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NEW METRICS

Defining and measuring impact

Actis has created its own open-source impact scoring methodology in response to demand from LPs. Shami Nissan and James Magor detail the challenges involved

Investing for impact may be nothing new, but the increased popularity of strategies that seek to gain positive societal and environmental outcomes is a trend that has emerged over the past few years.

However, quantifying and reporting on non-financial performance in an easily comparable way remains a challenge and a lack of standardisation in the way impact is measured causes confusion.

In an attempt to address some of these issues, Actis has developed its own impact measurement methodology that provides an impact score and an impact multiple that allows the firm to report portfolio companies' overall positive impact alongside financial performance. It is also making the methodology open source, so it will be available for others to use. We caught up with Actis' head of responsible investment, Shami Nissan, and James Magor, a responsible investment manager at the firm, to find out more.

We don't see a tension between intentionality and returns. Impact does not dilute commercial performance

Shami Nissan

Q What led you to work on your impact multiple scoring methodology?

Shami Nissan: One of the main triggers was conversations we've been having with LPs. Some are more knowledgeable on impact, with in-house expertise, and others less so. The question we are being asked is "What is the impact of your investments?" However, there is no established way to measure impact, so it is up to us to frame the response appropriately. They are discerning enough to ask GPs about how much impact they are having, but can often find it challenging to understand and measure impact across sectors and investors.

We don't self-identify as an impact investor, but our investments have been generating positive impacts for many years. We wanted to devise a framework that would measure and quantify positive impact from initial investment through to exit and be able to report this as objectively as possible so that it could sit alongside financial measures, such as IRR and return multiples. We believe we have developed a methodology that allows us to convey what we've achieved while at the helm of a portfolio company and allows us to report in a more standardised way across different businesses.

The open source impact measurement methodology we use draws on the work of the Impact Management Project (IMP) which has built consensus amongst more than 2,000 practitioners about the five dimensions of impact: what, who, how much, contribution and risk.

James Magor: The concept of double and triple bottom line investing has been around for a long time, but there are no common industry standards for private equity investors to report on nonfinancial performance on a balanced investment scorecard. We have sought to devise an impact score and an impact multiple that sit neatly alongside financial metrics, such as IRR and multiple on invested capital.

Q You'll be making the methodology open source. Why is this?

SN: This is an important aspect of what we are trying to achieve. We want to build consensus around a measure that will help LPs assess impact performance of GPs, many of which just don't have the resources to develop methodologies for measuring impact. We want to be transparent and demonstrate what good looks like – otherwise you have a black box that is difficult to unpick and understand.

JM: It's about building confidence and credibility for the scoring system, too. The methodology must be transparent in order for the impact numbers to be credible and worthwhile.

Q So how do you ensure the numbers are credible?

SN: Part of this comes down to the design of the methodology and we're aligning our approach to the United Nations' 17 Sustainable Development Goals, or SDGs – a recognised framework that's already being used by LPs and other GPs. The SDGs are becoming an increasingly common language and are widely adopted as a set of global goals. The impact measurement methodology

Q There are some that might say it's impossible to boil myriad and complex positive external impacts down into a single figure. What would you say to this?

SN: We wouldn't claim that our impact multiple is the answer to everything. You can't reduce some aspects of impact to a single number, so there will always be elements that need to be expressed through a narrative. For these, you have to report in a more qualitative way. The example I'd give is our investment in CSH in Uganda. This was to be the country's first credit bureau, however the lack of an official ID system in Uganda was a barrier to its creation. The company introduced fingerprint ID and credit analysis to the market – this was a first for Uganda and this biometric ID system become the basis for a countrywide ID system.

When it comes to impact measurement, we have data on how many customers benefited from access to credit and how new credit ratings were able to lower the cost of borrowing. But what we can't capture in a single number is how the creation of the first credit bureau in the country catalysed a country-wide biometric identification system, which in turn has generated further benefits to Ugandan citizens and the state.

JM: The most challenging to capture are often the first movers in a market, such as those introducing the first medical testing laboratories in Sudan. You can use statistics to report on the number of tests carried out, but that's not the point because their sheer existence actually has the greatest impact on society.

we use builds upon our long-established ESG framework so we are confident that we are being rigorous and systematic in our approach to measuring impact. However, what's really important is that we are seeking third-party verification on the data itself as well as the process.

We recognise that there is some scepticism and cynicism around impact. There are some that question the validity of firms' claims to deliver positive outcomes and there are concerns about GPs impact-washing their strategies. Third-party verification of our system should help put these issues to bed.

Q You said your firm doesn't consider itself an impact investor per se. So how does the creation of the impact multiple sit with this statement?

JM: Actis has a strong ESG track record, based on the philosophy that robust environmental, social and governance frameworks create more resilient and therefore more valuable companies. In addition, we have long recognised that our companies have a broader positive impact that extends beyond the company itself into society at large. It's just that, until now, we haven't been able to systematically measure positive impact in an objective and robust way. We will continue to develop and enhance our approach to ESG, but we'll now also capture the positive impact of our portfolio companies on society and the environment.

SN: It's about being more systematic and evolving our approach. In instances where our investment has, for example, connected people to the energy grid, we've always been able to report financial and ESG metrics (safety performance), but now this approach allows us to capture broader impacts (number of households »

» connected to the grid, first time connections, community safety talks delivered). Our strategy hasn't changed; what has changed is that we will now measure positive impact.

Some private equity houses have launched new funds with impact labels. These funds are often distinct from their other offerings. We're not walking down that road. We are simply applying our impact approach across all of our funds.

Q Part of the methodology is based around intentionality to create impact. There are some that would argue that, as a private equity investor, your role is to deliver returns first and foremost. How would you answer that?

SN: We don't see a tension between intentionality and returns. Impact does not dilute commercial performance. We will assess deals in the normal way as well as identifying positive impacts we want to achieve, such as whether the investment will create jobs, improve access and affordability to an essential service or generate clean energy. In fact, a strong case can be made that impact can contribute directly to company value and therefore returns and we have many examples of this.

When it comes to achieving impact through investments, there is ample room for different investment strategies to co-exist such as concessional finance and blended finance, but that's not what Actis does.

JM: The markets in which we invest have considerable and growing needs for core infrastructure and essential services, such as healthcare and education. That demand creates a compelling commercial opportunity but investing in these sectors also generates significant positive impacts.

SN: In energy and infrastructure, for example, we're investing in large physical assets. With these, you need effective community engagement to gain a social licence to operate and reduce risk from interruptions. That means you have a lot of opportunity to deliver huge impact to local communities if your strategy is well thought out. In turn, community support can safeguard and create financial value – the two reinforce each other.

Q By your admission, some investments will be more inherently impactful than others. How do you manage that?

SN: We recognise that some investments will have more inherent impact than others and that is fine. What we commit to is to increase the impact of the company during the time of our ownership.

We think of the positive impacts associated with our investments according to whether they are generated by the core or ancillary activities of the investee company. So when we identify a particular positive impact we give extra weight to businesses with these specific impacts as part of their strategy. For example, if we invest in a company providing an essential healthcare service, the positive impact on that particular country or market is generated by a core activity of the business. Yet if you looked at a power plant that ran health camps in the local community, the health impact wouldn't be scored as highly because the impact is generated by a peripheral philanthropic activity rather than the core activity of the business.

Q Does that mean you'll be driven towards more inherently impactful investments?

JM: Not exclusively because there will be some investments that are not highly impactful when we first invest but we believe are capable of increasing their impact during our ownership; they may not have a high impact score but they will hopefully have a high impact multiple because we have increased positive outcomes through our influence. An example of this would be an education

Magor: *the methodology must be transparent*

investment we made in Latin America. At the point of investment, we looked at affordability and because the business was catering for mid to high-income groups, it was having relatively low positive impact. During our ownership, we introduced distance learning courses (roughly half the cost of campus-based), which opened up tertiary education to a different demographic – those on lower incomes and working mothers, for example. When we analysed the investment using our methodology, it still wasn't a top impact investment, but it was one of the highest from a multiple perspective because of the improvements to access, affordability, a significant rise in student numbers overall and an increase in percentage of female students, during our ownership.

Q How do you see this developing?

SN: We'd like to see a lot more collaboration across the industry on this subject and we would like to sit at the heart of discussions. We recognise that there are acute needs in the developed markets but Actis has been investing with impact for a long time in the growth markets and we believe we can speak with some authority on how private equity investment can help to address growth market societal needs. There is a need for the investor community to convene and develop a common approach to impact measurement which will ultimately be of benefit to all. ■