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PART I

Introduction

Background

VC Co is an early stage cleantech venture capital firm based in North America and was interested in exploring and analyzing the impact measurement space. The company was wondering whether it should measure and report the social/environmental impact of its portfolio companies to its Limited Partners. VC Co has one active earlier stage fund in addition to a later stage fund, and has not to date measured social/environmental impact of either. VC Co's portfolio inherently has strong environmental benefits, given its investments in clean energy and technology. The firm invests for outsized financial returns and environmental sustainability.

VC Co was seeking to understand key trends in impact measurement, including related drivers, and how peers are engaging in this topic. This client wanted to know what both the challenges and benefits are of measuring impact and was seeking a general recommendation on whether it should undertake any type of measurement or reporting. VC Co was interested in having visibility into the types of metrics other VCs are using to determine the magnitude and importance of the social/environmental impact of their portfolio companies.

This report represents a portion of the work provided to VC Co and focuses on the market trends and analysis segments. It does not directly discuss the recommendation provided to VC Co.

Project Approach

In order to answer VC Co's question on impact measurement, a sound methodology was developed. The project approach included interviewing eight practitioners in the field, receiving expert advising from Fuqua's CASE i3 program, conducting a comprehensive literature review, and analyzing six impact reports.

PART II

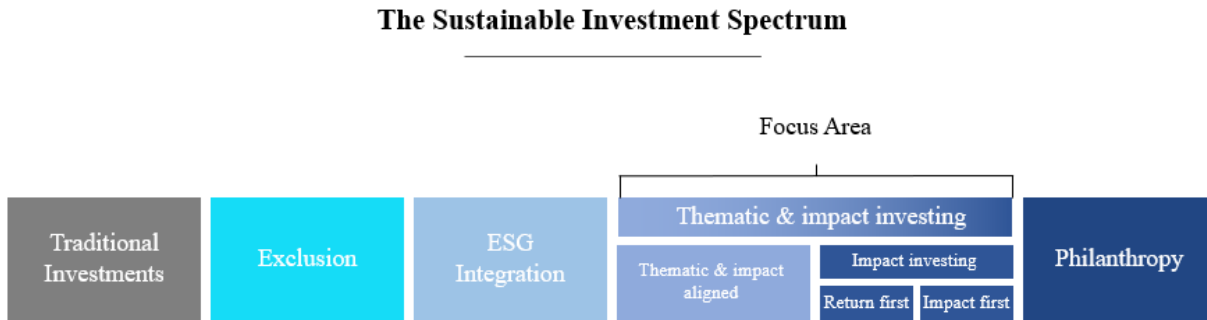
Introduction to the Role of Impact in the Private Sector

To start, it is important to have a clear definition of what impact means in this context. The report *In Pursuit of Deep Impact and Market-Rate Returns* by Sonen Capital defines impact clearly, stating that impact is “the long-term difference achieved for individuals, families, communities, or the planet.” It is necessary to recognize that all companies (and in turn investment results), have both positive and negative impacts. Impact is deeply rooted in how firms change outcomes for their broader set of stakeholders.

Interestingly, impact is considered in two ways within the industry: in terms of ESG, referring to a company’s internal policies and practices, and business model impact, referring to a company’s business model, including products and services. ESG, which stands for Environmental, Social, and Governance, is often used to screen public investments and is focused primarily on how a company manages social and environmental risks, and the procedures it puts in place to ensure its operations do not negatively affect society or the environment. An example of ESG is a telecom company developing a supplier code of conduct that includes disclosing emissions data. On the other hand, business model impact (often referred to simply as “impact” in the impact measurement space), focuses more on a company’s outward social and environmental impacts that are generated as a result of the nature of the business and its business model. While all firms can in theory have strong ESG, not all firms are capable of having positive business model impacts, as this is in some ways dependent on industry and the type of business. An example of business model impact is how Apeel Sciences, a company that provides a bio-based coating for produce, reduces food waste and emissions. This project considers business model impact as opposed to ESG given the unique advantages of VC Co’s portfolio.

There is a wide spectrum when it comes to what is termed “sustainable investing” (Figure 1). The scale below shows the range between traditional investments and philanthropy, with different methods of investing in socially responsible companies in between. This project specifically focuses on thematic and impact investing.

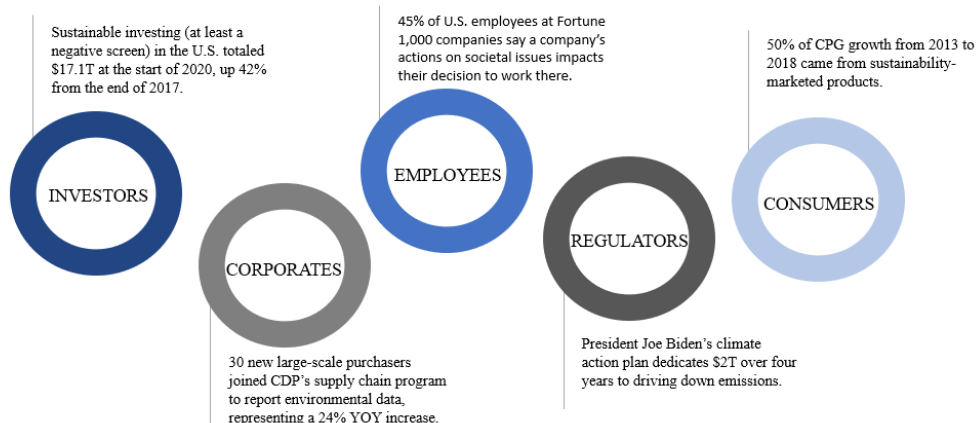
Figure 1. The Sustainable Investment Spectrum



In recent years, the purpose of business has been shifting from maximizing short-term profits to long-term stakeholder value. Traditionally, companies have only been evaluated based on their financial metrics, while societal and environmental ramifications have been overlooked. However, with the growth of the Internet and social media, consumers have been able to “see inside” corporations, and this transparency has increased the reputational risk for bad actors. Additionally, studies have shown that incorporating non-financial considerations into decision making does in fact, improve returns. As a result of this evolution, in 2019, nearly 200 CEOs of major U.S. corporations signed the Business Roundtable’s statement with a new definition of a corporation, which includes, but is not limited to, investing in employees, dealing ethically with suppliers, and supporting communities.

Given this shift in the definition of a corporation, the demand for companies to have positive impact is growing (Figure 2). Stakeholders that are shaping this demand include investors, corporates, employees, regulators, and consumers. The figure below demonstrates proof points for how each stakeholder is seeking this change.

Figure 2. Drivers of the demand for companies to have positive impact



Now that it is apparent that investors, amongst other stakeholders, are seeking to understand the impact of companies, it is helpful to dive deeper into why this is the case. Four reasons were identified and are outlined below.

1. **To attract capital:** Some Limited Partners have a goal to dedicate a portion of their funds to “impact” categories. Additionally, there has been an uptick in Limited Partners asking General Partners to fill out questionnaires about their impact practices.
2. **To improve returns:** According to the Global Impact Investing Network’s (GIIN) survey, 57% of respondents identified that they captured business value from impact data. Some companies also note that having positive social/environmental performance can improve customer acquisition, which ultimately improves returns for investors.
3. **To address public pressure:** Companies that demonstrate how they are improving society and environmental issues are more likely to maintain a positive brand image, while those that have little regard for impacts outside their shareholders may attract negative media attention.
4. **To fulfill the investor’s mission:** There is an emerging group of impact investors and VCs focused on solving the global challenges that have been defined by the UN Sustainable Development Goals framework. In fact, the market size of impact investing has grown with a 17% compound annual growth rate in the last several years to reach a \$715B market size.

From this analysis, it is evident that the role of the private sector is transforming, as it begins to consider non-financial criteria and outcomes.

PART III

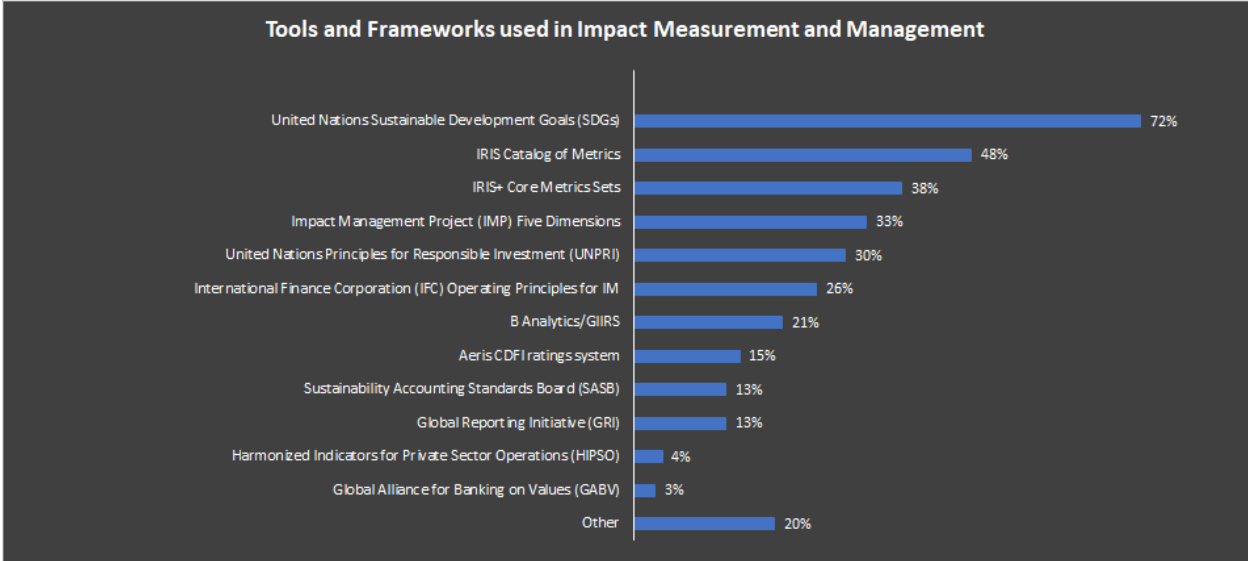
The State of Impact Measurement

Frameworks and Tools

With the role of impact growing in the private sector, investors are trying to figure out how to properly measure impact in a logical and consistent way. To date, there are over 150 tools, resources, and methods claiming to support impact measurement and management, which makes impact measurement

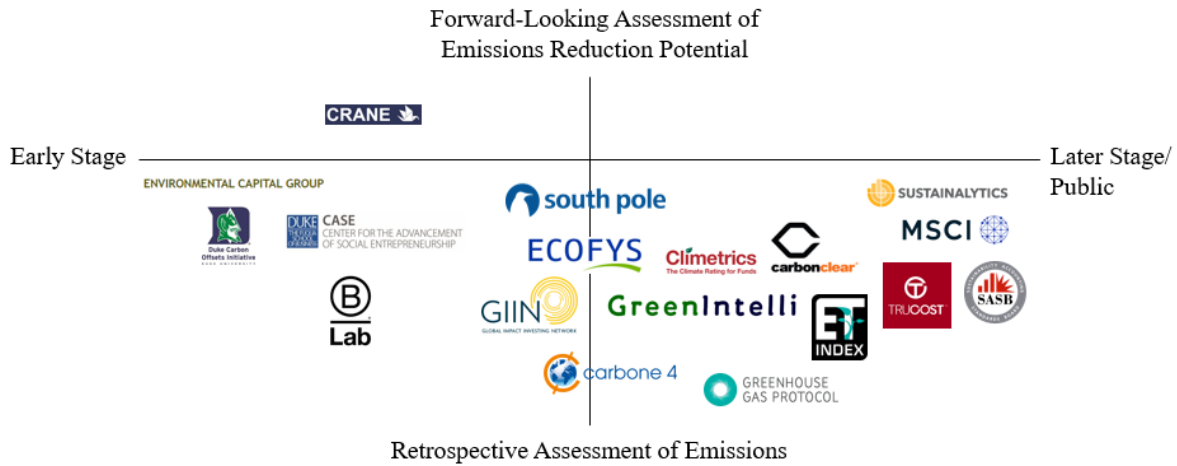
challenging to navigate and interpret. The graph below from GIIN’s 2020 report provides an overview of the tools and frameworks used in impact measurement and management and presents the ones that are most commonly used amongst impact investors (Figure 3). The UN Sustainable Development Goals framework is the most widespread, with 72% of impact investors using it, followed by the IRIS Catalogue of Metrics and the IRIS+ Core Metrics set.

Figure 3. Tools and frameworks used in impact measurement and management



Because VC Co has a number of companies in its portfolio that help enable the reduction or directly reduce carbon emissions, it is helpful to understand the tools and providers that support emissions reduction methodologies and calculations (Figure 4), as shown below from Prime Coalition’s Assessment of Early-Stage Ventures report published in 2017. Almost all of the emissions reduction quantification tools analyze retrospective emissions. Crane is a new tool in the industry that aims to help project the emissions reduction potential of early-stage ventures.

Figure 4. Climate impact assessment tools and providers



VC Perspectives on Measurement

Opinions on measuring impact diverge significantly amongst VCs. For VCs with energy and environment themes in favor of carefully measuring and managing impact, they feel that measuring impact helps identify better investment opportunities. Andrew Haughian, General Partner at Pangaea Ventures, said that “It’s critical to measure the impact and understand how that will grow over time. At the end of the day, impact is the opportunity. The bigger the impact, the bigger the market, and the bigger the potential returns for our LPs.” On the opposite side, some VCs that have funds with similar themes feel that measuring impact is a poor use of time and resources. Andrew Beebe, a Managing Director at Obvious Ventures, has stated, “We don’t require hard metrics in sustainability or impact from our portfolio [companies] for specific reasons. First, it’s super hard...[and] companies will pivot, and when they change, you have to rejigger all of those impact measures.”

To get to the root of why these perspectives differed so drastically, investor types were identified and bucketed into personas (Figure 5). As seen from the graphic below, five investor types have been established, with information included on “Type” (describing the return and impact level profile), “Description” (explaining the high level characteristics of the investor persona), and “IMM” (providing a description of the persona’s impact measurement and management practices).

Figure 5. Investor personas

	Thematic investing			Impact investing	
	General Twist	Net Positive	Special Advantage	Double Trouble	Impact Laser
TYPE	Market returns & a thesis involving impact theme, generalist	Market returns and net positive impact across verticals	Market returns and net positive impact, specialist	Market returns and impact driven	Impact first, willing to accept concessionary returns
DESCRIPTION	-Larger firms that develop investment themes related to the UN SDGs -Continue to invest in areas unrelated to impact as well	-Often have several theses related to impact theme(s), but may be hesitant to call self an "impact investor" -Open to investing in a variety of verticals, motivated by a broad set of values	-Specialize in a subset of verticals or technologies with deep investor experience in these areas -Competitive advantages in these verticals or technologies may arise from improvements in social or environmental outcomes	-These are driven by creating impact and solving social or environmental problems; call self an "impact investor" -Believes there is substantial profit to be made by focusing on impact potential, uses impact as a tool to advance strategy	-Emphasize optimizing how to address social or environmental issues, which may result in a financial tradeoff; call self an "impact investor"; catalytic capital -Often willing to take greater risk and mostly focus on very early-stage companies
IMM	Unlikely to engage in any kind of impact measurement and management, although may develop related PR or marketing materials	Tend to avoid measuring and managing impact, may use a formal or informal process/checkpoint to ensure investments are net positive	May manage/report impact of portfolio companies with focus on a few key metrics that can be aggregated; use at least an informal screen to ensure investment will be net positive	Later-stage funds often spend significant time reporting and measuring impact with robust analysis; early-stage funds model magnitude of impact in due diligence with external reporting less common	Very common to calculate potential impacts during due diligence; depending on LP base/firm strategy, will monitor/measure impact of its portfolio companies in alignment with a specific goal

In addition to the detailed investor personas, a benchmarking analysis was performed (Figure 6). The analysis included basic information on the peer VC firms, including mapping each to an investor persona, a summary of their impact and reporting practices, and details on their external engagement in the impact space. From the chart below, one can conclude that most peers integrate a negative screening process to exclude investments in companies with net negative environmental impacts (e.g. oil and gas), while external engagement amongst the peer set is limited. VC 8 is the only one that has a publicly available impact report.

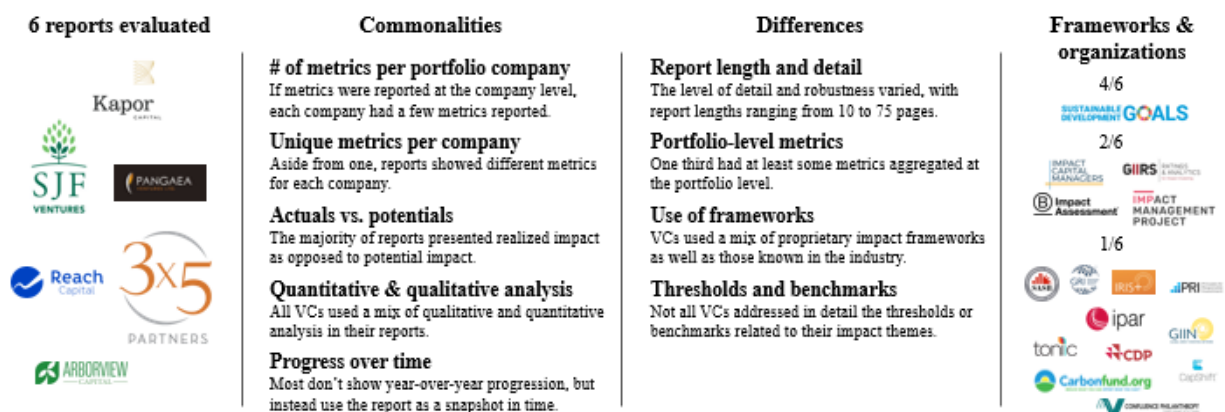
Figure 6. Peer benchmarking of focus on impact measurement

FIRM DETAILS				IMPACT MEASUREMENT & REPORTING				EXTERNAL ENGAGEMENT			
Company	HQ	Year Founded	Investor Persona	Focus Level on Impact Measurement (1-5)	Negative Screen?	Internal Measurement?	Public Impact Report?	PRI Signatory?	IMP Community Member?	Impact Capital Manager Member?	GIIN Member?
VC 1		2010s	Double Trouble								
VC 2		2000s	Special Advantage								
VC 3		2010s	Net Positive								
VC 4		2000s	Double Trouble								
VC 5		2000s	Net Positive/ Special Advantage								
VC 6		2000s	Net Positive								
VC 7		2000s	N/A	N/A							
VC 8		2000s	Special Advantage								

In conjunction with benchmarking peers, six impact reports were reviewed and analyzed to identify general commonalities, differences, and frameworks used (Figure 7). These impact reports were recommended by experts during the stakeholder interview process and deemed as best-in-class.

The six reports evaluated include those from Kapor Capital, SJF Ventures, Pangaea Ventures, Reach Capital, 3x5 Partners, and Arborview Capital.

Figure 7. Impact report analysis



Existing Challenges

Despite the progress that has been made over time with impact measurement, many challenges still exist.

The main challenges are:

1. **Values Judgement:** Impact means different things to different people, making it difficult to “compare” impact across portfolios.
2. **Lack of Standardization:** There is no regulation determining how impact must be reported, which has led to different companies using different metrics and methodologies. This unfortunately leaves room for greenwashing and confusion.
3. **Company Specific:** Companies often have different impact metrics, as they address different social/environmental problems, and have different business models. Metrics are difficult to aggregate and more time must be spent explaining methodologies.
4. **Enablers:** Measuring the impact of companies that enable impact, rather than directly create the impact, can be difficult and subjective.

5. **Pivoting:** Early-stage companies often pivot, which can dramatically change their actual and expected impacts. Thus, meaning can be lost.

Given these challenges, it is necessary for VCs to weigh the value measurement and reporting brings against the time, resources, and effort required.

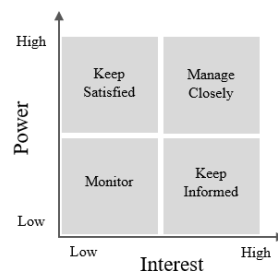
PART IV

Impact Measurement Best Practices

Upon reviewing and analyzing six impact reports from VCs and speaking with experts in the field, the following best practices were identified:

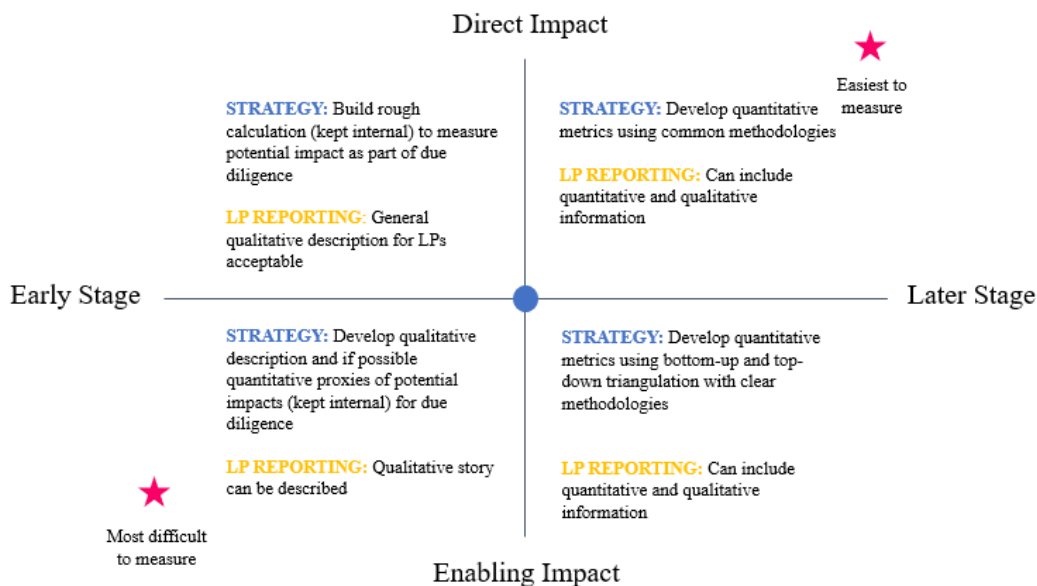
1. **A VC's impact measurement approach should stem from its strategy and LP base.** Before engaging in impact measurement, it is critical that a VC reflect on its purpose and mission. This type of reflection will help the firm determine if measuring impact is worthwhile, and if so, to what depth. There is a spectrum of how firms view their roles in creating impact, a point which cannot be discounted. Firms that invest for impact or along impact themes are not necessarily impact investors in the way the term is used in the industry. Therefore, a firm must consider what its goals are beyond financial returns and if and how impact measurement can support those objectives. Additionally, it is important for a VC to understand its different LP segments and what they are looking for in terms of impact for investments. Not only should the desires of existing LPs be considered, but also the requirements of LPs the VC would like to attract capital from in the future. While some LPs may find impact measurement a positive differentiating factor, others may have a negative perception that seeking impact lowers returns or that impact measurement is a poor use of funds. VCs can use the stakeholder analysis map featured below to determine which LPs to cater to most (Figure 8).

Figure 8. Stakeholder analysis matrix



- What and how to measure and report depends on company stage and form of impact.** There are differences when retroactively assessing impact compared to projecting potential impact. Much more speculation is required for forecasting impact, as the impact is heavily dependent on company growth and profitability. Additionally, portfolio companies can either have direct impact, such as a solar solution replacing coal, or enabling impact, such as energy storage enabling the cost of solar to decline, and thus more solar energy to be incorporated into the grid. The graph below outlines guidelines for a measurement strategy and LP reporting for the various cases (Figure 9).

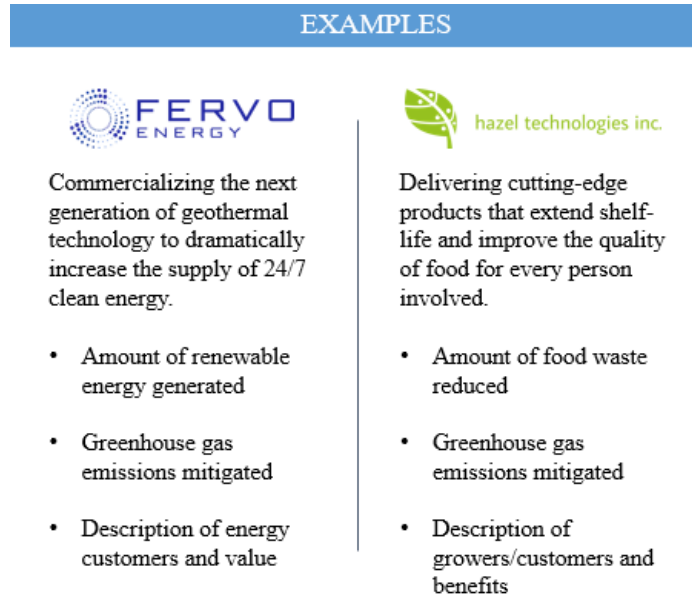
Figure 9. Strategy and reporting recommendations based on company stage and type of impact



- Frame the impact problem with benchmarks and thresholds.** It is necessary in reporting to provide context on the impact issue the company is trying to solve and describe the magnitude of the issue. By defining a quantitative benchmark, a VC makes it easier for the reader to gain a sense for how a portfolio company is addressing the particular issue and how much progress it has made or plans to make.
- Choose metrics that matter (and can be reasonably calculated).** When measuring impact, to start, VCs should collaborate with their portfolio companies' executives to discuss potential metrics and create alignment. It will help to identify what data a portfolio company is already tracking and determine if it can be leveraged. Rather than making reporting a burden by trying to track and quantify all types of social and environmental impact, it is more effective to focus on

the few key metrics that are most material. If a portfolio contains companies that have a similar type of impact or if the fund itself is aiming for a specific impact, it can be helpful to roll up a few metrics at the portfolio level. When choosing metrics, VCs should consult the GIIN IRIS+ tool, which contains shortlists of key performance indicators built on standard metrics. The figure below provides two examples of startups and proposed impact metrics (Figure 10).

Figure 10. Examples of impact metrics



5. **Reporting a scale, quality, and stakeholder metric per impact is necessary to paint a full picture.** The graphic below provides the meaning and an example of each and maps the dimensions of impact evaluated that were outlined in GIIN’s 2020 survey (Figures 11 & 12).

Figure 11. Three core metric components to measuring impact

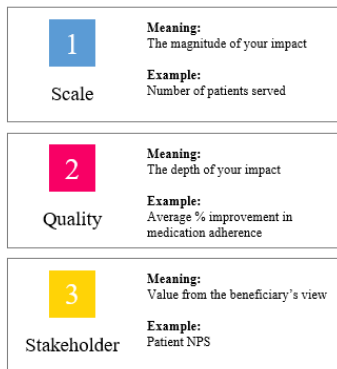
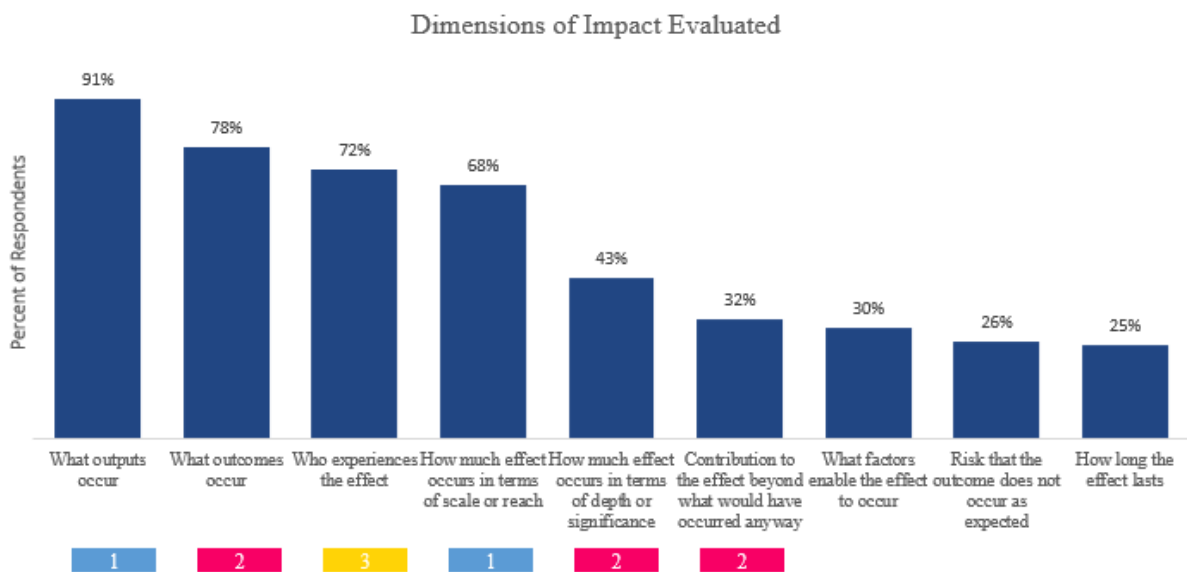


Figure 12. Global Impact Investing Network survey on dimensions of impact evaluated by impact investors



Advanced practitioners not only discuss outputs, but also outcomes and efficacy

Survey published in January 2020; n = 276 impact investing practitioners

6. **Be transparent with methodologies used and acknowledge gaps.** In reality, LPs tend to care much more that GPs have a clear, defensible impact measurement methodology than about the particular metrics or outcomes themselves. For example, SJF stated in its 2020 impact report that “SDGs are a measure of focus, and the number of targets or goals to which a company maps should not be construed as a measure of degree of impact,” which illuminated how readers should interpret the information provided.

PART V

Recommendation

A recommendation was provided to VC Co, which took into consideration the market research conducted, peer cohort analysis, and the firm’s investment strategy. Given the context of the project, part of the recommendation involved mapping portfolio companies to the UN SDGs to provide a succinct view of the type of impact the portfolio has, in addition to developing specific case studies. As stated earlier, the final recommendation will not be discussed in detail as part of this report.

PART VI

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