Bundesinitiative IMPACT INVESTING

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position paper #01

Impact Investing

This position paper summarizes a normative conceptual framework of the Bundesinitiative Impact Investing [BIII, German National Initiative for Impact Investing] that offers a differentiated definition of impact-oriented investment approaches. It serves the purpose of agreeing on a definition of "genuine" impact investing that is on the one hand sufficiently sharp and unambiguous for a clear differentiation from conventional ESG approaches as well as between different impact investing qualities. On the other hand, the definition should be sufficiently broad and low threshold so that institutional investors are encouraged to increase their impact-oriented allocations.

The paper also clarifies basic terms such as "investor impact" or "intentionality", as there has been some ambiguity in the past. The proposed differentiated definition of impact investing is based on the definitions of GIIN, FIR/France Invest, Koelbel et al. [2020], Busch et al. [2021] as well as on numerous rounds of discussion as part of the working group Impact Measurement and Management of the BIII as well as numerous bilateral and multilateral discussions. The position paper forms an important basis for the work of the BIII, which going forward will offer further distinctions in relation to different asset classes.

Considering the current practice, it should first be noted that the term "impact investing" is often used for a wide range of investment activities.

These have in common that they are based on an assessment of an investable asset's empirical, "real world" effects [impacts] on society and the environment. Such a broad understanding is reflected in ambitious impact investing market size estimates that rely on self-reported data, but also involve some ambiguity with regard to conceptual definitions.

BIII would like to bring about more clarity and proposes a normative definition for "genuine" impact investing based on four core characteristics:

1. **Asset Impact:** Real-world, significant and net-positive impact at company/asset level.

2. **Investor impact:** Net-positive, significant impact of the investor on the asset impact through financial/non-financial support, engagement etc.

3. **Intentionality and Accountability:** A clear impact intentionality and accountability for impact based on robust observable evidence.

4. **Impact measurement and management:** A "functional" [i.e. sufficiently effective] measurement and management system for real-world impact.

1. ASSET IMPACT

The positive impact should be empirically verifiable

The investee [asset/portfolio company] creates a significant and net-positive real-world impact over time.

Real-world: The positive effect should be empirically verifiable [i.e. noticeable or observable in physical reality, on stakeholders/ecological environments]. All impact approaches should meet this criterion.

Significant: To be “significant”, real-world impacts should meet normative sustainability requirements in terms of breadth, depth, speed, and efficiency. The respective context – taking into account the size of the company and the current importance and urgency of sustainability requirements, thresholds and allocations – should be taken into account.

Net-positive: This means that the totality of all relevant, verifiable effects - intended and unintended, direct and indirect, short-term and long-term - is positive, can be ethically justified and, if possible, does not contain any significant, insufficiently managed negative effects on external stakeholders or the environment.

There are generally two ways to create significant and net-positive real-world impact at the company/asset level:

a. Impactful business activities: The investee’s business activities [including its operations and/or products and services] make a significant contribution to the generation of net-positive asset impact over time [across the value chain and lifecycles].

b. Impact transformation: By transforming an investee, a previously net-negative or marginal impact productivity is significantly improved towards a net-positive impact productivity.

2. INVESTOR IMPACT

Through their activities, the investor contributes significantly to an additional, net-positive asset impact

Through their activities, the investor contributes significantly to an additional, net-positive asset impact, which would otherwise not have been expected ["impact-generating investing"]. On the one hand, investors can enable improvements or scaling of asset impact through financial support. On the other hand, they can improve business activities with a positive impact or initiate or enable an impact transformation through non-financial support and engagement [i.e. the exercise of control, influence]. A general check of the extent to which investor impact occurs can be carried out by asking: What difference would it make for the asset impact if the activities of the [impact] investor had not taken place?

Net-positive: This means that the entirety of all relevant real-world changes created or enabled by the investor – intentional and unintentional, direct and indirect, short-term and long-term – are positive, can be ethically well-justified and, if possible, has no significant negative effects on external stakeholders or on the environment.

Significant: To be "significant", investor activity should contribute to a noticeable additional real-world asset impact compared to an "asset impact-as-usual" scenario. At a minimum, the investor impact should be sufficiently plausible or scientifically probable. Ideally, causal assumptions are supported by empirical studies. Some use cases where significant investor impact appears plausible or probable in principle include:

a. Primary investments across all asset classes, where the injection of fresh capital enables effective business activities and impact transformations that otherwise would likely not have taken place.

b. Successful non-financial support and engagement activities, for example in the context of VC/PE investments [venture capital/private equity investments], loans, infrastructure investments, real estate investments, which visibly improve impact productivity and otherwise would likely not have taken place.

c. Secondary stock investments require successful activist engagement leading to a significant additional asset impact. This is the case, for example, when management is made to make effective decisions that it would not otherwise have made, or when the signal effects are so strong that they demonstrably affect the company's value or the cost of capital. This seems especially plausible when it comes to investing in small caps or rather inefficient capital markets in emerging economies.

3. INTENTIONALITY AND ACCOUNTABILITY

Clear impact intentionality and impact accountability form the basis for strategy and execution

From the very start there should be a clear impact impact intentionality and impact accountability as the basis for planning and strategic alignment. Motivational intentionality is difficult to prove directly but becomes manifest in the observable behavior of the investor/asset manager, in their documented impact strategies or mandates, and in the documentation and practical implementation of a well thought-out theory of change and an impact governance system.

4. IMPACT MEASUREMENT AND MANAGEMENT [IMM]:

There is a functional impact measurement and management system that includes all investment processes from sourcing to exit. The application of the impact principles as a currently recognized IMM well-established best practice framework for IMM facilitates effectiveness, predictability, and replicability in relation to the management of relevant impacts and ESG risks. Investors are encouraged to have their IMM system verified externally, to share their experiences and best practices with others, and to report transparently.

Overview: Orientation framework for impact approaches

		(3) **Clear Impact Intentionality/Accountability**		
		(4) Functional, real-world IMM [impact is managed]	**No** functional, real-world **IMM** [impact is not managed]	
(1) Significant, net-positive, real-world **Asset Impact**	(2) Significant, net-positive **Investor Impact**	"GENUINE IMPACT INVESTING"	THEMATIC INVESTING	**impact-generating investing**
	No significant net-positive **Investor Impact**	IMPACT ALIGNED INVESTING WITH IMM	THEMATIC INVESTING	**impact-aligned investing**

CONCLUSION

The four characteristics presented in this paper enable
- an external differentiation from conventional ESG approaches as well as
- an internal differentiation of various impact approaches, which in practice are often referred to as “impact investing”.
“Genuine” impact investing activities fully satisfy all four characteristics. Thematic investing is characterized by the fact that there is impact intentionality and impact accountability, but a functional IMM system is not used. Since an investor impact is usually not explicitly claimed, the term can be used to describe impact-generating and impact-aligned investing activities.
In addition, there is another form of impact-aligned investing in which impact measurement and management is practiced, but significant investor impact either does not exist or appears improbable or difficult to achieve. Examples of use cases where this is a likely consideration include:

a. Secondary and passive investments across all asset classes.
b. Secondary stock investments with micro holdings and conventional [non-activist] ESG engagement strategies at large caps.

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