Impact Measurement for Complex Portfolios

GEM

A PRIMER FOR APPLYING THE IMPACT MANAGEMENT PROJECT FRAMEWORK TO A GLOBALLY DIVERSIFIED, MULTI-MANAGER PORTFOLIO

Executive Summary

- Effective impact investing requires rigorous impact measurement.
- Many frameworks for measurement exist, but the Impact Management Project (IMP)created a comprehensive and intuitive model that can be applied to institutional portfolios invested across asset classes and impact objectives. [i]
- In 2019, GEM partnered with Bridges Impact+ Advisory Arm to adapt and apply the IMP framework to GEM's ~$10 billion endowment-style portfolio.[ii]
- GEM engaged in a thorough assessment of investment strategies, including (a) the impact of portfolio companies on key stakeholders, and (b) each investment manager's contribution to impact.
- The output is a map of the portfolio, with strategies categorized along an impact continuum from "Traditional" to "Acting to Avoid Harm" to "Benefiting Stakeholders" to "Contributing to Solutions."
- This paper describes GEM's process and presents case studies that seek to demonstrate the framework's potential to catalyze a paradigm shift in the way endowments, foundations, family offices, and other institutional investors integrate impact and investment objectives.

Measuring & Managing Impact at GEM

Aligning an investment portfolio with social values requires a rigorous and comprehensive impact measurement framework. A well-conceived framework (a) helps investors establish priorities and ensure accountability, (b) can unlock a wider set of investment opportunities across asset classes, geographies, and impact themes, and (c) supports the synthesis of vast amounts of data and information into clear, actionable insights.

In 2017, the Impact Management Project (IMP) emerged as a global, open-source forum for developing consensus on how to measure, manage, and report impact. GEM partnered with Bridges Impact+ Advisory Arm (including members of the team that initiated the development of the Impact Management Project) to adapt and apply the IMP framework to GEM's ~$10 billion endowment-style portfolio.

The IMP framework addresses four key challenges to impact measurement and management.

1. The framework is applied to investments across geographies, asset classes, and impact themes. Historically, many of the leading impact measurement systems and tools have focused in specific areas of the market, limiting their utility for investors that manage multi-asset class and multi-manager portfolios.
2. The stakeholder-centered approach captures impact across a range of stakeholders, in contrast to models that prioritize one stakeholder over another, which often creates a false choice among equally important considerations. Further, it goes beyond ESG integration, an investment approach that we believe is important for mitigating ESG risks and capturing opportunities, but does not fully capture stakeholder impact.
3. The framework levels the playing field across all investments – including those that are not marketed as "impact" investments. It prioritizes impact outcomes over impact reporting, and focuses our attention on stakeholder experiences. Ultimately, we care more about how our clients' investments affect the planet and community than how well our third-party investment managers report this information.
4. The IMP reflects global consensus among thousands of impact investors. In our view, the impact investment industry does not need another system; rather, we need to move forward, building upon the expertise of leaders who have committed their careers to impact investing.

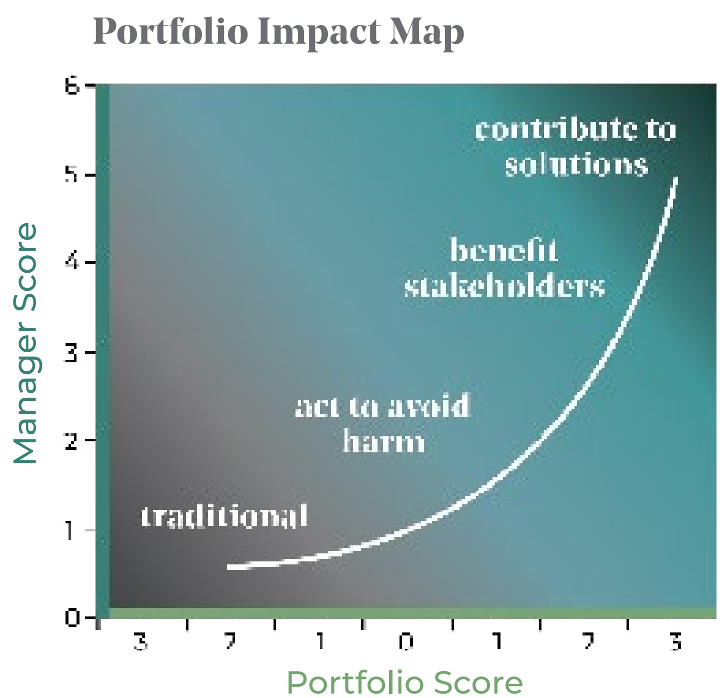
IMPACT MANAGEMENT PROJECT

The Impact Management Project (IMP) is an impact assessment framework developed with contributions from more than 2,000 enterprises, investors, and practitioners, to build global consensus on measuring and managing ESG risks and positive impacts. The IMP framework evaluates the impact of any investment on key stakeholders in order to classify impact as Acting to Avoid Harm (A), Benefiting Stakeholders (B), and Contributing to Solutions (C). The IMP framework also considers the investor's contribution to impact, based on the actions that drive outcomes in an investment or portfolio.

Notably, the IMP categorizes enterprise impact as A (Act to Avoid Harm), B (Benefit Stakeholders), and C (Contribute to Solutions), and then considers investor contribution to develop an impact class matrix; the GEM approach differs in that the manager score (i.e., investor contribution) is incorporated into the categorization of the strategy along the impact continuum.

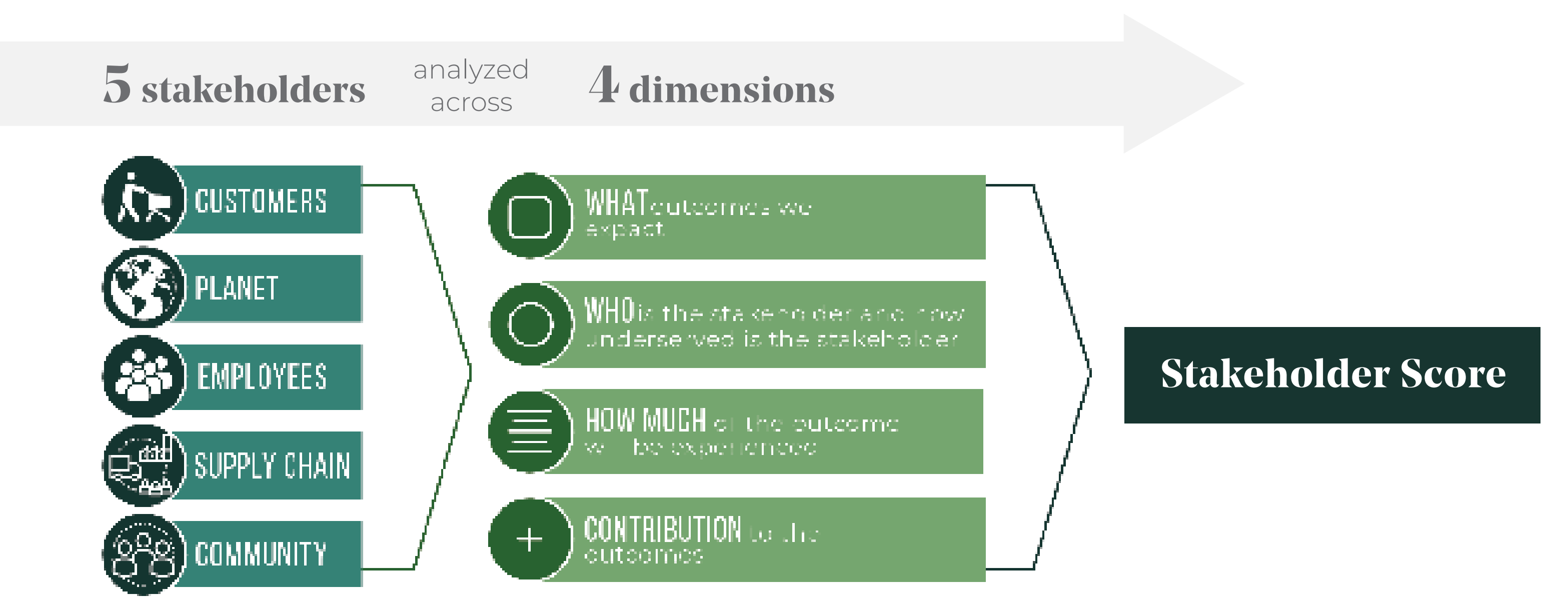
The Portfolio Impact Map

The IMP distinguishes between enterprise impact (i.e., how a company affects stakeholders), and investor contribution (i.e., how the intentions and actions of the investor contribute to impact). GEM's portfolio is invested primarily with third-party, active investment managers. We therefore adapted the framework to measure the impact of each manager's strategy according to two scores: (1) the Portfolio Score, which quantifies the impact of portfolio companies on five stakeholders, and (2) the Manager Score, which quantifies the manager's actions that contribute to the impact of the portfolio. Strategies are mapped on the Portfolio Impact Map with the x-axis corresponding to Portfolio Score and y-axis corresponding to Manager Score. This provides a visual representation of the impact of each strategy in our portfolio. Together, these two scores provide insights that support the team in categorizing each strategy along an impact continuum from Traditional to Contributing to Solutions.



Portfolio Score

We center our analysis on the outcomes experienced by five stakeholders: customers, planet, employees, supply chain, and community. We begin with a bottom-up analysis of the portfolio company's impact on each stakeholder according to four dimensions of impact. We capture quantitative and qualitative inputs across all four dimensions for each stakeholder in GEM's Stakeholder Scoring Model (available upon request), which results in a numerical Stakeholder Score for the impact of the portfolio company on each of the five stakeholders.



In contrast to the IMP's five dimensions, we incorporate risk information into all four dimensions and into our manager underwriting process, and therefore do not consider risk as a separate dimension in GEM's Portfolio Scoring Model.

We believe investors should not have to prioritize one stakeholder at the expense of another. But we also know that some investments have an outsized impact on specific stakeholders. For example, pharmaceutical companies can often have life-or-death consequences for customers, which is an outsized impact relative to the impact on the employees who produce and sell the medicine. These stakeholder experiences should not be given equal weight in the analysis.

We therefore assign Stakeholder Weights within investment areas to quantify the relevance of each stakeholder to the company's overall impact. Stakeholder Weights range from 5% to 50%, which ensures that all stakeholders are incorporated into the analysis, while prioritizing stakeholders within industries where they experience outsized impact. Stakeholder Weights are determined based on the investment area's **potential impact** on the stakeholder, and the **stakeholder's agency** relative to impact experienced.

Potential Impact

An industry's potential impact on each stakeholder is based on research demonstrating the relationship between the industry and the stakeholder. For example, global retail companies are rated as having high potential impact on supply chain workers, given the large number of workers in retail supply chains; the historically limited access to safe and healthy working conditions, benefits, and fair wages; and the range of long-term outcomes for supply chain workers.

Stakeholder Agency

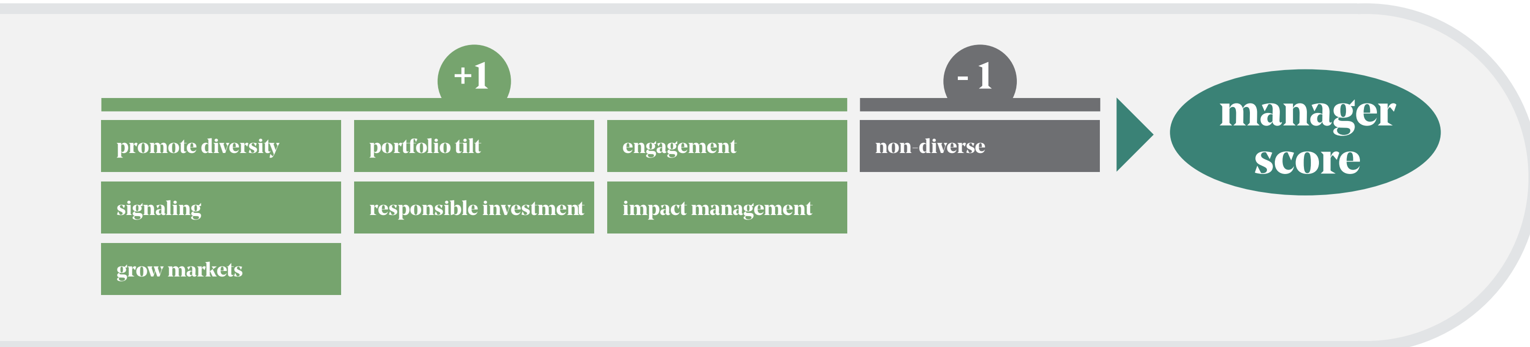
The stakeholder's agency in experiencing outcomes is based on research demonstrating the stakeholder's ability to avoid or continue experiencing outcomes. For example, retail supply chain workers tend to have lower agency relative to the impact experienced, as demonstrated by fewer job opportunities or limited access to better working conditions in similar geographies.

The Stakeholder Scores are multiplied by the corresponding Stakeholder Weights, resulting in a Company Score. The Portfolio Score is the weighted average of Company Scores within the portfolio.

Investment areas are grouped according to similar impact features resulting in 35 investment areas, such as retail or pharmaceuticals, each with unique weighting schema.

Manager Score

The Manager Score is the sum of investment manager attributes that contribute to the impact of the portfolio. Positive manager attributes (equal to +1) include promoting diversity, equity, and inclusion at the firm and/or portfolio companies; utilizing responsible investment policies and practices; signaling to the market that social and environmental factors matter; tilting the portfolio towards positive impact and away from negative impact; engaging with portfolio companies to drive impact outcomes; measuring, managing, and reporting on impact outcomes; and growing historically overlooked and undercapitalized markets. The only negative manager attribute (equal to -1) is for non-diverse managers, which we define as firms with five or more owners or decision-makers and no representation from women or racial/ethnic minorities.



Research and Application

We completed our first portfolio assessment over an eight-month period in 2019, entering approximately 14,000 data points to categorize the impact of nearly 100 strategies across asset classes, investment sectors, and geographies. During this period, we met monthly with our partners at Bridges Impact+ Advisory Arm to review the portfolio and develop consensus to codify our view on investment strategies and sectors. This process resulted in **key components** of our research and application process.

Rigorous, stakeholder-focused research: we prefer third-party research produced by organizations that primarily focus on stakeholder experiences, with limited conflicts of interest related to the information they provide. While we subscribe to investment research tools, we do not believe these are the best sources of information for understanding stakeholder experiences.

Standardized assumptions: we established baseline impact assumptions for industries and stakeholders – for example, our research-based assumption is that retail companies typically have negative outcomes for supply chain workers. These assumptions are the backdrop against which we seek data-driven evidence that companies produce more positive or more negative outcomes versus the baseline. This supports our evaluation of a vast number of companies even with limited data, and it helps to differentiate companies that exceed or underperform the status quo on a relative basis.

Portfolio applications: we apply this framework to every investment in our portfolio because it provides investment insights that make us better fiduciaries and stronger investors. It also provides additional information about our clients' investment portfolios, which can support them in making informed decisions about the role of mission alignment and impact investing at their institutions.

What We Learned

Investment Case Studies

Impact measurement frameworks are only as useful as their practical application to investment portfolios. In the following case studies, we demonstrate how the IMP framework revealed information at the company-, industry-, and manager-levels that supported our team in making better decisions about impact risks, opportunities, and ultimately impact categorization in the portfolio.

Food for Thought

A Stakeholder-Centered Review of Fast Food

Impact investors often apply industry exclusions, such as tobacco and fossil fuels, to their portfolios in an effort to avoid harm. **The stakeholder-centered impact assessment shows us that fast food may be the most negative industry in terms of average impact on all five stakeholders.**

Customers: Affordability is a positive outcome for customers, particularly the 50 million food-insecure households in the United States.[III] However, fast food is high in sodium and calories and served in large portion sizes that lead to increased intake, with immediate and lasting negative impact on customers.[IV]

Planet: The agricultural supply chain behind food production and consumption is inextricably linked to climate change, accounting for approximately one quarter of global greenhouse gas emissions, and consuming a significant amount of the world's fossil fuels.[V]

Employees: Average fast food employees in the US – even at higher-paying chains – earn significantly below the living wage required to meet basic needs.[VI] Further, employees experience dangerous working conditions: a 2015 survey of 1,500 fast food restaurant workers revealed that 87% were injured on the job in the previous year.[VII]

Supply Chain Workers: The agricultural sector is known for labor issues including health problems, poor housing, workplace abuse, and low wages.[VIII]

Community: Communities experience the long-term consequences of poor health outcomes, such as increased healthcare costs, disruptions in work productivity and school attendance, chronic diseases, and shorter life expectancy.[IX]

A **stakeholder-centered approach:** Our Stakeholder Scoring Model amplifies negative or positive impact scores based on how underserved stakeholders are relative to outcomes. Based on our analysis and research, the stakeholders affected by the negative outcomes of fast food companies tend to be underserved relative to the outcomes. For example, people working in fast-food jobs are more likely to live in or near poverty, and more than half of families with members working in fast-food jobs rely on public assistance programs. About 87 percent of fast-food workers lack employer health benefits.[x] The negative impact of fast food companies is not simply in paying low wages; it is that members of American families who are most in need of higher pay and employer benefits primarily hold fast-food jobs.

Our Stakeholder Weights increase the relevance of specific Stakeholder Scores based in part on stakeholder agency. In the case of fast food, the stakeholders experiencing negative outcomes also have the least agency. For example, the planet cannot avoid the negative impact of fast food production. Farm workers (supply chain) lack protection from US labor laws for joining unions and collective bargaining and are often marginalized populations – approximately 73% are foreign born and nearly half lack work authorization.[xi] The negative impact of fast food companies is amplified by the fact that the stakeholders experiencing some of the worst outcomes lack agency in escaping the negative outcomes they experience.

Given the negative impact across stakeholders—particularly stakeholders who are underserved or lack agency relative to the impact they experience — GEM's baseline score for fast food companies is -1.4, among the lowest across industries that we evaluated.

Bucking the Trend

Addressing Negative Impact in the Retail Industry

The apparel industry is responsible for approximately 20% of wastewater worldwide and 10% of global carbon emissions.[xii] The industry is known for abusive and dangerous supply chain working conditions, highlighted by the 2013 Dhaka Factory collapse and reports of forced labor and modern slavery in supply chains that accounts for as much as $127B in garments and footwear annually.[xiii] Retail companies tend to score negatively, given the significant negative outcomes for stakeholders with the least agency (planet and supply chain). **However, our review revealed a European online retailer that is investing resources to reverse negative outcomes and change industry and consumer behaviors.**

Company practices: The retail company – a portfolio company for one GEM manager – maintains industry-leading policies and practices in sustainable and ethical fashion. They invest in dedicated sustainable sourcing teams and ethical trade teams, with 30% of their business undergoing Responsible Sourcing Training.[xiv] They set ambitious goals, and measure and monitor progress using external auditors. For example, they have a commitment to sourcing 100% of cotton from sustainable sources by 2025, and reached 83% progress towards that goal in 2018 according to external review. Last, they demonstrate commitment to transparency and improvement. For example, they are committed to providing full visibility into five tiers of their supply chain, with three of five fully mapped and the remaining two partially mapped (tiers indicate what materials or products are provided at various stages in the manufacturing process). The company posts their targets and their progress towards those targets on their website.

Industry leadership: The retailer is committed to using their brand and position to influence the industry. They are a member of several global organizations that address ethical and sustainable fashion. These include Ovibashi Karmi Unnayan Program (OKUP), a grassroots migrant worker organization in Dhaka, the Global Fashion Agenda, focused on accelerating the circular fashion economy, and the Action Collaboration Transformation (ACT), working towards living wage and collective bargaining for factory workers globally. They contribute to the Fashion Transparency Index, where fashion brands provide transparency into raw materials sourcing and supply chain working conditions, and in which they ranked in the top 5% of 200 global brands in 2019.

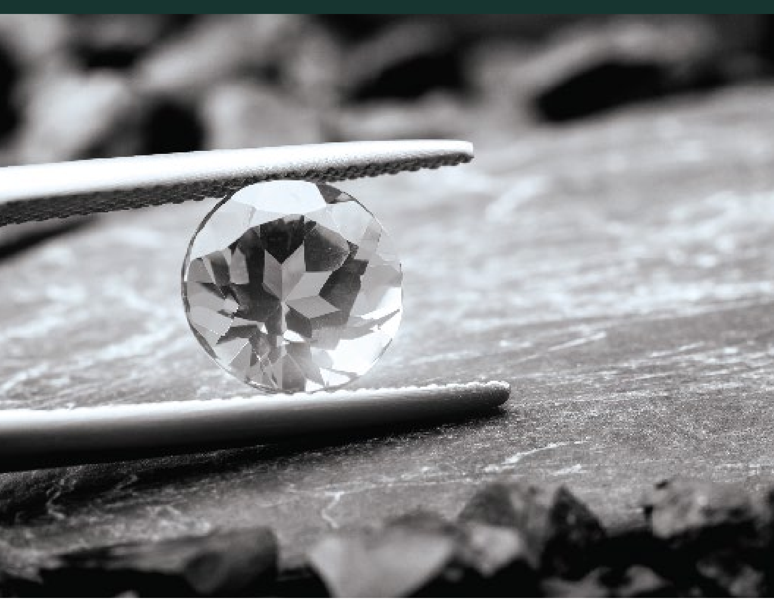
Furthermore, they work to influence their customers and partners. Rather than refusing to work with suppliers that do not meet their standards, they partner with them to set targets and measure outcomes. They partner with other sustainable brands on their platform and provide training and support to those brands to deliver better outcomes. They also work with community organizations in regions where they source materials to enhance community benefits. Last, given their significant online media presence (~20 million followers across various platforms), they advocate for sustainable and ethical fashion in an effort to change consumer behavior.

Based on the company's significant effort to improve outcomes for stakeholders, and to change industry and consumer behavior to expand positive outcomes, the company received a score of +1.2 versus GEM's baseline score for retail companies of -0.8.

A Hidden GEM

Avoiding Harm in the Mining Industry

The mining industry is recognized for significant negative environmental outcomes, with a reputation for extracting value from communities. However, when executed responsibly, mining can be a source of wealth creation for communities and provide critical materials for the global transition to renewable energy. **Our analysis of a metals and mining manager revealed how a responsible approach to the mining industry can avoid much of the harm inherent to the industry and result in better outcomes for stakeholders.**



portfolio score The manager considers social and environmental practices in determining companies, regions, and areas of the industry to include or exclude. For example, they do not invest in deep-level mining in South Africa due to safety issues, cobalt due to child labor issues, or coal due to environmental and social impacts. They exclude investments in countries with poor labor standards, higher rates of corruption, and poor corporate governance regulations, such as the Democratic Republic of the Congo. Meanwhile, the manager invests in predominantly listed companies, which draws increased attention to environmental issues and employee, supply chain, and community health and safety. They invest in companies in countries like Canada and the US, where workers tend to benefit from enhanced safety and labor standards, including access to unions and collective bargaining.

manager score Members of the investment team sit on the boards of nearly all of the companies in which they invest, where they work to ensure that management teams address environmental and social issues promptly and appropriately. They also work with local stakeholders on projects that ensure that the community benefits from mining operations, such as workforce training programs for local mineworkers and social programs to benefit families. For example, in Ecuador, the project team initiated a clean water project that provided sanitation services to the community; in Arizona, geologists from the mine volunteered in local schools giving after-hours seminars on geology with the goal of empowering students to eventually work on the mining projects in their area.

Driven by the manager's selection model, the manager's portfolio companies received a Portfolio Score of +0.5; this is well above GEM's baseline score for mining companies of -0.8. The Manager Score totals +6 out of a possible 7 for actions the manager takes to avoid harm in the industry and create positive outcomes for stakeholders. Even though the manager is operating in a traditionally harmful industry, we categorized the manager as A - Acting to Avoid Harm.

Big Bets

Unlocking human potential through Financial Innovation

Technological innovation is just beginning to change how we interact with financial markets, displacing legacy systems and processes used by global financial institutions. Meanwhile, 2018 marked a tipping point at which more than half of the global population reached middle class or wealthier.[xv] **One of our most successful venture capital managers generates positive impact across stakeholders by investing in financial technology and innovation.**

portfolio score The manager invests in companies that address critical needs for individuals and small businesses.

For example:

- Small business credit: Two thirds of small businesses faced financial challenges in 2019, with nearly 70% relying on the founder's personal funds to address those challenges.[xvi] One portfolio company provides business credit cards that do not require a personal loan guarantee or credit score from the founder, and enable access to a line of credit with no annual fee, reducing burdens for entrepreneurs.
- Individual credit: Establishing and maintaining solid credit is critical to wealth creation; yet many people lack consistent, reliable credit information. One portfolio company provides access to credit scores and financial data to help consumers effectively manage personal finances and improve their credit profile. The company supports customers with digestible information from credible sources (such as Center for Responsible Lending) to educate them on building and maintaining solid credit. Company data demonstrates improved credit scores for users, with the greatest improvements for customers with the lowest initial scores.

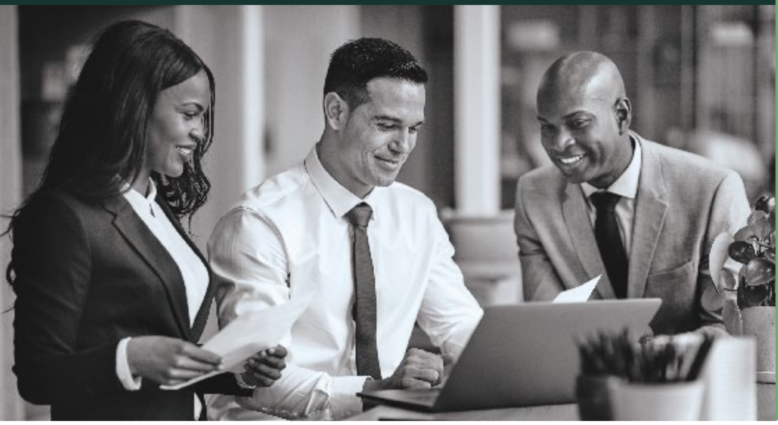
manager score The manager approaches investing with a mission in mind: to change the world of finance by making it more efficient and transparent. Several of their portfolio companies are representative of this philosophy. Further, their global reach reflects their focus on making financial markets more accessible and useful to the rising global middle class. The team's global perspective and diverse experiences are well suited to support portfolio companies to drive positive outcomes.

Based on their positive portfolio companies and deep manager engagement, the manager scored among the highest in our portfolio, with a Portfolio Score of +1.7 and Manager Score of +5. This is among GEM's highest-scoring managers in the portfolio.

Diversity as a Strategy

A Differentiator in Private Equity

Studies demonstrate that diverse teams make better decisions and have stronger performance,[xvii] and yet the vast majority of investment firms and companies are led by non-diverse teams. **Our review revealed how one manager's approach to diversity, equity, and inclusion as an investment strategy leads to positive outcomes for stakeholders and strong returns.**



Firm Leadership: More than half of the firm, including half of investment team members, are women and/or people of color. By contrast, 21% of investment professionals are women and 3% are black across the industry.[xviii] The firm adheres to a "People First" philosophy, aiming to "show the world that you can be a PE firm that puts up strong results and treats people well [and] show that you're winning financially because of that philosophy, not in spite of it." This approach is evident in their practices, policies, and reporting, as well as our conversations with firm leadership during the diligence and monitoring processes.

Identifying and Developing Diverse Leaders: The firm created a CEOs-In-Training (CIT) Program that recruits and trains MBA graduates for executive positions within the technology and services companies in which they invest. The program targets 50% women and 30% minorities within each CIT class, ensuring significantly more diverse leadership across the portfolio than in the technology and services industries broadly. Furthermore, all CIT program members are trained on diversity, equity, and inclusion practices, increasing the likelihood of developing portfolio companies into more diverse and inclusive organizations over time.

The aggregate Portfolio Score equaled +0.8 due to generally positive impacts across stakeholders at the company level. Meanwhile, the manager's commitment to increasing diversity within their private equity firm and within portfolio companies demonstrates meaningful impact at the manager level, reflected in a Manager Score of +5.

About GEM

GEM is a leading provider of institutional investment solutions for endowments, foundations, sovereigns, families, and other long-term investors. Since 2007, GEM has specialized in delivering the highest quality service and support to our clients, enabling them to achieve their long-term investment goals. With a global reach, broad investment capabilities, and an experienced team, GEM strategically tailors solutions to meet the unique needs of each investor we serve. For more information, visit www.geminvestments.com.

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The third party sources of information used in this report are believed to be reliable. GEM has not independently verified all of the information and its accuracy cannot be guaranteed.

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Endnotes

[i] For more information, visit www.impactmanagementproject.com.

[ii] As of December 31, 2019.

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[xiv] Based on information provided in the company's 2019 modern slavery statement.

[xv] Hamel, Homi Kharas and Kristofer. "A Global Tipping Point: Half the World Is Now Middle Class or Wealthier." *Brookings* (blog), September 27, 2018. https://www.brookings.edu/blog/future-development/2018/09/27/a-global-tipping-point-half-the-world-is-now-middle-class-or-wealthier/.

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