Pacific Community Ventures

The Impact Due Diligence Guide

Practical guidance for investors seeking to systematically assess investments' anticipated impact

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About the Author

Pacific Community Ventures (PCV), a nonprofit social enterprise and community development financial institution (CDFI) based in Oakland, California, envisions a world of thriving communities where everyone has a fair shake. Our mission is to invest in small businesses, create good jobs for working people, and make markets work for social good. We achieve our mission through a combination of fair lending, free mentorship, skilled volunteerism, impact investing consulting services, and field-building research.

This guide was developed by PCV's research and consulting team, which leads projects intended to foster the growth and increase the efficacy of the impact investing field. The team's extensive experience developing impact due diligence systems, both for PCV's loan fund and several consulting clients, has both inspired and informed this initiative. PCV's experience in impact due diligence formally began in 2014, when the organization worked with Community Vision (formerly NCCLF) to develop a quantitative social impact rating tool. Since then, PCV has partnered with several other investors to develop formalized impact due diligence approaches, including BlueHub Capital, Community Housing Capital, and the MacArthur Foundation.

Our Research Partners

IMPACT MANAGEMENT PROJECT

The Impact Management Project (IMP) is a forum for building global consensus on how to measure, manage and report impact. Since 2016, the IMP has brought together a Practitioner Community of over 2,000 organizations to establish norms and share best practices. The IMP also facilitates the IMP Structured Network, an unprecedented collaboration of standard-setting organizations who are coordinating efforts to provide complete guidelines for impact measurement and management.

GIIN GLOBAL IMPACT INVESTING NETWORK

The Global Impact Investing Network (GIIN) is the global champion of impact investing, dedicated to increasing its scale and effectiveness around the world. By convening impact investors to facilitate knowledge exchange, highlighting innovative investment approaches, building the evidence base for the industry, and producing valuable tools and resources, the GIIN seeks to accelerate the industry's development through focused leadership and collective action. Ultimately, the GIIN focuses on reducing barriers to impact investment so more investors can allocate capital to fund solutions to the world's most intractable challenges. The GIIN does this by building critical infrastructure and developing activities, education, and research that help accelerate the development of a coherent impact investing industry.

Acknowledgements

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We would also like to thank our advisors, Karim Harji, Program Director of the Oxford Impact Measurement Program, and independent consultant Jane Reisman, who offered valuable support throughout this project. Thanks to Belissa Rojas of IDB Invest, Christian Rahbek Rosenholm of the International Finance Corporation, and Catherine Dun Rappaport of BlueHub Capital for providing insightful feedback. Last, but not least, a special thanks to our interview subjects: the fund managers, foundations, development finance institutions, institutional investors, consultants, and industry experts who helped us document lessons in effective impact due diligence. For a full list of organizations that participated in this project, see Appendix A.

Navigating the Guide

WHO IS THIS GUIDE FOR?

This guide is intended for impact investing practitioners seeking to enhance the likelihood of having a positive impact by systematically assessing the anticipated economic, social or environmental effects of their investments.

WHAT DOES THE GUIDE CONTAIN?

This guide is comprised of two sections, each containing case studies demonstrating how investors have successfully developed and implemented processes to assess anticipated impacts during due diligence.

- **Developing Impact Due Diligence Approaches**
  This section contains practical guidance on developing impact due diligence approaches, including recommendations for both novices as well as seasoned experts in impact measurement and management (IMM). Investors should review this section to determine which approach is most appropriate for their organization and draw upon recommendations to develop resources and processes to evaluate expected impacts.
- **Implementing Impact Due Diligence Approaches**
  This section offers recommendations intended to help investors operationalize a systematic approach to impact due diligence within their organization. This includes guidance on integrating impact due diligence into existing processes, staffing, engaging with investees, informing investment decision-making, and enabling more rigorous post-investment evaluations.

THE GUIDE CONTAINS A LOT OF INFORMATION. WHERE SHOULD I START?

Reading the guide from start to finish may be overwhelming, particularly for those who are new to IMM. For this reason, we visually differentiate between sections focused on principles and processes, recognizing that readers may first want to know *what* to do before *how* they could do it. Content that is primarily related to guiding principles is preceded by a light bulb icon, while sections primarily containing technical or process-related guidance is notated with a gear icon.

Guiding Principles	Process Guidance

Note that while some sections contain both principles and processes, they have been categorized by whichever content predominates the section.

A NOTE TO THE READER

This guide intends to provide actionable advice to a diverse community of impact investors. While the guide identifies best practice-informed recommendations for investors seeking to develop and implement approaches to systematically assess anticipated impacts, each organization's approach to impact due diligence will need to reflect its unique priorities and constraints. For example, investors' impact themes, staffing model, internal expertise, and asset class influences their ability to accurately evaluate their investments' expected impacts. We hope that investors will use the portions of this report that are most useful to them.

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Introduction

While impact measurement and management (IMM) has become increasingly sophisticated and widespread in recent years, most investors focus primarily on what happens after, not before, investments are made.

To be sure, some leading investors are employing systematic approaches to examine impact prior to committing capital, but utilizing IMM during due diligence remains an underdeveloped practice.

In response, PCV launched the impact due diligence initiative in partnership with the Impact Management Project (IMP) and with research support from the Global Impact Investing Network (GIIN). The objective of this project was to assess emerging best practices in impact due diligence as well as develop practical guidance for investors across asset classes and impact areas.

The first of two reports, ***Impact Due Diligence: Emerging Best Practices***, was published in July of 2019 and surfaced the common impact due diligence approaches and practices employed by industry leaders.

This second report, ***The Impact Due Diligence Guide***, offers detailed recommendations regarding the design and implementation of impact due diligence approaches.

Findings and recommendations included in these two reports have been informed by extensive desk research on emerging best practices in impact due diligence; interviews with leading practitioners, researchers and consultants; the PCV team's experience developing impact due diligence systems for clients and for PCV's loan fund; and discussions at numerous conferences and industry convenings. See Appendix A for details on our research methodology.

Defining Impact Due Diligence

Assessing impact during *due diligence*, which we broadly define as all aspects of the investment process that occur before making an investment, is essential to effective impact investing. Not only does impact due diligence enhance investors' capacity to make more informed investment decisions and increase the impact of their portfolios: it also helps safeguard the entire field against "impact washing" as the market grows.

The research team's market scan revealed that most approaches to impact due diligence fall within three categories: narratives of expected impact, due diligence questionnaires, and quantitative tools. These archetypes are not mutually exclusive, as many investors employ two or all three approaches.

NARRATIVES OF EXPECTED IMPACT

Written descriptions of anticipated impact enable investors to consistently document their impact-related expectations. Typically appearing as a paragraph in an investment memorandum, narratives of expected impact are often the first formalized approach investors employ to evaluate impact expectations. While using this method alone lacks the standardization of an impact-focused due diligence questionnaire or systemized due diligence tool, narratives of expected impact can allow investors to develop an understanding of the types of questions and information that should be collected using questionnaires and quantitative tools.

DUE DILIGENCE QUESTIONNAIRES

Impact-focused due diligence questionnaires (DDQ) are sets of questions about prospective investees' impact that usually all potential investees are required to answer. Impact DDQs can be standalone documents or integrated into 'traditional' DDQs that assess an investment's expected financial risk and return. Impact DDQs allow investors to implement a consistent approach to impact due diligence and are typically used to gain a holistic understanding of a potential investee's objectives, anticipated impacts, unique characteristics and applicable risks. These primarily qualitative assessments can be utilized to gain a nuanced understanding of prospective investees' anticipated impact.

WHAT IS ANTICIPATED IMPACT?

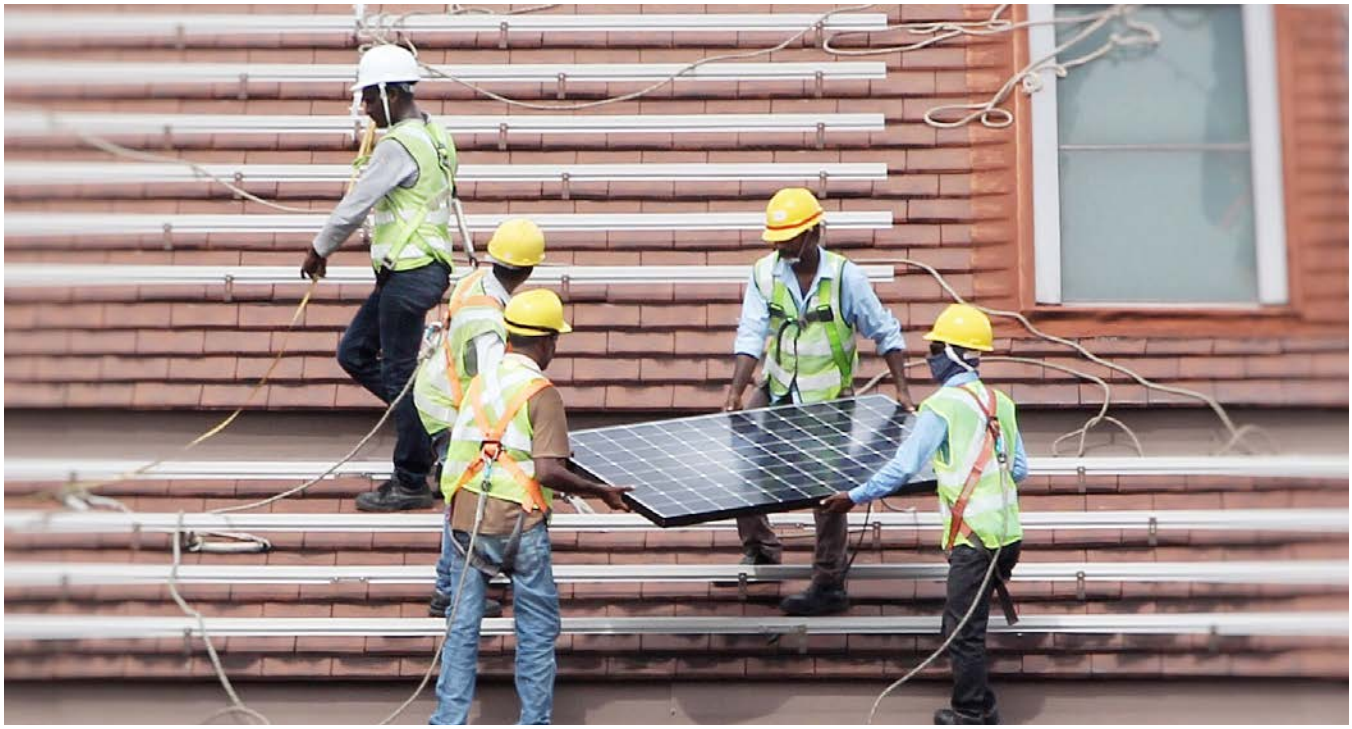
When we refer to assessing expected or anticipated impact, which is used interchangeably throughout this report, we are not only referring to the projected impacts of an investment. This is, in fact, only one component of an evaluation of expected impacts. Instead, assessing anticipated impacts encompasses an examination of potential investees' current impact, forecasted impact over the life of the investment, as well as current and expected impact risks.

Quantitative impact due diligence tools produce expected impact scores that can be used to inform investment decisions.

QUANTITATIVE TOOLS

Quantitative tools help investors translate both qualitative and quantitative information about prospective investees into standardized, numeric scores that can be more easily compared across a portfolio as well as all prospective investment opportunities. To develop quantitative impact due diligence tools, investors select relevant indicators based on their investment strategy and impact themes, relying on the IRIS+ taxonomy of investment themes, IRIS+ metrics and Core Metrics Sets where possible, and develop scoring guidelines to inform the assessment.

Each indicator is then assigned a weight to ensure the tool reflects the investor's priorities. Quantitative due diligence tools then produce expected impact scores that can be used to inform investment decisions. Implementing new systems or processes—including formal impact due diligence—can require significant time and resources, so it is important for investors to choose the most appropriate approach given their internal capacity and priorities. For guidance on which approach to first explore, readers should refer to the following section in this guide: Identifying the Appropriate Approach to Impact Due Diligence for your Organization.



EMERGING AREAS OF BEST PRACTICE

Impact due diligence is an emerging area of practice, as most impact investors do not yet have formalized approaches to assessing anticipated impacts. Still, interviews with leading practitioners revealed ***seven areas of best practice*** *that should be widely adopted by the impact investing industry. These emerging best practices, which are described in detail in our companion report, were incorporated wherever they are relevant throughout the recommendations contained within this guide.*

ASSESSING IMPACT USING THE FIVE DIMENSIONS

BRIDGING THE DIVIDE BETWEEN ESG AND IMPACT ASSESSMENTS

ALIGNING WITH THE SUSTAINABLE DEVELOPMENT GOALS

ELEVATING THE PERSPECTIVES OF KEY STAKEHOLDERS

EVALUATING A COMMITMENT TO IMPACT AND LEARNING

ADOPTING A PORTFOLIO-WIDE APPROACH

PRIORITIZING ACCESSIBILITY

1 **Assessing Impact Using the Five Dimensions**: The Impact Management Project (IMP) is a useful and widely accepted set of norms for understanding and assessing impact. Investors should check their approaches against the five dimensions of impact to ensure they are comprehensively assessing expected impacts on people and the planet.

2 **Bridging the Divide Between ESG and Impact Assessments**: When assessing anticipated impact, investors should ensure they are evaluating all impacts an enterprise has that matter to people and planet including those related to business operations (i.e., ESG considerations) as well as products or services. In this way, investors can evaluate all impacts that matter–not just the intended positive ones.

3 **Aligning with the Sustainable Development Goals**: Since the Sustainable Development Goals (SDGs) were released by the United Nations Assembly in 2015, investors have used these 17 goals as a means of articulating the connections between their investments' impacts and the United Nation's global development agenda. Incorporating the SDGs into impact due diligence helps ensure that prospective investments' anticipated impacts align with the global development agenda, as well as enable effective communication about expected impact across a diverse portfolio. This best practice is most appropriate for investors whose strategies are intentionally designed to contribute to the SDGs or whose objectives have significant overlap with the global goals.

4 **Elevating the Perspectives of Key Stakeholders**: Incorporating the perspectives of those who are impacted by investees helps investors better align on impact goals, mitigate impact risk, amplify stakeholder voices, develop feedback loops between investors and investees, and assess both investor and investee contribution.

5 **Evaluating a Commitment to Impact and Learning**: Investors should explicitly assess investees' commitment to achieving impact as well as their ability to improve, adapt, and learn. Specifically, investors should evaluate whether investees' impact thesis is clearly defined, their understanding of key stakeholders' needs, the robustness of their IMM systems, whether they have financial incentives linked to impact performance, and their ability to change strategies and tactics based on results.

6 **Adopting a Portfolio-Wide Approach**: Investors should develop a consistent impact due diligence approach that enables direct comparisons of different types of investments across a portfolio. This is an essential component of effective, impact-driven portfolio management. Sector-specific questions and indicators are in some cases necessary to achieve a sufficient level of rigor in impact due diligence, particularly for those with diverse portfolios. However, investors should adopt sector-agnostic frameworks and generalizable questions and indicators, where possible, to ensure impact due diligence processes are more easily implementable and results are comparable.

7 **Prioritizing Accessibility**: To ensure that their impact due diligence approaches can be easily adopted, investors should use consistent language, appropriately balance rigor and efficiency, and seek to understand the expectations of internal and external audiences. While new impact due diligence systems will take time for staff to learn, investors should strive to build ones that are not burdensome to facilitate adoption. This will encourage investor and investee relationship-building and set internal stakeholders up for success in performing their impact due diligence-related roles.

1

DEVELOPING A SYSTEMATIC APPROACH *to* IMPACT DUE DILIGENCE

Winning Organizational Support

1.1

Developing Impact Goals

1.2

Identifying the Appropriate Approach to Impact Due Diligence for your Organization

1.3

Developing Narratives of Expected Impact

1.4

Building an Impact-Focused Due Diligence Questionnaire

1.5

Building a Quantitative Impact Due Diligence Tool

1.6

Readers seeking to champion impact due diligence initiatives can download this progress tracker to monitor and review their ongoing progress as they develop a systematic approach to assessing investments' anticipated impact.


Market Investments.
200
175
125
100
25

Winning Organizational Support

1.1

*For many investors, the first step to developing internal buy-in is **educating key stakeholders** across the organization about what impact due diligence is and why it's important.*

The concept of systematic impact due diligence is still relatively new to most organizations, and champions of impact due diligence initiatives have found that educating internal stakeholders was one of their biggest challenges. Those responsible for developing impact due diligence approaches found it useful to share the following resources with their colleagues:

- Examples of impact due diligence tools and processes (including mock-ups of the tools, where available)
- Value to the organization and investees (for more information, see the companion report: ***Impact Due Diligence: Emerging Best Practices***)
- Proposed process for developing the impact due diligence approach
- Expected costs associated with development and use
- Expected staffing implications, including incentives and performance reviews related to pre- and post-investment impact performance

STAKEHOLDER *(Definition)*

Persons or groups directly or indirectly affected by an intervention, including those who may have stakes in a project and/or the ability to influence its outcome, either positively or negatively.

Calvert Impact Capital™

Calvert Impact Capital: Winning Organizational Support

CALVERT IMPACT CAPITAL IS A NONPROFIT INVESTMENT FIRM THAT DEPLOYS CAPITAL TO APPROXIMATELY 100 MISSION-DRIVEN ORGANIZATIONS WORLDWIDE, INCLUDING INTERMEDIARIES, FUNDS, AND PROJECTS.

Individuals and institutions invest in Calvert through their Community Investment Notes. When developing their impact due diligence approach, Calvert's impact team worked to garner widespread organizational support for the effort. Calvert engaged investment officers early on, soliciting feedback on specific sections of the impact due diligence tool and showing them how the tool would benefit them once implemented. Champions of the project were able to win buy-in from management by creating an internal advisory group, which allowed those involved in setting organization-wide strategy to provide inputs to ensure that the tool was developed in line with the organization's strategic objectives. By including both staff who interact directly with investees as well as senior leadership, Calvert achieved early buy-in from all key stakeholders to develop a more robust impact due diligence approach.

As with any initiative focused on organizational change, champions of impact due diligence projects should first **speak with colleagues who are most likely to be supportive of this work** and are able to help garner additional support. In some cases, this will be investment staff, while in others, management will be the strongest ally. For example, investment staff may be excited about the possibility of more effectively evaluating higher impact investments, while management could be concerned about the impact of changes to due diligence on the pipeline and deal flow. Conversely, investment staff might be concerned that implementing impact due diligence will negatively affect their workflow or constrain their ability to do deals, while management may be excited about codifying expected impact to make better investment decisions.

Champions can help assuage staff's concerns by sharing the following perspectives:

- Codifying the organization's methods for evaluating expected impact will enable investment staff to more efficiently evaluate anticipated impact moving forward, and more quickly train new investment staff to understand the characteristics of more or less impactful deals.
- While developing a formal impact due diligence approach requires an upfront investment of staff time, efficiency gains will be achieved in each stage of the investment process, including when preparing investment memos, communicating with the investment committee, and making investment decisions.
- Impact due diligence may enable them to make investments with higher expected impact than average, but which would have previously been screened out due to higher financial risk.


LINCOLN
ELECTRIC

Developing Impact Goals

1.2

Developing concrete impact goals is critical to effective impact management and is essential to building impact due diligence approaches—whether qualitative or quantitative.

After garnering organizational support, investors should begin by **aligning on their own intended impacts**—if they have not already done so. Clear impact goals will lay the foundation for the development of their impact due diligence approach. There are several formats for documenting and visualizing impact goals, including logic models and theories of change (see the Glossary for definitions). Even if an investor does not build a logic model or theory of change, they should **document their impact objectives and how they expect to contribute to them.**

OVERVIEW OF A LOGIC MODEL

INPUTS	ACTIVITIES	OUTPUTS	OUTCOMES	IMPACTS
Resources that are deployed in service of a certain set of activities	Actions that are performed in support of specific impact objectives	Tangible, immediate practices, products and services that result from the activities that are undertaken	Changes, or effects, on individuals or the environment that follow from the delivery of products and services	Changes, or effects, on society or the environment that follow from outcomes that have been achieved

Adapted from Measuring Impact: Subject Paper of the Impact Measurement Working Group of the GB Social Impact Investment Taskforce, 2014.

The process of codifying intended impacts can help investors ensure that all internal stakeholders are aligned on their impact goals.

VALUE OF ARTICULATING AND CODIFYING INTENDED IMPACTS

By aligning on their intended impacts prior to developing their impact due diligence approach, investors can develop a deeper understanding of their impacts on key stakeholders and build internal consensus on the purpose of their activities—and very existence.

Develop a Deeper Understanding of their Impacts on Key Stakeholders

To develop an understanding of investments' anticipated impact, it is essential for investors to **engage their key stakeholders to understand how their investment may affect them**. This should be documented in logic models or theories of change or outcome maps. Investors should solicit input from intended beneficiaries—or those with the closest relationships with them, which in many cases are existing investees—to understand how they are affected by the investor's activities. Through this approach, investors are better positioned to identify the outputs, outcomes, and/or impacts of their investment activities, which is essential to developing a robust impact due diligence approach. For more detail on elevating the perspectives of key stakeholders, see ***Impact Due Diligence: Emerging Best Practices***.

Developing Consensus

The process of codifying intended impacts can help investors **ensure that all internal stakeholders are aligned on their impact goals**. This is particularly useful, given that investment staff may have diverse views and assumptions about their firm's impact, even if all agree on the investor's mission. For example, while all staff may agree that the investor should be creating opportunities for those at the base of the pyramid, staff may have differing opinions about which opportunities are most important, and for which demographic groups. Impact goals can also be used with potential investees to establish alignment around shared objectives as part of impact due diligence, and are described further in ***Impact Due Diligence: Emerging Best Practices***.

Undertaking the following steps will ensure investors form a solid foundation to guide the development of an impact due diligence approach. Investors should:

- Understand the impact goals they are seeking to achieve
- Refer to the IMP's five dimensions of impact (what, who, how much, contribution, and risk) to ensure their impact goals are sufficiently comprehensive. For additional information on using the five dimensions within due diligence, please refer to our companion report on impact due diligence best practices as well as the IMP's website.
- Identify how they will support or generate this impact as an investor
- Describe how they expect investees to achieve intended impact
- Document anticipated stakeholders who will be impacted
- Examine possible unintended outcomes

Toniic's Developing an Investment Strategy offers guidance on how to articulate impact goals and build out a corresponding theory of change, including examples and external case studies. CERISE also offers the CERISE-IDIA, an impact-driven investor assessment, which helps investors assess five key areas that are critical to operationalizing their impact strategy. The Excel-based tool assesses the alignment of an investor's processes with its impact goals along the following categories: impact thesis, governance, products and procedures, business model, and data protocols.

Organization- or portfolio-wide impact goals, codified through an impact thesis, logic model, or theory of change, can then be used to develop transaction-level impact goals. The IMP's emerging consensus on impact goals recommends the following:

- Define the expected experience of impact across the five dimensions, including the Risk the investor is willing to take that the effect is different than their expectation
- Judge whether the effects that people and planet experience by engaging with the delivery model(s) are significant and how they likely contribute to them
- Set goals to prevent negative effects that they judge to be significant, which their contribution is making either worse or not any better
- Decide, based on their intentions, constraints, and financial goals, whether to set goals to increase positive effects that are significant and which their contribution is likely to make even better

As part of their guidance on setting impact goals, the IMP has also developed the ABC framework that describes how investors may contribute to impact through their investments in enterprises/assets as part of their portfolio:

A. **Act to avoid harm**: e.g., an ethical bond fund

B. **Benefit stakeholders**: e.g., a positively-screened best-in-class ESG fund

C. **Contribute to solutions**: e.g., a private equity fund making anchor investments in businesses that have a significant effect on income and employment for underserved people

See the IMP's Guide to Classifying the Impact of an Investment for detailed information on how to apply the ABC framework to the goal-setting process.

IMPACT GOALS SHOULD BE CONTINUOUSLY REFINED

Investors need to develop well-defined impact theses and goals to develop effective impact due diligence approaches. However, they should be continually working to understand the impact of their investments, should question the assumptions in their investment and impact theses, and revise their goals based on available evidence and lessons learned from investment performance.

Gary Community Investments: Developing Impact Goals

GARY COMMUNITY INVESTMENTS (GCI), WHICH INCLUDES THE GARY COMMUNITY INVESTMENT COMPANY AND THE PITON FOUNDATION, INVESTS IN FOR-PROFIT AND PHILANTHROPIC SOLUTIONS FOR COLORADO'S LOW-INCOME CHILDREN AND THEIR FAMILIES.

In addition to developing a theory of change, GCI developed *theories of impact* for each of the four outcome areas in its theory of change. The theory of impact framework is used to evaluate portfolio-level performance, help understand the investments and activities that are contributing to desired outcomes, as well as determine where course correction is needed.

Used alongside its theory of impact framework is GCI's Transformational Impact Grid (TIGR), an impact due diligence tool that helps them invest resources into highly effective organizations that are creating transformative impact. The TIGR along with GCI's Impact Management Plans are used to evaluate new opportunities, clarify expectations for investment results and report on progress.

Identifying the Appropriate Approach to Impact Due Diligence for Your Organization

1.3

The table below outlines considerations for investors as they **determine which approach to impact due diligence is right for their organization**. Impact due diligence should be a continuous process of improvement, too. If an investor starts with an impact due diligence questionnaire, they should plan to revisit their process and consider whether developing a quantitative impact due diligence tool, which increases the rigor of assessing expected impact, would be appropriate.

APPROACH	THIS APPROACH IS BEST FOR INVESTORS WHO...
NARRATIVES OF EXPECTED IMPACT	• Want to adopt a consistent approach to impact due diligence and document expected impact • Lack the capacity to build or implement a due diligence questionnaire or a quantitative tool
IMPACT-FOCUSED DUE DILIGENCE QUESTIONNAIRE	• Are interested in developing a deeper, more systematic approach to understanding anticipated impact • Have the capacity to ask each investee a standard list of questions, and revise their questions accordingly to assess impact • Have sufficient organizational buy-in to use the responses to inform decision-making
QUANTITATIVE IMPACT DUE DILIGENCE TOOL	• Are interested in systematically comparing quantitative assessments of anticipated impact across a portfolio • Manage, or expect to manage, a portfolio of at least twenty investments • Have the capacity to thoughtfully develop, methodically test, systematically implement, and continuously refine their tool • Have a project lead who can dedicate at least five hours weekly for four to twelve months to the design and implementation of the tool • Have sufficient organizational buy-in to use the scores produced by their tool to inform decision-making • Would like to understand their portfolio's aggregate level of anticipated impact over time • Are interested in developing a deeper understanding of the strongest predictors of impact over time

Developing Narratives of Expected Impact

1.4

As an entry point into impact due diligence, impact investors should begin by articulating the anticipated impact of their investments in a narrative description, in alignment with the five dimensions.

Relying on intuition or ad hoc analyses of impact alone is inadequate for addressing impact as part of the investment process. While preparing written descriptions of expected impact lacks the standardization of a due diligence questionnaire or quantitative tool, they allow investors to begin understanding their prospective investees' anticipated impact in alignment with industry conventions.

To develop a narrative of expected impact, ask investment staff to write an overview of the impact they expect to see for the investee according to each of the five dimensions. These are typically included within an investment memorandum alongside information about the financial viability of the investment. By framing narratives of expected impact around the collective norms of the IMP, participants will at minimum be consistent with field-wide consensus around the definition of impact and how it can be a part of decision-making. As investors increase their capacity to implement more rigorous impact due diligence, preparing written summaries of expected impact will set the stage for the development of their questionnaires or quantitative impact due diligence tools.

It is important to note that investors should continue preparing narratives of expected impact even after they have developed impact-focused questionnaires or quantitative tools. Many interviewed investors were adamant that, even where quantitative impact due diligence assessments are available, an accompanying narrative is critical to comprehensively communicating the prospective investee's anticipated impact and the capital's role in supporting that impact. When preparing investment memos, investors should synthesize their impact due diligence analysis into a narrative of expected impact explaining the potential investee's approach to impact, anticipated impact, unique considerations and applicable risks.

Accompanying narrative is critical to comprehensively communicating the prospective investee's anticipated impact.

Building an Impact-Focused Due Diligence Questionnaire

1.5

Impact-focused due diligence questionnaires (DDQs), which include a consistent set of questions asked of potential investees, help investors understand how the potential investee intends to generate their expected impact, which enables them to assess the expected impact of the investment. The size and rigor of the DDQ should reflect the breadth and depth of the investor's impact goals as well as their capacity and tolerance for impact risk, i.e., the likelihood that expected impact will not occur.

PROCESS FOR DEVELOPING A DDQ

Investors develop due diligence questionnaires by:

CLARIFYING IMPACT PRIORITIES

Clarifying their impact priorities and approach by soliciting feedback around the impact of the current portfolio

ASKING QUESTIONS

Identifying relevant questions to ask potential investees

ITERATING ON THE LIST OF QUESTIONS

Iterating on the list of questions to streamline, standardize, and ensure coverage across the five dimensions of impact

McConnell

McConnell Foundation: Building a Due Diligence Questionnaire

THE MCCONNELL FOUNDATION MAKES GRANTS, INVESTS, BUILDS CAPACITY, AND CONVENES TO PROMOTE THE CREATION OF INNOVATIVE SOLUTIONS TO SOCIAL, CULTURAL, ECONOMIC, AND ENVIRONMENTAL CHALLENGES.

For McConnell's impact investments, they have developed a robust due diligence guide, including due diligence questions that assess strategic fit of the investment. This includes an evaluation of the investee's value proposition, organizational capacity, additional risks, sustainability standards, and deal structure. This guide has helped them comprehensively understand the expected impact of potential investments and ensure mission-alignment with their organization prior to making investments.

CLARIFYING IMPACT PRIORITIES

To develop a due diligence questionnaire, investors must build internal consensus around their targeted impacts, how they prioritize these impacts, and approach to achieving them. As detailed in this guide, developing impact goals can help investors develop consensus around, and clarify, their intended impact. Therefore, investors should revisit these foundational documents prior to developing a DDQ focused on anticipated impact.

Investors can **clarify how their organization's impact priorities and investment approach translate to concrete characteristics of high-impact investments** by soliciting feedback from staff with the following questions: "Which investments in the current portfolio do you consider most and least impactful? Why?"

By answering these questions, investment staff can surface aspects of positively impactful investments and companies that may not have been explicitly named as a priority to the investor, but which represent a material effect that should be assessed when considering the anticipated impact of an investment. For example, an investor may identify that investees whose projects are related to a community or city-wide economic development initiative are more likely, all else equal, to achieve impact, even if supporting community or city-wide development plans is not an explicit priority for the investor. Additionally, completing this exercise can give investors confidence that they have comprehensively identified the key impacts created by their portfolio—both positive and negative—as well as the most salient characteristics of high- and low-impact deals.

BlueHub Capital: Clarifying Impact Priorities

BLUEHUB CAPITAL, FORMERLY KNOWN AS BOSTON COMMUNITY CAPITAL, IS A NATIONAL NONPROFIT CDFI DEDICATED TO BUILDING HEALTHY COMMUNITIES WHERE LOW-INCOME PEOPLE LIVE AND WORK.

BlueHub provides financing for affordable housing; education, healthcare, and other community facilities; commercial real estate in economically distressed neighborhoods; solar energy that benefits low-income families; and foreclosure prevention. To inform the development of its quantitative impact due diligence tool, BlueHub's Vice President of Learning and Impact Measurement partnered with loan officers to develop a scoring rubric that reflected the lending team's goals for supporting impactful loans. Based on this work, she and the lenders identified "who and where," or the characteristics of intended beneficiaries and the places where borrowers operate, as important areas to prioritize within their impact due diligence tool.

ASKING QUESTIONS

Investors **ask questions of the investees—and ideally their intended beneficiaries, directly**—to understand how investees' business practices and products or services effect people and the planet. Questions generally fall into three focus areas:

	FOCUS AREAS	EXAMPLE QUESTIONS	EXAMPLE OF INVESTORS EMPLOYING THIS APPROACH
INVESTOR	Investee/investor impact goal alignment; ability of the investor to support the investee	• How well does the potential investee align with the investor's impact goals? • How, if at all, can the investor support, improve, or scale the investee's work with financial and non-financial capital?	• McConnell Foundation
INVESTEE	Understanding the investee's business practices and products or services, its expected impact, how the investee assesses their impact, and the investee's business model	• What problem is the investee trying to solve, and what is their proposed solution? • What impact does the investee expect to happen by providing this product or service, both positive and negative? • How does the investee measure this impact? What, if any, measurement system is in place? • What business plan does the investee have to reach its objectives? Is impact integrated into their business model?	• McConnell Foundation • Acumen Fund • HIP Investor
BENEFICIARY	Beneficiary experience using the product or service	• What was your experience with the product or service, both positive and negative? • What, if any, changes did you experience as a result of the product or service, both positive and negative? • What would you do without this product or service?	• Charities Aid Foundation • Acumen Fund

ITERATING ON THE LIST OF QUESTIONS

Developing impact due diligence approaches, including questionnaires, requires multiple iterations over time to balance rigor and efficiency. There are a few key factors to consider when **refining the list of questions**:

- **Update and pare down the list to reduce the burden on the investee (and investor)**: Assessing impact is an inherently complex activity, but investors should work to simplify their approach where possible. For example, investors can ask the investee what indicators they already report on to articulate the impact of the offered product or service. Also, minimize duplication of efforts; for example, seek out opportunities to leverage existing information from the financial due diligence process, the collection of contextual information, and/or publicly available datasets.
- **Ensure applicability across the portfolio**: Seek to understand how a group of more specific questions could be combined into a single higher-level question that asks for the same piece of information across investees. (For example, rather than ask separate questions about the availability of affordable housing, quality education and employment opportunities, an investor could instead ask, "to what extent does this community have access to opportunities?" and subsequently collect housing, education and employment-related data to answer the higher-level question.) This will reduce the burden on investment staff, facilitate the adoption of the impact due diligence approach, and ensure that a systematized approach is implemented across all investments. For further guidance, please see the section on adopting a portfolio-wide approach to impact due diligence within our companion report, ***Impact Due Diligence: Emerging Best Practices***.
- **Strive for coverage across the five dimensions of impact**: It is important to ensure that the final set of questions assesses impact across the five dimensions; developing coverage across all dimensions will likely require some refinement of the question set. Investors should strive to incorporate questions corresponding to the dimensions often cited as more challenging to assess: Contribution and Risk.
- **Leverage IRIS+ guidance**: Investors should review IRIS+ guidance, including resources on the evidence linking strategic goals to outcomes as well as Core Metrics Sets related to their strategic goals, to develop due diligence questions. By reviewing relevant IRIS+ Core Metrics Sets and IRIS metrics and translating them into due diligence questions, investors foster standardization in impact due diligence, enable comparability of investments, and harmonize pre- and post-investment IMM approaches. For additional guidance, see the GIIN's Using IRIS+ within Due Diligence.

To understand the expected impact of the potential investee, systematize their due diligence approach, and enable coverage across the five dimensions, investors should at minimum implement an impact-focused due diligence questionnaire. Doing so will serve as the foundation for developing a more rigorous approach to impact due diligence: a quantitative tool.

Building a Quantitative Impact Due Diligence Tool

1.6

Quantitative impact due diligence tools use consistent scoring guidelines to synthesize qualitative and quantitative information into standardized scores, which allow investors to systematically compare anticipated impact across prospective investment opportunities.

To be effective, quantitative due diligence tools must be:

- **Reliable**: Based on credible evidence regarding the link between investments and desired outcomes.
- **Standardized**: Can be used to compare different types of investments and across time.
- **Consistent**: Consistently applied with the same criteria across a portfolio.
- **Flexible**: Accommodates different types of investments and can be applied across sectors and impact themes.
- **Accessible**: Easy to understand by staff and key stakeholders.

(See the Adopting a Portfolio-Wide Approach and Prioritizing Accessibility sections of Impact Due Diligence: Emerging Best Practices for more details.)

This section provides guidance on the types of investors for whom a quantitative impact due diligence tool will be most useful and outlines the process for developing one that meets the above criteria.

PROCESS FOR DEVELOPING A QUANTITATIVE IMPACT DUE DILIGENCE TOOL

Developing an impact due diligence tool should be divided into seven discrete phases of work, with each phase building on the prior one:

CLARIFY OBJECTIVES

Clarifying the organization's impact objectives, approach to impact, and priorities

IDENTIFY STRUCTURE

Identifying a structure and indicators to guide the assessment

DRAFT SCORING GUIDELINES

Drafting scoring guidelines for each indicator

ASSIGN WEIGHTS

Assigning weights to each indicator

BUILD TOOL

Building the impact due diligence tool

TEST AND REFINE

Drafting scoring guidelines for each indicator

BUILD DATASET

Building an investment portfolio dataset to benchmark investment scores

CLARIFYING IMPACT OBJECTIVES, APPROACH TO IMPACT, AND PRIORITIES

Since quantitative impact due diligence tools ascribe value to investees' characteristics and activities, investors must first clarify their impact goals, their approach to achieving these impacts, and their prioritization of intended impacts. For guidance in this area, please see the section on developing impact goals.

IDENTIFYING AN APPROPRIATE STRUCTURE AND SET OF INDICATORS TO GUIDE THE ASSESSMENT

Investors should **begin by identifying an overarching structure** to organize the information collected during impact due diligence. Investors should strive for a consistent approach that can be applied portfolio-wide (see section 6 within the emerging best practices report) and should consider the following:

- Stakeholder groups (e.g., investees, customers, communities, ecosystems)
- Types of impact (e.g., environmental, social)
- Types of processes or practices (e.g., defining and monitoring social goals; board/management/employee commitment to social goals, responsible treatment of clients, responsible treatment of employees, and balance of financial and social performance)

We recommend using stakeholder groups, or the Who impact dimension, as the overarching organizing structure, as we have found it **easier to ensure that the indicators and questions pertaining to each stakeholder group are mutually exclusive**. Indicators and questions, in our experience, tend to be more challenging to categorize when using type of impact or type of process/practice.

For example, an investor may seek to support economic development and social justice, two interrelated impact objectives. Using them as categories within a quantitative tool would make it challenging—and potentially arbitrary—to justify the assignment of questions and indicators. Instead, an investor could assess to what extent they advanced these goals via the expected effects on their key stakeholders.

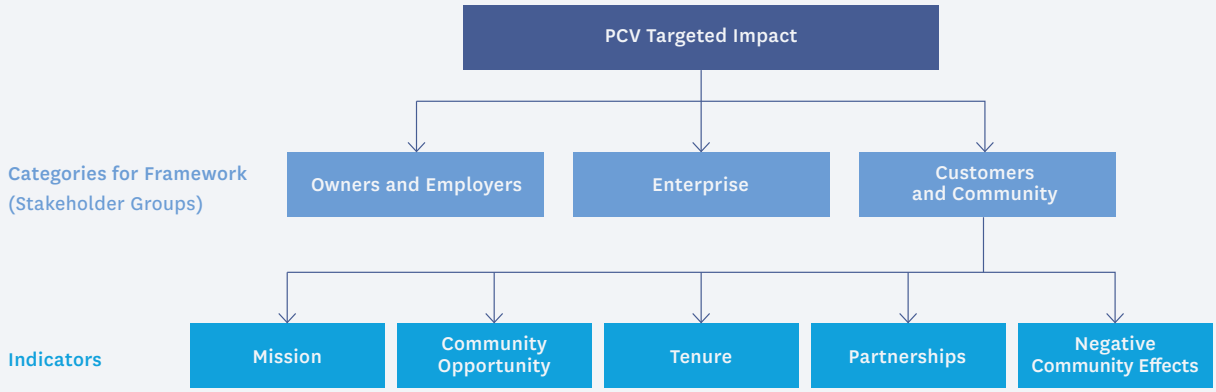
After aligning on an overarching structure to guide their assessment, investors should **identify indicators** that align with the investment characteristics they would like to evaluate. When selecting indicators, investors should:

- Include a mix of indicators that **rely on quantitative and qualitative information** (e.g., PCV's tool includes a "Number of Employees" indicator that is based on quantitative data while the "Willingness to Engage with PCV to Improve Job Quality" is based on a qualitative assessment)
- Ensure the indicators are based on information they will **be able to realistically collect** during due diligence, considering relevance to the investee's stakeholders and business model, and data quality. (e.g., while understanding the demographics of customers may not be possible during due diligence, it can be assessed post-investment. As a proxy, investors may wish to assess the demographics of the areas where potential investees operate.)
- Strive to **minimize complexity** by selecting indicators that will be applicable across the full array of investments, draw from standard indicator sets avoiding duplicative or closely correlated indicators, and selecting indicators that will differentiate prospective investments (e.g., investors should not include an indicator on mission-alignment if investments would be screened for mission-alignment earlier in the due diligence process).

Pacific Community Ventures: Identifying an Appropriate Structure

PACIFIC COMMUNITY VENTURES (PCV), A NONPROFIT CDFI THAT LENDS TO SMALL BUSINESSES IN LOW-INCOME COMMUNITIES, AIMS TO CREATE GOOD JOBS THAT SUPPORT STRONG LOCAL ECONOMIES AND EQUITABLE COMMUNITIES.

PCV's quantitative impact due diligence tool is structured around its impact on key stakeholder groups: small business owners and employees, enterprises, and customers and communities where businesses operate. For each key stakeholder group, PCV has identified a set of qualitative and quantitative indicators to guide its assessment of each loan's anticipated impact. Within the customers and community section, for example, PCV included indicators focused on the enterprise's mission, the community's access to opportunity, the enterprise's tenure in the community, the enterprise's partnerships, and the enterprise's risk of contributing to negative community effects. To further clarify the types of information each indicator is intended to evaluate, the tool includes guiding questions for each indicator. The guiding question accompanying PCV's indicator on the enterprise's mission, for example, asks the scorer to answer the following question: "*Does the business aim to provide or produce a product or service with a significant social benefit?*" Identifying an intuitive framework and developing guiding questions for each indicator made the tool more accessible to staff and strengthened staff members' understanding of the purpose of each indicator.



- **Ensure coverage of relevant environmental, social and governance (ESG) practices**. In many cases, impact investors evaluate the impact of investees' products and services without systematically considering their business practices. Without assessing ESG practices, an investor will not be able to generate a holistic picture of the investee's business and evaluate all positive and negative impacts that matter, including intended and unintended ones. See ***Impact Due Diligence: Emerging Best Practices*** for resources on bridging the divide between ESG and impact assessments.
- **Use IRIS+ to foster greater standardization** in impact due diligence, enable comparability of investments, and harmonize pre- and post-investment IMM approaches. The same IRIS metrics should be used within both due diligence and post-investment monitoring to harmonize ex ante and ex post analyses of impact, i.e., to determine if anticipated impacts are ultimately realized. However, investors should recognize that they may not know which metrics are the most appropriate to track until after finalizing the terms of the investment. For guidance on selecting and using IRIS+ to inform investment decisions, refer to existing IRIS+Core Metrics Sets and see Using IRIS+ within Due Diligence, as well as IRIS+ for Decision-Making.
- Ensure that the full set of selected indicators **assesses the investment's anticipated impact across the five dimensions**. For additional details on using the five dimensions within due diligence, please see our companion report: ***Impact Due Diligence: Emerging Best Practices***.

While investors should adhere to the parameters above while initially selecting indicators, the indicator list should be refined throughout the course of testing. Many investors find it useful to start with a longer list of indicators and pare down this list during testing (e.g., removing duplicative or less important indicators), focusing on those that are most closely linked with the investors' goals and which can be applied across a diverse portfolio. The section on Adopting a Portfolio-Wide Approach within our companion report on impact due diligence also provides guidance on systematizing indicators across impact due diligence approaches with an eye towards standardization.

This will also help ensure that the investment team can easily learn how to use the tool, which will be especially beneficial to organizations experiencing rapid team growth or turnover. In addition to identifying relevant indicators, investors should consider **developing guiding questions** alongside each indicator to clarify the type of information they want to collect and evaluate.

"

With inputs from our partners regarding the relative importance as well as similarities between collected indicators, we were able to streamline the SPI4-ALINUS social due diligence tool from 200 to about 60 indicators."

—Jurgen Hammer
Managing Director, *Social Performance Task Force Europe*

Community Vision: Refining indicators

COMMUNITY VISION (FORMERLY NCCLF), A CDFI BASED IN SAN FRANCISCO THAT LENDS TO NONPROFITS AND SOCIAL ENTERPRISES IN CALIFORNIA.

Community Vision was one of the first investors to develop a quantitative impact due diligence tool. Through testing, Community Vision was able to significantly reduce the number of indicators in the tool to include only those that meaningfully differentiated investment scores.

Refinement of Loan Rating System Indicators

Framework before and after phase III testing (March-June 2015)

3	Impact on Borrower Clients
3.1	Client Base
3.2	Client Base Demographics
3.2.1	Race / Ethnicity
3.2.2	Other Demographics
3.3	Household Income
3.4	Essential Services
3.5	Community Multiplier Effect

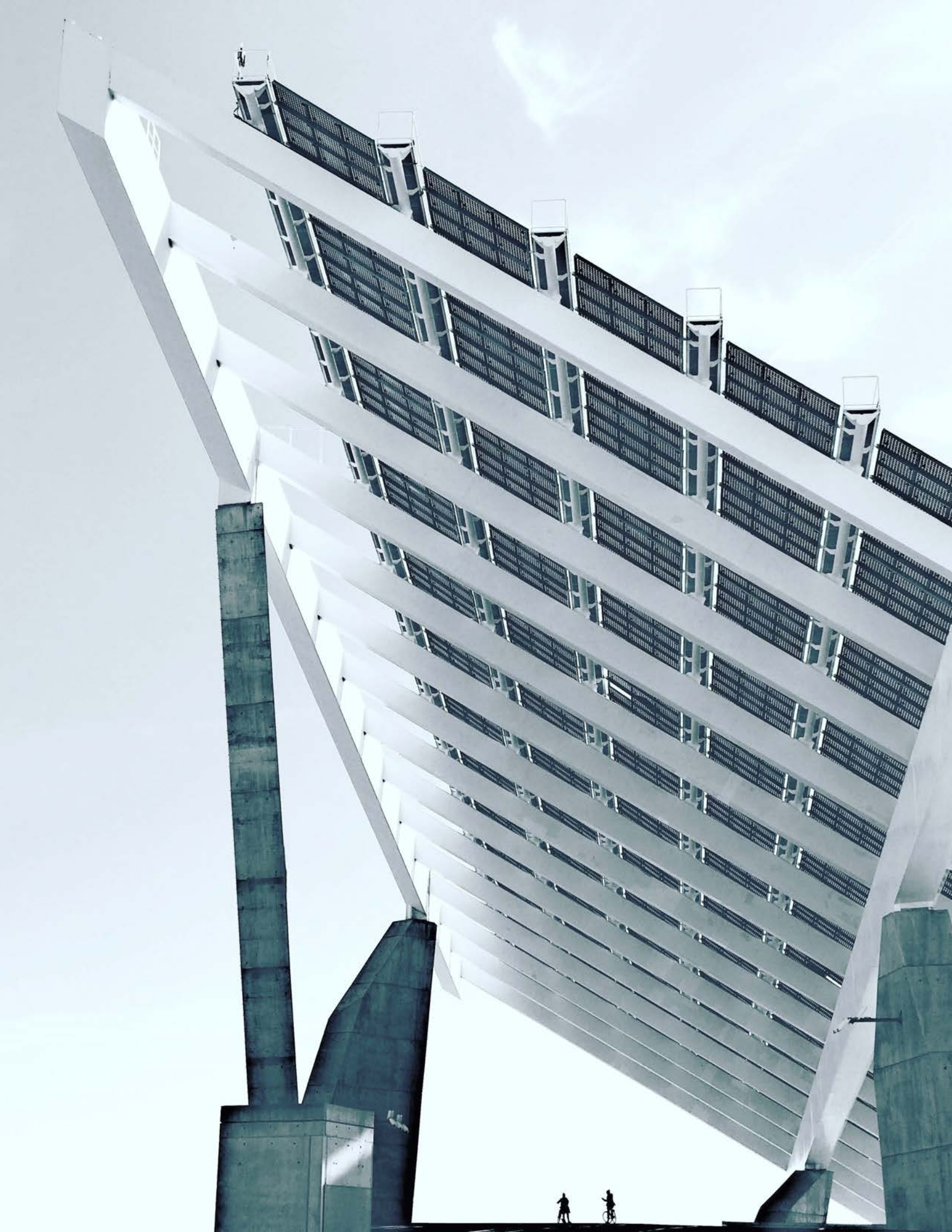
→

3	Impact on Borrower Clients
3.1	Client base race / ethnicity
3.2	Client base income
3.3	Essential Services
3.4	Community Multiplier Effect

4	Impact on Financing
4.1	Availability
4.1.1	Unique Financing
4.1.2	Other Financing
4.2	Leadership
4.3	NCCLF Factor
4.3.1	Partnership
4.3.2	Anchor / Essential Investment
4.3.3	NCCLF Consulting

→

4	Impact on Financing
4.1	No other funding available
4.2	Lessons for the field
4.3	Facilitates additional funding
4.4	Anchor / Essential Investment



DRAFTING SCORING GUIDELINES FOR EACH INDICATOR

The scoring guidelines enable investors to translate quantitative and qualitative information into standardized numerical scores, which are then synthesized to produce categorical and overall scores. When **developing scoring guidelines**, investors should strive for guidelines that:

- **Minimize ambiguity**: The scoring guidelines should be specific enough that they ensure different investment staff would assign the same prospective investment the same score.
- **Align with ranges in scores within the existing portfolio**: Ranges for quantitative scoring guidelines should be based on ranges associated with the current portfolio or pipeline if an investor has not yet deployed capital. If an investor wants to create a three-point scale indicator on the number of residents housed, for example, they should use ranges for housed residents that align with investments in the top-, middle-, and bottom-thirds of the portfolio.

SCORE	RELEVANT CURRENT PORTFOLIO STATISTIC	SCORING GUIDELINE
2	The top third of investments in the portfolio (or pipeline) have housed 100 or more residents	Investment will finance housing for 100 or more residents
1	The middle third of investments in the portfolio (or pipeline) have housed 50 to 99 residents	Investment will finance housing for 50 to 99 residents
0	The bottom third of investments in the portfolio (or pipeline) have housed fewer than 50 residents	Investment will finance housing for fewer than 50 residents

- **Are streamlined**: The scoring guidelines should be concise and easy-to-use, so investors should seek to minimize the amount of text in the guidelines. If the scoring guidelines were examining target beneficiary characteristics, for example, the guidelines should list out the characteristics and point values tied to each rather than writing out all possible permutations. See below for an example.

EXAMPLE OF GOOD AND BAD SCORING GUIDELINE PRACTICE	
✓	Scores range from 0 to 2 and are based on whether targeted beneficiaries are: • Women • People of color • Low-income Each characteristic is worth one point.
✗	Scores range from 0 to 2 and are based on the characteristics of targeted beneficiaries: 2 = Targeted beneficiaries are women, people of color, and low-income 1 = Targeted beneficiaries are women and people of color OR women and low-income OR people of color and low-income 0 = Targeted beneficiaries are neither women, people of color, nor low-income

- **Leverage location-based datasets where available and relevant**: Incorporating location-based datasets into the scoring guidelines can help reduce the burden on investees. Opportunity 360 data, for example, can be used to evaluate a community's access to opportunity in the United States in the following areas: housing stability, education, health and well-being, economic security, and mobility.

Note that, in diverse portfolios, investors should consider whether to use sector-specific guidelines to more accurately assess anticipated impact across sectors.

> There are valuable datasets from the World Bank and other development organizations as well as a vast world of social science research that impact investors can draw from. We don't think investors have quite figured out how to tap into those resources when developing impact management systems."
>
> —**Mariah Collins**
> Manager, *Bridgespan*

An investor who invests in both housing and education projects, for example, found it helpful to develop sector-specific ranges for an indicator assessing the targeted number of beneficiaries for each investment. As a result, this ensured that the investor avoided systematically penalizing housing projects, which tend to have a lower number of beneficiaries. Note that it is easiest to incorporate these sector-specific guidelines when the different sets of scoring guidelines for each sector use the same scoring scale for the same indicator (e.g., in the examples above, all sectors used a 0 to 2-point scale for the indicator on the targeted number of beneficiaries).

A word of caution, however: investors should recognize that including sector-specific guidelines increases the complexity of developing, testing and implementing a quantitative impact due diligence tool, so these should only be included if sector-agnostic indicators insufficiently reflect anticipated impacts or do not differentiate investment scores. It may be the case, for example, that while investments in certain sectors tend to receive lower scores on certain indicators, the same indicators and scoring guidelines are appropriate for the whole portfolio. (E.g., investments in housing projects may tend to benefit fewer individuals than investments in education projects, and an investor will want to consider investment "reach" as part of their decision-making and so would not want to adjust scores based on differences in their expected impact across sectors.)

ASSIGNING WEIGHTS TO EACH INDICATOR

Since it is highly unlikely that all indicators are equally important when assessing anticipated impact, investors should **assign each indicator a weight** to ensure the quantitative tool accurately reflects the organization's priorities, which should incorporate the priorities of those most affected by the investment. To avoid adhering to false rigor when choosing weightings, investors should assign each indicator to broad categorical buckets correlated with standard weightings. Investors, for example, are more likely to have the ability to distinguish between low-, medium-, and high-importance indicators versus between indicators that should be worth seven or thirteen percent of the total impact due diligence score.

It is important to consider that weights are based on relative importance; while it may be tempting to assign all indicators as medium or high importance, this will only be a productive exercise if the weightings introduce differentiation across the indicators. It can be helpful to begin with more differentiated weightings to better understand the specific impacts of different indicators and then refine the weightings throughout the course of testing.

While weightings will be unique to each investor, it is worth noting that several investors weight indicators related to investor contribution the most heavily. This aligns with the perspective, espoused by Paul Brest, Kelly Born and others, that investments are not truly impactful unless they have additionality, or contribute to impact that would not have likely occurred but for their investment.

BUILDING THE TOOL

This section focuses on **building Excel-based quantitative impact due diligence tools**. While some investors are utilizing robust web-based platforms to inform their due diligence, including GIIRS and the B Impact Assessment, the majority of investors, especially those operating in developing countries where they might not have consistent internet access, prefer Excel-based tools to online tools. Additionally, since this guide seeks to empower a diverse set of impact investors to build their own impact due diligence approaches, we believe that Excel is currently the most ubiquitous software to support widespread adoption. See section 7 in ***Impact Due Diligence: Emerging Best Practices*** for details on the importance of prioritizing accessibility.

Investors should include the following elements in their Excel-based quantitative impact due diligence tools:

- An overview/instructions sheet, to help team members understand how to use the tool
- An investment information sheet, which is referenced throughout the tool
- Scoring sheets (one to align with each major category from the framework)
- A scoring summary sheet
- Sheets containing additional guidance

Community Vision: Assigning Weights to Each Indicator

TO AVOID INTRODUCING FALSE RIGOR INTO THE ASSIGNMENT OF INDICATOR WEIGHTS, COMMUNITY VISION ASSIGNED EACH INDICATOR AN IMPORTANCE OF HIGH, MEDIUM, OR LOW.

Indicators deemed to be high importance were weighted five times as heavily as those assigned low importance, and indicators assigned medium importance were weighted three times as heavily as those assigned low importance. Assigning indicator weights based on these high-level categorizations enabled Community Vision to more accurately assess the potential investment's impact in alignment with their objectives without introducing additional subjective complexity into their assignment of weightings.

Overview/Instructions Sheet

Investors should **develop an overview/instructions tab** that describes:

- The contents of the tool
- Any technical considerations (e.g., tools that use VBA macros should include instructions for all users to enable macros to ensure full functionality)
- Guidance on the order in which different steps should be completed, if applicable (some tools pre-populate certain pieces of information based on information entered elsewhere in the tool)
- Guidance on where in the workbook users should input information obtained during due diligence
- Guidance on where in the workbook users should look for final scores
- Contact information (typically an email address) for a team member who is available to answer questions about the tool

Investment Information Sheet

Next, investors **should create an investment information sheet**, which should appear before the scoring sheets in the impact due diligence tool. This sheet can store identifiers and other key information, such as the enterprise's address, that will be used throughout the assessment. Investors should also include fields for the investee's contact information in case any later follow-up is required.

Scoring Sheets

Investors should then **build scoring sheets** into which users can enter the information used to score each indicator. Tools should include a separate scoring sheet for each major category used as part of the organizing structure; separating the indicators out onto multiple scoring tabs both makes the scoring tabs less overwhelming and reduces the amount of scrolling—which should be minimized wherever possible.

When developing scoring sheets, investors should:

- Build in data validation checks to ensure the data is complete and logical
- Auto-populate data wherever possible (e.g., one investor asked about certifications early in the assessment and then used the parameters underlying that certification to populate other fields in the tool)

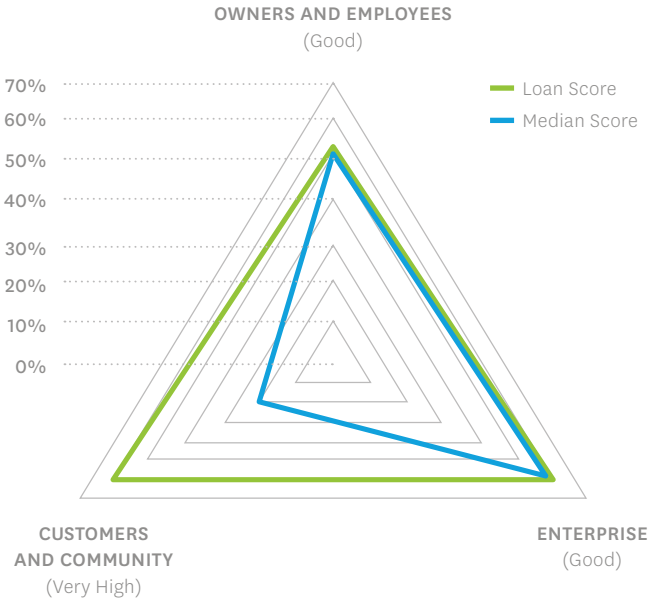
Investors should also include an open-ended comments field alongside each score so that the user could add notes clarifying the rationale for their decisions and any unique circumstances that were considered; investors using both an initial scorer and a reviewer should include comments fields for each. See the section later in this guide on Staffing Impact Due Diligence for guidance on determining which staff are responsible for the use and ongoing management of the impact due diligence tool.

Scoring Summary Sheet

Investors should **build a scoring summary sheet that aggregates data** across scoring tabs and **translates the individual indicator scores** to categorical and overall scores, typically displayed in a table. Investors should consider assigning qualitative classifications to the overall and categorical scores based on a comparison to investments in the current portfolio or pipeline. (E.g., quintiles could be assigned as very high impact, medium impact, moderate impact, limited impact).

Investors should also **include a visual comparison** between the prospective investment opportunity and the existing portfolio. (See section 6 in ***Impact Due Diligence: Emerging Best Practices*** for more on the importance of adopting a portfolio-wide approach.) Most investors include a radar or bar chart to highlight the prospective investment's comparison to the existing portfolio. Others have found it helpful to include a visual comparison based on color-coded cells, with the color-coding tied to conditional formatting based on the investment's scores.

PCV IMPACT DUE DILIGENCE TOOL



Pacific Community Ventures, 2019.

SCORING SUMMARY

CATEGORY	IMPACT RATING	LOAN SCORE	MEDIAN SCORE
OVERALL SCORE	Good	55%	57%
Owners and Employees	Good	54%	52%
Enterprise	Good	63%	61%
Customers and Community	Very high	58%	20%

Sheets Containing Additional Guidance

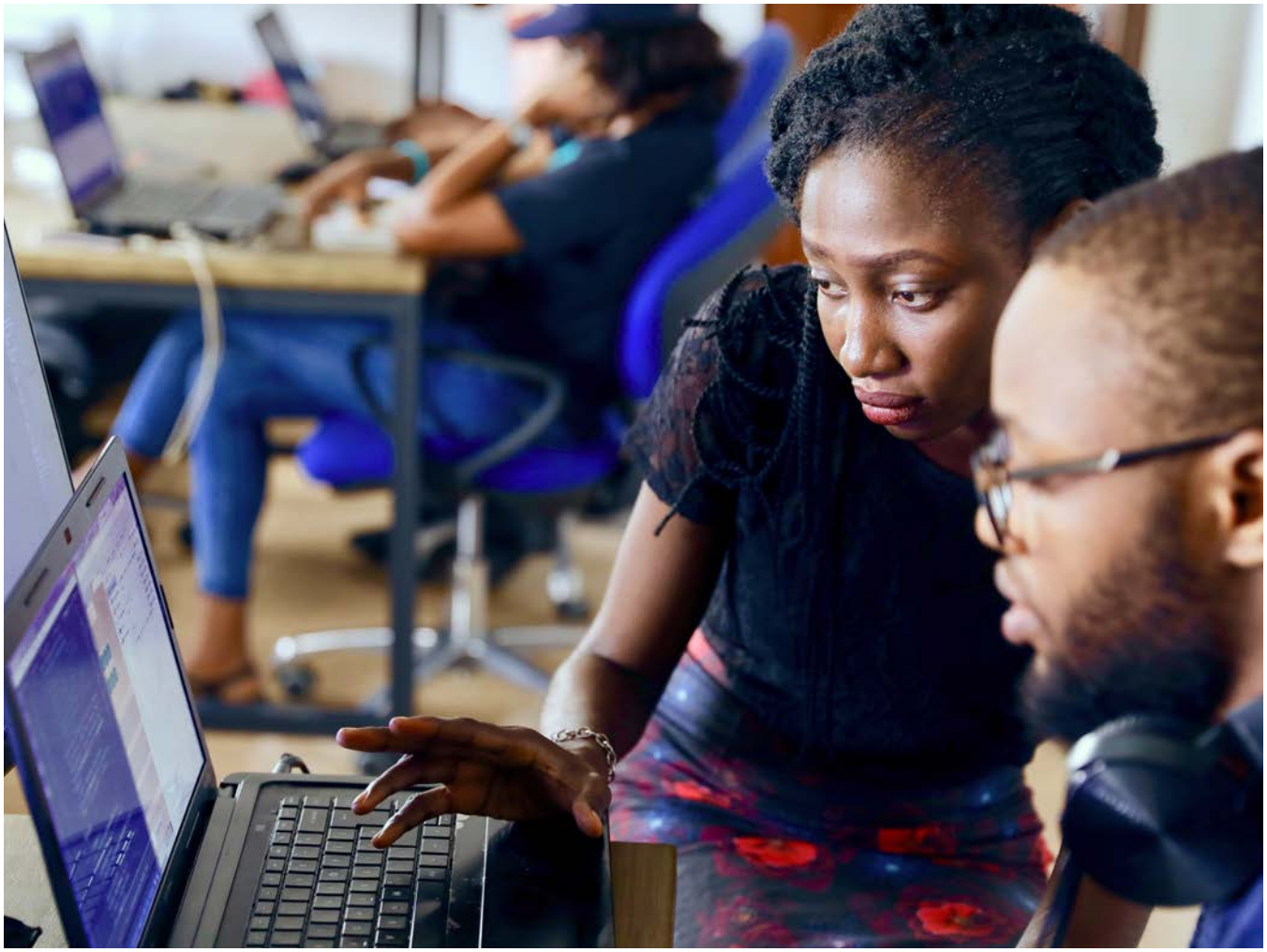
In some cases, **determining an indicator's score will require the investor to gather and interpret third party data**, particularly for location-related socioeconomic, environmental or demographic indicators. For these indicators, it is helpful to prepare detailed guidance for users within a separate sheet rather than within the scoring sheets. For example, an investor may include guidance on calculating a community's poverty rate, extent of gentrification, or relative access to transportation, housing and jobs by accessing and analyzing publicly available data. For examples of some of the datasets referred to in these additional pieces of guidance, see Appendix B: Data Resources.

TESTING AND REFINING

It can be challenging for investors to develop impact due diligence approaches without applying them to their work, so investors should **refine quantitative impact due diligence tools by testing them on investments in their current portfolio**. If the tool is being developed for a relatively new fund with a small existing portfolio, investors should test the tool on the existing pipeline of investment opportunities for which they have access to relevant data. Using the tool to test investments will help the investor understand what is working well and where there are opportunities for refinement. More specifically, impact investors will want to evaluate the areas detailed below in order to calibrate their tool.

Most investors find it helpful to go through several rounds of iteration, testing in batches of five to ten investments, soliciting feedback, refining the tool, and then repeating. Please note that the testing and refinement period is generally most productive when investment staff, who are likely to be the ones using the tool moving forward, are engaged, as they are typically best positioned to share actionable feedback to refine the tool based on their understanding of what information they can feasibly collect from potential investees.

CONSIDERATIONS	KEY QUESTIONS
INDICATORS	• Are the indicators intelligible to those who are not deeply familiar with our approach? • Are there any sets of indicators that feel duplicative? Any areas where there is an opportunity to streamline? • Are there any indicators that are missing? Are there any gaps or areas not covered?
CLARITY / APPROPRIATENESS OF SCORING GUIDELINES	• Are there scoring guidelines that are confusing or ambiguous? • Are there scoring guidelines that don't accurately reflect the organization's intended impact?
USER EXPERIENCE	• Are there elements of the tool that are confusing or difficult to use? If so, what are they?
SCORES	• Are there sets of indicators for which the scores are closely correlated? If so, is there an opportunity to streamline? • Are there indicators for which all investees, or nearly all investees, receive the same score? If so, is there an opportunity to streamline? • Are the investments that the organization believes to be most impactful receiving the highest scores? If not, why? • Are the investments that the organization believes to be least impactful receiving the lowest scores? If not, why?



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When piloting our tool, lending staff gave feedback on questions that needed to be clarified, scores that weren't aligned with their experience, and aspects of the tool that could be improved to make it easier to use. That feedback was essential, and is one of the reasons we now regularly use the tool and find it genuinely helpful. "

—Catherine Dun Rappaport
Vice President of Learning and Impact Measurement, *BlueHub Capital*

BUILDING AN INVESTMENT PORTFOLIO DATASET TO BENCHMARK INVESTMENT SCORES

For an impact due diligence tool to effectively guide investment decision-making, the scores it produces must be compared to relevant benchmarks. (See section 6 in ***Impact Due Diligence: Emerging Best Practices***.) In other words, investors need a way of defining strong and weak scores. Since investors tend to develop their own unique tools based on their organization's impact objectives, approach to impact, and priorities, as well as the lack of relevant impact-related benchmarks in most sectors, it is unlikely they will be able to use externally-available benchmarks. Therefore, investors should use benchmarks based on the impact due diligence scores of investments in their current portfolio. If investors are launching a new fund and do not yet have a portfolio, they can use data from the prospective investments in their pipeline instead.

To **establish relevant current portfolio benchmarks**, investors must:

- **Score all investments in the current portfolio** by using the impact due diligence tool
- **Calculate the median portfolio score**, both overall and for each category in the organizing structure
  - > This data can be used to populate charts visually comparing the prospective investment to the current portfolio
- **Identify the number of rating categories to employ** (e.g., using 3 categories—high impact, moderate impact, and low impact) and **calculate the scoring cutoffs**, both overall and within each category, for the relevant number of rating categories (e.g., in the 3-category example, the investor would want to identify the cutoff scores for the top third of the portfolio, middle third of the portfolio, and bottom third of the portfolio)
  - > The cutoff can be used to assign ratings based on the distribution of investments across the existing portfolio

EXAMPLE: RATING BASED ON DISTRIBUTION OF INVESTMENTS IN THE EXISTING PORTFOLIO

RATING	HIGH IMPACT	MODERATE IMPACT	LIMITED IMPACT
OVERALL	60%	40%	0%
INVESTEE	70%	30%	0%
CUSTOMER	55%	50%	0%
COMMUNITY	50%	40%	0%

Note: Scores shown represent the minimum scores required to qualify for each category.

Investors should **continue to update the investment portfolio dataset and scoring cutoffs as new investments are made**; ensuring the scoring cutoffs are updated in both the Excel tool and investment portfolio file. Continuously updating the scoring cutoffs ensures that prospective investments continue to be compared to relevant portfolio benchmarks.

2

IMPLEMENTING A SYSTEMATIC APPROACH *to* IMPACT DUE DILIGENCE

Integrating Impact Due Diligence into Existing Processes

2.1

Staffing Impact Due Diligence

2.2

Using Impact Due Diligence to Strengthen Relationships with Investees

2.3

Using Impact Due Diligence to Inform Decision-Making

2.4

Using Impact Due Diligence to Inform Post-Investment Evaluations of Impact

2.5

Integrating Impact Due Diligence into Existing Processes

2.1

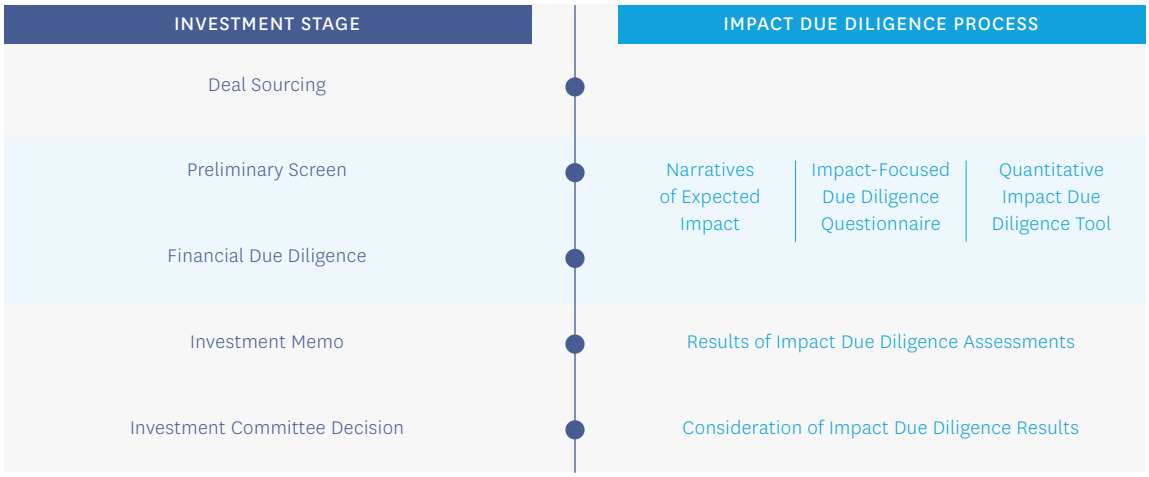
Engaging in impact due diligence is much more than a technical exercise and requires staff time, organizational buy-in, and thoughtful implementation.

This section provides an overview of strategies for successfully integrating impact due diligence into existing processes to foster adoption and ensure ongoing use, both considering staffing implications as well as existing investment processes.

PROCESS FOR CONDUCTING IMPACT DUE DILIGENCE

Investors should conduct impact due diligence, whether it be a narrative of expected impact, due diligence questionnaire, or quantitative tool, in parallel with financial due diligence. This enables investors to more efficiently integrate impact due diligence into existing processes and streamline data collection.

INTEGRATING IMPACT INTO PRE-INVESTMENT DECISION MAKING



Pacific Community Ventures. Representation of Pre-Investment Decision-Making. 2019.

Note that while many investors integrate some questions about impact into an initial screening of an investment's viability, most impact due diligence occurs after the preliminary screen.

INTEGRATION INTO EXISTING PROCESSES

Investors have found it helpful to integrate impact due diligence into the following stages of the investment process, which helps ensure that they are used to drive decision-making.

Implementing a new impact due diligence approach may also require the development of a new workflow. Involving the staff affected by these changes may help increase their buy-in, as they will have more time to contribute to and learn their new workflows.

> "We've considered giving loan officers tablets to fill out the [impact due diligence] tool in real time when speaking with potential borrowers, but I think that constantly entering data during the conversation might make it challenging for loan officers to build rapport with entrepreneurs."
>
> **—Mike McCreless**
> Impact Management Project and Former Senior Director of Strategy and Impact, *Root Capital*

PROCESS	ROLE OF IMPACT DUE DILIGENCE
DEAL SOURCING	Investors should highlight their intended impact in marketing materials and on intake forms to strengthen their pipeline of impact-aligned investment opportunities.
PRELIMINARY SCREEN THROUGH FINANCIAL DUE DILIGENCE	Investors should conduct their impact due diligence assessment in parallel with financial due diligence to streamline data collection. Since investors often collect information for impact due diligence assessments through conversations with investees, they should integrate discussions of impact, especially regarding how key stakeholders are affected, into conversations around the organization's business model and financial performance. (See section 4 of ***Impact Due Diligence: Emerging Best Practices.***) However, investors should complete the scoring of their quantitative tools separately to allow the conversations to flow more naturally. Note: The practice of conducting impact and financial due diligence concurrently should yield efficiency benefits for investors across asset classes, but investors focusing on public equity investments will also likely conduct these assessments by leveraging publicly available information and ESG datasets (e.g., MSCI, Sustainalytics). (See section 3 of ***Impact Due Diligence: Emerging Best Practices*** for details on the importance of bridging the divide between ESG and impact assessments.) For an example of how ESG is integrated into investment due diligence for public equities see Neuberger Berman's white paper on ESG investing.
INVESTMENT MEMO	Investors should incorporate the results of expected impact assessments into investment memos alongside the results of financial due diligence assessments. Investors should synthesize the results of the qualitative assessment into a **narrative of expected impact** explaining the potential investee's approach to impact, anticipated impact, any unique considerations and applicable risks. Many investors are adamant that, even where quantitative impact due diligence assessments are available, an accompanying narrative is critical to comprehensively communicating the prospective investee's anticipated impact and the capital's role in supporting that impact. (For example, descriptions of the extent to which customers are underserved, the expected influence the company may have on its industry, or any unique aspects of the business model that enhance or detract from the company's ability to achieve impact may be easiest to convey with a narrative that accompanies a quantitative impact score.) Investors with quantitative impact due diligence tools should also incorporate the results of their quantitative assessments by including tables summarizing investment's overall and categorical scores, as well as charts showing each investment's anticipated impact performance in relation to the existing portfolio. See section 7 of ***Impact Due Diligence: Emerging Best Practices*** for an overview of the importance of prioritizing the accessibility and comprehensibility of impact due diligence approaches.
INVESTMENT COMMITTEE MEETING	To ensure that financial and impact performance are used to drive decision-making, investors should present the results of impact due diligence assessments alongside assessments of financial performance at investment committee meetings. While each investor's unique organizational structure influences the format of these meetings, it can be helpful to include both investment officers and members of the impact team in these discussions.

Staffing Impact Due Diligence

2.2

To win internal buy-in for, collaboratively develop, and effectively implement systematic approaches to impact due diligence, staff members across the organization must have clearly defined roles and responsibilities.

Although each investor's organizational structure will surface unique considerations, this section offers high-level guidance on effective strategies for developing and implementing formalized approaches to impact due diligence.

ASSIGNING RESPONSIBILITY AND DETERMINING ROLES

To be successful, staff across the organization should work collaboratively to develop and implement the organization's approach to impact due diligence.

DEVELOPMENT

While developing a systematic approach to impact due diligence should be a collaborative effort across teams, each investor should identify a single project lead to ensure accountability. While successful project leads can have investment or impact-focused roles, they should possess the following qualities:

- Influence across the organization, including the ability to modify existing processes
- A strong understanding of the organization's targeted impact
- Relevant expertise, or a willingness to seek out relevant resources, to inform the development of the organization's approach to impact due diligence
- The capacity to develop, implement, and refine a systematic approach to impact due diligence (E.g., at least five hours per week for four to twelve months.)

Pacific Community Ventures: Staffing the Development of an Impact Due Diligence Tool

TO DEVELOP THEIR QUANTITATIVE IMPACT DUE DILIGENCE TOOL, PCV WORKED CROSS-FUNCTIONALLY.

PCV's Research and Consulting team worked with PCV's Lending team to gather feedback on indicators, indicator weights, and scoring guidelines; the feasibility of collecting certain indicators from investees; and whether the tool was holistically assessing anticipated impact. Given that the lending team works most closely with investees, it was important to collect their feedback and ensure their buy-in as the quantitative tool was developed.

- Significant knowledge of the existing portfolio and/or pipeline, where applicable, including insights into which investments are perceived as more or less impactful
- A strong understanding of existing processes and the feasibility of different assessments

While the project lead should serve as the champion of the initiative and remain accountable for the overall outcome, the lead should engage staff members across teams to ensure that developing the impact due diligence approach is a collaborative initiative. In particular, it will be critical to engage members of the management and investment teams:

- **Management:** Given that senior leadership sets the organization's strategy, including the organization's impact objectives and investment approach, it is critical to engage members of the management team to understand and align on the organization's expectations, priorities, and the types of impact it seeks to achieve. See the Developing Impact Goals section for more details.
- **Investment Staff:** Since investment staff have the most direct contact with investees and often the best understanding of their impact models, the project lead should solicit input from investment staff to clarify their interpretations of the organization's impact objectives and approach to impact.

As a next step, the project lead should draft the preliminary impact-related DDQs, indicators, weights, and scoring guidelines, soliciting feedback from management and investment staff as capacity and interest allow.

The intensity of each type of staff member's engagement will vary by project and across organizations; as the initiative moves from the conceptual stages of development into testing and refinement, management usually becomes less involved and investment staff play a more significant role. Investment staff are instrumental in providing feedback on the viability of collecting specific data since they typically have the most direct contact with investees; this includes when data may be collected and where there might be ambiguity around the data collected. During the final stages of refinement, this perspective typically enables the investment team to provide valuable concrete guidance that helps improve recommended processes.

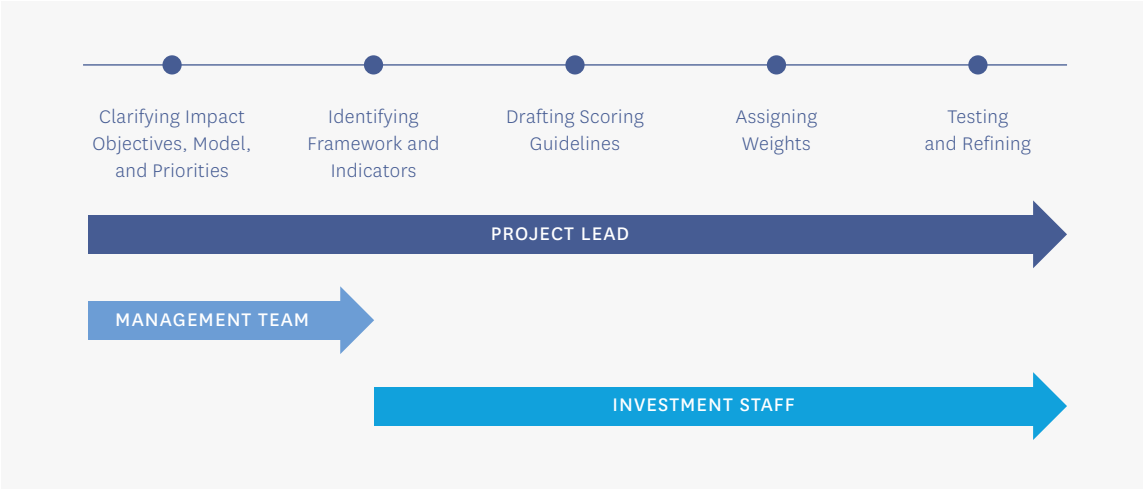
While not always feasible, the project lead should also consider engaging and soliciting feedback from existing investees to better understand the relevance and availability of the information and data needed to administer the impact due diligence tool. In this way, the project lead can elevate the perspectives of key stakeholders and ensure the tool reflects the priorities of those who are impacted by the companies or projects they finance.

"

The loan officers intimately know what's happening in the communities we serve, which is why we relied upon their perspective when we built a tool to efficiently and effectively assess anticipated impact."

—Mike McCreless
Impact Management Project and Former Senior Director of Strategy and Impact, *Root Capital*

CROSS-TEAM COLLABORATIVE APPROACH TO DEVELOPING A QUANTITATIVE IMPACT DUE DILIGENCE TOOL



Pacific Community Ventures, 2019

USE

Similar to the development process, the implementation of formalized approaches to impact due diligence should also involve collaboration across teams. While staffing models for IMM will vary based on each investor's organizational structure, level of buy-in, and capacity constraints—as outlined in the GIIN's State of Impact Measurement and Management Practice—investors should consider engaging the groups of staff members detailed in the table that follows as interest and capacity allow. For smaller investors who have staff engage in both investment and impact measurement activities, the potential roles for team members as described in the table becomes more flexible and overlapping.

> "We have spent a lot of time educating the investment committee about our impact due diligence approach, but that has been immensely valuable. This is the first time they've had nonfinancial methods to evaluate our portfolio."
>
> —Fortune 500 Institutional Investor

TYPE OF STAFF MEMBER	POTENTIAL ROLE(S)
IMPACT STAFF	• Overseeing administration and ensuring use of the impact due diligence tool, supporting investment staff where questions arise • Reviewing completed impact due diligence assessments to ensure consistency across investments
INVESTMENT STAFF	• Engaging in discussions with potential investees to collect information necessary for impact due diligence assessments • Presenting the results of the impact due diligence assessment, along with the financial due diligence, at investment committee meetings
ANALYSTS	• Sourcing and pre-populating location-based data to reduce the burden on investment staff
INVESTMENT COMMITTEE	• Reviewing summaries of impact due diligence assessments as part of investment decision-making

The most effective approach to bolstering staff members' ability to speak about the tool is to teach them how to use it—or at least familiarize them with it. Project leads should therefore facilitate staff trainings so that staff can articulate the use case for impact due diligence and its impact on the investment process.

Where applicable, investors should also educate the investment committee on impact due diligence. This can help ensure the approach is viewed as credible, committee members have an understanding of how impact due diligence is used and can offer input into the tool's development, and can, where desired, discuss expected impact when making investment approval decisions.

BlueHub Capital: Staffing Impact Due Diligence

WHILE THE DEVELOPMENT OF BLUEHUB'S QUANTITATIVE IMPACT DUE DILIGENCE TOOL WAS LED BY A MEMBER OF THE IMPACT TEAM, THE INITIATIVE WAS A COLLABORATIVE EFFORT THAT INVOLVED THE LOAN FUND PRESIDENT, LOAN OFFICERS AND PORTFOLIO MANAGEMENT STAFF.

Impact Due Diligence Tool Development

The development of BlueHub's quantitative impact due diligence tool was led by the organization's Vice President of Learning and Impact Measurement. She took the lead on drafting initial indicators and scoring guidelines, and on assigning preliminary weights. She vetted early drafts of the tool with the full lending team and piloted a semi-final version with lenders. Together, they rated historic loans and adjusted scoring guidelines so that the tool better captured the impact of those loans. This helped ensure that the final tool was user-friendly and produced scores reflective of loans' actual impact. As part of this process, the Vice President of Learning and Impact Measurement enhanced the tool to simplify and streamline the assessment process, to minimize subjectivity and use objective data, and to make findings accessible. Engaging loan fund staff members throughout the lifecycle of the project helped BlueHub efficiently integrate the tool's use into existing processes and to develop buy-in. The current impact due diligence scoring process takes staff 30-45 minutes per prospective loan, and staff use it for almost all loans under consideration.

Using Impact Due Diligence to Strengthen Relationships with Investees

2.3

This section explores the ways in which investors can use impact due diligence to strengthen relationships with investees, as well as build their capacity.

Impact due diligence requires an investment of time from both investors and investees. While it is intended to help investors better understand anticipated impact, investors can use impact due diligence to strengthen relationships with their investees by helping them to derive value from the process. (See section 4 of ***Impact Due Diligence: Emerging Best Practices*** for more details.) This section explores the ways in which investors can use impact due diligence to strengthen relationships with investees, as well as build their capacity.

Impact investors conducting systematic impact due diligence can strengthen their relationships with investees by:

- **Developing a shared vision around intended impact**: During impact due diligence, investors speak with investees to collect the information necessary to assess anticipated impact and to understand the perspective of key stakeholders affected by the investment. These discussions support alignment between the investor and investee and signal that impact is a priority, and help foster a strong foundation for additional conversations on impact post-investment.

- **Offering investees insights to help them better understand their strengths and weaknesses in relation to impact**: Some investors choose to share the results of impact due diligence with their investees directly, helping them to better understand their strengths and weaknesses in relation to impact. One investor found that this practice helps encourage transparency, ensure accountability, and promote progress over time. Another investor views the discussion following the share-out of results as an opportunity to both increase the investees' capacity and also gauge their commitment to impact; this investor sees questions from investees on opportunities to increase their impact as an indication of their genuine commitment. (See section 5 of ***Impact Due Diligence: Emerging Best Practices*** for more details on the importance of evaluating a commitment to impact and learning.)
- **Offering guidance on risk mitigation strategies and opportunities to improve their impact**: Several investors cite using impact due diligence to identify impact risks, and many of these investors use these insights to develop risk mitigation strategies that they then share with their investees.
- **Providing investees with referrals to resources, service providers and other investors that can help them improve their performance**: Investors gain a deeper understanding of prospective investees' strengths and weaknesses during impact due diligence, and they can use this knowledge to inform more effective referrals to technical assistance providers, other investors or other resources with the potential to help bolster investee performance.

We found that some of the enterprises we were evaluating weren't generating significant impact, so we developed a report on the strategies they could implement to become more impactful. Empowering organizations to increase their social impact is essential to our approach."

—**Yulia Romaschenko**
Director of Programmes and Donor Relations, *Charities Aid Foundation*

Bridges
Fund Management

Bridges Fund Management: Using Impact Due Diligence to Strengthen Relationships with Investees

BRIDGES FUND MANAGEMENT IS A UK-BASED FUND MANAGER SPECIALIZING IN SUSTAINABLE AND IMPACT INVESTING.

Bridges benefits from the IMM expertise and thought leadership of the Bridges Impact+ team. Bridges builds strong relationships by engaging deeply with potential investees during impact due diligence. The Bridges team begins by developing investment-specific logic models in collaboration with investees, which fosters a shared understanding of the investment's anticipated impact and signals Bridges' commitment to impact. The logic model is then used to guide a discussion of the impact metrics that could be tracked over time. While building investment-specific logic models may not be the right approach for all investors, especially those with a high volume of transactions, the practice of engaging closely with investees during impact due diligence can help all investors ensure alignment between investments and impact goals.

Using Impact Due Diligence to Inform Decision-Making

2.4

For investors to maximize the value of their impact due diligence assessments, they should use their assessments to inform both pre- and post-investment decision-making.

INTEGRATING IMPACT DUE DILIGENCE INTO EXISTING PROCESSES

Pre-Investment

Prior to closing investments, investors can use impact due diligence assessments to support portfolio strategy by:

- **Ensuring attainment of impact thresholds or targets**: Some investors set quantitative, impact-rating thresholds, which are *minimum acceptable* scores for an investment or portfolio, as well as targets, which are desired scores for an investment or the portfolio overall. Investors with impact-rating thresholds or targets use the results of impact due diligence assessments to understand how prospective investments would impact their overall portfolio performance, and whether making that investment would enable the portfolio's impact scores to remain within its targeted parameters. While setting quantitative impact thresholds or targets can help with portfolio management, some investors are wary of implementing these practices too quickly, given uncertainty regarding the accuracy of newly-implemented impact due diligence tools and the limited availability of data that could inform the selection of realistically achievable impact thresholds or targets. Impact thresholds and targets should only be used when investors have obtained sufficient evidence that their quantitative impact due diligence tools are adequately predictive of impact.
- **Moving towards the efficient impact frontier**: Several investors are using, or hope to begin using, the results of quantitative impact due diligence to move closer to creating an efficient impact frontier, at which a portfolio delivers maximum impact for a given level of financial return.

Root Capital: Moving Towards the Efficient Impact Frontier

ROOT CAPITAL IS A NON-PROFIT SOCIAL INVESTMENT FUND THAT FINANCES SMALLHOLDER FARMERS ACROSS AFRICA, LATIN AMERICA, AND SOUTHEAST ASIA.

Root Capital has been a pioneer in developing quantitative impact due diligence tools and facilitating investors' movement towards the efficient impact frontier. Root Capital conducts quantitative impact due diligence assessments of each investment's prospective social and environmental impact; the organization then plots the risk-adjusted expected financial returns of loans on one axis of a graph and the expected aggregate impact from the quantitative assessment on the other to ensure that the portfolio effectively balances financial return and expected impact. Root Capital uses this method to improve their decisions around loan approval, capital allocation, and portfolio goal-setting.

Since investors must understand each investment's prospective impact to balance impact and risk-adjusted financial return across the portfolio, quantitative impact due diligence tools are a critical step towards effectively executing this portfolio strategy.

Prior to investment, impact investors can use impact due diligence assessments to inform individual investment decisions by:

- **Informing whether a prospective investee receives financing:** Investors seeking to build an impactful portfolio use the results of impact due diligence assessments, where they are available, to inform decisions about capital deployment. While a few investors use quantitative impact scoring cutoffs from quantitative impact due diligence assessments (e.g., deals must score more than a 5), most view quantitative scores as one of several important inputs informing the investment decision.
- **Informing investment terms:** Some impact investors are, or hope to soon begin, using the results of impact due diligence assessments to inform investment terms. Impact investors providing loans, for example, offer lower risk-adjusted interest rates to investees with greater expected impact.

> We assess expected impact whenever we're evaluating an investment opportunity. We discuss the targeted social or environmental impact, but also collect impact data and ensure it informs the investment decision."
>
> **—Anna Kanze**
> Chief Operating Officer, *Grassroots Capital Management*

CASE STUDY

The Rise Fund's Impact Multiple of Money: Informing Whether a Prospective Investee Receives Financing

THE RISE FUND WAS LAUNCHED BY TPG, ONE OF THE WORLD'S LARGEST PRIVATE EQUITY FIRMS, WITH TWO-BILLION-DOLLARS IN 2016.

The Rise Fund aims to achieve market-rate returns along with a social or environmental impact and has developed a methodology to calculate the economic value of the social or environmental impact they believe will occur from each dollar invested. This methodology is known as the Impact Multiple of Money™ and has six steps:

1. Assess relevance and scale
2. Identify evidence-based outcomes
3. Estimate the value of those outcomes to society
4. Adjust for risks
5. Estimate terminal value
6. Calculate the social return on every dollar invested

The Rise Fund will only invest in companies when the Impact Multiple of Money calculation suggests that $2.50 of social or environmental return will be generated for every $1 of capital invested. This is expressed as an Impact Multiple of Money™ of 2.5×, and demonstrates how the Rise Fund uses impact due diligence to inform investment decisions.

HERON

Heron: Informing Decision-Making

HERON IS A PRIVATE FOUNDATION WITH A MISSION TO HELP PEOPLE AND COMMUNITIES HELP THEMSELVES OUT OF POVERTY BY CHAMPIONING PEOPLE, PLACES, AND ENTERPRISES WHO CHALLENGE BROKEN CONVENTIONS AND DARE TO CHANGE.

Heron works to achieve their impact by using the spectrum of investment tools, from grants to below-market investments (e.g., loans) and market-rate investments (e.g., fixed income, equity). Using Net Contribution, Heron has committed to aligning their entire portfolio with their mission. When Heron defines the net contribution of an enterprise, they ask what the aggregate effect of that enterprise is on the world, including both positive and negative effects. Heron then uses the net contribution lens to analyze how enterprises both consume and generate four types of capital: human, natural, civic, and financial. To ensure that Heron is consistently applying the net contribution lens and holding all enterprises to the same standard, they:

- Collect and report data at the enterprise level
- Measure both negative and positive performance of the enterprise
- Track and report data over time
- Track and report data across the totality of the enterprise as it relates to all relevant stakeholders and capitals
- Recognize that enterprises have a limited zone of control
- Whenever possible, ensure that the data has integrity (and is ideally even audited)
- Apply the framework as appropriate across enterprise types, tax statuses, and asset classes
- Apply the framework as appropriate on a peer-relative basis

By applying its net contribution approach, Heron is able to more efficiently compare the expected and realized impacts of a diversity of investments both before and after capital is deployed.

- **Informing impact covenants in investment agreements:** Some investors use impact due diligence to identify impact risks and develop remediation plans to address those impact risks. One investor's quantitative impact due diligence tool even includes potential risk mitigation strategies, which are cited in conversations with potential borrowers. Some investors incorporate adherence to remediation plans as specific impact covenants in the investment agreement. Other investors have used impact due diligence to identify opportunities to achieve greater levels of impact and have set impact targets codified as impact covenants that include financial incentives (e.g., reduced interest rate for loans) for achieving results during the investment period.

Post-Investment

After investments are deployed, investors can use the results of impact due diligence assessments by:

- **Identifying appropriate technical assistance providers and resources**: Since conducting impact due diligence assessments strengthens investors' understanding of their investees' strengths and weaknesses, investors are using this knowledge to help them more effectively select appropriate technical assistance providers for each investee.
- **Establishing impact baselines and/or impact targets, against which investees' performance is assessed over time**: Investors cited using information from impact due diligence to establish impact baselines and guide the development of impact targets. For additional guidance on investee-specific, transaction-level targets please see the IMP's guidance on this topic.
- **Informing compensation and career advancement**: While none of the investors interviewed link quantitative impact due diligence scores to compensation and advancement—even though a handful of investors compensate fund managers based on impact performance—this was cited as the "next frontier" of elevating the practice of IMM such that expected impact is deemed as important as expected financial risk and return.

IDB Invest: Using Impact Due Diligence to Inform Ongoing Assessments of Impact

IDB INVEST IS THE PRIVATE INVESTMENT ARM OF THE INTER-AMERICAN DEVELOPMENT BANK AND HAS A PRESENCE IN 28 COUNTRIES.

IDB Invest developed the Developmental Effectiveness Learning Tracking and Assessment (DELTA) framework to guide impact due diligence as well as its Developmental Effectiveness Analytics (DEA) system. The DEA system, uses a consistent evaluation framework across the life of an investment that enables IDB Invest to systematically assess project and portfolio progress towards expected impact results, identify areas where additional support is needed, and facilitate learning based on organizational experience.

Using Impact Due Diligence to Inform Post-Investment Evaluations of Impact

2.5

Investors should regularly use their impact assessment tools employed during due diligence to determine whether expected impacts have been achieved, which can be complemented by post-investment IMM and third-party evaluations of impact.

Linking pre- and post-investment IMM processes allows investors to test the accuracy of impact due diligence approaches, empowering them to improve how they assess expected impact as well as revisit their impact goals or theory of change. This empowers the investor and the investee to test their assumptions, identify risks and course-correct if necessary, increasing the likelihood that significant positive impact will be achieved.

Further, by linking impact due diligence to post-investment evaluations, investors can ensure that they are appropriately incentivizing staff to pursue positive impact. By assessing investment staff's performance not only by analyzing the expected impact of their investments, but also by assessing the ongoing impact performance of the investments, investors 1) increase the likelihood that they will actively seek to improve investees' impact over the life of their investment and 2) decrease the risk that staff will overinflate expected impact.

The IFC's AIMM system links a project's anticipated impact with ongoing results measurement and ex-post evaluation.

WITH A COMMITTED PORTFOLIO OF OVER $57 BILLION AS OF THE END OF 2018, THE INTERNATIONAL FINANCE CORPORATION (IFC) IS THE LARGEST GLOBAL DEVELOPMENT INSTITUTION FOCUSED EXCLUSIVELY ON THE PRIVATE SECTOR IN DEVELOPING COUNTRIES.

In 2017, the IFC started to pilot an impact due diligence tool called the Anticipated Impact Measurement and Monitoring (AIMM) system. The system evaluates a project's anticipated impact along two dimensions:

- **PROJECT OUTCOMES:** These refer to a project's direct effects on stakeholders (including employees, customers, suppliers, government, and the community); the direct, indirect, and induced effects on the economy and society overall; and the effects on the environment.
- **MARKET OUTCOMES:** These refer to a project's ability to catalyze systemic changes that go beyond those effects brought about by the project itself.

The second "M" stands for "monitoring," an essential component of the AIMM system. Each development outcome claim in IFC projects is explicitly tied to one or more monitoring indicators, regularly tracked during portfolio supervision. By tracking these indicators, the AIMM system links project ratings with real-time results and measurement findings. There is also a structural link between front-end diagnostics and ex-post evaluation functions.

The IFC IMM system thus connects (1) diagnostics to (2) ex-ante project selection/scoring, which is tied to (3) results measurement during portfolio supervision and, ultimately, to (4) ex-post evaluation.

Conclusion

By distilling our experience with impact due diligence and drawing upon the practices of leading impact investors, our aim is to encourage readers to give formal impact due diligence a try.

Whether your organization is new to impact management or is an experienced practitioner seeking to adopt emerging best practices in IMM, we hope this report contains useful resources that empower you to more efficiently, accurately and systematically assess expected impact—thereby strengthening your ability to achieve your goals and positively influence the world.

We ask that readers not be daunted by the diversity and complexity of approaches taken to assess anticipated impact. Rather than seeking to implement all approaches and practices surfaced in this report, investors should focus on incremental improvements to their impact due diligence and reference the sections most relevant to them. In so doing, impact investors will realize our collective vision of building a sustainable financial industry that meaningfully tackles, rather than contributes to, the most critical issues we face today.

APPENDIX A

RESEARCH METHODOLOGY

This guide has been informed by extensive desk research on best practices in impact due diligence; 38 interviews with leading practitioners, researchers, and consultants; and the PCV team's experience developing impact due diligence systems for clients and PCV's own loan fund.

During the desk research phase, PCV examined nearly 50 organizations, including investors and advisors, to understand practices they had developed on impact due diligence.

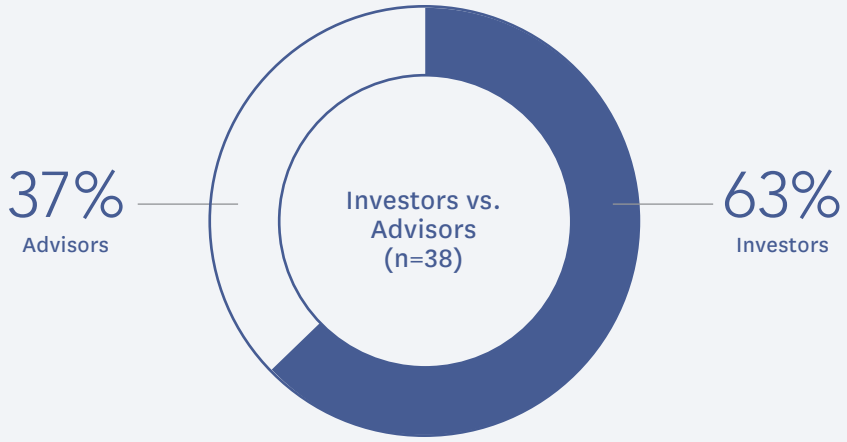
Based on this review, PCV created a list of practitioners and advisors engaged in impact due diligence for the interview phase; the IMP and the GIIN also provided input to the list of potential interviewees. Interviews took place from August to October 2018 and were 60 minutes in length.

INTERVIEWEES		
NAME	ROLE	ORGANIZATION
Abigail Rotheroe	Head of Impact	Project Snowball
Abiskar Shrestha	Investment Manager	MicroVest
Anna Kanze	Chief Operating Officer	Grassroots Capital Management
Ashley Elliot	Global Liaison	GIIN East Africa
Barbara Magnoni	President	EA Consultants
Belissa Rojas	Strategy and Monitoring Sr. Specialist, Development Effectiveness Division	IDB Invest
Ben Carpenter	CEO	Social Value UK
Brendan Maher	Vice President of Integrated Capitals	Heron Foundation
Bryan Locascio	Senior Associate	Tideline
Caitlin Rosser	Senior Officer, Impact and Communications	Calvert Impact Capital
Catherine Banat	Director of Responsible Investing	RBC Global Asset Management
Catherine Dun Rappaport	Vice President of Learning and Impact Measurement	BlueHub Capital
Charly Kleissner	Co-Founder	Toniic and KL Felicitas Foundation
Christian Rosenholm	Senior Professional	International Finance Corporation
Christina Gotfredson	Impact Manager	Gary Community Investments
Conor Sullivan	Associate	Bridges Fund Management
David Pritchard	President, Board of Directors	Social Value US / Independent Consultant

INTERVIEWEES		
NAME	**ROLE**	**ORGANIZATION**
David Sand	Chief Impact Strategiest	Community Capital Management
Dean Hand	Alternative Investments Manager	Ashburton Investments
Elizabeth Teague	Senior Social and Environmental Performance Manager	Root Capital
Eric Rice	Portfolio Manager, Global Impact Portfolio	Wellington Management
Erica Barbosa Vargas	Director, Solutions Finance	McConnell Foundation
Francois de Borchgrave	Managing Director	KOIS Invest
Genevieve Edens	Senior Manager, Social Impact	WaterEquity
Jean Chorazyczewski	Program Director, Business Assistance	Fair Food Network & Michigan Good Food Fund
Jeremy Nicholls	Founder and Former CEO	Social Value UK
Jurgen Hammer	Chief Investment Officer and Head of Social Performance Management	Grameen Credit Agricole Microfinance Foundation
Karim Harji	Programme Director	Oxford Impact Measurement Programme, Saïd Business School, University of Oxford
Luke Apicella	Manager, Prudential Impact Investments	Prudential Financial
Mariah Collins	Manager	Bridgespan
Matt Barry	Chief Impact Officer	Gary Community Investments
Mike McCreless	Investor Content Lead, Formerly Senior Director of Strategy and Impact	The Impact Management Project, formerly Root Capital
Namrita Kapur	Managing Director, DEF+Business	Environmental Defense Fund
Oscar Benitez	Manager	Third Sector Capital Partners
Paul Herman	CEO and Founder	HIP Investor
Pieter Oostlander	Founding Partner	Shaerpa
Saheba Sahni	Senior Investment Associate	Tufts University Investment Office
Sara Olsen	Founder and CEO	SVT Group
Stephanie Cohn Rupp	Managing Director	Tiedemann Advisors
Sydney Bolger	Associate	Tiedemann Advisors
Sophie Mechin	Development Manager, Solutions Finance	McConnell Foundation
Tamar Pashtan	Head of ESG	Vital Capital
Tanay Tatum-Edwards	Business Development Associate	MicroVest
Tom Adams	Chief Impact Officer	Acumen Fund
Tony Berkley	Vice President, Strategy and Impact	Prudential Financial
Yulia Romaschenko	Director of Programmes and Donor Relations	Charities Aid Foundation Russia

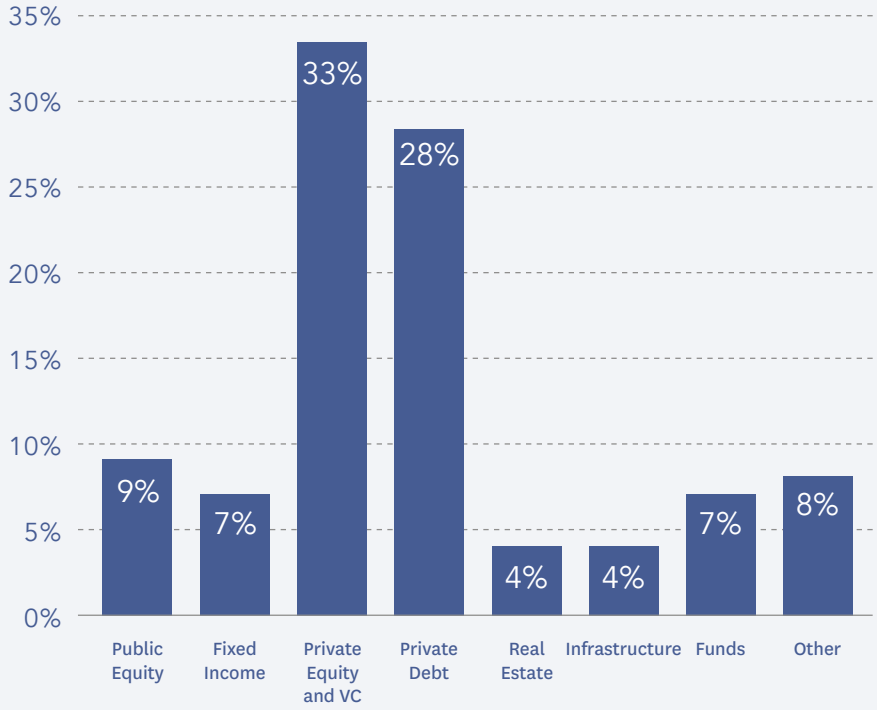
RESEARCH METHODOLOGY *(continued)*

CHARACTERISTICS OF INTERVIEWEES



NUMBER OF INTERVIEWEES

Of the 38 interviewees, 24 (or 63%) were investors; 14 (or 37%) were advisors. Advisors included consultants or members of field-building organizations.



INVESTORS BY ASSET CLASS

(Percent of Respondents)*

Of the 24 investors interviewed, respondents favored private debt and private equity/venture capital (61%).

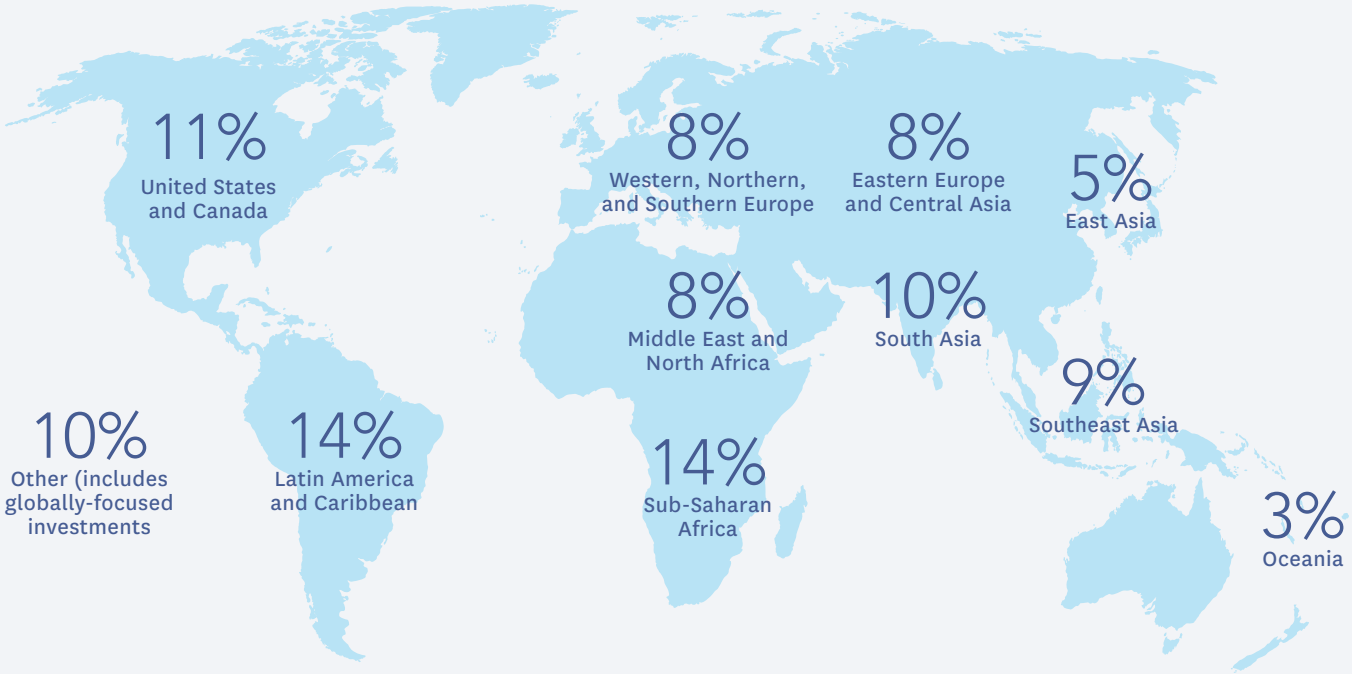
** Note: Investors may allocate to multiple asset classes (24 investors interviewed)*

INVESTORS BY GEOGRAPHIC ALLOCATION

(Percent of Respondents)*

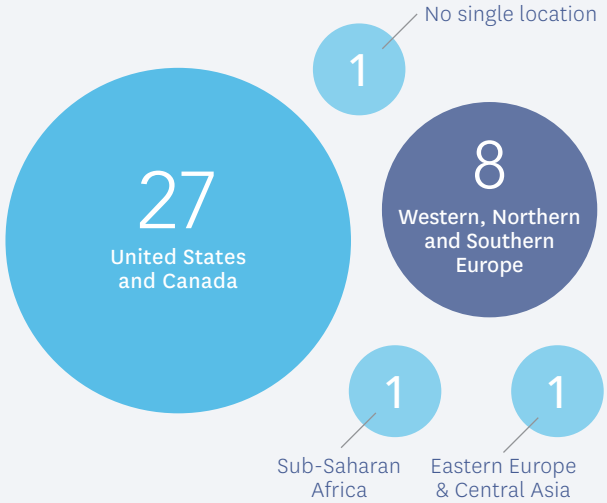
62% of investors invest in emerging markets. Of all regions, Latin America and the Caribbean and Sub-Saharan Africa are the two most common regions receiving investment. The U.S. and Canada, South and Southeast Asia, and other (including Global) were not far behind.

** Note: Investors may allocate to multiple geographies (24 investors interviewed)*



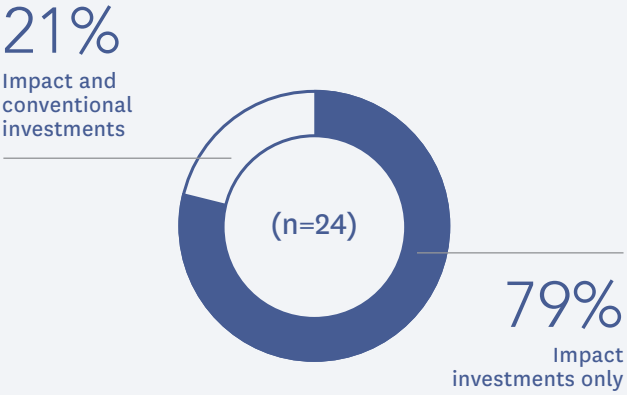
INTERVIEWEE HEADQUARTERS LOCATION

Most interviewees (27 of 38) were part of organizations headquartered in North America (the U.S. and Canada). Western, Northern, and Southern Europe came in second with eight interviewees.



IMPACT-ONLY & CONVENTIONAL INVESTORS

Of the 24 investors, 79% exclusively make impact investments while 21% make both impact and conventional investments.



APPENDIX B

DATA RESOURCES

As noted throughout the guide, location-based datasets can be valuable resources for impact due diligence, as they can be used to bolster the rigor of assessments without requiring additional information from investees. While PolicyMap is an excellent resource for U.S. location-based datasets, it requires a *paid* subscription.

In this section, we highlight a selection of *free* datasets that can be incorporated into impact due diligence. While this is not an exhaustive list of resources, it is intended to help investors begin to think about the types of external datasets they can leverage to strengthen their assessments of anticipated impact.

Other types of external assessment tools can feed into impact due diligence assessments. One commonly cited resource is the Poverty Probability Index, which is a poverty measurement tool for enterprises with a mission to serve the poor. The tool is most useful for investors with an international focus and uses 10 questions about a household's characteristics and asset ownership to compute the probability that the household is living below the poverty line.

NAME	FOCUS	GEOGRAPHY	DATA LOOKUP METHOD
CIA World Factbook	Comprehensive (includes information on people, government, economy, geography, communications, transportation, military, and transnational issues)	International (country level data)	Select the country from the dropdown at the upper right and navigate to the relevant category
Enterprise's Opportunity 360	Opportunity Index scores for housing stability, education, health and well-being, economic security, and mobility	United States (census tract level data)	Manual lookup of individual addresses (enter address in a search bar and select "Get Enterprise Opportunity Report" when bubble pops up)
FFIEC Geocoding	Census data (tract income level, median family income, % below poverty line, % minority, etc.)	United States (census tract level data)	Manual lookup of individual addresses (enter address in a search bar and expand the census demographics box to show relevant census tract information)
Health Resources & Services Administration	Various healthcare-related data points, including status as a medically underserved area/population	United States (census tract level data)	Manual lookup of individual addresses (enter address in a search bar and check the relevant layers you would like to see to determine classification)
MIT Living Wage Calculator	Living wage	United States (county level data)	Manual Lookup of Regional Benchmarks

NAME	FOCUS	GEOGRAPHY	DATA LOOKUP METHOD
ECONOMIC INNOVATION GROUP Opportunity Zones Map	Opportunity Zone status	United States	Manual lookup of individual addresses (enter address in a map to zoom to the appropriate region and then look at the key)
Ramsar Sites Information Services	Wetland type, ecosystem services, statutory designations (e.g., UNESCO Biosphere Reserve, World Heritage Site), Management Plan, Threats	International (worldwide coverage)	Select relevant layer and zoom to relevant portion of map OR navigate to the "Exports" tab to download a data file
SPOTLIGHT ON POVERTY & OPPORTUNITY Spotlight on Poverty and Opportunity	Poverty rate, child poverty rate, senior poverty rate, extreme poverty rate	United States (state level data)	Select a state to see key statistics
SDG Impact United Nations Development Program SDG Impact	Reports on SDG-enabling investment opportunities and conditions in target markets and sectors	170 countries	To be determined; this resource is still in the process of development
protected planet United Nations Environment World Conservation Monitoring Center's Protected Planet	World Database on Protected Areas (WDPA), Marine Protected Areas, Indigenous Peoples and Community Conserved Areas and Territories (ICCA), Protected Area Management Evaluations (PAME)	International (worldwide coverage)	Zoom to the relevant portion of the map to identify protected areas
USDA United States Department of Agriculture Economic Research Service	Food deserts	United States (census tract level data)	Manual lookup of individual addresses (enter address in a map to zoom to the appropriate region and then look at the key)
THE WORLD BANK IBRD • IDA | WORLD BANK GROUP World Bank	Agriculture & Rural Development, Aid Effectiveness, Climate Change, Economy & Growth, Education, Energy & Mining, Environment, External Debt, Financial Sector, Gender, Health, Insurance, Poverty, Private Sector, Public Sector, Science & Technology, Social Development, Social Protection & Labor, Trade, Urban Development	International (country level data)	Navigate by country or indicator to access relevant data

APPENDIX C

QUESTIONS TO GUIDE ONGOING REFINEMENT OF APPROACHES TO IMPACT DUE DILIGENCE

PROCESSES	RELEVANT STAKEHOLDER OR TOPIC	KEY QUESTIONS
SOLICITING FEEDBACK FROM KEY STAKEHOLDERS	Investment team	• What elements of the organization's approach to impact due diligence are working well? What elements have been challenging? • Are there important considerations that are not reflected in the organization's existing impact due diligence approach? If so, what?
	Investees	• Were the impact-focused questions asked of you during due diligence relevant? Were there impact-focused questions you felt you should have been asked but were not? • Has the impact due diligence process provided any value to your organization? If so, what?
REVIEWING APPROACH ANNUALLY	Staffing	• Are there opportunities to redistribute responsibilities to reduce the burden on the investment team? For example, are there questions impact analysts could pre-populate using existing data sets before the investment team completes the remainder of the impact due diligence assessments?
	Scope	• Does the existing approach apply the appropriate level of rigor given the investor and investees' capacity constraints?
	Quantitative Indicators, Questions, and Weights	• Are all the indicators and questions included relevant given the most recent understanding of the organization's impact? • Are there new indicators that should be added? • Do the indicator weights still accurately reflect the organization's priorities? If not, how should they be revised?
	Quantitative Scoring Guidelines	• Are there any scoring guidelines that would benefit from clarification? • Are there any scoring guidelines that should be updated based on a deepened understanding of the organization's impact?
	Data Inputs	• Does the data included in the tool represent the latest release available for that dataset? • Are there any newly released datasets that should be incorporated to strengthen the tool?

PROCESSES	RELEVANT STAKEHOLDER OR TOPIC	KEY QUESTIONS
REVIEWING APPROACH ANNUALLY *(continued)*	Next Steps	• Are there opportunities to implement new tools and/or processes to strengthen the organization's approach to impact due diligence? • Are there opportunities to use the results of impact due diligence assessments in different ways?
REVIEWING APPROACH IN CONCERT WITH ANY MAJOR ORGANIZATIONAL UPDATES	Organizational Structure	• Has the organization added new capacity in any areas? If so, how can this additional capacity, and or the new skills/resources that come with this capacity, be leveraged to strengthen the organization's impact due diligence? • Where might there be opportunities to shift impact due diligence responsibilities to increase efficacy?
	Impact Model	• Do the organization's impact due diligence processes and tools still align with the organization's strategies for generating impact? If not, what needs to change?
	Impact Objectives	• Do the organization's impact due diligence processes and tools still accurately reflect the organization's impact objectives? If not, what needs to change?

APPENDIX D

COMMONLY USED IMPACT DUE DILIGENCE QUESTIONS

The following table reflects commonly used impact due diligence questions that were cited by the 38 investors, researchers, and consultants interviewed for this research.

IMP ALIGNMENT	IMPACT DUE DILIGENCE QUESTIONS
WHAT	• What types of activities, products, or services does the investee engage in or offer? > E.g., for a food-related business, do they engage in production, collection, aggregation, and/or processing? > E.g., for financial service providers, do they offer loan, deposits, compulsory insurance, voluntary insurance, or other financial services?
	• What, if any, is the impact on the environment from the supply chain, business operations, and product or service—positive and negative, intended and unintended?
	• What, if any, is the impact on the community from the supply chain, business operations, and product or service—positive and negative, intended and unintended?
	• What, if any, is the impact on the community from this product or service—positive and negative, intended and unintended?
WHO	• Who are the target beneficiaries? Describe them according to the following characteristic categories: socioeconomics, demographics, etc. (including male/female, urban/rural, etc.)
	• What is the target environment? Describe it according to the following characteristic categories: habitat, plant/animal species, geography, conservation status, etc.
	• Where is the product or service sold? Is it sold in a regional, national, or international/global market?
HOW MUCH	• How many permanent employees are at the investee organization, according to designated demographic and socioeconomic categories?
	• How many people does the investee organization serve, according to designated demographic and socioeconomic categories? By product or service? How many are active?
	• How long have customers been using the product or service?
	• What is the degree of change, if any, compared to the baseline experienced by the customers from the investee's product or service?
	• Over what time period did the change occur from the investee's product or service?

IMP ALIGNMENT	IMPACT DUE DILIGENCE QUESTIONS
CONTRIBUTION	• **Signal that impact matters:** does the investor factor in the impact of an enterprise—such that, if all investors did the same, it would ultimately lead to a 'pricing in' of effects on people and planet by the capital markets?
	• **Engage actively:** does the investor use expertise and networks to improve the environmental/societal performance of businesses?
	• **Grow new or undersupplied capital markets:** does the investor anchor or participate in new or previously overlooked opportunities that offer an attractive impact and financial opportunity?
	• **Provide flexible capital:** does the investor recognize that certain types of enterprises will require acceptance of lower risk-adjusted return in order to generate certain kinds of impact?
	• How, if at all, will the investment enable the investee to attract additional investment (e.g., from conventional investors)?
	• Is the investor expanding access to capital by providing financing to an investee without comparable alternatives?
	• Is the investor's financing critical to the investee's financial viability?
	• Is there any non-financial support that the investee is requesting that the investor is positioned to offer (e.g., technical assistance)?
	• Have investors conducted shareholder engagement in the past or demonstrated a willingness to do so in the future if needed?
	• Is the investee providing a valued product or service? What, if any, is the need for this product or service in the market? What would the customer or user do without this product and/or service?
	• To what extent can the investees' intended beneficiaries (e.g., customers or employees) access similar products, services, or employment opportunities?
	• What, if any, is the investee's impact on the sector in which they operate?
	• What, if any, change(s) does the customer or employee see from the investee's product or service? E.g., for employment, what is the wage of the next best employment option (or, is this not the best employment option)?
	• What, if any, evidence does the investee have of its expected outcomes?
	• What is the investee's track record of delivering their expected outcomes?

IMP ALIGNMENT	IMPACT DUE DILIGENCE QUESTIONS
RISK	• Does the investee collect and use data to understand and manage the performance of their enterprise (e.g., do they have an IMM system)?
	• Does the investee incorporate customer or user voice in their systems or processes?
	• Is the product or service and its delivery channels designed to meet the users' needs and preferences?
	• How does the product or service impact the community and/or the environment?
	• Has the investee codified their impact goals (e.g., via an impact thesis, logic model, theory of change, or similar framework)?
	• Is impact embedded into the business model of the investee? E.g., will impact increase as the enterprise scales?
	• How well does the potential investee align with the investor's impact goals?
	• What external factors might disrupt the delivery of the expected impact (e.g., political, social, economic, reputation, etc.)?
	• Are employees, customers and users responsibly treated?
	• How does the investee balance social and financial performance?
	• Do staff at all levels support the mission of the investee? E.g., does the board and management commit to the impact goals?
	• How might the impact differ than is anticipated? Examples below. > If an investee aims to create jobs, will they also contribute to the loss of an even greater number of jobs? > Is there a risk of deforestation, soil degradation, water quality concerns, or other environmental risks? > Is there a risk of gentrification and/or displacement?

APPENDIX E

GLOSSARY OF TERMS

Below is a glossary of terms, including organizations and abbreviations, used throughout the guide along with their definition.

TERM	DEFINITION
IMPACT MEASUREMENT AND MANAGEMENT (IMM)	To make effective impact investments, impact measurement and management must be practiced post-investment. Investors should identify and consider the positive and negative effects one's enterprise's actions have on people and the planet and then figure out ways to mitigate the negative and maximize the positive in alignment with one's goals. More guidance is provided by the GIIN, among other organizations.
STAKEHOLDER	Persons or groups directly or indirectly affected by an intervention, including those who may have stakes in a project and/or the ability to influence its outcome, either positively or negatively.
IMPACT MANAGEMENT PROJECT (IMP)	Facilitates a global network of standard-setting organizations to coordinate efforts that can accelerate widespread impact measurement and management; through this work, they developed the five dimensions of impact.
GLOBAL IMPACT INVESTING NETWORK (GIIN)	The global champion of impact investing, dedicated to increasing its scale and effectiveness around the world. The GIIN convenes impact investors to facilitate knowledge exchange, highlight innovative investment approaches, build the evidence base for the industry, and produce valuable tools and resources.
LOGIC MODEL	Graphic depiction (road map) that presents the shared relationships among the resources, activities, outputs, outcomes, and impact for a program. It depicts the relationship between a program's activities and its intended effects.
THEORY OF CHANGE	Graphic depiction (road map) of how and why a desired change is expected to happen in a particular context. It maps out the resources, activities, outputs, outcomes, and impact for a program. It can include what happens both inside and outside a program's "sphere of accountability," as well.
INDICATOR	Unit of measure, either qualitative or quantitative, that indicates the state or level of something.

APPENDIX F

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