Investor Influence in Private Markets:

How investors' activities can result in changes in outcomes for people and/or the natural environment

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This work would not have been possible without the broad input from diverse stakeholders across the investment, business, civil society, academic, and labor communities. We would like to thank all of the approximately 200+ individuals who provided input throughout this project through our consultation processes, and those who served as periodic advisors to this project. We also extend our deep gratitude to Chris Jurgens and the Omidyar Network who offered the financial support to make this project possible.

The project team was led by Mike McCreless of Impact Frontiers and Delilah Rothenberg of the Predistribution Initiative, and included Ellen Carey Maginnis, Peter Bent, Jackson Gates, Victoria de Castro, Amanda Feldman, Nao Sudo, and Shannon Mullins.

Impact Frontiers is a non-profit learning and market-building collaboration for investors seeking to integrate impact alongside financial considerations in investment decision-making.

The Predistribution Initiative (PDI) is a non-profit working with institutional investors and their stakeholders to co-create improvements to market and investment structures that share more wealth and influence with workers and communities, ultimately reducing system-level risks.

1. Executive Summary and Introduction

Historically, the impact and sustainable investment communities have primarily focused on the effects of portfolio companies on social and environmental outcomes. However, this is not the whole picture. Investors' activities can also result in changes in outcomes for people and/or the natural environment.[1] This paper explores the potential for investors in privately-listed companies to measure and manage these activities and outcomes.

"Impact management" is defined as the process by which an organization understands, acts on, and communicates its impact(s) on people and the natural environment, in order to reduce negative impacts, increase positive impact(s), and ultimately to achieve sustainability and increase well-being.[2] Investors may wish to manage their impacts because they are ethically motivated to do so, because they believe it affects their financial risk and/or opportunity, or both.

The "Investor Influence" project (formerly termed "Investor Contribution 2.0"), facilitated by Impact Frontiers and the Predistribution Initiative, takes an expansive view of the multifaceted ways investors can shape outcomes for stakeholders and the natural environment (for the purposes of this paper, we refer to people and the natural environment collectively as "stakeholders") and recommends that these considerations should be an embedded part of investors' impact management approaches, recognizing that:

- Investors' activities can lead to both positive and negative changes in outcomes.
- Investors can influence outcomes not only through their portfolio companies but also through their own activities as a firm.
- This influence can happen through several pathways, including addressing (or contributing to) system-level issues.

For those investors with the goal of positively changing outcomes experienced by stakeholders, this project also frames the importance of considering the extent to which the investor's activities caused those changes in outcomes.

Additionally, for private capital asset classes, this project provides tools to measure, manage, and report on both intended positive impacts and potential negative consequences of investors' activities, aiming to equip investors with the resources needed to navigate their complex roles responsibly. These tools are available in documents linked to this discussion document: Positive Investor Contribution Claim Template and Proposed Investment Structures & Governance Disclosure Templates for Private Equity (PE), Private Debt (PD), and Venture Capital (VC).

The practice of impact management is highly context-specific. Some of the most interesting and valuable work is in translating general concepts into concrete actions that are practical and well-suited

[1] For the purposes of this paper we use the term investor to include both General Partners (GPs) and Limited Partners (LPs) given the scope of this project was specifically relating to private equity, private debt, and venture capital. However, some findings documented in this paper may be applied across asset classes, and thus may be applicable for asset owners and allocators and asset managers more broadly.

[2] Actions of Impact Management, Impact Management Platform.

to on-the-ground realities. With this in mind, we anticipate partnering with leading investors to publish case studies that bring the abstract concepts of investor influence to life.

2. Context and Goals

History and evolution of this project

The Investor Influence project advances work that Impact Frontiers and PDI commenced in 2020 with the Impact Management Project (IMP) to draft examples of metrics with which investors can measure, manage, and disclose investor contribution to impact and systematic and systemic risks,[3] referred to as "system-level risks" for the purposes of this paper. Numerous standards and sources of guidance exist to support companies' management of their impacts, but little exists to support investors' management and disclosure of their own contributions to impact and to system-level risk and opportunities. This has left practitioners interested in measuring and managing their investor contribution the task of creating bespoke metrics and determining how best to integrate them into their investment processes and decision-making.

In 2020, the IMP, in partnership with PDI, asked its community of practitioners to consider and debate the ways in which investors — separately from the enterprises they finance — contribute to negative social/environmental outcomes and system-level risks to investors' portfolios. These discussions were synthesized in a discussion document: Negative Investor Contribution.

To advance findings and develop guidance on how to measure and manage investor contribution, in 2022 PDI joined with Impact Frontiers, with the support of Omidyar Network, to revisit the definition of investor contribution and develop new tools to support its measurement and management.

The initial intended output of this project was a prototype set of investor contribution metrics, to be published as an open-access resource to support practitioners with measuring, managing, and reporting their positive and negative contributions to impact. To achieve this, existing investor contribution metrics were solicited from investors. However, this approach encountered several challenges:

- Each metric seemed to capture a different, incomplete view of investor contribution (described further in Appendix 1);
- The pathways through which investors impact people, the environment, and systems are not well-understood by the market, nor are the feedback loops through which investors' impacts on systems affect investors' portfolios; and,
- There was little focus from practitioners on metrics of negative contribution.

[3] "Systematic risks" refer to non-diversifiable risks originating from the market's systematic dependencies on people and the environment. "Systemic risks" refer to any major disturbance in environmental and social systems that results in cascading effects for the economy and financial system.

The project therefore evolved to focus on developing other tools investors could use to assess and manage how their actions cause or could potentially change stakeholder outcomes.[4] The development of these tools resulted in the revision of concepts and terminology which are the basis of this paper.

Target audience

The Impact Management Platform, a collaboration between the leading providers of international public good standards, frameworks, and guidance for managing impact, published a paper called the *Imperative for Impact Management* in June 2023.[5] This paper highlighted three key motivations for enterprises, investors, and other financial institutions to manage their impacts on people and the natural environment. These motivations included:

- To achieve sustainability and promote well-being;
- To manage idiosyncratic financial risks and opportunities; and,
- To prevent the accumulation of system-wide risks to the financial system and to contribute to system-wide opportunities.

The *Imperative for Impact Management* argues the need for organizations to take impacts as the starting point in the consideration of sustainability issues and to embrace a wider view of impact management. It advocates that all organizations, including investors, need to go beyond focusing on sustainability-related financial risks of and opportunities for individual enterprises to consider more holistically the impacts that they and investees are having on people, the natural environment, and systems. The paper suggests that impact management is relevant for all organizations in part because it is a necessary condition for mitigating risks, both at the entity and at the system-level. The Investor Influence project uses this framing as additional rationale for incorporating the effects of investors' own activities into investors' impact management approaches.

While the concepts in this paper apply to all investors in private markets, the intended audience focuses on those investing with an impact, responsible, sustainable, and/or system-level lens. The concepts and tools relating to causal impact are likely to be of more interest to impact investors or investors claiming to have positive impacts than the other categories.

Shifts in terminology

There are many terms used to describe the connection between investors' activities and the resulting changes to outcomes for stakeholders. The IMP played a key role in establishing the importance of investors in affecting outcomes for stakeholders. Almost eight years after the IMP's original framing of investor contribution was established, this paper puts forward a number of recommendations regarding the effects of investors' activities that reflect the evolution of the industry. This project lays the

[4] The evolution of this project is reflected in the change of the project's name which was originally titled as Investor Contribution 2.0.

[5] The Imperative for Impact Management: Clarifying the Relationship Between Impacts, System-wide Risk and Materiality, Impact Management Platform, June 2023.

groundwork for recommendations that can be adapted and developed further by investors, service providers, standard-setters, and other industry actors.

Three of the most important changes put forward to the concept of investor contribution are summarized in the table below:

Aspect of Investor Influence	Prior approach	Revised approach
Changes in outcomes	The original definition of investor contribution developed from the IMP consensus focused on four strategies or actions by which investors could pursue positive investor contribution.	Investor actions are not intrinsically positive or negative. Rather, it is the result of an investor's activity on people and/or the natural environment, in context, that can be positive, negative or neutral. In terms of preventing negative impacts, an investor's actions and governance may be sufficient or deficient, as per established human rights and environmental norms (see below for further detail).
Types of investor activities	The original focus was on impacts achieved through investment in and engagement with portfolio companies.	Investors influence outcomes on stakeholders not only through investment and engagement with portfolio companies, but also via their own activities as a firm.
Terminology	The term, investor contribution, included investor actions that caused changes in outcomes as well as investor actions that were associated with changes in outcomes but did not cause them. Specifically, it included the strategy known as "signaling that impact matters," defined as follows: "Investors employ this strategy when they proactively and systematically consider measurable positive and negative impacts of assets as part of their investment decision-making process and communicate this consideration to investees and the market at large. These considerations should affect the investment decision, meaning that impact considerations could lead to a different investment decision. "If all investors implemented 'signaling' strategies, it would ultimately lead to a 'pricing in' of social and environmental effects by the capital markets. Often referred to as values alignment, this strategy expresses investors' values and is an important baseline. But alone, it is not likely to advance progress on societal issues when compared to other forms of contribution."	Investor influence replaces investor contribution as the broad term that includes all outcomes that investors are directionally associated with. When the changes in outcomes likely would not have occurred but for the investor (particularly regarding positive impacts), then it can be considered "causal investor impact," or "causal impact" for short. Like investor influence more broadly, causal investor impact can occur through investment and engagement with portfolio companies as well as through the investor's own actions as a firm.

In addition to the three changes outlined above, this paper lays out the various components of investor influence, as follows.

3. Components of Investor Influence

An investor, like any organization, conducts activities that can be linked with changes in outcomes for stakeholders. This unidirectional association is called investor influence. This influence can be positive, negative, or neutral. For some investors, their influence on stakeholders informs their strategy and/or their approach to risk management. There are also outcomes that are in no way associated with investors' actions.

When framing investor influence, there are four important components to consider:[6]

- The **types of investor actions** that can influence outcomes
- The **pathways** through which activities can influence outcomes
- The **resulting outcomes** experienced by stakeholders
- The extent to which the actions **caused** the outcomes, meaning the outcomes likely would not have occurred in the absence of the investor's action (i.e., the difference in outcome relative to likely counterfactual scenario.)

Consideration of causality is relevant primarily (or only) for positive impacts. For negative impact, a materiality assessment leveraging the precautionary principle and human rights due diligence are appropriate. These recommendations are further elaborated on below and later in this paper.

> The UN Rio Declaration on Environment and Development defined the precautionary principle which states: "Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation." Similarly, the United Nations Guiding Principles on Business and Human Rights state that it is a private sector entity's responsibility to conduct human rights due diligence to prevent human rights violations. Several sustainability standards, including the Global Reporting Initiative (GRI), reference and apply these principles.

Each of these components is summarized below and is the focus of the following four sections:

Types of investor activities: Investors' activities can be classified in two overarching categories:

[6] In some cases, particularly for investments lacking control features, the extent to which an investor's actions influenced outcomes may be worth exploring. Note that these components are framed as being retrospective (ex-post) assessments of the effects of investors' actions, but the concepts can also be applied when considering the ex-ante assessments.

- *Through investments*: Includes investment activities related to capital allocation, pricing, and structuring as well as engagement activities with investees.
- *As a firm*: Includes activities related to the internal workings of the firm — including strategy — as well as the firm's engagement activities with outside stakeholders.

Pathways of influence: A pathway is the sequence of events that links an investor's activities with its effects on stakeholders. There are two primary pathways through which an investor's activities can result in changes in outcomes:

- *Through the capital chain*: Typically speaking, asset owners and allocators invest through asset managers, who invest in companies (or sovereigns and municipalities, collectively with companies referred to as "investees"), who provide jobs, products, services, and other outputs that have effects on specific stakeholders.[7] These impacts on stakeholders (sometimes independently, or through the accumulation of impacts) also have the potential to have system-level effects.
- *Through other channels*: Investors' activities can be linked to effects on people and/or the natural environment via many other ways, including through contribution directly to system-level issues. For instance, investors can work through intermediaries (like lobbyists) to influence policy and regulation, which can have effects on stakeholders.

Resulting stakeholder outcomes: An outcome is the level of well-being experienced by stakeholders as a result of an event or action.[8] Investor activities can result in positive or negative outcomes which can be intended or unintended.

Causality: Causality is the relationship between the cause and effect — in this case, the investor's activity and the resulting stakeholder outcome. This can be framed as accounting for the counterfactual.[9] Counterfactuals are the difference between what happened with the investor's action and what would have happened otherwise, without the investor's action. An outcome can be caused by an investor's action, meaning that it likely would not have occurred anyway. Alternately, an investor's action can be simply aligned with that outcome, even though the outcome likely would have occurred anyway.[10]

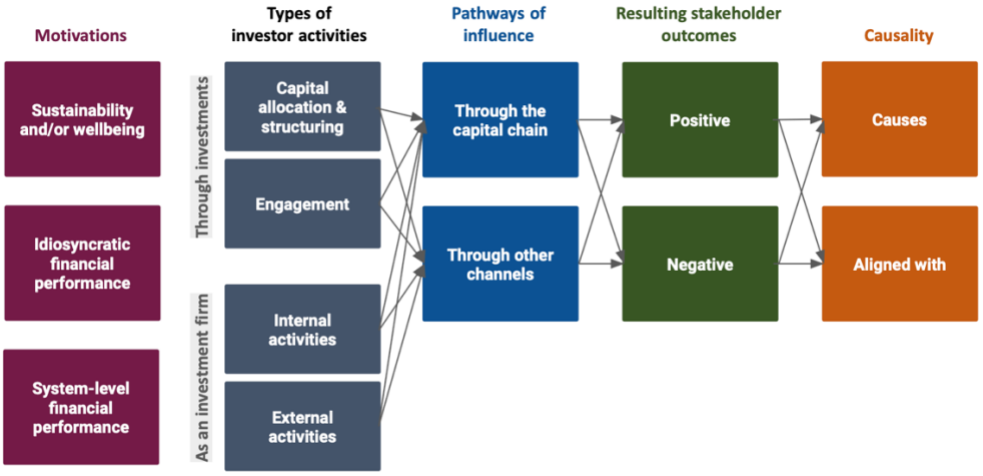
Bringing these components together: **Investors' activities** taken through different **pathways of influence** can result in **positive or negative outcomes** for stakeholders. In some cases an investor's

[7] Note that asset owners and allocators can also invest directly in investees without asset managers as an intermediary.
[8] Five Dimensions of Impact, Impact Frontiers.
[9] Counterfactuals cannot be measured directly because they represent a state of the world that did not occur. However, they can be estimated, sometimes with a high degree of confidence. The Positive Investor Contribution Claim Template is focused on positive causal investor impact and aims to support practitioners in addressing this challenge.
[10] Of course, the third case would be where the investor had no association with the impact at all.

action likely **causes** the outcome (or change in outcome), while in other cases the investor's action is **aligned with** an outcome that likely would have occurred anyway.

These four components and the relationship between them are illustrated below.

Diagram 1: The components of investor influence and the relationship between them



As noted in the diagram above, each component of investor influence can relate to any other. In other words, any type of investor activity can go through any of the pathways and result in positive or negative outcomes in which causality can or cannot be established. Together these four components comprise the ways in which investors can influence outcomes, and each component is described in detail in the following sections.

Types of investor activities

An investment organization, like any other, conducts activities that can result in changes in outcomes for stakeholders. This section highlights the two main types of investor activities, each of which has two channels.

Activities through investments

- *Capital allocation and structuring* — Activities related to the amount, price, terms, conditions, structures, and other financial characteristics of investments and loans as well as exit decisions and broader market structure influences.[11]

[11] An example of *broader market structure influences* includes practices such as roll-ups of portfolio companies that result in market concentration. See the Proposed Investment Structures & Governance Disclosure Templates for PE, PD, VC for more details on these types of activities. Note that *capital allocation and structuring* may also include the types of companies that investors allocate to and an investor's investment strategy more broadly (noting that depending on interpretation and context, strategy may also fall under activities as a firm).

- *Engagement* — Non-financial activities such as leveraging roles on investees' boards or board committees, as well as other related investor activities that can influence the ways in which investees operate. These types of activities are variously referred to as stewardship, active ownership, non-financial engagement, or technical assistance.

Activities as a firm

- *Internal* — Activities related to an investor's own organization such as practices associated with governance, compensation, tax, diversity, equity, and inclusion (DEI), and cross-firm strategy.
- *External* — Activities related to an investor's external engagement activities other than with investees, such as influencing policy and/or regulation, building data infrastructure for more robust reporting, and collaborating with other investors and industry/sector-level associations.

The framing of these categories of activities, particularly the inclusion of an investor's *activities as a firm*, reflects emerging practice for how standard-setters[12] are communicating the ways in which investors can influence outcomes.

These categories are not mutually exclusive, and some activities may span across types of activities and/or channels. For example, an investor may embed social and environmental related provisions into a term sheet, tying the investor's capital to emissions reductions and the reduction of other negative environmental impacts alongside technical support from the investor in order to do so. As a result, the portfolio company improves its operational practices to meet these requirements. These investor activities span both *capital allocation* and *engagement*.

Similarly, a firm's investment strategy or approach to DEI may be part of *activities as a firm*, while also influencing the investment strategy. Evidence from the Small Business Administration[13] suggests that investment decision-makers of color (a result of internal *activities as a firm*) are more likely to direct investments towards entrepreneurs of color (a result of an investor's activities relating to *capital allocation*). Nevertheless, as a starting place, these categories are easiest to understand when presented in isolation, before exploring ways they can be combined.[14]

An important shift in thinking about investor influence is that activities themselves are not intrinsically positive or negative. Rather, it is the results of an investor's activity on people and/or the natural environment, in context, that can be positive or negative.

Examples:

[12] For example, see the Investor Reporting Framework of the U.N.-backed Principles of Responsible Investment, the SDG Impact Standards of the U.N. Development Programme, GRI's Capital Markets Technical Committee, as well as other standards targeted at investors within the Impact Management Platform.

[13] Measuring the Representation of Women and Minorities in the SBIC Program, Prepared by the Federal Research Division, Library of Congress, October 2016.

[14] It may be that *activities through investments* and *through the capital chain* are entirely or nearly synonymous. However, the distinction between *types of investor activities* and *pathways of influence* helps highlight that impacts created through the capital chain can reverberate to have systems-level effects, and that investors can influence systems directly without going through the capital chain.

- Providing concessionary capital is not itself intrinsically positive. However, the provision of this capital may — or may not — result in positive outcomes for stakeholders that would not have occurred otherwise. Each case would need to be assessed individually, in context.
- Influencing a company's capital structure to increase its debt burden, even to high levels, is not an intrinsically negative action, nor does it necessarily cause a negative impact on stakeholders. However, it may lead to the deterioration of a company's financial position, which may in turn result in negative outcomes for stakeholders (e.g., loss of quality jobs or quality and affordable goods and services).

This does not diminish the expectation of investors to have strong governance policies and procedures in place to prevent negative impacts, and where the intention is expressed, to pursue positive impacts. For instance, in the second example above, failure to implement a risk management framework to prevent the observed negative impacts would be considered a deficiency in impact management and governance. Indeed, internationally established human rights and environmental norms invoke concepts such as the precautionary principle and human rights due diligence as responsibilities of organizations to prevent negative impacts.[15]

While this paper puts forward the proposition that any investor activity itself cannot be considered positive or negative, it also positions the importance of establishing impact management systems which include robust policies and procedures to prevent, avoid, mitigate, and remedy risks and negative impacts on stakeholders resulting from investors' own actions as well as those resulting from their portfolio companies. While not having a risk management system in place may or may not result in negative impacts in any particular case, the lack of such policies and procedures reflects deficiencies in governance.

Pathways of influence

There are many different routes through which investor influence can occur, but for the sake of simplicity, this project boils them down to two main pathways: those that flow *through the capital chain*, and those that flow *through other channels*.

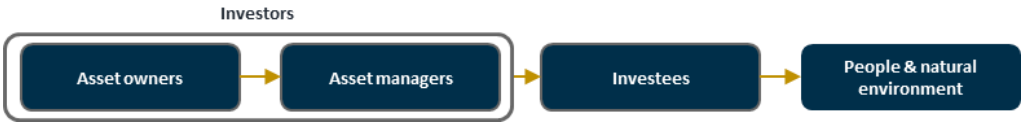
Through the capital chain

Asset owners and allocators often invest through asset managers, who in turn invest in companies or other investees.[16] Asset owners and allocators may also invest directly into some of these investees. These investees provide jobs, products, services, and other outputs which in turn affect people and/or the natural environment. A simplified view of this capital markets chain is illustrated in Diagram 2 below. Note the yellow arrows are one-way, with the arrowhead pointing to the entity or stakeholder that is affected.

[15] Guidance on materiality assessments upon which such risk and impact management systems can be based is provided by GRI.

[16] Note that investment can include lending and that investments can be made into companies, enterprises, sovereigns, municipalities, or other asset managers and/or structured products — all of which are classified as "investees" for the purposes of this paper.

Diagram 2: Linking an investor's activities through the capital chain

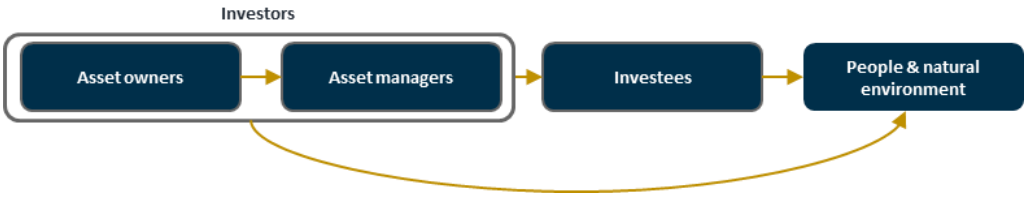


Example of positive impact through the capital chain: An asset manager provided a bridge loan to a business experiencing significant cash flow challenges. This type of financing was not available from others in the market and allowed for the business to remain open, with fully functional operations, and enabled the business to keep all employees on staff with full benefits.

Through other channels

Investors' activities can influence outcomes for people and/or the natural environment through other means including at the industry/sector level, via policy and regulatory influence, intermediaries, and the financial system more broadly. Investors, as firms themselves, also provide jobs and engage in other activities which have effects on people. These other channels can affect system-level issues which in turn affect all stakeholders in the capital markets chain, including investors themselves.[17] They are summarized in the diagram below by the curved arrow added to the bottom of the capital chain.

Diagram 3: Linking an investor's activities through firm activities and other channels



Example (negative impact — pathway of influence via activities as a firm externally and through systems): An investor engages in lobbying and political spending as a firm-level activity which conflicts with social and environmental mandates of one or more of its funds. These lobbying efforts result in changes to regulation that negatively affect stakeholders and are in conflict with the stated mandates of its funds.

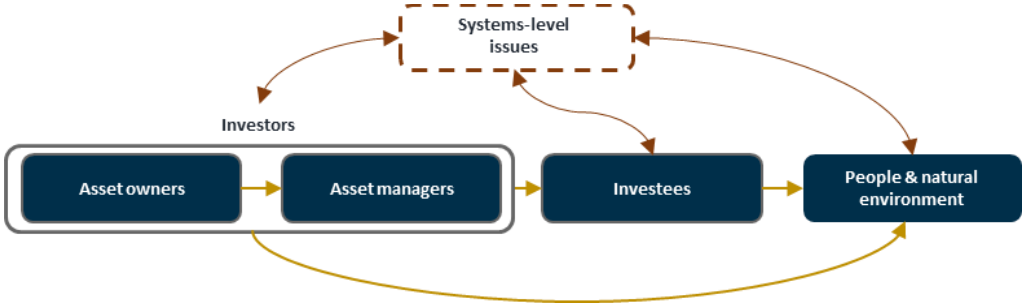
The diagrams above illustrate one-way pathways in which people and/or the natural environment are affected by investors' activities. However, stakeholder outcomes are often embedded in and influenced by complex systems that investors can also influence via their activities. A system is a set of connected elements that interact, generating outcomes. Systems can be at the local, national, or global level and can span various contexts including natural ecosystems, social communities, and financial/economic infrastructure as examples.

[17] Note that in many cases, influence *through other channels* will align with *activities as a firm*. However, since influence *through other channels* can also occur through the buildup of impacts as a result of *investment* activity, the categories are separate.

System-level issues refer to those which can affect environmental systems (e.g., relating to climate change, water scarcity, biodiversity) and social systems (e.g., economic, financial, and political).[18] These system-level issues, and changes in them, can affect all stakeholders within the capital chain, including investors themselves. As an example, investors may contribute to climate change by way of the emissions associated with their investments (i.e., in carbon intensive industries) and/or their activities as a firm (i.e., by use of corporate jets). In turn, climate change is an issue that will affect economic and financial systems and therefore investors. In terms of inequality, research suggests that increasing the share of the investment sector and certain investment structures within the economy can contribute to increased inequality, which can then affect the stability of financial markets and investors themselves.[19]

The relationships between investors and system-level issues are represented by red bi-directional arrows in the diagram below. The diagram captures pathways through which investors' activities influence other stakeholders more holistically and how influence can happen *through the capital chain*, the *investor as a firm*, as well as *through systems-level issues*.

Diagram 4: Linking an investor's activities through the capital chain, direct impacts via firm activities, and contribution to system-level issues



Investors' influence *through the capital chain* and *through other channels* can accumulate. That is, investor activities can result in changes in outcomes that may not seem significant on their own, but when aggregated can lead to larger issues which subsequently affect a broader set of stakeholders and even reverberate back to investors through feedback loops — climate change being but one example of this.

System-level issues and impact management: The concept of "systems" is complex, and this paper only begins to summarize the concepts at a high-level. A growing number of investors are exploring

[18] For instance see Systems-Level Considerations and the Long-Term Investor: Definitions, Examples, and Actions, Steve Lydenberg, The Investment Integration Project, 2017 and ESG 2.0: Measuring and Managing Investor Risk Beyond the Enterprise-level, Delilah Rothenberg, Raphaele Chappe, and Amanda Feldman, Predistribution Initiative, 2021. Note that these systems are typically intertwined, with increasing recognition that economic and financial performance depends on the environment and nature.

[19] For instance, see Inequality and Financial Sector Vulnerabilities, Anni T. Isojaervi and Sam Jerow, FEDS Notes, April 2024, and ESG 2.0: Measuring & Managing Investor Risks Beyond the Enterprise-level, Delilah Rothenberg, Raphaele Chappe, and Amanda Feldman, Predistribution Initiative, 2021.

ways to integrate systems thinking, and there are several organizations offering tools to help investors incorporate system-level thinking into their investment approach.[20]

For the purposes of this paper, we have used the term "system-level issues" to capture the broad framing of this concept. Many organizations think about these issues as "system-wide risks and opportunities" and acknowledge the effect they have on societies, economies, and markets — ultimately affecting investment value. There is increasing recognition that asset owners and allocators need to address such risks directly and that market participants, collectively, can influence system-wide issues. These concepts are described in more detail in the aforementioned organizations' work and the Impact Management Platform's report The Imperative for Impact Management: Clarifying the Relationship Between Impacts, System-Wide Risk and Materiality — The need for greater consideration of system-wide risk.

Resulting stakeholder outcomes

An outcome is the level of well-being experienced by a person, group of people, or the condition of the natural environment, as a result of an event or action.[21] Investors' activities can result in **positive** or **negative outcomes** for people and/or the natural environment. These changes in outcomes can be intended or unintended.

- *Example (positive)*: An investor structures its investment to influence a company to provide employees with ownership stakes in the company. This increases the company's productivity, reduces turnover, and improves the distribution of wealth to employees, therefore increasing their financial security and economic mobility.[22]
- *Example (negative):* An investor structures its investment in such a way that places a significant debt burden on a company. This debt burden forces cost-cutting measures which lead to layoffs, salary freezes, and reduced benefits for employees.[23]

In impact management, outcomes are defined as "positive" or "negative" by comparing them to social and ecological thresholds.[24] A social or ecological threshold defines the range of performance that is considered positive/sustainable versus negative/unsustainable. These ranges are set with reference to

[20] For instance, see Impact Frontiers' Getting Started with Systems Mapping & Impact Management as well as resources from The Investment Integration Project (TIIP), PDI, and The TransCap Initiative, all of which are organizations that explore system-level investing from different angles.
[21] Impact and the Impact Pathway, Impact Management Platform.
[22] If this happens across many companies, socioeconomic inequality may decrease, potentially affecting economic systems and, thus, diversified investors' portfolios, though this thesis would need to be further validated.
[23] If this happens across many companies, socioeconomic inequality and system-wide financial leverage may increase, potentially affecting economic systems and, thus, diversified investors' portfolios, though this thesis would need to be further validated.
[24] Thresholds and Allocations, Impact Management Platform.

social norms or planetary limits that have been identified through scientific research and societal context-specific consensus building.[25]

Thresholds: Research on and the application of thresholds is important but nascent. Take, for example, an investor who provided capital to a profitable enterprise which allows the company to expand its operations, including hiring more workers. However, the company compensates employees below the minimum livable wage, as defined by the MIT Living Wage Calculator. While the investor may be able to demonstrate that its capital enabled employment growth, which is desirable, the outcomes experienced by individual employees would still be negative because the individuals are not earning a living wage. Thresholds are often debated; for instance, some stakeholders advocate that only paying above a living wage, such that the wage allows for the worker to build wealth, should qualify as a positive impact. While consensus is stronger around climate thresholds (i.e., 1.5 degrees), further work is being done to identify thresholds for other environmental and social issues.

Causality

Causality is the relationship between the cause and effect, or in this case the investor's action and the resulting stakeholder outcome. This "causation" can be framed as accounting for the counterfactual. Counterfactuals are the difference between what happened with the investor's action and what would have happened otherwise, without the investor's action.

- Example (positive): An investor with special expertise and networks in climate and deeptech identified a company developing technology whose potential had been overlooked by other investors. Though the company had struggled to raise its next round of financing and was facing probable layoffs, this investor stepped in to lead the round, making the largest individual commitment and also bringing in several co-investors. As a result, the company's growth accelerated, and it ultimately sequestered significantly more carbon from the atmosphere than would have been possible without this round of investment. While the counterfactual cannot be proven, contextual evidence strongly suggests that the investor's interventions changed the trajectory of the company and its effects on climate.

Tracing investors' activity to changes in outcomes for stakeholders is challenging. Consideration of causality is not a requirement for establishing or managing an investor's influence, and it is not typically relevant when considering negative impacts.

[25] For examples of additional detail on thresholds visit Impact Frontiers' Norms under the "What" dimension, the work being done by UNRISD on Sustainable Development Performance Indicators (SDPI) and work being done by the organization r3.0 on a Global Thresholds & Allocations Network (GTAN), and a Global Thresholds & Allocations Council (GTAC).

Counterfactuals and negative investor impact: The consideration of counterfactuals when assessing negative changes in outcomes can be established in some cases, but is not necessary from an impact management perspective. Given the nature of negative impacts, investors have the responsibility to measure, manage, and mitigate potential negative outcomes without consideration of counterfactuals.[26] This essentially means developing and implementing strong management frameworks to assess, mitigate, avoid, and remedy potential negative impacts of actions alongside any assessment of potential positive impacts.

Precedent for this practice as a global norm exists with responsibilities as outlined by the UN Guiding Principles on Business and Human Rights. For example, companies and investors have a responsibility to work toward ensuring that any child labor issues in the supply chains of their portfolio companies are addressed, regardless of whether the affected children would have performed similar labor in the absence of the company. The counterfactual is typically not a relevant consideration when considering negative impacts. Investors interested in managing potential negative impacts through their investor activities may consider referencing the draft disclosures under development in the Proposed Investment Structures & Governance Disclosure Templates for PE, PD, VC.

The importance of establishing causality (or not) depends on the strategy of the investor and the pathways in which they seek to influence outcomes. Investors with a mandate to positively change outcomes for stakeholders are likeliest to consider possible counterfactuals.

Some of these investors may be willing to accept less risk-adjusted financial return than they could otherwise obtain in order to create impact that would not otherwise occur.[27] Investment organizations funded by governments (such as development finance institutions and multilateral development banks) or that receive tax-advantaged capital are also likely to consider possible counterfactuals. In other cases, investors may seek competitive risk-adjusted financial returns alongside impact, as in the example above.

In many instances considering possible counterfactuals is not a priority for investors. For example, investors may seek to influence one or more system-level issues with the intention that outcomes for stakeholders will improve, but the complexity of the system-level issues and the number of contributing factors render counterfactual analysis difficult or impossible. In these instances, investors can, and are encouraged to, measure and manage towards system-level outcomes even when causality cannot be established.[28]

In other instances, investors may have a mandate to invest in companies that are meeting high social and/or environmental standards or that are addressing global challenges, but not necessarily to

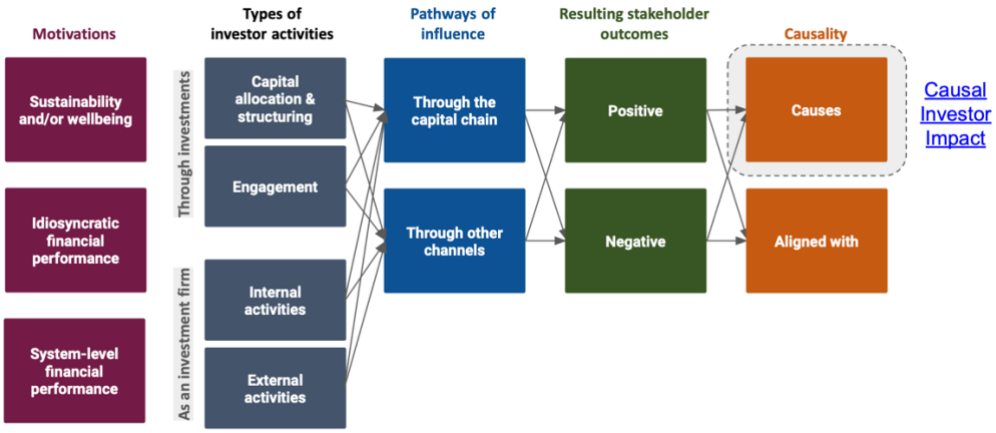
[26] Investing for Impact: Operating Principles for Impact Management, International Finance Corporation/The World Bank, February 2019.
[27] See for instance the work of the Catalytic Capital Consortium.
[28] For instance, the Taskforce on Climate-related Financial Disclosures (TCFD), Taskforce on Nature-related Financial Disclosures (TNFD), the Transition Plan Taskforce (TPT), and emerging Taskforce on Inequality and Social-related Financial Disclosures (TISFD) are all intended to support investors in such evaluation. See also: (Re)Calibrating Feedback Loops Guidance for Asset Owners and Institutional Investors: Assessing the Influence of System-level Investing, The Investment Integration Project, December 2023.

accelerate or increase those companies' impacts in ways that would not otherwise have occurred. This is the case with many investors that self-identify as "sustainable investors." Based on these investors' mandates, establishing counterfactuals is not aligned with these investors' strategies.

The term, *causal investor impact*, (or just *causal impact*) can be used when causality (with regard to positive impact) is part of the investor's goals, and/or when contextual evidence gives good reason to believe that it is more likely than not that the investor's actions result in changes in outcomes. It is defined as "a change in outcomes caused by an investor's action(s) that wouldn't have likely occurred in the absence of the investor."

The term, *investor influence,* is broader and can be used regardless of whether investors' goals involve causing changes in outcomes that would not otherwise have occurred. Not included in the graphic below is a box illustrating "not associated with" which would capture activities in which there is no association with any change in outcomes from investors' activities.

Diagram 5: Causal Investor Impact



Causal investor impact, since it involves counterfactuals, cannot be measured directly, only estimated. There is often uncertainty involved in these estimates. The uncertainty may pertain to the magnitude of the impact, the likelihood that it would have occurred anyway, or both.

This challenge is not unique to impact management. Uncertainty and measurement error are present in financial accounting and reporting, as well. Those fields generally recommend disclosure of estimates — and even disclosure of the uncertainty itself — so long as the information is relevant and faithfully represented and sources and methods used are described.[29]

Therefore, investors interested in causal impact are advised to consider the magnitude of the impact; the likelihood that it would have occurred anyway; and the evidence for both magnitude and likelihood. For a burden of proof, investors are encouraged to seek "a preponderance of evidence" that provides

[29] For instance, the Conceptual Framework for Financial Reporting — one of the foundational documents of the International Accounting Standards Board — states: "Even a high level of measurement uncertainty does not necessarily prevent such an estimate from providing useful information" (paragraph 2.19).

good reason to believe that a claim about the amount and likelihood of causal impact is more likely true than not (i.e., more than 50% likely to be true).[30]

Resources to explore further: It's important to note the significant roles that investors can play in activities where causality cannot be established. Relatedly, while establishing the counterfactual may not be possible or a priority, investors are still encouraged to measure changes in outcomes associated with their activities. Certain aspects of the Proposed Investment Structures & Governance Disclosure Templates for PE, PD, VC are designed to support such measurement and management. In addition to PDI, The Investment Integration Project (TIIP) is one of many organizations encouraging investors to adopt system-level goals — and design strategies and activities, including measurement techniques — to support the realization of these goals. Their latest report, *(Re)Calibrating Feedback Loops* provides detailed guidance to Asset Owners and Institutional Investors on ways in which investors can influence system-level issues, including approaches to measure this influence.

[30] For instance, an investor might provide strong evidence that causal impact is unlikely and will be small in amount if it does occur. Conversely, an investor might provide weak evidence that causal impact is likely and will be large in amount. Regardless of whether the amount and the likelihood of causal impact are zero, small, or large, investors are encouraged to apply a consistent burden of proof: a preponderance of evidence leading the user to believe that a claim is more likely true than not.

4. Conclusion

This discussion document advocates for a comprehensive approach to management of outcomes associated with and caused by investors — both positive or negative, intended and unintended. To support this comprehensive approach, this paper illustrates how:

- The activities of investors can result in both positive and/or negative outcomes.
- Investors can influence outcomes through their *activities as a firm*, as well as their *investment activities*.
- The activities of investors can influence outcomes through portfolio companies (*via the capital chain*) but also through other means, including by *influencing system-level issues*.

For those investors with the goal of positively changing outcomes experienced by stakeholders, this paper also frames the importance of considering the magnitude of the impact; the likelihood that it would have occurred anyway; and the evidence for both. When it comes to negative impacts, as per the Impact Principles and internationally established human rights and environmental norms, it is an investor's responsibility to establish impact management systems which prevent, avoid, mitigate, and remedy risks and negative impacts on stakeholders resulting from their actions, as well as those resulting from their portfolio companies. Guidance on materiality assessments upon which such management systems can be based is provided by GRI.

Accompanying tools and templates from Impact Frontiers and under development from PDI can help practitioners to get started, and both organizations look forward to presenting case studies of leading investors' practices as part of future work on this topic.

Appendix 1: "Investor Contribution: The Elephant in the Room No Longer?"

By Jackson Gates and Mike McCreless, ImpactAlpha, April 19, 2023[31]

Imagine two investors that publish impact reports both stating that their investments created 10,000 new jobs. In one case, the investor's capital and engagement with the company was critical to the creation of those jobs, while in the other, the investor's role was incidental and the jobs would have been created anyway.

Both of these are good outcomes; there is nothing to criticize here. But from an impact perspective, surely we prefer the first!

How can we as investors avoid negative impact and identify and focus our capital and our efforts where they will create the greatest positive change? This is our inspiration for the Investor Contribution 2.0 public consultation that we have launched in partnership with the Predistribution Initiative.

Similar to ImpactAlpha's recent Metrics Madness tournament, we recently undertook a similar exercise to collect metrics for investor contribution to intended positive impacts in private capital markets – that is, the contribution that investors make to changes in outcomes for stakeholders and the natural environment that would not have likely occurred in investors' absence[32] — and experienced some "metrics madness" of our own.

Over the past nine months, Impact Frontiers and the Predistribution Initiative, supported by Omidyar Network, have been engaged in a consensus-building effort dubbed Investor Contribution 2.0 to develop resources that investors can use to measure and manage their own positive and negative impacts, as distinct from those of portfolio companies.

New approaches for managing investor contribution are emerging out of that madness, and we are now soliciting feedback from practitioners on those approaches through a public consultation period.

It's a wonky topic, but it matters. For one thing, the question of whether impact investing has an impact depends on it. And regulators are beginning to take notice. For instance, the U.K.'s Financial Conduct Authority's recent consultation paper on "Sustainability Disclosure Requirements (SDR) and investment labels" proposed that investor contribution should be a requirement for the Sustainability Impact fund label. In this post we'll focus on just one aspect of investor contribution: investors' intended positive impacts on people and the natural environment.

Trying — and failing — to standardize metrics of investor contribution to intended positive impact

While impact investors increasingly recognize the importance of investor contribution — it is one of the nine Impact Principles to which more than 170 investors are signatories — little guidance exists to support investors with managing this aspect of impact performance. In the absence of standardized

[31] Minor edits to the version originally published in ImpactAlpha have been made to reflect that the public consultation on investor contribution is now completed, as well as changes made to terminology since then.
[32] We are not proposing any attribution analysis (i.e., estimating what % of an outcome an investor caused, for instance by pro-rating their share of the total capital provided to the enterprise).

metrics, many impact investors have begun to create their own bespoke metrics for investor contribution.

In 2022, we set out to collect as many of these bespoke metrics as we could through an open call; add metrics proposed in industry resources and disclosure frameworks; de-duplicate and organize them; suggest metrics for relevant impacts and risks that investors are not currently measuring; and then publish a shared set of metrics that investors could use to measure and manage their contributions to positive and negative impact.

As we began to review the 200+ bespoke metrics we had collected, however, we were reminded of the fable of the blind men each touching a different part of an elephant: each metric seemed to capture a different, incomplete view of the investor's contribution to impact. (See this short video for a more detailed explanation.)

As we looked more closely, we realized that each of the bespoke metrics spoke to one or more of the following elements of investor contribution:

1. Investor actions (e.g., capital allocation, non-financial engagement, investment structure, and governance)
2. Investor-level counterfactual (i.e., what would the company likely otherwise have received from investors?)
3. Change in company activities (i.e., what did the company do as a result?)
4. Company-level counterfactual (i.e., what would the company likely otherwise have done?)
5. Change in outcomes for end-stakeholders and the natural environment
6. Stakeholder-level counterfactual (i.e., what would stakeholders and/or the natural environment likely otherwise have experienced?)

We've published the full list of bespoke metrics that we collected here, if you'd like to review for yourself.

We realized that, when it comes to intended positive impacts, investor contribution does not lend itself to standardized metrics. A "metric" for investor contribution would need to capture not only the change in stakeholder outcomes, but also the causal linkage between the investor's action(s) and that change in outcomes.

Such causal linkages, between a particular action or set of actions and a particular change in outcomes, are necessarily context-specific and therefore difficult to "standardize." A particular action or set of actions may not always cause a change in outcomes that wouldn't have occurred otherwise: the context within which that action takes place often determines whether it is likely to result in a change in outcomes that wouldn't have occurred otherwise.

In other words, coming up with a list of commonly observed investor actions is easy. Yet to equate an investor action that wouldn't have been taken otherwise with investor contribution — absent its effects on companies and ultimately on end-stakeholders — is a contradiction in terms. The entire point of investor contribution is the impact on people and the planet!

This series of reflections led us to gravitate away from creating a standardized set of investor contribution metrics, and towards the idea of a credible narrative for investor contribution that considers counterfactuals. Considering counterfactuals means considering context.

What if, rather than standardizing metrics for investor contribution to positive impacts, we instead standardized the expectation that investors consider each of the six elements of the "investor contribution elephant" in a structured, evidence-informed way?

To be sure, most investors won't always have robust information about all six elements of investor contribution listed above. Many investors have only partial visibility into company impacts, and even less into counterfactuals (i.e., what would have happened otherwise). But these six elements can still provide a shared structure by which we communicate what we do know and don't know about our investor contribution — and most importantly, help us to improve that investor contribution.

We've mocked up a simple template to provide investors with a structured way to think through and gather evidence for their own investor contribution.

Confronting Counterfactuals with Credible Narratives

The template prompts investors to consider counterfactuals, or the difference between what happened with the investor's investment and what would have happened otherwise, without the investor's investment.

Counterfactuals are the tusks of the elephant upon which efforts such as this one tend to impale themselves. To put it bluntly, investors will rarely if ever be able to prove what would have happened in their absence. To expect otherwise is folly.

What we are proposing is that counterfactuals are still worth thinking about — even if you know you'll never have proof. Proof is not the point. The point is to inform decision-making. For that we can use evidence that falls short of proof.

In lieu of either standardized metrics or rigorous proof of counterfactuals, we are exploring the concept of a **"credible narrative"** for investor contribution: a structured, thoughtful account of the six elements of the "elephant," informed by evidence to the extent possible.

A credible narrative of investor contribution provides good reason to believe that the investor's action caused a specific change in outcomes for end-stakeholders or the natural environment that wouldn't have likely occurred in their absence.

Credible narratives of investor contribution can be qualitative or quantitative, short or long. They are essentially a theory of change, customized for a specific use by investors. Like any theory of change, they can express ex-ante goals, or ex-post results. And like any theory of change they can differ in quality.

The GIIN has similarly pointed to theories of change for investor contribution in its recent Guidance for Pursuing Impact in Listed Equities, noting that "further work is needed to develop methodologies for

how to consistently assess the presence and quality of investor contribution." We are proposing a structure for this, albeit in the context of private capital markets rather than listed equities.

Paddy Carter, British International Investment's Director of Impact, proposed a standard of evidence akin to that of civil law, which requires a preponderance of evidence that leads one to believe that the claim of investor contribution is more likely true than not. By contrast, the standard of evidence for criminal law requires proof beyond a reasonable doubt — an unnecessarily and possibly unreachably high bar.

By prompting investors to thoughtfully consider the likelihood that their action(s) did or are expected to cause changes in outcomes that wouldn't have likely occurred in their absence, this approach improves upon bespoke metrics that present an incomplete view of the whole "elephant." At the same time, it doesn't require extensive or impractical data collection and analysis. Our proposal is that investors assess whether there is a sufficiently compelling case that their action(s) have caused or are expected to cause a change in outcomes that wouldn't have likely occurred in their absence. In other words, a sufficiently credible narrative.

To be clear, many investors may not have a credible narrative of investor contribution for many of their investments — and that's to be expected. Many responsible or sustainable investors do not aspire to directly cause positive impacts that wouldn't otherwise have occurred.

Even for investors that do, some investments offer greater opportunity for investor contribution than others. Investors can and do employ a "portfolio approach" in which a subset of the portfolio's investments represent most of the investor contribution.

In practice, it will fall to the relevant decision-maker to judge the plausibility of investor contribution. Evaluating asset managers' claims of investor contribution can be a constructive and proactive role for asset owners and allocators to play in impact management. Consensus that emerges from our public consultation about the essential features of a "credible narrative" can help them do so, as can third-party verification and assurance.