A SHORT GUIDE

How to Develop an Impact Strategy

INVESTMENT IMPACT INDEX™
innovative · measurement · management

A Short Guide:

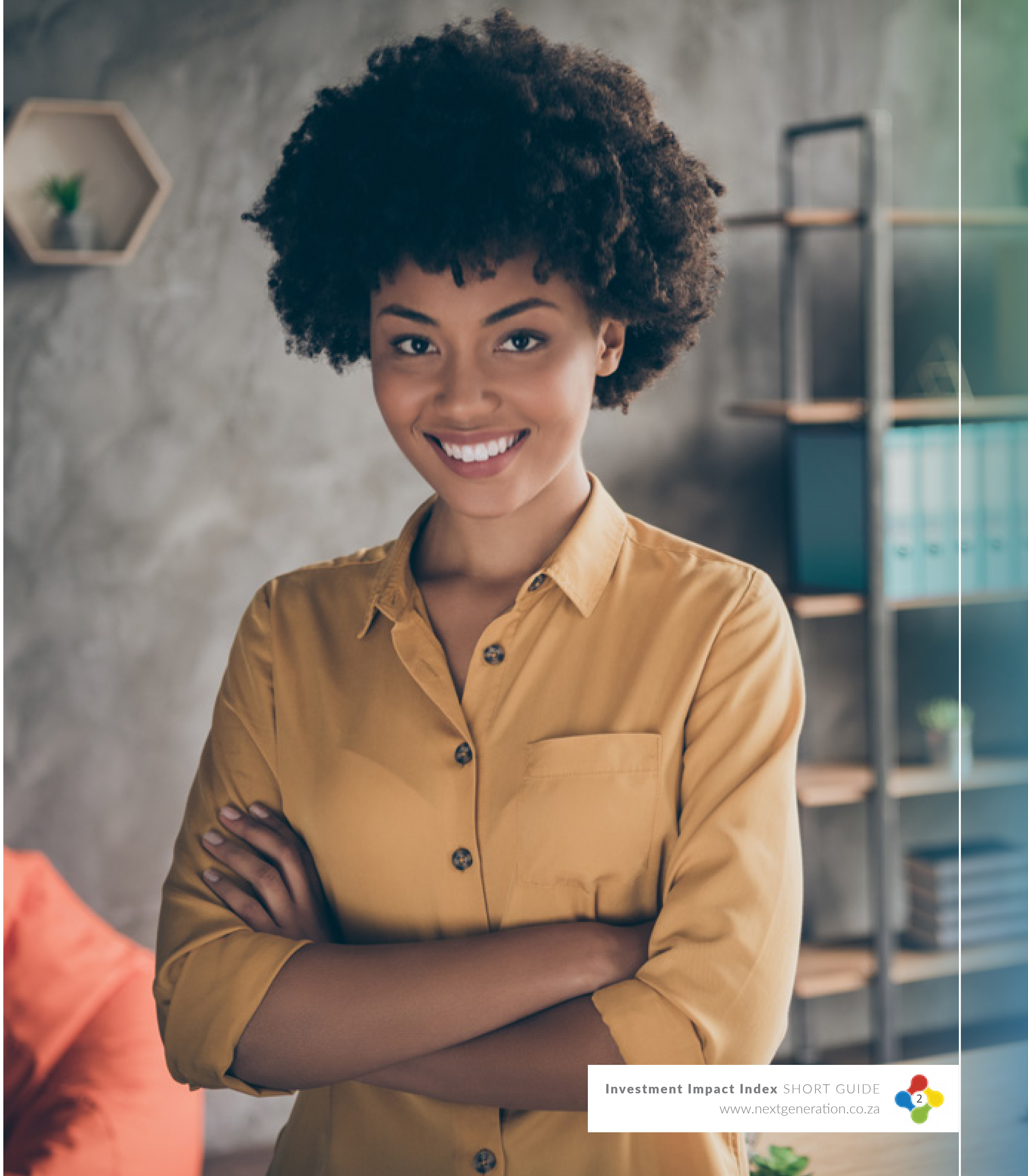
Creating an Impact Strategy

Introduction

Strategy is different for every organization. For social and impact investors it is critical because it guides everything that they do. Impact strategy only means one thing – it clearly spells out the intent of the investor. It outlines the intent:

- To impact specific sectors
- To impact specific stakeholders
- To measure that impact
- To ensure equitable return on investment

An impact strategy clearly outlines the purpose of the investment, it is a detailed roadmap to achieve the impact, and provides a long term vision of how such impact will be achieved as well as how the investment will be measured to determine success of the impact vision.



What makes a good impact strategy?

- The impact strategy should be developed and owned by those who will take it forward. Engaging all stakeholders within the impact value chain, investors, investees, beneficiaries, influencers in the process helps ensure that they are part of the strategy and for realizing the strategy.
- The impact strategy should get to the heart of what the investment is about to achieve. It also creates the space for important or difficult conversations about what are the trade-offs, concessions, expectations and results in a more robust and meaningful strategy.
- The impact strategy should combine analysis with imagination. Strategy development is structured - but structure is not necessarily the enemy of creativity.
- The impact strategy must be lived. A good impact strategy should be emergent - setting a direction of travel but adapting along the way. Effective investors regularly review their strategy as they learn more about what works in practice, and manage their expectations about what is relative, material and effective.

What is the strategy process?

Impact strategy development sits within a wider, iterative process. This short guide focuses on the first two aspects of the strategy process: **preparation and development.**

OVERVIEW OF THE PROCESS

The approach outlined in this document takes investors through preparation and onto information-gathering and analysis (the strategy triangle), before bringing this together to assess options and develop the most suitable strategy. The strategy can then be implemented, and regularly reviewed.

The diagram below provides an overview of the individual components making up the impact strategy development process and will be discussed in more detail in the sections to follow.

Leadership, governance and culture focused on continuous learning

STRATEGY PREPARATION PHASE

- Review
- Contextualise
- Stakeholders
- Leadership

Resources allocated to strategy development process

STRATEGY DEVELOPMENT PHASE

- Purpose
- Resources
- External
- Strategic choices

Resources allocated to deliver strategy

STRATEGY IMPLEMENTATION PHASE

- Planning for impact
- Delivering impact
- Assessing impact
- Reviewing impact

How to plan for impact

To become an impactful investor that creates value in all dimensions, for all stakeholders, you need to start by thinking about the value and impact you want to create. This will require a very specific vision and making it visible and tangible. Explicitly mapping the impact you want to create is a great guide for strategic thinking and action. The best way to start thinking about impact is to draw up a Theory of Change (ToC).

A framework for your impact strategy

A Theory of Change visualizes how and why a desired change and therefore the envisaged impact is expected to happen. Change here means economic, societal or environmental progress, and an investors influence on that high-level change is impact. As such, a ToC also helps to ask the difficult questions: What do an investor believe needs to happen in the world, and what is their role in it?' What is the investor's purpose and vision? It also means having to be brutally honest when it comes to negative impact.

A theory for impact

A theory of change model looks like this:

INPUTS	ACTIVITIES	OUTPUTS	OUTCOMES	IMPACT
The resources we invest to achieve the impact	The actions taken to carry out the investment model and strategy	The direct results and outputs of the investment	The intended and unintended outcomes of the investment	The ultimate impact achieved by the investment

This logic model is also a **value creation model**, and it describes the resources needed (inputs), the activities and direct results thereof (outputs). These outputs can often be expressed through existing performance indicators, such as number of products sold, score in customer satisfaction or amount of materials re-used. But what are the outcomes, and finally, what is the impact? These seem like difficult questions, but from a distance, it's usually simple. It really helps to start at the end, with the desired impact, and follow a process of back mapping to specify what the investor needs to do to achieve this impact.

Some investors are taking serious steps in quantifying or even monetizing these high-level impacts through impact measurement, but just mapping these cause-and effect paths qualitatively without adding data is a valuable step in itself.

An impact thesis

A clearly articulated impact thesis is coherent and evidence-based, stands out among competitors in the market, and can be distilled to a concise and persuasive pitch.

A well-crafted, coherent investment and impact thesis integrates all the pieces of a complex investment strategy into a single narrative that is thoughtful, thorough, and supported by data and other evidence. Impact investment funds have more complex stories to tell than traditional investment funds, which makes it especially challenging to develop a coherent fund narrative. From the outset, fund managers should have a clear sense of their fund's intended impact in the context of their investment strategy and managers should be prepared to share it externally.

For many impact investors, the impact thesis is usually driven by the value set of an individual or organization and can reference a theory of change, often with reference to specific impact objectives such as access to clean water or affordable housing. An impact thesis can reference a target population, business model or set of outcomes through which the investor intends to deliver the impact.

In crafting a clear impact fund thesis, fund managers might ask themselves: What existing need in the market does my investment thesis address? What is the evidence that the need exists, and what is the extent of the need? What is the theory of change? What underlying assumptions does the thesis imply? Do my proposed sector of investment, deal size, and deal type fit existing market needs? Do the expected returns and exit strategies seem realistic and appropriate given the market, investee potential, and investor expectations?

Demonstrating how a fund fits into the competitive market landscape is an important part of a coherent story. Fund managers might ask themselves: Would the fund be unique in the marketplace? How is it unique? What would make the fund compelling to investors? How does the fund's impact strategy compare to others in the market? Answers to these questions influence key fund management practices, such as which types of LPs to target or investee businesses to approach given their capital requirements? For example, a venture capital fund that focuses on early-stage companies in the concept phase expects high risk and high return. The fund management team must also be assembled carefully, as team members' individual experiences in each sector or industry and their local relationships can make or break a fund's success.

Developing an impact strategy

Developing an impact strategy starts with the vision you have for impact.

It then evolves into specific plans of how to achieve the impact, which will happen on several levels, namely:

- Impact achieved by individual investments
- Impact achieved by theme or focus area
- Impact achieved across portfolios
- Total impact achieved by the investment fund

Theory of change

Total Impact - Impact thesis

IMPACT BY INDIVIDUAL INVESTMENTS

IMPACT BY FOCUS AREA OR THEME

IMPACT ACHIEVED ACROSS PORTFOLIOS

PREPARATION: BEFORE YOU START

A new strategy may result in change - a new direction, cessation of activities, different people. Before you embark on developing your strategy, make sure you are prepared:

- **Review your existing strategy and impact data:** Previous strategy is likely to include successes you want to maintain, as well as elements that need to change. Impact data will provide insights into what works (or not). Reviewing what has gone before - both what is written and what happens in practice - helps to identify what should be stopped, continued, or scaled up.
- **Identify your red lines:** What are the things that cannot change? Is your mission/impact vision and objectives set in stone? How about your organizational structure? Being clear upfront about what is up for discussion - and what is not - helps identify how radical the new strategy can be.
- **Identify key stakeholders, including users (end beneficiaries):** Engaging stakeholders in the strategy process will lead to better decisions, provide legitimacy to any change of direction, and spread ownership of the organization's purpose. Considering when and how to involve different stakeholders is vital.
- **Assess leadership:** Change requires a CEO, senior management and investment team and board that is up to the task. A strong team sets a clear direction, makes difficult decisions, takes tough action and implements uncomfortable processes. Board support is vital. Not all leadership meets this demanding criteria - a strategy is still helpful where leadership needs strengthening and can help to determine the ultimate composition of the team.
- **Commit time and resources:** Last but not least, effective strategy takes time and resources. Allocate these both to the strategy development process and also to delivering the strategy.

DEVELOPING YOUR STRATEGY

Identifying your core impact objectives

A natural starting point is to look at your core purpose, and to agree this with key stakeholders. Many investors get confused between different terms and how to frame the core purpose. Your core purpose may comprise of:

- **Vision:** How you want the world to be. It is inspirational and specific, but not limiting.
- **Mission:** The purpose of your investment fund and the change you want to make. This change should contribute to the vision—it does not have to provide all the answers.
- **Goals:** These are specific to a strategy or project or fund and is usually measurable in some way. Goals can be high level and ambitious, complemented by lower level objectives contributing to the endgame.
- **Values:** The attitudes and beliefs that underpin all of your investments.

?

QUESTIONS TO ASK:

- What is your core purpose?
- What change do you want to make?
  What concrete things do you want to achieve?
- What are your top priorities; what activities deliver these?
- How can you add most value? Do stakeholders agree?

VALUES, MISSION, GOALS, VALUES

- Workshop to understand differing perspectives and reaching consensus
- Does your organization have a shared sense of purpose or how will your values, objectives and targets affect the investment strategy?

THEORY OF CHANGE

- Workshop to map how the organization/fund will achieve its goals
- How will your fund and investment create the change you want to see and what are your assumptions?

ACTIVITIES MAPPING

- Excercise to map how the organization/fund will achieve its intended impact objectives
- How do your current activities fit with your core objectives and purpose, what should you not do, what does not work, what compromises will you consider or trade-offs?

STAKEHOLDER MAPPING

- Engaging with stakeholders to understand their journey with your products and services, consider from the investment fund, investee's intent to the end user - in other words, right across the impact value chain
- What do stakeholders value the most, does it align with your objectives, how can you optimize the impact experiences of your investees and their beneficiaries?

IMPACT NETWORKS

- Excercises to map how your activities fit within a broader impact network or ecoysystem and identifying gaps
- Consider the impact value chain across and within sectors, both up and downstream
- How can you collaborate with others or complement their work or how can others influence the impact of your investments for maximum impact?

Assessing your resources and competencies

Understanding your resources and capabilities and linking these to your impact objectives while recognizing shortcomings and risks, is a good place to start as it will influence the type (depth and scale) of impact you can potentially achieve.

?

QUESTIONS TO ASK:

- What are you good at (expertise and experience) and what makes you distinctive?
- What evidence do you have of impact achieved so far (per investment, per theme/focus area, per portfolio, per sector?)
- Do you have the right skills and experience and what else do you need to guarantee impact and return on investment?
- What resources do you have - and are you using them efficiently?

ORGANISATIONAL ANALYSIS

- Engagement, organizational (site) visits, interviews, SWOT and GAP analysis, tailored reserach per geography, sector
- Consider direct, indirect as well as negative impact
- Consider risks that will impact the impact and return objectives
- What are our strengths and weaknesses and how should we operate?

GOVERNANCE AND LEADERSHIP REVIEW

- Review of board, investor and investee roles, composition, skills, interaction, processes and culture
- Do we have the right people and processes to achieve our impact objectives or what is missing

CULTURE AND VALUE ANALYSIS

- Analysis of culture and readiness for impact
- Does our vision, purpose, objectives and targets align, does it support our investment impact strategy, what should we keep or change?

IMPACT ASSESSMENT AND ASSURANCE

- Skills, competencies, support to assess impact, audit impact practices, validation and verification of impact data
- What do we want to achieve, how will we manage impact and how will we measure, analyse, verify, assure and report impact and return

COST BENEFIT ANALYSIS

- Analysis of financial management systems, business models and investment cases
- Are the investments secure and sustainable? How do we know?

Mapping the external environment

Understanding the external environment will have a direct impact on the effectiveness of investments as well as the outcomes of the investments. Mapping can happen on several levels, including:

- **Needs mapping**: To determine the areas of the greatest need and how these might be changing in response to services being delivered.
- **Landscape analysis:** Can identify new innovative approaches to achieve greater impact, at scale, and greater cost efficiency, it can also identify benchmarks to measure impact against or identify potential threats that would limit impact. Or it could also identify opportunities for collaboration or benchmarking. Or it could also include sector, geographic, competitor or innovation analysis.

?

QUESTIONS TO ASK:

- What needs are you addressing now and what are the future trends in new needs?
- How is the economy, environment or society changing – i.e. demographics, technology adoption, etc.
- What is the policy or regulatory environment and what potential risks does it pose?
- Who is doing what and where do we fit in the value chain?

PESTLE ANALYSIS

- Facilitated discussion of political, economic, social, technological, legal and environmental trends
- What is happening that might affect the impact strategy now and in the future?

SYSTEMS MAPPING

- Mapping systems around investors and investees, beneficiaries and other stakeholders, networks, ecosystems, connections, and root causes of issues to be impacted
- What are the points of leverage in the system or how can we influence others?

NEEDS MAPPING

- Analysing the needs data, baselines, future trends, and considering impact of early interventions (pilots)
- What is the scale, nature and location of need and how is it changing?

STAKEHOLDER LANDSCAPE ANALYSIS

- Desktop research and expert interviews to understand other investors and stakeholders in the landscape and their interests
- Whose interests are aligned with ours, who has power and influence in this sector?

MARKET ANALYSIS

- Analysis of market context for products, services
- Are new product or service development required, what role will innovation or technology play, are there new entrants or disruptors?

Making strategic choices

The outcome of the research process outlined above, will provide the guidance for action plans. Strategic decisions require careful and dispassionate judgments. Building from the analysis - the objective is to:

- **Assess your role:** When is service delivery and investment appropriate and what are the alternatives?
- **Assess potential solutions:** What are the pros and cons of different options?
- **Allocate resources:** Can you deliver on the strategy (in totality) or do you need to prioritize?

Framing options to assist in decision making – such as setting criteria for how to decide – will help stakeholders to engage with choices, determine what is possible and consider sensitive trade-offs.

?

QUESTIONS TO ASK:

- Is leadership ready to integrate and execute the strategy?
- How will you decide between investment choices?
- How will you execute?
- What has worked in the past?

ROLE ASSESSMENT

- Assess whether your focus will be on addressing needs, changing systems, aggregating or leveraging resources, work across ecosystems or in specific sectors or changing behaviour
- What approach will maximise impact? What role will best complement other investors work?

OPTIONS APPRAISEL

- Select criteria for assessing solutions, score potential options (e.g. using a matrix) and prioritise
- How do we prioritise, which issues/sectors or opportunities to focus on, what initiatives to develop, how to select investees that best fit our objectives?
- How to rank, rate and prioritize opportunities vs risks vs returns?

SCENARIO PLANNING

- Building on previous analysis, develop plausible scenarious and discuss implications for strategy
- What are the risks associated with the different scenarios and what are our assumptions?

RESOURCE ALLOCATION AND TRADE-OFFS

- Estimate resources needed to deliver on priorities, identify any tensions (e.g. depth vs. breadth vs. scale)
- What is the cost vs impact, what do our resources permit, what are the trade-offs?

ACTION PLANNING

- Plan next steps to implement strategy and revisit leadership, culture, resources, stakeholders
- What will bring strategy to life, is our ambition matched by leadership, culture, resources, objectives and targets?

From development to implementation

- **Be proportionate:** Do not think you have to look at everything at once - perhaps start on a single investment programme or a single investee company in a specifc sector or geographic location.
- **Include relevant stakeholders early:** If you neglect key viewpoints during strategy development the strategy is unlikely to be realistic and implementation will be challenging.
- **Strategy change takes time:** Especially if there are implications for peoples' roles, or if you want to change working cultures or staff behaviour. Allow your timelines to be flexible if it proves necessary.
- **Leadership needs to match ambition:** If your strategy requires taking risks, your leadership style will need to support this. The leadership team may itself need support to adapt and change.
- **A radical change will require a change in cultures and habits:** This is as important as processes and implementation plans. Consistent communication will be key to embed change.
- **Strategy and operational plans go hand in hand:** Do not be tempted to include operational detail in your strategy (often 3–5 year plans), but recognise that if strategy is not translated into operational plans (often annual plans), it is unlikely to be acted upon.

If you have read this far, also look out for our other resources.

We are constantly updating our short guides series. We are working on a follow up guide that will focus on managing and measuring your impact.

NEXT GENERATION
expertise • impact • return

INVESTMENT IMPACT INDEX™
innovative • measurement • management

Address: Future Space | 2 Bruton Road | Nicol Main Office Park | Bryanston

URL: www.nextgeneration.co.za | www.investmentimpactindex.org

Facebook – @investmentimpactindex

Instagram – impactindex_org

Twitter – @impactindex_org

Linkedin – Investment Impact Index

Youtube – Next Generation Consultants