the body of evidence needed to best support the impact of a fund.

This report specifically addresses the impact of investment funds and not the impact of investors in the funds. It should be noted that, in impact evaluations, the transition from one to the other is not automatic, nor is the transition from the impact of the underlyings to that of the funds. Indeed, a fund can have a positive impact without the investor buying a share in this fund having a positive impact itself. As with any impact evaluation, additionality must be evaluated. However, in some cases, purchasing a unit of a fund does not proportionally increase the fund's capacity to generate impact, for example in the case of closed-end funds, where the unit purchases take place on a secondary market and do not result in an additional capital injection for the fund.

7 And which, at the date of publication of this report, was the subject of extensive consultations with the members of Impact Frontiers, notably around the document "Definitions & strategies around the investor's contribution", which identifies investor actions likely to produce a positive change that would not have occurred without the investor, going beyond mere intentionality. The investment's contribution is classified into four categories: capital allocation, non-financial commitment, investment structures and the internal practices of the financial institution.

1. OBSTACLES AND ACCELERATORS TO MEASURING THE IMPACT OF FUNDS

The working group has identified what its members believe is currently slowing or accelerating the adoption of best practices in measuring the impact of funds.

A. THE VARIOUS OBSTACLES

→ **Widespread confusion** among investors between the impact of funds and the impact of underlyings,

→ **Accessing the impact data of investee companies is challenging,**

→ **Accessing the impact data of comparables** or benchmarks (to qualify additionality in the outcomes obtained) **is challenging**,

→ The singularity of the impact and the **difficulty of aggregating** at the portfolio level:

- *Impact metrics specific to each activity and sector,*
- *Lack of consistency in metrics and calculation methods between companies within the same sector,*
- *The qualitative aspect of certain themes (for example, well-being at work) and the fact that their additionality is difficult to demonstrate.*

→ **The absence of evaluation methods that are recognised** and standardised,

→ **The absence of clarifications or regulatory obligations** specific to impact-driven funds,

→ **The low proportion of assets among investors (particularly institutional investors) dedicated to impact-driven funds** and, sometimes, the lack of a request made by these investors to impact funds to measure their impact,

→ **Any cost** (financial and human) associated with the implementation of measurement procedures,

→ **Lack of skills on the market** regarding techniques not yet applied in the financial sector (with the exception of a few segments, such as impact contracts),

→ **The *de facto* priority placed by management companies on other issues,** notably the very demanding requirements of compliance with new regulations,

→ And lastly, the widely shared perception (which the working group's members called to "demystify") within management companies around the measurement of a fund's impact, which would in principle be considered "very cumbersome", "impossible" (in practice) or "impossible" (by nature).

B. THE CURRENT ACCELERATORS

→ **Regulation** that gradually improves and harmonises companies' ESG data reporting obligations (NFDR, CSRD, taxonomy, French Climate and Resilience Act) and should thereby facilitate the availability and standardisation of raw data for investment funds,

→ **Some companies' desire to be supported by investors** to improve their strategy and impact reporting, which again facilitates the availability of data,

→ The adoption of **remuneration mechanisms for executives** of companies that private equity funds invest in based on impact metrics (which nevertheless are still mainly adopted by the underlying companies),

→ **The increase in the expectations of certain institutional clients** (asset owners) regarding the measurement of funds' impact,

→ The development of **partnerships between academics and management companies** and of training offers that help fuel discussions on these subjects and improve available skills.

There is an asymmetry between obstacles and accelerators, the former being consequently larger than the latter, which explains a certain inertia in the sector around this issue.

We feel that the accelerators mentioned are secondary and not very decisive. A more significant catalyst would, in our view, be the existence of a label involving requirements for measuring the impact of investment funds and, secondly, once best practices have been established, consideration could also be given to translating these advances into regulations.

2. METHODOLOGICAL DIFFICULTIES IN MEASURING THE IMPACT OF FUNDS

A. THE FUNDAMENTAL PROBLEM

In its strictest definition, impact is an induced change compared to a counterfactual scenario. To say that a fund (or a community of investors) has had an impact through an investment implies i) that an observed change was caused by the actions of the fund (or of the community of investors) and ii) that the change is indeed additional compared to the alternative situation in which the actions of the fund (or of the community of investors) would not have occurred.

In doing so, **a fund's impact is not automatically deduced, by proportional attribution, from the impact of the underlying companies.** Holding X% of a company (in the form of debt or shares) does not enable a fund to attribute X% of its impact (positive or negative), for several reasons. A company's impact is not necessarily proportional to its capital. Even if this were the case, investments, when made via secondary markets, do not increase the capital available to companies. There is therefore no shortcut to easily bypass a counterfactual analysis when evaluating a fund's impact.

Unfortunately, impact evaluations suffer from a fundamental problem: the counterfactual necessary to evaluate additionality cannot be observed (for the same action at the same time), as there is no parallel world in which the action analysed would not be implemented. The effect cannot be observed simultaneously in two different states (with and without the action). Consequently, instead of using a true counterfactual, **we must resort to an approximation using the most suitable comparable possible.**

The counterfactual problem would disappear if it would be possible to find a "perfect clone" for each of the investments made. Unfortunately, these perfect clones do not exist[8] and the **"for lack of anything better" approximations** proposed by the various existing quantitative methods are imperfect. In doing so, they introduce **methodological biases** that prevent the fund's additionality in the outcomes obtained from being established with absolute certainty.

Example: evaluating a fund's impact by comparing changes in the underlyings' non-financial performance with those of comparable companies runs the risk of the difference being mainly due to factors specific to the underlyings that already existed before the investment (e.g. if the company's management was particularly involved in an ESG issue and the fund's action did not increase this involvement).

8 Furthermore, if they existed, differentiated treatment could in some cases pose ethical problems.

Example: deducing from the observation of an acceleration in the improvement in the underlying's non-financial performance that a fund has had an impact may be incorrect if an external factor resulted in this improvement for the underlying and for other companies (e.g. a change in regulations or a media campaign by NGOs targeting an entire sector).

B. METHODOLOGICAL BIASES

This section includes some methodological biases (confounding factors) that are common in quantitative impact evaluations:

Selection bias

A particular type of bias occurs when the treated "units" (the underlying assets that the fund invests in) are in fact different and incomparable compared to the untreated units that serve as a comparison group. This incomparability may be caused by observed or unobserved differences in characteristics that affect selection and observed outcome. Two types of selection bias are particularly common. **Self-selection bias** occurs when, for example, underlyings with intrinsic characteristics making them more likely to obtain better non-financial performances are also more likely to enter the fund's portfolio.

Example: a self-selection bias may occur when entrepreneurs concerned by environmental themes approach private equity funds with an environmental impact for their capital increases. In doing so, the improved environmental performance of these companies post-investment cannot be fully attributed to the fund's actions.

Investment bias

Investment bias occurs when the fund expressly chooses underlyings for characteristics that make them more likely to show good non-financial performances in the future.

Example: an investment bias occurs when a fund selects underlyings based on their executives' awareness about sustainability issues. In doing so, the good non-financial performance relative to competitors during the investment period cannot be attributed exclusively to the fund's actions.

Secular trend

Another potential source of misinterpretation occurs when external factors gradually improve the impact indicators of all companies. In this case, the comparison of the post-investment and pre-investment indicators necessarily results in an upward biased estimate of the fund's impact.

Example: a gradual increase in awareness of the climate issue among company executives (due to a constant change in collective values, media pressure or regulation) leads to an upward biased estimate of the impact of funds investing in these companies if the impact is evaluated through a comparison over time of climate indicators at the level of the underlyings.

Maturation

The impact evaluation must also take into account the fact that companies' natural processes of maturation and development can produce significant changes independently of investors' actions. In doing so, observing an improvement in the underlyings' non-financial performance over time cannot provide irrefutable proof of a fund's impact, particularly in the case of small, fast-growing companies.

Example: it is well known that ESG ratings are positively correlated with the size of companies (due in particular to the mobilisation of greater resources to complete rating agencies' ESG questionnaires). Consequently, the improvement in a growing company's ratings cannot be fully attributed to the management company.

Interfering events

Short-term events may also produce changes that may introduce a bias in impact evaluations. These interfering events can be macro events (such as a change in regulation) that affect all similar companies or micro events that concern just one or a few of them (such as a change in management or the action of another fund invested in the company).

Example: while a conventional fund (without an active engagement policy) invests in a company, the company is also heavily engaged by an impact-driven fund. In such a case, based solely on the observation of an improvement in the company's non-financial performance, the conventional fund could be wrongly credited with the impact generated by the impact-driven fund's actions.

Spillover effects

Spillover effects occur when the members of the comparison group are indirectly affected by the fund's interventions on portfolio companies. There may be positive spillovers (through imitation or emulation) or, conversely, negative spillovers (substitution) that, respectively, create a downward or upward bias in impact evaluations when comparing the underlyings' non-financial results with their peers' results.

Example: an increase in the employment of workers with a disability in a company as a result of a fund's actions may lead to positive news in the local press for the company and in turn generate a change in competing companies' behaviour. In such a case, the fund's estimated impact would be biased downwards.

Example: the same increase in the employment of workers with a disability in a company as a result of a fund's actions may conversely reduce the recruitment of workers with a disability among competing companies (e.g. if the number of workers with a disability is limited in the employment pool). The fund's estimated impact would then be biased upwards (since the hiring figures among competitors are themselves biased downwards).

Depending on the sophistication of the quantitative methods used to evaluate the impact, these different methodological biases are controlled to varying degrees.

3. PRESENTATION OF THE DIFFERENT POSSIBLE METHODS

In this section we present the main methods available for conducting an impact evaluation.

These have been extensively documented in sectors other than finance, first and foremost public policy and philanthropy, which for several decades have been striving to evaluate the effectiveness of specific programmes (development aid, poverty reduction, employment or innovation stimulation, etc.). In this respect, these sectors can act as scouts for finance, which could, with some adjustments, be inspired by the methods developed.

Driven in particular by these sectors' efforts, evaluation is now a fully-fledged academic discipline, supported by numerous scholarly societies[9], dedicated academic publications[10] and manuals for practitioners[11], and impact evaluation is one of its preferred areas of analysis.

A. QUANTITATIVE METHODS

Quantitative methods seek to numerically evaluate a fund's impact. A distinction is made between "basic" quantitative methods that make simple comparisons without seeking to carefully reconstruct a counterfactual scenario, as opposed to counterfactual methods that use sophisticated econometric procedures to reconstruct the counterfactual scenario.

While **no impact evaluation method can claim to protect against all possible methodological biases,** counterfactual methods are constructed in such a way as to control much more potential biases than basic methods.

I. "BASIC" QUANTITATIVE METHODS

SECTOR COMPARISON

This method involves comparing the non-financial results of the underlyings in the portfolio with peers selected based on apparent characteristics (size, sector, geographical presence, etc.). This selection, which is both discretionary (the fund chooses both the underlyings it invests in and those that make up the control group) and superficial (as it does not seek to include characteristics that are not directly observable), introduces the possibility of numerous biases. For example, because participation in the treated group (the underlyings in the portfolio) or the comparable group is not randomised, selection biases (self-selection or placement) may disrupt the evaluation.

9 European Evaluation Society, UK Evaluation Society, American Evaluation Association, French Evaluation Society, etc.
10 American Journal of Evaluation, Evaluation, Evaluation Review, New Directions for Evaluation, etc.
11 World Bank (2016), Impact Evaluation in Practice, Second Edition.

TREND COMPARISON

Another simple method is to compare the underlyings in the portfolio before and after the investment. A before-after comparison seeks to establish the impact of an action (an investment) by tracking changes in outcomes for the beneficiaries (the underlyings) over time. Essentially, this comparison assumes that if the fund's action had not taken place, the underlying's sustainability performance at the end of the investment would have been exactly the same as before the action, which is a very bold assumption. A more rigorous version (called interrupted time series evaluation) requires several data points on the underlyings before and after the investment, in order to detect a possible change in trend once the investment is in place. It will be concluded that the fund has had a positive impact if the investment period coincides with an improvement compared to the past trend. In either case, the observation of an increase (or an acceleration in trend) may nevertheless be due to external factors such as interfering events or a maturation effect (e.g. consideration of ESG issues once a critical mass has been exceeded by the companies).

We note that it is becoming a relatively common practice for impact-driven funds to present longitudinal changes in the impact KPIs of their underlyings in their annual impact reports. A good practice would be to present these changes from a basis of comparison, as well as providing a detailed link between their actions as a fund and the outcomes observed.

We consider this basic approach to be an interesting start to impact evaluation. However, when used in isolation, according to the working group, it is insufficient for quantifying the fund's impact or demonstrating the fund's additional contribution.

COMPARISON WITH AN OBJECTIVE

This approach is not strictly speaking an impact evaluation method, as it does not seek to identify a point of comparison that would serve as a counterfactual scenario (even a rudimentary one). **Instead, the non-financial results observed at the level of the underlyings are compared with objectives set by the fund ex ante.** This method is more intended to provide a course for the fund manager, who (when the objective is sufficiently ambitious) is expected to motivate the implementation of actions with potential impact. In the absence of comparables in time or space, this method does not in itself support the fund's additionality in the outcomes obtained. However, when combined with other methods, it can contribute to a compelling body of evidence of the fund's impact. Furthermore, for the incentive and transparency they offer, setting, monitoring and reporting non-financial objectives at the level of underlyings is a practice considered necessary for impact-driven funds.[12]

While imperfect, the three methods presented in this section are the first step in evaluating a fund's impact with a view to moving towards more robust approaches. They constitute **an initial methodological horizon that in principle can be reached, as of today, for impact-driven funds.**

12 See the definition of impact finance, available here

Focus: the COMPASS methodology of the Global Impact Investing Network (GIIN) to compare and evaluate investors' impact

Published in May 2021, the investor guide on this methodology proposes a quantitative approach enabling investors to maximise their impact in the investment process.

The aim is to enable market participants to compare the social and environmental impact of investments that can "reasonably" be attributed to them, without losing sight of the primary role that the underlyings play in this impact.

More than an external communication tool, these indicators aim to be used internally in investment decisions, in comparison with past indicators, market benchmarks, peers or by comparing them with the scale of the change required to meet sustainable development challenges.

Three standardised indicators are proposed per impact theme:

→ **Scale:** impact by absolute value on each of the impact themes (e.g. number of customers receiving inclusive financial services, hectares of sustainably cultivated land), which may be the subject of a target being set regarding the underlying over the investment period;

→ **Pace:** average annual growth rate of this impact, comparable to the market's average growth rate but also to the growth rate required to achieve the sustainable development goals (e.g. 12% average annual growth in individuals with access to drinking water);

→ **Efficiency:** impact per amount invested to qualify the impact created according to the stage of development of the underlying companies, asset classes, countries or other factors (e.g. 610 additional individuals with access to drinking water on average each year per USD 100,000 invested).

A collaborative database is being developed by GIIN, encouraging voluntary data sharing among its members. The first impact themes for which data are available are access to finance and agriculture. Work is under way on the energy theme.[13]

13 For more information, visit thegiin.org/research/publication/compass-the-methodology-for-comparing-and-assessing-impact/

II. "COUNTERFACTUAL" QUANTITATIVE METHODS

Counterfactual quantitative methods are experimental (i.e. recreating in real life the conditions of a laboratory experiment) or quasi-experimental econometric approaches used to accurately evaluate what the outcomes would have been without a given action. The aim is therefore to create a counterfactual with great rigour, i.e. a "b", scenario in which the evaluated action has not been carried out.

The aim of these methods is each time to be sure of the observed effects' statistical significance. In practice, **they all require very large samples** (several hundred underlyings in the portfolio and the control portfolio), which is a prerequisite for reducing to an acceptable level the risk of false positives (wrongly concluding that the fund had an impact) and false negatives (wrongly concluding that the fund had no impact).

RANDOMISED CONTROLLED TRIALS

This experimental method, popularised among the public by the work of Esther Duflo, involves randomly selecting treatment and control groups and isolating them from other interventions that may affect the observed outcomes. When randomisation is implemented on a sufficiently large sample, the only difference on average between the treatment and control groups is that the latter did not receive the intervention. The observed and unobserved characteristics in both groups are supposed to be similar and differences in outcomes observed between the two groups can be attributed solely to the treatment. This experimental approach is often presented as the gold standard in evaluation, as it alone could ensure the absence of selection bias and demonstrate a causal relationship between the intervention and the observed outcomes. The downside is that it is very cumbersome to implement and involves methodological precautions (randomisation) that are largely incompatible with the practice of investment funds (which, of course, do not randomly select their holdings!).
The following two methods are called quasi-experimental because they overcome the randomisation constraint, while allowing for a precise selection of the control group.

MATCHING

Matching compares the outcomes of the treated group (the underlyings in the portfolio) with those of comparables, selected for each unit, based on observed characteristics. The main idea is to choose, for each unit (underlying), a statistical twin from the sample of possible comparables. They must be identical in all relevant (observable) characteristics. This is a very high requirement and requires excellent descriptive data. Therefore, if the number of relevant characteristics is high, it may be very difficult to find an exact match and it follows that not all treated units (underlyings in the portfolio) can be matched with an untreated unit (a comparable underlying). One solution for overcoming this difficulty is to use a variant of the method called "propensity score matching", which aggregates and summarises all the information on the observed characteristics in an index and selects for each treated unit the closest comparable according to that index. In all cases, if there are unobservable differences in the characteristics of the treated and untreated units (the underlyings in the portfolio and their assigned twins) that affect the observed outcomes, the evaluation will remain biased.

THE DIFFERENCE IN DIFFERENCES METHOD

This method should be understood as the cross-referencing of two "basic" quantitative methods presented previously: sector comparison and trend comparison. This cross-referencing ensures greater robustness of the outcomes obtained by eliminating some of the methodological biases associated with each of the two basic methods. The difference in differences method uses the data on (non-financial) results collected before and after the investment for the treatment group (the underlyings in the portfolio) and control group (the comparable portfolio). The method requires the creation of a control group which, overall, has in the past displayed **a temporal trend parallel** to that of the securities in the portfolio (e.g. a 5% reduction per year in carbon intensity over the five years preceding the investment) even though, in terms of level, both groups may find themselves in different situations at the time of the investment (e.g. the securities in the portfolio showing a carbon intensity 30% lower than the control portfolio). The aim of a temporal parallel trend criterion is to ensure that both groups have similar observable and unobservable characteristics. The central idea of this method is to look at whether there has been a trend reversal for the securities in the portfolio that would not be found in the control portfolio. A major practical limitation of this method is that it requires data for the treatment and control groups over several periods before and after the investment.

B. QUALITATIVE METHODS

Qualitative analyses provide expansive and valuable information that is not available with quantitative methods. These methods enable stakeholders (e.g. the executives of investee companies) to express their views on an observed outcome. Qualitative methods also help to identify and understand the multiple factors that can influence the success of an impact approach. Above all, qualitative methods can help to interpret quantitative outcomes by explaining the mechanisms (involving internal and external factors) that led to the observed outcomes, and in this way help to qualify the possible causality and additionality of the impact actions deployed.

While quantitative methods provide an estimate of "how much", qualitative methods provide valuable detail on "how". These differences make the two types of approach – quantitative and qualitative – extremely complementary.

I. "BASIC" QUALITATIVE METHODS

SURVEYS

The aim here is, for example, to use a questionnaire to survey the beneficiaries of the evaluated action (e.g. the executives of the investee companies) on their evaluation of the action deployed (the fund's intervention) and its effects. Other stakeholders (other investors, experts, etc.) may also be called upon. The questions then revolve around the causality of the fund's actions and their additionality.

INTERVIEWS

Compared to surveys, interviews require personal interviews with stakeholders that allow for a more interactive discussion and in-depth analysis of the responses provided.

Like quantitative methods, qualitative methods can involve methodological biases when processes are not carefully defined. These biases may interfere with the selection of participants (selection bias), the behaviour of the interviewer (bias in positioning questions, formulation of questions and answers, confirmation in the interpretation of answers, etc.) or the behaviour of respondents (acquiescence bias, social desirability, etc.).

Another important limitation is the difficulty of questioning additionality using qualitative tools. In the absence of an obvious counterfactual scenario, respondents will have difficulties in accurately evaluating this aspect.

II. "STRUCTURED" QUALITATIVE METHODS

"Structured" qualitative methods organise the collection of responses in a highly organised way that attempts to eliminate the traditional bias of qualitative interviews. **For example, the Qualitative Impact Assessment Protocol (QuIP)** is an impact evaluation approach developed at the University of Bath that uses a process ensuring that interviewers and respondents do not receive any information on the evaluated impact investment (double-blind procedure) that could influence their analysis.

Instead, the impact analysis is based on the self-reported attribution of impact in the narratives provided by respondents. Interviewees (e.g. executives or managers of investee companies) are asked a series of questions about impact themes, starting with open-ended questions which are then extended with closed-ended questions. The causality process is specifically addressed when evaluators identify and encode causal statements provided by interviewees, divided into explicit and implicit attributions to the fund's actions. QuIP also assesses additionality by examining statements regarding external factors (that were not related to the fund's actions), so that the attribution of the impact is not overestimated.

C. LOGICAL METHODS

Lastly, there is a third family of methods: **logical methods for validating Theory of Change** (TOC). TOC is a theory that links actions put in place with expected outcomes via intermediate objectives. The purpose of the logical methods based on the TOC is to validate each intermediate objective set ex ante. This step-by-step verification of the scenario, when validated, suggests that the action was a factor in the final outcome because all the intermediate stages of this scenario have been successfully completed.

Like qualitative methods, impact evaluation methods based on theory of change contrast with the "black box" approach of quantitative methods. The latter often only report a quantitative evaluation of the impact, focusing on the statistical significance of the observed typical effect, but do not attempt to answer the questions of "why" and "how". By detailing step by step the scenario that led from actions to outcomes, logical methods provide an accurate view of the processes at work. They are also extremely complementary to quantitative approaches.

The method of impact evaluation through validation of the theory of change extends, with a rigorous process, the approach proposed by Impact Frontiers, which aims to qualify an action as an "investor contribution" if the investor can provide a "plausible narrative" linking its specific actions to specific changes in outcomes that would probably not have occurred otherwise. This "plausible narrative" will ideally be informed by the views of affected stakeholders.[14]

14 See "Investor Contribution Definitions, Strategies, Communication and Reporting Templates" – consultation ongoing for publication in Q3 2023.

4. EVALUATION OF THE DIFFERENT POSSIBLE METHODS

The matrix below evaluates the different methods presented above according to a list of eight criteria selected by the working group. The first four criteria evaluate the practical difficulties associated with the different methods (on a scale of – - – to 0), while the last four focus on the quality of the outcomes obtained (on a scale of 0 to +++).

Table 1: analysis matrix of impact evaluation methods

		Basic quantitative methods			Counterfactual quantitative methods			Basic qualitative methods		Structured qualitative methods	Logical methods
		Sector comparison	Trend comparison	Comparison with an objective	ERC	Matching	Difference in differences	Surveys	Interviews	Structured interviews	Contribution analysis
Process	Cost	-	-	-	-	- -	- -	-	- -	- -	- -
	Technicality / practical difficulty	-	-	-	- -	- -	- -	-	-	- -	- -
	Need for own data (descriptive and impact) (pre- and post-investment)	-	- -	-	-	- -	- -	0	0	0	-
	Need for comparable data (descriptive and impact) (pre- and post-investment)	-	0	0	-		- -	0	0	0	0
Outcomes	Ability to demonstrate causality	+	+	+	+++	+ +	+ +	+	+ +	+ + +	+++
	Ability to demonstrate additionality	+	+	0	+ +	+ +	+ +	+	+	+ +	+
	Ability to quantify the total effect (aggregation and weighting)	+ + +	+ + +	0	0	+++	0	0	0	0	0
	Ability to enter the statistical significance of the typical effect	0	0	0	+	+++	+ + +	0	0	0	0

The matrix highlights the weaknesses and strengths of the different methods. It is clear that counterfactual quantitative methods differ from other methods by simultaneously displaying the greatest practical difficulties in implementation and the highest quality of outcomes obtained.

5. BEST PRACTICE RECOMMENDATIONS

Based on the characteristics of the different methods, the working group agreed on a hierarchy of combinations of methods, from level 1 (least convincing) to level 5 (most convincing). These combinations, which each time rely on a maximum of two methods, reflect the complementary nature of quantitative methods on the one hand and qualitative or logical methods on the other, and the differences in robustness between "basic" and more sophisticated methods.

Table 2: proposed combinations of impact evaluation methods

The working group sees level 2 as a minimum level to consider today for implementation in the near future for impact-driven funds.

Level 1	Level 2	Level 3	Level 4	Level 5
A "basic" quantitative method	A "basic" quantitative method **+** a "basic" qualitative method	A "counterfactual" quantitative method **OR** A "basic" quantitative method **+** a "structured" qualitative method **OR** A "basic" quantitative method **+** a logical method	A "counterfactual" quantitative method **+** a "basic" qualitative method	A "counterfactual" quantitative method **+** a "structured" qualitative method **OR** A "counterfactual" quantitative method **+** a "logical" method

We recognise that the vast majority of impact-driven funds do not currently have methods in place to validate this level 2. **However, it seems to us that this step is achievable for the majority of these impact-driven funds, as level 2 does not involve particularly sophisticated and/or costly methods** (see sections 3 and 4). As a reminder, "basic" quantitative methods include sector, trend or target comparison, while "basic" qualitative methods are based on surveys or interviews with portfolio companies about the fund's intervention and its effects.

In addition, the working group recommends considering a medium-term increase from the minimum level to level 3, alongside strengthening knowledge among management companies (and more generally throughout the financial ecosystem) regarding the different impact evaluation methods and the growing availability of data.

CONCLUSION

There are many benefits to a rigorous evaluation of the impact of funds claiming to be impact investment, as mentioned in the introduction. Rigorous methods already exist, having been gradually developed over several decades in fields outside finance, and now require adaptation to financial products.

Feedback from the members of the working group, as well as interviews with practitioners conducted within the framework of the working group, show that management companies and institutional investors are currently not very advanced on this issue, due to a lack of technical skills specific to the methods presented (or even substantial incentives to use these methods according to some members of the working group). Management companies seem (relatively) more advanced in terms of measuring the impact of underlyings, even if they do not necessarily communicate on the methods and tools used.

Overall, it seems to us that finance can still make significant progress in measuring its impact, particularly by integrating the most sophisticated methods, which are still largely unknown, with the exception of very specific segments that use them regularly (primarily investors in impact contracts).

To improve the current state of knowledge and practices, we have identified the following levers as being decisive in significantly advancing practices in terms of measuring the impact of funds within management companies:

→ A specific request from institutional clients;

→ A recognised and shared framework through the development of an Impact label or through formal commitments (such as the IFD's Impact Charter) and, subsequently, as practices are expanded and disseminated, regulatory clarification regarding the methods to apply (alongside the growing availability of data) and regulatory referencing of observed best practices.

→ Lastly, the obstacles identified in this working group lead us to build a list of additional recommendations that, in our view, are likely to advance the ecosystem's skills:

→ Training of the internal teams of "impact-driven" funds in the matter of evaluating the fund's impact,

→ The adoption of market standards based on practices that are easy to implement for management companies,

→ Building bridges with other disciplines (philanthropy, public policy) through interdisciplinary forums or the involvement of experts in these disciplines within management companies,

→ Educating institutional and individual investors about impact and measurement to raise the level of knowledge of all components of the ecosystem.

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FOR MORE INFORMATION

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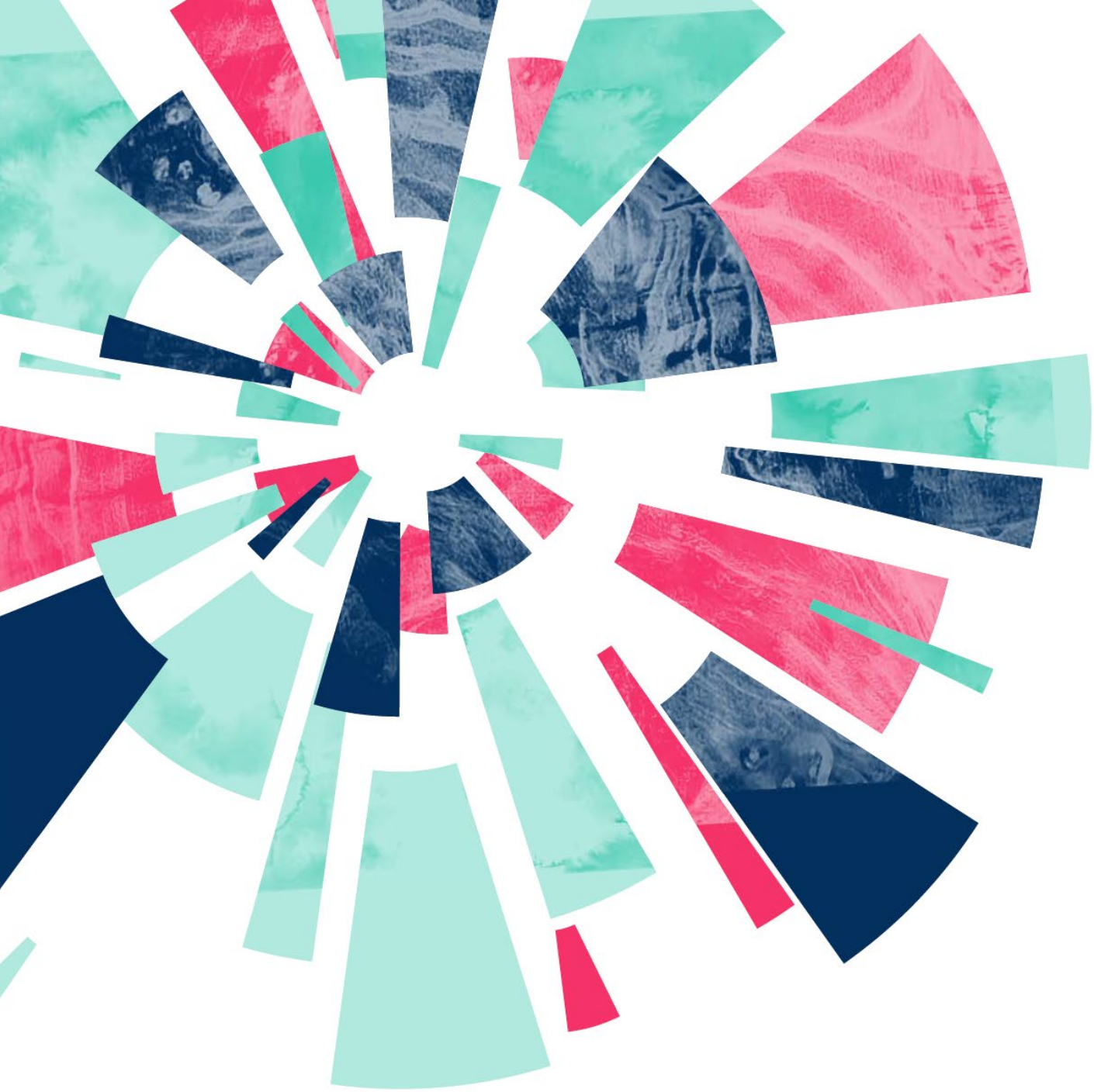

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