MSc in International Business

MASTER'S THESIS

INVESTING WITH DUAL OBJECTIVES

An assessment of the investment process of impact investors

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Abstract

Impact investing opens up for effectively addressing social and environmental challenges at a greater scale than governments and philanthropists alone can afford. However, there exists a conceptual confusion on the definition with regards to how the dual objectives – social and financial returns – should be approached. Historically, pursuing these two objectives simultaneously has been deemed incompatible. Thus, this thesis aims at exploring how impact investors approach their dual objectives in an investment process. Furthermore, as personal opinions and feelings affect the perception of these objectives, additional challenges to the investment process may arise due to goal misalignment between the investors and entrepreneurs. Therefore, this thesis further analyses how potential challenges that may arise along the investment process can be controlled for or mitigated.

By interviewing investors and advisors within the field, we address the above-mentioned challenges. First, we find that impact investors generally emphasise the financial objectives. Furthermore, by utilising the traditional agency theory within the impact investment setting, we find that a thorough pre- screening and due diligence of potential investments is necessary in order to better align goals, and hence, reduce information asymmetries. Moreover, we find that more rigid and contingency-based contracting on impact is optimal to constrain or encourage certain behaviour by the entrepreneur in cases where uncertainties are present. Lastly, we find that in a lack of a proper impact assessment tool, active involvement can be employed to ensure disciplined behaviour by the entrepreneur. Nevertheless, we see that the lack of proper ways to measure social impact is the main source for potential agency problems throughout the whole impact investment process.

Acknowledgements

This master thesis is the result of a journey of both academic and personal reflection and learning. It has simultaneously been a challenging and rewarding process. To make this possible, we have received valuable support from certain people, and we would like to take this opportunity to express our gratitude.

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1. Introduction

The world today is facing significant challenges related to social and environmental issues. Historically, these types of issues have been addressed by governmental institutions and philanthropic organisations and have been separated from the financial markets (Rodin & Brandenburg, 2014). However, due to the complex and numerous issues humanity is facing today, such as climate change, increasing inequalities, poverty and population growth, government support and charity is no longer sufficient to accommodate these issues (ibid). This has led to rising demand for alternative funding methods and ways to solve social and environmental problems in today's society.

Over the last couple of decades, new and innovative funding methods have gained worldwide momentum and attention among investors and those ventures and projects receiving funding. The concept of conducting investments to yield social outcomes started to evolve gradually in the late 1940s, but it is first within the last decade that the concept has developed into a more formal and sophisticated way of investing (Höchstädter & Scheck, 2015). The concept of investing with social returns in mind has evolved from conducting negative screenings, which means excluding companies that do not comply with specific ethical, social and governmental criteria, to gradually developing into what today is called *impact investing* (ibid)*.* From traditionally seeking to maximise financial returns, investors started to identify opportunities to receive financial returns *while* contributing to solutions to social and environmental problems. Bugg-Levine & Emerson (2011) define impact investing as investments with the *intention* to generate measurable social and/or environmental impact, alongside financial returns. Impact investors can thus be seen as investors that pursue dual objectives of financial returns and social and/or environmental (*hereafter referred to as social)* impact.

Despite the increased interest for impact investing since the term was coined in 2007, the academic field is still in an early phase of development (Höchstädter & Scheck, 2015). Conceptual clarity remains an issue, due to a lack of a unified understanding of the definition, rooted in different personal opinions and feelings on the expectations of impact and financial return. Furthermore, a better understanding of the phenomenon can be achieved by clarifying how impact investors approach an investment (Roundy, Holzhauer & Dai, 2017). Existing literature on the manner specify that impact investors conduct a similar investment process to that off traditional investors, but with an additional track for assessing the impact dimension (Grabenwarter & Liechtenstein, 2011). As a result, impact investors seek to incorporate traditional financial criteria and social objectives in their investment process; however, how these dual objectives are approached is yet to be explored.

Furthermore, as the definition on impact investing is vague, the inclusion of the social objective into the investment process might contribute to challenges in terms of aligning the impact goals of the investor with those of the entrepreneur (Roundy et al., 2017). Within traditional investing, there are already challenges in aligning the incentives of the investor with that of the manager of firms in the pursuit of financial wealth. This is referred to as agency problems within financial theory. The problem is a result of conflicting objectives that may arise between an agent with a venture that needs financing (manager), and a principal providing funds for the venture (investor) but also has opinions on how the investment should be utilised. If conflicting objectives are present, managers might have incentives to pursue their own interests at the investors' expense. Thus, adding a social objective on top of the financial one might further complicate this already challenging process. Hence, it is essential to explore how such investment risks can be reduced within the impact investing scene.

This leads us to the overall aim of the thesis, namely, to examine how the dual objectives are approached in the investment process by the impact investors. Furthermore, we will see what potential agency problems that arise with the inclusion of the social objective, and how we can control for those problems.

1.1 Research objectives and research question

Our research objective is therefore twofold. Firstly, by understanding how impact investors approach their dual objectives in an impact investment process, we can contribute to the understanding of what is emphasised by the investors as of today with regards to social and financial return. Secondly, by applying the agency theory as a theoretical framework, we can further explore how the dual objectives of impact investors might lead to agency problems in their investment decisions, and how these problems can be controlled. Lastly, by exploring the investor preferences for financial and social returns, we can provide suggestions on how different investors can approach potential agency problems. Based on this, our research question is as follows:

"How do impact investors approach their dual objectives in an investment process, and how can the investors control for agency problems that might arise with the inclusion of the social objective?"

1.2 Purpose and motivation for the thesis

The purpose of this thesis is twofold. First, we seek to understand impact investors' approach to the dual objectives in an investment process. Second, we want to shed light on the relationship between impact investors and entrepreneurs to find out what risks and challenges that might occur during an investment process, and how the investors' approach to dual objectives affects this. Previous studies within the field have mainly focused on the relationship between venture capitalists and entrepreneurs, and there is a gap in the literature when it comes to frameworks that can be applied in an impact investing setting to analyse the same. Although many of the implications from the traditional theory can be transferred to impact investing, it is necessary to investigate the investment process with an additional focus on the social objectives. Thus, by including a social objective approach to existing theories and frameworks, the purpose of this thesis is to understand how impact investors are considering their dual approach, what potential challenges they are facing and how they can control and mitigate these challenges.

The motivation for this thesis stems from our general interest in the social aspects of finance and how the financial world can contribute to the greater good. Hence, we find the idea of using investments as a mean of achieving social and environmental impact, fascinating. We find it highly interesting to witness the development of a field that combines finance with philanthropy, and we genuinely believe that impact investing can gain legitimacy and become a way to solve social and environmental challenges in the world in the long run. Therefore, we hope that by investigating the topic further in this thesis, we can gain and spread knowledge, which can lead to an increased interest for impact investing among other students, investors, and practitioners in the field.

1.3 Contribution to previous research

This thesis contributes to the limited research on impact investing, and as far as we know, there is no other research conducted on the same topic on agency problems within impact investing. Practitioners in the field (our interviewees), which we have contacted, confirm that we are addressing a pressing issue which has not yet explored. The importance of an in-dept analysis of the topic is acknowledged by the interviewees. Furthermore, our study enlightens opportunities for impact investors on how they should approach their dual objectives and, during the investment cycle, overcome potential challenges and risks.

1.4 Outline of the thesis

To answer our research question, we adopt the following structure consisting of seven chapters, see Figure 1. Chapter **two** is the methodology chapter, where we argue for our choice of research approach, research philosophy, and research strategy, along with the choice of methods we want to apply in order to analyse our research question. Chapter **three** starts with a general review of the impact investing scene and its actors. The chapter further touches upon the most relevant features of impact investing for our thesis, to create a foundation for the rest of the thesis. Chapter **four** reviews the agency theory, the classical agency problems, and the different mechanisms available to control them. Further, the chapter review these control mechanisms, and addresses what considerations impact investors need to account for in their investment process. We then move on to chapter **five,** which is the analysis chapter. The analysis follows a structure based on our two-folded research question and our theoretical framework. In chapter **six** we briefly discuss our key findings and use propositions as a way to summarise them. We further highlight the theoretical and practical implications of our thesis. Finally, in chapter

seven we present our conclusion, along with limitations of the research and future research recommendations.

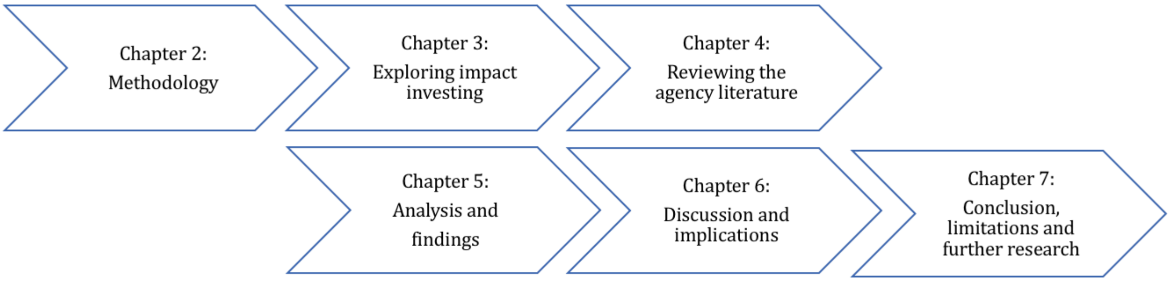

Figure 1: Outline of the thesis.

1.5 Delimitations

We limit our thesis to focus on the impact investing market in the Nordics. The impact investing market is regulated by institutional laws and practices, which is why we find it most natural to study the impact investing market in the Nordic countries where the institutional and regulatory systems are assumed to be more similar than, for example, if we would have included the markets of the Americas or Asia. Moreover, it will be easier for us to reach out to potential interviewees from the Nordic countries due to the geographical location.

We choose to include impact investors who have experience with conducting direct equity investments but also has experience with funds, through social impact bonds or similar. To get the views of a broader spectre of impact investor on these types of investments, and to see the topic from a different angle, we also choose to not only include impact investors but also impact investing advisory companies. We include different investor types along with the advisories to get a broad understanding of investors' behaviour and perception of dual objectives, in terms of financial and social expectations, and risk mitigation of potential conflicts that might arise during an investment process. Lastly, fundamental financial principles and terms will not be described in detail. It is thus expected that the reader has a basic financial understanding.

2. Methodology

This chapter aims to present the chosen methodological assumptions, which have been used in order to develop the research design and data collection for this thesis. The data collected will be used in the analysis section in order to answer our main research question. Furthermore, this section will provide an understanding of the systematic approach utilised in the thesis, and our argumentation for the chosen method.

2.1 Research philosophy

The research philosophy is important as it helps clarify the research design, which will make it possible to collect the data we need to answer our research question. According to Saunders et al. (2012) a research philosophy deals with the development of knowledge – how new knowledge should be gathered, analysed and used. The adopted philosophy will contain a set of assumptions and considerations, which in the end will constitute a credible research strategy and support the methodological choice (Saunders, Lewis & Thornhill, 2012).

The literature identifies three different types of philosophical research assumptions: ontology, epistemology, and axiology. Ontology is the study of the nature of reality, of what is perceived real (Saunders et al., 2012). It is concerned with the assumptions we make in order to believe that something makes sense or is real (Kivunja & Kuyini, 2017). The ontological assumptions can be further divided into objectivism and subjectivism. *Objectivism* regards the social phenomenon as independent of social actors (Bryman, 2012), while *subjectivism* finds that it is the perceptions of social actors that form the social phenomena (Saunders et al., 2012). When conducting our research, where the focus is to assess the investment process of investors when dual objectives are pursued, we find it most useful to combine the experienced investors' subjective thoughts and meanings on the matter with secondary literature. Hence, in this research, both subjectivism and objectivism will be the underlying ontology.

Epistemology is related to the knowledge that is established acceptable – what is *"known"* to be true (Bryman, 2012). The philosophy studies the origin and nature of knowledge, along with its limits. Epistemologically, the objectivistic obtains knowledge about the social world through observable and measurable facts, while the subjectivist believe that feelings and attitudes should be accepted as knowledge (Saunders et al., 2012). As the existing literature on impact investing is limited, we will apply both primary data and secondary data in our thesis. Given this, we take on both an objectivistic and a subjectivist view, as we believe looking into investors' opinions and attitudes combined with secondary literature on the subject is the most appropriate way to generate knowledge. While collecting primary data, we will take on a subjective role and be involved in the fieldwork, whereas we will take on an objective role while collecting the secondary data. Here, we will have a distanced approach to the research and not influence the research outcome (Aliyu, Singhry, Haruna & Abubakar, 2015).

Axiology refers to the ethical issues that need to be taken into consideration when planning and executing research. It focuses on the nature of valuation, and how the researcher's own values affect the research process (Kivunja & Kuyini, 2017). Being conscious of our values is of great importance as it increases the awareness of biases we are making in drawing conclusions from the data, and hence it will make the results more credible (Saunders et al., 2012). We are going to conduct semi-structured interviews in order to collect data to answer our research question, so to account for biases, we refrain from the use of leading questions. Hence, our questions are constructed as open questions where we keep our interference at a minimum. In such way, the respondents' answers will be independent, and we will get an understanding of the topic from the eyes of the respondents. Like this, the axiology of the paper will be more balanced one, where we assume that the outcome of the research unintendedly will reflect some of our values, as the topic is of our interest, but where we are trying to present a balanced report of the findings.

In addition to the three different philosophical research assumptions, there are five major philosophies: positivism, critical realism, interpretivism, post-modernism and pragmatism (Bryman, 2012; Saunders, Lewis & Thornhill, 2016). This thesis will follow a critical realist philosophy. According to Bryman (2012), critical realism can be placed in the middle of positivism and post-modernism as the philosophy assumes that an entity can exist independently of our knowledge to it, at the same time as implying that the social world is always mediated and thus subjective. Critical realists argue that what we experience are sensations and that researchers can only understand the social world if they understand the social structures that have given rise to the phenomena that they are trying to understand (Saunders et al., 2012). Moreover, critical realists acknowledge that the social world is continuously changing (ibid). A critical realist view is a useful approach in this thesis as it allows us to analyse investors' attitudes and thoughts through dialogues and interviews, especially since impact to some extent is subjective and different investors might have different perceptions of it. We thus acknowledge that the social world exists, but that in order for us to understand it, we need to gain a deeper understanding of the social structures within it.

2.2 Research approach

The methodology can either follow a deductive, inductive or abductive research approach. Using the deductive approach, one develops hypotheses based on existing theory and then further test these hypotheses through collected data. The inductive approach starts with the collection of data and then a theory is proposed towards the end of the research process as a pattern is found in the collected data. Lastly, through abductive reasoning, a researcher seeks to choose the "best" explanation by the use of existing theory to explain the knowledge gathered in the research process through collection of data (Bryman, 2012).

We will combine methods, as our research will use existing theories and frameworks combined with our primary data collection to explain the challenges that might arise in the relationship between impact investors and investees. This is in line with Saunders et al.'s (2016, p. 152) view on combining methods: *"one may apply a hybrid approach which could involve the use of a theoretical framework to help you make sense of your findings."*

2.3 Research strategy

The research strategy explains the methods that are used to collect data and distinguishes between quantitative research and qualitative research. Quantitative methods entail a deductive approach where theories are tested (Bryman, 2012). It includes the search for patterns and context based on quantifiable data, which is more in line with the positivistic model. Qualitative methods, by contrast, encompass an inductive approach where the emphasis is placed on the generation of theories (ibid). The method incorporates interpretivism, where one focus attention on how individuals interpret their social world (ibid).

In this research, we try to understand how principals better can manage their relationship with agents within a social investing scene and reduce potential agency conflicts. To acquire an understanding of this, we believe a research approach that emphasises words instead of quantification in the collection and analysis of data, is required. Hence, the qualitative approach seems more appropriate. A qualitative approach will also be more consistent with our choices of research philosophies and research approach. The main research methods entailing a qualitative approach are ethnography/observation, focus groups and interviews. *Ethnography* and *observation* are based on data collection through observation and listening to gain an understanding of the culture of a group, whereas the ethnographic approach targets a specific group while observation includes all individuals (Bryman, 2012). This research strategy is not appropriate in our study due to how time-consuming it is. An investment process, which is what we examine, may take place over an extended period, and might also differ from investor to investor. Therefore, this strategy would not be suitable for us to conduct as it would not have been done properly due to our time and resource limitations. Moreover, *focus groups* is a group interview where a specific topic is discussed between the participants (Saunders et al., 2016). Such an interview could have been appropriate for our study; however, it was impossible to find a time slot which suited all of our participants.

Lastly, *interviews* are also used to gather qualitative information. By conducting interviews, we get an insight into what the respondents see as important, whereas we capture their reflections on the subject and thus acquire a contextual understanding. In other words, it allows us to get richer and more detailed answers. Hence, this is our preferred method to collect primary data. There are two main types of interviews, namely unstructured– and semi-structured interviews. We have chosen to conduct semi-structured interviews as we have some fairly specific topics which need to be covered (Bryman, 2012). Consequently, we will develop an interview guide.

Furthermore, secondary data, which is data previously collected for another purpose (Saunders et al., 2012), will also be used in order to gather necessary information. Secondary data is a good alternative towards collecting new primary data, as it allows the use of high-quality data at the same time as one saves time and it holds a low cost (Saunders et al., 2016). The literature can contribute to a richer analysis and can also be used to support or reject the findings of the primary data collected. However, as there is limited secondary data on what we study, a lot of the data we find can have been collected for a purpose that does not match our need, which can affect how the data is presented (Saunders et al., 2012). Besides, we do not have much control over the quality of the secondary data (Saunders et al., 2012). An elaboration of how we will use these two methods to answer our research question will be presented in the following sections.

2.4 Semi-structured interviews

Due to the nature of our research philosophy, semi-structured interviews are considered to be the most appropriate interview method. Saunders et al. (2012) state that semi-structured interviews include themes and possible key questions to be covered, but that the use may vary from one interview to another. Given that our interviews will be conducted with both impact investors and impact advisory companies, following this structure will allow us to omit or add additional questions to the respondents where it seems natural. The interview guide that will be used for the interviews will be based on the theoretical framework we intend to use in our analysis and will include three main areas of interest (see Appendix 1). These areas are the pre-investment phase, contracting and post-monitoring, respectively. Each of the main areas has following sub-questions related to the topic. The interview guide follows the structure of our indented framework to ensure that all the relevant topics are included. The interview guide starts with a few introduction and background questions to make the respondents feel comfortable and to set the basis for the interview. In the end of the interview, the respondents will be asked a few more open questions and to elaborate further on the touched upon topics or topics that we perhaps did not cover during the interview. We acknowledge that we might have to do some minor changes to our interview guide after conducting the first interviews if we notice that we do not get the answers we are seeking for or if we need more concrete answers. Therefore, we take into consideration that small changes in the interview guide might occur.

2.4.1 Selecting participants

When selecting participants for our interviews, a generic purpose sampling approach will be followed. Purpose sampling is a non-probability form of sampling, and participants are not chosen on a random basis, but on their relevance for the research questions. This sampling method also seeks to include a variety of participants with different key characteristics that might be relevant to the research question (Bryman, 2012). As further stated, generic purpose sampling may be employed *"in a sequential or in a fixed manner and the criteria for selecting cases or individuals may be formed a priori (for example, socio-demographic criteria) [...])* (ibid, p. 422).

Based on this approach, several factors have to be considered when selecting participants. Due to the nature of impact investing and potential different return preferences and motives behind impact investing, we choose to include different investor types in our sample. We will aim at selecting investors from different backgrounds and types of companies, whom we believe can provide us with different views on the topic. Our preferred sample of investors will therefore range from angel investors and family offices to funds. By including investors from various segments of the market, we will get a more complete understanding of how investors approach the investment decision and whether they share the same opinions about it or not. The nature of our research question is somewhat complex, and it is essential to obtain a general understanding of the perceptions of impact investing in the market. Family offices and business angels are less restricted than large funds, and it can therefore be interesting to see the differences between them. Furthermore, since we choose to follow a purpose sampling approach, we have developed some criteria that the investors in our sample need to fulfil in order to be relevant for our research:

- Based in the Nordics
- Actively engaged in impact investing
- Perform investments aligned with the definition of impact investing
- Directly investing in ventures and enterprises, not only funds

As mentioned, the impact investing scene in the Nordics is still in an early stage of development, and we thus expect that it can be challenging to find relevant participants. Therefore, we take into consideration that this might cause some delays in our research process. However, when we are contacting potential investors, we will also ask about recommendations for other investors or organisations to contact, which Bryman (2012) calls the *snowball effect*. This sample method can be used when participants are harder to get a hold of (ibid). This can allow us to get in touch with investors we would typically not have found by searching the Internet.

Additionally, to see impact investing from a different angle, we choose to include impact investing advisory companies in our sample as well. These companies have extensive experience from a broad range of investor types and investment strategies, which can provide us with more overall opinions about impact investors and their investment process. Moreover, we can use the answers from the advisory companies and compare them with the responses from the impact investors to see whether their statements are aligned or not in order to conclude at a later stage. Thus, we can use this information to control whether the investors are saying the same as the advisors with experience from the field. We choose to apply some defined criteria for the advisory companies, too:

- Based in the Nordics
- Actively engaged with advising impact investors on different impact investing strategies

- Engaged in projects that seek both social and financial returns

Based on the criteria mentioned above, we have found seven participants we believe will bring valuable inputs and opinions to our research. The selected participants for our study are shown in Table 1 below. After conducting the interviews, we will confirm the date and length of the interviews we have held, and state the information in the appendices of this thesis.

Name	Company	Type	Location	Type of interview
Frederik Engedal and Laura Paludan-Müller	Nordic Development Corporation	Advisory company	Denmark	Face-to-face
Malene Bason	Future Impact	Advisory company	Denmark	Face-to-face
Ingrid Stange	Partnership for Change	Angel investor/ family office	Norway	Skype
Mika Pyykkö and Juuso Janhonen	Sitra	VC fund	Finland	Skype
Silje Veen	TD Veen	Family office	Norway	Skype
Espen Daae	Ferd Social Entrepreneurs	Family office and accelerator	Norway	Skype
Regitze Makwarth Olsen	Maj Invest	PE fund	Denmark	Face-to-face

Table 1: In-depth interviews with impact investors and advisory companies. Source: Authors' own.

Our informants' experience and knowledge of the market play an important role in the selection process. Ingrid Stange from Partnership for Change (PfC) can be seen as an early adapter in the venture philanthropy and impact investing scene in Norway, while Malene Bason has a long experience from the traditional finance industry and investment processes. She now runs her own impact advisory company and assists impact investors from the initial stage throughout the whole investment process. Frederik Engedal and Laura Paludan-Müller from Nordic Development Corporation (NDC) have both experience from the impact investing field and have a genuine interest in the topic. In their daily work, they work on developing a new investment strategy that can achieve social goals with financial returns, and they possess a general knowledge of different investors in the market. Mika Pyykkö and Juuso Janhonen work for the Finnish venture capital fund Sitra, and have both an extensive knowledge about traditional venture capital and impact investing. Silje Veen comes from the family office TD Veen, where they have been conducting investments with social objectives for decades. Espen Daae from Ferd Social Entrepreneurs (Ferd SE) works closely with start-ups and entrepreneurs, and because he is a portfolio manager, he has in-depth knowledge about investment processes and strategies. Ferd SE also functions as an accelerator for impact start-ups, which is why Espen can share valuable insights about the investees in the field. Lastly, Regitze Makwarth Olsen works for Maj Invest and is responsible for the company's ESG reporting on their impact funds. Therefore, Regitze has personal experience from impact management and monitoring processes.

2.4.2 Conducting the interviews

The interviews will either be conducted in person or via Skype, based on the geographical location of the participant. For the investors based in Norway and Finland, the interviews will preferably be conducted over Skype. For the investors and advisory companies based in Denmark, all the interviews will preferably be held in person. The interviews should be held in comfortable surroundings based on the participants' preferences, for example in their offices or in another location they prefer. Both of us will participate in the interviews, where one of us will ask the questions, while the other one will take notes to make sure no data is lost. The interviewees will be given the choice of either conducting the interview in Norwegian (participants from Norway) or English, according to their preferred language. We expect most of the interviews to be conducted in English, but if some of the interviews are held in Norwegian, we will translate the relevant quotes from the interview(s) that we want to apply in our analysis. Lastly, we aim at holding one hour-long interviews, but acknowledge that some interviews might be shorter due to busy schedules or varied interest of elaborating about the topic.

We will send out the interview guide on beforehand to the interviewees to ensure that they understand the topics well and to give them time to prepare more thorough answers.

We will send the interview guide to all the interviewees except from one, as this person wants to have a brief call before the interview instead. Before the interviews, the participants will be explained the purpose of our study as well as some rules regarding the length of the interview, recording, and rights concerning confidentiality. This will be presented to make the respondents feel comfortable and to make them aware of how we intend to use the information they provide. The respondents will also be asked if we can record the interviews. Recording the interviews are expected to be extremely helpful for us afterwards as it allows a more accurate interpretation of the answers and will enable us to concentrate more on the ongoing conversation (Bryman, 2012).

2.5 Secondary data

In addition to the primary data obtained from the semi-structured interviews, secondary data will also be relevant to use in our thesis. The secondary data will mainly consist of peer-reviewed academic articles, practitioner literature and reports from acknowledged companies such as J.P. Morgan and McKinsey. We will search for the academic articles by using Google Scholar and Copenhagen Business School's databases, among others. Practitioner literature on impact investing will in most cases be retrieved from The GIIN and World Economic Forum, as these two organisations have conducted extensive research about the subject. For example, The GIIN's Annual Impact Investor Surveys can be very useful to get a closer understanding of the behaviour of impact investors and their perception of the investing process, that later could be used to compare our own results from the interviews with impact investors.

The secondary data will further help us to get a deeper understanding of the research area in our thesis, and the primary data through data triangulation. Hence, we will be able to support or reject the answers of the respondents, and further challenge them by elaborating on points that might not be stated directly in the responses of the interviewees. By reviewing other literature, we will also gain a comprehensive understanding of the impact investing scene that might enable us to ask questions that are not necessarily obvious without having a basic knowledge of the theory.

When searching for secondary information, we aim at including literature from different years, authors, and organisations. We will start the literature search with only searching for impact investing, impact investors and closely related terms, however, since the topic is still young and the literature about it might be limited, we will also take other associated keywords into account, such as social investing, social finance and ethical investing. We thus assume that some general implications from these topics can be closely connected to impact investing. If we choose to include literature that is not necessarily directly related to impact investing, a further assessment will be conducted in order to decide its relevance and to discover connections that also can be applied in impact investing.

2.6 Data analysis

After conducting the interviews, all of them will be transcribed to make sure that no relevant information gets lost. Transcribing the interviews will also allow us to get a thorough understanding of the topics covered, which can make it easier when we start writing the analysis. The interview guide can be found in Appendix 1 and all the transcribed interviews can be found in Appendix 2. As mentioned previously, all the interviews should preferably be held in English, but if that is not the case for some of the interviews, we will transcribe the interview(s) in Norwegian and translate relevant quotes we want to use. In cases where we will use direct quotes from the interviews, we will send the citations to the respective interviewees for approval before using them.

2.6.1 Semi-structured interviews

In order to analyse the qualitative data that we will gather in the semi-structured interviews, each interview will be recorded, if accepted, and then further transcribed. In Appendix 1 and 2, respectively, we will include an explanation over the interview guide and its structure, in addition to the transcribed interviews themselves. Furthermore, as a method for analysing the data, we have chosen to code our transcribed interviews as Bryman (2012) state that coding is a great method to process and analyse qualitative data. He further argues that the principles of coding are well-developed by writers on grounded theory. We expect to derive rich and varied responses from our interviewees due to the use of the semi-structured interviewing method. Hence, we will code the qualitative data in our Excel sheet by colour, as we believe it will be hard to quantify the different answers with, e.g. code words.

However, we acknowledge that such coding of qualitative data has been criticised due to the possible problem of losing the context of what is said (Bryman, 2012). To minimise the possibility of losing context, we will make a matrix in an Excel sheet where we first organise the answers next to each other on the sheet based on categories the interview is built upon, to get a brief overview of the transcriptions. The different questions will be presented down the columns, and the different answers of the participants will be displayed horizontally next to each other on the same row. Next, we will then read through the questions and transcripts several times and consider what part of the answers that can help us with answering our research question. Every time we read through the transcriptions, we will eliminate content that will not help improve our understanding of any of the constructs in the interview guide. In the end, we will be left with a brief summary of the most critical aspects of the answer to each of the respondents. After this, we will be able to review the summaries and acquire an understanding of "what can help us answer what part" and colour the transcripts respectively. Finally, we will compress the data by extracting the relevant information from the colour-coding in each interview. A sample will be attached in the appendices so that the reader can get an understanding of how the primary data was interpreted.

2.7 The credibility of research findings

Unlike quantitative research, qualitative research deals with interpretation of non-numerical information, which inevitably tie in with human thoughts and senses, and subjectivity. Within qualitative research, such elements are considered essential as they can add extra dimensions which will enrich the findings (Leung, 2015). Nevertheless, such subjective perspectives and contextual ramifications have fuelled never-ending controversies regarding the quality of qualitative research (ibid). Hence, it is crucial to assess and establish the credibility of research findings.

In order to evaluate the trustworthiness and quality of research, it is common practise to test the reliability and validity. Reliability is concerned with how reliable the results of research are and refers to the extent to which the data collection is consistent (Saunders et al., 2016). Furthermore, validity refers to the accuracy of an assessment; whether or not it measures what the researcher set out to measure (Carmines & Zeller, 1979) Lastly, we will address the issues of generalisability.

2.7.1 Reliability

As reliability refers to the consistency of measures, it concerns the extent to which a primary data collection process yields the same results if repeated (Carmines & Zeller, 1979). In qualitative studies, where the findings are non-numerical, this emphasises the importance of thoroughness when collecting the data (Leung, 2015). To ensure the reliability of this thesis, we provide a detailed description of how the primary data collection was conducted, including the interview guide. A repeated interview of the same participants would probably generate the same results if conducted in the near future, especially since we put effort into interviewing both impact-first investor and finance-first investors. However, it is important to acknowledge the continuous growth and development in the impact investing field, both academically and in practice, thus a similar study conducted later in time could yield different results.

Nevertheless, we assume we will find differences in the answers of the investors, due to their investment preferences along with knowledge and experience within the field. Hence, interviewing other participants could also develop different results based on this. Also, our study will be conducted on investors from the Nordic countries, hence conducting the same research in other geographical areas could yield different results.

There is always concerns of reliability related to response bias, where answers will be "manufactured" as participants may respond inaccurately or falsely to questions (Saunders et al., 2012). To decrease the possibility of bias, we choose to interview investment advisors within the impact investing field in addition to impact investors themselves, to triangulate the responses. Triangulation is a technique that facilitates validation of data through cross-verification (Saunders et al., 2016). Hence, we can check if the investors give us responses that reflect their actual actions and thoughts, and not just answers which would make them and their firms look good, which is somewhat common within the field of social finance. For example, if the investors exaggerate the importance of the social aspect in their investment decisions, we can double check with the advisors to see if that is usually the case for that specific investor type. Also, for our respondents to be able to speak as freely as possible, we will offer them anonymity to increase the reliability of their answers.

Furthermore, we will be conscious of our interpretation of the replies, to mitigate observer bias. This is especially important in our research as we have developed a personal attachment to the field through our study. Thus, we will have the interview guide present during the interviews to make sure we ask what we intend. We will also both be present during the interviews, and we will look over each other's interpretations of the answers in the analysis.

2.7.2 Validity

In qualitative research, validity refers to the "appropriateness" of the tools, processes, and data used to answer your research question (Leung, 2015). It is concerned with the integrity of the conclusions that are generated from the research (Bryman, 2012). To ensure the validity of the thesis, we will build the research upon the stages in an already existing framework within the chosen theory. The framework highlights three steps which need consideration in an investment process when looking at how to ensure that an agent act in the best interest of their principal. We will explore whether that traditional framework also is suitable within an impact investing setting, hence, our interview guide will be developed based on the same three phases to ensure that all aspects of the process are covered in our research. This interview guide will be sent to our respondents prior to the interview, for us to acquire more detailed answers during our interviews. Our interview guide includes open-ended questions and allows us to ask the interviewees to elaborate in greater details if needed.

Furthermore, in cases where we are not sure whether we have understood a statement correctly, we will explain our impression of their responses to check whether we got it right or not. Saunders et al. (2012) supports such testing, and argue that one should discuss topics from a variety of angles and test understanding to secure a highly valid semi-structured interview. Furthermore, respondent validation will be conducted to improve the accuracy and credibility of our findings further. This includes providing the relevant interviewees with an account of our results based on the interview (Bryman, 2012), to ensure that this reflected the intended meaning of the interviewee.

Moreover, we will include data triangulation to increase the validity of our research. Combining semi-structured interviews with secondary data when studying the same phenomenon provides us with the ability to argue both for and against the findings of our primary data. In such a way, we shed light on the differences and can better clarify the validity of the data we collect through the semi-structured interviews. However, as there is limited secondary data on the manner, we will have to use literature from similar topics as well in our analysis. We will thus clarify this in all instances where it is necessary and take it into account whenever we make any conclusions.

2.7.3 Generalisability

Generalisability refers to whether our findings are applicable to other settings (Saunders, Lewis, & Thornhill, 2012). To be able to generalise, it would be necessary to select samples of sufficient numerical sizes (ibid), whereas we will only interview five impact investors and two advisors. Yet, to mention, the financial advisors within impact investing is included with the intention of getting knowledge on how the "average" impact investor acts and thinks, in addition to the use of secondary data and data triangulation. Hence, some of our results might be generalisable to a certain extent. However, our aim is not to make generalisations about the entire population of impact investors, but to understand a particular context.

3. Exploring impact investing

The following chapter is divided into two main parts. The first part aims at providing the reader with a general introduction to impact investing and related terms connected to the concept. This part will thus give the reader background information about impact investing and widely used terms and concepts, in order for the reader to easier be able to follow the logic behind our thinking in the rest of the thesis. The second part provides a more theoretical approach to impact investing and includes important dimensions of the impact investing market and impact investors' approach to financial and social returns, and lastly, potential risk factors related to impact investing. This part is thus essential to answer our research question.

3.1 What is impact investing?

The term *impact investing* was coined in 2007 during the Rockefeller Foundation's meeting at the Bellagio Center in Italy (Bugg-Levine & Emerson, 2011). Leading profiles from finance, development and philanthropy were gathered to explore ways of investing for social and environmental impact by building a worldwide industry. The meeting resulted in a launch of the *Impact Investing Initiative* in 2008 which sought to implement the industry-building plans created one year earlier (Jackson & Harji, 2012). Although investing for creating social impact is not a new phenomenon, impact investing differs as the investments are made *intentionally* and with *purpose*, meaning that impact investors actively choose investments they believe will create social or environmental impact (Höchstädter & Scheck, 2015). Impact investing was thus established as a hybrid term; the investments are made with the intention of creating *both* social and financial returns.

Impact investing gained attention due to dissatisfaction about the existing financial system, ineffectiveness of philanthropy and public spending, and the need for a more effective capital allocation (Calderini, Chiodo & Michelucci, 2018). Generally, impact investments are made in both developed and developing countries and may include a range of different investment types, such as private equity, funds and public equity markets, debt, deposits and guarantees (ibid). The term is recognised by large corporations and institutions worldwide and has gained attention from a broad range of investors, both individual and institutional (GIIN, 2019b). The range of investors includes fund managers, family offices, private foundations, pension funds and private investors. The initial interest was typically seen from wealthy individuals, foundations and private investors, however, the market has recently gained attention from large mainstream organisations, too, such as Credit Suisse, J.P. Morgan and BlackRock (Social Impact Investment Taskforce, 2014).

3.1.1 Impact investing defined

Although most investors and academics agree on the overall definition of impact investing, there is still a need for a uniform definition of the term to clearly outline what it includes and stands for (Höchstädter & Scheck, 2015). The widest used term is created by The Global Impact Investing Network (GIIN), which states that *«Impact investments are investments made with the intention to generate positive, measurable and environmental impact alongside a financial return»* (GIIN, 2019b). Höchstädter & Scheck (2014, p. 449) view impact investing as investing with dual objectives, and state that impact investing combine *«philanthropic objectives with mainstream financial decision making.»* According to Bell (2013) impact investing is seen as an «emerging paradigm shift» in both entrepreneurial finance and philanthropy. In a prominent article, O'Donohoe, Leijonhufvud, Saltuk, Bugg-Levine & Brandenburg (2010, p. 5) define impact investing as *«Investments intended to create positive impact beyond a financial return ... [that] requires the management of social and environmental performance in addition to financial risk and return.»* Another definition is set out by Bridges Ventures (2010, p. 3), stating that impact investing consists of *«actively placing capital in businesses and funds that generate social and/or environmental good and a range of returns, from principal to above market, to the investor.»*

Moreover, to avoid any confusions later in the thesis, the impact investing terminology needs to be defined. In this thesis, the word *impact* will thus refer to the social and/or environmental results of an investment. Many investors tend to not focus on measuring the impact itself but settle for measurement of indicators such as *activities* or *outputs*

(Saltuk & Idrissi, 2015). In this thesis, we do not differ between impact at particular levels of depth, and the word *impact* may therefore include leading indicators as well as the impact itself. However, in case some of the investors from our interviews are mixing the terms, we find it relevant to explain the differences between the terms here.

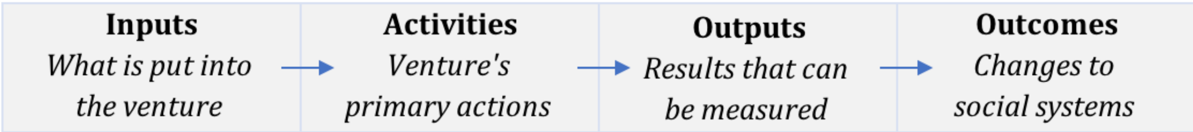

Figure 2: The impact value chain. Source: Authors' own, adopted from Saltuk & Idrissi (2015).

Additionally, when we later in this thesis discuss impact *measurement* and *monitoring*, we follow the social impact consultancy firm inFocus Enterprises' definitions:

"Measuring social impact refers to the measurement of long-term social change and what happens along the way of this change, from details about the social problem you are addressing, to details about activities you run and the short-and medium-term results of these activities" (inFocus, 2016, p. 7).

"Monitoring is the systematic and continuous assessment of the progress of a piece of work over time, which checks that things are 'going to plan' and enables adjustments to be made in a timely way, integral to day to day management" (inFocus, 2016, p. 8).

3.1.2 Core characteristics of impact investing

Based on the outlined definitions above and existing theory, impact investment can further be divided into three main components, namely *intentionality, return expectations* and *impact measurement* (Findlay & Moran, 2018).

Intentionality. One of the main components of impact investing is an investor's *intentions* to have positive social and/or environmental impact through his or her investing (Jackson, 2013). Investing to create social or environmental returns is what distinguishes impact investors from conventional investors, who mainly invest to achieve financial returns. According to Bugg-Levine & Emerson (2011), conventional investors tend to reject the idea that they should pay attention to the social impact of their investments, as they believe that the financial returns will be lower. However, an increasing number of investors choose to use their capital to achieve *blended value*: *«[...] we do not seek either wealth or social justice: we seek both»* (Bugg-Levine & Emerson, 2011, p.12)

Return expectations. Although impact investors seek to create a social return, they also seek to generate a financial return on capital, or at minimum, a return of the principal (Höchstädter & Scheck, 2015). Furthermore, impact investors target investments across different asset classes, and the expected financial returns vary from below market to risk-adjusted market rate (GIIN, 2019b). For long, there has been a general belief among conventional investors that impact investing does not result in risk-adjusted market-rate returns. However, evidence shows that impact investments often meet the expectations and even outperform traditional investments in some cases (Mudaliar, Bass & Dithrich, 2018). Still, more empirical research is needed to understand the performance of impact investments fully.

Measurement. Included in the term «impact investing» is the investors' ability and commitment to measure and report the social and environmental impact of underlying investments. How investors approach the measurement component, depends on their objectives and capabilities to measure, their goals and intentions (GIIN, 2019b). There does not exist a global measurement method for measuring social impact as of today. However, several tools and frameworks have been developed, such as the GIIN's Impact Reporting and Investment Standards (IRIS) (Reeder, Jones, Loder & Colantonio, 2014).

3.1.3 Related terms

Seeking to achieve social benefits and financial returns is not a new phenomenon. Investors have been targeting social and environmental projects and ventures for decades, although the focus and incentives of the investments have changed over time. As there exists a broad scope of literature covering related topics to impact investment, we find it necessary to define what impact investing is – and what it is not. The following section will therefore highlight some of the closest topics related to impact investing and point out the main similarities and differences.

Environmental, social and governance (ESG). According to Van Duuren, Auke Plantinga & Scholtens (2016) ESG investors seek to conduct either a negative screening by, e.g. excluding industries or companies, or a positive screening where particular companies are included (ibid). ESG investors usually structure their portfolio to meet a minimum goal of each of their selected dimensions (Revelli, 2017). By doing so, ESG investors focus on the social side of the investment and not only the financial side. However, despite the focus on social and environmental factors, ESG investors still seek to maximise their financial return before a social return, whereas impact investors are willing to accept a lower return by creating positive value (ibid).

Socially responsible investing (SRI). Socially responsible investing draws on several factors from ESG investing but is more focused on creating social value. Höchstädter & Scheck (2015, p.455) state that SRI is *"often defined as the integration of certain non-financial concerns, such as ethical, social or environmental, into the investment process."* The SRI investment process is based on a negative screening process, where companies are excluded based on social, environmental or governmental concerns (ibid). Although a positive screening has been argued for as an investment strategy, SRI investors seek to obtain a near commercial return (ibid). SRI investors differ from impact investors by focusing on minimising negative externalities alongside financial returns (Rodin & Brandenburg, 2014). Impact investors, on the other hand, are intentionality and proactively seeking to create positive social value alongside financial returns (Höchstädter & Scheck, 2015).

Venture philanthropy. Höchstädter & Scheck (2015) further argue that impact investing is placed somewhere between conventional investing and venture philanthropy. Instead of viewing impact investing as a replacement for venture philanthropy, it should instead be considered as a complementing funding method (Rodin & Brandenburg, 2014). Venture philanthropy differs from impact investing in terms of its primary goals. Venture philanthropists are looking to create and grow sustainable businesses that can solve current social issues, but do not require financial returns on their investments (Hehenberger & Alemany, 2017). Additionally, venture philanthropists focus mainly on the social aspects and do not value the environmental elements to the same extent as impact investors do (Rodin & Brandenburg, 2014).

Social finance. Social finance, sometimes referred to as social investing, is said to be an umbrella term for impact investing, and the terms are often confused. Social finance seeks to finance projects and ventures that can result in both social and financial returns (Rizzi, Pellegrini & Battaglia, 2018). The term is broadly defined and includes approaches such as crowdfunding, ethical banking, microfinance and social impact investing (ibid).

Social impact investing. Last, but not least, the term social impact investing tends to be used interchangeably with impact investing. Evidence shows that the use of the terms depends on geography; in the US the term impact investing is widely used, while as in Europe and the UK, the term social impact investing is the preferred term. Glänzel & Scheuerle (2015), however, argue that social impact investing relates to *social first* approaches, meaning that the investors are willing to accept lower returns or higher risks on their investments. In this thesis, we will thus use the term impact investing, as impact investors may take on either a *social first* or a *financial first* perspective (Brest & Born, 2013). To sum up, Figure 3 shows how impact investing relates to similar terms.

<table>
<tr><th colspan="2">Finance-only</th><th colspan="2">Social finance</th><th colspan="2">Impact-only</th></tr>
<tr><td colspan="6">Impact investing</td></tr>
<tr><td>Traditional investments</td><td>Social responsible investing</td><td>Finance-first investing</td><td>Social-first investing</td><td>Venture philanthropy</td><td>Philanthropy</td></tr>
<tr><td colspan="3">Targeting competitive financial returns</td><td colspan="3">Targeting below-market returns</td></tr>
<tr><td colspan="6">Targeting high-impact objectives</td></tr>
</table>

Figure 3: Related concepts and impact investing. Source: Authors' own, adopted from Social Impact Investment Taskforce (2014).

3.2 Identifying the impact investing market

This section aims to give a brief introduction of the impact investing market and the operating actors. Later on, selected dimensions of the impact investing market identified by Höchstädter & Scheck (2015) will be discussed in order to provide the reader with a better picture of the impact investing scene.

The market for impact investments is continually growing, and the impact investments assets under management are increasing steadily every year. According to the 2018 Annual Impact Investor Survey, the global value of managed impact investing assets is estimated to USD 228.1bn (Mudaliar et al., 2018) and is expected to surpass USD 2tn by 2025 (Roundy et al., 2017). However, due to the lack of a precise definition of the market and its instruments, estimates of the market size might differ (Abt, 2018). As the market has evolved, it has gained interest from large institutional investors, and international organisations such as the UN have promoted the market (PRI, 2018). Impact investing is not only gaining attention from institutional investors; at country levels, governments are showing increased interest, too. As an example, a social impact investment taskforce was established in 2013 by the Group of Eight (Go8) with the aim of creating a vibrant social impact investment market (Roundy et al., 2017).

Jackson (2013) states that the actors in the impact investing industry can broadly be divided into four categories: asset owners who own capital, asset managers who deploy capital, demand-side actors who receive and utilise the capital, and service providers who help make the market work. Roundy et al. (2017) further state that impact investors can operate in several ways, namely as groups of investors, individual investors, or as institutional, venture capital funds. Figure 4 below provides an overview of different actors in the impact investing scene.

Actors in impact investing			
Asset owners	***Asset managers***	***Demand-side actors***	***Service providers***
High net worth individuals/families Corporations Governments Employees Retail investors Foundations	Investment advisors Fund managers Family offices Foundations Banks Corporations Venture funds Impact investment funds/intermediates Pension funds Sovereign wealth funds Development finance institutions Government investment programs	Corporations Small and growing businesses Social enterprises Cooperatives Microfinance institutions Community development finance institutions	Networks Standards-setting bodies Consulting firmst NGOs Universities Capacity development providers Government programs

Figure 4: Actors in impact investing. Source: Authors' own, adopted from Jackson (2013).

Höchstädter & Scheck (2015) review in their paper strategic options that are generally available to impact investors, and identify five dimensions that are relevant for clarifying the scope of impact investments and the market. The dimensions considered most relevant for this paper are geography and demography, financial or organisational structure, and asset classes and financial instruments. These dimensions will be explained below.

3.2.1 Geography and demography

The first dimension addresses the end beneficiaries of impact investments and their geographic location. Impact investments can be allocated across a range of sectors, geographies, stages of businesses and asset classes. Although impact investments are often associated with developing markets (Jackson & Harji, 2012), numbers from the 2018 Annual Impact Investor Survey show that 56% of the assets under management was allocated to developing markets, whereas the remaining 44% was allocated to developed markets (Mudaliar et al., 2018). However, O'Donohoe et al. (2010) argue that it is common for impact investors to focus on either developing or developed countries due to requirements for different expertise and personal values and preferences. Furthermore, the top sectors of impact investments include financial services, energy, microfinance, housing, and food and agriculture (Mudaliar et al., 2018).

A study conducted by EY states that the demand for sustainable investments is partly driven by millennials that seek to invest in line with their values (Ernst & Young, 2017). Findings from Financial Time's Special Report on impact investing highlights the same results, and states that women and millennials are the ones who most often are driven by investing for social targets alongside financial returns (Walker, 2018).

3.2.2 Financial or organisational structure

This dimension addresses the financial and organisational structure of impact investments' recipients. There are different opinions about the characteristics of investees, especially regarding the organisational structure, size and stage of the business (Höchstädter & Scheck, 2015). Most of the literature does not explicitly focus on the investee but focus on the incentives of the impact investor instead. Other authors mention the investee on a general level but refer broadly to organisations that generate a social return. However, some literature provides more detailed information about the structure of the investees (ibid). A general perception is the explicit or implicit requirement of *mission primacy.* Chua, Gupta, Hsu, Jimenez, & Li (2011, p.19) refer to *«companies whose primary goal is delivering social and environmental good»* or other organisation types such as social purpose organisations, social enterprises or mission-driven organisations. The most used definition, however, is given by Brown & Swersky (2012) that claim impact investing is defined around the investees' organisation type and investor motivation. This limits impact investing to socially motivated investors who invest in socially motivated organisations; for-profit organisations that are fully commercial are excluded. Therefore, only organisations that use their surpluses to primarily reinvest to obtain their social mission and put social goals before profit maximisation can qualify as impact investment investees (ibid).

3.2.3 Asset classes and financial instruments

Generally, impact investors can invest across all types of asset classes and financial instruments. O'Donohoe et al. (2010) name several traditional examples, such as debt, equity, guarantees and deposits, but also more innovative investment possibilities as social impact bonds (SIBs). However, several practitioners have argued that impact investments mainly include private debt and equity, and that impact investments are investments outside of public equity markets (Höchstädter & Scheck, 2015). Godsall & Sanghvi (2016) support this view and argue that the impact investing industry needs to include more specialised products to evolve further.

3.3 Dual objectives in an impact investment process

Unlike traditional investors, impact investors are seeking to obtain impact alongside their financial returns. Yet, according to literature, it is still unclear how impact investors approach their two-folded aim in their investment decisions. Moore, Westley & Nicholls (2012) argue that combining logics from mainstream finance focusing on financial returns and logics from philanthropy creating benefits for the society is incompatible. What motivates impact investors are still unclear (Roundy et al., 2017) and in order to emphasise *intentionality* and ensure social and financial balance, investors' motives need to be understood (Findlay & Moran, 2018). Bugg-Levine and Emerson (2011, p.9) state that any investment can have a positive social impact, yet *«some are closer to the action than others.»* O'Donohoe et al. (2010) mention three main approaches to impact investing, namely financial return, social impact expectations and risk. These three approaches will be further explained below.

3.3.1 Financial return

Roundy et al. (2017) find that impact investors' financial return expectations vary to a large extent. However, what differs traditional investors from impact investors, is the desire for approaching social objectives. According to the 2018 Annual Impact Investor Report, 64% of the investors in the survey pursued risk-adjusted, market-rate returns, while the remaining investors sought below-market rate returns. Among these, one-third of the investors engaged in both conventional and impact investing, while two-thirds only engaged in impact investing (Mudaliar et al., 2018). Moreover, O'Donohoe et al. (2010) find that some impact investors expect returns that compete and potentially outperform traditional investment benchmarks.

To fully understand the return expectations and motives that drive impact investors, the term *impact investor* needs to be defined further. Brest & Born (2013) identify two main categories of investors: the socially *neutral* investors and the socially *motivated* investors. Their view on investor types is aligned with related literature about financial-first and social-first investors.

Socially neutral investors are investors that *«[...] are indifferent to the social consequences of their investments»* (Brest & Born, 2013). Socially neutral investors may only be motivated by profit; however, their investments may unintentionality still contribute to impact. The question that arises is thus whether an investment actually has an impact. An essential part of measuring impact is assessment compared to a set goal, which is not doable when investing without a purpose (ibid). Theoretically, socially neutral investors can therefore not be classified as impact investors due to the lack of *intentionality* investing for a social purpose.

Socially motivated investors. Socially motivated investors differ from socially neutral investors as they value particular products and aim for both social and financial returns. Socially motivated investors are divided into two sub-groups, which are *non-concessionary* investors and *concessionary* investors (Brest and Born, 2013). The former is not willing to make any financial sacrifices or take on more substantial risks to create social impact and is characterised as *financial-first* investors. Ormiston, Charlton, Scott Donald & Seymour (2015) explain that financial-first investors usually include banks, pension funds and sovereign wealth funds that seek to achieve market-competitive returns. Grabenwarter & Liechtenstein (2011) argue that financial-first investors traditionally have questioned the impact component in any investment as value-destroying redundancy, but gradually have started to realise that their financial return models are not sustainable in the long run unless impact is taken into consideration.

Concessionary investors, on the other hand, are willing to take on greater risk or lower returns in order to achieve their social or environmental goals and are said to be *impact-first* investors (Brest & Born, 2013). Impact-first investors usually include foundations and family offices, which seek to maximise social and environmental returns. Yet, impact-first investors typically have expectations of at least a return of the principal (Ormiston et al., 2015).

3.3.2 Social impact expectations

As previously discussed, impact investors seek to generate positive impact alongside financial returns, which is why excluding investments with negative social consequences is not sufficient enough to meet the impact expectations (O'Donohoe et al., 2010). For impact investors to define and assess whether their social impact expectations are met or not, measurement systems need to be employed to measure the actual impact. Despite the focus on impact measurement, commonly adapted measurement practices do not exist in the field. A common set of measurement tools for investors is important for the legitimacy of impact investing, and several projects have been developed and put into effort during the past years (Findlay & Moran, 2017). The measurement of non-financial gains is important to several of the actors in the market, not only to the impact investors (see Figure 5).

Actors	Seek to
Investors	Find out the extent to which their actions are helping or hindering wider social goals, with special reference to which areas of sector, on what time-scales, and what levels of risk
Fund managers	Benchmark the effectiveness of different investments against each other, or over time
Enterprises/investees	Use metrics to determine what progress is being made, and the potential scope for improvement
Beneficiaries/ investment recipients	Participate through consultation or more proactive involvement in the measurement, in order to help improve the effectiveness of the investment in terms of social or environmental goals

Figure 5: What impact investing seeks to measure. Source: Authors' own, adopted from Reeder and Colantonio (2013).

Impact measurement can take place in different phases of the investment process but has traditionally been focusing on the pre-investment phase. However, in the later years, the post-investment phase has gained more attention, with a focus on monitoring and management of the predicted positive and negative impacts with an investment (Reeder & Colantonio, 2013). The impact measurement process includes identifying the positive and negative effects investment actions have by mitigating the negative and maximise the positive in alignment with the set goals (GIIN, 2019a).

One of the most commonly used methods for impact measurement is the Impact Reporting and Investment Standards (IRIS). IRIS sets out a consistent definition for financial, social and environmental performance and seeks to provide a standardised taxonomy (Jackson & Harji, 2012). IRIS is applied by investors, fund managers and investees for tracking and monitoring performance and social outcomes. Another recognised measurement system is the Global Impact Investing Rating System (GIIRS). The system uses four performance areas to assess companies and funds, namely governance, workers, community and environment (ibid).

A research study of American impact investors conducted by So & Staskevicius (2015) highlights four key elements of the measurement process:

1. **Estimating impact:** Conducting due diligence pre-investment
2. **Planning impact**: Deriving metrics and data collection methods to monitor impact
3. **Monitoring impact**: Measuring and analysing impact to ensure mission alignment and performance
4. **Evaluating impact**: Understanding post-investment social impact of an intervention or investment

Different tools can be applied in the measurement process. Two widely-used tools are theory of change and social return on investment (SROI) (So & Staskevicious, 2015). Jackson (2013) also emphasises the importance of theory of change, and how the concept can explain the process of intended impact by analysing the performance data and comparing it with the intended goals of the investment. According to So & Staskevicius (2015), theory of change should be applied in the two first steps of the measuring process, while SROI is generally applied in the two later steps. SROI take into account the costs for the key stakeholders of an investment, against the anticipated social benefits (ibid). This method is therefore useful to compare potential investment opportunities.

3.3.3 Risk and challenges

According to O'Donohoe et al. (2010), the risk level impact investors face depends on the investment, stage and size of the business, sector and geography. Investments conducted in developing markets further face a higher risk due to political uncertainties and business environment risks (ibid). Furthermore, risk factors that are relevant for impact investors also include impact risk, financing risk, business model execution and management risk, and lack of proper exit opportunities (Mudaliar, Pineiro, Bass & Dithrich, 2017). In addition to risks that might occur during a traditional investment process, impact investors face increased risks concerning the social objectives of their investments (Schiff & Dithrich, 2018). Such risks may include challenges with obtaining the desired social benefits as well as missing exit opportunities. The latter is of particular concern for investments in developing markets where exit options are more limited (ibid).

Moreover, by reviewing the literature, several challenges in the impact investing market were identified. Most of the challenges are related to impact measurement and lack of transparency in the market. Measuring and managing impact investments possess a significant challenge for investors, while the lack of transparency on impact performance, targets and results are of further concern (Mudaliar et al., 2017). These challenges are also identified by a report on impact investing conducted by McKinsey, that states that clarification of impact measurement standards is crucial for the development of the field (Godsall & Sanghvi, 2016). The authors thus address the need for a consistent measurement process by devising a set of metrics for social and environmental results for investors and investees to clarify and state their expectations of the investment (ibid).

4. Reviewing the agency theory

The principal-agent theory has traditionally been used as a theoretical framework for venture capital/private equity studies (Chua et al., 2011) where the investment relationship between the investors and entrepreneurs has been in focus. The theory revolves around the issue of the agency problem and its solution (Panda & Leepsa, 2017). Although the theory is highly relevant to apply to analyse the relationship between impact investors and investees, no previous studies have been conducted about the topic. Hence, we would like to explore how the theory can be applied in an impact investing setting when social objectives must be taken into account as well.

Following, this section begins with reviewing the agency theory. The traditional agency problems will be introduced, along with an overview of how these problems are usually mitigated. Moreover, we elaborate on how this framework can be applied within impact investing, and what considerations one must do when including the social objective that impact investors seek to obtain. The aim is to use the theory to understand the complex investing relationship of impact investors and investees, and to gain an understanding of how adverse selection and moral hazard can be reduced or controlled for in an impact investment setting.

In line with previous studies of the topic, the investor is seen as the principal and the entrepreneur is seen as the agent.

4.1 Separation of ownership and control

The 1976 article "Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure" by Jensen and Meckling was the first detailed theoretical exploration of agency theory (Lan & Heracleous, 2010). The article helped establish agency theory as the dominant theoretical framework within corporate governance (ibid). Agency theory is directed at the principal-agency relationship, in which one party (the principal/owner) delegates work and decision-making authority to another (the agent), who performs that work on the principal's behalf (Jensen & Meckling, 1976). Agency theory attempts to describe the relationship using the metaphor of a contract (ibid). Furthermore, the classical agency problem arises whenever the managers have incentives to pursue their own interests at shareholder expense and is a result of the delegation of the decision-making authority to the agent (Agrawal & Knoeber, 1996).

The relationship between shareholders as principals and managers of ventures as agents is a classic example of such an agency relationship. The separation of ownership and control is usually present in many small and medium-sized firms, founded with external capital, along with bigger corporations (Van Osnabrugge, 2000).

4.1.1 Asymmetries of information

In a situation where an agent is supposed to make decisions on behalf of a principal, information asymmetries are common between the parties (Bellavitis, Kamuriwo, & Hommel, 2017). This means that there is certain information which is available only to one of the parties and not the other, whereas the agent is usually the most informed party because of the knowledge and direct involvement in the environment the agent gets through his/her job (Panda & Leepsa, 2017). Owners, on the other hand, depend on the manager to get the information (ibid). If the information asymmetry is used by the agent for his/her advantage, rather for the benefit of the principal, such asymmetries can be of concern.

4.1.2 Causes of agency problems

Agency theory is concerned with resolving two primary causes of agency problems that can occur in principal-agent relationships, due to the rise of information asymmetries as a result of the separation of ownership from control (Eisenhardt, 1989). Firstly, is the *agency conflict* that occurs when (i) the desires or goals of the principal and agent are not in alignment and (ii) it is difficult or costly for the principal to verify what the agent is actually doing (ibid). Secondly, is the *conflict of risk-sharing* that arises when the two parties have different risk preferences (ibid). Both conflicts lead to situations where the agent has incentives to act in a way that is not in the best interest of the principal (ibid).

4.1.3 Two particular agency problems

These two conflicts lead to two particular agency problems, namely, moral hazard and adverse selection. Moral hazard occurs when the agent does not pursue the effort initially agreed upon in the contract (Fama & Jensen, 1983). Adverse selection, on the other hand, refers to the misrepresentation by the agent as to his/her abilities – an identification problem (Eisenhardt, 1989). Both of these dilemmas increase the likelihood of the emergence of contractual inefficiencies. Contractual efficiencies create an opportunity for the agent to pursue self-interest behaviour at the expense of the principal. To mitigate these agency problems, principals have different mechanisms available.

4.1.4 How to deal with agency problems

The resulting value loss from separating ownership and control is called an agency cost, and all mechanisms which contributes to a reduction of such costs is minimising the value destruction caused by the agency problem (Van Osnabrugge, 2000). Within agency theory, the unit of analysis is the contracts governing the relationship between the principal and the agent (Eisenhardt, 1989). The contracts are often used to limit the agency costs which may occur due to these particular agency problems (Van Osnabrugge, 2000). The contracts often specify the rights or the agent, performance criteria on which the agent is evaluated, and the payoff functions they have (ibid). If it was costless to write a contract, then an optimal contract could be written which would be fully comprehensive of all future scenarios, and hence the agent would be bound to act in the best interest of the principal. This would induce risks to be shared optimally. However, Jensen & Meckling (1976) argue that it is generally impossible at zero cost to ensure that the agent will make optimal decisions from the principal's viewpoint. Thus, the focus of the agency theory is on determining the most efficient mechanisms governing the principal-agent relationship (Eisenhardt, 1989).

The literature identifies two primary contractual approaches (to investor-firm relations) which can shed light on how to decrease the agency problems that arise as effects of moral hazard and/or adverse selection (Jensen & Meckling, 1976).

First, there is the principal agent approach, which is mainly concerned with determining the optimal contract between the principal and the agent. For an optimal contract to be formulated, where foreseeable future contingencies are considered, pre-investment screening and due diligence of the firm is conducted to reduce asymmetries of information (Eisenhardt, 1989). *Secondly* is the incomplete contracts approach, which assumes that contracts always are incomplete, and hence it is the ex-post allocation of control which is in focus (Hart, 1995). With this approach, one focuses on post-investment monitoring and control rights, rather than ex-ante screenings and contract writing (Bellavitis et al., 2017). Each of these approaches places great emphasis on different phases of the investment process. However, they both recommend risk reduction at each stage.

The principal-agent approach

The principal can limit divergences from their own interests by advocate pre-contract *screening* and *due diligence* to reduce the asymmetries of information between the principal and the agent (Van Osnabrugge, 2000). This is done by gathering information in order to screen out projects and entrepreneurs who do not meet the set criteria (Zacharakis & Shepherd, 2007). When information asymmetries are reduced, and one has uncovered areas of concern when evaluating the venture and entrepreneur, a more comprehensive contract can be written (Kaplan & Strömberg, 2000). The contract will then consider the foreseeable future contingencies, and thus further have the ability to restrain those decisions of the agent that affect the welfare of the principal (Van Osnabrugge, 2000). According to theory, the optimal comprehensive contract will not be breached.

There are two main ways in which the contractual approach aims to limit an agent's ability to pursue his/her agenda (Eisenhardt, 1989). These two main ways are behaviour- or outcome-oriented contracts. The former is appropriate if the principal can observe and verify the agent's behaviour because then he possesses information about the agent, which will result in disciplined behaviour by the agent (ibid). For example, if an investor is very active in a company, and have a board seat, he will be able to verify if the agent act as agreed upon. Hence, exact goals do not necessarily need to be stated in the contract.

The latter explains that if the outcome of the contract is incentive based, then the agents will act in favour of the principal (Eisenhardt, 1989). This is because the contract aligns the preferences of agents to that of their principals, since the reward for both depend on the same actions (ibid). (Eisenhardt, 1989). This is because the contract aligns the preferences of agents to that of their principals since the reward for both depends on the same actions (ibid).

Incomplete contracts approach

The incomplete contracts approach assumes that it is costly to write a decent contract itself (Hart, 1995). Thus, the contract will always be incomplete, and therefore it is the ex-post *monitoring* and *allocation of control,* which is considered essential and paid attention to, rather than ex-ante screening and contract writing (ibid).

As mentioned, contracts specify the rights of the agent and the performance criteria on which the agent is evaluated. However, the incomplete contracts approach supposes that the exact nature of the investment is uncertain and thus the outcome cannot be specified in the initial contract. Hence, with this approach, revisions and renegotiations sometimes take place (Hart & Moore, 1999). Such renegotiations will thus first appear when the state of nature is realised, and it concludes that the agent does not perform as agreed, such as when managerial opportunism is present (moral hazard), or in cases where the performance of the venture has taken a (negative) unexpected turn (Hart, 1995). Revision of the contract can be considered at any time where goal incongruence between the parties is discovered (ibid). Hence, the importance of monitoring the agent's behaviour to see if it is aligned to that of their principals, and to measure the performance of the venture to make sure it is on par with the goals agreed upon initially or at least in the best interest of the owner (principal) (Hart & Moore, 1999).

As this approach considers the positions of each party if the other party does not perform as agreed, it takes into consideration what organisational arrangements that can be made to allocate control (Van Osnabrugge, 2000). Agency risks can be reduced through board control and management replacement rights, as the principal is provided with the ability to influence the company's strategic direction through active involvement in the investment (ibid). Also, in cases of poor venture performance, the principal can change the management of that venture, whereas in extreme cases, the principal will be able to replace the whole management (Iliev, Lins, Miller & Roth, 2015). Hence, the greatest protection that equity holders have is their vote. Negotiating such board control and management replacement rights into investment contracts provide investors with two main advantages:

1. When an entrepreneur/manager is willing to give up power through board control, that manager is indicating quality and portrays a commitment not to behave opportunistically (Bellavitis et al., 2017).
2. In case the prospects of the venture deteriorate, investors will be entitled to intervene (Hart & Moore, 1999).

Control rights thus contribute to constraining certain agent behaviours and reduce the possibility of agency problems.

4.2 Revising the control mechanisms central in agency theory from a social perspective

The traditional agency theory is not applicable without adjustments to the field of social finance (Spiess-Knafl & Scheck, 2017). There are many differences between traditional investments and impact investments, especially regarding the goals of the investments and return expectations. As previously identified, impact investors may have different return expectations, which can result in conflicts as part of the trade-off considerations the agents have to make.

The purpose of this section is to revise the mechanisms used to control for agency problems, from a social perspective. Since there exists little or no literature on these mentioned control mechanisms within impact investing, we will use some literature from the traditional venture capital/private equity setting as a basis in our analysis. Hence, this section will present some of the traditional literature that will be applied in the analysis and account for the challenges that might arise due to the inclusion of the social objective in the investment process, where limitations and necessary adjustments of the theory are taken into consideration.

4.2.1 Screening and due diligence

As previously discussed, agency problems are caused by moral hazard and adverse selection. Adverse selection arises when it is difficult for the investor to evaluate the quality of the investment, and therefore it typically appears in the pre-investing phase (Bellavits et al., 2017). The venture usually has access to more information about the business model and growth prospects than the investor has, and might have different goals and incentives with the investment. A thorough pre-screening and due diligence is therefore crucial for investors to evaluate the potential of the venture and to make sure that goals are aligned.

In terms of impact investing, pre-screening and due diligence are conducted the same way as for conventional investments, but with an additional focus on the social aspect of the investments (Grabenwarter & Liechtenstein, 2011). The pre-screening phase is further used to search for prioritised sectors and to exclude investments that do not fulfil the requirements of impact investing (ibid). Pre-investment screening can, in addition to evaluate risk profile and return expectations, be used to measure an investment's potential for creating *impact* (Loveridge, 2016).

O'Donohoe et al. (2010) point out that due diligence is important for impact investors to assess the investees' values and growth targets to decide whether their social impact expectations are met or not. Furthermore, Schiff & Dithrich (2018) find that most impact investors consider their exit opportunities during the due diligence as well, in order to decide whether or not to make the investment based on the impact motives and strategy of the investee. According to The GIIN (2019c), due diligence in an impact investing setting has four core functions: 1) as a risk management tool; 2) as a way to identify the social or environmental impact; 3) as a means to identify ways to add value to improve the impact of an investee; and4) as a way to respond to limited partner expectations.

Jackson & Harji (2012) claim that due diligence is often held closely within institutions and that there is a lack of incentives to share these tools, which can potentially amplify the process of an accurate assessment of investees that deliver both financial and social returns.

4.2.2 Contracting

As mentioned previously, contracting is a well-known tool to prevent agency problems. However, the challenge with aligning incentives between principals and agents gets even more complicated by adding a social impact objective. In contrast to the extensive literature about the contractual relationship between investors and entrepreneurs in traditional finance, the literature on social impact contracts is limited. Evans (2013, p. 139) addresses the need for a theoretical basis for impact investing and states that:

> *"Such a framework would enable the design of investment approaches to better fit investors' desired combination of financial returns and impact as well as provide a 'tool-box' for understanding and adjusting the investment contract or environment in the case where outcomes deviate from target performance."*

Geczy, Jeffers, Musto & Tucker (2018) address this challenge and claim to be the first to analyse the effect of impact goals on contracts and how to add the impact aspect to the traditional contracts. In their paper, they examine several different contract forms to evaluate how contracting practices within this setting adapt.

Saltuk & Idrissi (2015) state that the contractual relationship depends on investor preferences; some investors prefer to allow more flexibility for the investee by keeping impact goals out of legal documentation, while other investors prefer to utilise legal contracts. Hence, an important consideration is whether to include the social objectives directly in the contract. When evaluating this, literature by Hart & More (2008) will be applied, as it evaluates the appropriateness of rigid versus flexible contracts in situations characterised by uncertainty, which is somewhat the case in impact investing. Moreover, Holmstrom & Milgrom (1991) have explored the problem of multi-tasking in contracts, and since multiple objectives are a core feature of an impact investor's investment process, it would be natural to look at how contracting practices vary when the agent is responsible for multiple tasks. Furthermore, when assessing how the contract should be structured, literature by Kaplan & Strömberg (2001;2003), which examine contractual designs, i.e. the allocation of cash-flow and control rights, and incentives will be used.

Nevertheless, clearly defined goals and preferred outcomes are undoubtedly of importance in an impact investing process, not only for the investors, but also for the investees. The decisions by managers of social enterprises are difficult to communicate and hence formulate into contracts since the impact of the different measures can have a variety of outcomes.

4.2.3 Monitoring and control

Monitoring of managers is essential to prevent the agents from maximising their own welfare and not that of the principal (Panda & Leepsa, 2017). Specification of the rights of the agent as well as the performance criteria on which the agent is evaluated are usually incorporated in the contract. Thus, monitoring includes a review of the managerial decisions of the agent along with an assessment of output (performance measures) through internal audits to ensure contract enforcement (Namazi, 2014). The principal therefore engages in monitoring and control of the agent to see if the agent is behaving as planned and to measure the performance of the entrepreneur to see if the originally agreed-upon goals are being met.

In an impact investment, the principal must also consider to monitor, control and measure the progress made on achieving the social objectives agreed on. The need for monitoring in order to enforce agency contracts or as a basis for negotiation of an incomplete contract, calls attention to the difficulty of such monitoring due to the issues of measuring impact. According to Jackson (2013) the quantification of social value has been proven to be a complicated and time-consuming process. Godsall & Sanghvi (2016) state that the lack of frameworks to measure impact makes it difficult to measure and benchmark impact. For principals to be able to closely monitor and enforce their control rights if the investee is not behaving as planned, principals need to find a way to incorporate the social aspect into their post-investment process and establish routines for how they measure and monitor the progress.

Impact investors can thus apply the same monitoring and control mechanisms as conventional investors; however, the inclusion of social objectives must be taken into consideration along the way.

4.3 Moving forward

After having introduced the impact investing market and discussed the theory and relevant dimensions of the market, we have gained a deeper understanding of the market structure and the operating actors in the market. Furthermore, by reviewing the agency theory, we have developed some thoughts on what potential challenges that might arise in an impact investing setting due to the inclusion of social objectives. We identify a gap in the literature and a lack of a theoretical framework to explain such a situation in an impact investing setting. Thus, in the analysis, we will apply the traditional agency framework and, by taking social considerations into account, explore how impact investors can accommodate the agency risks they are facing by control for and mitigate these challenges.

5. Analysis and findings

In this chapter, we will analyse how impact investors' approach the dual objectives in their investment decision and how they can mitigate and control for agency problems that might arise during the investment process. We will use both primary data collected by in-depth interviews with impact investors and advisory companies, as well as secondary data related to the topic. The chapter will be divided into two main sections, and we will analyse and present our findings along the way.

The first section seeks to answer the first part of our research question, namely how impact investors approach their dual objectives in an investment process. The topic will also be further elaborated on in the second section of the chapter. The second part of the analysis aims at examining how potential agency problems in an impact investment process can be controlled for and mitigated. Thus, this part seeks to answer the second part of our research question. We will base the section on the traditional agency framework but take into account the adjustments for social objectives as identified in the theory chapter. The framework consists of three main steps to control for and mitigate agency challenges, and each step will further be analysed in-depth.

Throughout the chapter, we will report on the patterns we have observed and use the primary and secondary data to make comparisons, to assess similarities and differences between impact investors and traditional investors and to see if our findings comply with or contradicts existing theories within the field. Our findings from this chapter will thus serve as a foundation for propositions on how impact investors approach their dual objectives and can control for agency problems in the discussion chapter following after the analysis.

5.1 Impact investors' approach to the dual objectives

In our theory section, we learned that impact investors might have different expectations regarding financial return and social return. As we find this important to investigate, this section will explore the investors' approach to the two objectives, as it is relevant for the rest of the analysis. Thus, this section contributes to answering the first part of our research question: *"How do impact investors approach the dual objectives in the investment process…"*

5.1.1 Strong interest for the pursuit of the dual objectives

Among our interviewees, we find a strong motivation to create social impact, alongside a financial return. We find that all the investors explicitly aim to address social and/or environmental challenges with their investment, despite coming from different investment backgrounds. Many of the investors mention that they got involved with impact investing due to a need of doing something meaningful, to serve a greater purpose. Malene Bason (2019) says that she *"always sought for something more than just numbers"* and when she was introduced to impact investing, her thoughts were:

"It is still investments, which is my whole experience and career, and which I also like, but it also gives me something else, and it gives me a higher purpose than just generating some extra money."

(Appendix 2.2, q. 3)

Moreover, several of the investors question the responsibilities of investors, whereas the common opinion is that the actors within the financial sector have a responsibility to contribute to society. Hence, they stress the importance of deploying capital to form a society that maximises "the common good", and not just financial wealth of individuals. As Silje Veen (2019) puts it:

"*We created an investment profile that says that the investment is only good when it benefits both us and the society."*

(Appendix 2.5, q. 2)

Additionally, we find that the investors believe screening for social impact would be an integrated part of the investment process in the future. These findings further indicate that impact investors oppose the notion which has dominated the capital markets for many years – that the responsibility of business is solely to maximise profits for shareholders, guided by Milton Friedman. However, while this confirms that there is motivation to invest in companies that prioritise both the social and financial objectives, the next sections will explore how this is approached in practice.

5.1.2 Different investors, different preferences

Within the impact investing setting, there are a lot of different investor types. We find that the investors' approach to the dual objectives and return expectations in the investment process, varies based on investor type. Hence, for better understanding and clarification, this section will start by providing an overview of the investors and their structural differences.

Investor types

Impact investment represents a class of investors that can operate as individuals, as groups of investors, or as institutional, venture capital funds. Through our interviews and secondary sources, we learned that impact investors are mostly private equity/venture capital funds, angel investors and family offices, which is consistent with literature on the subject.

Private equity and venture capital funds invest with capital provided by others, and hence they have their own principals, and a multiple agency relationship exists; fund provider (principal) – fund (agent) – venture (agent). Because they have a responsibility to their principals as they invest on behalf of them, they must demonstrate competent behaviour from the very start of their investment process to signal that they are high-quality organisations (Van Osnabrugge, 2000). This implies that these investors will feel the pressure to present impressive qualifications, by delivering both a good financial return alongside social impact. This assumption is confirmed by our interviewees. Furthermore, we observe that they adopt a more formalised and professional inclusion of the social objective, as they have to report on the performance of the investees themselves.

Conversely, we find that business angels and family offices invest their own money, according to the interviews. These investors are usually high-net-worth individuals or families, which secure financial returns through their mainstream investments (Veen, 2019). Intuitively, one would thus believe that they are not under such pressure to behave in a certain way, as impact funds are. This is confirmed by two of our interviewees, Espen Daae and Ingrid Stange, a family office and a business angel, respectively, who state that they do not have to justify their choices to the same extent as venture capital funds. Hence, these two investor types are freer with regards to the integration of the social objective. They can either choose to give more attention to the social objective, or less. Further, they can adopt the methods they find suitable for the integration of the social objective into the investment process. Silje Veen and TD Veen for example, operate quite differently than Ingrid Stange and PfC, whereas TD Veen acts more as a "nice" venture capitalist with the financials in focus, opposed to PfC, which operates more as a venture philanthropist the social impact is valued the most. However, through both primary and secondary data, we find that their balance between the social and the financial differs based on the respective company's preferences.

Return expectations

We find that the general requirement among the investors is a financial return of above the principal, which is in accordance with the definition of impact investing. Nevertheless, as with social impact, we also find differences in expected returns across investors. Based on the return expectations of the investors in our sample, they can broadly be divided into two categories, where one of the groups steers in the direction of philanthropy/venture philanthropy, while the other group is more towards the financial side of the scale. Firstly, social impact is valued more than financial returns among one group of our respondents. These are the investors the literature identified as impact-first investors (Findlay & Moran, 2018), who are willing to undergo concessionary investments, meaning that they are prepared to sacrifice financial returns to achieve social benefits and high impact (Brest & Born, 2013). Stange (2019), an impact-first investor, elaborates:

*"**Social goals are always clear**, but now, when we have this formal family office kind of process, we also look at what could be the financial returns, **and if the financial returns are not expected, we could still do the investment**, but then we are aware of that."*

(Appendix 2.3, q. 8)

On the other hand, we find the investors that are defined as finance-first investors. We observe that this group of impact investors is less willing to compromise financial returns for social impact. As mentioned, venture capitals and private equity funds, who invest on behalf of their principals, are more pressured to deliver both social and financial returns. These investors are among the group of investors in our sample that prioritise the financial objective. Furthermore, we find that more investors can be placed in the finance-first category. For example, TD Veen prioritises the financials but highlights that they in some cases can accept a lower return if meaningful impact can be created. The financial advisors we interview also state that the financials are weighted the most in the investments they advise on. What we observe in overall, is that even though the finance-first investors prioritise the financials, they are all willing to some extent to sacrifice financial returns if the impact prospects are highly impressive. Further, they also say that the definition of impact investing is not purely based on philanthropy, so one should be able to expect a return, it is just subjective where the distinction should be and how to weight the two objectives. As Veen (2019) contends, if people within the field are competent enough, they should be able to provide both a financial return along with social impact, as in many cases, they are closely connected.

5.2 Agency problems and the inclusion of social objectives in the investment process

The following section seeks to analyse how agency problems that may arise due to the inclusion of social objectives can be controlled for or mitigated. In order to investigate this, we will use the theoretical framework explained in the theory chapter and look into three main areas of interest. In the beginning and during each of the three areas, we will examine how traditional investors approach each part before we analyse our own findings from our data collection to see whether impact investors follow the same steps, or if they include additional steps due to their social targets.

We started the first section of the analysis by presenting findings related to the first part of the research question: **"How do impact investors approach their dual objectives in an investment process…"** However, we recognise the importance of looking into the whole investment process when answering this question. Hence, this section will further examine this part of the research question, by going through the investment process, step by step, from the pre-investment activities to the post-investment activities. Furthermore, based on our theoretical findings, we take into consideration that even though impact investors perform similar functions in the same process, their approaches on how to control agency risks may potentially differ. Hence, this section will also analyse and elaborate on findings on the second part of our research question: **"… and how can the investors control for agency problems that might arise with the inclusion of the social objective?"**

5.2.1 Pre-investment screening and due diligence

According to our theoretical framework, the first step for investors to follow to avoid agency problems is to implement structured pre-investment activities. The pre-investment phase refers to all activities and tasks up to the signing of an investment contract and is mainly concentrated around *pre-screening* and *due diligence.* These efforts can be taken in order to gather information and screen out ex-ante unprofitable projects and bad entrepreneurs and ventures (Zacharakis & Shepherd, 2007). According to Landström (2007), among the factors of importance for investors when evaluating investments, the most crucial factor is claimed to be the entrepreneur and the team. By conducting a thorough pre-screening and due diligence, the investor's performance is most likely to be improved, since success can be predicted from information contained in the business plan (ibid). Hence, the pre-investment activities contribute to a reduction in asymmetric information between the investor and the investee.

As stated in the literature, impact investors follow the same pre-screening and due diligence process as traditional investors, as they still are seeking a financial return

(Grabenwarter & Liechtenstein, 2011). In addition to serve as a method for evaluating a venture or an entrepreneur's potential to create financial return, the pre-screening and due diligence can be used by impact investors to screen for impact and exclude investments that do not fulfil the set requirements for impact investments (Grabenwarter & Liechtenstein, 2011; Loveridge, 2016). Due diligence is of particular importance for impact investors to assess if their goal expectations are aligned with those of the investees. Schiff & Dithrich (2018) argue that exit opportunities are an important part of the evaluation process as well, in case the investor and investee have different expectations to the time-horizon of the investment. As an example, Landström (2007) points out that venture capitalists often have more short-term goals than the investees.

Based on the above-mentioned considerations, the following section will proceed as follows. First, we will start by analysing how impact investors approach the pre-screening and due diligence, and how the process is conducted. Thereafter, we will examine how impact investors evaluate their investment opportunities, especially in terms of the weight they put into financial versus social returns. Lastly, we seek to understand how impact investors mitigate potential impact risk and evaluate their exit opportunities. The aim of the section is thus to analyse how the inclusion of the social objective influence impact investors' pre-investment activities and how potential information asymmetries and adverse selection can be controlled for.

Importance of pre-screening and due diligence

First of all, our findings are consistent in the way that all of the respondents find the pre-screening and due diligence process important and valuable. We find that most of the investors approach the pre-investment phase in the same way as traditional investors; however, always with an extra inclusion of social objectives and expectations. Most of the investors state that they conduct a standard due diligence, looking at financial and legal factors, and then consider social factors in addition. Moreover, some of the investors state that the pre-investment phase easily can take one to two years, often due to legal restrictions in the countries they invest in. It varies, however, how much effort the investors are sacrificing to make sure that the investments actually have potential for creating impact.

While some of the investors are using the pre-investment phase to evaluate the potential for impact, other investors are using it for assessing the potential of a sustainable business model that can create financial returns, which further can result in social outcomes. As an example, Stange (2019) underlines: *"I would never consider anything that does not have a strong social or environmental value. So my pre-screening is in terms of what is the purpose of the investment"* (Appendix 2.3, q. 7). On the contrary, some investors in the sample are focusing on how they can avoid any trade-offs by conducting the investment. Janhonen (2019) states that: *"At the moment, our main focus is financial returns, and we do not want to trade off financial returns for impact"* (Appendix 2.4, q. 7). We thus find that although the pre-screening and due diligence process are of high importance for all of the interviewees, it differs how they approach the process and what their initial aims are before conducting a proper investment evaluation.

Conducting pre-screening and due diligence

Next, we seek to examine how impact investors conduct their pre-investment activities when including social objectives. We acknowledge that different investor types might weigh the financial and social objectives differently, and thus have a different focus on their pre-investment activities. The intention with this section is therefore to understand how impact investors are experiencing this pre-investment phase, and how they approach it.

<u>Lack of consensus</u>

When asking the investors in our sample how a proper pre-screening and due diligence should be conducted, we notice that there is no common understanding among the investors of how it should be done. Many of the investors point out that there is a lack of consensus in the field on what a proper pre-screening and due diligence process should include, and where the focus should lie. We find that several of the investors are interested in and wish to conduct a thorough screening of potential investments, but that it is challenging for them to know precisely how to account for the social objectives while doing so. Based on her own experience, Bason (2019) tells that it is important for investors to define their investible universe before starting the screening and due diligence process. She further gives an example of how she prefers to approach it:

"Is it a negative screen or is it a positive screen? Do you start out by saying 'I only want to look at companies that are classified as impact companies, and then I go from there and do my financial analysis, or do I do a traditional investment process and quant screening and then at the end I look at impact.' I prefer that you actually flip it around and say 'my investible universe is only impact investing and then I do a financial analysis based on that.'"

(Appendix 2.2, q. 10)

Furthermore, as the impact investing scene is relatively new, many of our respondents say that it is often a bit of a "try-and-fail process" where best practices have to be developed along the way. We find that many of the investors are actively trying to figure out the best way of conducting impact investments. We find that the interviewees are aware of which investments they want to include in their portfolios and how they can make the process easier by including and excluding investments. Veen (2019) tells that they have divided their portfolio into three main groups, where the first group is based on a negative screening process, the second group considers sustainability and ESG goals, while the third group has an impact-only focus. In the latter group, Veen (2019) underlines that they require that all the companies are established with the *purpose* of creating impact. Janhonen (2019) addresses a potential challenge by portfolio screening:

"But we have done research on our past portfolio of about 300 companies we have invested in, and about half of them could have been impact investing cases if we had just stated impact goals to them. Now many investors are, retrospectively, taking their existing portfolios and turning them into impact portfolios."

(Appendix 2.4, q. 5)

Janhonen (2019) claims that after impact investing started to evolve, more and more investors claim that they are impact investors, but that in practice, their portfolios do not necessarily match the criteria for impact investments. If there are no set standards for what investors should consider, and look for, when searching for new investments, it might become difficult to evaluate the expected outcomes.

Challenges in the process

Based on the above, we find that the investors in our sample have different perceptions of the pre-investment activities and that they do not provide a common way to conduct pre-screening and due diligence. Our findings address a few additional challenges connected to these activities when including social objectives. The lack of common standards for how impact investors can screen for potential social outcomes, may lead to confusion among investors, and lead to investors focusing more on the financial side of the investment instead. Some investors in our sample recognise this and mention this as a partial reason for why they until now have mostly been screening for financial returns. Janhonen (2019) exemplifies this: *"When we did these investments, it was 2014, and the whole concept of impact investing was quite new to us, so impact due diligence was not that throughout"* (Appendix 2.4, q. 4). Additionally, we find that in contrast to traditional investments, there are no databases to look up financial products to create an investment strategy. This results in a more time-consuming pre-investment phase for impact investments, and a more challenging process for investors that do not possess that many resources. Bason (2019), who has a long experience of selecting traditional financial products, states that:

"[…] you do not have that for impact investing and the managers that have a longer track record with impact investing are not the usual suspects, so it is not BlackRock or JP Morgan, it is other names and as I said, they are not in the database, so it requires more research."

(Appendix 2.2, q. 9)

So far, our findings have addressed that impact investors find the pre-screening and due diligence process highly important. However, in contrast to traditional investing, where it is relatively clear how one should screen potential investments, the process seems to be perceived more complex by impact investors. We find that investors find it challenging to know what to focus on and that there is no straight forward way for investors to follow when screening potential investments. Besides, impact investors lack proper databases to look up potential investment strategies, which leads to more time required when searching for investments. Therefore, in order to avoid information asymmetries and adverse selection, it needs to be established a consensus in the industry of how screening and due diligence activities should be conducted when incorporating for social objectives, and best practices should be available for the investors in the market to make the process more transparent and manageable for everyone. In the next section, we will therefore take a deeper look into how investors evaluate potential investments and which criteria they are taking into account.

Evaluating impact investments

As mentioned in the theory chapter, adverse selection typically arises when it is difficult for investors to assess the quality of the investment (Bellavitis et al., 2017). This section will thus move on to analysing how investors evaluate the perceived quality of their investments, especially in terms of financial returns and social targets. Traditional investors employ different screening criteria when selecting potential ventures or entrepreneurs. The investment selection includes evaluation of the industry, the ventures' stage of development, location and size of the investment (Zacharakis & Shepherd, 2007). The investors might have different aims of the investment and hence emphasise different criteria, but usually, the attractiveness of the opportunity, such as the market size, strategy, product type and competition are considered before entering a deal (Kaplan & Strömberg, 2000). When evaluating these objects, uncovered areas of concern will be highlighted and later on affect the structure of the financial contracts (ibid).

Based on this, this section aims to examine how impact investors are stating their goals and expectations in advance of the investments, and whether or not they apply particular frameworks in the process to evaluate the potential for creating impact. When evaluating impact, several additional objectives could be implemented in the process, such as social goals, expected outcomes of the investments, and how to choose the right investee based on own preferences regarding business model and impact strategy. Moreover, based on our previous findings, impact investors might evaluate investments differently based on their preferences regarding financial and social returns.

Return expectations

As identified in sub-chapter 5.1, we find that investors in our sample regard financial returns expectations differently, although both financial and social return expectations usually are defined in the pre-investment process. One of the investors that identify themselves as an impact-first investor, is Stange (2019), who gives an example of this: *"[…] we also look at what could be the financial returns, and if the financial returns are not expected, we could still do the investment, but then we are aware of that"* (Appendix 2.3, q. 8). On the contrary, is the other group of investors, that identify themselves as finance-first investors. These investors usually require at least a market rate return on their investments and are not willing to sacrifice financial returns to create more impact. However, this does not mean that the finance-first investors in our sample do not value social returns – they simply value the financial part of the investment higher. This is in line with Brest and Born's (2013) findings on finance-first and impact-first investors, which state that even though finance-first investors are looking for a certain return on their investments, they are still able and interested in the social side of it, too. While we have identified that investors usually take on the role as impact-first or finance-first, a few interviewees in our sample express different views on it. One of these interviewees is Paludan-Müller (2019), who believes that it is not necessarily either-or:

"It they do two investments, one might be a return of 10% with a relatively low impact, and they might do another investment with a return of 1%, but with a high impact. So it is not necessarily either or, I think."

(Appendix 2.1, q. 10)

Even though one group of the investors in our sample characterise themselves as impact-first, our findings imply that most investors in our sample still are financial-first. This is also consistent with the views of the financial advisors. Hence, we find that impact investors have different return expectations, which leads to different goal expectations when evaluating investments. Therefore, impact investors should search for investees that share the same return expectations both in terms of social and financial returns. If return expectations are not aligned, the risk for agency problems to arise increases.

Defining social and environmental goals

As we now have identified, impact investors have different views on the pre-investment process and potential return expectations. In order for investors to assure that the investment process gets as transparent as possible, it is therefore essential to make sure that their return expectations are aligned with those of the investees. Also, according to our theoretical approach, goal misalignments between investors and investees is one main reason why agency problems arise. Therefore, it is considered necessary for investors to state clear goals before they conduct investments to make sure that their goals are aligned with the goals of the investees. Landström (2007) argues that clarifying goals is an important aspect of the screening and due diligence part, as it will serve as a foundation for the formal contracts written later in the process. If goals and expectations are not stated or aligned, the contract writing can turn our more difficult, and the chances for agency problems to occur due to asymmetric information will probably increase. Thus, for impact investors, not only the financial goals have to be stated, but also social and/or environmental goals.

Based on our interviews, we find that social and/or environmental goals are usually defined early in the investment phase, often developed together with the manager of the respective investee. The degree to which clear goals are stated, however, varies substantially among the investors in our sample. It thus seems more important for some investors to clarify specific goals and expectations in advance of an investment than for others. Some investors claim that it is more like a "gut feeling" and that the most critical part of their evaluation process is to find managers that they trust, and with a business plan they can relate to and see the potential in. This is in line with traditional agency theory on venture capitalists and entrepreneurs, where it is stated that the most important factor for venture capitalists when selecting business opportunities, is usually their relationship with the potential investees (Landström, 2007).

This statement is supported by our findings. We observe that most of our respondents believe that to find investees that share the same values as them is extremely important and that they put a substantial amount of time into the process to make sure that they find managers they can identify with and get along with. Following this, some of the respondents in our sample state that they are quite flexible in terms of stating goals, as long as they believe in the business idea and the people. Thus, the first thing they consider is the business idea and the managers, whereas a more thorough screening often is conducted afterwards. Veen (2019) gives an example of this: *"We are pretty much open for everything, as long as the idea is appealing and the case looks good in terms of what we are receiving"* (Appendix 2.5, q. 4). Moreover, we find that many of our respondents consider the business purpose of the potential investees as important, meaning that they prefer to identify with the business model of the investees. Some of the respondents specifically mention that the investees need to have social impact as a core of their business. Bason (2019) supports this: *"So in my mind it has to be in the DNA of the organisation to look at impact investing"* (Appendix 2.2, q. 9).

Nevertheless, we identify similar challenges here as earlier where the investors in our sample mentioned that there is not a common way to conduct the pre-investment activities. We find that although the investors state social or environmental goals in advance, they express concerns about how they can make sure that these goals are actually met at a later stage. This can potentially harm and amplify the situation and give investors fewer incentives to spend time on defining precise goals during the pre-investment process if they cannot make sure that the goals are met after the investment is conducted. For example, Janhonen (2019) gives an example of a stated goal that was difficult to evaluate:

> *"We did set an impact goal for the investment, whereas sick days would be reduced by 10,000 within the year 2020, as well as getting a good financial return. The problem with it, though, was basically that we formulated the goal with the company, but after we made the investment, we figured there was no way of getting the information because employees do not have to report their reasons for sick days if they are sick less than three days."*
>
> (Appendix 2.4, q. 4)

Thus, by analysing how impact investors define the goals of their investments, we have identified that some investors define clear expectations, while others are focusing more on finding the right management team to collaborate with. We find that investors sometimes find it hard to know how their stated goals will turn out in the end, which again can lead to less incentives for stating goals in the first place. Hence, the next section will analyse how impact investors are assessing and evaluating the potential for creating impact when considering investment opportunities.

Frameworks used in the process

One field of the impact investing scene that is particularly underdeveloped is common grounds on how the potential *impact* of impact investments can be measured (Reeder et al., 2015). In the theoretical chapter, we identified the lack of proper tools and frameworks for evaluation, and it was further suggested that IRIS is one of the most widely used tools among investors worldwide. However, we find that none of the investors in our sample are applying IRIS or any similar tools in their screening and due diligence process. Only one investor state that they are basing their metrics on the IRIS, but that they do not directly apply it to their operations. Our findings address difficulties related to the most commonly accepted frameworks, and we find that these frameworks and methods in most cases are very time consuming and challenging to handle as they are complex and require a high amount of resources to use. Many of the investors we interviewed state that they do not have enough time or people to follow such widely defined frameworks and that it might seem a bit unrealistic that also smaller-sized impact investors with fewer resources should implement such evaluation tools. Bason (2019) states that: *"I have never met anyone who are using this because it is too overwhelming and they do not have the resources to use it. It has to be more pragmatic, especially to begin with."* Janhonen (2019) gives further examples of the challenges related to IRIS:

"Some KPIs from the IRIS are sometimes used among others, but they do not really know yet what of the measures are the good and right measures to use. Does it even measure the actual impact of the venture?"

(Appendix 2.4, q. 7)

Furthermore, many of the respondents express their concerns related to the lack of a standardised method for evaluation that can be applied across asset classes and investment types. This is in line with the literature, that states that even though the impact investing industry is growing, it is still in need of metrics and frameworks that apply to all the actors in the market (Reeder et al., 2015; Mudaliar et al., 2018). We find that the lack of a commonly used framework for evaluating impact has resulted in investors defining and creating their own metrics that they use for evaluation. Paludan-Müller recognises this:

"Yes, and in the lack of that, when organisations are starting to do it, we see it more and more, they are just making their own. Then you end up with a thousand definitions and standards and ways of doing it."

(Appendix 2.1, q. 9)

The majority of the investors in our sample mention that they are developing and implementing their own evaluation tools, or use the tools that the manager of the investee prefers. This might amplify the situation as it makes it difficult to obtain a global understanding of how potential impact should be evaluated, and the evaluation process might be very subjective, depending on what the respective investor believes is impact. Our findings further imply that investors are lacking methods for evaluating different investment types up against each other, especially in terms of comparing social investments against environmental investments. Related to this, is the issue that many of the investors think that it is more difficult to evaluate the social outcomes than the environmental outcomes, as the latter often is more tangible and easier to quantify. Bason (2019) highlights this: *"[...] the issue is that if you look at a social project, it is very difficult to measure the impact there, compared to an environmental project"* (Appendix 2.2, q. 13). Paludan-Müller (2019) also addresses the challenge of comparing different investments.

"The bottom line is that it is just difficult to make a simple tool to compare investments, because if they are not evaluated by the same standards, then how would you compare them?"

(Appendix 2.1, q. 9)

The lack of a commonly used framework and a standardised method that apply to all actors in the market can potentially harm the relationship between the investors and investees. If the expected impact cannot properly be measured before an investment is conducted and the expected goals are not clear, the investee might have incentives to behave opportunistically and take advantage of the fact that the investor cannot fully know what the investee is spending the money at. The investment process becomes less transparent when a detailed structure of the investment plan cannot be provided, and it might become more challenging for investors to make sure that the investees are behaving as planned if they do not have any defined goals to benchmark against. The next section will thus discuss how investors approach the potential impact risk and green-washing in their investment decisions.

Evaluating impact risk

When a venture capitalist evaluates an investment, several risks could occur. According to the agency theory, asymmetric information arises when investors possess less information about the investment situation than the ventures. It is therefore crucial for investors to evaluate potential risk factors connected to an investment and actively work on solutions on how to mitigate these risks. When distinguishing between success and failure among ventures, most research finds that the quality of the entrepreneurs and the management is the most significant criteria (Kaplan & Strömberg, 2000; Zacharakis & Shepherd, 2007). Usually, venture capitalists assess whether the entrepreneur or venture meet some minimum qualifications during the screening stage, and then a final evaluation on the management is done ex-post, based on the actual actions and outcomes (Zacharakis & Shepherd, 2007). Additionally, the investment analysis will include more extensive research to assess the likely success of the venture and potential profitability if the business plan of the venture does not fail. The venture's potential to grow at a high pace is often given much consideration as the investor intends to increase the company's value within a specific time horizon (ibid).

According to the theory, potential risks regarding financial returns are more and more recognised, but when it comes to evaluating impact risks, methodologies still need to be established (Reeder et al., 2015). As for venture capitalists, impact investors might experience that they have a different goal alignment than the investees. However, the process of evaluating these potential risks gets more complicated when taking social objectives into account as it is difficult to define what impact is and to state concrete goal expectations.

Relationship with investee

Firstly, our findings show that evaluation of impact risks is in most cases an integrated part of the due diligence process, and that impact investors find it important to understand what drives the manager of the investee and find managers that they can relate to. By doing so, the investors seek to minimise the chances of goal misalignment and hence agency problems by investing in companies that share the same mission as themselves. This can be directly connected to venture capital theory, where it is stated that venture capitalists prefer to invest in ventures that they believe share the same goals and values (Landström, 2007). Bason (2019) underlines this: *"An extremely important part of the due diligence process is that you understand what motivates or drives the managers, and what they are measured on. How are they compensated?"* (Appendix 2.2, q. 14). As we previously found, impact investors emphasise the relationship to the investee when evaluating investment opportunities. The investors in our sample further elaborate on this, and state that a good relationship potentially can prevent goal misalignments and asymmetric information, as both parties trust each other and aim for the same targets. Stange (2019) states that finding the right investor is one of the most crucial factors for them: *"When we invest with PfC in for example Ethiopia, we only invest with people we* ***know*** *share our vision, and we tend to keep working closely with the same people, and we have local partners we work closely with"* (Appendix 2.3, q. 10). This point of view is aligned with findings from Chua et al. (2013) that show that angel investors often selects entrepreneurs that they know and trust.

What can be challenging with impact investing, which also can be related to challenges in venture capital theory, is that many impact investees are in an early stage of growth or start-up companies, and the business model might not have proved yet that it is sustainable in the long run. For example, Bellavitis et al. (2017) claim that ventures that are in an early growth stage are more uncertain, and hence carry more adverse selection risks. Our findings are therefore aligned with the traditional theory that states that the relationship between investors and investee companies is significant to avoid such risks.

Different investment types

Two of our respondents point out another way to avoid impact risk, namely to consider other types of investments than the traditional private equity investments or fund investments. Both of the respondents from Nordic Development Corporation and Sitra express their interest in social impact bonds (SIBs), which is a relatively new investment instrument. Briefly explained, SIBs are contractual agreements where the government is giving private investors returns for their investments in social programs, as long as specific outcomes are acquired (Times, 2018). Pyykkö (2019) from Sitra argues why they chose to start focusing on SIBs: *"One reason that we started to focus on social impact bonds when we started our impact investing development operations was because we wanted to be sure that when we are talking about impact, we are really talking about impact*" (Appendix 2.4, q. 6). Engedal (2019) claims that he has not yet experienced any goal misalignments in a SIB project: *"Not really in terms of social impact bonds, but then again, it is a new mode and I think all of the investors are pretty aware of what they are doing"* (Appendix 2.1, q. 12).

As the expected social outcomes of these types of investments are more explicitly defined, it can also be easier for investors to calculate the expected impact and to get a more transparent investment process, as the funding is provided based on achieving some set goals. Hence, based on our findings, investors have different approaches to impact risks. However, even though investors can choose to invest in companies they identify with, it can still be challenging to make sure that the investors are working towards the agreed goals and making sure that the defined goals are actually met.

Green-washing

A crucial aspect of impact risk is the phenomena *green-washing.* Green-washing, or *purpose-washing*, can be defined as: *"Purpose-washing occurs when investors are misled about a manager's impact intentions (including measurement) or an investment's potential impact"* (Findlay & Moran, 2018, p. 7). According to the authors, the phenomena can be avoided by increasing knowledge and transparency about impact investing, and for impact investors to require measurement and reporting standards (ibid). The latter will be discussed more in detail later in the post-monitoring section.

All of our respondents agree that due diligence is a vital part to correlate return expectations and to clearly define what the goals of the investment are. Many of the investors also explain that green-washing is still occurring from time to time and that some companies claim that they care more about impact investing than they actually do. As identified previously, many of the investors in our sample choose investees that have values that are closely related to their own, and that they invest mainly in projects they genuinely believe can create a positive impact. Some of the investors even argue that they do not experience any green-washing because of their close relationship to the managers of the investees and because they select investment opportunities very carefully. Stange (2019) says that the relationship with their partners is important and that they have only experienced tendencies for green-washing at very early stages:

"We work very closely with our partners, so that … if we see that they do not share our social mission, we would not go on with PfC, that is true. But that has only happened at very early stages, where we have seen it before we have really gone in with really heavy investments."

(Appendix 2.3, q. 13)

Moreover, we asked the investors in our sample of what they think should be done to make the investment process more transparent. All of them agree that the most important action is to create a generally accepted framework for impact investors and the financial inclusion industry to implement worldwide. Our investors clearly state that they would like to have standardised metrics they could monitor and measure on and that it would be easier for everyone to compare investments with such metrics. Some of the investors also highlight that the traditional venture capital and private equity industries traditionally have not been transparent and open. Thus, these investors argue that it would be helpful to organise peer-to-peer support and create an open environment for impact investors and investees to share experiences and methods.

In this section, we find that the impact investment process is still considered quite non-transparent, which might lead to impact risks and green-washing. If these risks cannot be controlled for, it might increase the probabilities for agency problems to arise. Our findings thus point out the importance for investors to have a close relationship with their investees in order to mitigate asymmetric information caused by different goal alignments and visions for the investment.

Exit opportunities

The last dimension of the pre-investment phase that needs to be discussed is exit opportunities. In traditional finance, when evaluating a possible investment, an assessment of exit opportunities is typically included in the due diligence process. Exit strategies are often explicitly evaluated as investors usually wish to sell their stake at a profit, after a particular growth, or the investor might want to exit if the venture shows no significant progress in providing capital (Kaplan & Strömberg, 2000). If proper exits are not clear or seem risky, the perception of risks connected to the investment might seem higher (Paludan-Müller, 2019).

We find that the respondents in our sample have different views on exit opportunities and the perceived risk connected to it. While some of the respondents clearly think exit opportunities should be evaluated and taken into consideration before an investment is conducted, other respondents claim that it is relevant, but that the process does not differ much from traditional investing, although for investments undertaken in emerging markets, there are extra risks related to, e.g. political concerns and currency risks. One respondent state that they usually do not consider exit opportunities as they believe strongly in their projects, and if something happens along the way, they will put much effort into finding a beneficial solution for both parts.

Moreover, we find that since the impact investing market is not yet fully established, many of our respondents do not have that much experience with exiting investments yet, as many of the investments they are involved in have not reached the stage of exit yet. Usually, according to some of the interviewed investors, an investment is held up to 5-10 years, and even longer if the partnership with the investee works out well, and the business idea proves to be able to generate the expected results. This is also recognised in a report conducted by J.P. Morgan, where the authors find that although exit opportunities are mentioned as one of the major concerns connected to impact investing, the impact investing field is so young that most investors have not exited their investments yet (Saltuk, Bouri & Leung, 2011). However, we find that there are still questions related to exit opportunities that need to be answered. Paludan-Müller (2019) highlights that the perceived risk might be considered higher due to the lack of common practices:

"I know it is an ongoing concern, but it is not something I have experienced myself. I can just recognise that it is one of the big things that are still lacking in order to actually know what you are going in to and how you do this, because as an investor, it is like … the concept is very much like, how do we measure, what is the risks and how do we exit. If there are no answers to this, then the perception of risk is just increasing."

(Appendix 2.1, q. 13)

As with other areas of impact investing, exit opportunities are also dependent on the investment type. For example, Veen (2019) states that they have divided their portfolio into active and passive investments, where exit opportunities are considered to a larger extent for the active investments. When conducting active investments, they thus try to build some common values within the company, which hopefully can result in a good exit at a later stage. Stange (2019) shares some of the similar thoughts and says that the most important part for them, is that the projects are financially sustainable when they exit projects. However, a plan for the exit still takes place: *"We create a plan for our exit, and we do not leave until we see that is the state"* (Appendix 2.3, q. 12).

This indicates that there are certain unsolved questions related to exit opportunities, but that most of our interviewees do not have a hands-on experience with exiting impact investments yet. However, our findings also indicate that exit opportunities is an area that needs to develop and become more transparent for investors to perceive it as less risky to enter impact deals. Having clearly defined exit opportunities can also help to create a more open and transparent investment relationship between the investors and investees, and help to make sure that the same goals are shared all the way through the exiting of the investment.

Preferences for pre-screening and due diligence

So far, we have identified some slightly differences in impact investors' preferences for pre-screening and due diligence activities. According to Landström (2007), venture capitalists spend 40% of their time on pre-investing activities, and 60% of their time on post-monitoring activities. Our findings show that finance-first investors tend to focus primarily on the pre-investment activities. These two investors are Maj Invest and Sitra. Worth noticing here, is that Maj Invest is the only company in our sample that invest in mature companies, where the rest of the companies invest in early-stage ventures or start-ups. Maj Invest and Sitra both acknowledge that the monitoring and controlling phase are still emphasised, but that the pre-screening and due diligence processes are the most time-consuming ones. Olsen (2019) states that there is much more work attached to the pre-investment process due to legal requirements and contract writing.

Takeaways

The first section of the sub-chapter has focused on the pre-investment phase investors go through before conducting investments. We have tried to understand how impact investors incorporate the social objectives into their pre-investment phase and touched upon dimensions that we believe are of importance to answer our research question later on.

Our findings so far imply some notable things. Firstly, there is a lack of consensus among impact investors on how the pre-screening and due diligence should be conducted when accounting for social objectives. Secondly, we find that some of the investors in our sample state goals in advance of the investment, while others consider it more as a "gut feeling". We find that there is a considerable challenge related to the lack of a standardised framework to evaluate the investments' potential for social impact and that this, among other things, can potentially lead to green-washing, a less transparent investment environment and difficulties with establishing goal alignments. Lastly, we find that many of the investors are yet to implement exit opportunities in their pre-investment phase, as many of their investments have not reached that stage yet, due to the young age of impact investing.

As pre-screening and due diligence serve as the foundation for the contractual relationship between investors and investees, we will in the next section examine and elaborate on contracting practices to mitigate and control for agency problems.

5.2.2 Contracting

If the entrepreneur's effort is aligned with the investor's objective, the financial contract – i.e. the allocation of cash flow and control rights, can be designed to provide incentives for the entrepreneur to behave optimally and hence mitigate agency risks. The screening analysis should act as a basis for the design of the financial contract, where the contract will reflect differences in perceived quality and risks (Kaplan & Strömberg, 2001). Hence, if the initial appraisal of the management (through screening) indicate that there are some issues present, one can adjust for that in the contract and allocate rights to the principal in the contract which facilitates monitoring and hence minimise the impact of that identified risk.

One has learned to write contracts based on solving the general problem of delegated money management, which is already a complicated management (Geczy et al., 2018). Including the social objective complicates this already challenging problem of aligning incentives between principals and agents and raise the question of how contracting practices should adapt. Therefore, in this section, compare practises of our interviewees with literature on traditional contracting methods whose aim is to avoid agency problems. By doing so, we are evaluating how specific elements of the contract constrain or encourage certain agent behaviours, which will further provide us with the ability to suggest ways in which the contract should be structured to avoid agency problems. To mention, our findings from the interviews is limited on this matter, due to lack of experience from some of the investors. Hence, more traditional literature will be applied for this analysis.

Construction of contracts

The basis of contract theory is that the contracts include control rights, to the principal, to take action that can lead to severe consequences for the entrepreneur if there is a breach of contract (Hart & Moore, 1999). We learn from our interviews that the allocation of control rights is a central feature of the contracts as a protection mechanism. Furthermore, the interviewees state that they consider voting rights, board control, liquidation preferences, etc. when formulating a contract. This suggests that despite the prevalence of comprehensive contracting among our investors, contracts are considered inherently incomplete. These findings give support to the incomplete contracts approach by Hart. According to Hart (1995), the inclusion of control rights is rooted in the idea that contracts can never be comprehensive enough, and thus the allocation of power should be incorporated in the contract. According to incomplete contracting theory, the control rights are the basis of the contract and the most significant element to include (Hart & Moore, 1999), as they allow shareholders to steer the company strategy in the right direction and gain control over the company if necessary (Bellavitis et al., 2017).

Furthermore, most of our interviewees who have experience within the field of contracting, mention the shareholder's agreement as a significant part of the contracts. They state the shareholder's agreement as an agreement between the shareholders of a company. Its purpose is to protect the shareholder's investment in the company, by specifying important rules relating to the governance of the company and the relationship between the shareholders (Janhonen, 2019). Hence, the relationship among the shareholders is supposed to be fairer, and beneficial both to majority as well as minority investors (ibid). As all of our investors are minority investors, we see this agreement as essential in protecting the investment, and as a mean to prevent the rise of agency problems.

Within impact investing, however, you might believe all the entrepreneurs seeking funds are well-meaning people, and hence you do not need a contract to tell them what to do. Nevertheless, among the investors in our sample, all of them apply contracts when entering deals. This is mainly to make sure that the entrepreneurs act as agreed upon. This complies with the agency theory that states that contracts are present to control for potential managerial opportunism (Eisenhardt, 1989). Stange (2019) expresses that it is important that the investor and the entrepreneur both know each other's expectations, and one way to make sure they do, is by including the expectations in the contracts. By doing so, one can increase the probability that the goals of the investor and the entrepreneur are aligned.

<u>Inclusion of the social objective</u>

Direct contracting

As said, the entrepreneur will incur costs if he/she fails to live up to the expectations stated in the contract. Hence, contracting directly on desired objectives is valuable, to reduce the possibility for agency problems (Geczy et al., 2018). Since the defining characteristics of impact investing is the pursuit of dual objectives – positive social and/or environmental impact as well as financial returns – one could predict that both of these components are included as objectives in the contract.

For most of the participants in this research, social expectations are included in the contract. The inclusion of social goals in the contract seems highly important for PfC, to make sure impact is achieved. They have even received help from KPMG to develop a goal mission alignment tool, with parameters that are included in the contract. Although one cannot generalise based on the sample size in this research, the normal seems to be that the social goals are incorporated in standard VC/PE contracts as additional policies, and not the main policy. This is the most common approach among the interviewed investors. Furthermore, Bason (2019) who operates as an investment advisor within the field, with loads of experience from traditional investing, states that in her opinion, social goals should always be incorporated in the contract within the impact investing scene. However, she has not yet had the chance to advise on contracting to her clients, and hence have not experienced the consequences of such contracting.

Nevertheless, not all of the participants in this thesis include the social objective in their contracts. Veen (2019) mentions that their company do not specify social goals into their contracts, but rather assess in the pre-investment screening of the firm if their efforts will lead to social impact. Maj Invest operates in the same way. However, even if they do not have any social targets when investing, Olsen (2019) specify that they ensure to invest in companies that have a social mission included in their business plan because it is necessary to have a social focus in the financial inclusion industry.

Geczy et al. (2018, p. 10) state that direct contracts can be divided into rigid and flexible contracts, whereas *"a flexible contract allows parties to adjust their outcomes to uncertainty; a rigid contract creates a bright line where a binary outcome is easier to determine."* Also, the authors provide an example of terms that would be considered either rigid or flexible within the direct contracting:

	Direct contracting
Rigid	Adhere to ESG standards
Flexible	Incorporate impact into due diligence

Table 2: Rigidity and flexibility within direct contracting. Source: Authors' own, adopted from Geczy et al. (2018).

This might indicate that TD Veen and Maj Invest follow a more flexible approach, whereas the others are more rigid in their contracting.

Hart & Moore (2008) propose a model in which parties do not only care about performance measures that are stated in contracts but also about consummate performance (performance within the spirit of the contract), which will be provided if the agent is treated well. The journal suggests that a party may enjoy providing such consummate performance, which to simplify, indicates performance beyond what is stated in contracts. Naturally, one can compare the efforts of the entrepreneurs seeking funds from impact investors, with a party willing to provide consummate performance. The entrepreneurs seek the funding from impact investors, in the first place, because they have a desire to create meaningful impact alongside financial returns (Daae, 2019). Hence, the model makes sense, as the parties do not only care about earning a certain amount of money but about creating meaningful impact. With this in mind, investors can choose to write flexible or rigid contracts on future trades. What is beneficial about flexible contracts is that they allow adjustment to uncertainty, yet they also have the potential to lead to shrinking on the consummate task, which is a disadvantage. This indicates thus that if one is uncertain of how impact is valued by the entrepreneurs, the contract should be more rigid to avoid shrinking on the task of pursuing impact.

Furthermore, Hart & Moore (2008) assume that parties are more likely to put constraints on variables where there exists a significant conflict of interest, like price, than on variables where conflict is less extreme, being the nature of the good to be traded. Considering this from the impact investing perspective, it suggests more contracting on financial parameters (price), and less around the nature of impact (nature of the good). Put differently, the flexibility of the contracts, with regards to the impact created, will depend on the level of disagreement of the value of that impact. Hence, low expectations of disagreement indicate the use of a flexible contract, and high expectations of disagreement indicate that a rigid contract is a better fit.

The notions above suggest that in an investment setting where the value of impact is significantly valued, it should be included in the contractual terms if there is a possibility of disagreement on how much certain impact is valued. In cases where there exists a pressure to deliver both a good financial return alongside social impact, we view a greater potential for disagreement, because of the higher tension between a strong financial goal and a strong impact goal which can lead to distortion of the social objective. This applies to the finance-first investors in general, as they value impact high, but is not willing to sacrifice any financial return. Hence, a rigid contract is suggested in such cases where there is a strong focus on both objectives, and where the investors are not willing to achieve social impact at the expense of financial returns. Furthermore, we posit less potential disagreement for impact-first investors, because of the relatively lower tension between goals – impact comes first, and there is no requirement to achieve a significant financial return. Also, our findings indicate that impact-first investors have a more embedded impact than finance-first investors, as their primary focus in their pre-screening is to find investees with potential to create impact, and not financial returns. Therefore, one could allow for the use of more flexible contracting within this setting.

That being said, if there are any doubts with regards to how much the entrepreneur value impact, and hence possibilities for disagreement, the theory by Hart & Moore (2008) suggests it is better to take advantage of rigid contracting to avoid moral hazard as a result of asymmetric information. The financial return is what increases the wealth of the entrepreneur, and hence, intuitively, one would assume this is what the entrepreneur will target unless otherwise is proven or stated. Overall, this further implies that the greater the information asymmetry and uncertainty, the more rigid contracting. Hence, as start-ups and early-stage ventures are characterised by uncertainty (Kaplan & Strömberg, 2003), also with regards to the respective entrepreneur, it is proposed that they would use more rigid contracting. We find support for this idea when comparing it to the patterns we observe among our interviewees, as most of them operate or advise as suggested.

TD Veen is the only one who does not act according to this notion and hence is more vulnerable for moral hazard. Even though they were willing to sacrifice some financial return for significant impact, there will still be too strong of a tension between their social and financial goals for them to use flexible contracting, if they want to protect themselves against possible agency problems. Furthermore, Maj Invest does not state goals or targets in the contract either. Nonetheless, they state that they invest mostly in mature and sound businesses, where they will have a proven track of the entrepreneur. Hence, there is not necessarily a need for rigid contracting based on the uncertainty element. Yet, as they are a finance-first investor, we could expect tension between the goals. Furthermore, Olsen (2019) argues that even though they do not have specific social goals implemented in the contract, they do include a mission drift in the business plan which contains certain social elements, so they would have to maintain their social mission. Thus, one could argue that their contract is not entirely flexible and that their actions reduce the probability of agency problems.

Furthermore, as said in the theoretical chapter on contracting within the agency theory, if one can observe and verify the behaviour of the agent, the agent's behaviour will be more disciplined. Therefore, it might be important to emphasise that both TD Veen and Maj Invest usually require a board seat when investing, and hence can verify that the agent act as agreed upon. Accordingly, the investors are less prone to agency problems, as moral hazard, if they have a board seat.

Direct contracting on multiple tasks

Since multiple objectives are a core feature of an impact investor's investment process, it would be natural to look at how direct contracting varies when the agent is responsible for mutual tasks. Holmstrom & Milgrom (1991) have done research on this and make the point that when an agent is responsible for multiple-tasks, rewarding only the measurable activities can lead to the agent spending too much time on the rewarded activities relative to the other desired activities. Hence, there might exist a trade-off between objectives. Thus, assuming that impact performance is hard to measure in an impact investing context, and therefore somewhat hard to contract on, it might not be optimal to tie compensation to the financial objective because this could lead to distortion of the social objective.

As there exists a potential trade-off between pursuing the social or financial objective, the multi-task theory indicates that the agent must choose the way to allocate effort towards the objectives. He must decide whether to focus on strong performance on financial objectives, as it is easy to measure, or a balanced, but lower, performance across both the objectives. This notion seems to fit more the impact-first investors, as they are more willing to sacrifice financial returns for impact. Among the investors who not claim to be impact-first investors, the financial objective seems to be valued the most, even though they are eager to achieve both. This also appears to be the case in general among impact investors as of today. Hence, it does not seem like a realistic option to not contract on financial measures to achieve more impact. However, as they experience a tension between the two tasks, it looks like these investors try to incorporate contractual incentives on impact, in an attempt to support impact. We will elaborate on this in the following section.

Contractual design

Here, we will present evidence on how our interviewees structure their contracts, and if they are structured optimally, with regards to avoiding agency problems. Furthermore, we will elaborate on how the contractual design can encourage certain agent behaviours, but also constrain others, in the views of both primary and secondary data. If structured right, the contractual design can mitigate, and in the best case, avoid agency problems, according to theory.

Allocation of cash-flow rights

From the interviews conducted, we see that stage- and performance-based contractual designs often are the chosen approach for investments in early-stage ventures within the impact scene to make sure that impact is created. Staged contracting means that the investor makes a contingent/staged release of his/her financing commitment, depending on whether certain milestones are being met by the investee (Kaplan & Strömberg, 2000). Pay-for-performance contracting, on the other hand, make compensation contingent on performance (ibid).

Bason (2019) proposes that, within impact investing, such contracts should be contingent in terms of both financial and social objectives. This makes sense as impact investing itself is concerned with creating both social and financial returns. According to the interviews, contingent contracting is used mainly to adjust for uncertainties about the management, that was identified during the pre-screening stage, as an incentive for the entrepreneurs to make sure that he/she stays on the path initially agreed upon. In other words, these contracts are being used to avoid goal incongruence and loss of capital.

According to the views of both Holmström (1979) and Lazear (1986), performance-contingent compensation is indeed one way to overcome misalignments of goals and opportunistic behaviour, when actions are not verifiable. This is because firm output (e.g. impact) or profits, are correlated with effort and thus can be contracted on (Holmström, 1979). Furthermore, Kaplan & Strömberg (2000), just as our interviewees, explicitly mention these two contractual designs as methods used primarily to adjust for management uncertainty by overcoming conflicts of interest between the entrepreneur and investor.

Moreover, research further suggests that if the entrepreneur is willing to accept an incentive structure that punishes poor performance, it is a signal of quality – then the entrepreneur must have great faith in his/her business plan and abilities (Bellavitis et al., 2017). As a further matter, in the conducted interview with Daae (2019), he states that if a venture does not deliver good enough performance, the relationship with that venture can be terminated. Hence, by taking advantage of contingent designs, the investors can protect themselves by reducing the amount of funds they have to put at risk for a particular investment, and so reducing the potential losses that they can incur. On the contrary, if one use contracts that are not contingent, and thus provide the venture with all the committed capital at the beginning of the relationship (signing), there is no way of getting the money back if the venture completely fails. Then, the investment is a sunk cost from the investors' side.

Uncertainty and asymmetric information may characterise early-stage ventures if the entrepreneur of the venture has no previous success with founding of a company. This is mainly because the entrepreneur's effort is relatively more important in a new venture's development phase (Kaplan & Strömberg, 2003). Therefore, it seems appropriate for the investors to use contingent contractual designs when entering a deal with a venture in its early stage. The theories insinuate that only high-ability entrepreneurs will accept compensation contracts, and hence those managers have an intention of following the pre-defined business plan – ergo, the possibilities for goal incongruence or opportunistic behaviour, are reduced. Furthermore, as the investors want to control the uncertainty, they should offer contingent contracts where the level of sensitivity with regards to equity compensation, match the level of uncertainty and asymmetric information. As mentioned, depending on how great an investor value impact, social milestones can be included in the contracts, and hence one can increase the probability for meaningful impact to be created.

Among the early-stage ventures in our sample, most of them use types of contingent contracting. TD Veen, which does not state social goals in the contract, does not typically uses contracts where payments are contingent, yet in cases where they are sceptic, but wants to give a helping hand, they can make funds contingent to remove some of the risks. Moreover, Maj Invest operates differently than the others by not making funds contingent. This can yet again be rooted in their decision to invest in mature companies which are characterised by less uncertainty.

Allocation of control rights

All the investors in our sample claim that control rights are stated in their contract to control for the typical agency risks. The contracts usually include the same control rights as in VC/PE, such as voting rights, liquidation rights and board control rights, among others. Furthermore, the advisors from NDC (2019) state that control rights usually only are exerted if the respective entrepreneurs are not acting according to the set-out business plan, or if a venture performs poorly. As said, outputs are correlated with effort, according to Holmström (1979), and hence this statement implies that the control rights are contingent on observable measures (output) of the financial and non-financial performance. This statement is supported by the other interviewees. When contracts are contingent on performance, investors get a good indication on when they should intervene. As in traditional investments that are contingent on financial performance, investors can step in when goals are not met (NDC, 2019). Additionally, the voting rights which is included in the shareholder's agreement, collectively, give the investors the power to replace management in cases of breach of contract or very poor performance (Olsen, 2019). Furthermore, due to the same reasons, investors can withdraw from the investments. Hence, Olsen (2019) argues that they have much leverage in the companies.

Research by Aghion & Bolton (1992) supports the use of such state contingent control rights and argue that they are of great importance when the entrepreneur's actions are observable but not verifiable, as it constrains or encourages certain behaviours by the entrepreneur, and hence control for moral hazard. However, they stress the importance of such control rights to be state-contingent only, as the entrepreneur usually has the best competencies with regards to the "good" in question. This is consistent with research done by Kaplan & Strömberg (2003) as well, and furthermore, the perception seems to match that of our interviewees. Daae (2019), for example, says:

"We do not want to take over the companies. We recognise that the social entrepreneur has real lasting value to the company, and we cannot do the same work. We are investment professionals with certain skills in the field, but we cannot run the company as entrepreneurs. The companies are typically not mature enough to kind of survive without the spirit of the entrepreneur."

(Appendix 2.6, q. 15)

Moreover, the interviewees say that the business plan, which has been evaluated as effective in achieving positive impact, has to be followed, and that certain alterations need to be approved by the investors. However, away from that, the funding does not seem to be tied to any specific clauses on the equity side. Grants and loans, on the other hand, have a bit more strict rules (Daae, 2019; Stange, 2019). Furthermore, Malene Bason advises her clients to be more pragmatic with regards to the usage of the funding. If the investor has done a good screening, then the investor has invested in entrepreneurs who share much of the same values with regards to impact as himself. Hence, Bason (2019) says that one can be pretty sure that the investment is going to have some impact. Overall, the way our interviewees act is consistent with what existing literature recommends.

Takeaways

The control rights act as the basis of a contract between an investor and an entrepreneur, as it allows shareholders to steer the company strategy in the right direction, as they can gain control over the company if necessary, e.g. if there is a breach of contract. We can separate between rigid and flexible contracting, whereas the latter allow for uncertainty, and hence does not incorporate exact goals into the contract. However, flexible contracting can lead to shrinking on the task of pursuing impact if it is not stated in the contract, hence, if there exist any uncertainty in how impact is valued by the entrepreneurs, the contract should be more rigid around impact. Furthermore, rigid contracting is also suggested in cases where there exists a strong tension between two goals, as the situation where investors are just as eager to achieve both social impact and a strong financial return. Lastly, we find that contingency-based contracts on impact, both with regards to allocation of equity and control, is optimal to constrain or encourage certain behaviour by the entrepreneur.

5.2.3 Post-investment monitoring and control

The third part of the principal-agent framework is the post-monitoring and control part. According to the literature, this part is likely to be more utilised by investors if the contracts are incomplete, meaning that they are not fully comprehensive of all future contingencies. Hence, instead of focusing all effort on pre-screening and due diligence to formulate contracts, one accepts a less comprehensive contract on the basis that more post-monitoring and control efforts will be employed. This section will thus discuss the post-investment process and ways of controlling and monitoring investments. The theory states that if investors cannot observe the actions of the investee, the investee might behave opportunistically and hence, the investors will face challenges related to moral hazard. The aim of this section is thus to obtain an understanding of how agency problems can be avoided by monitoring and controlling the investments.

Monitoring is an important part of the relationship between a venture capitalist and an entrepreneur (Landström, 2007). The importance of monitoring stems from the potential goal misalignment coupled with asymmetric information between the two parties, which again may result in moral hazard from the entrepreneur's side (ibid). Monitoring is thus referred to as the procedures and routines that are applied by the venture capitalist to evaluate the entrepreneur's performance and behaviour. As demonstrated, the allocation of control rights is a central feature of the financial contracts, and are traditionally allocated such that if the venture acts in a way which is not in alignment with the interest of the investor, the investor can take the necessary actions. However, to verify the actions and efforts of the entrepreneur, the investors need to incur monitoring of their investments and the venture itself. According to Hart (1995), investors usually conduct a more thorough post-monitoring of their investments if they find it too complicated or costly to write contracts that take all possible outcomes of the investment into consideration. The post-monitoring is hence seen as the most essential phase for these investors. Moreover, Kaplan & Strömberg (2000) state that the investment analysis done in the pre-investment screening and due diligence is often used as a guide for post-investment monitoring.

Traditional investors have several options for monitoring of their investments. By for example taking on an active role in the board of the venture, the investors can enforce their rights and influence and steer the strategic direction of the venture (Bellavitis et al., 2017). On the other hand, the situation might be a bit more complex for impact investors due to their dual objectives. While as impact investors have the option to follow the same procedures as traditional investors in terms of monitor the financial side of their investments, they face several potential challenges when monitoring the social side. As previously identified in our thesis, there is a lack of frameworks to evaluate impact investments, and investors face the problem of possible green-washing. Therefore, it is crucial for investors to be able to monitor their investments if specific goals with expected outcomes are not clearly stated.

The section will proceed as follows. At first, we will analyse how social impact can be measured. In order to monitor the investees, investors need to be able to measure the actual outcomes of the investment, which is why we seek to examine this process. Later on, we move on to how investors actively can monitor their investments, and how they control the investees if they are not performing as expected.

Measuring social impact

One of the remaining questions in impact investing is *how social impact can be measured* (Reeder et al., 2015). The state of impact measurement is still not satisfactory, and common methods and metric systems are still in an early phase of development (Reeder & Colantonio, 2013). If impact cannot be measured, it will be more difficult for investors to know whether the investees are behaving opportunistically or are following the original plan. As previously explained, So & Staskevicius (2015) argue that there are four key elements of measuring impact, namely; estimating, in terms of due diligence; planning, which includes deriving metrics and data collection methods for monitoring; monitoring, which focus on measuring and analysing impact to ensure mission alignment and performance; and lastly, evaluation of the post-investment impact of an intervention or investment.

<u>Stating social and/or environmental goals</u>

Following the approach of So & Staskevicius (2015), a few of the interviewees argue that one way to approach impact measurement is to define social and/or environmental goals for each project and measure the results compared to the initial expectations. One investor suggested that by mapping activities, outputs, outcome and impact, one can benchmark or apply the theory of change to examine if the intended effect is reached or some adjustments are needed. Bason (2019) states that one should take the investment strategy into account first, and figure out a way to measure the impact afterwards: *"I think you have to look at the specific strategy and say what kind of impact you are reaching for and then figure out how to set some kind of metrics"* (Appendix 2.2, q. 23). If expected goals and expectations are stated, the measurement process gets more straightforward, since investors and investees know what they have to measure and report on.

<u>Impact reporting requirements</u>

According to Findlay & Moran (2018), the probability for goal misalignments between the investor and investee is increasing if the impact cannot be monitored and reported accurately. Therefore, we seek to get a deeper understanding of whether the investors in our sample have implemented any impact reporting requirements or metrics, and if so, which requirements they are using. Several of the interviewees say that they have developed various types of reporting requirements to measure and report on their impact progress. While developing these, the investors define metrics and measurement methods and agree on what makes the most sense for them to evaluate. Three of the interviewees mention concrete examples of how they have implemented such requirements in their organisations. These investors state that they have developed some impact reporting schemes, where quarterly or annual reports are produced, respectively. Daae (2019) gives an example of the chosen way of reporting in Ferd SE: *"We have an annual impact report that we publish at Ferd SE. All companies are required to report annually on agreed parameters, so we try to aggregate […], and then we report on individual KPIs as well"* (Appendix 2.6, q. 17). This is in line with results from an in-depth analysis over impact investors conducted by J.P. Morgan, which finds that most impact investors are either reporting on a quarterly (29%) or annually basis (44%) (Saltuk et al., 2011). Other investors tell that they are yet to develop reporting tools as they lack the expertise to take them through and that this is especially related to direct investments. Jahonen (2019) explains that, e.g. fund investments or SIBs, on the other hand, more standardised reporting tools are often developed together with the managers running the funds or the mangers of the SIBs.

Many of the investors in our sample have implemented reporting methods and metrics; however, there are still some of the respondents that state that they have no such reporting systems in place. The latter group of investors is thus more prone to situations of moral hazard, as the investees are not required to report on their actions, and can thus act opportunistically.

Frameworks and methods for measuring impact

While some investors have developed specific tools for impact measurement, other investors believe that there is no accurate way of measuring the actual impact created. These investors state that the measurement process is a matter of personal opinions as there exist numerous ways of doing it, and since the definition of what impact actually *is,* to some extent is subjective. Closely connected to the concerns identified in the pre-investment process, are the issues with lack of ways to compare and measure investments after they have been conducted. Our findings show that none of the investors acknowledge IRIS or any similar methods as a proper way of measuring impact. Again, the question of how one can compare investments is addressed by Engedal (2019):

> *"I think the social impact is a lot more complex than environmental or economic impact, because there are so many different variables. You cannot control everything, you cannot measure everything, you cannot measure all the 800 indicators on each investment, and even if you could, how do you weight them compared to each other?"*
>
> (Appendix 2.1, q. 26)

The majority of our interviewees share the opinion that the existing methods are mostly relevant for large institutional investors that have enough capacity and experience to apply such complex measurement frameworks. Most of the investors agree that the impact investing market is just not *there* yet and that many of the investees are rather small organisations without the resources to conduct comprehensive measurement reports for their investors. Daae (2019) is one of the investors that argues that some of the investees are simply too small to have enough resources for a thorough impact measurement report:

"[…] recognising that these companies are very different, and quite a few of them are at an early stage and have not done this before, we have to be pragmatic about it. We cannot really expect a company with 1-2 employees to do a full impact management report."

(Appendix 2.6, q. 18)

In addition to IRIS, the SROI is mentioned in the literature as one of the main methods of measuring impact (So & Staskevicious, 2015). However, none of the investors in our sample state that they are using this method either. For example, Stange (2019) tells that they applied SROI a few years ago, but that it resulted in just a number and not much information, and that it was very time consuming to use. Several of the investors thus state that they have, like in the pre-investment phase, developed their own ways of measuring their created impact. Bason (2019) shares the same view regarding the usage of IRIS, based on her experience with impact investors: *"The IRIS I think would only be for big institutional investors with large investment teams. I think so far it is kind of hand-held"* (Appendix 2.2, q. 23).

The lack of proper tools for measuring and reporting on impact can complicate the investment process substantially. If investors do not have clear ways of measuring the created impact, it is challenging for them to know what is good impact and what is not, and to know when to interfere if an investment steers in the wrong direction. As stated by Paludan-Müller (2019): *"[...] regular investors are so trained in financial evaluation, so they would know exactly when to do what. I think it would be more difficult if they do not feel that the social part is meeting their expectations"* (Appendix 2.1, q. 29).

Thus, this section has provided us with valuable insights on how impact investors approach the challenge of measuring impact. It is clear that the lack of measuring and reporting tools complicates the process, and it makes it more difficult for investors to know if the investees are behaving as agreed on or not. Similarities to the pre-investing phase where no globally accepted frameworks for evaluating impact, also constitutes a challenge in the post-investment phase. We do, however, find that some of the investors we interview are not directly *measuring* the impact they create; instead, they focus on impact *management* and *monitoring* of the investees' progress. This brings us over to the next section, where these topics will be further analysed.

Monitoring and control

From the previous section, it is clear that it is difficult to define an exact way of measuring impact, and that investors in our sample approach this differently. This section thus seeks to examine the monitoring process among impact investors, and what common practices of monitoring might be. As stated in the introduction to the post-monitoring section, investors may demand board seats and management replacement rights to control the direction of the venture (Bellavitis et al., 2017). In an impact investment, monitoring further requires the investors to make sure the social objectives are upheld, and that the investee is reaching the goals agreed upon in advance. The monitoring process thus serves as a mean to avoid moral hazard from the investee.

From our findings, we can see that investors apply different methods to monitor their investment and that some investors are putting more effort into monitoring than others. While some investors have fairly structured monitoring processes in place, other investors tend to mainly focus on the financial return, whereas the social outcomes are considered more as a bonus.

<u>Lack of experience and resources</u>

Although some investors in our sample state that they are yet to develop structured monitoring processes, they stress that they still care about the social returns. The reason why they focus more on the financial part of the investment is often that they feel more confident in how to measure financial returns. Janhonen (2019) is one of the investors that claim that their main focus is monitoring of the financial return, but that they are working on including the social aspect, too: *"But that is something we should develop, as it is now a work in progress"* (Appendix 2.4, q. 18). The impact advisory companies we interviewed agree that lack of experience and resources is a challenge for investors that seek to monitor their investments. Paludan-Müller (2019) states that *"So the monitoring and the evaluation part is … I mean, it is definitely important and it is what makes a difference, but also attached to a lot of heavy work"* (Appendix 2.1, q. 24). It is further highlighted that the complex monitoring process and uncertainties related to the process might lead to investors hesitating to enter the market, especially if they want to do it *right.*

Active versus passive role in the investee

By analysing our results, engagement in the monitoring process seems to be dependent on the investment type. While direct investments tend to be heavily monitored by the investors, more passive investments, such as, e.g. fund investments, tend to result in less focus on the monitoring of the investment. Moreover, we find that it depends on whether the focus of the investors is on social returns or financial returns. Even though all our interviewees address the importance of social returns, some of the investors are more willing to accept a trade-off in return for social impact. We find that one group of the investors are very active in their investees and have a well-established monitoring process implemented, while the other group of investors have chosen to prioritise it less, often due to the high amount of resources it requires. Among these investors, only one investor clearly states that they do not want to be actively involved in their investments, due to the amount of time and resources it requires.

We find that for the investors that focus considerably on monitoring, most of them engage actively in the investees. The active involvement is often in terms of board seats, but also in terms of field trips and on-site visits to their investees' respective locations. As an example, Stange (2019) is one of the investors who prefer to be actively involved. She tells that they work closely with their investees and often visit them to check up on their progress and maintain a good relationship with them. Moreover, she states that: *"What we offer is not only financial investments, but also operational"* (Appendix 2.3, q. 26). Daae (2019) states that active involvement is a crucial part of their investment approach:

"We attend every board meeting, we have workshops with them 2-3 times a year, […] we do workshops on impact management, we help them with financial workshops and stuff, and we also invite them in twice a year for a joint two-day workshop for all the companies where we all meet and discuss various topics that we think are relevant to them and things we want to communicate to them […]."

(Appendix 2.6, q. 19)

Additionally, Daae (2019) addresses that impact is a subject on every board meeting, and that by having such a close relationship with their investees, it is easier to make sure that impact is a part of the everyday business for the companies. Bason (2019) shares similar opinions about active involvement and field trips, and argues that field trips are essential for the measuring and monitoring process to carefully follow up on the investee's progress and behaviour.

On the other hand, the investors we found to be less involved in their investees, share the view that it requires too much effort and resources to actively engage in the investees' operations. The investor that stated that they prefer not to be actively involved states that they used to take on an active role in past investments and that they usually always required a board seat. However, after a strategy change a couple of years ago, they decided to change their direction and externalise their investment processes, which is why they do not wish to be an active investor anymore. This investor, however, states that they often still want to have an advisory board seat. Another investor that is not always actively engaged is Veen (2019). She tells that due to their split portfolio of passive and active investments, they only seek to be involved in the latter.

Active involvement and board seats are both mechanisms to encourage disciplined behaviour of the investees. When the investors continually can keep track of the investees' performance, the chances for moral hazard will decrease. Hence, the investors who do not engage actively in the investee in terms of involvement and board seats etc., are more likely to be subject to less disciplined behaviour from the investees.

<u>Syndication</u>

According to theory, syndication can potentially serve as a method to avoid agency problems and can be applied in both the pre-investing and the post-monitoring phase (Bellavitis et al., 2017). Syndication refers to a situation where investors go together and collaborate about the due diligence and monitoring of an equity investment to share the costs and risks (ibid). Some of the investors in our sample mention syndication as a possible way of overcoming the time constraints and resource constraints related to post-monitoring of investments. For example, Bason (2019) states that: *"Ideally, I think what you would see is investors grouping together because they can share the resources. It is very time consuming and expensive"* (Appendix 2.2, q. 23). Another investor points out that in a typical venture capital setting, one would typically find companies that share the same values and expectations as oneself and go into the investments together. Janhonen (2019) points out that syndication is very typical for venture capital investments, and in those settings, the investors usually have the same understanding of what the goals are. However, Janhonen (2019) further claims that this might be challenging in an impact investing setting: *"[…] that is very difficult because in some cases you have investors who are just looking to optimise financial return, then you may have some philanthropic investors who are only interested in the impact of the company"* (Appendix 2.4, q. 6).

Moreover, we find that most investors in our sample do not mention syndication as a part of their investment process. That being said, the investors still put much focus on talking to peers and market experts and discussing with other investors in the field how best-practice monitoring processes could be implemented.

Poor performance

The theory states that an important part of the post-monitoring process is how investors are reacting to poor performance of the investees, and which actions that can be taken if poor performance is taking place (Bellavitis et al., 2017). Poor performance can, for example, be that the investee is not behaving as expected, or that the agreed-upon goals are not being met. As discussed previously, investors can require board control to better decide the strategic direction of the investees. Additionally, board control can be used by investors as a reaction to poor performance, and gradually, investors could replace the management of the poor performing investee (Bellavitis et al., 2017; Kaplan & Strömberg, 2002). Our focus will be on poor performance in terms of social returns, as the social aspects of the investment decisions are the subject of analysis in this thesis.

We find that investors share different opinions about the matter of poor performance. Worth noticing is that only one of the investors in our sample recognised management replacement rights as a way of responding to poor performance. This investor, however, only invest in mature businesses, while all the other investors in our sample invest in early-stage ventures and start-ups. Our findings are therefore in line with Bellavitis et al. (2017) that state that replacement of the management is more relevant when investing in mature companies.

Regarding board control rights, our findings show that the majority of the investors prefer to have a board seat in the company they invest in. For these investors, the view on how one should respond to poor performance differs among them. Two of the investors share similar opinions about the concern and claim that it depends whether the poor performance is because the investee needs more help and can be controlled, or if it is due to generally poor performance. If the case is the former, the investors say that they will try their best to support the investees by, e.g. provide them with more help, go in with consultants or add extra resources. If the poor results are due to bad performance, on the other hand, the investors state that they might withdraw from the investment or confront the investee, but that they *rarely* would enforce their board rights. Stange (2019) underlines that a close relationship with the investees potentially can prevent poor performance:

"[...] if the poor performance is because there is no alignment in the mission, we sort of have withdrawn from some, but mostly, since we work closely with people that we know, we do not reinvest in organisations that we see are not good."

(Appendix 2.3, q. 28).

The other investor highlights that even though their company possesses a significant capital and easily could rule over smaller entrepreneurs if things do not turn out as planned, it is not their style to do so and that they would rather try to solve the problems together with their investees. Hence, although these two investors possess board seats, they state that they would not use their rights unless the case is very extreme. As an example of a worst-scenario setting, one of the investors pointed out that they would help the investees to scale down their businesses or develop a controlled exit plan.

On the other hand, a few other of the investors share some slightly different thoughts. One of these investors states that it depends on the investment type, and that, for example, it is easier to intervene in direct investments, and that the process is more complicated for fund investments, as it requires the majority of the investors behind you. Engedal (2019) also claims that it depends on the investment type: *"The investor's right to intervene depends on the investment type [...]. Sometimes the investors will have full responsibility and right to design and substitute the intervention, sometimes he will have a more passive role"* (Appendix 2.1, q. 28). Veen (2019) tells that they would enforce their board rights if the investee is not performing as expected.

"If some of these companies completely takes off or suddenly does not follow what one agreed on, and if you not are a majority owner, the way to do it is to use our board rights, first and foremost […]. If this does not work, one would try to execute a balance of power, e.g. us together with two others constitutes a majority."

(Appendix 2.5, q. 17)

Another point of view comes from the two impact advisory companies we interviewed. Both of them state that the reactions to poor performance do not differ substantially from traditional investing. However, Bason (2019) points out that the impact investors seem to be more patient because the area is relatively new. Paludan-Müller (2019) claims that it might be harder for investors to know when to respond in an impact investing setting and that it depends whether the investors have the expertise and experience to interfere and evaluate along the way. Paludan-Müller (2019) further states that:

"I think it would be more difficult if they do not feel that the social part is not meeting their expectations. When do you do something then, and what would you do, how would you make it happen?"

(Appendix 2.1, q. 29)

Bason (2019) argues that many of the investors have experience within monitoring financial performance and that it thus can be difficult for them to know precisely how to respond to what they believe is poor performance in light of social performance. Again, this can be seen in connection to our previous findings where we identified that many impact investors lack experience about how they can measure and monitor their investments and when they should interfere if something does not go as planned.

Preferences for post-monitoring and control

Throughout our analysis, we have noticed that investors have different preferences in regards to the pre-investment phase and the post-investment phase. In the pre-investing section, we found that the two financial-first investors in our sample seem to prefer the pre-investing activities. On the contrary, we find that the two investors who define themselves as impact-first spend more time on post-investment monitoring and control than the finance-first investors in our sample. The investors recognise that the post-monitoring phase requires much more time and money than the pre-investment activities do. Furthermore, they state that in the future, one might see more and more traditional investors entering impact investment deals together with impact-first investors and rely on them to do all the hard monitoring work of the investment (Daae, 2019). Olsen (2019) believes that the monitoring not necessarily takes that many resources if the investee is running smoothly. Veen (2019) shares a split view on the matter; they focus 50/50 on the pre- and post-phase, depending on whether the investments are active or passive. For active investments, the focus lies on the post-monitoring, whereas for the passive investments, the focus is concerned on pre-screening and due diligence.

One can assume that impact-first tend to focus more on the post-monitoring and control phase than on the pre-investment phase, due to their quest for social outcomes. The primary goal for these investors is namely to create social impact, which is why monitoring is perceived crucial for them.

Takeaways

This section has addressed how impact investors measure and monitor their investments, and interfere by using their control rights if the investee is behaving opportunistically or not in line with what was initially agreed on.

The most important remarks from this section include first and foremost the lack of a global framework to measure impact, that is applicable and pragmatic enough for all investors in the market to employ. We find that it is challenging for impact investors to compare investment across asset classes due to this and that the investment process becomes less transparent when there are no adequately defined measurement practices in place. Next, we find that there are also challenges connected to the monitoring part, but that many of the investors in our sample engage actively in their investees in order to monitor their progress and to steer them in the right direction if something deviates from the original plan. Lastly, most investors in our sample require a board seat in their investees' boards, which can be used to control the direction of the investee and in the worst scenario, used for intervention.

6. Discussion and implications

The primary purpose of this thesis has been to answer the research question: *"How do impact investors approach their dual objectives in an investment process, and how can the investors control for agency problems that might arise with the inclusion of the social objective?"* The following section will explain the key findings of this thesis and point out four propositions which sum up our most significant findings from our conducted research. Furthermore, we will discuss theoretical and practical implications that can be derived from our study.

6.1 Key findings and propositions

Across our interviews, we find a strong motivation among Nordic impact investors to incorporate both the social and financial objectives in the investment process. The investment process is similar to that of a standard venture capital/private equity investment process, where the financial objective is formally incorporated and assessed in coherence with market standards by all our interviewees. Furthermore, the investors approach the social objective similarly, even though there are some differences. Overall, equal for everyone is that the social objective is approached less formally, and more in an intuitive manner. We have learned that investors define impact investing differently, where for some, just the presence of social impact can be sufficient to satisfy the social objective. Moreover, certain typical financial criteria, such as the possibility for development and growth along with the entrepreneur/management, are considered equally significant to achieve social or environmental impact.

Overall, compared to the financial objective, we find that less consideration is given to the social objective even though impact investors aim to address both. The strong familiarity with traditional financial decision making seems to be a boundary, as they are more knowledgeable about how to achieve the financial objective, while there within the impact setting is no recognised standard on how to address the social objective. All of the investors stressed the importance of a common framework or defined indicators because as it is now, the assessment is very complex. This further complicates the ex-post monitoring of the objective. Hence, we find that it simplifies the process to make decisions based on parameters investors are familiar with, which leads to limited incorporation of the social impact objective in the investment process. This leads us to our first proposition:

Proposition 1:
The financial objective is emphasised in the investment process of impact investors.

Our results highlight the importance of a thorough pre-screening and due diligence process for impact investors. The findings indicate that these activities are essential for investors to screen for potential impact and evaluate the attractiveness of the investments, both in terms of social and financial returns. As we have identified, most of the investors in our sample expect a financial return in addition to the social value added by their investments, which is why traditional due diligence on the financial side still is important for impact investors. However, the investors also need to identify clear goals and expectations when considering investment opportunities to ensure goal alignment with the investees. We find that there is a lack of evaluation frameworks on the social side for investors, which can make it challenging to know which social returns one can expect.

Aligned with traditional venture capital theory, we find that the most crucial step for impact investors to avoid goal misalignments is to only invest in ventures with a business plan they believe can lead to sustained social impact, and with managers they can identify with on a personal level. We find that the lack of transparency in impact investments might lead to impact risks and green-washing and that the lack of evaluation methods and tools worsens this situation. If the investors cannot properly evaluate the expected outcomes of the investments, it might be more challenging to state clear goals in the contract later on, and the investee might possess information that is withheld from the investors due to this. Thus, the first step impact investors should take to mitigate potential agency conflicts is therefore to conduct a thorough pre-screening and due diligence where the potential for creating impact alongside financial returns is carefully considered. Then, the investors should identify and define their goal expectations and search for investees they genuinely believe share the same views as them and which they think can reach the agreed-upon goals. By finding the right investees and management team, the investors can further prevent the occurrence of impact risk and green-washing resulting from information asymmetries and adverse selection.

Proposition 2:
In the pre-investment phase, impact investors should evaluate investees on the potential for creating impact alongside financial returns and find entrepreneurs that share their values and visions.

After the pre-screening, comes the structuring of contracts. The contract contains an agreed upon business plan based on the pre-screening that reflects differences in perceived quality and risks. This plan has further been assessed by the investor and is considered effective in achieving the desired impact. The control rights act as the basis of a contract between an investor and an entrepreneur, as it allows shareholders to steer the company strategy in the right direction, as they can gain control over the company if necessary, e.g. if there is a breach of contract. We can separate between rigid and flexible contracting, whereas the latter allow for uncertainty, and hence does not incorporate exact goals into the contract. However, flexible contracting can lead to shrinking on the task of pursuing impact if it is not stated in the contract, hence, if there exist any uncertainty in how impact is valued by the entrepreneurs, we find that the contract should be more rigid, to prevent potential managerial opportunism. Furthermore, rigid contracting is also suggested in cases where there exists a strong tension between two goals, as when investors are just as eager to achieve both social impact and a strong financial return.

Furthermore, the multi-tasking theory by Holmstrom and Milgrom (1991), suggest that if there is a tension between the two goals; financial return with straightforward measures, and impact with more ambiguous measurements, the agent will probably spend more time on the easy-measured tasks. Hence, this theory suggests that one should not tie compensation to the financial objective. This might be a solution for impact-first investors, but finance-first investors who also desire social impact alongside their investments, does not seem willing to put the financial return at risk. However, if there exist a strong tension between the two objectives, it seems like the investors should try to incorporate contractual incentives on both measures, in attempt to achieve impact simultaneously as financial returns. Furthermore, we find that contingency-based contracts, both with regards to allocation of equity and control, is optimal to constrain or encourage certain behaviour by the entrepreneur. Contingent contracting on the social objective provides the entrepreneur with the incentive to deliver social impact alongside the financial return. Furthermore, contingent control rights acknowledge the social entrepreneurs' value to the company and hence allow for flexibility to a certain limit, yet it prevents the problem of moral hazard by giving the investors the possibility to intervene in cases of breach of contract or very poor performance. Thus, we propose the following:

Proposition 3:
Impact investors should apply contingency-based contracts, where the level of rigidity on impact and sensitivity with regards to allocation of equity and control rights, should match the investors' level of perceived uncertainty.

Our last proposition suggests that impact investors should take on an active role in their respective investees in order to monitor and control the progress of the investment and to make sure that the agreed-upon goals are being met. This proposition is based on our findings that show that there is no globally accepted frameworks or metrics for impact measurement, and it can thus be very challenging for impact investors to know whether their social return expectations are actually being achieved. Several of the interviewed investors state that they lack expertise in impact reporting and management and that the existing methods are in early stages of development. If the outcomes of the investees cannot be adequately measured and reported on, they may take advantage of the situation and behave opportunistically. When social outcomes are not properly measured, it can be difficult for investors to know exactly when to intervene and take the necessary actions to avoid moral hazard. We thus suggest that impact investors should be actively involved in their investees by having board seats, attending board meetings and follow up and monitor the investment closely. If the investment is not going as planned, the investors can interfere and steer the management team back on the right track again to make sure the intended impact is created. Furthermore, it will become more challenging for investees to steer away from the initial strategic direction and behave opportunistically when they know that the investors are monitoring their actions carefully.

Proposition 4:
Impact investors should have an active role in their investees to control and monitor the progress and outcomes of the investment.

Our research has thus revealed impact investors' preferences for financial return and several steps they could follow to avoid agency problems that may arise due to their inclusion of social objectives. Although it might require more time and resources for impact investors to evaluate and monitor their investments than for traditional investors, it is considered necessary due to the early stage of the market and lack of global standards. We thus acknowledge that since the financial markets are continually changing, better and more effective methods for avoiding agency problems for impact investors are likely to emerge in the future when the concept has gained more legitimacy and include a broader range of investors and investees.

6.2 Theoretical implications

In this study, we find that Nordic impact investors adopt a similar investment process to that of venture capital/private equity funds but incorporate an impact assessment as well. In financial theory, there is much research on agency theory and how to manage the relationship between investor and investee to avoid agency conflicts, when pursuing financial targets. However, adding a social objective on top of that complicates the relationship in different ways. Our research provides new insights on how impact investors approach their investment decisions and potential mitigate agency conflicts that arise due to the inclusion of a social objective. We contribute to the understanding of what challenges impact investors may face when they choose their investments, and how these challenges differ from a traditional investment process. Furthermore, our research contributes to the literature by providing suggestions on how agency problems can be controlled for and mitigated by impact investors.

We find that the agency theory is relevant to apply in an impact investing setting, as impact investors face many of the same challenges as traditional investors do. The framework serves as an initial step to understand the investment process impact investors are going through. However, we recognise a need for an adjustment in the framework to take social objectives into account. The agency theory suggests that investors could conduct a thorough pre-screening and due diligence and formulate specified criteria from these processes into contracts that consider all possible outcomes. If it is difficult to formulate appropriate contracts in advance of the investment, the theory states that investors instead could put more effort into monitoring the investee ex-post to make sure that the initial goals agreed on are achieved.

On the contrary, our findings imply that it is not sufficient for investors to follow an either-or approach, and that they instead should focus on all three steps to control for and mitigate agency risks. We identify the importance of pre-investment activities for investors to screen for potential impact and financial return, and the importance of a formalised contractual relationship. Additionally, we also identify that due to the early stage of the impact investing market and lack of procedures and standards for measuring social impact, impact investors need to actively monitor the investees as well. Thus, our theoretical findings imply that impact investors should take on all the three steps to avoid agency problems, and that the theory thus is not applicable without taking these considerations into account.

6.3 Practical implications

Impact investors

As impact investing is a new field, our study can provide suggestions for how impact investors can incorporate their dual objectives into their investment process. We find that most impact investors emphasis the financial objectives and that the financial returns are also the most critical factor for them when they conduct their pre-investment activities. Some of the investors argue that it is easier for them to evaluate the financial return expectations than the potential social outcomes. Thus, for impact investing to gain legitimacy, there is a need for a better evaluation and assessment tool for social impact.

Our findings imply that the impact investing market is not that transparent and that investors do not share much information, such as best practices and ways of tackling challenges they are facing. This implies that it could be useful for investors to collaborate more across organisations and investment strategies. Investors should engage in establishing networks and forums where they can learn from each other and provide each other with tips and advice how to, e.g. screen for the best investments or control their investments if something turns out differently than planned. An example of such a network is Toniic, a global action network for impact investors, founded in the US in 2010 (Toniic, 2017). Similar organisations have been established in the Nordics, however, they are still in a very early stage of development.

Furthermore, we identify that different investors have different perceptions of whether one should prioritise the pre-investment phase or the post-monitoring phase. We can to some extent see some tendencies for impact-first investors to focus on the latter and finance-first to focus on the former. However, we acknowledge that our research on the matter is not sufficient enough to provide conclusions, but we believe the area should be investigated further in the future. If the investors' preferences for the different steps are clearer, one could develop the best solution for the respective investor that do not require too much effort from the investors' side.

Measurement and monitoring

As we find that some impact investors focus on evaluating the financial returns and that all of the investors prefer to invest in ventures that they can identify with, the next implication is regarding measurement and monitoring opportunities for impact investors. We find clear evidence for a need for substantial improvement of existing measurement and monitoring frameworks and tools available for actors in the impact investing market. When impact investors cannot receive accurate measures on their created impact, the investment process becomes less transparent and uncertain for the investors. We find that all of the respondents in our sample would appreciate a set of defined metrics and tools defined by acknowledged organisations within the field. Each project and investment strategy need different measuring and reporting, and if there exists no standard way of doing it, it makes it rather tricky for investors to know how to compare and measure their different investments and projects. This implies the need for specific core metrics and measurement tools to be developed, which impact investors can implement in their processes and adjust depending on their personal needs.

Industry

Our research indicates that there is a need for greater clarity around what impact is, and what it is not. What different investors and actors in the market consider as impact can be very subjective, and the lack of a common understanding in the market for how impact can be measured and what impact actually *is*, complicates the situation. This may further result in that investments can be labelled as impact investments, even though they are actually not (World Economic Forum, 2018). We find that there exist many similar terms such as responsible investing, ethical investing and sustainable investing, and the lack of a common set of principles to guide impact investors through the jungle of investments to create social good, can harm the transparency in the market.

Policymakers

Our study finds that impact investors target both investments in developing and developed countries, but that the market is difficult to orient in and several key concerns need to be addressed. Policymakers in the Nordics should engage in developing practices and establish national as well as international standards for impact investing to attract more attention to the field. Moreover, policymakers should collaborate on developing standards that apply to all the investors in the market to make it more accessible for investors who seek to conduct impact investments. Organisations such as Norfund, The Development Bank of Norway, or IFU, the Danish Investment Fund for Developing Countries, should take on an active role to promote impact investing activities nationally and to use their expertise to establish common grounds in the field. When impact investing gains more legitimacy and standardised systems and methods for investments, it can decrease the risks and uncertainties related to the concept and contribute to more sophisticated and transparent investment processes.

7. Conclusion

There was a time when the only option for financing positive social change was through philanthropy. However, as concerns about scarcity and inequality become increasingly urgent, many actors within the financial industry are eager to help. Impact investing address this challenge and opens up for effectively making an impact at a greater scale than philanthropy alone could provide. Even though impact investing is a rapidly emerging force in capital markets (Geczy et al., 2018)it is still largely unexplored in academia. Hence, the term "impact investing" suffers from interchangeable use of terminology. However, the fundamental idea is to use capital to drive two objectives, namely social impact and financial return, simultaneously.

Nevertheless, we find that these two objectives are approached differently by investors in the industry due to different social and financial return preferences. Furthermore, the inclusion of a social objective complicates an already challenging process of aligning goals between the investor and investee. Thus, we provide evidence on how such principal-agency problems potentially can be controlled for and mitigated.

Firstly, we find that although the actors within the impact investing scene try to address the social objective alongside the financial one, the process is not as formal and rigid as for the financial objective. Hence, the incorporation of the social objective is rather limited. The biggest constraint seems to be the lack of a proper assessment tool for evaluating and measuring impact throughout the whole investment process. This results in an emphasis on the financial objective.

Next, by applying the traditional agency framework, we seek to analyse how impact investment risks can be controlled for with contractual and non-contractual mechanisms enlightened in the theory. We observe a great importance of a throughout screening and due diligence ex-ante, where relevant and critical information about the entrepreneurs is gathered. By doing this, the investors screen out projects that do not fulfil the investors' defined criteria for impact, and the investors get the opportunity to choose entrepreneurs they can identify with to avoid goal misalignments and asymmetric information.

Furthermore, the screening phase acts as a basis for the design of the financial contracts that will reflect perceived differences in quality and risk.

Consistent with theory, we find that rigid contracts are optimal to control for uncertainties as they provide both parties with each other's expectations. Deviation from the contract can lead to utilisation of control rights by the investors, thus, the entrepreneur might behave more disciplined. Besides, we find that if there is a tension between the dual objectives, the investee will most likely spend more time on the easy-measured tasks, which in our case is the financial side of the investment. Hence, the multi-task theory suggests that investors should not tie compensation to the financial objective. However, as we find that impact investors emphasise the financial objective, such a trade-off does not seem optimal. That being said, we find that investors try to incorporate contractual incentives on impact as an attempt to support the social objective when there is a tension between the goals. Lastly, we find that contingency-based contracts, both with regards to allocation of equity and control, are optimal to constrain or encourage certain behaviour by the entrepreneur.

Furthermore, it seems like the impact investors in our sample do not consider the contracts to be fully comprehensive of all future scenarios, as ex-post monitoring and control efforts are utilised. This supports the theory that contracts are inherently incomplete. Thus, active involvement in the investee is employed to discipline the behaviour of the agent. Indeed, our study supports this, as the investors claim that post-investment efforts are applied to make sure that the agreed-upon goals are being met.

In conclusion, we see that the traditional agency framework also can be applied within the impact investing setting as a tool to identify where potential agency problems might arise, and how to mitigate them. Considering how difficult it is for investors in this context to assess the quality of a company ex-ante and measure the investee's effort ex-post, the mechanisms within the traditional agency theory help us to understand how investment risks can be controlled for or reduced with contractual and non-contractual mechanisms. Although we find mechanisms that can mitigate potential agency problems, we also find that the biggest constraint is the lack of proper ways to assess and measure impact throughout the entire investment process. Thus, we propose that a framework that can be utilised by the whole industry should be developed. This framework has to be more pragmatic than, for example, the IRIS, which contains hundreds of different metrics. The inclusion of such a framework could formalise the process of incorporating impact goals in the investment process, which could lead to more rigid incorporation of the objective. In addition to contribute to a more transparent investment process, such a tool may also change the way impact investors approach the dual objectives.

7.1 Limitations

When conducting a research of this scope, it must be acknowledged that limitations can emerge. Hence, we would like to point out the main limitations we found that could affect the results of the study.

First of all, our research faces limitations related to the number of respondents in our sample. We included seven main informants, where five of them were impact investors, and the two last ones were impact advisory companies. By including more in-depth interviews with the same investor types, our research could have been strengthened, and potentially give us a different result. While the sample size is reasonable to provide an overview on key issues from an empirical perspective, generalisations, for instance regarding the investment process of impact investors, can only be preliminary and need further examinations. However, our research can to some extent be generalisable due to the fact that we included impact investors and advisory companies only from the Nordic countries.

Moreover, we find that it is important to mention that we have seen great differences between the two impact investor types, namely, impact-first and finance-first, throughout the research, and hence could have explored these differences further. Nevertheless, the interviews and secondary literature both gave us limited information on the manner. A greater sample size would be more suitable in order to explore this, as it would provide one with the ability to generalise more than what we can in this research.

Lastly, although many of the investors in our sample also have experience from traditional finance, our results could have been strengthened if we also included traditional investors in our sample for comparison. This could have enabled us to better understand the differences between impact investors and traditional investors.

7.2 Future research

To our knowledge, this study is one of the first studies that addresses potential challenges in an impact investment process, seen through an agency lens. However, our findings only cover a small area of the topic, and other aspects could be interesting to look into as well. As the last part of our thesis, this section will thus give recommendations for future research that could be interesting to conduct.

Firstly, it could be interesting for future researchers to take the *net* impact created into account. In our research, we only focus on impact in general, and we do not consider the net effect created. Future research could therefore analyse agency problems in an impact investing setting by focus on the net impact created, which makes the process more complicated.

Secondly, our research consisted of primary in-depth interviews combined with secondary data. For further research, it could be relevant to take our findings and develop them further by for example set up hypotheses and test the results empirically. By conducting a more quantitative study, one would be able to get more objective and accurate data, as the investors in our sample probably have subjective feelings and opinions about the topic.

Moreover, in future research, it could also be interesting to analyse several dimensions of the principal-agency framework. This could be situations where an impact-first and a financial-first investor are investing in the same investee, or a situation where an investor is investing through a fund, and the fund thus is responsible for monitoring the investee, but also to provide the investor with information and reports regarding his/her investment.

Future research could also to create in-depth analyses of several impact investors types and compare them in order to find the best solutions for the particular investor type to avoid agency problems. As identified in the analysis, impact investors seem to have different perceptions on the most crucial steps of the investment process, which is why future research could focus on the optimal solution for investors, based on their preferences.

Lastly, we acknowledge that the impact investing field is still young, and a lot of work is required in order for the field to develop and gain legitimacy. This thesis thus represents an initial attempt to introduce impact investors dual approach in their investment decisions and how this dual approach might result in increased risk during their investment lifecycles. By gaining a deeper understanding of these challenges, new and adjusted frameworks can be developed in the future to better explain potential agency problems for impact investors and how they can be controlled. We hope that this study can lead to an increased interest for the topic, and that our findings have identified areas that are relevant for further research.

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9. Appendices

9.1 Appendix 1: Interview guide

Some of the questions has been adjusted a little throughout the process, but the wording of the sentences is still the same.

Introduction

1. Could you tell us about your background and experience with impact investing?

- Could you further give us a brief overview of your company and motivations for impact investing?

Impact investing – Concept

2. What types of investments do you engage in?

- Asset classes, size of the investment, stage, sector, location

Investment process

Part 1: Pre-investment process

3. Could you please describe the pre-investment process?

- Pre-screening, due diligence
- Can you think of how the pre-investment process within impact investing might be different from that of a traditional one?

4. What criteria do you use when you evaluate a potential investment?

- Financial vs. social targets
- Are any frameworks used in the process (e.g. IRIS)?

5. How does your organization evaluate the impact-risk?

- Mission alignment
- Green-washing

6. How is possible exit opportunities evaluated? Are there any concerns connected to this?

Part 2: Contractual relationship

7. What is your approach regarding contracts?

- What do they include?
- Can you think of how the contracts might differ from traditional investment contracts?
- Do you always use contracts when investing?

8. How much flexibility is allowed by the investees?

- Is there any flexibility at all or is the investment controlled?
- How do you make sure that the investee is complying with the agreed terms?

9. How are goals defined in your contract?

- Balance of social goals vs. financial goals

10. Do you invest as a majority or minority investor?

- Are board-control and management rights defined in the contract?

Part 3: Post-investment process
Monitoring and measurement

11. Have your organization implemented any impact reporting requirements?

- How do you make sure the defined goals are met?
- What requirements?

12. How do you measure social impact?

- Frameworks etc.

13. How do you monitor the investments?

- Financial returns, social results

Control

14. Do you take on active involvement in the investee?

15. How do you respond to poor performance (if any)?

- Intervention, control rights, management rights, staged financing

<u>Last remarks</u>

16. Do you think the pre-screening and due diligence phase is more costly/more difficult to conduct than the post-monitoring phase?

17. What do you think can be done to make the impact investing process more transparent?

- With regards to unclear definitions of impact, lack of standardised measurement tools, different goal alignments between investors and investees, etc.
-

<u>Other</u>

- Do you have any additional comments? Is there something we have not touched upon you would like to elaborate on?

9.2 Appendix 2: Transcribed interviews

We could not always hear what the respondents were saying, so then we have indicated this in the transcripts by using dots (…).

When referring to interviews in the text, we will refer to Appendix 2.1 for respondent 1, Appendix 2.2 for respondent 2, and so on.

<u>Respondent: 1</u>
Interviewees: Frederik Engedal and Laura Paludan-Müller
Company: Nordic Development Corporation

Date: 08.04.2019
Duration: 01:00:25

Introduction

Interviewer: Could you give us a brief overview over your company and motivations for impact investing?

Engedal: Sure. I guess I, first of all, believe that it is necessary, we are to reach the goals we want as a society, with the SDGs or some other goals, but I think with way the private sector dominates most markets and societies now, achieving anything in terms of sustainability or impact without the private sector is not really feasible, and impact investment is one way in which to align the agendas of the private sectors and the other sectors. And personally, I think that I found out relatively late that I was interested in impact investing. I was already on a business track to become a teacher or a professor or whatever.

P.-Müller: I mean, we come pretty much from the same place and the same study actually, but I think for me, it was actually starting out with my exchange in Canada where I had this strategies for sustainability course, and it was actually the first time I heard about can you do capitalism in another way, do it have to be maximization for shareholder or do you actually have other responsibilities. So to have that discussion about capitalism, that was a complete eye opener actually. Also, the first time I heard about how can you make social innovation, how can you actually link all that money we have in the world with something that maximise good, I think that is amazing. I think that is actually the whole purpose of making social or environmental return together with financial. I think that is the way you actually go forward and make solutions to some of these problems.

Interviewer: What types of impact investments do you consult on?

Engedal: There are different types [of impact investments] but they all follow the same basic principle. It is a model invented in the UK in 2010, so not that old, and it has not been tried a lot, and there are not any finished programs to evaluate whether or not it works as intended. But the basic idea is that the municipality or another form of a government authority that wants to commission some form of social change, decides to pay some other organization, typically an NGO or a private sector company, to deliver results instead of delivering a service. The way it usually functions if a government body contracts with an external service provider, they pay for a specific set of services to be delivered and not a specific set of results to be delivered. The problem is that you of course also can only pay for results after the service has been delivered, and NGO service providers usually cannot afford to deliver the services upfront of the payment, so the third part of the program is external investors who pays the service deliver upfront under condition that they will get a return if they are successful and deliver results, which trigger government payment for the results.

Interviewer: Do you think those investors are also interested in the social aspect, or do you think they care more about the financial?

Engedal: Absolutely. For now at least, it is primarily because of the social, and also in the very first programs, primarily investors were high-net-worth individuals and foundations etc. As an investment, it is simply not been tried enough to, or even not possible to evaluate the risk properly, which excludes most of the commercial investors.

Interviewer: What are your motivations and aims of your clients?

P.-Müller: I mean, does it not depend on what investors we are talking about? Institutional investors they are under some legal requirement, that means that they cannot invest in stuff that is not giving them a return compared to, you know, the market return. So for them, it would be risk and return, for now at least, almost be the most important stuff. The social stuff would mainly be because our clients want it. But if you take philanthropists or family offices, which are the ones who have been the most into it for now, it is the social side that is the important one where we actually do it as an investment and just not granting money. Then we can actually, you know, making *more* social impact because we can sustain it and make it also economic stable.

Engedal: About the institutional investors, it is not that they necessarily do not care about the social impact, but they are by law required to, no matter what, to consider the financial return above all else, but they do still try to maximise their social impact within the frameworks.

P.-Müller: Yeah, and they would get a fee, legally, if they did not meet those requirements so for them it is just really important, and also my experience is that the environmental sides of impact investments are more established than the social sides of it. It is easier to measure and easier to collect [...]. Take solar panels, you see there is a business model with it, and you can actually measure it and you can expect that this is going to be a trend that is going to continue for the next 10 years. For the social side of it, it is more difficult. When does it work, what is the output?

Interviewer: **Let us say they [the institutional investors] have two different options, both of them will guarantee them at least a market-rate of return, but one of them is just a market-rate return, but with higher impact, and the other one is a higher return, but with a lower impact. Do you necessarily think they would go for the higher rate of return?**

Engedal: That is a good question. It depends from company to company and from person to person in those companies. There is not a well enough established field to really say anything about in terms of pension companies. There is a matter which I guess is the closest to impact investing in Danish pension funds-

P.-Müller: Still mostly ESG, right?

Engedal: Yeah, it is still mostly negative screening, so there is not really an established impact investing practice among institutional investors in Denmark.

P.-Müller: Yeah, and a lot of is really... you forget the organizational side of it, when you just talk about the rate of return. I mean, it is really driven by who is actually the manager, and what is the intention; do they want to drive this agenda forward or do they feel most responsible to [...] maybe in a bit more conservative way.

Engedal: If a pension fund in Denmark starts a more progressively or radical impact investment, it would likely be a sub-department somewhere with a manager that has the specific job description of making high impact investments. So he would of course go for the high impact if he can, but if you ask a regular pension fund manager, they would likely just consider whatever CSR or ESG of the possible investment and code of conduct they have to sign up to.

P.-Müller: My experience is that they are not trained at all to even evaluating or assessing the social or environmental impact of it. I think you could say that institutional investors are finance-first, primarily because of legal requirements.

Investment process

Part 1: Pre-investment process

Interviewer: **Could you please describe the investment process; from the first encounter with a possible investee through the final investment decision/deal?**

Engedal: First of all, the question really depends on the type of investment, organizations and people. It can be everything, as we discussed, from pension funds which will probably not even engage with the investee at all, just look at whatever material from some middle man or fund manager and decide this is a high impact investment, and then there is all the way down to the private side with VCs and angel investors who invest in some agricultural projects in developing countries, and then there are social impact bonds, which we primarily can speak about. The investment process is not really clear yet, there have not been any real social impact bonds in Denmark yet, so we push it a lot, and specific service providers push it, and maybe the municipality will push it and also investors that are actually looking. But it is not happening in any sort of established process. Typically, we will either be contacted by some organization that got a good idea, or we have a good idea ourselves, and we will try to mobilise partners around this idea which is both service providers and of course in this case also municipalities and then the investors are actually the last step. Because at least here in Denmark, the reason that we do not have more social impact bonds is not lack of investors but more due to lack of projects that are investible.

Interviewer: **Is the focus mainly on the pre-screening or post-monitoring process? According to theory, many investors choose to focus on one of them.**

Engedal: Sure, but there are two reasons that make it kind of difficult. First of all, there are not any set standards for how you can measure impact, so again, it depends on whether you are an institutional investor that look at some sort of index and decide I like this because it produces windmills or if you do a social impact bond where actual return is dependent on the social impact created. But that is of course very strict monitored. The investor will not screen the investees so much based on do they provide some sort of good, but do we believe in their ability to create a specific impact.

P.-Müller: But actually, I think you can categorise it into two really broad categories, just based on our knowledge. For social impact bonds, it would be the monitoring and actual final result that would be important, because this is determining what return the investors would get. This is only from my own experience, nothing within our work here, but for institutional investors, what I have been seeing is that it is actually very much try or never, because again, there is no standards and no specific way of how you do it, so let us just take these two funds that we can see promise impact and let us just try. For them, pre-screening is much more important, who is the manager of the fund that we want to invest in, do we trust the manager, do we think he knows what he is doing, and actually they have not been into the monitoring or evaluation at all. They are just saying let us just try and then we see if our plans are working and then we see how we are doing and then we are going to do it in the same way with others funds and investments, and then we are going to see in the long way how to actually evaluate this. So I think from that point of view it is pre-screening that is of importance. You do not even have any knowledge within the institutions of how we are measuring this or how do we do this. They are so used to the finance part.

Engedal: I think the exception to that might be investments that are either completely or partly driven by philanthropists. For example, a lot of the impact investments in Africa are led by investment funds established by the Bill Gates Foundation or Rockefeller Foundation, and I think some of them, again based on my own experience, have pretty robust monitoring systems and take a more active management part afterwards because they actually want to succeed with some predefined goals and not just measure the metrics. I think you will see the whole spectrum, depending on the investor you choose.

Interviewer: **How is a possible investment decision evaluated?**

Potential financial returns/social impact

Any frameworks used in the evaluation (balanced scorecard, theory of change, IRIS, etc.)?

Engedal: There are some [specific frameworks], there is IRIS and the big one now is of course the SDGs, which is probably going to be the primary tool going forward, and whether it is as precise or well-defined as IRIS [...] they made a certification our of IRIS now as well which I cannot remember the name of, but people are already starting to use it. Then there are foundations especially, that have their own scorecards or metrics, both in terms of impact investing and when they hand out donations where there is a much greater focus on how they measure the impact. So that is a huge, confusing field.

Interviewer: **I have read that is also one of the reasons why it is so hard to develop impact investing, because there is no standardised tools**

P.-Müller: Yes, and in the lack of that, when organizations are starting to do it, we see it more and more, they are just going to make their own. Then you end up with a thousand definitions and standards and ways of doing it.

Engedal: Yeah, but the definition of impact investing is that if you intend to make an impact investment, then it is an impact investment, so right now, pretty much everyone can say that they are creating impact because they are measuring something, and say that the intention to increase what they measure is technically an impact investment. In terms of our work, when we do social impact bonds, the result indicator is the impact that is measured, which is maybe how many people are going to be employed or…

P.-Müller: That is actually kind of simple, right? We have a homeless project so how many people that used to be homeless are not homeless anymore.

Engedal: Yeah, it is straight forward compared to a lot of other impact investments, but because return is directly dependent on it, there is much more requirements about the validity of the measurement, so instead of having standards for what should be measured, defined by every individual project, there are being developed standards for how to evaluate the economic impact resulting from reaching some results so how much will the municipality benefit if this person gets employed. There are being developed standards for what is the degree of evidence we need for this claim, do we need to have random control group studies or can we do the baseline, or can we make some trans-municipal system; all results cause the same in all municipalities. There is a different kind of standard that are needed, but there are still-

P.-Müller: The bottom line is that it is just difficult to make a simple tool to compare impact investments, because if they are not evaluated by the same standards then how would you compare them.

Interviewer: **How do your clients view the balance of social and financial performance (finance-first vs. impact-first)?**

Are the social goals or financial goals in focus? Equal?

Engedal: Anyone who invest in our projects it is not because of the return, first and foremost. Both because of course creating the impact that you want to create, but also because they want help try out a new model of delivering welfare in Denmark, so create an innovation agenda. I think the other terms again, it depends on which investors you speak to and which kind of investments you are talking about. I think there is quite a significant portion that do not value one over the other, but has both as a requirement. If they do two investments, one might be a return of 10% with a relatively low impact, and they might do another investment with a return of 1% but with a high impact. So it is not necessarily either or, I think.

P.-Müller: Yeah, I think it is really good to think about the balance, like, it is a little high here and a little low here, and the next one can be the other way around.

Interviewer: How does your clients evaluate the impact risk?

Mission alignment

Engedal: It depends on the form of the investment, I would say, because let us say it is a loan where you as an investor do not have a lot to say and it is specifically stated in your contract that the loan is dependent on you reaching this kind of impact, which I have not seen. But, if it is an equity investment, and you buy 30% of a company, then you have 30% of the saying, because you are in the board and can do active management if you want. I would say that in terms of social impact bonds, it is a big problem because you are not used to evaluating the risk of whether or not you are able to reach a social outcome. It is not technically that different than saying we can reach this performance financially this year, but one of the ways it has been done in Finland for example, is that actually instead of contracting with a service provider directly, the investor contracts with an intermediary. That has also been done in the UK. Then the intermediary would be obliged to pay the investors returns if they get results. Then it is their job to find the right service providers to provide the service. So if it is a 5 year program and after 1 year the investors can see that this is not going according to the plan, then they can ask the intermediary to find new service providers.

Interviewer: Have you experienced any goal misalignments in any projects you have had?

Engedal: Not really in terms of social impact bonds, but then again, it is a new model and I think all of the investors are pretty aware of what they are doing. I have read about instances in the UK, where social organisations may have felt what you describe as "goal misalignments" – specifically as they were critical towards having to spend much more time on reporting on performance goals rather than spending time with their clients/target group. I cannot comment on whether or not this was a result of misalignment between the investor and investee or rather just an inherent part of results-based contracting. From personal experience when I wrote my thesis a few years back, I had some cases where there was a conflict between the investor and investee after the investment had been made, because they … especially the investees, felt that the investors were overstepping their boundaries and they wanted to involve in the office and say that you should have a new CEO or whatever. But it was unclear who was right, so to speak, and whether it was fully legal etc. And it was not ever concerned with the impact side so much, more the financial side.

P.-Müller: I know that some of the pension funds that have been investing in some of the new SDG funds etc. have been branding it as this is impact investing and for developing countries, but when it comes to it, they have really high requirements for the return, meaning that some maybe good projects, that could have had a high impact, are not being made because they have really high requirements for returns.

Interviewer: How are possible exit opportunities evaluated? Are there any concerns connected to this?

Engedal: Again, it depends on the form of investment. I do not think we have seen any exits on social impact bonds actually, I think people usually stay. I remember reading about troubles with exiting in African investments, but I cannot say if that is specifically impact investments or […].

P.-Müller: I mean, I know it is an ongoing concern, but it is not something I have experienced myself. I can just recognise that it is one of the big things that is still lacking in order to actually know what you are going in to and how do you do this, because as an investor, it is like … the concept is very much like, how do we measure, what is the risk, it is definitely a risk and how do we exit. If there are no answers to this, then the perception of the risk is just increasing.

Part 2: Contractual relationship

Interviewer: What is your approach regarding contracts? Do you also write them?

Engedal: We are supposed to, but have not written any yet, but it is hopefully right around the corner.

Interviewer: What types of contracts (outcome-/behavior-based, what do they include?

Engedal: Actually, social impact bonds are also called social outcome contracts. So specifically, you contract for certain outcomes and that is the main part where you say we have these results, and if the results are reached, each result trade us a payment of this size. For example, for a homeless it could be get an apartment and trade us a 1000 DKK. Maintain the apartment for two months and trade us another 1000 DKK, get a job, trade us 2000 DKK and so on. That is the first thing it establishes. The next thing would be how is this measured and by who; what are the requirements for documentation etc. That would be it of terms between the municipality and whoever is the outcome provider or service provider. Then, the investors would actually also make a contract with the service provider, and say like, we are going to make you a loan and you will pay us back based on whether you reach these results defined in the other contract. But these contracts can look … there is no established standard. Every project is still pretty much build from the ground, and we have to take all the different stakeholders' preferences into account, and given that, it is all very experimental and it always turns out different.

Interviewer: Is flexibility to the investees allowed or is the investment process more controlled?

Engedal: Ideally, it would be completely unrestricted because you are paying for results and not a service, that is kind of the point. The argument is that the social sector in terms of NGOs and private sector service providers have a lot of capabilities and abilities to innovate and provide new and effective services, but are hindered by the government because the government is restricted in terms of what they are allowed to buy. The Danish *Socialstyrelsen* would say if you want to help homeless, you can use one of these three pre-approved methods to doing so. So by paying for results instead of a service, the idea is that the service provider is going to figure out what works. That is the ideal situation, but not at all how it would end up here in Denmark, at least.

P.-Müller: That would be the point, yes. The problem in reality would probably be that the municipalities would like to control, and then you maybe do not get the ideal, but something in between. That would be a compromise and be fine, but-

Engedal: There are issues, especially in Denmark where we have such an expensive welfare state, because let us say you pay some private organization to provide loans for the homeless, and then suddenly this private organization goes bankrupt and cannot provide these loans anymore. The government still has a responsibility to provide this homeless person with a home, but now there is no one to provide the loans, so that is a big risk for the government.

Interviewer: How are goals typically defined in the contracts? You already mentioned that it is mostly outcome-based?

Engedal: Yes, in terms of social impact bonds, that is true. Again, that would hugely depend on the form of the investment. Some contracts might not at all include goals, just be where the impact investor believes this is an impact investment so I am going to invest in your company.

Interviewer: So they do not state any social or financial goals at all?

Engedal: Well, I mean, if they buy an equity share of a company, you are not in a position where you can demand that they act in a certain way, you of course have your shares and you can vote accordingly, but the payment is not triggered-

P.-Müller: No, you would not have demands, but expectations. For instance, a lot of impact investments are private equity, and then you would just have the expectations that you would invest in this because you believe in the company and in their solution and I think it can make me a 20% return and also environmental and social impact.

Engedal: And then it would of course be up to the investor to say that okay, it has been 2 years, I do not think that you are as performing financially or impact vise as I hoped, so I am either going to exit or going to vote to find a new CEO, etc.

Interviewer: **Do your clients usually invest as a majority or minority investor?**

Engedal: Private equity, again, will also entirely depend on the investor. I guess the larger the investor the less they prefer being a majority investor, while angel investors and VCs might be more willing to take on more, but that is just my guess.

P.-Müller: I would agree.

Engedal: Active management it resourceful and intensive, so.

Interviewer: **Are board control rights and management rights defined in the contract?**

Engedal: If it is a private equity investment, it would be according to the number of shares I do you have, I guess. I do not have any examples of how you could do it with loans.

P.-Müller: For institutional investors, it would definitely be that is the right you get when you invest. And for VCs that is the entire point of doing the investment, but that is just in general and not specific for impact investments.

Interviewer: **Can the contract ever be complete, or is it sometimes renegotiated?**

Engedal: For a social impact bond, I have never heard about anyone renegotiating a contract, so I do not know how that would work. You can adjust your expectations, but I do not think you could renegotiate it. Of course you could, but it would always be in one part's interest not to renegotiate it.

Part 3: Post-investment

Monitoring and measurement

Interviewer: **Do you consult on impact reporting requirements?**

Engedal: We consult on defining the metrics and measurement, and what makes sense to evaluate, we do not do the actual process of measuring.

Interviewer: **How do one make sure the defined goals are met?**

Engedal: For social impact bonds, it would almost per definition be an external independent evaluator that is paid to do some auditing of some kind.

P.-Müller: Actually, it is like traditional auditing companies that are moving into this field, because they have the legitimacy and the credibility. But of course it would be really necessary to use an external evaluator.

Interviewer: **Yeah, and I guess it must also be quite a lot of work.**

Engedal: Yes, and that is also a problem for many of the social sector organizations, because they are pretty small and do not have experience or people to do this. Both in terms of social impact bonds, at least in the UK there has been quite a lot of critique from the investees, because they suddenly have to care as much, or more, about filling in forms and evaluating what they do, rather doing what they like to do. The same happens in Denmark, we do not have social impact bonds yet, but philanthropic foundations also requires a pretty heavy documentation. I just had a meeting with one last week and they said they basically need to hire an entire new person just to be in charge of evaluating and documentation. So it can be pretty heavy for those organizations. But, I do not think in terms of private equity investments and larger impact investments, that the reporting requirements will be a part of what the investees do, it will be something that the investors do.

P.-Müller: But then from the investor point of view, it will be like, this takes so much resources and why do we have to do this. So the monitoring and the evaluation part is … I mean, it is definitely important and it is what makes a difference, but also attached to a lot of heavy work.

Interviewer: With regards to this, do you think there is a higher cost by conducting post-monitoring or a pre-screening/due diligence?

P.-Müller: I think the problem is just that they do not know how to. It is not necessarily that the costs are higher, it is just easier to jump in and say yes, this look good, they have a good record, and we have met with the manager and he knows what he is doing. That is just easier to do, whereas evaluating requires that you have the tools and standards to actually do that. When you have learned that or when you have implemented that, I do not think that the costs are higher, but the problem is that they do not know how to.

Engedal: Yes, and I have seen investments where they actually surveyed rural African farmers twice a year, and they went out to these farms to check up on the conditions and that kind of evaluation is obviously really expensive. I have also seen investments where the investors have called the investees and been like, so how many people did you hire this month and what are their wages. So it depends on the standards of the evaluation. In terms of social impact bonds, it is very expensive. Because it depends if it comes with a base line study or if you need a control group etc. A control group study of, say, 500 people in Denmark, would quickly be 1-2 million DKK on top of the cost of the program.

Interviewer: How can social impact be measured?

Engedal: There is not an acceptable way of measuring it. It the matter of personal opinions. Some people claim that measuring ESGs or P/Es and all of that counts, and then we have IRIS which what, have 800 different indicators, and then you have foundations that have their own extensive Excel sheets to measuring impact. I think the problem is that social impact is a lot more complex than environmental or economic impact, because there are so many different variables, you cannot control everything, you cannot measure everything, you cannot measure all the 800 indicators on each investment, and even if you could, how do you weight them compared to each other. I think a lot of peoples' approach is that we invest with the specific purpose of reducing unemployment or achieving more clean water in some regions in India, that you could actually measure. But that, of course, leads to the problem that investments' impact are not comparable to other investments. There are people who claim that we should make standards like the IRIS, and then there is people like myself that say that some standards are necessary, but you cannot really objectively standardise social impact, so it is very difficult and there is no answer to it yet, and whoever figures it out […].

Interviewer: It seems to be the greatest problem with impact investing?

Engedal: But that is whether you regard it as a problem or not, because you also for example make standards for what counts as impact and how much is that impact worth. That is one way, but you can also make principles for what does this form of impact within any field need to live up to. Is it an additional impact, would it have been created without the impact investing, does it negatively affect anyone, etc. So you could make standards that-

P.-Müller: You could make standards that are broader principles and not 800 small measures. I think that is what the discussion is about right now. I think the next step will be some kind of can we make an agreement to go this way or this way.

Engedal: Because we have the ESGs which are the broadest of broad measurement. Pretty much any company in the world could pick one of the measurements and slap on the front of the factory and say that we are making impact because we are partnering with other organizations. That is, of course, not what most impact investors define would as impact, but I guess if it makes more people care, it is not a necessarily a negative thing.

P.-Müller: Yeah, but you would still have to measure that, right? You still have to say like, okay, we want to ensure something with climate. Then you would still need to measure it somehow. For example we have made this reduction of CO_2, we have made these tons of clean water, we have made sure that these cars are not polluting anymore.

Engedal: Yes, but then the problem is again that you say okay, we have cleaned this amount of water, but somewhere in the supply chain there is a child worker, so do you create a positive or negative impact?

Control

Interviewer: Do your clients ever interfere in the investment, e.g. by being actively involved in the investment / controlling what the investment is used for?

Engedal: The investor's right to intervene depends on the investment type. In a SIB, the investor's rights to intervene in the service delivery will be specified in the contract – it can vary a lot across cases. Sometimes the investors will have full responsibility and right to design and substitute the intervention, sometimes he will have a more passive role. I think that is one of the questions that are not really answered yet. It is a Danish concept, so what post-investment governance responsibilities should the investors have. But, they will have some degree [...] they should be able to look at the preliminary results and adjust what is not working, accordingly. We actually do not have any experience with this.

P.-Müller: The question could also be: Do they actually have the expertise to interfere and evaluate along the way? I think that would be to some extent difficult if you are not experienced in either specialised technical stuff about the environmental or social stuff. At least institutional investors would monitor on a regular basis, interfere and call and ask like, what is going on.

Interviewer: How do your clients respond to poor performance (if any)?
Intervention, control rights, staged financing, etc.?

P.-Müller: Not within here.

Engedal: No, I would not say so, but of course that happens, but not specifically to impact investment. But whether they would step in if the impact is not met, yes, I guess so, but in the same as in traditional investments. There are of course some investors that do not care about the impact, just say they do, but…

P.-Müller: I think they would have a harder time knowing when to respond, especially regular investors are so trained in financial evaluation, so they would know exactly when do we know what. I think it would be more difficult if they do not feel that the social part is not meeting their expectations. When do you do something then, and what do you do, how would you make it happen.

Other

Interviewer: Do you have any additional comments? Is there something we have not touched upon you would like to elaborate on?

P.-Müller: I think it would be interesting to take a look at the perception of risk, within all the contracts and the relationship between the investors and investees, also just for requirements for returns and what they want to invest in. Also to make an overall framework.

Respondent: 2

Interviewee: Malene Bason
Company: Future Impact
Date: 09.04.2019
Duration: 00:53:59

Introduction

Interviewer: Could you tell us about your background and experience with impact investing?

Bason: Sure. So my background is, I began my career working for a pension fund in the investment division so I did the investment strategy and risk management for the pension fund, and then for the last eight or so years I worked at Danske Bank as Head of Manager Selection so selecting external products for the bank's platform, and that's just, you can say, traditional investment products, but lately also focused on ESG, and the last year I launched my own investment advisory company on primarily impact investing but also on ESG because my experience is that many investors are still struggling with the ESG; they're not really ready, not many of them are ready to talk about impact investing

Interviewer: Mhm, that is also our perception of it.

Bason: Yeah, I thought when I launched it, you know, that being in the Nordics would make sense and that a lot of investors would be interested. I think they are interested, but they are just not there yet. It is another way of investing, and it is another mindset and that takes time for them to grasp, especially in the finance industry where you are very traditional thinking and the people in the investment departments in pension funds and insurance companies are very traditionally focused, so I think there also needs to be a cultural change as well.

Interviewer: How did your motivation for impact investing start, given that you have been working for a pension fund and for Danske Bank?

Bason: Yeah, you could say that pretty much my whole career I have been working with traditional finance, but I think the last couple of years I have also thought like, I needed something that makes a little more sense to me, and then I think I have always been a bit different, I have always in my work focused on the more qualitative aspects of finance, so for instance, in my last position where we selected investment teams, the focus have been very much on the qualitative, so how do you assess the people who actually invest. If it is not a computer then it is people and to understand who they are and what motivates them and how they corporate. That has been my primary focus and I have always seeked for something else than just numbers. And then I had a meeting last year with a woman from my network and she told me that she had met with the CEO of The Global Impact Investing Network (GIIN) who was in Denmark, and she came from the foundation side and told me about this. It was, all of the sudden I was like, this is it, it makes so much sense for foundations to think about impact investing and so they make impact, not only with the little part where they make grants, but for the whole investment portfolio as well. So I realised that this is what I wanted to focus on because it ticks all the boxes. It is still investments, which is my whole experience and career and which I also like, but it also gives me something else and it gives me a higher purpose than just generating some extra money.

Interviewer: **Could you give us a brief overview over your company and what you do?**

Bason: Sure. So I give advice, I don't pick specific investments. At this point in time it is very much educational advise so I am talking to many investors about what is impact investing and making it a little bit more concrete, so they understand how they could go about impact investing. And then it is helping them set up a strategy, new investment strategy, that incorporates impact investing, and then when they are ready, I have a lot of experience in selecting products. There is a lot of green washing as you probably also know, so it is an area where you really need to do your due diligence properly and that is what I have done for my whole career so. I do think, you know, it is not worse for impact investing, I think you always have to do a proper due diligence when you select products. And then the last, as you can say, service I offer is monitoring of the products, so that if investors are investing in products, then I can monitor and make sure that they actually do what they say they do on a continuous basis. I haven't gotten to that part yet, so now it is very much focusing on the education. Actually, just yesterday I had my first foundation I started talking to half a year ago and he was like completely blank on impact investing and he was like why does that make sense for me. And then yesterday I had a meeting with him and he proposed for his board that they would take a whole new look at the investment portfolio and both implement ESG policy and also look at impact investing. And now he has all those ideas you know, like and if I do this with this real estate and we can transform it, that is impact investing right. So it is just really fascinating to see that once they get it, especially for the foundations, it makes a lot of sense, and they can do it in so many ways. You could see especially in the US that a lot of the very wealthy people, that is what they do with their money, they invest in impact investing, because they do not really need them in the short term and then it is a good purpose.

Impact investing - Concept

Interviewer: **What types of impact investments do you consult on? Is there anything specific or just a more broad range of investments? For example type, size of investment, stage, sector etc.**

Bason: So I think going back to where the investors are and which state they are in now, I do consult on direct investments but I also realised that for many investors that have never done impact investing, it is quite a big step to do direct investments. It is very resourceful as well. So the way that I think about it is… many people talk about listed equities, listed structures, can that be impact investing or not, and maybe it is not, but in my mind and my overall purpose with my business, is to move as many assets in the right direction as possible by making a change. So I think for most investors it would make sense to kind of start with some listed structure and then when they get more comfortable with it, they move on to the direct investments. So to answer your question, I actually look at the whole spectrum of asset classes and within different sectors.

Interviewer: **Have you noticed that the investors are more into start-ups or established firms? Start-ups are a bit more risky?**

Bason: It is. Especially what I have noticed is that if you are to invest in start-ups, it has to be in the local area, because I have seen several people trying to get funding for products that are start-ups but in emerging markets, because that is where the biggest need is, right? The issue is then that it is risk and risk. Risks from the start-ups and risks from the emerging markets. And a lot of political and currency risks. So I think if you are to do impact start-ups, then investors prefer to invest in the local area, also of course it is easier to relate to. And on the other hand, if you want to go to emerging markets, then it is probably more the listed structures that they can accept. But I think again that it is just the matter of getting started, and then get some experience and figure it out. Of course there are bad impact investments but there are also bad traditional investments, so in my mind it is really not any difference. There will be some that are good and some that will fail.

Interviewer: What are your clients' motivations and aims of their impact investments? Do they care more about the social or financial aspect? Is there ever greenwashing?

Bason: So I think for the investors that I advise, I only advise for professional investors, I know that all of them demand a competitive return for the investment, and that is also only the type of investments that I look at. So they need the return. But I think especially for the pension funds, it is interesting, because I talked to some of the people in the investment teams, and they clearly think that they do not need this, but experiences just a huge push from the members of the pension fund, demanding that "we have our money here and you invest on behalf of us, and we need you to start looking at x, y, z." So for instance, NP Pension, especially on the ESG side, they are pretty sophisticated. They have excluded a number of different types of companies. That is being led by the members and not by the investment team itself.

Interviewer: It is very interesting that the members have that kind of influence.

Bason: Yeah, I think it started with people signing a document, so they got like 7000people to sign that they wanted pension funds to [...]. Talking about that, you see from a state level a pressure, you see of course the SDGs, and also the European Commission with the Sustainable Action Plan and also professional investors to be more open and include ESG in their investment process. So you see it from a state level, and then you have, there is really not a corporation today that do not know what ESG is and not have them somewhere on their website probably. And then it is the matter of who actually does something and about green washing. Then you see it from the bottom up. There was also an interesting situation in Boston a few months ago where the city council demanded that the people managing the city's pension funds would be looking at the ESG and also actually impact investing, investing more in the local community. I think also in Australia you have something similar like that. So you have pressure from above and pressure from below, and there is also pressure from your competitors. In my mind, it is only going in one direction, it is just the matter of how fast each of the investors [...].

Investment process

Part 1: Pre-investment process

Interviewer: Could you please describe the investment process; from the first encounter with a possible investor through the final investment decision/deal?

Bason: You could say that the way that I start out is by discussing what kind of impact do you want to create. Is there a specific focus that makes sense for you as an organization. So I think that is always the starting point, it is not as I have a short list of strategies and then I go out and this is what I show. I basically have to start from the beginning every time. And then I think what is difficult is that, you know, now I have selected products for many years and we have various databases where you just look up. So if I want to see US equities, I can look up US equities, and then

I have five or six hundred different strategies. You do not have that for impact investing and the managers that have a longer track record within impact investing are not the usual suspects, so it is not BlackRock or JP Morgan, it is other names and as I said they are not in the database, so it demands more research. By now I of course know what names are out there, but I would always have to do some desk research to come up with some strategies, and then I think that the due diligence part is to some extent the same as I would do for a traditional strategy, looking at the same team and having a strong focus on is this like an add-on or really something that they do. That is why I am also sometimes a bit disturbed by the big traditional managers that all of the sudden have various impact strategies. Some of the portfolio managers are doing an impact strategy at the same time as doing a traditional strategy. Then I think it just becomes and add-on and not something truly integrated. So in my mind it has to be in the DNA of the organization to look at impact investing. Especially for the team itself the only focus that they have would be some other things that I would consider. And then of course very much on how they measure the impact, and that is a whole topic in itself.

Interviewer: **What is the greatest difference between the pre-screening and due diligence of traditional investing and impact investing?**

Bason: I would say that again, making sure how they implement and how they go about impact investing. Is it a negative screen or is it a positive screen? Do you start out by saying I only want to look at the companies that are classified as impact companies, and then I go from there and do my financial analysis, or do I a traditional investment process and quant screening and then at the end I look at the impact. I prefer that you actually flip it around and say that my investable universe is only impact investing and then I do a financial analysis based on that. Then I think that the Impact Management Project, the way they kind of set up to look at impact and how many people are affected by it and what are the risks, I think that is a good framework and good questions to ask yourself when assessing whether on the impact side, this is something that makes sense or not. Does this contribute with significant impact, or is it just moderate? Ideally, I do not know if you read it, I think it was in the latest Harvard Business Review, there was an article about impact investment advisory and they have come up with this Impact Multiple of Money (IMM) which is basically the impact per dollar invested. It is another metric you can use when assessing and then you can assess investments across strategies and sectors, just like an information ratio or whatever. I think that if that could be developed further so that other people could use it, that could be an interesting development.

Interviewer: **How is a possible investment decision evaluated?**

Potential financial returns / social impact

Bason: Yes, I think for most investors it just has to be a market return, but not necessarily above the market return. That would be in the financial side. On the social side or environmental side, we would before the investment set up, together with the manager, some criteria. They themselves have some KPIs or what you would call them, they have targets for what they want to reach. It is basically just whatever targets the manager has set, we need to all the time monitor if they reach those targets. Again, it means unfortunately that it is very different from manager to manager.

Any frameworks used in the evaluation (balanced scorecard, theory of change, IRIS, etc.)?

There are not any frameworks for pre-screening to my knowledge. GIIN has the system called IRIS, but it has around 500 different metrics and is way too complicated and time consuming for most of the investors. I have never met anyone who are using this because it is too overwhelming, and they do not have the resources to use it. It has to be a bit more pragmatic, especially to begin with.

Interviewer: Do you feel that some investors are using their own metrics?

Bason: The ones that I talk to mostly use what the manager is using, and then they accept having different types for different strategies. But again, I think that is definitely an area under development and I think there is a lot of action and work being done. It is very subjective, and then the issue is that if you look at a social project, it is very different measuring the impact there compared to an environmental project. That is why if they were able to explain the IMM where you can use it across sector, that would be ideal. The you would have one metric that you could use across all sectors.

Interviewer: How do your clients evaluate the impact risk, for example regarding different goal alignment?

Bason: I would say that that is a part of the due diligence. An extremely important part of the due diligence is that you understand what motivates or drives the managers, and what are they measured on. How are they compensated? Is it mostly on the social part, because then you know that that is what is going to drive them. But always when I do due diligence the compensation part is very important because that is what drives them. I am sorry but in the end, that tends to be what motivates people the most, the compensation.

Interviewer: I guess it is also important to make the process a bit more transparent and define clear goals. Have you ever experienced any cases where there was a goal misalignment?

Bason: Not really, actually. But you could say that given my background, I have a tendency to look more at the financial type of managers, whereas if you come from the philanthropic side, than the people that you know are more focused on that and they might be the people you end up working with.

Interviewer: Are possible exit opportunities evaluated? Are there any concerns connected to this?

Bason: Exit opportunities are also a part of the due diligence. Just as it would be for traditional liquid investments. So in that sense I actually do not see any difference assessing impact strategies. I think always in emerging markets there is an extra risks, but so far I have only looked at strategies in developed markets.

Part 2: Contractual relationship

Interviewer: What is your advised approach regarding contracts? What is the best approach within impact investing?

Bason: To be honest I do not have any experience with that. What I am thinking is that, ideally you could have a performance fee, so if you generate a return that is above some kind of hurdle rate, then you get some extra payments. So ideally, I guess, you could have the same on the impact side. So this is your target, and if you go above that target, there is some kind of carrot for the managers, so they have an incentive to really reach as high an impact as possible. But I think you need to have the impact part as a part of the contract, definitely.

Interviewer: Do you define what exactly the social goals that need to be accomplished?

Bason: I know in the social investment where there is a corporation with the public sector, the whole concept is that you only get paid as an investor if you are actually able to reach the impact targets, which of course give them a strong incentive to do a proper work. So I think that is definitely a way to go about it.

Interviewer: Do your clients usually invest as a majority or minority investor?

So far I think it has been minority, also because it is early days. I think it is about getting comfortable with the area and once you develop some more experience you are ready for bigger investments.

Part 3: Post-investment process

Monitoring and measurement

Interviewer: **Do you consult on impact reporting requirements?**

Bason: Yes. You know, I do not have any specific, is more like general reporting. In my mind, it is extremely important. Again, it is not different than the financial returns if you say this is what I am going to deliver, then I need to see a report showing that you actually deliver this and if you have not, I need to know why you have not. I do not see it any different from the financial side, but now they have to report on two areas instead of just the financial return. But is it exactly the same, so when we agree on looking at the contract, we agree that you would have to make some impact in this and this area to some extent, and then then tell me about the development, what have you done, what did not work and why, what have you learned from it.

Interviewer: **How can you make sure that the social goals are met?**

Bason: This is also one thing that complicates it. You have to move away from talking about output and then talk about outcome.

Interviewer: **So should flexibility be allowed?**

Bason: You know, that was what I was going to say. In general, I have a very pragmatic approach, because I think some in the industry have a tendency to be a bit too preachy, it has to be perfect you know, otherwise it is not impact investing. I kind of think that my motto is do not let perfect be the enemy of good. Why let us not just get started and then we get some experience and things develop, and we can adjust in the way we report and measure, instead of doing nothing and sit and wait for everything to be perfect. I think people have to be pragmatic and say yes, we are not going know what kind of impact this investment is going to have, but we are pretty sure that it is going to have some impact and that is good enough for us.

Interviewer: **How can social impact be measured?**

Bason: Again, I think it is very much depending on the type of strategy. Even in social impact there is a number of different types of strategies. I think you have to look at the specific strategy and say what kind of impact are you reaching fr and then figure out how to set some kind of metrics. But for traditional investments I would also go once a year to visit the manager onsite. If they were based in Chicago I would go there and spend a whole day in their office, not only talking to the people investing but the whole organization, and I think that you have to do the same for these kind of strategies. Field trips are an important part of measuring impact.

Interviewer: **I guess that can be quite expensive? Also if you have IRIS you almost need an own person responsible for that?**

Bason: The IRIS I think would only be for big institutional clients with large investment teams. I think so far it is kind of hand-held (meaning that smaller organizations are using their own metrics). That is of course also one of the reasons why people are hesitating to enter this space is because there are so many uncertainties and it can take up a lot of resources if you want to do it right. Also, for these companies and organizations, if you go out and say that we do impact investing, you need to make sure that what you are actually investing in is generating some impact, because otherwise it is going to backfire. Ideally, I think, what you would see is investors grouping together and doing some of the investments together because then they can share the resources. It is very time consuming and expensing. Ideally, in this stage, it would make sense for investors to corporate a bit more than they have traditionally done.

Interviewer: How do you feel that your clients are following up on the impact performance? Do you feel that they are interested in knowing the exact impact or do they just invest and not showing any interest afterwards?

Bason: No, I think they are very interested, definitely. My experience is that they are just as interested in the social return as the financial return.

Interviewer: Is it important for your clients to receive measurable (social) returns from their investment?

Bason: Yes. Again, also many investors are using this as sort of a marketing or branding exercise. So, if you are able to post on your website that our investment strategy is able to save x amount of CO2 or something like that, it is also for some investors something that they are looking for.

Control

Interviewer: Do you clients ever interfere in the investment, e.g. by being actively involved in the investment / controlling what the investment is used for?

Bason: I would say, luckily, I have not experienced that and to be honest I do not think that investors should, because that is why they hired a manager, because of the expertise. But that is again exactly the same as traditional investing where you see some investors wanting to interfere how the investments are done, which is silly because then you might just do it by yourself. Either hire someone else or, you know, let them do the work.

Interviewer: How does your clients respond to poor performance (if any)?

Bason: So far, at least my experience is, that they have a bit more patience with the strategies of the investments than they would probably have, just because again it is a new area. Especially also on the impact side it takes a bit longer to see the effect.

Last remarks

Interviewer: Would you say the focus is mainly on the pre-screening or post-monitoring process?

Bason: Normally, I actually tell people that the good thing about impact investing is that it forces you to monitor the investment more closely, because you look at the impact reporting or the impact measuring. So I think you need to have a strong focus on the monitoring, but I also think you need to have a strong focus on the due diligence. I know I have said it a lot of times, but actually think that on the traditional finance side, you also ought to spend much more time on monitoring than what investors are doing today. So I actually do not think that there should be a difference, but I know there is, because people are not focusing on it.

Interviewer: Do you consider the pre-screening and due diligence to be more expensive than the monitoring?

Bason: No, I actually think the monitoring is going to be more extensive than for the traditional investments, so you will spend more time on monitoring, I think. I think it is a good exercise because it forces the investors to better understand what is going on, also on the financial side. I think it is actually very beneficial, but yes, it will probably take some extra resources.

Other

Interviewer: Do you have any additional comments? Is there something we have not touched upon you would like to elaborate on?

Bason: No, I think it is very interesting. However, another interesting point could be that impact investing gathers people from a lot of different backgrounds, and they would have different ways on looking at impact investing and approaches of impact investing. That could also be a bit confusing. I look at it as a traditional investment but with an extra aspects, but if you come from the philanthropic side you have a very strong focus on the impact and the financial part might not be that important. And what I realised was that there are not actually not that many people with a strong financial background in the impact investing market. If you look at the investors, yes, but on the advisor side, it is actually coming from more of the philanthropic side. But again, it is also extremely interesting and valuable with all the people with different background, we just need to figure out how to develop it.

Respondent: 3

Interviewee: Ingrid Stange
Company: Partnership for Change (PfC)
Date: 09.04.2019
Duration: 00:30:20

Introduction

Interviewer: Could you tell us about your background and experience with impact investing?

Stange: Of course. I have an MBA from UC Berkley and I have a MSc from the Norwegian School of Economics, and I have worked with impact investing on both for-profit and for non-profit. So I have done several investments which are mostly impact, and I have some investments that are combining impact and financial returns. So I try to avoid investments that are not impact oriented.

Interviewer: Could you give us a brief overview over your Partnership for Change (PfC) and what you do there?

Stange: So PfC, I am talking about myself now as an individual, but PfC is an NGO, so what we do there, is for impact-only. But we do investments but those investments are purely social and we call them, what do you call them … loans that are, it is not microloans, they are … you know if you have this continuum from grants to pure finance, I am sure you have seen that, so we are on the side before financial returns, so loans that we give out, to the extent that we give out loans, are with a 2% interest rate. It is not high interest rates. But most things from PfC are what we call entrepreneurial grants. By entrepreneurial grants we mean that we give grants to enable our partners that will build businesses that would be financial sustainable for them, but we do not expect to get the money back. So that is social impact purely.

Interviewer: So you conduct some investments yourself as a private person?

Stange: Yes, there have been some investments within medical technology and climate.

Impact investing - Concept

Interviewer: What types of investments do your clients engage in?

Types, size of investment, stage, sector, location, time-horizon

Stange: These has been direct equity, and also fund investments. Funds are with a climate purpose. We have also done some direct investments in companies that have had climate CO2 emission as their purpose. On the educational side, I go in with my own practical work, operations and strategic and practical work, and money, to enable building specific […]. So my purpose is always the social, but I try to also make sure that there is a financial return. So I am an impact-first.

Interviewer: **Do you invest more in early-stage ventures or more established businesses?**

Stange: It tends to be start-ups and early stage businesses, and I tend to also go with my own activities. So it is very high risk, but it try to reduce the risk by my own sort of inclusion to the projects.

Interviewer: **Do you also invest in emerging and developing markets?**

Stange: Yes, absolutely. Through PfC we only work in developing markets, in Myanmar and Ethiopia. For other investments I have been investing also in emerging markets.

Investment process

Part 1: Pre-investment process

Interviewer: **Could you please describe the investment process; from the first encounter with a possible investor through the final investment decision/deal?**

Pre-screening process, due diligence

Stange: So I never consider anything that does not have a strong social or environmental value. So my pre-screening is in terms of what is the purpose of this investment. But that is a very informal screening because I would never even consider another investment. So the post-monitoring … it has all the time been what we call impact management, rather than impact measurement, so we try to reduce risk by our own involvement. And this is the case in PfC and in the case in our private investments also. Until recently, has been a very informal process, but now, in the family, we have created a board, we have four children, or not children, but some very smart, young people, and they have become part of the board and such require more of a formal process, because the pure fact that we are now 6 people in the board it is no longer over the breakfast. And also because they are very skilled financially.

Interviewer: **Do you state clear social or environmental goals in the due diligence process?**

Stange: Social goals are always clear, but now, when we have this formal family office kind of process, we also look at what could be the financial returns, and if the financial returns are not expected, we could still do the investment, but then we are aware of that.

Interviewer: **How is a possible investment decision evaluated?**

Is there any KPIs you look for when you do the screening?

Stange: When it comes to PfC, we are now building fairly rigid structure of impact measurement. We have developed recently together with KPMG a sort of an impact measurement program, quite rigid, and that we are now in the process of building into our decision making. But all of our investments, also in PfC, are based on where we see that we can make an impact, also with our own skills.

Interviewer: **How do you view the balance of social and financial performance? Is it also the social first?**

Stange: Yes.

Interviewer: **How do your clients evaluate the impact risk?**

Mission alignment

Stange: That is the most important [goal alignment]. Because the impact is the most important. When we invest with PfC in for example Ethiopia, we only invest with people we *know* share our vision, and we tend to keep working with the same people, and we have local partners we work closely with. So the mission risk is the one we really take seriously. Market risks are … for us it is more important that we are manage to create jobs and education for young women than the financial returns are.

Interviewer: Are possible exit opportunities evaluated? Are there any concerns connected to this?

Stange: Yes. The major concern is that we want to make sure that when we leave, the project will be financial sustainable.

Interviewer: Do you follow up on that somehow, or how do you know that the projects stay financial sustainable?

Stange: Yeah, we create a plan for our exit, and we do not leave until we see that that is the state.

Interviewer: But in cases you for example figure out that they might put a bigger focus on the financial returns, and you notice that there is a misalignments of goals, do you consider that in potential exit strategies?

Stange: Yes, I think we work very closely, we never invest financially purely. We work very closely with our partners, so that … if we see that they do not share our social mission, we would not go on with PfC, that is true. But, that has only happened at very early stages, where we have seen before we have really gone in with really heavy investments. But, we want our partners to have financial return, and we want them to want to have financial return. But the work they do should be socially impactful.

Interviewer: So do you feel that you have a more active involvement in your investments?

Stange: Yes, we have a very active involvement. But our return should be social, and our partners return should also be financial. But that does not go to us, that goes to them. Because we want to empower them.

Part 2: Contractual relationship

Interviewer: What is your advised approach regarding contracts?

Stange: We have fairly strict contracts, because my experience, I guess it is everyone's experience, is that we need to know each other's' expectations, so we never do things without contracts. I have done that in the past, but it has never been a good idea.

Interviewer: What do they usually include? Is it usually social goals, or?

Stange: Usually here are the goals we want to achieve, and we are getting better and better at this as we go along, because we keep learning what we did wrong the last time. This is also where we have gotten help from KPMG to build sort of a goal mission alignment tool in a way.

Interviewer: Do you have more of an outcome-based or behavior-based contracts?

Stange: We make contracts for each project, and when we see that this is going how we wanted to, we might expand it, but then it would be new contracts.

Interviewer: Is flexibility to the investees allowed or is the investment process more controlled?

Stange: […] Hospitality school, she is now finalizing this payment, but we have been very flexible in terms of when she should repay, and she has been allowed to set the payment plan, and if she does not pay, we will accept that, because she is still in a very early stage in an emerging market, so things are not so easily planned. But she has paid back. She will be paying back the final portion during this and the next year.

Interviewer: Do your clients usually invest as a majority or minority investor?

Stange: Minority. We are not big enough to be majority. But those projects that we go into are very small, like 2-4 million NOK, and then we are sort of *the* investor. Privately, I am not big enough to be a majority.

Interviewer: Can the contract ever be complete? Or do you allow renegotiation of the contract?

Stange: Yes. Because the purpose of our contract, since we have a social goal, an impact-first focus, we are negotiable to make sure that our partners know exactly what we expect, and that we are not misunderstanding each other in terms of what they expect from us and what we expect from them.

Part 3: Post-investment process

Monitoring and measurement

Interviewer: Do you use any impact reporting requirements?

Stange: The approach we do there, is that we do impact management rather than impact measurement, which means we are very closely engaged in the projects. But then again, through KPMG, we are in the process of developing some sort of impact reporting scheme. And for the time period of the reporting, we try to have quarterly reports, but that is not financial, that is more in terms of where it is going.

Interviewer: How can social impact be measured?

Stange: This is a part of the work we do. We set up social goals for each project, and measure that, and this in the making. That is new to us.

Interviewer: So you do not look at the typical IRIS, etc.?

Stange: No, there is this social return on investment, we tried to use some of that some years ago, but to me it became sort of garbage in, garbage out. It is very difficult, I mean, you get a number, but it was very time consuming and did not give much information.

Interviewer: How is impact performance tracked? Do you follow it up closely?

Stange: Yes, because we work with them.

Interviewer: Do you sometimes travel to the places you have projects?

Stange: All the time. So either there is people from PfC working with a project and following up very closely. And being part of the project, so to say. What we offer it not only financial investments, but also operational.

Control

Interviewer: Do you have a more controlling role in what the investment is used for?

Stange: Yes, we do, because we earmark the investment to projects. So for example, we say, if there is a school we want to support, we say we will help build an income generating operation. That is what we put that money into.

Interviewer: How do you respond to poor performance?

Stange: If the poor performance is because they need more help, we try to give more help. If the poor performance is because there is no alignment in the mission, we sort of have withdrawn from some, but mostly, since we work closely with people that we know, we do not reinvest in organizations that we do not see are good. But when we see that they are doing what we are agreeing upon and the results are good, we can co-invest. So we build up a portfolio with partners that are good.

Last remarks

Interviewer: Would you say the focus is mainly on the pre-screening or post-monitoring process?

Stange:	The managing [impact management]. I would say we spend much more time on taking part in the investment once we have done one, often more than monitoring itself so operational support.
Interviewer:	**Are there huge cost differences? What is most cost-efficient?**
Stange:	Yeah. I guess we focus more … the pre-screening becomes sort of integrated in the management of the investments, because while we are operating together with our partners, we learn about new projects that we might go into, so that is almost included. I think we have a very different working process than most investors, because impact is our pure goal.

Other

Interviewer:	**Do you have any additional comments? Is there something we have not touched upon you would like to elaborate on?**
Stange:	No, I think you have relevant questions.
Interviewer:	One of the things we want to look into in our thesis is for example how the investment process can become more transparent-
Stange:	Yeah, I think to get the transparency, that is why we have decided to have an underground person that constantly works in the project, and when we see that there is need for expertise beyond what the local team has, we went in with support and tried to make it transparent by being there ourselves. Are you aware of an organization called Acumen?
Interviewer:	**No.**
Stange:	You should look into them. They also have good programs on how you do impact measurement. They have grants where they expect returns, not 20%, but 1-2%. It is a very interesting organization.

Respondent: 4

Interviewee:	Mika Pyykkö and Juuso Janhonen
Company:	Sitra
Date:	23.04.2016
Duration:	1:00:35

Introduction

Interviewer:	**Could you tell us about your company and your experience with impact investing?**
Janhonen:	Sitra is a public organisation, about 50 years old now. It is incorporated as a public fund, but actually, it is more about being ... these days, so Sitra is trying to different kind of projects to make the world a little better place. We are trying to find different ways to promote sustainable well-being. Mainly in Finland, but also through some spillover effect to Europe as well. Impact Investing is one of the close areas started about 4,5 years ago. Sitra has been making venture capital investments since the late 80s and invested directly in about 300 companies. We seied new investments in 2014 and concentrated on fund investments only. Today we only make fund investments in venture capital funds in private equity funds. Mika can tell you something about the involvement of impact investments projects in Sitra.
Pyykkö:	And we are still working under the control of the Finnish parliament. Somehow, we are quite independent because we are working but using the return coming

from our endowments, which is about 800 million euros at the moment. We are thus a semi-public organisation. I suppose we are quite unique globally as there is no other organisation quite like we are. And as mentioned we started our impact investing, let's say development activities in summer 2014. We set the goal that we do our best to create as well working as an ecosystem of the market in terms of impact investing. First, we had a plan for 2.5 years because that is that kind of know-how style of Sitra that we are ... about 2.5 years - 3 years. Our first time was at the beginning of 2016, but then we decided to follow one more year because we got a lot of feedback inside our whole organisation as well as our stakeholders, that the market is not really much now we have to do a lot of things. Still, in order to create real impact investing market and ecosystem, so nowadays we have decided to follow it to the end of this year. And that is going to be a final point in terms of that kind of - let's say - special development activities in terms of impact investing in Finland. And then one more point, in Sitra we have focused very much on the social impact bond model, as our operations in terms of impact investing, we have done our best to support the whole market and the rest of the market from our point of view, that part of the market which is the biggest part globally, in terms of impact investing. But at Sitra, we have really focus on social impact bonds or private ... .

Impact investing – Concept

Interviewer: What types of investments do you engage in? Do you invest directly into some ventures?

Janhonen: Nowadays we don't do any more direct investing. We stopped that in 2014 because the strategy changed, so we had about 30 years of experience in direct capital investments. We actually have a, as Mika said, an endowment capital, which is generating the profits that the whole operation is funded by so, Sitra is running on our own returns from the endowment capital, and that is investing the faith in ... equity in interest burying bonds in real estate. And then we have a more operational investment side which is venture funds because still, we are not completely that the venture capital funds are good faith investments, so that is why we sort of have changed. But yeah, in the past we have done about 300 direct investments in venture firms, but now we have about 10 left in our portfolio. And since the impact investment project started in 2014, we have done 3 direct investments after that, and we applied some of the impact investing principles in these three direct investments. We have invested in two social impact bonds that started in Finland, so we have basically, about 5 impact investments at the moment, I would say. And we also found fund investments to this one European fund, which give us some exposure to a little bit bigger number of companies and social impact bonds as well. Last year, we did a few, actually, three venture fund investments which themselves speak of as they are impact investment funds, or else there were financial investments. They were interesting with regards to financial terms, but we didn't apply the impact investment principles ourselves to these three investments.

Investment process:

Part 1: Pre-investment process

Interviewer: Could you please describe the pre-investment process?

Janhonen: It is pretty much the market standard, due diligence process. Of course, we don't do the direct investments anymore, but before we had a really thorough due diligence process with the companies we invested in, and it took from 3-12 months to complete. Of course, the most important thing of impact investments and direct investments is the team. So the team evaluation takes quite a lot of time. We want to know the people, we want to understand how they think, what is their knowledge? And then, of course, we would do the mandatory financial and legal due diligence as well, but in coherence with market standards. As a fund investor, we are a little bit more thorough in the due diligence process, so a little bit similar to for example DIF, who make really thorough due diligence. To diversify the investment and just trust in numbers so they make a lot of investments and trust that some will bring back their money by conducting good due diligence and try to select the best teams.

Interviewer: **Is the product itself evaluated the most, or the potential impact it can create?**

Jahonen: When we did these investments it was 2014, and the whole concept of impact investing was quite new to us, so out impact due diligence wasn't that thorough, so it was more about... I can give you an example. It is a company that manufactures green walls, so it is a wall that has plants in them. It would clean the air when the air circulated through the roots of the plant that was incorporated in the wall. It took out chemicals from the air and made it cleaner, so it can be used as an air purifier in indoor environments. Our hypotheses at the time, when we had a lot of indoor air quality problems in Finland, and a lot of sick days due to bad indoor air, was that the wall was supposed to reduce the sick days caused by the bad indoor air. That was then our impact thesis when we invested in it. In Asia for example, where the air is very polluted, it could have had really good market potential. We also thought it would be good to help the Finnish buildings with better air to decrease sick days. We did set an impact goal for the investment, whereas sick days would be reduced by 10,000 within the year 2020, as well as getting a good financial return. The problem with it though was basically that we formulated the goal with the company (sick day reduction), but after we made the investment we figured there was no way of getting the information because employees don't have to report their reasons for sick days if they are sick less than three days.

Interviewer: **Is it challenging to measure the outputs of the investments?**

Jahonen: I think it depends.

Pyykkö: When we are talking about impact, social impact or any kind of impact, we take that work very seriously and it is difficult for us to say that we really have been able to measure some outcomes or impact, because we really want to be sure that we talk about outcome or impact when we talk about or use those terms. But sometimes you know, we recognise that sometimes our colleagues are talking about impact or outcome but in fact, they are talking about output, but they are talking about impact because it is so popular. We really want to be sure that it is outcomes or impact which we are talking about if we use that term. We would not be an impact investor if we used output as the term.

Janhonen: There is a lot of impact-washing at the moment, because everyone want to be impact investors. But we have done research on our past portfolio of about 300 companies that we invested in, and about half of them would have been impact investment companies if we would just have said the goal to them. Now many investors are, retrospectively, taking their portfolios and turning them into impact portfolios, because there are always companies that have some sort of impact, or at least can have a positive impact from a certain perspective.

Interviewer: **How does your organization evaluate the impact-risk, in terms of mission alignment?**

Pyykkö: One reason that we started to focus on social impact bonds when we started our impact investing development operations because we wanted to be sure that when we are talking about impact we are really talking about impact.

Jahonen: That is very difficult, especially in the venture capital investments because most of the investment cases are syndicated, so you have a lot of investors investing in the same company, so that means that you have some sort of mutual understanding of what the goals are, and that is very difficult because in some cases you have investors who are just looking to maximise financial return, then you may have some philanthropic investors who are only interested in the impact of the company. This may lead to conflict of interests. There are examples of companies where impact and financial return go hand in hand, so if you maximise one you get the other one. But there are also cases where this is not the case, and then you have a problem if you haven't agreed beforehand what your actual target is and how you are going to achieve that. But I don't have any good solution for that, it is really a discussion with everyone, where everyone should understand each other's expectations. If you are making VC investment, look at the shareholder agreement to get an understanding of how the investment is going to be; what is the impact goal etc. The rules of the game need to be clarified. In the articles of association of the company, you can also see if they have incorporated the impact goal. These documents are public. You need to negotiate the contract after you have seen the shareholder agreements because you need to take it into consideration if there is any majority investor. If impact is very important to you, you should really consider this.

Interviewer: What criteria do you use when you evaluate a potential investment? With regards to financial vs. social targets, the use of frameworks in the process, etc.

Jahonen: At the moment, our main focus is financial returns, we don't want to trade off financial returns for impact. There is a lot of discussion on this if there is a need for the trade-off. What is impact investing, is it the philanthropic finance or capitalist return on investments? It is actually quite difficult to define exactly, but for the market to develop this enough, it is important that there will be a sufficient financial return. Basically, it should be risk corrected market rate returns. It is really important that the rules that go are created beforehand. If everyone is interested in a trade-off investing that is okay, but otherwise, some might lose on an investment that thought they would get a return on, and then you have a conflict of interest.

So far, our number of impact investments are so small. We have tried to look into the different types of frameworks, but for now we really haven’t found any good ones, so basically when we did these first ones, none of them ever came to the stage where we could have measured the impact of the investments. The other investors in the projects were not impact investors, so we had to give up the whole measurement. We only set a goal but didn't really measure it.

Pyykkö: We hope that we can learn something from our social impact bonds project also in terms of measurement. When we are talking about our social impact bond cases, we are talking about modelling, which mean that you have to understand the phenomenon and what is going to work, and what the most crucial points are you have to be able to influence in order to get the final impact you wish. I really hope we can learn something from that part of the market, and then also to modify and use that in venture capital fund investments.

Jahonen: Some KPI from IRIS are used without really understanding which metrics would be most suitable. Do they even measure the actual impact of the venture? The modelling will be very important, but so far it hasn't been done that thoroughly as it should be done.

Interviewer: How are possible exit opportunities evaluated? Are there any concerns connected to this?

Jahonen: To be honest, we are not that far yet. The three investments we did in 2014, one of them was exited by bankruptcy, but I'm not yet seeing so much valuation of the impact at the moment in the exit market so. I think it is in the future because the industry is still so young, and in normal investments, holding periods, for, for example, VC investments are 5-10 years. I think the average is 7, and I think it is not information yet about the exit opportunities.

Interviewer: So you take it as it comes? You don't consider it before you make the investment?

Jahonen: Well, these cases that we have done is normal VC cases which are companies that are operating in an area which has a possible impact, so the exit opportunities for them - of course, in the due diligence phase, we evaluate possible exit scenarios, so we always have to have a clear idea of how this company could be exited. The impact so far, it doesn't seem to be a problem in the exit, maybe with regards to the premium, but I don't think it gives any discount to the company at the moment. But for example, we don't have any big buy-out fund, that would be impact investment buy-out funds that are specialised in impact investment cases only, so there is no separate exit market for impact investing.

Pyykkö: ... my background so, my logic is a little bit different. Coming back to what you asked, I think one of the main challenges in impact investing and measurement and everything in the Nordics is that we are such a sophisticated market already, and when we are talking about investments to achieve something really crucial in terms of well-being of environment, you really have to do something quite big. We have a huge public sector, and everything is being taken care of already by the public sector in Finland and the Nordics, so you know, again, based on my understanding it is more challenging to be a real impact investor in the Nordics than some other part of the world. You really want to achieve some measurable impact. If you go to Africa and make some investments, you can be almost sure that you are an impact investor already.

Part 2: Contractual relationship

Interviewer: What is your approach regarding contracts? What do they include?

Jahonen: Well again, we use the market standard documents. In direct investments, which we don't do anymore, it is the shareholder agreement which is the most important document of the VC investments. You have to agree on everything in the shareholder agreement. And the articles of association is the other document, but we didn't use this one in our cases. For example, you have probably heard about the B-corp principles, the idea is that the company, the social enterprise, so you can get this B-corp status if you make a written statement that you will give half of your company operations profit to charity. So that is something you could put into the articles of association, and that cannot be changed. That is, for example, something we didn't use because I think that it will scare off some of the investors because then you are not getting that much return for your investment, which will mean lower valuation etc. Some companies, e.g. family companies, etc. may do this. So, in direct investments, it is the shareholder agreement which is the key document. On the fund investment side, it is the LPA - Limited Partnership Agreement, which is a defined agreement. And that is something which said all the rules that you have. We use the market standards, again, because that is the easiest for all the investors. Even for the two social impact bonds that were done here in Finland, have had the same form of documentation as normal venture and private equity funds. It is easy for all the institutional investors to understand. It is just some extra policies for the impact in the same document.

Interviewer: **In the contracts, are payouts ever contingent on performance, with regards to social and financial return?**

Jahonen: Indeed, actually, we have in one of the three funds that we did that year. One of them had this called impact hurdle, or you know, the VC funds have the carried interest structure, so that the manager of the fund get the performance fee regarding the financial return that they had. In this case, some of the carried interest was stopped if they achieved the impact goals, which was approved beforehand. And if they don't meet all the goals, then they will get less performance fee for the manager and also, the performance fee that the manager doesn't get, it goes to charity. Because otherwise, because normally, it is probably the 80/20 rule, so if the returns exceed the hurdle rate, which is 5-8%, 20% goes to the managers and 80% to the investors. If this 20% would be reduced, to let's say 10%, because of the manager is not meeting the impact goals, then the limited partners get more money, and then there will be a conflict of interest because the investors would hope that they are not meeting their impact goals so that they will get more money. That is why the rest goes to charity, and not the investors. Then the interest is aligned again. There are a few folks that have this kind of structure. I think it was introduced by the IAIF, some years ago. It has been applied in about 15 venture funds at this moment in Europe.

Interviewer: **Can you think of how the contracts might differ from traditional investment contracts?**

Jahonen: Contracts are just like the ones used in VC and PE, but with a section that also states social goals.

Interviewer: **How much flexibility is allowed by the investees? Are control rights considered?**

Jahonen: Case by case. They have to follow the business plan which will result in this positive impact. We didn't document that well, we only documented that they had to follow the business plan, if you want to alter the business plan you have to get the approval - that the investors will approve those changes. So, it is pretty much the normal kind of way. Of course, we monitor afterwards if the money has been used according to the contract. Normally it gives quite a lot of flexibility to the investees. The fund managers are really independent after they get the money, they can decide pretty much anything by themselves as long as they follow the documentation. Usually, some of the investors sit on the board, so they can have some influence on how the money is used.

Interviewer: **Do you invest as a majority or minority investor? Are board control and management rights defined in the contract?**

Jahonen: We only do minority investments. We normally did the syndicated minority investments and we normally wanted to have a board seat. Then we could be more actively involved. What stake of the company you get, how much money do you invest and what stage you invest in, matter because we are very early stage investors, hence we got quite big stakes in the company, and hence we could require getting a board seat.

Interviewer: **Does contracts ever need renegotiation?**

Jahonen: Yeah. Especially in venture capital investments. When you do the direct investments, there are different stages of investments, starting from the pre-seed or seed to series A to B to C. If you go into early stage you can pretty much write the shareholder agreements and then it's alright, but when the bigger investors come in, that investor probably in many cases want to make some adjustments to the documentations. If they don't get them, they don't invest, and then the companies (ventures) can go bankrupt. Basically, if at some point the big new investor wants to make any changes, you pretty much have to agree. That's the difficulty in venture capital investing. Buy-out works different, they buy maturity of the company, and they hold it until they exit so it is only one investor in one company, and then if you ... something, you can hold onto that. So that is the sort of different logic in these two investment styles. And in social impact bonds, there is a difference, because the program is already pre-determined. You know where the money is going to go, you know how long it is going to last, so all the rules are clear from the beginning. So, there is rarely a need to make adjustments in the contract afterwards. There might be some minor changes, like a change of key persons if someone leaves the company and someone new is hired, and some adjustments need to be done, but basically, what it is now, is that it stays the same the whole investment.

Part 3: Post-investment process

Monitoring and measurement

Interviewer: **Have your organization implemented any impact reporting requirements? How do you make sure the social goals you have set are met?**

Jahonen: That is something we didn't get to do with the three direct investments we had, so we didn't get to the reporting phase because we pretty much abandoned these measurements after the investments. It was too early for us, we didn't have enough expertise to take them through. We just set some KPIs in the beginning, but we didn't follow on with those. So, we don't have much expertise on that side. But on the fund investment, they normally, the fund managers, they have a template for their reporting which they present to the investors in their fundraising. From the social impact bonds, we sort of developed the reporting template together with the managers that are running the social impact bonds. But they are pretty much the standard investor reporting template, that is added with some impact elements.

Interviewer: **How can you actually measure the social impact?**

Pyykkö: We have mentioned the modelling. And somehow, we believe that by developing the modelling abroad, we can really compare closer the real outcomes and impact to measure. But we have to mention that we have a lot to do and learn and develop on that part of the process still, but because have done that ... in terms of social impact bonds, but we have to modify a lot of things when we are talking about other types of investments, but somehow we believe that somehow everything starts from that approach.

Jahonen: The social impact is really difficult to model, it's difficult to measure. At least, at this time, because we don't have much expertise at that field. But i think it is kind of, almost dangerous right the way that things are now. it is like, we have this product or service, and how many people are using it, and that is sort of the KPI for the social impact, and that is not good way to do it.

Pyykkö: - It is much outputs!

Jahonen: And even you don't know if that output is actually doing good or is it doing bad. It can lead to wrong conclusions, if you don't do the modelling first. So if you just start, to take something, and start measuring that, set that as a KPI, then you may end up doing something else than what you were planning to do.

Pyykkö: This is not to easy. We are dreaming about net impact. You know, the final impact should be NET positive. That is again more demanding, but we believe it is more important.

Jahonen: Because many actions or many products or many services, they have some negative effect and then they have this positive effect, and this should be like, taking it all into account and then make sure that the impact is net positive, so. The positive impact is bigger than the negative impact of these actions.

Interviewer: How do you monitor the investments?

Jahonen: Yeah. At this moment, because the number of our impact investments is so small, we have real monitoring for our financial return, that is something that we track, and the impact, the social and the environmental impact, we only monitor in an ad hoc way, in a qualitative way. Of course, we report from the e.g. fund managers and we read them, and understand, but we don't have any systematic approach for the monitoring of impact. It is something that comes on top of the financial return, so we get financial returns and then we get, at this moment, to feel good, because it is doing something else as well. But that is something that we should develop, as it is now a work in progress.

Control

Interviewer: Do you take on active involvement in the investee?

Jahonen It depends. In the past investments, we wanted a board seat. We actually did a strategy change in 2013, that stated that we don't want any more board seats, because they take so much of our internal resources so, in these three direct ones we did, we did not have a board seat. In some investments, sometimes, we have advisory board seats, which is sort of a few bigger investors who are ... all the investors and having sort of communication with the chief and the managers, so we have a few of those, but we don't require those as well. One of the reasons we stopped making new direct investments is because it takes a lot of resources. We want to externalise the investment process to other people, so they manage the investments. We don't want to get too involved in the investments any more.

Interviewer: How do you respond to poor performance (if any)?

Pyykkö: I got to start from the social impact bond perspective, and there it is a very good question because we have been prepared [...]

Jahonen: Yeah normally, in fund investments, yeah well actually, you pretty much always have the possibility to change the ..., or to dissolve the fund if needed. We only have these two impact bonds which, at least the bigger ones are performing quite well at the moment, so there is no need to intervene. In normal VC fund, VC impact funds, we are such a small investor that we cannot do anything by ourselves. That is a very good question. In direct investments, it is a bit easier, then you can intervene if something doesn't go as planned. With the fund, it is a little bit more difficult, you can, but then you would have to get the majority of the investors behind you, to back you because you cannot do anything by yourself. Often it is even limited, you cannot even sell you stakes in this ... and funds. There are some restrictions to selling them so. Yeah, it depends, case by case.

Last remarks

Interviewer: What is the more effective phase, the pre-screening phase or the post-monitoring and control phase?

Jahonen: I think it is really the pre-investment evaluation which is important. The screening process is really important because that is when you align your interest, it can be a fund investment, it can be a social impact bond investment or it can be venture, then you have several investors and you have the investee, so if you have to align their interest, it is done before the investment. When your money is in the fund/company, it is really difficult to do anything anymore. So, you cannot say "oh I didn't mean this" or "I didn't want it to be like that", so that is why I think the pre-screening and the pre-investment process is really important. Of course, the post-investment process is also important, because that is when there are reporting and measurements, and if something goes bad at that time, you can intervene, so. But I think the pre-investment process, that is more important. That is something we won from. We had different investors with different goals, so we were the only impact investor in our three direct cases, and we didn't have the majority, so we couldn't have pushed anything by ourselves, we couldn't force something to happen.

Interviewer: **What do you think can be done to make the impact investing process more transparent?**

Jahonen: I think there should be some sort of framework that could be generally accepted, but I think that is very difficult to accomplish. In general, I think in VC and PE, they haven't traditionally been that transparent, so it is difficult to make transparency within this process at the moment. It would be great if organizations like the Impact Europe or other organizations like that, that would set up some principles, of how this should be applied. I really don't know. There are a few networks, like "Tonic", which is a network for investors that are sharing their practices etc. So, I think it can also have work like this peer-to-peer support kind of thing - sharing good experiences and bad experiences. But to be honest, some of the VC industry hasn't been that good in sharing information.

Pyykkö: When we are talking about impact investing, there is that kind of joint understanding of what impact investing in principal means, you know - intentionality ... . You have an idea already before you make your allocation, of what you want to achieve. If you keep these principles, it is much more transparency nowadays. Many investors have done previous investments before this was even a thing, and now they are just starting to call those old investments impact investments because it is so popular. We should DO as we speak in impact investing.

<u>Respondent: 5</u>

Interviewee: Silje Veen
Company: TD Veen
Date: 23.04.2019
Duration: 01:12:04

<u>Introduksjon</u>

Intervjuer: **Kan du fortelle litt om bakgrunnen din og erfaringen din med impact investing?**

Veen: Ja. Hvis jeg skal gå helt tilbake til min personlige bakgrunn, såer jeg utdannet sivilmarkedsfører, helt tilbake til 1994, og min første jobb var å jobbe med marked og salg for Radisson SAS. Men jeg hadde en siviloppgave som det het den gangen, om lokal næringsutvikling, så etter 5 år der, så hoppet jeg på en enorm kjekk utfordring, og nesten en litt for stor en; jeg startet og ble grunder selv, så jeg startet et matkonsept som heter Food Story, og grunnla det fra scratch, og drev to kafeer og deli, kombinasjonssteder i Stavanger, og åpnet etterhvert i Oslo. Jeg drev frem til 2012, da hadde jeg holdt på i nesten 11 år, og solgte det først i Oslo, og så i Stavanger. Da fikk jeg jobbet mye med lokal næringsutvikling og et nytt matkonsept. Jeg var veldig opptatt av sunn og ren mat, så fikk jobbe med interessen min og bruke markedsføringserfaringen min veldig godt, så det var 10 år hvor jeg liksom fikk tatt hele boken fra kapittel 1 til 8 med hvordan man starter en egen bedrift. Den gangen var ikke økologisk mat så spesielt vanlig, det var ikke så mange her hjemme som var opptatt av økologisk mat. Etter 10 år fant jeg ut at jeg tror ikke jeg er den rette til å ta det videre, og han jeg eide det sammen med i Oslo var også interessert i å avslutte. Da landet jeg på at når vi skal selge i Oslo, skal vi selge i Stavanger også. Enten må jeg være helt på, eller helt av. Så gjorde jeg en ny helomvending og begynte i familieselskapet vårt, TD Veen, helt uten å komme fra finans, men jeg har jo vokst opp med dette i familien vår, og jeg var veldig usikker på hva jeg nå skulle gjøre. Og jeg har jo drevet min egen bedrift i 10 år og da blir man ganske egenrådig og vandt med å bestemme alt selv, så jeg var ganske usikker hva jeg kom til å passe med, men jeg bestemte meg å ta den utfordringen fra far som sa at jeg selvfølgelig skulle prøve, og begynte da i TD Veen i slutten av 2012. Og da var vi et familieinvesteringsselskap helt uten profil of synlighet, far investerte på magefølelse, jobbet i et kontor i et fellesskap der som Skagen-fondene er, og så måtte/ville vi flytte ut fordi det begynte å bli plassmangel, og da kjøpte vi det gamle Røde Kors-huset. I den flyttingen og i den beslutningen at dette har jeg lyst til å gjøre og lage en fremtid for neste generasjon, og valgte sammen med nye kollegaer å lage et investeringsmandat og verdigrunnlag og en plan for hvordan vi skulle utvikle porteføljen vår og fremstå på sikt, og har jobbet med det siden 2013.

Intervjuer: **Valgte dere med én gang å ha en samfunnsprofil?**

Veen: Det vil jeg si var med én gang. Grunnen til det er nok litt sammensatt. Når jeg begynte å jobbe her sammen med søsteren min, så ble det viktig å gjøre noe jeg synes var meningsfylt og legge opp en plan for fremtiden som jeg trodde på, så samfunnsperspektivet har vært der fra starten av, men blitt mye tydeligere i løpet av disse 5-6 årene. Det har vært litt arbeid som har utviklet seg, men jeg vil si at fra dag én har det vært helt avgjørende for at jeg skal jobbe her, og kanskje for noen av kollegaene mine også, jeg vet ikke. I det vi hadde lagt en investeringsprofil som sier at vi tror først at investeringen er god når den er god for oss og for samfunnet. Den er jo enormt vid definert, noe jeg er komfortabel med at den er, siden vi har gjort ganske siden den gangen for å avgjøre ganske konkret hva det betyr, og at det ikke bare blir noe som kan være en ganske stor fallgruve i impact-universet, at alle «skal» drive med det nå, og noen vet ikke helt hvorfor de gjør det eller hva de gjør. Sosialt entreprenørskap ble for oss en synlig måte å vise på at vi mener det vi gjør.

Intervjuer: **Kan du fortelle om hvilken type investeringer dere foretar?**

Veen: Ja, det er alt. Jeg kan gi dere noen grove inndelinger. Vi har investert ca. 30% i venture, tidlig fase/vekst. Der er det nesten bare teknologi. Og så har vi 30% i portefølje, sammensatt av direkte investeringer og litt børs. Vi er veldig lite investert i eiendom, hvis jeg skal si noe som er spesielt for oss. Til å være et familieinvesteringsselskap, er det vanlig å være et sted mellom 20-30%. Vi kommer jo fra å tro på aktive investeringer, å ha en relativt høy aksjeandel, vi liker å gjøre aktive investeringer.

Investeringsprosessen

Del 1: Før investering

Intervjuer: **Kan du forklare hvordan dere screener en potensiell bedrift før dere velger å gå inn?**

Veen: Ja, vi har et investeringsmøte én gang i uken. Nå er jeg arbeiderne styreleder, så mine nærmeste kollegaer er CEO og CFO. For å screene en investering vil jeg først si at vi får mange henvendelser, og da får vi en case eller prosjektbeskrivelse og ut ifra det, hvis det favner interessen vår, og det kan egentlig være nesten alt, men det er veldig ofte teknologi, og vi har en stor, ny satsing på bioteknologi. Vi er egentlig ganske åpen for alt, såfremt at ideen appellerer til oss og at casen ser bra ut i forhold til det vi får overlevert, og så vil jeg nesten si at vi nesten alltid får en anbefaling fra co-investorer. Så bruker vi tid på å screene det som blir sendt over av materiale. Hvis det ikke er bra, gjør vi ikke noe mer med det, og inviterer ikke til presentasjoner eller møter eller noe.

Intervjuer: **Men hvordan vekter dere sosiale og finansielle mål?**

Veen: Vi kan ha forskjellige tilnærminger til det. Porteføljen vår er inndelt i 3. Vi gjorde et arbeid i fjor hvor vi bestemte oss for at hvis vi skal være en betydelig impact investor må vi gjennomlyse porteføljen vår og se om vi er gode nok i dag. Da delte vi inn i 3 hovedkategorier; lav, som er «no-harm», altså negativt filtrert; bærekraftig, som betyr at de scorer godt i forhold til ESG; og så er det impact som den øverste kategorien. Der har vi stilt som krav at det skal være selskaper som er etablert med **hensikt** om å gjøre en impact. Vi har også delt inn porteføljen i aktivt og passivt eierskap. I aktive investeringer sitter vi i styret og jobber ganske mye gjennom styrevervet vårt. Vår opplevelse i fjor når vi intervjuet mange andre familieselskaper og leste mye litteratur, er at det er enormt forskjellig hva folk sier er impact. Men når vi sier at vi har lyst til å prøve å gå litt foran, så har vi på en portefølje som er pluss/minus 2 milliarder NOK, valgt å si at 15% **skal** være impact, og da har vi ganske strenge krav til hva det er. Så har vi per i dag 53% innenfor bærekraft, og resten på nøytral. Og spørsmålet deres om hva vi tenker når vi får en henvendelse, om samfunnsbidraget eller det finansielle, som er et godt spørsmål... hvis vi nå satte denne nye porteføljen vår opp, så var impact-delen på 7.5%. Så bestemte vi oss for at innen det første året skal den opp til 15%. Det har vi klart allerede, så vi ligger litt foran. Måten vi gjør det på er at vi søker med litt andre briller enn det vi gjorde før. Hvis vi får henvendelser fra folk som spesifikt driver innenfor impact-universet, vil jeg ha større nysgjerrighet for å lete enda grundigere der. Vi har ikke investert direkte i olje og gas spå 10 år, men vi er investert i fond og obligasjoner, og obligasjoner i Norge i dag er nesten umulig å gjøre uten å være involvert i olje eller gass.

Intervjuer: **Typisk av de impact-selskapene dere investerer i, hvor viktig er avkastningen? Med tanke på det finansielle vektet mot det sosiale?**

Veen: Det kan jeg godt svare på. Det er også en lang diskusjon. Tilbake til 2013 klarte vi så lett som bare det å levere 10-15% avkastning. Det var helt andre renter. Du kunne plassere store deler av porteføljen ganske sikkert, og få god avkasting. Sånn er det ikke lenger. Men den gangen hadde vi en diskusjon om at dette kanskje betyr at vi må være villige til å godta en lavere avkastning. Et samlet styre stilte seg bak dette. Å få avkastning på pengene sine i dag blir bare vanskeligere og vanskeligere. Så det arbeidet vi leverer god avkastning på, fikk vi ikke akkurat drahjelp på, når markedet også ble ganske ruskete. Men vi har klart det ganske godt likevel, og jeg har bestemt meg for at vi skal også levere god finansiell avkastning. Det er noen som sier at når det gjelder skikkelig impact, har det ingenting å si om vi får et avkast på investeringen. Vi har landet på at, vet du hva, med FNs bærekraftsmål, som vi er nødt til å forholde oss til i fremtiden, så ligger det ikke bare problemer, det ligger også spennende forretningsmuligheter. Siden vi tross alt er en finansiell aktør, er det viktig for oss å vise at vi kan klare begge deler. Så vi har en forventing om en gjennomsnittlig forventet avkast på hele porteføljen vår på 8.7%. Da skal yield-kategorien helst ligge på 6. Det er klart at nesten ingen fikk det til i fjor, så det er et ganske tøft mål, men så langt ser det ut til at vi skal få det til. Jeg har lyst til å bevise at du ikke skal måtte velge, og det har jeg blitt enda mer overbevist om nå, enn det jeg var tilbake i 2012. Det er så mye som skjer, og hele dette grønne skifte har fått nye sterke drivere, så det lange svaret mitt er at vi aksepterer en lavere avkastning, fordi vi som et familieselskap må ha et langsiktig perspektiv. Det er folk som kan faget sitt som jobber her, og da skal vi også være i stand til å gi et finansielt avkast og samfunnsmessige investeringer. Det er et hjul som henger sammen.

Intervjuer: **Bruker dere noen rammeverk, f.eks. IRIS, når dere evaluerer en potensiell investering?**

Veen: Vi har valgt, dette har styret etterlyst, og en del av de nye kollegaene våre spør hvilken verktøy vi bruker når vi evaluerer en ny investering. Svaret på det, er at vi bruker vår egen kompetanse og vår egen dømmekraft, og til syvende og sist, hvis vi ser et case vi kunne tenke oss å se nærmere på, vil det møte vi har hos oss der vi treffer teamet være det aller, aller tyngste på vektskålen. Treffer vi folk som vi tror har en kraft og gjennomføringsevne, kombinert med evnen til å formidle til omverden hva du skal i gang med, så er det nesten 50% av måten vi evaluerer på. Hvis vi får en god følelse på første møte, vil vi be om å få mer informasjon oversendt, f.eks. historiske regnskap og referanser.

Intervjuer: **Hvordan kan dere forsikre dere om at de ikke bare driver med green-washing?**

Veen: Som et eksempel, i ett av bioteknologiselskapene vi har investert i sitter vi sammen med en av de beste i Norge innenfor bioteknologi. Da leser vi rapporter, konkurrentanalyser, markedsrapporter, trendanalyser og det vi kommer over. Vi har jo ikke 20 analytikere som sitter oss, så det er jo hovedsakelig 2 personer som går gjennom det. Hvis vi tror på det vi leser, sjekker vi det og sjekker med miljøet vi investerer i hva de tenker. Det er ingen metode hvor vi trykker på knappen og siler oss gjennom tjue ting. Fordelen med å være såpass få som vi er, er at vi sitter ganske tett på hverandre i diskusjonen og evalueringen av det vi leser. Ulempen er at vi ikke kan være direkte investert i så mange selskaper.

Intervjuer: **Vurderer dere noen gang exit-mulighetene i screening-prosessen?**

Veen: Jeg ville sagt at ... dette er jo veldig forskjellig. Hvis vi f.eks. skal investere i et selskap som ligger på børs, passive eiere, da er det kanskje CFO som leser det han kommer over av analyser, og så kjøper vi oss opp der. Vi er ikke store på børsnoterte aksjer. 5-6 stk. kanskje. Der vi investerer direkte, så klart tenker vi exit, men sammenlignet med PE-fond, som tenker exit fra dag én, så gjør vi ikke det. Vi tror på ideen og teamet i forhold til vår investeringsprofil og det vi ønsker å levere av samfunns-gode investeringer og god avkastning. Så går vi inn sammen med de og bygger selskapet. Vi gjør det med baktanken om at dette kommer til å bli en god exit en gang, men vi sitter ikke å tenker på det annenhver dag, og vi jager det heller ikke. Vi prøver å bygge noen verdier i selskapet og følge det så langt at vi forhåpentligvis kan lage en god exit. Og det tar 5-10 år.

Del 2: Kontraktmessige forhold

Intervjuer: **Hvordan forholder dere dere til kontrakter? Bruker dere kontrakter i hver investering, og hva inneholder de?**

Veen: Ja, litt avhengig av hvor stor investeringen er, vil vi gjøre det jeg kaller en mini-DD. Vi vil be om å få se eventuelle aksjonæravtaler, vi vil se nøye på hvem resten av eiergruppen er, veldig avhengig om det er pensjonsfond eller private investorer, så er det ofte skrevet avtaler før vi kommer inn, som kan appellere til oss, eller det motsatte. Det er enkelte typer, f.eks. Norfund eller Innovasjon Norge, vil ofte ha krav til sine investeringer, hvor de jobber inn aksjonærer på sine betingelser. Det er jo helt forståelig, og noen ganger helt okay, men hvis vi ser at de er veldig rigide, så kan det faktisk være en grunn for at vi ikke går inn, for vi vet av erfaring at det ikke alltid det er en fordel. Det blir på en måte et avtaleverk for selskapet som kan stå litt i veien for frisk kapital.

Intervjuer: **Er det slik at dere av og til holder igjen midler til dere ser at de oppnår det dere har avtalt?**

Veen: Du kan f.eks. gjøre ... Ja, hvis vi er veldig skeptiske, men har lyst til å hjelpe noen, er kanskje konvertibelt lån den «softeste» måten å gjøre det på. Men en kan også f.eks. si at man deler kapitalen i to, at man går inn med den ene delen nå, og holder den andre delen igjen, hvor noe av risikoen er fjernet litt. Men da gjerne på avtalt kurs. Det gjør vi også. Mye av det har vi god kompetanse på innad i virksomheten, men vi bruker advokater på det. Noen ganger har vi muligheter for å forme avtaleverket ganske mye, men andre ganger kommer vi inn der eiergruppen er ganske satt. Så avtaleverket er veldig viktig, vi gjør en screening selv og siden vi er såpass vektet innenfor teknologi, så har vi advokater som vi bruker til å gjøre IP-sjekken, for eksempel. Det kan være veldig forskjellig fra case til case.

Intervjuer: **Hvis dere utformer kontrakter, inkluderer dere da også et sosialt aspekt, eller ligger fokuset på det finansielle?**

Veen: Vet du hva, det er et godt spørsmål. Jeg vil si at vi ikke er så gode på å si hva det sosiale målet vårt er. Jeg vet ikke hvorfor. Jeg vil tro at det blir mer og mer vanlig. Frem til nå har det bare vært en slags selvfølge som henger i luften. Jeg må også si at fra å nesten bli litt ledd av i enkelte miljøer i forhold til profilen vår, og til nå ha et lite forsprang og til å ha gjort noen gode investeringer ... jeg har sittet i impact-selskaper med eiere som kun sitter der fordi de synes at dette virker til å være en veldig god investering, og ingenting vondt om det, mens nå kommer mye større aktører enn oss, kommer til oss på investeringer vi har vært inne på mange år allerede, fordi de har blitt pålagt av eierne sine til å øke eksponeringen for impact. Jeg er opptatt av en annerkjennelse av det som et seriøst felt

Intervjuer: **Lar dere organisasjonene/prosjektene dere investerer i ha mye fleksibilitet med tanke på hva pengene skal brukes til?**

Veen: Jeg tror at vi har rykte på oss og er kjent for å være ganske tolerante eiere. Men det er fordi vi har en grunnleggende tro på at eierne av selskapet vet hva som er best for selskapet. Når det er sagt, så kan det skje ting, utvelgelser og selvfølgelig retninger [...], hvor vi kan bli oppfattet som enormt krevende og veldig engasjerte. Da er aktivt eierskap ganske krevende. Men vi har nok en unormalt stor ydmykhet for teamet i selskapet, med mindre det tar av i helt feil retning. Vi tror på gode folk og gode ideer. Det som vi virkelig kan bidra med er finans-kunnskapen og hvordan man kan sikre finansieringen fremover.

Intervjuer: **Investerer dere som en majoritet- eller minoritetsinvestor?**

Veen: Det kommer helt an på, men jeg ville sagt **aldri** som majoritetseier, fordi vi tror at de som har startet selskapet vet best. Men hvis vi havner som den eneste finansielle eier, og man havner i en situasjon hvor de trenger mer kapital, er det tungt å være den eneste finansielle eier. Men majoritetseierskap er ikke viktig for oss.

Del 3: Etter investering

Overvåking og måling

Intervjuer: **Har dere noen spesifikke rapporteringsverktøy?**

Veen: Altså, da kan man jo begynne å tenke for hver enkelt investering, for oss å gå inn og finne ut i et selskap hva de hver for seg bidrar til FNs bærekraftsmål, er svært vanskelig. Jeg tenker ikke at vi skal gjøre det i detalj, men jeg vil finne en måte vi kan gjøre det for oss selv. Det er, globalt i dag, ikke et felles verktøy for å kunne gjøre den kategoriseringen og lage de ulike knaggene å henge det på. Det er tusen spørsmål å svare på der. Hvis vi f.eks. investerte i et solcelleselskap i stedet for olje, hva bidrar vi med da? Hvis vi tar det solcelleselskapet i stedet for det andre, er det noen forskjell der? Jeg tror vi kommer til å ende opp med noen verdier som sier blant oss i finansbransjen, prøve å flytte kapitalen denne veien, som er den bærekraftige veien. Hvilken bidrag er det, tror jeg vi kommer til å ende opp med.

Intervjuer: **Er det da i kontrakter du ser for deg at de finansielle og sosiale målene dere har, blir møtt?**

Veen: For å prøve å svare litt bedre på det dere sier der: Hvis vi hovedsakelig investerte i impact-fond, ville vi nok vært mer opptatt av å få den rapporteringen. F.eks. Grieg Invest, de har en gjennomlysningsmetode hvor du i porteføljen du har som kunde i fondet deres, har en mulighet for å lese fotavtrykket i prosent for hver enkelt investering. Den er **ekstremt** bra. Det er det beste som finnes av det som har blitt lagt i Norge, vil jeg si. De har brukt 10-15 millioner NOK på å lage den. Men sånn som nå når vi investerer direkte, har ikke vi som krav om en egen rapportering på hvordan bidrar du til mindre søppel osv., det blir mer en generell rapportering på at selskapet er tro mot visjonene og planen for retningen. Vi har ikke noen rapporteringsplan, men i de fondene som vi i fremtiden evt. vil gå inn i, det kan hende at vi tvinges litt til å gjøre, siden vi har såpass mye penger som settes i arbeid.

Kontroll

Intervjuer: **Hvis dere oppdager at de ikke presterer som planlagt, hva gjør dere da?**

Veen: Vi har helt siden 2012 sagt at vi ønsker å investere i selskap som har teknologi som gir befolkningen tilgang til å lettere kunne bli diagnostisert enkelt, f.eks. når det gjelder hudkreft. F.eks. for bioteknologiske selskaper, har det lenge vært et belastet område, men med et ordentlig regelverk og den nye generasjonen innenfor bioteknologi er det jo fantastiske muligheter for å kvitte oss med sykdommer for alltid. Hvis noen av disse selskapene tar helt av eller plutselig ikke følger helt det man har blitt enige om, om man ikke er majoritetseier, er måten vi gjør det på å bruke styreplassen vår først og fremst. Vi sitter alltid i styret når vi er aktive investorer. Hvis man ikke når frem der, vil man prøve å utøve en maktbalanse, f.eks. oss sammen med de to andre utgjør en majoritet.

Annet

Intervjuer: **Fokuserer dere hovedsakelig på pre-screening eller post-monitoring? Eller fokuserer dere like mye på begge deler?**

Veen: Det er 50/50, vil jeg si. Fordi man som regel vil være aktiv, gjør vi et veldig grundig forarbeid. Da når vi går inn, da liker vi de vi går inn i, enten folkene eller produktene. Altså der vi er passive, bruker vi 90% av tiden i pre-screeningen, og der vi er aktive er det jo helt klart etter vi er gått inn som er 90%, og så er 10% pre-screening. For når vi er passive er vi jo passive, og da blir det liksom å selge deg ned eller opp.

Intervjuer: **Har du noen forslag til hva som kan bli gjort for å gjøre investeringsprosessen mer overskuelig og gjennomsiktig?**

Veen: Ja, i fjor gikk Verdensbanken ut med noen kriterier som må innfris for å kunne kalle deg en impact investor. De fikk jeg aldri sett, og jeg lurer på om de noen gang kom. Så den ville jeg faktisk ha etterlyst litt. Det var snakk om å lage 5 kategorier som man da må svare til for å kunne stemple seg selv som en impact investor. Kjempegodt forslag, synes jeg, selv om jeg aldri har sett dem. Jeg tror det kan være veien å begynne. Jeg tror vi må begynne litt globalt, og si «her er kriteriene», og folk kommer selvfølgelig til å si at dette er helt ubrukelig og for mye osv., men da begynner man gjerne fra et sted.

Intervjuer: **Har du noen oppfølgende spørsmål eller kommentarer?**

Veen: Dere peker på mye interessant og viktig, og så er det jo en veldig forskjell om man er et fond, familieselskap, etc.

Respondent: 6

Interviewee: Espen Daae
Company: Ferd Social Entrepreneurs
Date: 25.04.2019
Duration: 00:50:07

Introduction

Interviewer: **Could you tell us a bit about your background and experience with impact investing?**

Daae: Sure. I am a chemical engineer by training, I studied in the UK, I have a master's degree in chemical engineering with process by technology, did my master's thesis on lifecycle assessment of renewable energy problems, basically whether you should recycle or burn paper in the UK […]. I started working in the environmental energy space right away, mainly in London and Oslo doing renewable energy investments first, and then life science investments in a venture capital setting after that, worked a lot with the big problems such as energy sufficiency, renewable vs. fossils, and worked a lot with the big life science problems such as Alzheimer's diagnostics and development, and in the last 4 years I have worked with Ferd Social Entrepreneurs (Ferd SE) where I focus on social innovation and social entrepreneurship in particular, investing in social entrepreneurs in the Nordics, where they try to achieve societal change in a commercial way. It is not mainly philanthropic, it is venture philanthropic.

Interviewer: **Could you give us a brief overview over Ferd SE and what you do there?**

Daae: Ferd SE is a not-for-profit part of the Ferd conglomerate. Ferd is a family office owned by the Andreassen family, it has 30bn NOK under management, and the majority is commercial investments, property, major industrial holdings, hedge funds, listed equities. And Ferd SE is a "darling" of the owner, where he has a personal motivation and a personal interest making a difference. So that ambition flows all the way to division to division, whereas in Ferd SE we focus on it specifically, it is kind of a part of the ethos of the company. So we have some core values that focus on leaving lasting footprints and creating value, and that flows through the whole company.

Impact investing – Concept

Interviewer: **Could you elaborate on the investment types you engage in? E.g. asset classes etc.**

Daae: Sure. We do some grants, equity investments, guarantees, convertible loans, and the ticket size is typically from very small, so-called seed money, to maybe 20 million NOK per investments, some of them are larger, up to 30-40 maybe, but typical ticket size for equity investments is 5-15 million NOK. When it comes to grants, there are mainly 1-2 million NOK per year over a period of 3-6 years, and they are contractual grants where you enter into an agreement for a period of time where we provide certain visibility during that period. So stage vise it is early stage. It is angels/venture stage, and we are typically the only professional investor in many of the companies, and we are trying to help them become commercial earlier and help them scale their business models, so it is growth capital/expansion capital if you like. They have proven their social ambition, but they have not necessarily proven the commercial potential of the business model. Geographically, it has been mostly Norway related, recently we have made some investments outside Norway, we made one fund investment in Denmark.

Investment process

Part 1: Pre-screening and due diligence

Interviewer: **Could you please describe the pre-investment process in terms of pre-screening and due diligence?**

Daae: Sure. We typically get a lot of deal flow that just comes to us and people contact us because we are among the few investors that are willing to invest in the sector. So we see a lot of deals, maybe 3-400 per year, and lot of companies we see many times. So we would typically have a dialogue with the companies over an extended period of time, where they will come to us with an idea, they would gradually develop the idea, and at some point we will think that they are ready. We have a two-tier investment process: We have a foundation year where we typically invest maybe 500.000 NOK, and provide them with additionally support where we provide a network, competencies, competence screening, help them put in place governance systems, strengthens the board and get to know them. So the first year is kind of getting to know each other and see if we are right for each other. Before that, we screen them both for impact, intentionality, we screen them for a business model that is robust enough to scale, and we do due diligence on the legal side, business side, organization, impact, theory of change, we do some market screening and check with customers… Typically, the companies we take into the foundation year will have 1-2 employees and have 1 million NOK of turnover and they are looking to scale. They have proven that there is a willingness to pay, but they have not gotten everything in place. And then if that year works, we can take them on to a 3 year program, initially, where we provide 1-2 million NOK, and we provide a physical board member, so we would add a nominate from Ferd, or other divisions in Ferd, or from a portfolio company, or from our network. We try to build an independent board with them and follow up on them shoulder to shoulder over that period of 3 years. The initial year is milestone-based, and the 3 year full program is definitely milestone-based. So this is on the grant side. We can mix and match between grants, loans and guarantees, we have done all, and on the equity side it is a much more standard investment process where we typically go out and get external due diligence by lawyers and do … you would recognise it as a kind of standard venture capital investment process, but without being a voucher capitalist, it is venture capital. It is venture capital with a heart, if you like. I think it is also worth mentioning that compared to a traditional venture capital process, the social entrepreneurs have a really strong social ambition and are typically not that fuzzed about making money. We need to understand their motivation but also their capacity to stay in the game, and quite a lot of them have funded their companies from their personal pockets, maybe gone without a salary for a long time, and we need to understand the transition from being a really poor entrepreneur with a burning passion for something into a company that is run in a professional way. And that requires an additional due diligence element on the individual. We can either do that externally, but typically we do it internally. We get to know them and speak to them over an extended period of time. We get to know the individual. In 2018, we started an accelerator, it is called Social Startup, and we ran it in 2018 for the first time with a 125 applicants, 35 companies to a boot camp, and we then followed them for a period of 6 months, and as far as pre-screening goes, that is a good way for us to get to know the companies and see if they are investment ready.

Interviewer: **Could you tell us a bit more about the criteria you are using when evaluating a potential investment?**

Daae: We are social-first, so for us, we do not have any return criteria. We are funded by the parents which basically means that we can really fund the companies in terms of focusing on the social, and help them gradually become financial independent. So we are looking for a business model that is scalable, we are looking for the social impact to be the core of the business, we are not looking for TOMS Shoes kind of business where you make money and donate shoes, we are looking for a perfect integration of the activity of the company and the actual impact created. We are looking for something that can scale both nationally, but potentially also internationally. Sometimes we take something that works outside Norway and take it to Norway, and sometimes we help companies grow outside. I think at the core, the ambition of the entrepreneur, so we are looking for a passionate entrepreneur that is coachable. Quite a lot of them are so strong and so convinced that they are not necessarily the most coachable people in the world. And then humility and ability to work in a team sometimes have to be developed.

Interviewer: **Do you use any globally accepted frameworks such as the IRIS when you evaluate potential investments, or have you developed your own metrics?**

Daae: We have developed our own screening system. We are doing a key metrics in a diamond that we draw and we have certain ways of presenting that, and we have also developed a competence radar where we screen and interview the companies. Primarily in the foundation year, we work with them to see where we can add some value, where they have needs, and we monitor that over time. So every year or every 6 month we go through that again and see how it developed. We also take that on the accelerators, so the early-stage companies are also screened in the same way.

Interviewer: **It is interesting to hear this, because according to theory, investors use those standardised methods, while none of the investors we have talked to so far have actually ever used them.**

Daae: I think some of the screens are propriety, and there are companies that are trying to sell you software or trying to make a living as an entrepreneur selling a screening software. I do not think the market is there **yet.** Most people in the business are using their own systems, and some are just basically relying on the face factor, like 'I like this idea and I will just invest in it' Because the amounts are relatively small and it does not always justify full due diligence or full commercial screen. So if you are investing 1 million NOK you do not want to spend 250.000 on pre-screening.

Interviewer: **How do you evaluate impact risk and prevent goal misalignment?**

Daae: Well, we do milestones agreed on in advance, so let us say that for the 3 year program we do 6 milestones, we give them a payment upfront signing, and we agree on certain impact goals and commercial goals, and quite often the commercial goals are staged towards being self-sustained. So in the end of the 3 years the goal is to have a 100% of your cost covered by revenue. And let us say you start at 50, you kind of percentage vise cover your costs to a higher and higher degree, until you reach break-even in the end of 3 years. That is pretty much a standard goal. And then we have that each of the companies have certain KPIs they work towards, and then we will agree on improvements to that, and sometimes they reach them, and sometimes they do not. We are not really too strict on enforcing, and we happily renegotiate if we have to, but it is a way of making sure that things do not run out of control. We also always have an observer on the board, from Ferd SE, and sometimes we have additional board members, also in the early-stage companies. But typically, we nominate from outside Ferd SE to make sure we do not abuse power. So we can have proper governance. Governance is really important to us.

Interviewer: **Do you ever experience green-washing?**

Daae: It is not relevant at all. I mean, if there is even a hint of green-washing you do not get through the door here. We have enough companies that really are a 100% impact, where the problem with making money is not taking something that makes money and try to make it green. So we are more struggling with the early-stage business models that are trying to sell to difficult customers, with uncertainties in the decision making, public procurement processes, trying to really make a sustained change. There is no question about the intentionality of the entrepreneurs here.

Interviewer: **How do you evaluate possible exit opportunities, and are there any concerns connected to this?**

Daae: We do not have funds, so we do not have a fixed time period, so we do not have to exit. If you look at Ferd as a company we have held investments for over 50+ years, I mean, if something is good then we keep it. We will exit when we can no longer add value. If we feel that we have either developed the company as far as we can, or if the relationship with the entrepreneur is such that we pull in different directions, then we will look for an exit. Sometimes an entrepreneur can come to us and say that they want to exit in 3-5-10 years, and then we can incorporate that into the shareholder agreement. We have done that, and quite often we have no fixed term or no fixed ambition, and it has a lot to do of why we do this. It is not with a profit motive, we are investing with relatively small amounts, in companies that will not really make a financial difference to Ferd as a corporation. So we are more focused on the social impact and helping them becoming independent.

Interviewer: **What if you see that there is not as much social impact as you wanted? Do you ever exit the investment then before planned, or?**

Daae: Yeah, that has happened, where we could basically see that the company did not develop as it should and that the business model would not become sustainable, and maybe the entrepreneur says that 'we have not managed to do what we set out to do' and then pretty much we will terminate the relationship in a friendly way. We would do it hand in hand with the entrepreneur. Sometimes we will help them scale down and sometimes we will exit. But quite often we will follow through the 3 years, and have a controlled exit. Very rarely we will exit before the 3 years.

Part 2: Contractual relationship

Interviewer: **What is your approach regarding contracts? Do you always use them, and what do they typically include?**

Daae: Let us say for loans, that is pretty much regulated by Norwegian law, so you can have a simple 1 or 2 pages saying 'there are the loan terms' and that is pretty much how we do it for loans. For guarantees, it is the same. On the grants, we have a 3-4 pages document that sets out some expectations and milestones, and on the equity investments it is a full investment agreement with shareholder agreements.

Interviewer: **Can you think of any way the contracts might differ from traditional investment contracts? Do you for example include a focus on social goals?**

Daae: Yes, sometimes we have specific social clauses, typically in the grants and the loans, we will always have that, and sometimes we will have, let us say, conversion terms that will have a social twist to them, so we will convert to a certain value if you reach these financial and social goals, and a different value if you do not. And we can use both financial and social goals for that. When it comes to equity, we will sometimes have additional provision to make sure that the company stays on track and that the entrepreneur stays, since it is very much tied to the individual contribution of the entrepreneur, and sometimes we even have specific clauses that provide special protection for vulnerable employees or target groups. If the company should go bankrupt we can provide additional funding to help these vulnerable employees to reenter the work force, for example. Apart from that, on the equity side, I would call them "nice" venture capital contracts, they have drag-along, tag-along, sometimes they have restrictions on what the entrepreneur can and cannot do, confidentiality, etc. so pretty standard venture capital contracts on the equity side.

Interviewer: **How much flexibility do you allow for the investees?**

Daae: We typically provide funding at the […] of the management, but we always insist on minority protection, so that certain things will always be required board approval, and we will typically, let us say we take on a 10-20% stake in a company, we will always have much higher control than that in the board. Not necessarily for our own protection, but to make sure that the company is run in a sustainable way. We will typically not let key decisions be run according to the normal shareholding laws, but we will have additional clauses. And typically, there will be a kind of sign-off cascade on organizational levels for certain amounts of spending that need to be approved, if you go outside the budget you need approval for that etc. But in general, our funding is not tied to any specific clauses on the equity side, they often are on the grant and loan side. So for example we can grant funding for an additional position, but that position would maybe have to be a finance person, or we need sales, so we basically allocate money to a sales person.

Interviewer: **Do you mostly invest as a majority or minority investor?**

Daae: As a whole, we often do majority investments, we want to have a significant minority stake. We do not want to own the company, we do not want to be the social entrepreneur and take over the company, and I think it would be a … disaster is not the word, but we do not want to set ourselves up to take over the companies. In a venture capital or private equity setting, if it goes wrong, you take over the company, but that is not how we do it here. That recognises that the social entrepreneur has a real lasting value to the company, and we cannot do the same work. We are investment professionals with certain skills in the field, but we cannot run the company as entrepreneurs. And again, that also recognises that the companies are typically not mature enough of survive without the spirit of the entrepreneur.

Interviewer: **Can the contracts ever be complete, or do you usually renegotiate during the process?**

Daae: I think that in our end of the impact investing spectrum, we are so heavily involved in the companies, we work so closely with them, the monitoring costs are huge anyway, it is not really a lot that I can write in a contract that would save any costs anyway. They can be renegotiated, but that is basically, let us say, you are trying to sell to a municipality, and you cannot sell, they cannot buy, it takes longer, they need more funding … we are not going to enforce a contract and take over a company if the social ambition fails to materialise. We try to help them, we will add more people, we will help them with our contracts, we will introduce them to people, we will try to find other ways around it. But let us say that we lend them some money, and they want to sell the company, we will enforce our loan agreements and get the profit of the sale, but we may not force the sale or may not be difficult, but … there is a balance there. We will only renegotiate if it makes sense. We are recognizing that we have a long standing relationship with the entrepreneurs and that we are part of their decision making … I would say we are a big brother with a deep pocket.

Part 3: Post-investment process

Monitoring and measurement

Interviewer: Have you implemented any impact reporting requirements?

Daae: Yes. We have an annual impact report that we publish at Ferd SE. All companies are required to report annually on agreed parameters, so we try to aggregate, that is not always easy, but we are looking at high and low impact and high and low intensity as kind of aggregation premises, and then we report on individual KPIs as well. We support our companies in publishing and support them in impact management strategies, we help them develop frameworks … but there is always reporting requirements. And recognizing that these companies are very different, and quite a few of them are at an early stage and have not done this before, we have to be pragmatic about it. We cannot really expect a company with 1-2 employees to do a full impact management report.

Interviewer: How do you measure social impact?

Daae: We try to map the activities, the outputs, the outcomes and the impact and if you look at what social value the UK are doing, they have a pretty comprehensive approach, we also look to what Bridges Asset Management are doing, so in the UK, the companies are pretty good. And it is basically … if you do a certain thing, you have a theory of change, you think something would happen, you look at what results you get, you will measure that. You will say, well, if I get this result, I will get this outcome, then you look at the outcome and see if that matches a certain social impact. You can either do that by benchmark or by research or whatever, and then you can say, well, I did not get my intended impact so I will change my activities, or I am going to do more of my activities to get my intended impact. So it is a pretty standard theory of change.

Control

Interviewer: How do you monitor the investments in terms of financial and social results? Do you for example do field trips or get involved in the investee?

Daae: Very involved. We attend every board meeting, we have workshops with them 2-3 times a year, both on marketing and media strategies, we do workshops on impact management, we help them with financial workshops and stuff, and we also invite them in twice a year for a joint two-day workshop for all the companies where we all meet and discuss various topics and things that we know that are relevant to them and things we want to communicate to them, so we have an annual process where we meet twice a year. And also the impact reporting is the responsibility of the board, so the board has to process it and sign up on it. In addition, impact is a subject on every board meeting. So it is very much a part of the everyday business for these companies.

Interviewer: You said that you take on an active role in the investees, but how do you respond if they do not perform as expected?

Daae: If it is poor performance that we can control, we will help them by adding resources, we will add consultants, we will help them with training and introduce them to different customers. We basically try to do business development with them shoulder to shoulder. If it is outside of their control, we might change some milestone payments, if they are doing a really bad job, we will tell them, but very rarely we will enforce our rights. I mean, we are a 30 billion company, we could rule over these small entrepreneurs like we want to, but that is not our style. So we really try to work our way out of the problems with them, and I think we differ from a few others where we would probably assume some of the costs into in doing that and help them, rather than being brutal. And sometimes we see that companies … that the whole basis for their social ambition has fallen away, the market is not there, and then we help them kind of to rewind, exit or scale down. But that is very rarely. We are trying to help them.

Interviewer: Would you say that you put most focus into the pre-screening part or the post-monitoring part?

Daae: Let us say … the due diligence and the pre-screening will cost €10.000 and require 40 hours of work. The post-monitoring, the kind of daily involvement with the company, will cost 5 hours a week, 52 weeks a year, times 5-10 years, you are talking a few thousand hours. It is not even close. So we are investing our network, our competencies in addition to our money, so most of the companies that comes to us, comes not because of the money, but because of the additional value added. Very, very clearly. What we do in the beginning, is to see whether we think it is a good fit, and then we spend all the time in the world to help, to actually discover how we can just help. I think we are different t many others because we are more focused on the social return than on the financial return. and if you have a fund and need to make a financial return, if you have a hurdle rate or whatever, you need to be much more efficient in the post-monitoring phase. And my guess is that you would probably still have twice the costs in the post-monitoring than you would have in the initial pre-screening, maybe three times.

Other

Interviewer: So do you think investors that are financial-first would focus more on the pre-screening since it does not require that much effort?

Daae: Yes, that makes sense. But I think in general because of the impact management reporting and the frameworks you have to follow, it is more expensive to do a post-investing monitoring in an impact investment, than in a non-impact investment. However, I think that will change as everybody will have to impact reporting. Quite a few of the investors in general in venture capital, you would like to invest with your friends, so you only go in with one or two other companies that have the same focus as you. Here, I think mainstream investors that are looking for a financial return would quite happily go in with somebody like us to rely on us doing all the hard post-monitoring work and the impact management and the shoulder to shoulder and all that, and they could kind of be the financial skimming the surface. We do not really see that yet, but I think there could be a market for that.

Interviewer: Do you think there is anything that could be done to make the whole impact investment process a bit more transparent?

Daae: You could speak to students that ask questions for their thesis, ha ha. No, seriously, venture capital is pretty much a close business, so you invest with your friends and you do not share a lot. I think sharing, be open about the processes and inviting companies and investors into impact investment will help. We are trying to do that, we are trying to invite more investors invest alongside us, and we are offering to do a lot of the work to help grow the field. I think we will have the opposite problem very soon; there will be too much money chasing too few deals, and the investee companies can pick and choose at high valuations. So I think there will be kind of a divide between those who are good at presenting themselves and will attract a lot of money, and they will have both a financial return and social return, and they can pick and choose, and then there will be all the others that do not have a clear business model and it will be tougher. I am not sure that an angel investor investing 200.000 NOK into a company because they like the idea will ever have to worry about investment frameworks, IRIS, benchmarks and stuff. They would have to rely on somebody who says that it is okay. And the problem is costs. If you are a small company looking for small investments, it is quite hard to get across the due diligence, because it will cost you €10.000 anyway to get a lawyer involved, and I am not certain it makes sense for the investor or the investee to make it too difficult. I think it is … you have to put good governance processes in place and you have to have a good shareholder agreement, and educating social entrepreneurs or impact companies on what a shareholder agreement typically **should** include, what the clauses are, tag-along, drag-along, certain rights that are okay and that are common. I think that makes sense, to actually teach the community that you have to sign the shareholder agreement and you have to agree on certain terms, and you have to accept that somebody who investing 10% into you company will have the rights of a 40% investor. And unless you accept that, you will not get investors. So I think there is a certain educational need among early-stage companies, and there is a certain educational need for investors that you can get a financial return at the same time as you get an impact. Because most people do not seem to believe it. And weighing those two up, I do not think you need the framework, you just need a good presentation, good documentation and skilled entrepreneurs.

Interviewer: **Do you have any additional comments?**

Daae: I think it is a good topic.

<u>Respondent: 7</u>

Interviewee: Regitze Makwarth Olsen
Company: Nordic Development Corporation
Date: 29.04.2019
Duration: 01:00:25

<u>Introduction</u>

Interviewer: **To begin with, could you maybe tell us a bit more about your background and experience with impact investing?**

M. Olsen: Yeah maybe I should just start maybe just an overview of my invest? My invest, is an asset manager. We have two business areas which it's a traditional asset management with listed companies where we have portfolios both stocks and fixed income. And that's offered to both institutional investors and been adviced in-house. And then you have mutual fund also called Investeringsforæningen Maj Invest, which offers our products to two retail clients. And the other business areas private equity where Danish private equity with five funds investing in Danish companies, and then we have two microfinance funds investing in financial inclusion banks in South America and Latin America, Africa and Asia and then we have two funds investing also in traditional private equity in Southeast Asia as well. And I'm responsible for responsible investment both in asset management, so the listed portfolios and in private equity both Danish and and the financial inclusion funds. But my main focus is is the two financially inclusion funds with the social impact strategy we have there. Yes I mentioned that i am a CBS graduate and my experience with ESG started, or impact started when I got here. So I filled up all my knowledge and experience from my position here. I havent worked with the ESG and impact prior to the beginning here.

Impact investing – Concept

Interviewer: **Can you tell us a bit about the types of investments you engage in? But could you maybe elaborate a bit on the asset classes and the size of the investment, stage and etc.**

M. Olsen: So on in financial inclusion those two funds. We invest in unlisted companies, it's debt. Actually it's the ticket size is typically between 10 and 25 million U.S. dollars. And that usually constitutes a minority position of 10 to 30 percent in our portfolio companies. So we always go in as a minority investor. The companies are in the top segment of microfinance institutions, so they could own, they could actually be regulated banks, they could also be institutions defined as non-banks financial institutions and be advise. Or in mirco, or well-established microfinance institutions. So we go into the companies after they have developed from NGO, maybe started as a financial institution and then the next level. So they're always pretty well established when we go in, and then we keep develop, there still needs to be potential for development or growth. But we do tap into the to the regulated institutions established.

Interviewer: **So you don't invest that much in startups and early stage business?**

M. Olsen: No, not at all actually. That's with this strategy.

Interviewer **Yeah I guess it also is connected to a bit more risk.**

M. Olsen: Year, it is our experience that the partners are more experienced with the well established banks. Yeah. So that's that's our business area thats our defined investment strategy. Yeah. Yeah.

Investment process

Part 1: Pre-screening and due diligence

Interviewer: **Could you also maybe tell us a bit about the pre-investment face?**

M. Olsen: So we always carry out of course a due diligence but the pre investment phases can be quite long. From the companies which are in our pipeline it can be maybe one are up to two years before we actually invest, and before the transaction goes through. So we are in dialogue with other actors in the market, other investors, we discuss usually for a long time with the company trying to make the like the contractual factors, and so one. That's quite a long process before we go into a company before we invest. Once we decided to invest we do of course a thorough due diligence which is both legal, financial and also social. So it has three factors in the due diligence and more specific about the financials and stuff. I don't know much about diligence but it is a part of the process.

Interviewer **Do you know if you put a lot of focus on the social aspect of it or?**

M. Olsen: We define ourselves as a financial first impact investor. The financial is always our first target and our first priority. But we always ensure to invest in companies that also have a social mission because it's necessary in the financial inclusion industry to to have a social focus. I forget the word... As a wall climbing crew. So it is important for us that they do have a social focus and a social mission in their business. But we don't have specific targets, social targets. It could be for example that we will only invest in companies that have at least 50 percent female clients. It could be whatever target. But we don't have metrics like that. Obviously. The financial potential for growth is a sound business. And then report on other social factors afterwards.

Interviewer: When you evaluate a potential investment do you use any standardised frameworks like the IRIS or similar?

M. Olsen: The social part inspired by IRIS. We don't use it from from A to C but then there are a lot of different indicators. So you can actually pick different indicators that are relevant for your portfolio. We have, we have defined which you also see the report, we've defined six social indicators that we report on and that we monitor. When we have an investment and they're inspired by the SMART campaign which is that client protection principle. And they were inspired by IRIS and the social performance task-force. So industry standards are the background for our social indicators and monitoring.

Interviewer: How would you evaluate the impact risk, for example, that the organization you invest that don't share the same social objectives as you do? Or for example if you agree on a social result before the investment and then you see that the organization does not follow up on that?

M. Olsen: Well. So we we always have a very close relationship actually with the portfolio companies. We usually have a board seat that's the only requirement. We have made exceptions to that but then we usually get a forward observer seat. So we're always taking part in the boards, board meetings and receive board material. So we are always in a close dialogue with the companies. In our contract, we include the, like mission trips prevention. So they should keep, it is a requirement from us that they keep their social mission. That's actually part of the contract. So it is it is crucial for us that they keep and maintain a social mission throughout the entire investment. We haven't experienced yet that a company has wanted to change its whole mission or vision in terms of the social part because it is, it's part of the sector too, it's part of the industry, part of the mindset. But it's crucial for all of the investors that they keep their social mission. So on the investors part, everybody in story said they have a social mission. So we haven't experienced it yet but if it were to happen, we would of course, with our investors, co-investors, we would engage in close dialogue again and discuss with the board. We also have the power to replace management. So we have a whole process that we could like initiate, if a company were to breach any social factors or any other factors for that matter.

Interviewer: How do you evaluate possible exit opportunities? Are any concerns connected to this. If you for example invest in developing countries or?

M. Olsen: Yeah exit also I know that there are a complete strategy. But we always discuss, we invest usually together with like minded investors and we have a very close relationship actually with our competitors and other investors. So usually we engage in close dialogue with other investors and then an exit process can also take up to one to two years maybe, finding the right investor. Has to be the right time for exit in terms of the valuation price and so on. So, but we don't have like we don't have any requirements for our exit in terms of which investors should buy an exit but it will typically be a like minded investor because you have to have some knowledge about the sector and the industry to invest because otherwise you cannot contribute to the company. And usually the companies the portfolio companies also want the experienced investors from the sector because they want to develop and they want someone who can help them still grow and contribute to their business. So its just kind of a closed sector with like-minded investors going in and out of the companies.

Interviewer: Do you evaluate the exit opportunities in terms of, if they were to breach a contract. Yeah like if they weren't to follow up on what you agreed on in the business plan?

M. Olsen: And so what we do in that case. It's part of our risk assessment. Yeah we havent yet exited a company, in any case, based on a breach on anything. Okay, so it's always been like a calculated and planned exit. Yeah. So we've never exited a company prior to to deadline. We have the companies five to seven years. Unless a really good opportunity comes up.

Part 2: Contractual relationship

Interviewer: The next part is actually that contractual relationship. But should we skip that one or?

M. Olsen: I think some of the questions I can answer.

Interviewer: Do you know if the contract would include any social goals?

M. Olsen: Not goals not no. Because we don't set targets or goals but they do include, like I mentioned, the mission drift. So they have to maintain their social mission. And they have to have a social focus but we don't have specific targets or goals that the company should do. Not in the contract. I have already said we are a minority investor. And we always ensure board seats. We always have contracts. We always had a shareholders agreement with the company of course. And we usually also make an agreement between these investors. So there's investors agreement as well, between the, there may be three to five six investors in a company. So we also have an agreement. On our collaboration with the company.

Part 3: Post-investment process

Monitoring and measurement

Interviewer: Have you implemented any impact reporting requirements?

M. Olsen: Yeah absolutely. We do require that it's included in the agreement, the shareholders agreement with the portfolio companies that they have to make a social impact report every year for us. Most of them actually report to me every quarter with a small report and then on an annual basis where we see the Social Impact Report or ESG report from the portfolio companies. So we monitor that every year and quarterly basis through board meetings, and then based on their reporting to us we make a report for each fund to our investors on an annual basis, and also report, or report quarterly just with a smaller reporting overview every quarter to the investors. And we started that, the business area has existed since 2010 and we started formalizing and organizing the social impact reporting in 2013. So in just a couple of years. Yeah. Whether it was before my, I started in 2013.

Interviewer: Do you have any idea how we can actually measure the social impact? I mean it's very widely discussed and there is no specific answer to it yet. What is your approach regarding that?

M. Olsen: It's it's very difficult to measure the outcome of the impact or to measure the impact and it's a big or a huge discussion area in the sector in the industry or if you go to Impact conferences everybody is discussing how can you measure this and what is the real impact? So we've started out slowly in our reporting but we don't actually measure impact, or we don't measure the outcome. So we report, like what's the outreach, how many women do they target. What is the portfolio risk? So is it a sound loan portfolio? Do they take savings, because they can also be a protection of their clients? And client protection. Do they have certifications like industry standard certifications or ratings? So we are more about monitoring what they do and reporting our indicators that we have chosen but we don't measure the outcome as if it's defined in the industry. Our method wouldn't be defined as as measurement, it is more monitoring and reporting on the information that we get from them, from the companies. But that said, so like we monitor and ensure they have a good corporate governance. That's part of our board work. We ensure that if they, if they would take their clients. If you heard about the SMART Campaign of the client protection principles and seven principles that focus on client protection, so prevention of overindebtedness, the range of products and services, prevention of client data grievance mechanisms, and so we monitor and ensure that they have a certification like the SMART campaign or similar. So in that way, yeah that's like our approach to the to the social part.

Interviewer: And in that part do you also use one of those big standardised frameworks or have you developed more your own metrics that you use for reporting?

M. Olsen: It's our own based on the standards that are in the industry. Again the IRIS, the SMART campaign. Yeah. So we have to find our own indicators which we believe are important or that we know that are important in this sector. And our investors focuses in particular I think on women, protection of women, outreach to women, and also like protection of overindebtedness or prevention of overindeptedness, and then grievance mechanisms, or the possibility of being able to make complaints to the companies, and how complaints are handled and the treatment of the clients. How are they treated by the loan officers in the field. So those are like before. And then also community programs like, do they provide non-financial services like educational programs skill training maybe some health services or other, non-financial services. So those are like the five primary areas that we believe are important and that our investors also care about.

Interviewer: Is that the same you screened for beforehand?

M. Olsen: Yeah I guess actually, this is the same, we look if they have community programs. Yeah. The smart campaign, which has these seven principals, all of those. How did they treat clients? What's the portfolio, is it a sound portfolio? There's no sign of overindeptedness with the clients. Outreach to women. How many branches. Are they in rural areas or are they like in areas that are less or unbanked. So yeah. So it is more the same, more or less the same we look into doing due diligence and monitoring.

Control

Interviewer: And how do you for example monitor the financial returns compared to the social returns. I mean now you already explained about the social returns but, the financial returns that you're just monitoring a traditional way?

M. Olsen: So we had like, you have a couple of analysts and an associate that monitor the companies that report to us every month or every quarter. So they analyze all the data we get from the companies, and they also check with them with them, there are some like in South America and India. They check with their reserve banks. So the companies reports to the Reserve Bank, it is the data matching unit. So yes I agree we have a financial team connected to our department as well so they do all the financial monitoring and reporting and we report to investors also on a quarterly basis, financials of the companies.

Interviewer: Is the monitoring based mostly on this reporting or do you ever travel to see the situation by yourselves?

M. Olsen: So the investment managers and the calmness they travel all the time to visit the companies because they also participate in board meetings, so they visit both prior to investments or during the due diligence and even also before we would do like the official due diligence, they will go visit the companies and go visit some of the branches in some rural areas or if it's in the city. And then of course during due diligence they will visit again with a due diligence team and then they go visit the companies on a quarterly basis usually in relation to board meetings. So we do actually go see what are their operations like. And like I said I've been twice, I've been to South America and India. To see the companies and how are they doing, and talk with some clients and to see that they're not just greenwashing. And like I mentioned most of the companies also have maybe a social rating or a rating by a smart campaign where it's a third party certification. So they actually, so I just, in India I attended, there's a rating agency called XXX rating. They cover like, I think both Asian Africa, and, Latin America. So I joined a consultant who did a four day survey of one of our companies in India. And then they would do so, they will make a conclusion and make a social rating of that company. So they interview like the entire management team, they go visit the field officers, talk to clients, and make the rating. So we do also use third party ratings because of course sometimes when we go as investors they want to show us, of course, the good story. So we also need like a third party to go see if everything is aligned that they say and do and wright.

Interviewer: **Do you sometimes take on an active role in the organizations that you invest in?**

M. Olsen: Yeah. A lot actually. As a board member in our, our - I don't personally, but it's the investment managers and the partners. They have a very active role and we're a very active investor because we want, we always step in to make the company grow. They're not necessarily in problems so, when we enter, mostly they're not. But they want they need help and they need experience. People in the board. In order to make them grow and develop as a company. And that's where our team of investment managers come, in and they have more than 20 years of experience. Most of them in this sector. So, and also because they have there in the board and many other financial inclusion companies and MFI so they can say like the best practice from one company and then you sit in another company. So yeah. So we are a very active investor.

Interviewer: **Can they also advice on the social side?**

M. Olsen: To some extent I would say. They have their focus is mostly on the traditional element of the company, but of course they have a discussion with the companies if they should do like a SMART certification or any social rating.

Interviewer: **They know about ESG probably?**

M. Olsen: Yeah I would say they have focused governance, like corporate governance is of course a big focus and it's part of their ensuring that they have the right policies and procedures in place and the board of directors is stuff like that according to regulation. So they check of course the regulation and everything, so corporate governance is a big part of their role, and social and environmental a bit less.

Interviewer: **Do you know how the investment managers, for example respond if there is any poor performance of their organizations? Do they have an intervention or do they use their board rights or?**

M. Olsen: So they, even though were a minority investor like, the investors of the company usually have the same mindset and have the same requirements which is for the company.

Interviewer: **So, as a minority, are you also protected by the shareholders agreement?**

M. Olsen: Yeah yeah. So we have minority rights and together with the other investors we have seen some companies replace management for poor performance. So we do actually have a lot of leverage in the companies.

Interviewer: **Do you also for example use contingent financing? That your funding is set contingent on any kind of performance, because sometimes they can release**

more funds if they see that the performance goes in that direction they wish for.

M. Olsen: To my knowledge no. No we don't have targets when going in, like that. No not usually. Sometimes we are provided with the opportunity to make additional investments in the company. They have like, if they release more shares or later on. And then we would of course only do that if it was a sound business opportunity. Yeah. But I don't believe we have any contingencies like that or any requirements.

Interviewer: It seems like it's more common for early stage?

M. Olsen: Maybe yes, there's more uncertainty. Yes I could imagine that probably isn't, like again our companies have pretty well established.

At last

Interviewer: Do you think that you spend more time on the pre screening process or is it mostly focus on that post monitoring of the investment. Because I guess there are a lot of different costs and time consumption connected to both methods.

M. Olsen: Yeah I think we do actually spend a lot of time pre-investment, we spend a lot of time finding the right deals, the right opportunities. Making the right contractual relationship. The company's discussing with other investors in the companies, assessing the company. So I would say the deal processing, I would estimate it's more equal time consuming as monitoring. Of course there's a lot of material to read. There's a lot to do in case, especially if there is some issue with the company that needs to be taken care of. That takes a lot of time of course. But if the company is running smoothly and it's just about monitoring the board meetings it's less time consuming. So I think it also depends on whether there is an issue with a company. But the due diligence in the pre-investment process is very long and very time consuming. So it is my estimate that it's in most cases more time consuming.

Interviewer: Yeah I guess it takes a lot of time to find the right investor, to actually make sure that this is something that you want to spend your money on.

M. Olsen: Depending on which country is, like in Latin America they have very very strict rules for flying investors usually entering into the country. So sometimes you can spend six to twelve months just in the legal stuff where our legal department is in communication with the legal department of the company and the financial regulator also in the country. So so that can take a lot of time as well. Yeah it's a lot of bureaucracy.

Other

Interviewer: Is there something you think that can be done to make the whole investment process a bit more transparent? Because right now there's a lot of confusion about it.

M. Olsen: Yeah I would, I would like that there was a defines who will say these are the 10 - 15 indicators that you should, that you should monitor and measure on, and report on and then that would be equal for all impact investors in the financial inclusion industry. It really is a jungle to find out which indicators should be used, what you should measure. We've looked also at our competitors and collaborators. In terms of what should we report on, and what to monitor. We have sometimes had small share information and experience meetings just to see what do you do? What can we do? What will work? So we have we have actually done that you know. So that relation I think we have a good relationship with our competitors. And work well, we had we had a very close relationship with IFU here in Denmark. Its a, they go usually in an earlier stage than we do, it's like a governmental... I don't remember

	what they're called, they're in the report. Investing in emerging markets, and they're go in, typically in NGOs and they have really great focus and well-developed social impact strategies for going in. So we've probably learned a lot of them in the beginning in particular. And defining also our indicators. Yes I think there is a good good spirit in there among the investors in the industry. But I would really appreciate a set of defined indicators, targets, goals, that everybody could use and compare because also all our clients and investors in the funds they cannot compare the funds in terms of social mission.
Interviewer:	**That's what we heard also other investors say and as for example, it's very difficult to compare social investments and environmental investments because the outcomes or outputs are so different. It doesn't really exist a framework to measure or to compare those investments. It is also so subjective what is considered better to measure.**
M. Olsen:	Yeah. So it really is difficult to do this. But maybe it's because it's so maybe a young industry in the regulated parts so. It might come, but it is it's very difficult. Yeah. Mm hmm.

9.3 Appendix 3: Coding of the interviews

The original matrix in excel included all of the seven respondents, however, due to limited space, we choose to present an example of one respondent in the appendix. This choice is made as the intention behind the appendix is to make the reader understand how the primary data was interpreted, rather than to read a summary of the transcribed interviews.

The following factors were highlighted:

Impact (social / environmental)	Green
Financial	Red
Screening and due diligence	Blue
Risks	Orange
Contracting	Purple
Measurement	Dark green
Monitoring	Pink
Control	Grey

Q.	Constructs	Specified	PfC: Ingrid Stange
1	Investor preferences		Purpose is always the social I am an impact-first So the post-monitoring…we try to reduce risk by our own involvement

2	Investor preferences		Direct equity, fund investments Start-ups and early-stage businesses
3	Pre-investment process	Pre-screening / due diligence	Never consider anything that does not have a strong social or environmental value Pre-screening in terms of what is the purpose of the investment Social goals always clear, but also look at financial return
4	Pre-investment process	Evaluation criteria	Developed an impact measurement program Based on what we see can make an impact
5	Pre-investment process	Impact risk	Goal alignment most important, because impact is the most important Invest in people we know share our vision Tend to work closely with the same people Take mission risk seriously
6	Pre-investment process	Exit opportunities	Major concern is financial sustainability when leaving a project Create a plan for exit
7	Contractual relationship	Include	Usually goals we want to achieve Expectations
8	Contractual relationship	Flexibility	Fairly strict contracts, need to know each other's expectations Flexible in terms of repay
9	Contractual relationship	Goals	-
10	Contractual relationship	Majority / minority	Minority. We are not big enough to be a majority
11	Post-investment process	Reporting requirements	Impact management insted of measurement

			Closely engaged in projects Developing impact reporting scheme Quarterly reports, but that is not financial
12	Post-investment process	Measurement	Part of work the we do. Set up social goals for each project and measure that There is SROI, but very difficult to use. Very time consuming and does not give much information
13	Post-investment process	Monitoring	Earmark the investment to projects We work with them
14	Post-investment process	Active involvement	People from PfC working with a project follow up very closely. And being part of the project, so to say
15	Post-investment process	Poor performance	If they need more help, we try to give more help, if there is no alignment in the mission, we sort of have withdrawn from some Mostly, we do not reinvest in organisations we see are not good
16	Lastly	Pre vs. post	We spend much more time on taking part in the investmentonce we have done one
17	Lastly	Transparency	To get the transparancy, that is why we have decided to have an undergrond person that constantly works on the project
18	Other		Acumen have good programs on impact measurement