Study on Impact Investing Activities in Listed Equity

Final Report

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Abstract

- This research report is about impact investing activities in listed equity investments, a particularly new area of impact investing that has expanded rapidly in recent years.

- Impact investing is an investment activity that seeks financial return, while at the same time creating impacts towards improving global environmental problems and socio-economic systems. While there is a conceptual overlap with so-called responsible investment or ESG investment, there is a clear difference in the fact that impact investments are made with a clear "intention" to create impacts, and that investors themselves "measure" and "report" on the impacts they have created to clients and the public. Originally, private equity and other private markets were the focus of activity, but impact investing activity in listed equity has grown rapidly, with some data showing that as of the end of 2019, around 60 investment managers globally offered more than 120 impact investment funds.

- The content of this study is based on interview surveys conducted with various third-party organizations and scholars involved in impact investing in Japan and overseas, as well as 11 institutional investors who are conducting impact investing activities in listed equity investments. While the activities of institutional investors in Europe and the United States are diverse, this study attempts to objectively grasp the diversity as much as possible and attempts to sort out and give an overview of the current status of the activities. Specifically, together with investigating the current status from the following six perspectives (see 3.1 to 3.6 for details), we breakdown the elements of the concept and approaches for the impact investing activities, and propose a framework to deepen understanding of diversified activities (see Chapter 4 for details).
  (1) Benefits of impact investing in listed equity
  (2) Relationship between impact creation and financial return
  (3) Establishment of impact themes
  (4) Impact measurement for listed companies
  (5) Publication of impact reports
  (6) Concept of additionality and role of engagement in listed equity investments

- This study also discusses six challenges in impact investing activities in listed equity investments that emerged through interviews with experts and practitioners. The report addresses the following six points (see Chapter 5 for details).
  (1) Lack of information disclosure necessary for impact measurement

(2) How to measure impacts on large companies that are diversifying their business
(3) How to assess the potential for future impact creation by companies
(4) Lack of empirical analysis on the relationship between impact creation and financial return
(5) How to engage in impact creation and report on its implementation
(6) How to address impact washing and ensure the integrity of impact investing

- As global environmental problems such as climate change and various social issues have become manifest and serious, it has been increasingly recognized that not only public sector initiatives, but also private sector initiatives are essential. The United Nations Sustainable Development Goals (SDGs), with a target deadline of 2030, have about 10 years remaining, and various stakeholders are required to strengthen and accelerate their initiatives. Under these circumstances, listed companies with large economic scale have a great deal of influence, and there is growing interest in the role they should play. This naturally involves investors who invest in listed companies. Impact investment activities in listed equity are expected to receive increasing attention as a way to support the solving of global environmental problems and social issues, including the achievement of the SDGs.

- We expect that the details of this report will provide some meaningful input for policymakers, practitioners, and other stakeholders, hoping that impact investing activities in listed equity investments will develop even more soundly in the future.

1. Background and Purpose of Research

1.1. Background and Purpose

In recent years the concept called "impact investing" has been spreading. As of the end of 2018, total assets under management amounted to $502 billion worldwide[1] and ¥344 billion in Japan[2]. The term impact investing was coined by the Rockefeller Foundation in 2007[3]. It is commonly used to refer to investment activities that seek to obtain both financial return and positive impacts on the global environment and socio-economic systems simultaneously.

While there are various factors behind the increasing focus on impact investing, as of March 2020, when this report was written, one factor is the growing sense of crisis over the achievability of the UN Sustainable Development Goals (SDGs), which have about ten years remaining until the target deadline[4].

The SDGs are international goals from 2016 to 2030 listed in the “2030 Agenda for Sustainable Development” adopted at the 2015 UN Sustainable Development Summit. In Japan as well, the SDGs Promotion Headquarters, which was established within the cabinet in 2015, has formulated implementation guidelines and action plans, and based on these, the relevant ministries, agencies and institutions are taking various measures. The Financial Services Agency, which commissioned this study, also published the document “Financial Administration and SDGs”[5], that summarizes initiatives being implemented from the perspective of the SDGs. Efforts are being actively made so that the SDGs are realized in the form of medium- to long-term investment return and corporate value enhancement.

While measures to achieve the SDGs are being implemented in countries and regions around the world, a lack of funds is still a major problem. According to the United Nations, while on the one hand $5 trillion to $7 trillion of annual funds are required in order to achieve the SDGs, the current status is that developing countries lack $2.5 trillion in funds every year[6]. To realize

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[1] GIIN (2019a) “Sizing the Impact Investing Market”

[2] Global Social Impact Investment Steering Group (GSG) Japan National Advisory Board (2019) “Current Status of Social Impact Investment in Japan 2018” (in Japanese)

[3] Rockefeller Foundation “Innovative Finance” <https://www.rockefellerfoundation.org/our-work/initiatives/innovative-finance/>

[4] UN “Decade of Action” <https://www.un.org/sustainabledevelopment/decade-of-action/>

[5] Financial Services Agency “Financial Administration and SDGs” (in Japanese) <https://www.fsa.go.jp/policy/sdgs/FsaStrategyforSDGs_rev.pdf>

[6] UNDP “Impact investment to close the SDG funding gap” <https://www.undp.org/content/undp/en/home/blog/2017/7/13/What-kind-of-blender-do-we-need-to-finance-the-

a society where the SDGs are achieved, the perspective of utilizing private funds is more essential than ever. Impact investing is gaining attention as a supplement to the funds needed to achieve the SDGs[7].

Of course, the existence of such a public policy need or importance does not guarantee the immediate flow of private investment funds, but the recent expansion of impact investing demonstrates that, in addition to earning financial return, the number of investors who have a clear intention[8] and act on to make impacts through investment, i.e., to contribute to improving global environmental issues or improving socio-economic systems through investment, is steadily increasing[9].

Emphasizing the importance of investment decision-making that considers environmental, social and governance (ESG) factors, the Principles for Responsible Investment (PRI), signed by 3,024 institutional investors around the world as of March 2020[10], has also proposed to add a new pillar of "real-world impact" to the traditional financial theory of optimizing risk and return. When the risk and return are similar, it proposes to select investments with higher impacts[11]. Such an idea seems to be steadily gaining traction among institutional investors.

SDGs-.html>. According to 2019 estimates by the staff of the International Monetary Fund (IMF), to achieve the SDGs in the areas of education, health, roads, electricity, water and sanitation, it was pointed out that in 2030, additional annual investment will be needed, with $0.5 trillion for low-income developing countries and $2.1 trillion for emerging market economics (Gaspar, V., Amaglobeli, M. D., Garcia-Escribano, M. M., Prady, D., & Soto, M. (2019) "Fiscal policy and development: human, social, and physical investments for the SDGs," IMF Staff Discussion Notes No. 19/03, January 23, International Monetary Fund).

[7] Ibid.

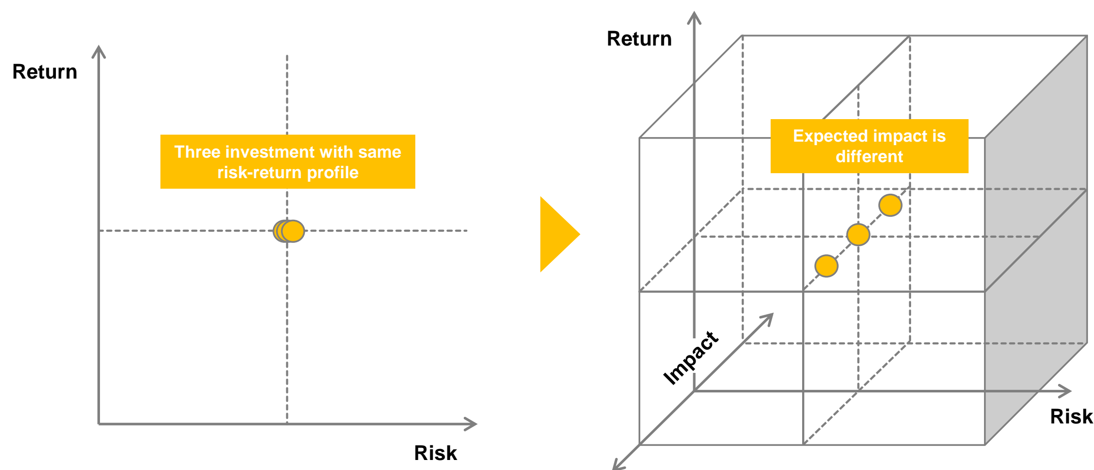
[8] The Global Impact Investing Network, (GIIN), which estimated a global impact investing market of $502 billion mentioned at the beginning, cites "intentionality" as one of the elements that characterize impact investing (GIIN "Characteristics of impact investing" <https://thegiin.org/impact-investing/need-to-know/#characteristics-of-impact-investing>).

[9] According to a survey conducted by the GIIN, 85% (n=235) of responding institutions selected "Very important" or "Somewhat important" for responding to customer requests when it comes to their motivation to make impact investments (GIIN (2019b) "Annual Impact Investor Survey 2019"). Also, in a survey of the public conducted by the UK's Department for International Development, nearly 30% of respondents said that the top five factors influencing their investment decisions included the impacts that their investment actions could have on the global environment and people (DFID (2019) "Investing in a Better World: Survey Results"). Furthermore, in a survey of members of a Dutch retail industry pension fund (Pensioenfonds Detailhandel), about two-thirds of respondents said that the number of SDG goals that the fund focuses on in its operations should be increased (Bauer, R., Ruof, T., & Smeets, P. (2019) "Get real! Individuals prefer more sustainable investments").

[10] The breakdown is 517 asset owners, 2,175 investment managers and 332 service-providers (as of March 23rd, 2020 <https://www.unpri.org/searchresults?qkeyword=¶metrics=WVSECTIONCODE%7c1018>).

[11] The paradigm shift from two-dimensional to three-dimensional, with the third axis of impact added to the risk-return axis, was described in a report published in 2014 by the Social Impact Investment Taskforce, established by the United Kingdom, the G8 presidency in 2013（Social Impact Investment Taskforce (2014) "Impact investment: the invisible heart of markets: harnessing the power of entrepreneurship, innovation and capital for public good"）.

Figure 1: Expansion from two-dimensional (risk-return) to three-dimensional (risk-return-impact)



Source: Prepared by Nissay Asset Management based on PRI (2017) "The SDG Investment Case" pp. 13

With impact investing in various asset classes currently, this study focuses on impact investing activities in listed equity investments. The purpose is to clarify the current status of efforts by the world's major institutional investors, and to gain insights into challenges when investors implement impact investing activities.

This study focuses on listed equity investments for the following three main reasons.

The first reason is the magnitude of the potential influence on improving global environmental problems and socio-economic systems, including the achievement of the SDGs. According to the International Finance Corporation (IFC), for funds that may be allocated to impact investing in the future, up to about $21 trillion are in public markets (listed equity and public debt)[12]. In addition to the potential scale of the size, there is a growing likelihood that it will actually expand rapidly in the future. Until now, the main players in impact investing have been foundations such as the Rockefeller Foundation, which coined the term impact investing, philanthropic investors, and development financial institutions. However, in recent years, along with the expansion of the concept of impact investing itself[13] and the entry of new players, those involved in impact investing have diversified. A growing number of

[12] In contrast, the amount of private market funds (private equity, private debt, etc.) that could be redirected to impact investing in the future is estimated to be around $5 trillion (IFC (2019) "Creating Impact: The Promise of Impact Investing").

[13] In the interview survey, it was pointed out that the concept of impact investing itself has become larger and that there is an overlap between the concept of so-called responsible investing and ESG investing.

pension funds and traditional investment managers, who have been active in promoting ESG investments as PRI signatories, are also embarking on impact investing. As mentioned above, with the recent slogan of “real-world impact”, the PRI itself is increasingly urging institutional investors who signed the PRI to consider the impacts of their investments[14]. These new players in impact investing are increasingly practicing impact investing in traditional assets such as listed equity. In fact, according to the Global Impact Investing Network (GIIN), one of the world's largest communities of impact investors, impact investing in listed equity is relatively small in scale, but its growth rate is high and the pace of expansion is fast[15].

The second reason is the growing concern about so-called "impact washing"[16]. While the expansion of impact investing in listed equity itself is often welcomed from the perspective of improving global environmental problems and socio-economic systems, concerns have been raised about funds that label themselves as "impact investing" for mere marketing purposes, even though they have not sufficiently created, measured and managed the impacts required of as an impact investment fund. In particular, listed companies with a global reach with complex business models and value chains have a high degree of difficulty for investors to measure the (positive and negative) impacts of their investments. Also, the aforementioned concerns are related to the fact that it is somewhat difficult to capture the relationship between the act of "investing" and "creating impact" through the portfolio companies, due to the nature of transactions in which listed shares are bought and sold on the secondary market.

The third reason is that listed equity has an important share in the portfolios of many individual investors and asset owners. That is to say, it is important for many investment managers in the investment chain[17]. Although the asset owners who explicitly practice impact investing or adopt impact investment funds are relatively small compared to ESG investment, the debate on impact investing activities in listed equity investments may become relevant to many stakeholders shortly.

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[14] For example, one of the goals for the next decade announced by PRI in 2016, the anniversary of the decade of formulation, was to “enable real-world impact aligned with the SDGs” and a variety of initiatives have been undertaken. (PRI (2016) “A blue print for responsible investment”).

[15] GIIN's analysis of the asset volume of impact investments in listed equity over time for the same institution reported a 57% annualized increase from 2013 to 2017 and a 25% annualized increase from 2014 to 2018. (GIIN (2018) “Annual Impact Investor Survey 2018”, --- (2019b)).

[16] Findlay, S., & Moran, M. (2018) “Purpose-washing of impact investing funds: motivations, occurrence and prevention,” *Social Responsibility Journal*, Vol. 15 No. 7, pp. 853-873

[17] According to Willis Towers Watson, as of 2018, listed equity investments accounted for 34.4% of total assets under management of the world's major investment managers, and as of 2018, the average equity investment ratio is 40.6% for the top 20 pension funds by asset size (Willis Towers Watson (2019a) “The world’s largest fund managers – 2019”, ---(2019b) “The world’s largest pension funds – 2019”).

It should be noted that, at this time, there is little prior research focusing on listed equity investment, and the current situation is not very clear[18]. Clarifying the situation not only contributes to the sound development of the impact investment market for listed equity, but could also serve as an important basic resource for planning, formulating, and implementing policies in many administrative fields, including financial administration.

1.2. Period Conducted and Methodology

This research, which was commissioned by the Financial Services Agency, was conducted by Nissay Asset Management Corporation from February to March 2020. All information in this report is based on information as of March 2020.

In addition to the literature review, we conducted research interviews with organizations and scholars related to impact investing, and institutional investors who practice impact investing activities in listed equity investments. The list of those who cooperated is as follows.

Figure 2: List of interviewees (in alphabetical order of organizational affiliation)

Name	Title, Organization
Euan Stirling	Global Head of Stewardship & ESG Investment, Aberdeen Standard Investments
Yo Takatsuki	Head of ESG Research and Active Ownership, AXA Investment Managers
Shin Furuya	Impact Investment Strategist, Domini Impact Investments
Michael Lewis	Managing Director, Head of ESG Thematic Research, DWS Investment UK
Murray Birt	Senior ESG Strategist, DWS Investment UK
Tetsuya Koizumi	President & Representative Director, DWS Investments Japan
Takanobu Fujiwara	Vice President, Head of Institutional Sales, DWS Investments Japan
Satoshi Fujino	Director, Head of Investment Strategy & Product, DWS Investments Japan
Hiroshi Tanaka	Director, Investment Strategy & Product, DWS Investments Japan
Will Pomroy	Director, Engagement, Federated Hermes International
Katharine Zafiris	Senior Associate, Market Building, GIIN
Naoko Kimura	Manager, Membership, GIIN

[18] For prior research focusing on impact investing activities in listed equity, besides the IMP (2019) "Having a positive impact through public markets investments: the investor's perspective", and Cole S. & Lynn S. (2018) "Wellington Global Impact." Harvard Business School Case 218-067, there is the session held at the PRI in Person 2019 Conference (See at <https://www.brighttalk.com/webcast/17701/373378>). At the GIIN, "Listed Equity Working Group" focusing on investment in listed equity has also been set up and discussions are taking place, and certain outputs can be expected shortly (GIIN "Listed Equity Working Group" <https://thegiin.org/listed-equities-workinggroup>).

T. Robert Zochowski	Director, Impact-Weighted Accounts, Harvard Business School
Neil Gregory	Chief Thought Leadership Officer, Economics and Private Sector Development, IFC
Clara Barby	CEO, Impact Management Project
Lisa Beauvilain	Managing Director, Head of Sustainability & ESG, Impax Asset Management
Tomoya Sakata	KAITEKI Promotion Office, Corporate Strategy Division, Mitsubishi Chemical Holdings Corporation
Toshiyuki Hamano	Group Manager, KAITEKI Promotion Office, Corporate Strategy Division, Mitsubishi Chemical Holdings Corporation
Huub van der Riet	Lead Portfolio Manager, NN Investment Partners
Ivo Luiten	Senior Portfolio Manager, NN Investment Partners
Satoshi Ueda	Head of Product Strategy Department, NN Investment Partners
Diane Damskey	Head of Secretariat, Operating Principles for Impact Management
Piet Klop	Senior Advisor, Responsible Investment, PGGM Investments
Dirk Meuleman	CEO, Phenix Capital
Jack Heapey	Associate, Phenix Capital
Fumi Sugeno	Head of Business Development, Japan Social Innovation and Investment Foundation (SIIF)
Yoshiko Fujita	Deputy Head of Business Development, Japan Social Innovation and Investment Foundation (SIIF)
Masato Takebayashi	Associate Director, Asia-Pacific Research, Sustainalytics
Takeshi Mizuguchi	Vice President, Professor, Faculty of Economics, Takasaki City University of Economics
Henk Jonker	Senior Investment Analyst, Impact Equities & Bonds Department, Triodos Investment Management, Triodos Bank
Elodie Feller	Programme Lead, Investment, UNEP-FI
Robert G. Eccles	Professor of Management Practice, Saïd Business School, University of Oxford
Christian Heller	CEO, Value Balancing Alliance
Joy K. Perry	Managing Director and Investment Director, Wellington Management
Hideo Ueki	Investment Director, Investment Product & Strategies, Managing Director, Wellington Management
Kazuya Yuasa	Head of Global Relationship Group, Managing Director, Wellington Management
Hayato Oya	Relationship Analyst, Global Relationship Group, Wellington Management
George Latham	Managing Partner, WHEB Asset Management

Note: All affiliations and titles are as of the time that the interviews were conducted.

2. What is Impact Investing?

2.1. What is Impact?

First, we would like to clarify the concept of the term "impact" that impact investors focus on.

While the English word "impact" is commonly used to mean "influence or effect", impact in the context of impact investing has a more specific meaning. Japan's Cabinet Office report defines it as "social and environmental outcomes resulting from the relevant businesses or activities, including short-term and long-term changes"[19]. The Impact Management Project (IMP)[20] defines impact as "a change in positive or negative outcome for people or the planet"[21].

What is common to these definitions of "impact" is the use of the word "outcome". It is important to correctly understand the meaning of "outcome" in understanding the concept of "impact", and for that purpose, it is necessary to clearly distinguish "output" and "outcome".

In the above-mentioned Cabinet Office report, output is defined as "products and services, etc. created by activities of an organization or business", while outcome is defined as "changes, benefits, learning and other effects brought about by output of an organization or business"[22]. Figure 3 compares and illustrates related outputs and outcomes.

In some literature, the term "social impact" is rather used, including the previously mentioned Cabinet Office report, but here, "society" or "social" are used to mean all of our society, including the global environment. In this report, we use the word "impact" to avoid confusion with the word "S" (social) in ESG investing, which started with listed equity and has now expanded to a wide range of asset classes.

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[19] Cabinet Office (2016) "Promoting social impact assessment - Basic concepts of social impact measurement for solving social issues and plans to be taken – Provisional translation" Working Group on Social Impact Measurement, pp. 8

[20] The IMP is an organization that seeks to create a global consensus among companies, investors and practitioners about how to express, measure and manage impacts.

[21] IMP "What is impact?" <https://impactmanagementproject.com/impact-management/what-is-impact/>

[22] Cabinet Office (2016), pp. 8

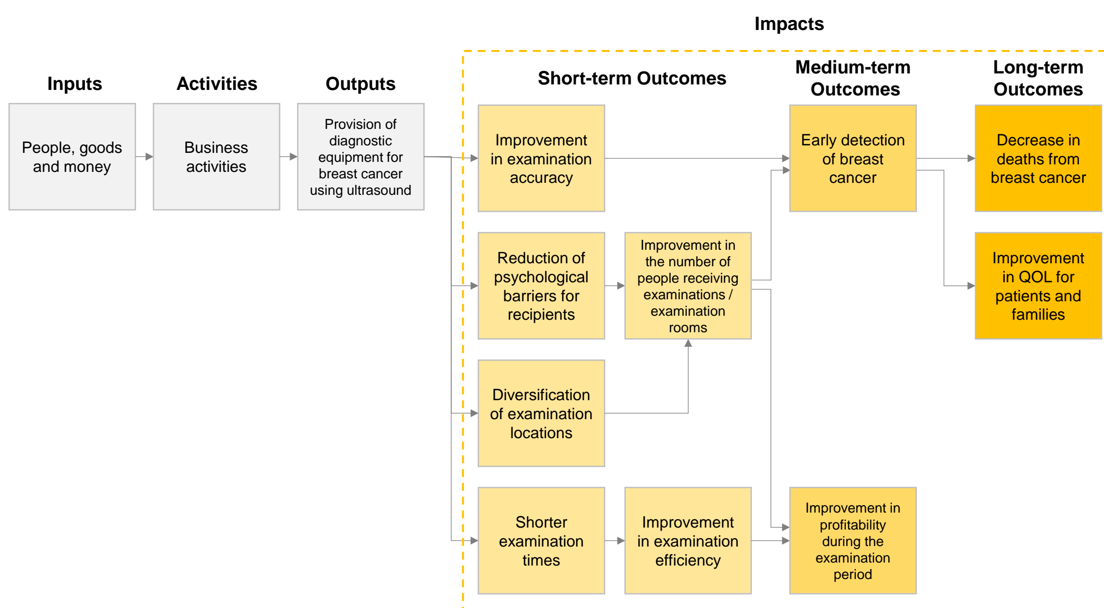
Figure 3: Comparison of output and outcome

Output (examples)	Outcome (examples)
Delivery of meals to X homeless people	Hunger is reduced by XX%
Provision of X insecticide-soaked bed nets	The number of malaria cases is reduced by XX
Provision of education to X children	Literacy rates in the local area improved by XX%

Source: Adopted from Epstein, M., & Yuthas, K. (2014) *Measuring and Improving Social Impacts: A Guide for Nonprofits, Companies, and Impact Investors*, Berrett-Koehler Publishers: San Francisco: CA, pp. 4

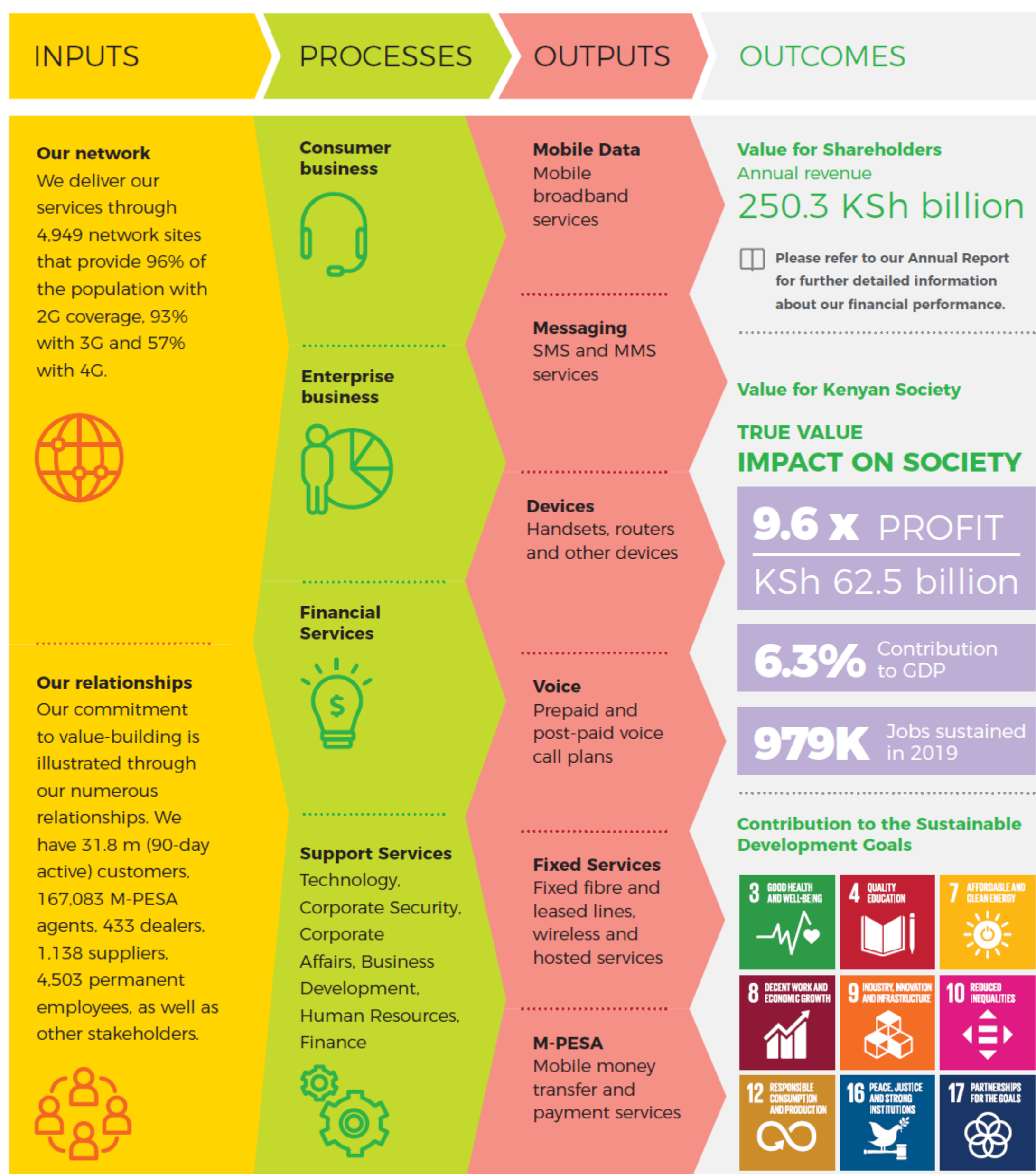
In order for an organization to have an impact, it needs to conduct business and activities based on the necessary inputs, and produce the outputs. And if the outputs are effective, it should lead to creating significant outcomes through a variety of channels. In order for companies and investors to measure the impacts and utilize it in future activities, it is important to "visualize" and understand the theoretical linkages from input to outcome. A graphical representation of this is called a logic model, which is generally expressed in a series of flows as shown in Figure 4. Some listed companies also disclose a logic model to show how their businesses are creating impacts (Figure 5).

Figure 4: An example of a logic model created by an impact investment fund



Source: Adopted from Capital Medica Ventures (2019) “Healthcare New Frontier Fund: 2018 Impact Report” pp. 14 (in Japanese, provisional translation by Nissay Asset Management)

Figure 5: An example of a logic model created by a listed company



Source: Safaricom “Towards Reducing Inequalities: 2019 Sustainable Business Report” pp. 17

However, it is not easy to properly understand the impacts generated just by looking at the level or change of some indicators (KPIs) related to the outcome. This is because what kind of impacts there are depends greatly on its context. For example, it is not hard to imagine that a certain increase in wage levels will have different size of impacts on stakeholders and socio-economic systems in the case of poor countries compared to wealthy countries.

The IMP proposes an analytical framework to better understand the impacts brought about by outcomes. Specifically, as shown in the figure below, it proposes evaluating and analyzing the impacts by breaking down the elements into five dimensions. Such a framework would allow companies and investors to discuss impact on a common ground.

Figure 6: The five dimensions of impact by IMP

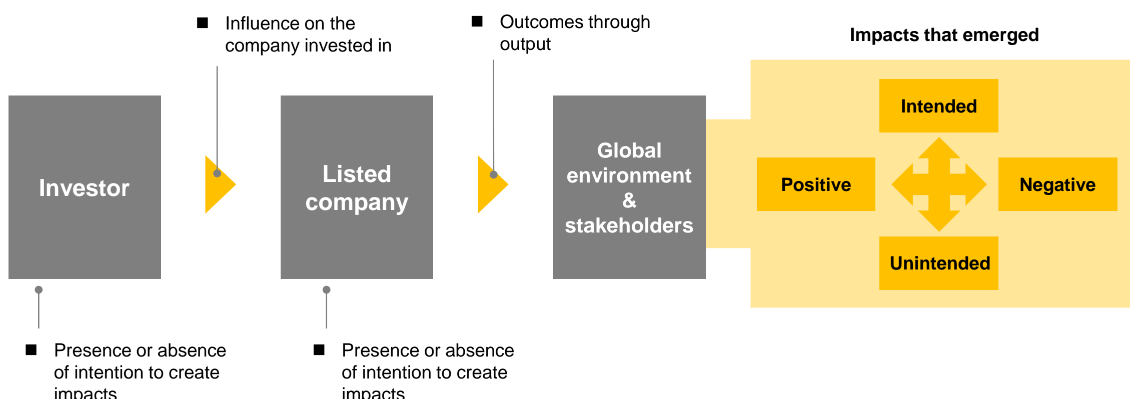
Impact dimension	Impact questions each dimension seeks to answer
What	➢ What outcome occurs in period? ➢ How important is the outcome to the people (or planet) experiencing it?
Who	➢ Who experiences the outcome? ➢ How underserved are the affected stakeholders in relation to the outcome?
How much	➢ How much of the outcome occurs – across scale, depth and duration?
Contribution	➢ What is the enterprise’s contribution to the outcome, according for what would have happened anyway?
Risk	➢ What is the risk to people and planet that impact does not occur as expected?

Source: IMP “What is impact?” <https://impactmanagementproject.com/impact-management/what-is-impact/>

Impact is not always positive, and some impact could be negative. Apart from intended impact, there is also unintended impact. Also, in the context of impact investing, impact itself comes from corporate activities, but investors behavior can influence the status of impact creation by companies through the influence on corporate activity via a variety of channels (3.6 describes in detail the channels through which investors influence companies that they invest in).

In practicing impact investing, it is necessary to distinguish between the impacts of corporate activities and the impacts of investors. Figure 7 illustrates the above discussion.

Figure 7: Impacts of corporate activities and impacts of investors



Source: Nissay Asset Management

2.2. Definition and Requirements of Impact Investing

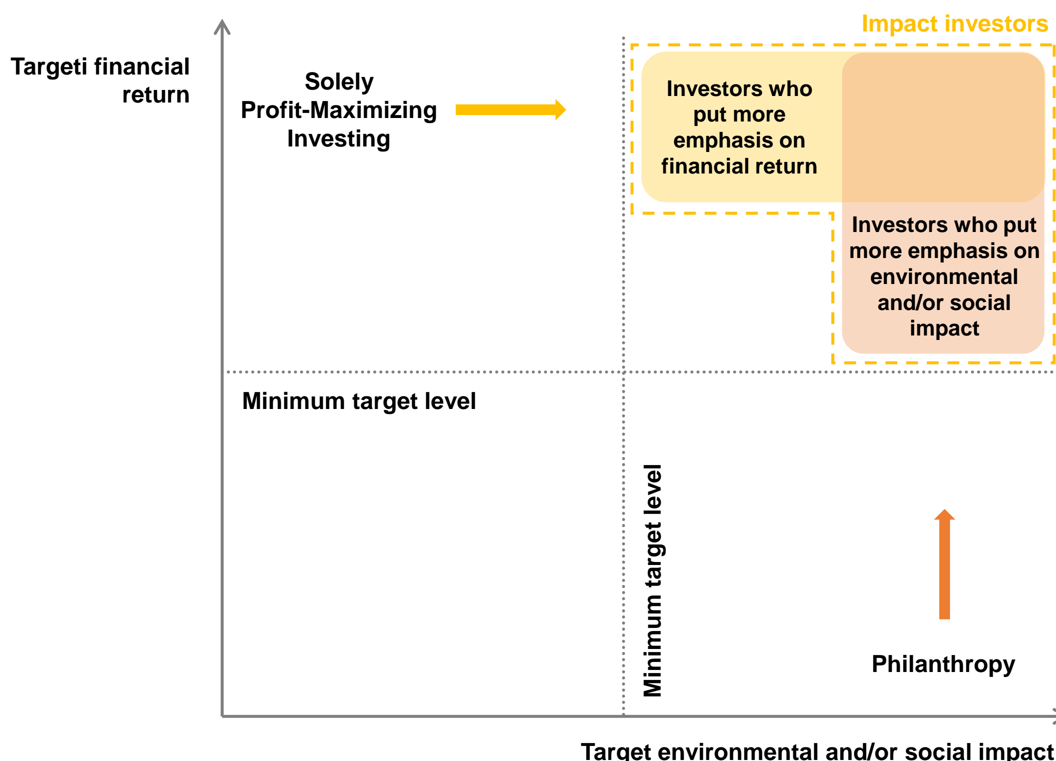
As mentioned at the beginning of this report, the term impact investing itself was coined by the Rockefeller Foundation in 2007 in Bellagio, Italy at a meeting that gathered leaders from financial industries, charitable enterprises and development institutions to discuss how to invest to create environmental and social impacts[23]. As investment aiming for both financial return and impacts (environmental and social impacts) at the same time, two years later, in 2009, the Monitor Institute illustrated impact investing as shown in Figure 8. To date, this figure has been cited by many stakeholders as an easy-to-understand visual representation of the concept of impact investing.

Figure 8 distinguishes between two types of impact investors with different degrees of pursuit of financial return and impacts. In the case of impact investing in listed equity, which is the focus of this research, it can be assumed that many investors focus on maximizing financial return, just as they do in the case of ordinary equity investments, and at the same time aim to create as much impact as possible[24].

[23] Harji, K., & Jackson, E. T. (2012) “Accelerating Impact: Achievements, Challenges, and What's Next in Building the Impact Investing Industry,” New York, NY: The Rockefeller Foundation

[24] In a new classification of sustainable investments proposed in November 2019, the Institute of International Finance an international organization established to maintain the stability of the international financial system, distinguishes between investments that pursue positive and measurable impacts as "impactful investments" (i.e., investments that pursue a market-rate or higher financial return along with the pursuit of a positive and measurable impact, and "philanthropic investments" (i.e., investments that pursue positive impacts but do not pursue financial return on par with the market average) (IIF (2019) “The Case for Simplifying Sustainable Investment Terminology”).

Figure 8: Concept of impact investing (simultaneous pursuit of financial return and impacts)



Source: Prepared by Nissay Asset Management based on Monitor Institute (2009) "Investing for Social & Environmental Impact: A Design for Catalyzing an Emerging Industry" pp. 32

However, the concept of aiming to have positive impacts on the world at the same time as aiming for financial return through investment was not necessarily first advocated by impact investing. For example, a similar way of thinking can be found in socially responsible investment (SRI) that has existed for a long time. Höchstädter & Scheck (2015)[25], who analyzed the differences in the use of the terms "SRI" and "impact investing", insisted that while both are related concepts, they are clearly distinct, or that impact investing tends to be treated as being ahead of SRI. As one of the reasons given in their paper, impact investing has a more active attitude toward solving environmental and social issues (in the case of SRI, there is a tendency to emphasize improving corporate initiatives in light of certain ESG criteria)[26]. Similarly, the term "ESG investment" has a wide range of concepts, and depending

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[25] Höchstädter, A. K., & Scheck, B. (2015) "What's in a name: An analysis of impact investing understandings by academics and practitioners," *Journal of Business Ethics*, Vol. 132, No. 2, 449-475

[26] Note that Höchstädter & Scheck (2015) cite other reasons such as the different nature of investments (SRIs are mainly listed equity, while impact investments are mainly private equity and private debt), the different size of the funds (impact investment funds are relatively smaller in size compared to SRI funds), and the different expectations of financial return and risk-return characteristics. However, as impact investing activity in listed equity investments, the focus of this study, has been growing, it is no longer practicable to distinguish between funds by size or asset class.

on who uses the term, it may include nuances such as contribution to solving environmental and social problems.

In this way, while impact investing is not necessarily a completely independent concept in terms of its purpose, there is a movement to clarify the requirements for impact investing and to draw a clear line between whether it is and is not impact investing. Underlying this is a growing concern about "impact washing" for the sound development of the impact investment market[27].

An example of requirement clarification is the four "core characteristics" of impact investing that the GIIN announced in 2019. According to this, one of the requirements is that investors themselves have the intention to create a positive impact. This suggests that changes in corporate behavior as a result of investment behavior that takes into account a company's ESG factors for the sole purpose of improving risk-return will not be included. In addition to this requirement of intention, the fact that investors themselves are required to measure the impact creation status and manage based on the data is also a unique requirement for impact investing.

In addition, the IFC announced in 2019 its "Operating Principles for Impact Management". While the GIIN has distilled and articulated the nature of impact investing, the IFC-led Principles set out principles for investors to incorporate impact considerations in addition to financial considerations at each stage of the investment lifecycle. The operational principles are process-focused and present the basic elements for building and operating a reliable "impact management system".

The operating principles are designed to cover both public and private markets. As of March 2020, 87 institutional investors have signed[28], but many of them are conducting impact investing activities in private markets. The institutions that have signed are required to meet all nine principles.

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[27] Rust. S. (2019) "Industry body sets out 'core characteristics' of impact investing," April 5, 2019, IPE <https://www.ipe.com/industry-body-sets-out-core-characteristics-of-impact-investing-/10030493.article> or, Flood C. (2019) "World Bank arm launches 'impact investment' standards," April 12, 2019, Financial Times <https://www.ft.com/content/b7acf8df-ec36-3e31-bfb4-825c97b9e852>, etc.

[28] Operating Principles for Impact Management "Signatories & Reporting" <https://www.impactprinciples.org/>

Figure 9: Definition, requirements and core characteristics of impact investing by GIIN

[Definition]

"Impact investing is an investment made with the intention to generate positive, measurable social and environmental impact alongside a financial return."

[Four Key Elements]

- **Intentionality:**
  Investment with the intention to contribute to social and environmental solutions.
- **Financial Returns:**
  Investment seeking financial returns. Target return levels vary.
- **Range of Asset Classes:**
  Can be made across asset classes.
- **Impact Measurement:**
  Investor commitment to measure and report on the social and environmental performance of underlying investments.

[Four Core Characteristics]

(1) Intentionally contribute to positive social and environmental impact

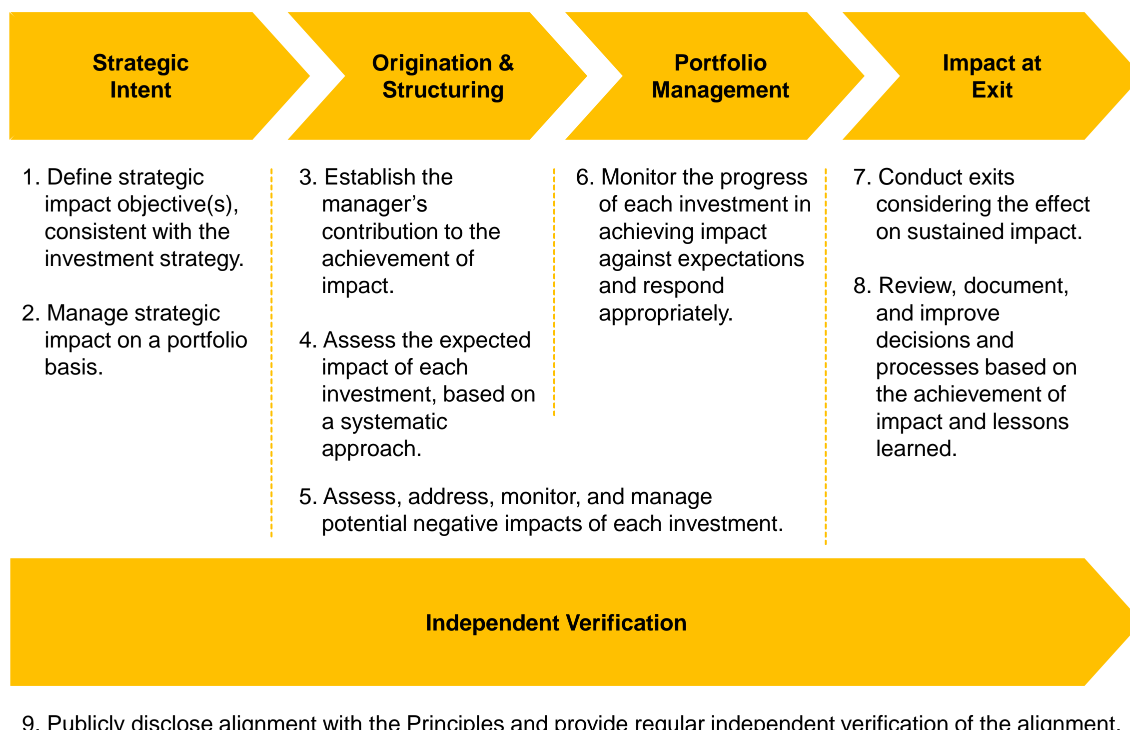
(2) Use evidence and impact data in investment design

(3) Manage impact performance

(4) Contribute to the growth of impact investing

Source: Prepared by Nissay Asset Management based on GIIN (2019c) "Core Characteristics of Impact Investing"

Figure 10: Operating Principles for Impact Management



Source: Operating Principles for Impact Management (2019) "Investing for Impact: Operating Principles for Impact Management" pp. 2

2.3. Expansion of Impact Investing Activities

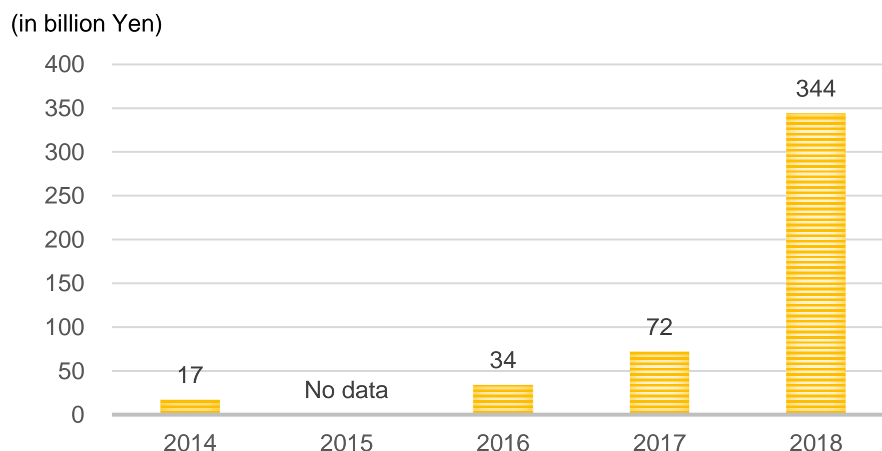
As mentioned at the beginning of this report, interest in impact investing has increased in Japan and overseas in recent years. As of March 2020, when this report was written, with regards to total global assets under management for impact investing, there is no statistical data that can be compared in a time sequence, but according to the latest estimate by the GIIN, it is estimated to be $502 billion at the end of 2018[29]. In Japan, assets under management are also expanding, and the Global Social Impact Investment Steering Group (GSG) Japan National Advisory Board[30] reports that it has reached ¥344 billion[31].

[29] GIIN (2019a)

[30] The GSG has its origins in the G8 Social Impact Investment Task Force, which was established in June 2013 at the call of David Cameron, Prime Minister of the United Kingdom, who chaired the G8 Summit, and was reorganized into the GSG in 2015 with the expansion of its membership beyond the G8. GSG National Advisory Boards have been established in each member country to discuss measures that will contribute to the development of impact investment in the member countries.

[31] GSG Japan National Advisory Board (2019)

Figure 11: Change in impact investing assets in Japan (2014-2018)



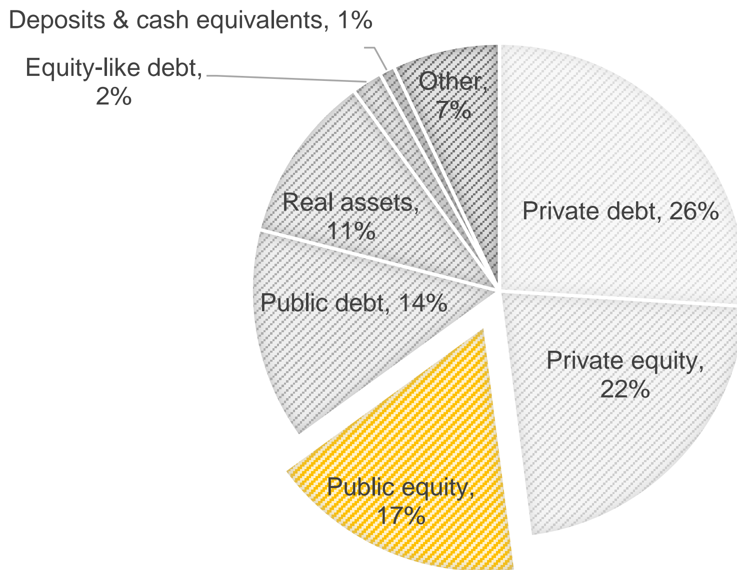
Note: The asset for each year in the graph is an estimate.
Source: GSG Japan National Advisory Board (2016) "Current Status of Social Impact Investment in Japan 2016", and —(2019)

While there is a wide range of asset classes in which impact investing is taking place, according to the GIIN, listed equity is the focus of this study at 17% of the total, indicating a certain presence in the impact investing market (Figure 12).

Figure 13 shows the rate of change in the size of impact investments by asset class between the two time points. This shows that impact investing in listed equity has grown significantly in comparison to other asset classes, with listed equity having the largest average annual growth rate of 57% between 2013 and 2017, and 25% between 2014 and 2018.

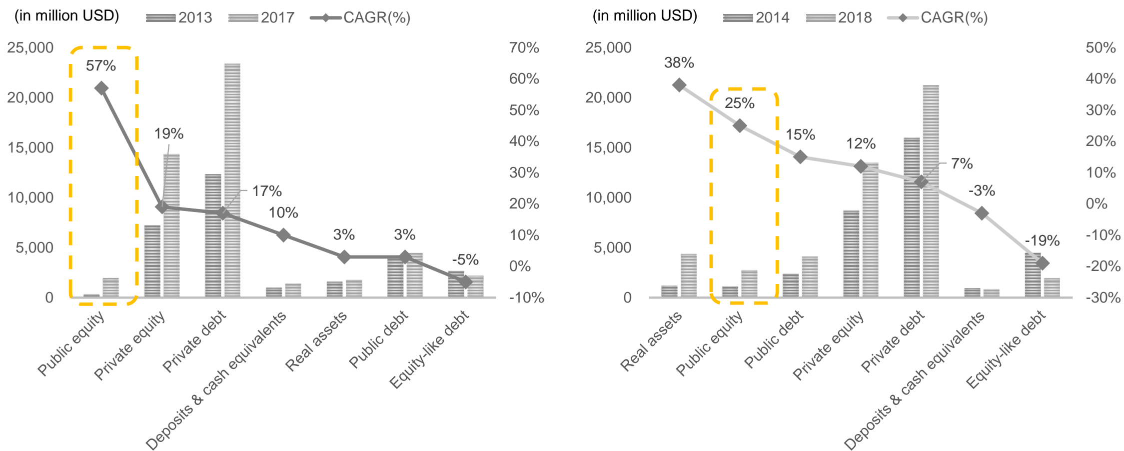
It is necessary to note that these are only the aggregate results of organizations that responded to the survey conducted by the GIIN, but given that the GIIN is the world's largest community of impact investors, it can be inferred that listed equity has a certain presence among investments labeled as impact investing, and that the presence of listed equity is currently on an increasing trend.

Figure 12: Breakdown of impact investing asset by asset class (in 2018)



Note: Based on a survey conducted by the GIIN between January and February 2019. The graph above covers 259 institutions with a total impact investing asset of $131 billion.
Source: Prepared by Nissay Asset Management based on GIIN (2019b)

Figure 13: Change in assets by asset class in the same organizations (Left: 2013-17, Right: 2014-18)

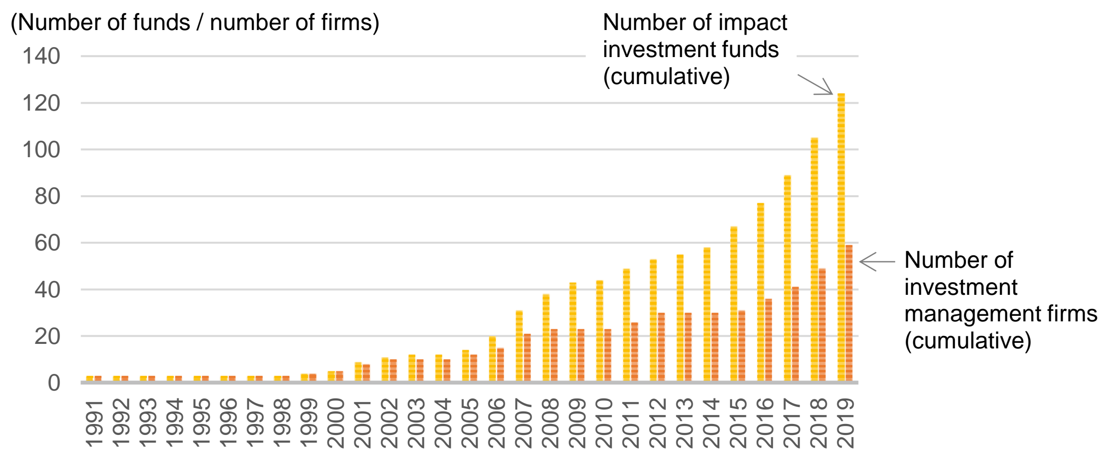


Note: A comparison of the same organizations that responded to the GIIN survey in each year; 81 organizations were compared in 2013 and 2017, and 79 organizations were compared in 2014 and 2018.
Source: Prepared by Nissay Asset Management based on GIIN (2018: 2019b)

Figure 14 shows the number of impact investment funds in listed equity over time, based on data from the Phenix Capital. The number of funds has increased significantly since the term impact investing are coined in 2007, and we can see that an increasing number of investment

managers are setting up new impact investment funds, especially since 2016. As for the scale of the funds, from those that are about tens of billions of yen, several have exceeded ¥100 billion.

Figure 14: Change in the number of impact investment funds in listed equity and the number of investment management firms to practice (1991 - 2019)



Source: Prepared by Nissay Asset Management based on the Global Impact Platform by the Phenix Capital <https://www.globalimpactplatform.com/>

Behind these changes there should be the following major trends[32].

Since the Rockefeller Foundation's advocacy of the concept of impact investing in the United States, the impact investment market has expanded, driven primarily by foundations, philanthropic investors, and development finance institutions. Much of the impact investment by these players have come from asset classes such as private equity and private debt (in fact, as shown in Figure 12, the proportion of private equity and private debt was still high at the most recent point in time).

Apart from this trend, however, some institutional investors who are engaged in ESG (or responsible) investing, which became a global sensation with the formulation of the PRI in 2006, have diversified their investment fund lineups in recent years by launching impact investment funds. Furthermore, this "new" impact investor is likely to practice impact investing in asset classes such as listed equity and public debt, rather than private equity and private debt, which have been the focus of the activities of "traditional" impact investors.

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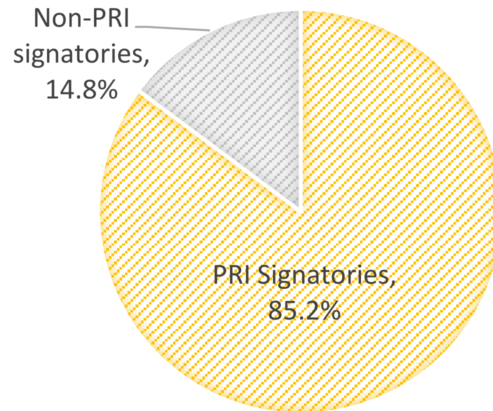
[32] Based on various materials as well as interview surveys.

This could have contributed to a new trend of "impact investing in listed equity," which is the focus of this study.

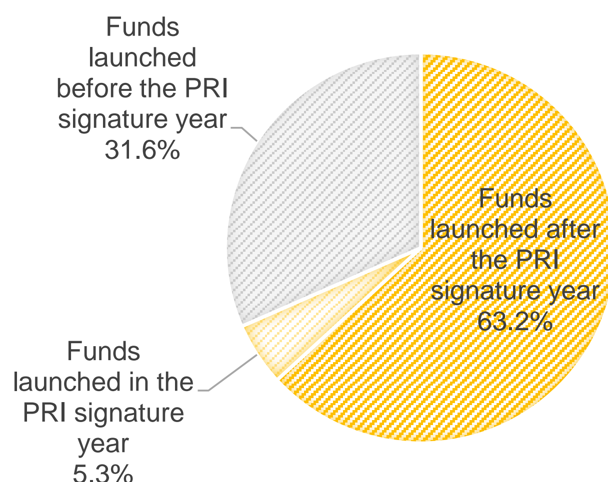
Figure 15 shows that at the end of 2019, 85.2% of the investment managers offering impact investment funds in listed equity were PRI signatories at the same time. In addition, 63.2% of impact investment funds from PRI signatories were set up later than the year the institution signed the PRI (Figure 16). These facts suggest that a large number of ESG investors who also make impact investments in listed equity are emerging.

Figure 15: Signatures on PRI by investment managers with impact investment funds in listed equity (in 2019)



Source: Prepared by Nissay Asset Management based on the Global Impact Platform by the Phenix Capital <https://www.globalimpactplatform.com/> and the PRI website.

Figure 16: Launch of impact investment funds and timing for PRI signature (1991-2019)



Source: Prepared by Nissay Asset Management based on the Global Impact Platform by the Phenix Capital <https://www.globalimpactplatform.com/> and the PRI website.

Another characteristic is that, even before the term ESG investing was invented[33], some institutional investors, who had been focusing on initiatives called Socially Responsible Investment (SRI) and/or Ethical Investment, have begun to redefine their own investment activities as impact investing through rebranding their funds by using the term impact investing, and/or to change their investment activities closer to impact investing.

In fact, as Figure 14 shows, funds classified as of today as impact investment funds are not necessarily launched after the establishment of the PRI in 2006, which triggered the spread of the term ESG investing, nor were they launched after the term impact investment was invented in 2007. Some have existed since the 1990s.

The IFC estimates the size of assets held by private financial institutions and households that could be allocated to impact investing in the future, with an estimated $21.4 trillion invested through listed equity/public debt and $5.1 trillion invested through private equity/private debt[34]. Given their potential size, the IFC is looking forward to the role that listed equity and public debt can play.

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[33] The term ESG, which is used in the six principles of the PRI, was created in the process of codifying the PRI, and was found to be used in a 2005 report in the public documents of UN agencies. (Freshfields Bruckhaus Deringer (2005) "A legal framework for the integration of environmental, social and governance issues into institutional investment" UNEP-FI).

[34] IFC (2019)

3. Current Situation for Impact Investing Activities in Listed Equity

This chapter describes the results of surveying impact investing activities in listed equity investments by major U.S. and European institutional investors.

We selected the targets for this as follows. The list of impact investment funds for listed equity included in the Phenix Capital's impact fund database[35] is used as a starting point in selecting the survey targets. Next, we selected investment managers that periodically publish reports on the impact measurement results of their impact funds on their websites (hereinafter referred to as "impact reports") and disclose a lot of information in those reports. In addition, we added institutional investors who have disclosed a lot of information about their views and initiatives regarding impact investing activities in listed equity. We then comprehensively considered information obtained through interviews with third-party organizations and scholars on impact investing, as well as through web searches, and determined the impact investing activities in listed equity from 11 institutional investors as the target of our survey[36].

The survey was conducted through a literature review and interviews with the relevant experts[37].

3.1. Benefits of Impact Investing in Listed Equity

To begin with, what are the benefits of impact investing in the listed equity asset class? There are various points to this question. Figure 17 summarizes and sets them out. Here we show the benefits for each of the three major players. While Figure 17 lists all possible benefits based on the literature review and interview surveys, it does not guarantee their completeness, nor does it promise that all of these benefits will occur in all impact investment activities.

(1) Benefits for Global Environment and Stakeholders

The benefit for the Global environment and stakeholders is the magnitude of the potential

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[35] Phenix Capital “Global Impact Platform” <https://www.globalimpactplatform.com/>

[36] The institutional investors surveyed in this chapter are Aberdeen Standard Investments, AXA Investment Managers, Domini Impact Investments, DWS Group, Federated Hermes International, Impax Asset Management, NN Investment Partners, PGGM Investments, Triodos Investment Management, Wellington Management and WHEB Asset Management (alphabetical order).

[37] See Figure 2 for the list of participants in the interview survey.

impacts.

Of course, bringing about certain positive impacts on the global environment and/or stakeholders is the ultimate goal of impact investment itself. While this is not limited to the listed equity asset class, one of the unique characteristics of listed equity is the magnitude of its potential impacts ("scalability"). In general, the scale of economic activity by listed companies is large, and the potential impacts on the global environment and/or stakeholders are significant due to the breadth of their areas of activity and the size of their value chains. If many of the listed companies work with the intention to create impacts, it is expected to have significant positive impacts on resolving global environmental problems and social issues. To look at it from a different angle, the negative impacts by listed companies have the potential to be enormous. Also, from the perspective of achieving the SDGs, it would be difficult to do so without the role of listed companies.

Given these points, it should be important for listed companies to pay attention to the positive and/or negative impacts of their corporate activities.

(2) Benefits for Individual Investors and Asset Owners

The benefits to individual investors and asset owners who supply investment capital are as follows.

The listed equity asset class has higher liquidity than private equity and is easy for many investors to practice. In addition, there is the benefit that it is possible to invest even from a small amount, and it is easy to invest even with a certain amount of money. In other words, impact investment funds in listed equity are superior in "accessibility" for individual investors and asset owners.

Another benefit is that if individual investors and asset owners have certain values and preferences regarding the creation of impacts that are separate from (or in addition to) the pursuit of financial return associated with their investments, they can better align their investment behavior with those values and preferences through investing in impact investment funds. Furthermore, assuming investors who achieve higher utility with higher investment impacts, the magnitude of the potential impacts (scalability) will not only benefit the global environment and stakeholders, but will also benefit individual investors and asset owners.

In addition, some institutional investors have pointed out that impact considerations in

investment decisions may result in higher financial return (for the relationship between impacts consideration and financial return, see 3.2 below).

Moreover, asset owners like pension funds typically adopt funds with multiple different investment strategies. This is a diversification of investment strategies, and aims at diversification effect of the asset portfolio. A portfolio of an impact investment fund built with impacts in mind tends to have different constituent companies and characteristics compare to a portfolio of conventional funds. In that case, the adoption of impact investment funds in addition to conventional funds would help to diversify the asset portfolio.

(3) Benefits for Investment Managers

The benefits for investment managers that manage impact investment funds are as follows.

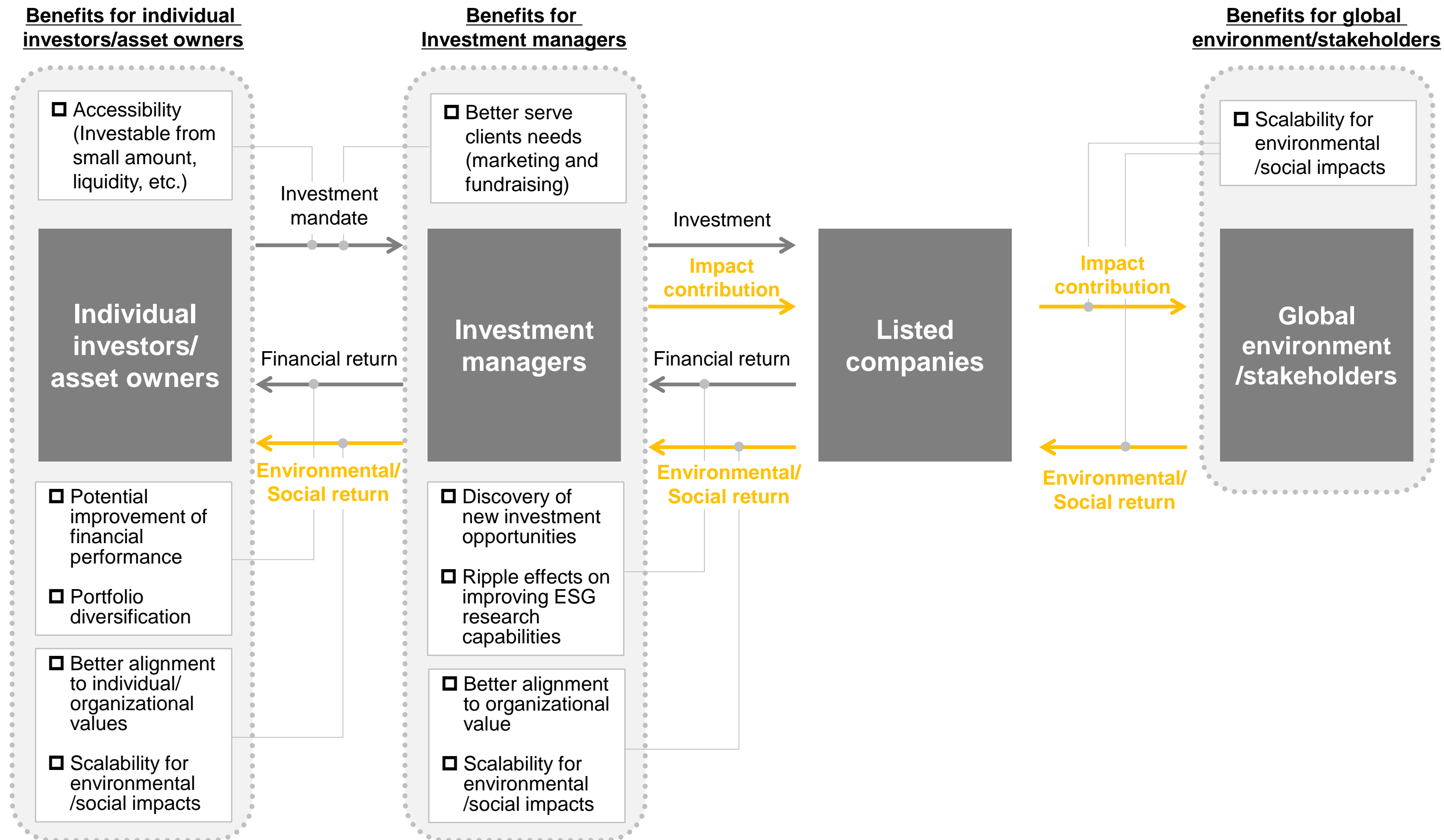
Firstly, investment managers can meet the needs of individual investors and asset owners who have specific values and preferences regarding impact creation. In other words, they have an advantage in terms of marketing and fundraising.

Secondly, consideration of impacts in the investment management process and decision-making may contribute to improved financial return (for the relationship between impact consideration and financial return, see 3.2 below).

Furthermore, more indirectly, the process of measuring and analyzing the potential and actual impact creation of portfolio companies (and candidates) can lead to a more multifaceted understanding of companies, which in turn can lead to an improved ability to analyze and evaluate companies from an ESG perspective. It means that there is a ripple effect of company analysis from an impact perspective on the overall company research.

In addition, the magnitude of potential impacts (scalability), which is one of the hallmarks of impact investment funds in listed equity, could significantly enhance their own utility if the investment manager itself has specific values and preferences regarding the creation of impacts.

Figure 17: Benefits of impact investing activities in listed equity



Note 1: While possible benefits are listed, it does not guarantee their comprehensiveness, nor does it promise that all of these benefits will occur in all impact investment activities.
Note 2: For public companies, there may be benefits such as improved financial performance due to capturing new business opportunities, and/or a reduction in the cost of capital by attracting a large number of impact investors. However, this survey did not conduct interviews with listed companies, and the benefits to public companies are hypothetical, so they are not included in the figure.
Source: Prepared by Nissay Asset Management based on various materials and interview surveys.

3.2. Relationship Between Impact Creation and Financial Return

Due to the nature of impact investing, which is the simultaneous pursuit of impact creation and financial return through investment, the priorities when these two are conflicting are often contentious. Such debate is based on the premise that there is a trade-off between impact creation and financial return, and is concerned about giving up some of the financial return in order to create impacts.

However, all of the institutional investors interviewed in this study were focused on maximizing financial return, and none indicated that they might give up some of their financial return for the sake of creating impacts.

On the contrary, many pointed out that investment processes and decision-making that consider impacts may enhance financial return in the medium to long-term.

The rationale is that global environmental problems and social issues are thought to be business opportunities for companies. In other words, there is a high need for products and services that contribute to solving global environmental problems and social issues, and the market is expected to grow rapidly. In other words, by investing in companies that receive such tailwinds, it is possible to both create impacts and pursue financial return.

In addition, the growth potential of product and service markets that contribute to resolving global environmental problems and social issues is often overlooked by general fundamental investors, indicating that the tendency for mispricing in the equity market is large. By allowing undervalued equity prices to return to decent levels over time, impact investment funds can earn attractive financial return.

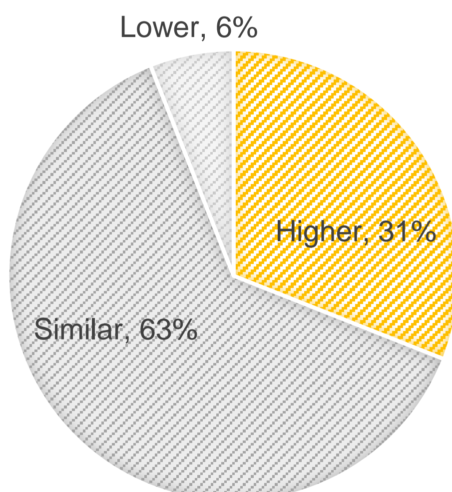
However, the impact investment funds interviewed in this survey are all active investments, and the companies that they invest in are not determined solely from the perspective of impacts. As the companies that they decide to invest in comes after taking into account the results of conventional fundamentals analysis or ESG analysis from the perspective of improving risk and return, there is no doubt that this is one of the factors that can help to avoid a trade-off.

Some asset owners also recognize the potential for impact investment funds to generate higher financial return. A survey by the Phenix Capital reported that many asset owners who

have adopted or are considering to adopt an impact investment fund perceive that impact investment funds provide comparable or better financial return than conventional funds (Figure 18).

At the time that this report was written, it would be difficult to empirically verify the relationship between financial return and consideration of impact in listed equity investment because the number of sample funds is limited and the track record of each fund is short. Empirical analysis needs to be accumulated.

Figure 18: Asset owners' perceptions of the risk/return profile of impact investing compared to general investing



Note: Results of a questionnaire survey on perception about the risk and return profile of impact portfolios compared to general portfolios. The number of responding institutions was 64 (the breakdown was 19 for banks & wealth management, 18 for pension funds, 8 for insurance companies, 7 for family offices and high-net-worth individuals, 7 for foundations, 3 for development finance institutions and 2 for endowments).
Source: Prepared by Nissay Asset Management based on Phenix Capital (2019) “Impact Investing: Asset Owner Trend Report”

Box 1: Debate over the Relationship Between Fiduciary Duty and Impact Consideration

In January 2019, the United Nations Environment Program Finance Initiative (UNEP-FI), the Principles for Responsible Investment (PRI) and the Generation Foundation jointly launched a new project about fiduciary duty for institutional investors. This project called "A Legal Framework for Impact" is examining how investors' consideration of their impacts on the global environment and the sustainability of socio-economic systems is positioned in the concept of fiduciary duty.

This is the third project led by the UNEP-FI regarding the legal interpretation of fiduciary duty.

The past two projects have analyzed whether institutional investors' consideration of ESG factors is consistent with their fiduciary duty. The first report, published in 2005, concluded that investors are allowed to consider financially material ESG factors under the fiduciary duty. This view is said to have supported the formulation of the PRI in 2006.

In addition, in the second report released in 2015, in light of the changes in the world with regards to ESG investing in the 10 years since the previous report, it went a step further with the view that failure to consider financially material ESG issues goes against fiduciary duty.

The third project, A Legal Framework for Impact, focuses on whether it is permissible under fiduciary duty for investors to consider the impacts on the global environment and socio-economic systems (sustainability) through the influence of investment activities on companies, rather than considering ESG factors to improve financial performance (risk/return). As part of the project, the interpretation of relevant laws and regulations in 11 jurisdictions, including Japan, will be examined. Depending on the conclusions and recommendations of the project, this could have a significant influence on the future impact investing activities of institutional investors who are required to act under their fiduciary duty.

Figure 19: History of UNEP-FI's report on legal interpretation of fiduciary duty

Year Published	Report Name	Main Conclusion
2005	Freshfields Bruckhaus Deringer (2005) “A legal framework for the integration of environmental, social and governance issues into institutional investment” UNEP-FI	Under fiduciary duty, investors are allowed to consider financially material ESG factors.
2015	UNEP Inquiry, PRI, UN Global Compact, & UNEP-FI (2015) “Fiduciary Duty in the 21st Century”	Failure to consider financially material ESG issues goes against fiduciary duty.
2020	(Not yet published) *As of March 2020	(A view about the legal interpretation of fiduciary duty regarding impact consideration will be provided.)

Source: Prepared by Nissay Asset Management based on UNEP-FI, PRI, & Generation Foundation (2019) “A legal framework for impact”

In addition, a survey of asset owners conducted by the Phenix Capital reveals that 94% of respondents perceive creating impacts to be part of their fiduciary duty. Considering that many of the asset owners who cooperated in the survey are already implementing or considering impact investing, this may differ from the average asset owner's perception, but there are a certain number of asset owners who regard impact consideration as part of their fiduciary duty.

Figure 20: Asset owners' perceptions of the relationship between impact creation and fiduciary duty

Question: Do you believe generating impact is part of your fiduciary duty?

Yes	94%
No	6%

Question: Do you have an impact mandate?

Yes	63%
Currently developing	28%
No	9%

Note: The number of respondents was 64 (the breakdown was 19 for banks & wealth management, 18 for pension funds, 8 for insurance companies, 7 for family offices and high-net-worth individuals, 7 for foundations, 3 for development finance institutions and 2 for endowments).
Source: Prepared by Nissay Asset Management based on Phenix Capital (2019) “Impact Investing: Asset Owner Trend Report”

Box 2: "Universal Ownership Theory"[38] and Impact Investing

The "universal ownership theory" is a theory that predicts that investors who meet the following three conditions, driven by economic motivations, will actively engage their portfolio companies and industries as a whole, as well as policy and regulatory authorities, to resolve "market failures" caused by positive or negative "externalities" associated with corporate activities. At the same time, universal ownership theory itself provides investors with a rationale for the above-mentioned investor behaviors.

- Long investment time horizon
- Because the assets under management are too large, there are restrictions on the sale of stocks, and they are virtually forced to manage by index investment or a widely diversified portfolio across the whole market that is substantially the same as index investment
- Making investments to efficiently maximize the assets under management as well as pursue absolute return

Investor behaviors unique to universal owners were first noted in a 1996 book by Robert A. G. Monks and Nell Minow, founders of the proxy voting advisory firm ISS, and then theorized in a series of studies in the late 1990s and early 2000s, primarily by James P. Hawley and Andrew T. Williams of St. Mary's College of California. As the theory predicts, many large public pension funds today engage in investor behaviors that are unique to universal owners. In fact, many calls themselves universal owners. For example, Japan's GPIF used the term "universal owner" for the first time in 2016 when it was looking to select ESG indexes, and it gave the following view: "it is reasonable to aim to maximize the long-term return of the portfolio through minimizing negative externalities, such as environmental and social issues"[39].

As mentioned above, what the universal owners see as a problem is "market failure" and they focus on the externalities that cause it. For example, the Norwegian Ministry of Finance, which oversees the Norwegian Government Pension Fund - Global, which claims to be a universal owner, has expressed the following view about the fund in its parliamentary report:

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[38] The description regarding universal ownership theory in Box 2 is based on Hayashi T. (2017) "The Development and challenges of Universal Ownership Theory" in Kitagawa T. (Eds.) New roadmap for the Governance Revolution (in Japanese), Toyo Keizai Inc, pp. 215-240, except where the source is specified.

[39] Government Pension Investment Fund (2016) "Call for Applications of Environmental, Social and Governance Indices for Domestic Stocks" (in Japanese, provisional translation by Nissay Asset management) July 22nd, 2016

“One company shifting costs onto the environment, which can increase this company’s return in isolation, may have a negative impact on other companies in the portfolio. This can result in a weakening of the overall portfolio. This effect is particularly strong for a “universal owner”[40].

This passage refers to the "negative externality" of environmental pollution caused by corporations, pointing out that the overall influence on investment performance may be negative as a result of the inclusion of both profitable and adversely affected companies in a universal owner's portfolio.

On the other hand, it is not limited to "negative externalities" such as environmental pollution or social problems that cause a "market failure". Conventional economics points out that "positive externalities" can also cause a market failure. And, as the IMP points out[41], this concept of positive externalities is considered to be very close to the concept of impact (positive impact) in the context of impact investing.

For example, a company's training of its employees to improve their skills may bring benefits to the company, but it may also bring benefits to its competitors when the trained personnel move to the competitor. That is, there are “positive externalities” in employee training. If this company does not put as much effort into employee training as is desirable for society as a whole, out of concern that it will benefit its competitors, this too is a "market failure".

As of March 2020, when this report is being written, the main focus of many investors who call themselves universal owners is to deal with the risk of losing the value of their entire portfolios due to negative externalities, but in the light of the "universal ownership theory", the upside potential of the entire portfolio due to positive externalities (positive impacts) may also attract more interest of universal owners shortly.

[40] Norwegian Ministry of Finance (2009) “On the Management of the Government Pension Fund in 2008, Report No. 20 (2008–2009) to the Storting,” pp. 47

[41] IMP “What” <https://impactmanagementproject.com/impact-management/what-is-impact/what/>

3.3. Establishment of Impact Themes

As described in the definition and requirements by the GIIN shown in Figure 9, impact investing activities are conducted with the "intention" of creating certain positive impacts. For this reason, many impact investment funds set and clarify in advance the specific areas and themes in which they aim to create impacts.

The impact investment funds in listed equity interviewed in this study have a variety of impact themes that are set by the institutions that manage them. The impact themes given are in many cases uniquely devised and defined by the investment managers, but in some cases, the goals and targets of the SDGs are used as is for the impact themes. However, even if the impact themes are independently set by the investment managers, the relationship between the relevant themes and the goals/targets of the SDGs tend to be clarified. In other words, they often present ideas about how contributions to impact themes can also contribute to the SDGs.

With regard to the establishment of a unique impact theme, some have pointed out that the SDGs are not suitable for direct use as impact themes because they are not only codified with corporate activities in mind. In other words, they have pointed out that it is more effective to set a unique impact theme from the perspective of linking it to the product and service market, the ease of setting KPIs for impact measurement (see 3.4 below for impact measurement), or the ease of data collection for impact measurement. As for themes set independently, new themes are added or existing themes are modified in response to changes in the situation surrounding global environmental problems and social issues.

Regarding the number of impact themes, it is common for the impact investment funds surveyed to set multiple impact themes with some degree of comprehensiveness. These themes are ranging widely from the environmental-related (E) to social-related (S) ones. Since, if the scope of impact themes is too narrowed, the characteristics of the impact investment fund's portfolio may be biased. From the viewpoint of investment management practice, it should be better to set a wide range of themes to some degree.

Moreover, in the IRIS+, the indicator catalog for impact measurement by the GIIN, a list of standard impact themes is provided along with KPIs for impact measurement. The IRIS+ classification of themes can be a useful reference for new impact investors when considering their themes (Figure 21).

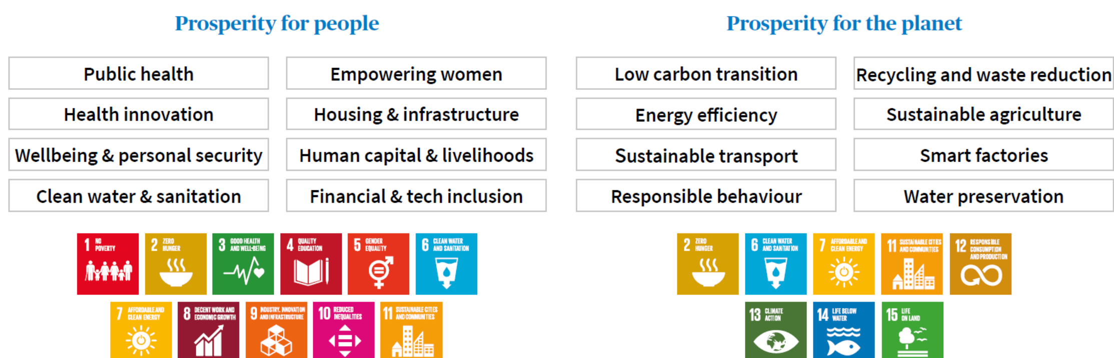
Figure 21: Examples of standard impact themes

Impact Category	Impact Theme
Agriculture	Food Security Smallholder Agriculture Sustainable Agriculture
Air	Clean Air
Biodiversity & Ecosystems	Biodiversity & Ecosystem Conservation
Climate	Climate Mitigation Climate Resilience and Adaptation
Diversity & Inclusion	Gender
Education	Access to Quality Education
Employment	-
Energy	Clean Energy Energy Access Energy Efficiency
Financial Services	Financial Inclusion
Health	Access to Quality Health Care Nutrition
Land	Natural Resources Conservation Sustainable Land Management Sustainable Forestry
Oceans and Coastal Zones	Marine Resources Conservation & Management
Pollution	Pollution Prevention
Real Estate	Affordable Quality Housing Green buildings
Waste	Waste Management
Water	Sustainable Water Resources Management Water, Sanitation, and Hygiene (WASH)

Source: Prepared by Nissay Asset Management based on GIIN (2019) “IRIS+ Thematic Taxonomy”

[Examples of Impact Themes Established by Institutional Investors (from Disclosure Materials)]

Our impact investing themes and links to the SDGs[4]



Source: AXA Investment Managers. For illustrative purposes only.

Source: Takatsuki, Y., & Smith, I. “Driving impact in listed assets investments” AXA Investment Managers, pp.6. Reprinted with permission.

■ Climate change, pollution and emissions	We invest in solutions for climate change, such as renewable energy and clean technology.
■ Water scarcity	We invest in solutions for water scarcity, such as wastewater treatment and water-saving technologies.
■ Food security	We invest in solutions for food shortages, such as efficient food production and food quality.
■ Healthcare	We invest in solutions for healthcare, for example hospitals in developing countries and healthcare innovations.

Source: Prepared by Nissay Asset Management based on PGGM Investments “Investing in solutions” <https://www.pggm.nl/english/what-we-do/Pages/Investing-in-solutions.aspx>

Source: Triodos Investment Management “Impact investing through listed equities and bonds” pp.3. Reprinted with permission.

3.4. Impact Measurement for Listed Companies

There are various approaches by which impact investors can measure the impacts of companies that they invest in. Figure 22 summarizes the efforts by the impact investment funds in listed equity who were interviewed for this survey (note that in some asset classes, such as green bond investments where the use of funds is limited to certain projects, the efforts to measure impact will focus on specific projects undertaken by companies. However, since this study focuses on impact investing in listed equity, the impacts are basically measured on the entire activity of the listed company.).

First, focusing on the corporate activities that are subject to impact measurement, the impacts can be broadly divided into two categories: "the impacts generated by the supply of products and services" and "the impacts accompanied by operations".

In addition, there are efforts to measure the impacts of products/services and operations by applying common KPIs to the companies in the portfolio, and efforts to measure the impacts by setting KPIs that are specific to each company, taking into account the individuality of each company (there are cases where both efforts are made.). It should be noted that the impact investment funds surveyed in this study conduct quantitative evaluations using some (common or unique) KPIs, and no one was found to conduct only qualitative evaluations.

In the case of products and services, instead of applying common KPIs to all products and services, it has become common practice to measure each impact theme (e.g., climate change mitigation, financial inclusion, etc.) using common KPIs that are appropriate for that theme.

When common KPIs are used, it is easy to aggregate KPIs at the portfolio level and check their changes over time, or compare them among companies in the portfolio. However, even if the KPIs themselves are applicable to various companies, the meaning of the level or changes in KPIs may vary depending on the geographical conditions and/or the situation of the impacted stakeholders (for example, the impacts of water supply on local communities may differ significantly between areas with severe water shortages and areas without such shortages.).

On the other hand, since the impacts generated by a company are highly specific to each company, it has been pointed out that appropriate KPIs should be customized and set for

each company. Furthermore, in order to appropriately understand the meaning of the KPIs, it is often pointed out that the evaluation should be performed with qualitative information as well. Many investors are using (or are considering to utilize) the five dimensions proposed by the IMP (see Figure 6) to more deeply analyze the impact creation status of individual companies. However, using this approach to measure the impacts of all the companies in a portfolio on a company-by-company basis would require a significant amount of human resources. When considering the specificity of impacts on a company-by-company basis, a number of respondents pointed out that a concentrated portfolio with a narrowed number of investee companies is more feasible than a portfolio that is diversified across a wide range of companies.

Most of the impact investment funds interviewed in this study focus on the impacts generated by the supply of products and services. In addition to products and services, funds differ on whether or not to include the operational impacts in the impact measurement. Some funds measure operational impacts, while others only check to see if a significant negative impact has occurred.

Figure 22: Typologies of impact measurement and reporting approach

Focus on Impact Measurement	KPIs for evaluation	Evaluation Methods (Quantitative/ qualitative)	Examples of Representative Efforts	Examples of Impact Reporting
Impacts generated by the supply of products and services	Common KPIs	Quantitative	■ Set common KPIs for each impact theme, and measure the total impacts of the portfolio [Example of KPIs] ・Amount of contribution to health care cost reduction ・Number of people with improved access to financial services	■ Report KPIs for each impact theme at portfolio level
	Unique KPIs for each company	Quantitative + qualitative	■ Evaluate the company-specific impacts created through the supply of products and services using unique KPIs set for each company together with qualitative information. [Example of KPIs] ・Average wage growth rate for participants in a certain education program	■ Provision of case studies
Impacts accompanied by operations	Common KPIs	Quantitative	■ Set common KPIs, and measure the impacts on the entire portfolio [Example of KPIs] ・Volume of greenhouse gas emissions ・Volume of material recycling ・Volume of new job created	■ Report KPIs at entire portfolio level
	Unique KPIs for each company	Quantitative + qualitative	■ Evaluate the company-specific impacts created through the supply of products and services using unique KPIs set for each company together with qualitative information [Example of KPIs] ・Improve indicators for the well-being of workers	■ Provision of case studies

Note: The figure summarizes efforts that are considered to be representative, and this does not mean that there are no other efforts that are not included here.

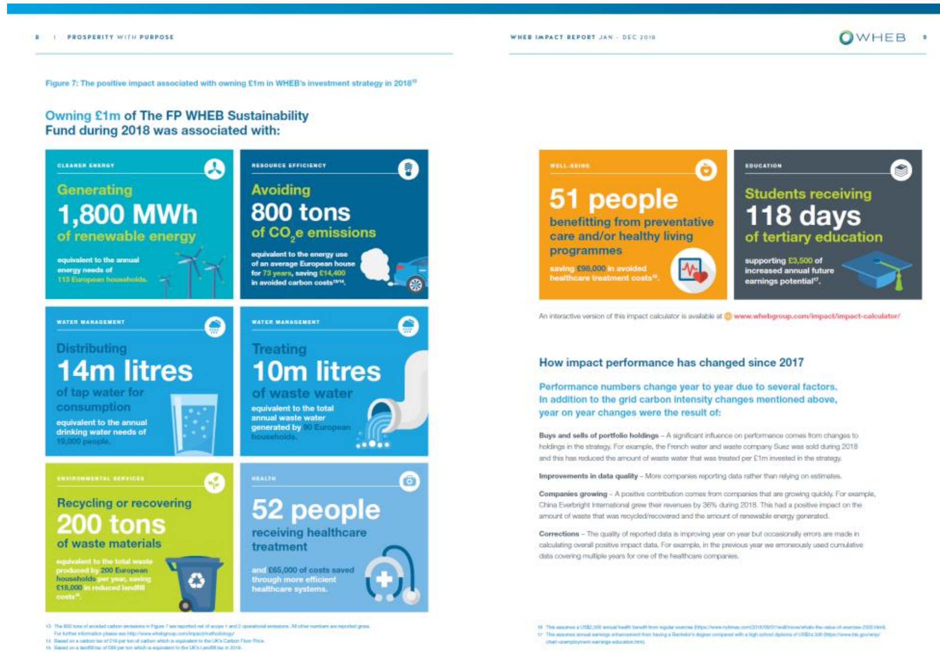
Source: Prepared by Nissay Asset Management based on various materials and interviews.

[Examples of Impact Measurement by Institutional Investors (from Disclosure Materials)]

■Impact measurement and provision of a case study for each impact theme

Source: Aberdeen Standard Investments “Global Equity Impact Fund: Annual Impact Report 2018” pp.10-11. Reprinted with permission.

■Impact measurement at portfolio level



Source: WHEB Asset Management “Annual Impact Report 2018” pp. 8-9. Reprinted with permission.

Box 3: Indicator Catalog "IRIS+" for Impact Measurement

The IRIS+ is one of the main activities of the GIIN and provides a catalog of indicators (KPIs) that investors can use when measuring and managing impacts. The latest version released as of March 2020 (IRIS 5.0) contains a total of 594 KPIs[42], each of which is defined, how they are calculated, and what kind of implications can be obtained from them. Furthermore, it links to impact category/theme classification defined by the IRIS+, as well as links to the SDGs and the five dimensions of the IMP (Figure 6), so that users can search for KPIs from various angles.

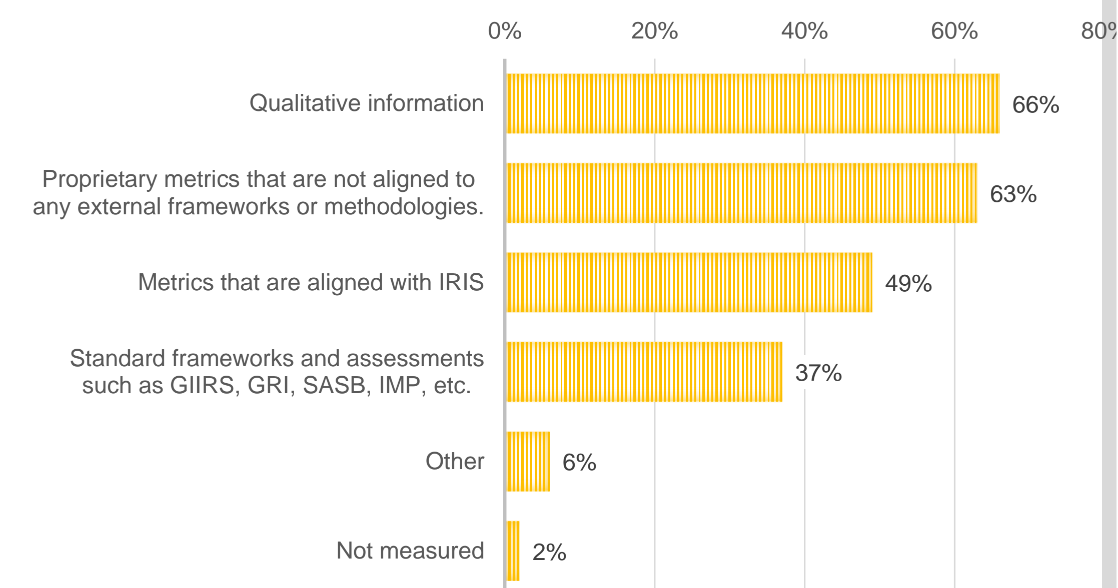
According to a survey conducted by the GIIN regarding impact measurement and management approaches by impact investors, 49% of the respondents answered that they are using "metrics that are aligned with IRIS" (Figure 23). This suggests that many investors are making use of the KPIs in the IRIS+, or their equivalent. Apart from "metrics that are aligned with IRIS", 63% of investors answered that they use "proprietary indicators that are not aligned with any external frameworks or methodologies". Given that each company has its own unique path from input to outcome, it is important to make appropriate use of the KPIs provided by the IRIS+, and to use its own KPIs as necessary, in order to appropriately understand the state of impact creation in portfolio companies.

In addition, in the same survey, "qualitative information" was most frequently used at 66%. Also, according to the survey, 44% of investors chose "qualitative information" and "proprietary indicators that are not aligned with any external frameworks or methodologies" at the same time, and the next most common combination was "qualitative information" and "metrics that are aligned with IRIS" at 34%.

Even if the KPIs themselves are at the same level or at the same rate of change, the implications may differ depending on the global environment and/or the situation of the stakeholders who will be impacted, which suggests that impact evaluation is not completed simply by calculating the KPIs, but by utilizing qualitative information together.

[42] GIIN "Catalog Downloads" <https://iris.thegiin.org/catalog/download/>

Figure 23: Information and indicators used for impact assessment (multiple choice question)



Note: The sample is 266 institutions.
Source: Prepared by Nissay Asset Management based on GIIN (2019b)

Box 4: Trends in the Development of Impact Measurement Methodologies and Tools

There is a growing movement to develop methodologies and tools to measure the impacts of the companies invested in or the entire portfolio. Examples include the "Investment Impact Framework" developed by the University of Cambridge's Institute for Sustainability Leadership (CISL); the "Impact Analysis Tool", developed by the UNEP-FI's Positive Impact Initiative; activities by the Value Balancing Alliance, an NPO established by several companies, including the German chemical giant BASF; and the Impact-Weighted Accounts Initiative led by scholars at the Harvard Business School (HBS) (see below for details. Note that this is just an example of representative activities, and does not guarantee comprehensiveness.).

In addition to the above activities, the GSG Japan National Advisory Board is conducting a project to demonstrate impact assessments and validate the assessment framework for private and listed companies in Japan from 2019 to 2020[43].

[43] Based on interview surveys.

(1) Investment Impact Framework by CISL[44]

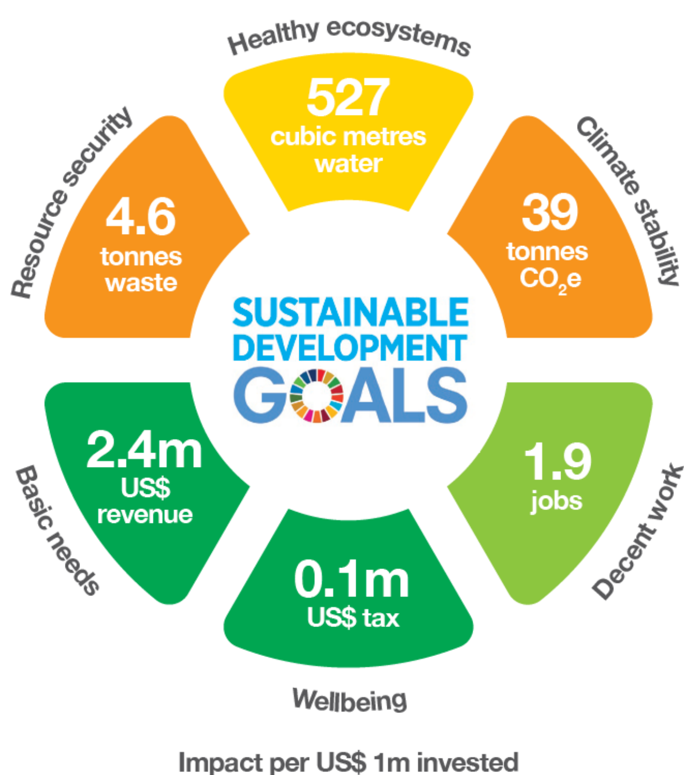
The Investment Impact Framework, developed by the Cambridge Institute for Sustainability Leadership (CISL), is a methodology for investors to measure the impacts of individual investment funds. Specifically, for each of the six impact areas (basic needs, wellbeing, decent work, resource security, healthy ecosystems and climate stability) created on the basis of the SDGs, specific indicators have been proposed to measure impacts. Investors can use this to quantitatively measure the impacts per unit of investment (for example, the impacts of investing $1 million) (Figure 24).

The framework presents ideal metrics for measuring impacts in each of the six areas, and then presents a set of metrics that are practically applicable considering the availability of data at the moment. Although it is difficult to apply the ideal metric immediately at this point, it is presented to show the direction to be taken in the future, including the enhancement of information disclosure by companies.

In the framework, the results of impact measurement are shown for each of the six areas. Since each of the six areas has different properties, it is not appropriate to add up the values of each area across areas or offset them (negative values in one area should not be offset by positive values in another area).

[44] University of Cambridge, Institute for Sustainability Leadership (CISL) (2019) “In search of impact - Measuring the full value of capital: Update: The Investment Impact Framework”

Figure 24: Example of impact measurement results



Source: CISL (2019) pp.10

(2) Impact Analysis Tool by UNEP-FI[45]

The UNEP-FI is developing an "Impact Analysis Tool" as part of its activities under the "Positive Impact Initiative" promoted by the organization. As of March 2020, an implementation manual of prototype tool has been published. The purpose of the tool is to understand the positive and negative impacts of corporate activities in each of the 22 impact areas prepared based on the SDGs (Figure 26).

Two types of tools have been developed, one for the analysis of individual companies and the other for the analysis of bank's loan portfolios. This should be related to the fact that the participants in the initiative are mainly banks.

The tools themself do not contain any data necessary for impact measurement. It is necessary for the user to prepare the required data and then insert it into the tool to run

[45] UNEP-FI (2019) "Impact Analysis for Corporate Finance & Investments: Tool Prototype, Introduction Manual"

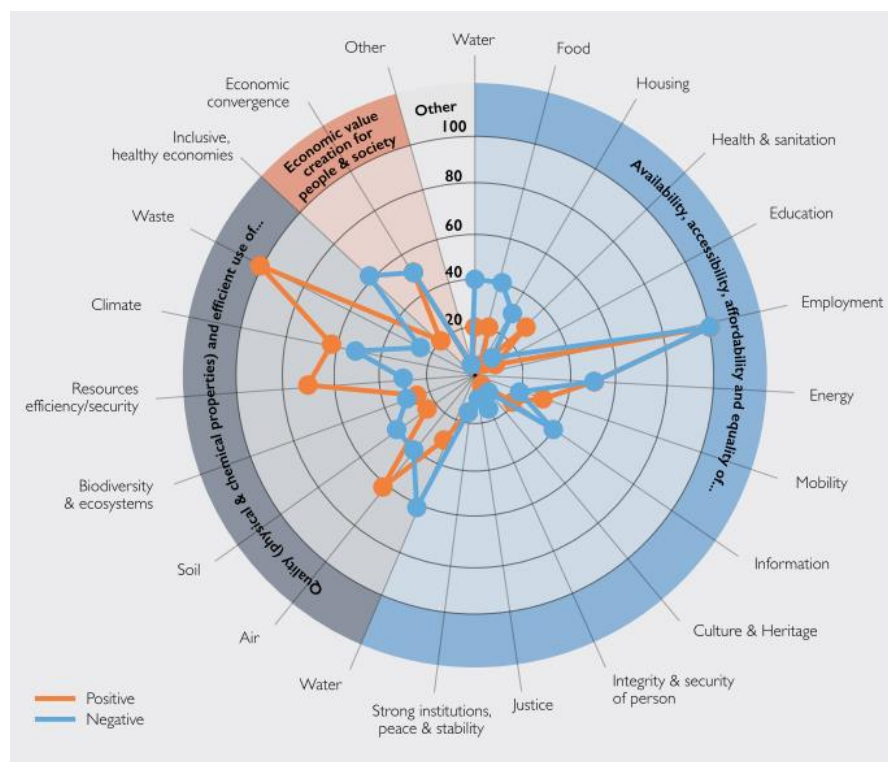
the analysis.

Figure 25: Main Activities of the UNEP-FI "Positive Impact Initiative"

Year	Main Events
2015	➢ UNEP-FI invites banks and other financial institutions to participate and declares "Positive Impact Manifesto". It points out the need for a new financial paradigm based on impact to fill the funding gap needed to achieve the SDGs.
2017	➢ Publishes the "Principles for Positive Impact Finance" that defines the basic concept of impact analysis and management by financial institutions and other stakeholders.
2018	➢ Publishes the "Impact Radar" that comprehensively defines the impact areas by capturing the core elements of the SDGs in a form applicable to business. ➢ Publishes the "Model Frameworks" that provides guidance for incorporating impact considerations into business processes and decision making for various financial methods and asset classes.
2020	➢ Based on the above principles and the definition of the impact areas in the "Impact Radar", develops the "Impact Analysis Tool" in order to identify, assess and monitor corporate impacts (there are two types of tools: one for analysis of individual companies and the other for analysis of bank's loan portfolios).

Source: Prepared by Nissay Asset Management based on UNEP-FI "Positive impact" <https://www.unepfi.org/positive-impact/positive-impact/>

Figure 26: Impact Radar



Source: UNEP-FI (2019) pp.10

(3) Value Balancing Alliance[46]

The Value Balancing Alliance (VBA) is a non-profit organization that was established in June 2019 by eight major European, U.S. and Korean companies including German chemical manufacturer BASF, auto parts manufacturer Bosch and Swiss pharmaceutical company Novartis. In December of the same year, Mitsubishi Chemical Holdings announced that it was the first Japanese company to participate[47], and it is involved in activities as one of the core member companies. The CEO of the alliance is Christian Heller, who comes from BASF. While the VBA is a project that is led by private sector practitioners, it is also collaborating with the "Impact-Weighted Accounts Initiative" promoted by scholars at the Harvard Business School (HBS), which will be described later, and is actively seeking to incorporate the knowledge of academia.

The main objective of the VBA is to establish methodologies for measuring the

[46] Value Balancing Alliance <https://www.value-balancing.com/>

[47] Mitsubishi Chemical Holdings (2020) "Mitsubishi Chemical Holdings Becomes First Japanese Value Balancing Alliance Member" March 11, 2020 <https://www.mitsubishichem-hd.co.jp/english/news_release/pdf/00896/01033.pdf>

contributions (impacts) of corporate activities on the global environment and socio-economic systems, and to develop new accounting standards that make use of these methodologies. One of the characteristics of this activity is that it does not only measure impacts but also focuses on converting it into monetary value. By expressing impacts with the use of monetary value, which is the most basic unit in the capitalist economy, the aim is to increase the comparability of impacts and encourage their use in decision making by companies.

Over the next few years, the VBA plans to develop methodologies for measuring impacts and converting value for money, and to actively collaborate with policy authorities and others for global dissemination. In fact, the VBA announced in February 2020 that it had achieved funding from the European Commission to develop management accounting principles and guidelines on the environmental impacts of business[48].

BASF, one of the companies leading the VBA, has already used a proprietary methodology called "Value-to-Society" to measure and convert its environmental and social impacts into monetary value and disclose the results[49]. Many other participating companies are also making similar efforts and disclosing information about it. The VBA will move toward the development of a standardized methodology that can be applicable to a wider range of companies, based on the efforts and knowledge accumulated by participating companies to date.

(4) "Impact-Weighted Accounts Initiative" by HBS[50]

The "Impact-Weighted Accounts Initiative" is a project undertaken by a research group at the Harvard Business School under the leadership of Professor George Serafeim in collaboration with the GSG and the IMP. Under the slogan of "reimagining capitalism", a methodology is being developed to convert impacts into monetary value and reflect it in financial statements so that not only financial aspects but also environmental and social impacts will be taken into account in the decision-making of companies and investors. This development was also conscious of the consistency with the five dimensions proposed by

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[48] Value Balancing Alliance (2020) "The Value Balancing Alliance's contribution to the EU Green Deal" <https://www.value-balancing.com/press-releases/the-value-balancing-alliances-contribution-to-the-eu-green-deal/>

[49] BASF "We create value" <https://www.basf.com/global/en/who-we-are/sustainability/we-drive-sustainable-solutions/quantifying-sustainability/we-create-value.html>

[50] Harvard Business School "Impact-Weighted Accounts" <https://www.hbs.edu/impact-weighted-accounts/Pages/default.aspx>

the IMP (Figure 6).

They have pointed out that at least 56 of large companies across the world have measured their environmental and social impacts in some way and converted them into a monetary value (of these 56 companies, 86% measure environmental impacts, 50% estimate the employment and social impacts, and 20% estimate product impacts)[51].

This is based on the idea that to significantly change in corporate and investor decisions, which are usually based on monetary value measures such as sales and profits, it is important that impacts must be also expressed in monetary forms, rather than being measured by another forms and brought into the decision-making process. By converting to value for money, various impacts can be directly compared on a common scale, and it is more intuitively understandable to corporate managers and investors. In addition, it would be easy to incorporate it into existing management tools and financial analysis methodologies.

As of March 2020, when this report is being written, this initiative has only just begun, but as early as February 2020, a working paper was published reporting the results of a trial of measuring the impacts of products and services and converting them into a monetary value for several sample companies[52]. More research will be conducted on the measurement of impacts and the methodology of value-for-money conversion shortly.

3.5. Publication of Impact Reports

The impact investment funds in listed equity interviewed in this study are increasingly taking steps to periodically disclose the results of their impact measurement in any form described in 3.4.

These impact reports cover individual impact funds (or multiple impact funds with similar strategies) and report on the impact created by the fund's portfolio companies, as well as the

[51] Serafeim G., Zochowski T. R. & Downing J. (2019) “Impact-Weighted Financial Accounts: The Missing Piece for an Impact Economy”

[52] Serafeim G. Trinh K. & Zochowski R (2019) “A Preliminary Framework for Product Impact-Weighted Accounts,” Harvard Business School Accounting & Management Unit Working Paper No. 20-076

status and results of engagement aimed at creating impact in the fund. Unlike annual reports or stewardship report, which report on the activities of institutional investors as a whole, these impact reports are specific to individual impact investment funds.

As for the frequency of publication of impact reports, most of them are published on an annual basis, but some of them are published at a higher frequency, such as semi-annually or quarterly.

However, since the disclosure cycle of non-financial information on the company side used for impact measurement is basically annual, the impact reports published more frequently than annually are mainly dominated by contents about activities in the most recent reporting period rather than the results of the impact measurement of the fund.

It is also pointed out that it is not necessarily important to publish impact reports more frequently than annually, since impact creation by portfolio companies does not take place over a short-term timeframe but over a longer period of time.

The content disclosed in the impact report is also diverse, as described in 3.4, due to the wide range of measurement approaches to impacts. When common KPIs are applied to the companies in a portfolio to measure impacts, the results of the analysis are often reported at the portfolio level. On the other hand, in cases where impact measurement focuses on company specificity, it is difficult to analyze at the portfolio level, so impact reports tend to spend pages describing individual cases, such as companies with a high percentage of ownership or companies that have made significant impacts.

Regarding engagement, some respondents said that it should be difficult to disclose detailed information on engagement, especially for ongoing dialogues with companies. Others also said that it should be difficult to disclose details on impact measurement for business reasons when the KPIs used for impact evaluation are unique know-how.

3.6. Concept of Additionality and Role of Engagement in Listed Equity Investments

As mentioned in Figure 7 in Chapter 2, while impacts are generated by corporate activities, investors can indirectly influence impact creation by influencing the activities of companies that they invest in. Of the impacts generated by companies, the part that is added by the

investment behavior of investors (in other words, the part that would had not happened without the investor's investment activities) is generally expressed by the term "additionality". And it is often argued that this additionality is one of the most important values that impact investors offer.

In Figure 27, the IMP sets out four channels for investors to contribute to the impact creation of companies.

Figure 27: Channels of impact contribution by investors classified by IMP

Viability in listed equity investments	Four channels for investors to contribute to impact creation	Specific details
Possible to implement	(1) Signaling to the market the focus on measurable impacts as investors	➢ Signaling through the influence on equity price via equity trading ➢ Signaling through setting up of new investment strategies and products
	(2) Active engagement with companies they invest in	➢ Encouraging impact creation by companies through dialogue (engagement) with the companies ➢ Dispatching directors, hands-on management support
Compared to the private market, limited room for implementation	(3) Provision of funds for activities and/or growth	➢ Funding for corporate activities aimed at capturing business opportunities with potentially high impacts and an attractive financial return
	(4) Provisions of flexible capital (patient capital)	➢ Provision of funds that can tolerate below market-rate return for the sake of high impacts

Note: The IMP states that "(4) Provisions of flexible capital (patient capital)" is part of "(3) Provision of funds for activities and/or growth", while (3) and (4) are part of "(1) Signaling to the market the focus on measurable impacts as investors", and "(2) Active engagement with companies they invest in" can be done simultaneously with (1) to (3).
Source: Prepared by Nissay Asset Management based on IMP (2019) "Investor contribution in public and private markets: Discussion document"

The first channel is the contribution that investors make by signaling to the market that they care about impacts. For example, the investment behavior of institutional investors with large assets is often covered in the media and often attracts attention from companies. Thus, companies may change their behavior in response to signals from investors, resulting in a

change in the state of impact creation by companies.

The second channel is the contribution made by investors by reaching out more directly to the companies in which they invest. Commonly referred to as engagement, its influence on corporate behavior tends to be greater than the signals it sends to the market[53].

The third and fourth channels are both contributions by supplying the necessary funds for corporate activities. It is easy to understand intuitively the claim that the creation of impacts by an investor is the providing funds for corporate activities that produce impacts, but some say that if the company could easily procure funding from another investor even if the first investor does not supply the funds, it would be debatable to consider it as a change brought about by the investor. (In other words, investors can only create impacts by directing funds to areas where there is a shortage of funds for activities.)

In any case, the IMP and many practitioners believe that it is primarily through the first or second channel that investors can contribute to the creation of impacts in listed equity investments, and that the third and fourth channels have limited feasibility compared to the case with investment in private markets. The main reason for this view is that listed equity investments do not contribute to the impact creation activities of companies by providing additional funds, since the main activity of listed equity investments is the trading of shares in the secondary market, except for public offerings.

For the impact investment funds in listed equity interviewed in this study, the second channel, i.e. engagement, was regarded as important. However, we found that there are two different schools of thought when it comes to measuring engagement outcomes. One is the idea that a prerequisite for impact investing is to demonstrate a clear contribution (additionality) by investors by measuring it in some way. The other is the notion that since measuring engagement outcomes is virtually impossible, finding companies that are creating significant positive impacts (impactful companies) and investing intensively in them is the value of impact investment funds in listed equity. From the latter standpoint, while engagement itself is important, the measurement of its outcome would not be a major focus.

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[53] Kölbel et al. (2019) summarized that there are three channels through which investors create impacts via portfolio companies: (i) engagement, (ii) capital allocation, and (iii) indirect impact. They pointed out that previous studies have found the most support for engagement impact, while capital allocation impact is partial and indirect impact is lacking in empirical evidence (Kölbel, J., Heeb, F., Paetzold, F., & Busch, T. (2019) “Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact”).

The interview surveys found that, while general engagement in responsible investing and ESG investing tends to require companies to address ESG risks in order to prevent portfolio devaluation, engagement in impact investing tends to be a "supportive" type of engagement that encourages companies to further strengthen their efforts to create impacts. It is not easy to encourage the creation of impact through engagement for corporate executives who have little interest or motivation in creating impacts. Instead, it is more likely to be effective to encourage companies that are already working to some extent to create impacts or that have a tendency to do so.

In addition, from a practical perspective, it is often pointed out that engagement is virtually essential in order to measure the impacts of companies that are invested in, as mentioned in 3.4. The information needed to measure impacts is not always sufficiently disclosed, and information has to be obtained through engagement by encouraging companies to disclosure. Some impact investment funds have even conducted questionnaire surveys of listed companies in order to obtain the data needed to evaluate their impacts.

Box 5: "Stewardship Theory"[54] and Engagement in Impact Investing

The relationship between shareholders as owners of a company and corporate managers is one of the central research topics in corporate finance research. The most commonly used theory when analyzing the relationship between the two is called "agency theory", which sheds light on the problem that managers (agency) who are delegated by shareholders (principals) act in their own best interests rather than those of shareholders. This problem stems from a lack of alignment between the interests of shareholders and management, and various studies have been conducted on prescriptions for solving this problem (e.g., management incentive systems and mechanisms for shareholders to monitor management).

On the other hand, phenomena that are difficult to explain by the "agency theory" can be found in the relationship between shareholders and corporate managers in reality, and there is a trend to examine the relationship between the two from a different theoretical

[54] In preparing Box 5, we referred to Kashiwagi, H. (2005) “Stewardship theory: A management theory based on a self-actualizing man: Description of the theory, literature reviews, and implications on future research,” *Japanese Journal of Administrative Science*, Vol. 18, No. 3, pp. 235-244 (in Japanese); and Kinoshita, Y., & Morita, M. (2019) “Role of Buy-Side Analysts Who Engage with Corporate Managers: How to Build a Mutual Stewardship Relationship With Management,” *Securities Analysts Journal*, Vol. 57, No. 12, pp. 26-38.

standpoint. It is called the "stewardship theory," which assumes that shareholders and managers serve the interests of the group through intrinsic motivations such as self-fulfillment and achievement, rather than assuming that they pursue only the maximization of self-interest through extrinsic motivations such as compensation.

Given that one of the requirements for being an impact investor is to have the intention of creating an environmental and/or social impacts in addition to pursuing financial return, as seen in 2.2, the image of an investor who pursues only the maximization of self-interest assumed by the "agency theory" is less applicable to an impact investor, but rather the image of an investor assumed by the "stewardship theory" is more applicable.

Prior research has suggested that the success or failure of engagement depends on the combination of whether the investor and the manager are "agent type" or "steward type", respectively. Specifically, the preferred combination is when the shareholder and the manager both choose "agent type" or both choose "steward type" to achieve a result that satisfies both of them. In the former case, the result is the minimization of potential costs, and in the latter case, the maximization of potential performance. Conversely, if the choice between the two is not aligned, either the shareholder or the corporate manager will be dissatisfied.

In applying this theoretical analysis, for the engagement of impact investors, who are assumed to be “steward-type shareholders”, to succeed, corporate managers need to act as “steward-type managers” who have an internal motive to create impacts in addition to improving corporate value. That is, the engagement of impact investors would be effective based on trusting relationships with the companies they invest in to support their impact creation activities.

While the above is just a theoretical analysis, it provides a perspective on the nature of engagement, which is virtually essential for impact investing in listed equity.

4. Framework for Element Decomposition of Diverse Impact Investment Activities in Listed Equity

As the GIIN has listed as a requirement for impact investing (Figure 9), most of the impact investing activities in listed equity has a clear "intention" to create impacts as well as pursuing financial return. The investors themselves also required to "measure" the status of impact creation in some way and "report" it to clients and the general public in the form of an impact report. However, as we have already discussed in this study, the approach to the practice and the thinking behind it varies from institutional investor to institutional investor.

In order to deepen our understanding of this diversity, we propose a framework that captures the idea and approach of impact investing activities in listed equity by decomposing the elements, as shown in Figure 28. Specifically, it is broken down into the following eight elements (this framework does not evaluate the goodness or badness of each element).

Element 1: Prioritization of financial return and impacts

While there may be a positive relationship between impact creation and earning financial return, this is not always the case. Each fund has its own way of thinking about whether to prioritize financial return when trade-offs between the two occur in impact investing activities, i.e. whether to give up some of the financial return for the sake of creating impacts.

Element 2: Goal of impact investing activities

There are a variety of impact investing activities in terms of their goal, from those that aim to mitigate the negative impacts of the portfolio company to those that seek to maximize the positive impacts in a more proactive manner.

Since negative impacts can be a reputational or regulatory risk for companies, even in general ESG investing that considers ESG factors to improve risk and return, it is often taken up in engagement activities (In other words, there may be cases in which ESG investors engage in the same investment behavior as a result despite having different objectives.).

Element 3: Impact themes

In an impact investment fund, it is common to set themes for impact contribution upfront and then solicit investments in that fund. Regarding the impact themes, there are a wide range of funds, from those that place greater emphasis on contributions to the SDGs that are already shared among a wide range of stakeholders around the world, to those that aim to contribute

to the resolution of more unique issues.

Element 4: Interpretation of additionality

Although there is widespread recognition of the important role that engagement plays in impact investing activities in listed equity investments, there are two mixed views on the interpretation of additionality: One is the view that the prerequisite for impact investing is to measure and show in some way how much impacts have been generated through the companies in which they have invested as a result of the engagement, and the other is the view that it is virtually impossible to measure the outcome of the engagement, but rather the value of an impact investment fund in listed equity is to find companies that have generated significant positive and clear impacts (impactful companies) and make selective investments in them.

Element 5: Source of impacts to be focused

Whether impact investors focus on the impacts through the supply of products and services in the portfolio company, or the impacts associated with the operations of the portfolio company, or both, varies from fund to fund. It should be noted that the institutional investors interviewed in this survey were more conscious of increasing their positive impacts, and from this perspective, many of them focused on the impacts generated by the supply of products and services.

Element 6: Impact measurement approach

With regard to the approach to impact measurement, some investors focus on conducting portfolio-level analysis by setting common KPIs, and others focus on the individuality of each company and have analysts to evaluate the impacts of each company individually.

In terms of measuring impacts at the portfolio level using common KPIs, investors are increasingly being asked to perform certain analyses regardless of whether their funds are impact investing or not, such as analysis of the carbon footprint of a portfolio and/or alignment of the composition of the portfolio with the 2°C target under the Paris Agreement.

Element 7: Investment management style

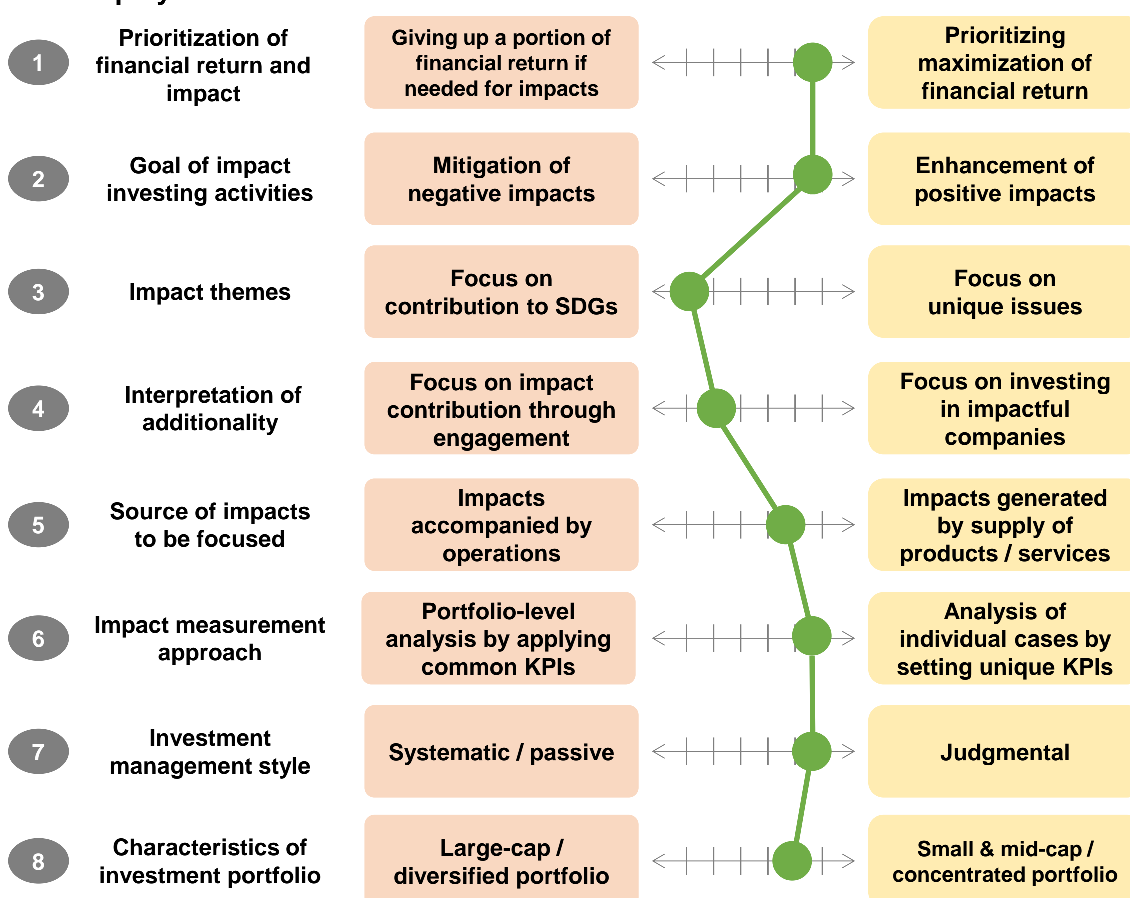
All of the impact investment funds interviewed by this study are actively managed funds. In other words, it can be assumed that the companies to invest in are judgementally determined by the portfolio manager. However, theoretically, this does not necessarily preclude the use of some quantified data on impacts to systematically determine where to invest or passively

managed impact investments.

Element 8: Characteristics of investment portfolio

Among the impact investment funds interviewed for this survey, they are likely to concentrate investment in small and medium-sized companies that have a relatively simple business model and it is easy to understand the relationship with a specific impact theme. But if from the perspective of the magnitude of the potential impacts (scalability), it is also probable to invest in large-cap companies with a more diversified portfolio. With the expansion of impact investing activities in listed equity investments, more funds with more diverse portfolio characteristics may likely to increase in the future.

Figure 28: Framework for element decomposition of impact investment activities in listed equity



Note: The green line is shown as a sample, not as an actual fund
Source: Nissay Asset Management

Impact investment can be considered part of ESG investment, as they take into account

environmental (E) and social (S) factors, as well as governance (G) for impact creation, but to view impact investment as a specific form of ESG investment is a bit too trivialized. This is because, as we identified in the eight elemental decomposition frameworks, even if we say "impact investment activities in listed equity investments" in a nutshell, the contents of these activities are different and diverse.

In the future, an industry-wide common approach may gradually take shape and become the de facto standard, but at least for now, it should not be a good idea to put impact investing activities in an overly uniform frame. Rather, it is more important for the future development of impact investing activities that various impact investors compete with each other in their ingenuity. At the same time, in order to further attract the interest of a wide range of investors, from the huge public pensions that are known as "universal owners" to individual investors, it will be important to develop a variety of impact investment activities that can meet a variety of needs and accumulate a wide range of knowledge.

5. Challenges in Impact Investing Activities in Listed Equity and Direction for Addressing Them

In this final chapter, we describe the challenges faced by investors in impact investing activities in listed equity and the direction for addressing them, as identified through this research.

(1) Lack of information disclosure necessary for impact measurement

The issue most frequently pointed out in the interviews conducted by this study is that it is currently difficult to obtain sufficient data to measure the impacts being generated by portfolio companies. The data needed to measure impacts is largely dependent on the disclosure of non-financial information by the companies in which investors invest, but since most of the information is disclosed on a voluntary basis by companies, the level of disclosure varies from company to company. For investors who try to measure impacts at the portfolio level using common KPIs, the reality is that for companies that do not disclose the information, it is measured by substituting estimated data. Therefore, some have pointed out the necessity for common guidelines and/or principles that show the indicators that should be disclosed for companies.

As mentioned in 3.4, many investors in impact investment funds focus on "the impact generated by the supply of products and services provided by companies". However, the impacts generated by products and services vary depending on the nature of the products and services and the parties to whom they are provided, there is a certain limit to uniformly setting KPIs in guidelines for information disclosure. Realistically, investors will be required to independently obtain the necessary data or encourage disclosure through interviews and engagements with individual portfolio companies.

On the other hand, since the impacts of operations is not as unique to each company as the impacts of products and services, it could be possible to provide a common indicator to some extent. In fact, as laid out in the discussion paper "Toward Common Metrics and Consistent Reporting of Sustainable Value Creation"[55] published by the World Economic Forum at the time of the Davos conference in January 2020, there is a movement to clarify the KPIs that companies should disclose in common. Such active discussions will also be a benefit to the activities of impact investors.

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[55] World Economic Forum (2020) "Toward Common Metrics and Consistent Reporting of Sustainable Value Creation," Consultation Draft

(2) How to measure impacts on large companies that are diversifying their business

Impact investment activities are required to periodically measure the impacts generated by portfolio companies and report the results. Many have pointed out that the challenge for listed equity investments is how to measure the overall impacts of a company that is large and diversified in its business.

In the impact investment funds interviewed in this study, the focus was often on companies whose products and services were expected to make a high contribution to the impact theme defined in each fund, and which accounted for a major portion of the company's revenue. These companies tend to specialize in a particular product or service area, and their size tends to be relatively small in what is commonly referred to as a small- and medium-sized company among listed companies. As a result, it is suggested that impact investors are more likely to be attracted to small- and medium-sized companies whose businesses are relatively simple and whose impacts are relatively easy to measure. However, from the perspective of the magnitude of potential impacts (scalability), it is not necessarily desirable that large companies that are diversifying their businesses will virtually be dropped out from the investment universe.

Like the Value Balancing Alliance or the Impact-Weighted Accounts Initiative (see Box 4), there are widespread movements toward the development and standardization of methodologies for measuring impacts, including large companies that are diversifying their businesses. These trends could also become important for impact investing activity in listed equity investments. Further consideration should be needed on how to deal with large companies that are diversifying their businesses in the practice of impact measurement.

(3) How to assess the potential for future impact creation by companies

Although it is required to measure the impacts of investee companies as part of impact investment activities, it is pointed out that most of the measurement efforts currently underway are only to capture a snapshot of the present or to measure the impacts that have occurred from the past to the present, and not necessarily to evaluate the future potential of the company to generate further impacts in the future.

Just as long-term fundamentals-focused investors make investment decisions by looking at the potential for future increases in corporate value, it should be important for impact investors to focus on the potential for future impact creation. To that end, it is important not only to monitor the KPIs that indicate the current status of impact creation, but also to

evaluate the strategies and governance that support the sustainability and improvement of impact creation activities at companies. More examples and best practices should be accumulated on how investors can more effectively assess the future impact creation potential of the companies they invest in.

(4) Lack of empirical analysis on the relationship between impact creation and financial return

The impact investment funds interviewed for this study are all focused on maximizing financial return, and a large majority claim to offer attractive financial return to individual investors and asset owners in the medium to long term.

The most common rationale for expecting high financial return in the medium to long term by incorporating the impact perspective into the investment decision process is that there is a high need for products and services that contribute to solving global environmental and social issues, and this can be an attractive business opportunity for companies. Of course, products and services that contribute to solving global environmental problems and social issues do not always succeed as businesses, but by carrying out so-called fundamentals analysis in addition to corporate analysis from the perspective of impacts, and by distinguishing and investing in companies that are attractive from the perspective of financial return, it could be possible to achieve both impact creation and attractive financial return at the same time.

Although the above assertion is logical, it is important to empirically examine whether companies whose products and services contribute to solving global environmental and social issues (i.e., creating significant impacts) tend to be superior in terms of financial performance, that is, whether impact funds actually perform better than conventional actively managed funds and ESG investment funds, awaiting the accumulation of data and track records. The enrichment of empirical evidence is important from the viewpoint of sound future development of the impact investment market.

(5) How to engage in impact creation and report on its implementation

With impact investing activities in listed equity investments, due to the fact that the buying of shares in the secondary market does not directly provide funds for the impact creation activities of companies, as mentioned in 3.6, there is growing recognition of the importance of influencing the impact creation activities of companies through shareholder engagement with the companies invested in.

However, ESG engagement to improve risk-return and engagement to create impacts are fundamentally different activities with different objectives (although there may be some overlap), and if both are to be carried out, they would require a considerable amount of human resources. At the moment, compared to the widespread awareness of the importance of engagement in impact investing in listed equity, the content of actual engagement is somewhat indirect in terms of investors' contribution to impact creation. This is because, although it is important, there is a lot of engagement that requires disclosure of the data needed to measure impacts. Further accumulation of cases and best practices on effective engagement approaches to impact creation should be needed.

At the same time, there should be more discussion about how to effectively disclose the implementation and outcomes of engagement in impact reports. Inherently, it is extremely difficult to scientifically verify how engagement has affected the state of impact creation by portfolio companies, i.e., what additional impacts it has succeeded in creating (This fact is true not only for engagement to create impacts, but also for stewardship activities that are commonly undertaken to increase corporate value and prevent dereliction.).

Therefore, a practical approach that impact investment funds could take would be to carefully disclose and explain to individual investors and asset owners not only the status and results of the engagement, but also the philosophy, implementation structure, and process of the engagement. At the same time, individual investors and asset owners should also be encouraged to scrutinize these disclosures and explanations and try to select impact investment funds that they believe are serious about engaging for impact creation or are expected to contribute to impact creation.

(6) How to address impact washing and ensure the integrity of impact investing

Many interviewees in this study expressed concern that while impact investing activities are gaining momentum, the integrity of impact funds as a whole could be undermined by "impact washing", where funds that do not adequately create, measure and manage impacts, are labeled as "impact investing" for mere marketing purposes.

Impact investing, which aims to contribute to solving global environmental and social issues, is a subset of ESG investing in the sense that some environmental (E) and social (S) factors, as well as governance (G) factors for creating impacts, are considered in the investment process, but impact investing and ESG investing are distinguished by the "intention" to create impacts and the "measurement and reporting of impacts" (see 2.2).

Nevertheless, it is relatively easy for institutional investors to declare that they have the "intention", and it is also possible to perform simple impact measurement using some mundane KPIs without too much effort. Therefore, "intent" and "measuring and reporting impacts" may be a necessary but not sufficient condition for the integrity of an impact investment fund. Ultimately, the question is whether, as an impact investment fund, it can "actually" contribute to the creation of impacts.

In order to enhance the integrity of an impact investment fund, it will become increasingly important to be more transparent in terms of what criteria and processes are used to evaluate and monitor companies, and what methods and team structure are used to engage with them, as well as to report on what kind of impacts are being generated in what areas, with a clear awareness of the difference between outputs and outcomes (see 2.1).

6. Closing Remarks

This study focuses on impact investing activities in listed equity and summarizes the overall picture of the wide range of activities practiced by the major institutional investors in Europe and the United States, as well as the challenges that have emerged through the study.

While impact investing itself has a short history, within this, impact investing conducted in the asset class of listed equity is a notably new area that is still immature in both practice and research.

However, in order to achieve the SDGs, efforts by a wide range of stakeholders such as international organizations, governmental institutions, civil society and private companies are considered to be important, and listed companies should play a considerably large role. And if listed companies have an important role to play, impact investors, who invest with a focus on the impact created by listed companies, also have a major role to play.

We hope that the content of this report will serve as a guide for policymakers, practitioners and other interested parties as they work towards the sound development of impact investing activities in listed equity investments, which are still in the process of being developed.

And last but not least, we would like to express our gratitude to the Financial Services Agency, which commissioned this study, and to all the people who generously cooperated in the interviews done as a part of this survey despite their busy work and research schedules.

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