Five Building Blocks for Impact Management

This article seeks to provide an overview of the different tools available to impact investors when building an impact management system. They could fall into five categories – objectives, standards, certifications, methodologies and metrics – and come into play at different stages of the impact management process. Ultimately, each investor must decide which combination, and what degree of customization, is appropriate for their impact strategy.

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As impact investing gathers pace, investors are refining their approach from an early emphasis on impact measurement – the practice of quantifying impact outputs and outcomes – to focus on impact management. The latter approach integrates impact considerations into each stage of the investment process, from setting investment goals and conducting due diligence, to portfolio management and reporting. It aims to understand impact more fully and improve social and environmental performance throughout the lifetime of an asset.

There are now various tools to manage for impact with increasing rigor and confidence. However, no unified best practice has yet emerged, and the proliferation of methodologies and metrics can be confusing.

Highlighting Key Frameworks

The sheer number of initiatives and organizations involved in developing impact management is indicative of the growing importance of this market. It also speaks to the impact industry's complexity and the need for multiple approaches.

To understand these frameworks and their roles, it is useful to classify them in five broad categories (Exhibit 1). Let's review some of the most prominent and widely accepted examples for each.

Exhibit 1: Taxonomy of impact management tools and frameworks

Category	Description	Examples
Objectives	Common language around social and environmental objectives for aligning the supply of and demand for impact capital	UN Sustainable Development Goals
Standards	Broad guidelines that provide a common basis for evaluating investor practices	International Finance Corporation's Operating Principles for Impact Management
Certifications	Standardized, third-party analyses for concisely communicating social and/or environmental performance	Aeris Impact Management Ratings, BREEAM
Methodologies	Instruments for facilitating the diligence, assessment, monitoring, and reporting of impact	Impact Management Project, bespoke methodologies
Metrics	Standardized definitions for measuring impact and comparing investments	Global Reporting Initiative (GRI), IRIS (e.g., PI5501: # students per classroom)

Source: Franklin Templeton Real Asset Advisors and Tideline. For illustrative purposes only.

Objectives. The numerous interpretations of impact objectives have posed a challenge to investors seeking to align around a shared set of goals. The creation of the UN Sustainable Development Goals (SDGs) was a significant step forward. These goals have helped align the public, private, and philanthropic sectors around 17 broadly recognized social and environmental priorities.

A challenge for investors is the lack of clarity on what it means to be "aligned with" or "advance" the SDGs. Efforts are underway to spell this out, including the United Nations' Principles for Responsible Investment (UNPRI) market map. A more precise definition will help impact investors communicate clearly about their goals, better set expectations, and strengthen accountability. In our view, the SDGs should inform the entire impact management system at all stages in the investment process.

Standards. Standards can help investors be more confident about what social and environmental practices and contributions are expected of them.

The market has been eager for a set of industry-wide best practices, and in 2018 the International Finance Corporation (IFC) released the Operating Principles for Impact Management. These encourage authenticity and transparency on the part of investors. However, they do not prescribe specific contributions and a taxonomy is not available, therefore investors will need to define and customize their specific contributions.

Certifications. Certifications can be used by investors as indicators in the screening and due diligence stages, as well as to demonstrate and report impact performance.

Third-party certifications range from sector-specific ratings, such as the Building Research Establishment Environmental Assessment Method (BREEAM) for sustainable real estate, to much broader multi-sector benchmarks, such as the Global Impact Investing Rating System (GIIRS) for the fund management industry.

Despite the proliferation of certifications, many asset owners are still not armed with enough nuanced data to gain comfort in asset managers and their impact management processes. In the coming years, more flexible and robust certifications need to be created to better assess impact management strategies across asset classes. In our experience, bespoke "impact due diligence" reports are also valuable tools in lieu of formal certifications.

Methodologies. Universal methodologies like the Impact Management Project's dimensions of impact (What, Who, How Much, Contribution, and Risk) are emerging as best practice for the industry. However, it is still common for investors to customize the Impact Management Project's methodology or develop their own to fit their unique priorities and needs.

Metrics. Before the development and adoption of standard metric sets like the Global Impact Investing Network's (GIIN) Impact Reporting Investment Standards (IRIS), what to measure and how to report on impact varied widely. The credibility of impact measurement suffered as a result.

IRIS has emerged as the most widely recognized and applied framework for metrics among impact investors. While often a core resource, many investors have found it beneficial to supplement IRIS metrics with proprietary metrics, qualitative information, and/or additional external frameworks and standards. We also believe that each metric should be mapped back to the SDGs.

Future Direction

Robust systems for impact management embedded in the investment process are taking on a central role in impact investing. After all, continued improvement on impact management lies at the heart of achieving social and environmental outcomes through investments with authenticity and rigor.

An example of how these building blocks can be used in practice in a private real estate portfolio is available at
www.ftinstitutionalemea.com/impactinvesting

About Franklin Real Asset Advisors

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