Setting our sights

A strategy for maximising social impact

September 2017

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Impact Investments

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About Nesta

Nesta is a global innovation foundation. We back new ideas to tackle the big challenges of our time.

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nesta Impact Investments

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Summary

Nesta Impact Investments (NII) was one of the first investors in Europe to develop and grow the field of social impact investment. We believe it is important to show that commercial businesses can achieve social impact and that commercial investors do not have to have a trade-off between financial returns and social impact. Where social impact and commercial strategy are aligned, making a positive difference need not mean sacrificing financial performance.

This document sets out the latest iteration of our approach to growing and demonstrating impact. It covers all aspects of the investment lifecycle: from the decision to invest through to portfolio management and exit.

The approach is based on experience from nearly five years of impact investing, learning lessons from where things have gone well and not so well, and using data from the 13 companies we have invested in over that time.

Third Space Learning

Making a positive difference need not mean sacrificing financial performance.

Our impact requirements

In order to qualify for investment, companies must be able to demonstrate:

- **Alignment between commercial activities and social impact** such that increasing the social impact of a product or service is core to the commercial strategy of a business.
- **Commitment to social impact** through management processes, personal and corporate behaviour, governance and structure.
- **Inclusion of disadvantaged groups** through either tackling problems felt most intensely by the disadvantaged or that have a proportionate reach or higher for relevant disadvantaged groups.

The crucial components of our refreshed approach are:

1. We take a structured approach to assessing potential investments by considering risks to social impact (impact risks) alongside the estimated impact on people's lives (impact returns) and then comparing the risk/return profile to our existing portfolio as a benchmark (see boxes).
2. We break down impact returns into the number of people reached (scale) and the importance of this impact on their lives (depth). We choose to give more weight in our analysis to businesses achieving high depth, by reaching in-need populations or being highly effective, than we do those businesses having little impact at high scale. The challenge for a technology-dominated portfolio is to find those ideas that can dramatically change lives for those in need, rather than simply reach large numbers of people.
3. We remain committed to providing a high level of support to companies to identify, measure and articulate social impact and use this to enhance commercial success. We are embedding a new impact management cycle within our own processes to ensure that the data collected is both useful and used. Early-stage companies are too stretched and fragile to spend time collecting information that is not useful for their success.
4. We have a renewed focus on regularly monitoring data demonstrating the quality of products or services, as well as demonstrating over the longer term more rigorous evidence of impact. The businesses in our portfolio are scaling rapidly, thus it is essential to ensure that the quality required to deliver impact is being maintained. This requires feedback on short timescales, typically quarterly.
5. We aspire to meet our own standards as set out here and are embedding our own processes for learning and reflection. As part of this, we will undergo an impact audit and to invite feedback from our stakeholders.

We take a structured approach to assessing potential investments by considering risks to social impact (impact risks) alongside the estimated impact on people's lives (impact returns).

Impact returns

We assess social impact returns on two metrics: scale and depth.

Scale is assessed based on the number of people reached annually. While scalability is core to our investment criteria and greater scale increases the impact return score for an investment, we do not set a minimum threshold.

Depth is the level of impact experienced by the ultimate beneficiaries of the venture. Depth depends on how **effective** a product or service is as well as the level of **need** in the population reached by the company. Unlike scale, we have a minimum standard for depth, to ensure we stay focused on the challenge of achieving meaningful change.

We welcome thoughts from mission-led businesses, other impact investors and asset owners.

The framework presented here seeks to test many unproven assumptions. As we pilot this new approach we welcome thoughts from mission-led businesses, other impact investors and asset owners for how we can strengthen our approach. The questions we will be asking ourselves are set out in each section. If you have reflections on these questions or think there are other questions we should be asking please get in touch, either by email (lucy.heady@nesta.org.uk), by attending one of our events or by commenting on our blog.

The quarterly learning and reporting cycle

Impact risks

Commitment to measuring social impact. The extent to which a venture measures its social impact, understands its beneficiaries and learns from the results. While businesses do not need to be measuring social impact when we invest in them, we see those businesses with higher commitment to measurement as lower risk.

Evidence-based. The credibility of a venture's theory of change based on all available evidence of how its product or service might lead to social impact. This includes evidence generated by the business itself and evidence from other relevant interventions in other contexts. We judge the quality of this evidence using the Nesta Standards of Evidence framework that has been widely adopted by organisations seeking to maximise social impact.

Stability in relation to external events. How likely it is that the social impact of a venture will be affected by factors outside of its control such as changes to government policy or economic shocks.

Reliance on others. The extent to which the impact of a venture relies on changing the behaviour of other people in a complex system (e.g. teachers or doctors) and what the incentives are for those people to change.

Capacity to deliver impact. The resources a company needs in order to deliver social impact. These resources include human, physical, intellectual and financial capital, professional and social networks of the team, their technical expertise and understanding of the end user.

Ethical business management. Whether ventures comply with best practices for ethical business management demonstrating respect for a wide stakeholder base and the physical and social environmental footprint of the business and its activities.

1

Our impact principles

Real change will only come if the positive impact continues beyond the life of our investment.

Nesta Impact Investments (NII) was one of the first investors in Europe to develop and grow the field of social impact investment. We believe it is important to show that commercial businesses can achieve social impact and that commercial investors do not have to have a trade-off between financial returns and social impact. Where social impact and commercial strategy are aligned, making a positive difference need not mean sacrificing financial performance.

This document sets out the latest iteration of our approach to growing and demonstrating impact, incorporating lessons from nearly five years of investing our proof of concept fund, Nesta Impact Investments 1 (NII1). It covers all aspects of the investment lifecycle: from the decision to invest through to portfolio management and exit.

Many elements of this refreshed approach are new. Over the next year we will continue to pilot the approach. As we do so we will be asking critical questions of ourselves. Those questions are highlighted throughout this document and we encourage readers to get in touch with additional questions where relevant.

Impact concepts

- **Social impact returns** are the difference that ventures make to people's lives over and above what would have happened in the absence of that venture.
- **Social impact risks** are the factors that affect how confident we are that the target social impact returns will be achieved.
- **Confidence** in how certain we are that a reported or estimated impact return is valid.

Our approach is guided by the following principles:

- Impact measurement must always link back to **the ultimate beneficiary**. While some interventions may have an indirect effect on the ultimate beneficiary group, our mission is to improve the lives and prospects of individuals.
- Impact measurement must **create value for investors and portfolio companies**, both social and financial. We work closely with our investees to help them identify, measure and articulate social impact and use this to enhance their commercial success.
- Impact measurement must be **rigorous and transparent**. People must have confidence in us.
- Impact reporting must be **accessible**. People must understand us and the benefits of our approach.
- Our approach must be **sustainable**. Real change will only come if the positive impact continues beyond the life of our investment.

These principles are derived from our theory of change, which sets out our strategic plan for creating impact.* We will assess the success of this approach based on the extent to which it adheres to these principles.

*Our therory of change can be found in Annex 1.

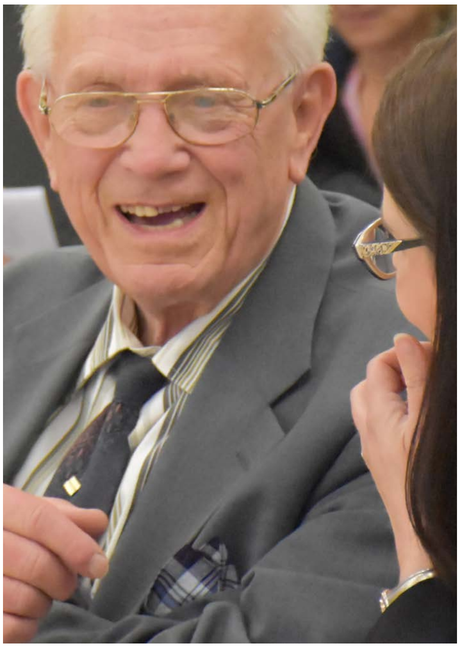
2

Selecting high impact investments

This section describes how we assess prospective investments for social impact. We aim to maximise our social impact by:

- Working in sectors with a high level of social need.
- Requiring that all investees demonstrate a commitment to social impact.
- Undertaking a structured assessment of estimated future social impact returns and social impact risks, benchmarked against our existing portfolio.

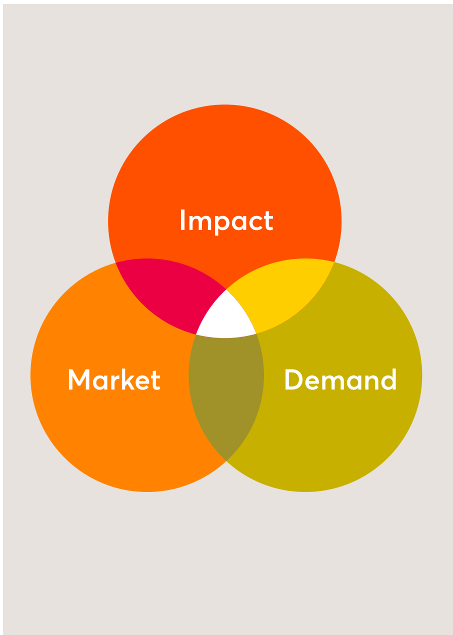
More detailed assessment frameworks for each concept presented here can be found in the Annexes 2 and 3.



Reconnections

2.1 Investing where the need is: A sector-led approach

We work in three sectors of significant social need: health, education and sustainable communities. Within each sector, we use available evidence to identify the approaches and subsectors that we expect to generate the most significant social impact. Our strategy within each sector is defined by those areas where we find overlap between potential for high impact, strong demand from the market, and a potential pipeline of deals.



The case for each investment must be set within the context of its sector. We start by identifying the targeted social outcome for the business. We then look for evidence that the intervention is as at least as likely to be effective as other interventions for the same target outcome.

Sector case study: Employability

The school-to-work transition highlights how we approach an area where the same target outcomes can be addressed in different ways. We know that more than a fifth of the UK's young people fail to make a successful transition from school each year, increasing their risk of becoming NEET (Not in Education, Employment or Training) and suffering other related problems. We also know from our research that there is a range of possible interventions to support young people in making a successful transition:

- Higher quality and accessible careers guidance.
- Higher quality and better access to further education and apprenticeships.
- Local labour market solutions for young people.
- Job search services that are tailored for young people with more emphasis on careers education.
- Employability skills training.

The variety of interventions provides us with a range of products and services that we look for as investible propositions. Some of the companies we evaluated or identified are:

Career guidance

Job search services

Higher quality and better access to further education

Employability skills

Local labour market solutions

Having reviewed a number of companies operating in the space, we established a clear sense of the strongest impact as well as most promising commercial opportunities. As a result of this target outcomes-based approach, NII identified and invested in GetMyFirstJob, which aims to get more young people into work by supporting the recruitment of young people into apprenticeships and traineeships, as well as providing careers advice and support with employability skills. It is a great example of a company that is tackling a social problem using well-evidenced methods (increasing access to opportunities and providing careers advice) in a commercially viable way.

2.2 Requirements

In order to qualify for investment, companies must be able to demonstrate:

- **Alignment** between commercial activities and social impact such that increasing the social impact of a product or service is core to the commercial strategy of a business. This maximises the sustainability of impact and reduces the risk of conflict with financial priorities. For example, our portfolio company Oomph! uses evidence of its positive impact on older people to increase its sales to care homes (see case study on page 24).
- **Commitment to social impact** through management processes, personal and corporate behaviour, governance and structure. For example, the management team of our portfolio company Arbor Education demonstrate a continued passion for using data in schools to drive impact for children. Their business processes are impact-focused and responsive to customer needs.
- **Inclusion** of disadvantaged groups through either tackling problems felt most intensely by the disadvantaged or that have a proportionate reach or higher for relevant disadvantaged groups. We also look for evidence that disadvantaged groups are included in the design of the product or service. For example, our portfolio company Third Space Learning provides tutoring to nearly 6,000 students each term, over 55 per cent of which are on free school meals (compared to the national average of 15 per cent).

Lesson from Fund 1: The importance of alignment

While the portfolio is still young, our strongest investments to date have demonstrated alignment between commercial success and social impact. We have been particularly successful with businesses where impact is core to their commercial strategy. For example, Oomph! use their evidence of impact on older people's health and wellbeing as part of their sales strategy.

As a consequence, we have introduced alignment as a specific requirement of Fund 2.

Oomph!

2.3 Assessing social impact returns

We assess social impact returns on two metrics: scale and depth.

2.3.1 Scale

Scale is assessed based on the number of people reached annually. Scale will be evidenced either through measuring the number of beneficiaries directly or, for indirect interventions, estimating it based on numbers of intermediate customers (e.g. schools or hospitals). When assessing a prospective investment we estimate the number of people reached five years from the point of investment which is the basis for scale targets set through the investment period. While scalability is core to our investment criteria and greater scale increases the impact return score for an investment, we do not set a minimum threshold.

2.3.2 Depth

Depth is the level of impact experienced by the ultimate beneficiaries of the venture. Depth depends on **how effective** a product or service is as well as the level of **need** in the population reached by the company. Unlike scale, we have a minimum standard for depth, to ensure we stay focused on the challenge of achieving meaningful change. This standard is set out in the Annex 3.

Effectiveness is the difference between what the intervention achieves and what would have happened in the absence of the intervention. Data on effectiveness is often collected on just a portion of the people reached by a business and may be collected infrequently as we do not expect it to change significantly over short periods of time. Often data on effectiveness has not been collected prior to NII's involvement and in this case the effectiveness is estimated based on evidence from other sources. We assign potential investments an effectiveness score using the scoring system in Annex 3. Anything scoring below a 1 on this scoring system is not counted.

Depth of impact depends on how effective a product or service is as well as the level of need in the population reached.

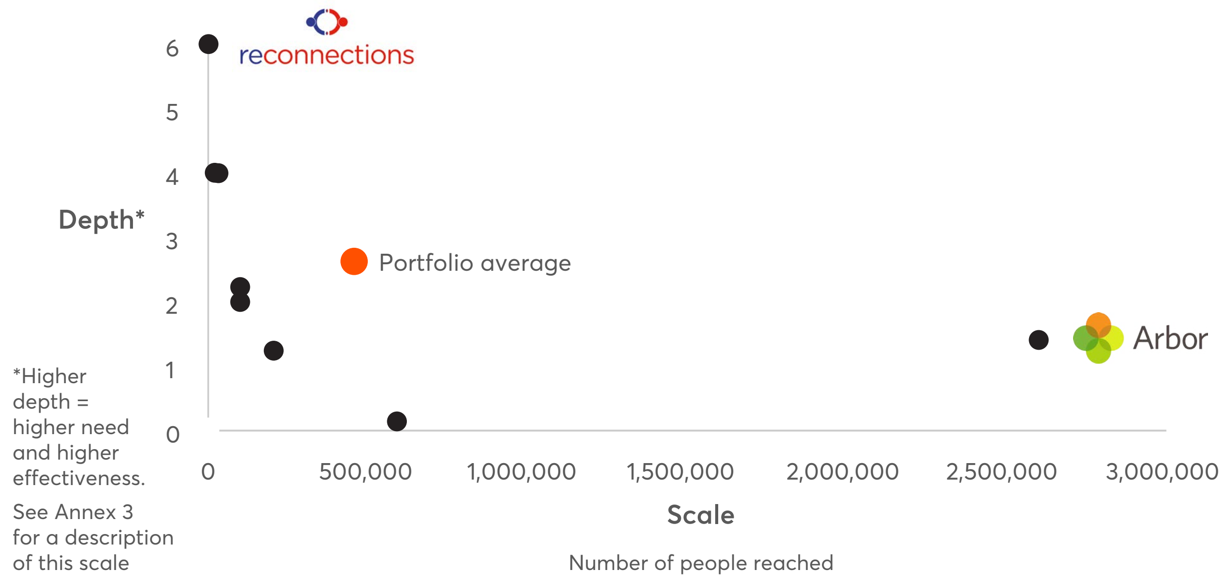
Need is a measure of how disadvantaged the particular target group is in relation to that particular outcome, i.e. the extent to which private markets or the public sector are not already meeting the needs of that group, or a particular group continues to experience more negative outcomes. For example, for a business looking to improve educational attainment, children from lower socio-economic backgrounds would be most in need. We assign potential investments an effectiveness score using the scoring system in Annex 3. Anything scoring below a 1 on this scoring system is not counted.

2.3.3 The depth/scale trade-off

Figure 1 plots our portfolio in terms of depth vs scale and shows the inverse non-linear relationship we have developed organically. It seems to be a feature of available opportunities that achieving greater depth of impact often involves large sacrifices in terms of scale.

We look to have a diverse portfolio that spans opportunities from lower depth/higher scale to higher depth/lower scale. Our exciting challenge is to find depth at scale and this framework is designed to favour investments to achieve this.

Figure 1: Target impact depth vs scale for current portfolio



2.3.4 An impact return 'score'

For each prospective investment, we combine depth and scale measures into a single 'score' that runs from 0-5. This score helps us to compare a diverse portfolio and set expectations around impact for future investments.

When calculating this score we give depth more weight than scale to reflect its importance. We see many innovations that bring a very light touch change to large numbers of people. Our scoring methodology has a bias to favour businesses that might currently be operating at smaller scale but have the potential to grow further. A higher return score reflects both increases in scale and depth but is more sensitive to an increase in depth.

Achieving greater depth of impact often involves large sacrifices in terms of scale.

When reporting return scores, we also make clear our confidence in that return estimate by reporting a likely range around the impact score to represent pessimistic and optimistic scenarios.

2.4 Assessing social impact risks

Based on our experience of impact investing we have identified the following factors as the biggest contributors to social impact risk during the investment period:

- **Commitment to measuring social impact**. We assess the extent to which a venture measures its social impact, understands its beneficiaries and learns from the results. While businesses do not need to be measuring social impact when we invest in them, we see those businesses with higher commitment to measurement as lower risk.
- **Evidence-based**. We assess the credibility of a venture's theory of change based on all available evidence of how its product or service might lead to social impact. This includes evidence generated by the business itself and evidence from other relevant interventions in other contexts. We judge the quality of this evidence using the Nesta Standards of Evidence framework that has been widely adopted by organisations seeking to maximise social impact (Annex 4).
- **Stability in relation to external events**. We assess how likely it is that the social impact of a venture will be affected by factors outside of its control such as changes to government policy or economic shocks.
- **Reliance on others**. We assess the extent to which the impact of a venture relies on changing the behaviour of other people in a complex system (e.g. teachers or doctors) and what the incentives are for those people to change.
- **Capacity to deliver impact**. We assess the resources a company needs in order to deliver social impact. These resources include human, physical, intellectual and financial capital, professional and social networks of the team, their technical expertise and understanding of the end user.
- **Ethical business management**. We assess whether ventures comply with best practices for ethical business management, demonstrating respect for a wide stakeholder base and the physical and social environmental footprint of the business and its activities. NII expects its investees to aspire to, and ultimately deliver, high standards in these areas with formal assessment of performance, preferably through a recognised scheme such as B-Corps, BSI or ISO accreditation.

To get an overall sense of the risk level of an investment and where it stands in relation to the portfolio, we score each risk and combine these to arrive at a risk score from 0-5. Both the overall and individual scores are considered. Currently we weight all risks equally but this will be reviewed as we learn more from applying the framework.

We assess the credibility of a venture's theory of change based on all available evidence of how its product or service might lead to social impact.

Lesson from Fund 1: Impact risk has many dimensions

Fund 1 defined impact risk as the standard of evidence provided by that venture. While this is an important factor in whether estimated impact is realised, we have learned in the last five years that there are other factors we can identify at the point of investment that may raise or lower the risk to achieving social impact.

As a result, we have broadened our definition of risk to reflect the importance of the skills and attitudes of the leadership team and the logic underpinning how the product or service will lead to impact.

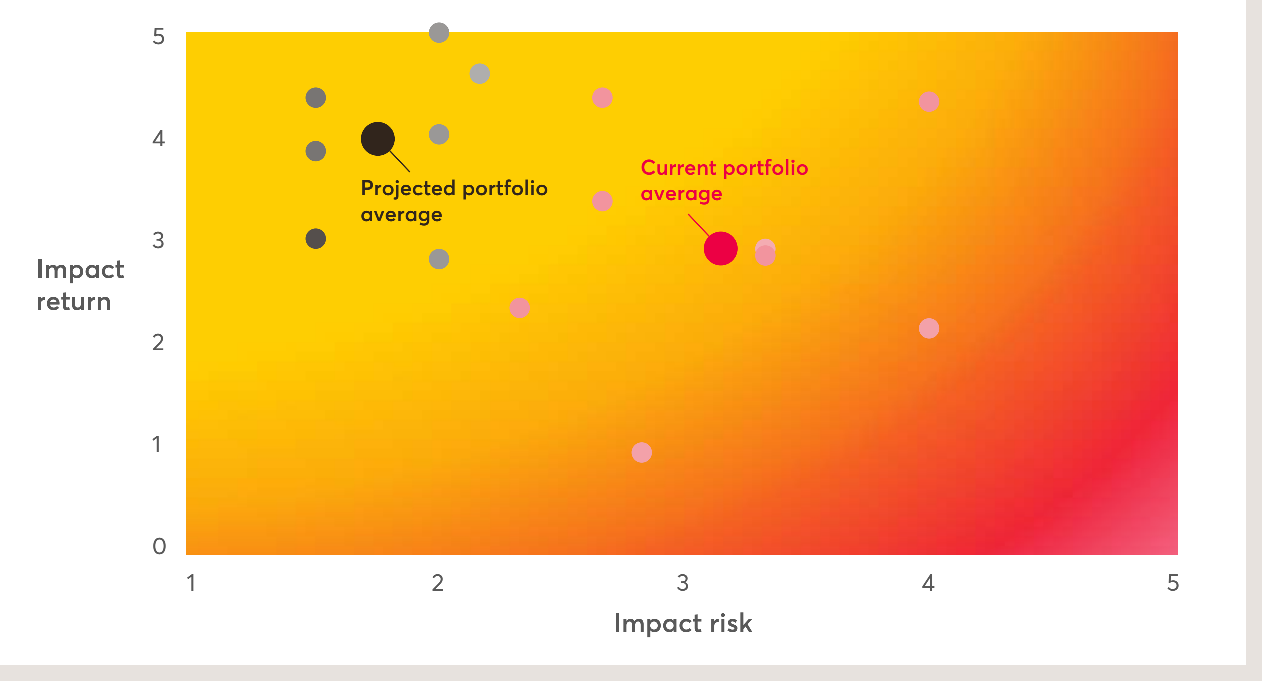
2.5 Balancing impact risk and impact return

Unlike financial risk and return, we do not expect impact risks and impact returns to be correlated. Nor do we expect to achieve a portfolio spread across different risk/return profiles. However, we do compare the risk/return profile of potential investments to our existing portfolio to ensure that greater risks are only taken where the potential for impact returns is higher.

Figure 2 shows the spread of expected social impact returns and risks of our portfolio as of Q1 2017, as well as the projected social impact returns and risk of our portfolio. Over the life of the investment, we expect our portfolio companies to reduce their impact risk and increase their impact return. A potential investment that falls outside the portfolio norms (represented by the curve) by being low on returns and high on risk, is unlikely to receive investment.

Our intention is to identify investment opportunities that have high social impact return potential across the impact risk spectrum.

Figure 2: Portfolio risk and return*



* See Annex 3 for an explanation of the risk and return scales

Learning questions for year 1 implementation

- What are the low-cost data sources we can use to verify the inclusion requirement?
- Is this the right balance between depth and scale?
- Does the benefit of a single scale for impact return outweigh the dangers of oversimplification? Are we encouraging an 'apples and pears' comparison of very different types of impact?
- How can we capture impact at a systemic level?
- Should some risks be weighted higher than others?

Risk/return and impact plan case study: Synopsis Healthcare

Synopsis Healthcare brings innovative data capture and analysis to an under-served, pre-operative market with their core product offering, Synopsis IQ. Synopsis IQ digitises the pre-operative care assessment procedures and aims to improve the collection and use of patient data before, during, and after surgery. Prior to our decision to invest in Synopsis Healthcare, we analysed the potential risk and return of the social impact from hospital adoption of Synopsis IQ.

Assessing Synopsis Healthcare's impact risk

The overall impact risk for Synopsis Healthcare is high, a 4 on our 5-point scale. The company has committed to measuring their impact, but there are gaps in the evidence base underlying the theory of change. Additionally, the impact is highly reliant on medical staff changing their behaviour in a complex hospital environment.

Impact Risk	Rating	Definition
Commitment to measuring impact	4	The team is thoughtful about how impact will be measured.
Evidence based	5	The business has a clear and logical theory of change (Level 1 in Nesta's standards of evidence) and, where relevant, the business has used the existing evidence base to design its products and services.
Stability in relation to external events	3	The social impact of the business might be affected by external events.
Reliance on others	5	The social impact of business relies on changing the behaviour of a system or group of people that may not have incentives to change (e.g. an electronic hospital booking system).
Delivery of outcomes	3	The team have some connections and expertise. They have a sound plan in place to compensate for any short coming that could prevent them from aquiring the necessary resources to deliver social impact.
Accountability and transparency	4	The company has practices/behaviours that promote good corporate governance, employee benefits and protection, environmentally friendly behaviour, or charitable aims. These practices are likely not formalised in documentation yet. They have not completed a BCorp assessment.

Assessing Synopsis Healthcare's impact return

Synopsis Healthcare's theory of change is complex. However, the most important positive impact is expected to be on improving patient outcomes, especially for patients aged over 65, through improved use of data.

The overall impact return for Synopsis Healthcare is high, a 5 on our 5-point scale. The key driver of Synopsis Healthcare's anticipated high impact return is extremely high scale. We estimate that the potential number of surgeries where Synopsis IQ could be applied for over-65s is one to two million. The average effectiveness across the cohort is likely to be only at our minimum threshold and only the over-65s are considered to be in an 'in need' group. This results in an estimate for the depth of impact that is low and below the portfolio average. Given that scale is so core to the impact case for this investment, we will be tracking it closely.

Scale		
Over 65	1,066,000	
Under 65	1,534,000	
Need		
Over 65	2	The group are below the average and it would likely not be successful without this intervention.
Under 65	1	The group are not far from the average and likely could have been successful without the intervention.
Effectiveness		
Over 65	1	The intervention provides individuals with increased access to a well-evidenced method.
Under 65	1	The intervention provides individuals with increased access to a well-evidenced method.

3

Managing for impact

This section describes how we manage our portfolio to maximise social impact after investment. Our focus during investment is on:

- Ensuring the right data are available at the right time so the business can act to improve its impact.
- Embedding a culture of measuring and learning from impact data.
- Managing social impact risk by putting in place plans for measuring social impact and building the capacity of businesses to follow these plans.

3.1 Developing an impact plan

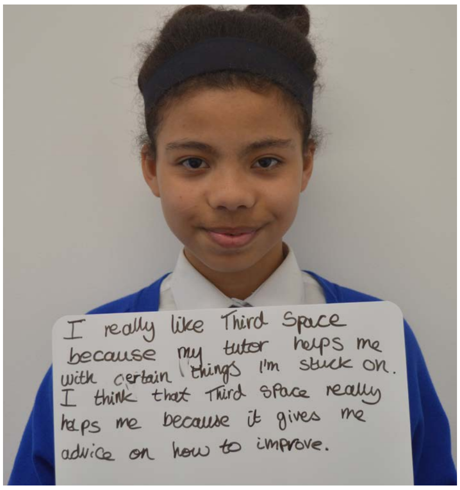
During the investment process we work in close partnership with portfolio companies to develop impact plans. The purpose of these plans is to:

1. Identify the data that will help ventures to increase their social and financial returns and setting targets for these over a three-to-five-year time horizon.
2. Setting out what they will measure, when and how, with a focus on improving data quality and standards of evidence to reduce impact risk and increase our confidence in reported impact.

3.1.1 Our data requirements

As a starting point for agreeing a measurement plan with ventures, we first map out how the venture sees that its activities will drive positive social impact. This is also known as a 'Theory of Change' approach. We use this as the framework to identify a small set of KPIs to track over the course of an investment. We do not mandate a predefined set of indicators and give our portfolio companies the space to set the agenda. However, we do have minimum data requirements:

- We expect ventures to regularly track scale, reporting on this figure quarterly at a minimum and preferably monthly.



Third Space Learning

Lesson from Fund 1: Setting expectations

We have found that co-development of an impact plan is a crucial time for setting mutual expectations about the time and effort required to measure impact. Where it has worked well, agreeing the impact plan has been an opportunity to ensure that the venture is well resourced to deliver on impact measurement and that timelines for data have been sensitive to business milestones.

We are committed to ensuring that a collaborative and realistic impact plan is set out before every investment.

We do not mandate a predefined set of indicators and give our portfolio companies the space to set the agenda.

- To understand depth we also require businesses to:
  - Collect data that gives relevant information on who they are reaching and their level of need. For example, Third Space Learning, a business that provides online tutoring in mathematics, tracks the number of pupils receiving free school meals.
  - We expect that the majority of ventures will assess the effectiveness of their approach within the first two years of investment. In complex situations an assessment of depth may not be possible for three years.
- Because maintaining impact at scale is a key challenge in rapidly growing businesses and a big risk to achieving impact, we also ask businesses to report on measures of quality. These metrics measure how consistently a product or service is being delivered at scale and helps to build confidence in the ongoing effectiveness of an intervention when direct effectiveness data are not regularly available.

We look for those indicators that are relevant to social impact and commercial success. Being able to identify such indicators is an excellent test of alignment.

Case study: Using data for continuous improvement and to enhance customer relationships

Arbor Education has developed software that provides schools with real-time analysis on performance across a number of core areas; a workflow module to improve areas of identified inefficiency and underperformance; and a full Management Information System (MIS) to record and analyse data across all aspects of its operation.

The company regularly surveys their users to determine their Net Promoter Score (NPS) and collect user insights on the products. All of this information is shared immediately with the rest of the company, driving development discussion. This company-wide awareness drives continuous improvement and innovation, enabling them to better meet the needs of their customers.

Arbor has also realised that measuring impact and focusing on improving student outcomes is not just a good thing to do, it is a competitive advantage and thus a key component of their marketing strategy. Their social impact approach is advertised prominently on their website.

A social company that wants to have a scalable impact on student outcomes

'We are one of the few ed-tech copanies who have clearly defined social goals enshrined into our company formation. We continually measure our impact on teacher time and satisfaction, intervention efficacy and student attainment; after all we believe doing good is good for business! We've also recently raised and invested over $5 million from socially minded investors to help increase our impact nationally and internationally.'

3.1.2 Improving measurement

When agreeing with a venture on how to go about collecting data we focus on finding approaches that help to mitigate social impact risk, will increase the confidence we have in the social impact reported, are feasible, given the skills and resources within the venture, and have a clear business case. The solution must consider both the quality of the data collected and the methodology for assessing social impact.

The quality of the data depends on a number of factors:*

- Survey response rates (how representative is the data?).
- Reliability (is the data collected in the same way every time?).
- Accuracy (i.e. do surveys ask what you actually want to know with sufficient detail?).
- Timeliness (was the data collected at the right time? How long does it take to convert the data into usable information?).

The reliability of methodologies for impact assessment is analysed using the **Nesta Standards of Evidence** (Annex 4). Collecting data on people who do benefit from the venture as well as those who do not (a control group) is a more robust approach. Using randomisation to ensure that there is no bias in how that control group is chosen is even more robust. Being able to repeat this many times and draw consistent lessons is the most robust of all.

Both improving the quality of data and increasing the robustness of methodology require investment of time and money. **Thus this investment must make sense in terms of reducing social impact risk or increasing social impact returns**.

We encourage organisations to invest in improving their data quality and standards of evidence where it makes sense and is cost-effective. As they are working with new products and ideas, it is not unusual or unexpected for our portfolio companies to have low standards of evidence at the point of investment. Building the evidence base during the lifetime of an investment is important to ensure that the venture is indeed having an impact and to allow the venture to change its model to increase impact. We believe that an evidence base also builds long-term value in the business. A well-aligned business will do better commercially if it can convincingly demonstrate its social impact to customers and investors.

Improving data quality and increasing standards of evidence are the best tools we have for reducing the impact risk of an investment.

*Integrity (is there any reason for a bias to be present? For more detail see Annex 5).

We focus on finding approaches that help to mitigate social impact risk.

Lesson from Fund 1: The importance of data quality

NII has been very successful in driving improvements in standards of evidence, which was the central element of our impact assessment for this fund. However, the quality of monitoring data was not an important feature of our early investment analysis and as a result we have experienced very mixed data quality results across our portfolio. This has been a barrier to ensuring that ventures are on the path to success and while longer, more rigorous evaluations are undertaken.

In future impact investment funds NII will apply a specific performance indicator for the fund to improve data quality in our portfolio. Each company is required to report on quality metrics at least twice a year and preferably four times per year.

A well-aligned business will do better commercially if it can convincingly demonstrate its social impact to customers and investors.

Case study: A focus on results builds intellectual capital

Reconnections is a service designed to help older people in Worcestershire to overcome loneliness. The project has been funded by a Social Impact Bond (SIB) and is managed by Social Finance UK.

Reconnections tackles loneliness by providing 1:1 personalised support for older people. The unique needs of each person in overcoming loneliness are assessed at enrolment to find appropriate activities and a local volunteer to support them in the programme. Following completion of the plan, older people are surveyed on a six- and 18-month basis to reassess their feelings of loneliness to determine the impact of the programme.

Reconnections is, to our knowledge, the first attempt to manage a countywide loneliness reduction initiative using a wide range of local, not-for-profit, delivery partners. Because of several ground breaking aspects of the programme Social Finance has been highly focused on the use of operational data to develop and optimise many aspects of the service. In particular management of delivery partner performance, volunteer recruitment and service user referral networks have all been developed and improved following regular review and analysis of operational data.

3.2 Embedding impact

Impact plans are often written with the best of intentions but staying focused on impact can be difficult alongside the day-to-day challenges of operating a small and rapidly growing business. Although we invest in businesses that align social impact with commercial success, conflicting priorities do sometimes arise. In particular, the creation of social impact is often a long-term goal that needs to be balanced against short-term financial concerns such as cash flow and sales figures.

Figure 3: The quarterly learning and reporting cycle

We help companies to maintain focus on social impact both by building the right culture and locking in hard incentives.

We build an impact-focused culture both within NII and our portfolio companies, by committing to a quarterly impact cycle that emphasises discussing the implications of data and agreeing actions based on insights (see Figure 3).

The creation of social impact is often long term and this needs to be balanced with short-term financial concerns.

Lesson from Fund 1: The challenge of maintaining focus on impact

Our highly standardised approach to a very narrow impact assessment framework for early investments in NII meant that we did not always strike the right balance of flexibility to changing business needs with maintaining a focus on impact.

As a result of this inflexibility some ventures became increasingly distanced from their impact plans to a point where measurement and engagement ceased to be relevant. Turning the situation around could then be extremely challenging as the venture, by then, had often lost its focus on measuring impact.

In future impact investment funds NII will strive to maintain a robust, but flexible approach to impact plans so that wherever a portfolio company starts to deviate from its impact plan, we work with the management team to develop a strategy for getting back on track or adjusting the plan in the same quarter. We will ensure that impact conversations continue to be held quarterly, no matter what the situation.

> *NII works alongside its portfolio companies, providing as little or as much support as required.*

The success of this approach relies on:

1. **Working in partnership**. A large part of our role is to ensure that companies are adequately challenged to focus on impact and to respect their unique understanding of the problems they are trying to solve. NII works alongside its portfolio companies, providing as little or as much support as required. This support ranges from technical input into evaluation design and data interpretation to assisting with applying for research grants or facilitating connections with researchers.
2. **Promoting transparency**. NII strives to be completely open with portfolio companies and expects the same in return. We understand that in order to promote transparency we must respect confidentiality. We will not seek to invest where we believe that management is not being transparent with us.
3. **Learning from failure and success**. We work with early-stage ventures trying to scale innovative products. Often, a product will not demonstrate the desired social impact or the venture finds that the original business model is not successful. As long as businesses continue to meet our requirements of impact alignment, commitment to social impact and inclusion, we will continue to support them and revise impact plans accordingly. Our Investment Advisory Committee provides oversight of these revisions.
4. **Regular reporting**. We expect our investees to report regularly on their social impact metrics, so that consideration of achieved and targetted impact become a routine part of board meetings. NII produces a quarterly report for LPs on each company that includes an assessment of social impact risks and social impact returns.

NIM aligns the incentives of portfolio companies and other investors towards measuring and improving social impact through the following measures:

- Building legal protection by requiring portfolio companies to include commitment to social impact into their constitutional documents.
- Requiring portfolio companies to deliver on impact plans as part of investment agreements.
- Structuring investments to support short-term investments in data collection or analysis where appropriate, to adhere to an impact plan.
- Ceasing to support companies that are not demonstrating delivery of, or commitment to impact by not making follow-on investments other than to protect existing investments with limited capital.
- Exiting investments in a managed way when it is clear that an investee is no longer commited to measuring its social impact, or its business model changes such that it is no longer aligned with social impact.

3.3 Impact after exit

Impact investing is a young market and investors are evolving best practices for ensuring social impact beyond exit. NII aims to embed social impact so deeply within our portfolio companies' cultures and business models that it lasts even as ownership changes. As we exit more of our portfolio companies, we will track them closely to see what lessons can be learned about ensuring social impact in the long term.

Learning questions for year 1 implementation

- Will our new focus on data quality yield results?
- How can we structure deals to introduce greater alignment of social impact and commercial success?
- What more can we do to preserve impact focus after exit?
- Are we striking the right balance between increasing emphasis on impact versus putting too many demands on the portfolio?

Third Space Learning

4

Reporting and transparency

Credible and transparent reporting on impact is crucial if the social investment sector is to become mainstream.

Credible and transparent reporting on impact is crucial if the social investment sector is to become mainstream. This section provides a brief overview of the information we will report to LPs and the public on the performance of our portfolio and our own success as a fund manager.

4.1 Regular reporting

We commit to reporting regularly at three levels:

1. Quarterly reporting on the financial and social impact performance of the portfolio and potential new investments, coupled with monthly reporting on a more ad hoc basis. This is a confidential report used within the investment team to input into strategic discussions and challenge the team on its social impact and financial returns.
2. Quarterly reporting to LPs on the financial and social impact performance of the portfolio. This is a confidential report designed to update investors on the health of our funds.
3. Annual public report summarising the performance of our portfolio against our projected targets for social impact and financial returns, NII's performance against its own metrics and lessons learned from the previous year.

At each of the levels we will report on the social impact risk and return of the portfolio, broken down into each of the underlying dimensions. We will track the performance of our portfolio annually including an annual plot of impact risk vs return.

When reporting on any estimate of social impact return or effectiveness we will also report on the confidence that we have in that estimate. **Our confidence is based on the quality of the data and the standard of the evidence.** It is a target of the fund to increase the confidence we have in our impact estimates and provide the market with reliable data.

Lesson from NII1: Impact at the investment committee

In NII1 we made sure that there was social impact expertise on the Investment Committee. Earlier in the life of the fund this expertise was concentrated in one person who often had to 'fly the flag' for impact alone. As the fund has progressed we have taken steps to ensure that all committee members feel equipped to participate in substantive conversations on social impact by making our impact assessment more transparent and consistent, highlighting particular areas for discussion.

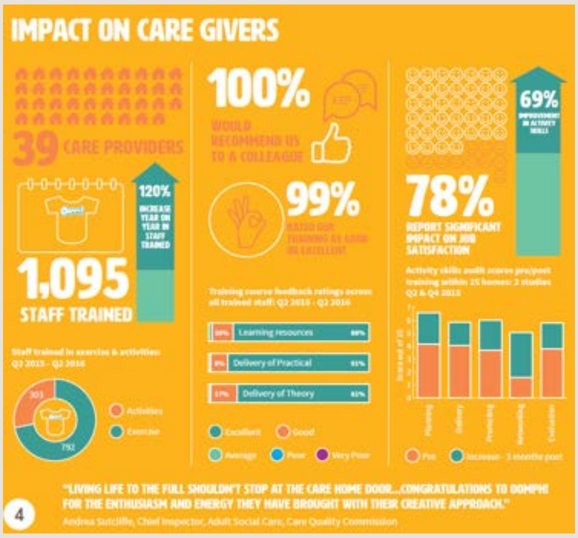
In future impact investment funds, we will continue to review the dynamic of conversations in the committee to maintain proper oversight and accountability for social impact.

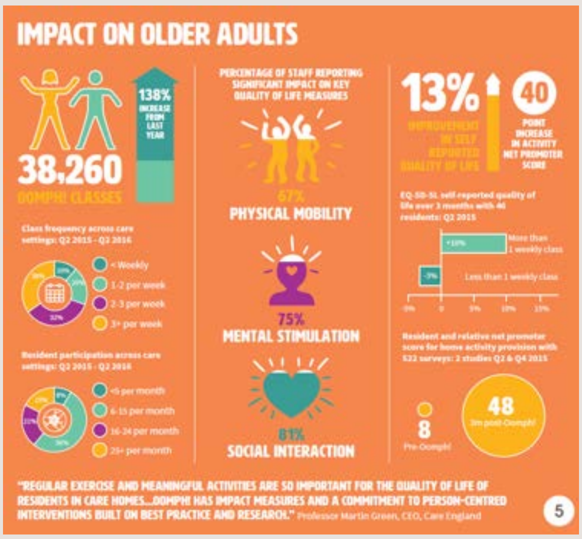
Case study: Using results to increase sales

Oomph! Wellness is an outstanding example of how impact data can be collated, reported on, and shared with current and potential clients. The value of this data to drive sales creates an alignment between Oomph!'s commercial strategy and the achievement of social impact.

Oomph! is an award-winning social enterprise dedicated to transforming the mental, physical and emotional wellbeing of older and vulnerable adults. They provide wellbeing training and support services to enable anyone working in care or community settings to deliver outstanding, sustainable exercise and activity programmes. Additionally, Oomph! have launched an end-to-end excursion service to enable older people to stay connected to the world around them via regular, meaningful outings.

Oomph! regularly surveys their users to understand the impact of the activities and publishes key results in an Annual Impact Report. Key to the report are two pages of infographics that show some of the most important impact metrics. The rest of the report shares personal stories of success in using Oomph!.





Measuring impact and reporting on it is core to the company's strategy. They have successfully used the data to improve the product as well as to generate sales. By publicly sharing key impact metrics, Oomph! are able to demonstrate the value and effectiveness of the business to potential clients.

4.2 Feedback from the market

NII made its first investments in 2013 and has yet to reach the point where exits are expected. When exits are made we will have clearer measures of success. Until this point is reached NII has to identify alternative ways of measuring interim performance and success which will include actively surveying stakeholders including the companies we invest in, the companies we don't invest in, our own LPs and wider industry stakeholders. NII will carry out this stakeholder survey on an annual basis following an initial survey in Spring 2017.

4.3 Independent assessment

NII recognises that it is best practice in social impact measurement to complement its own data collection with an independent assessment. Over the next year, NII will scope out what a practical and proportionate independent assessment of our funds would look like and who would be likely partners for us to work with.

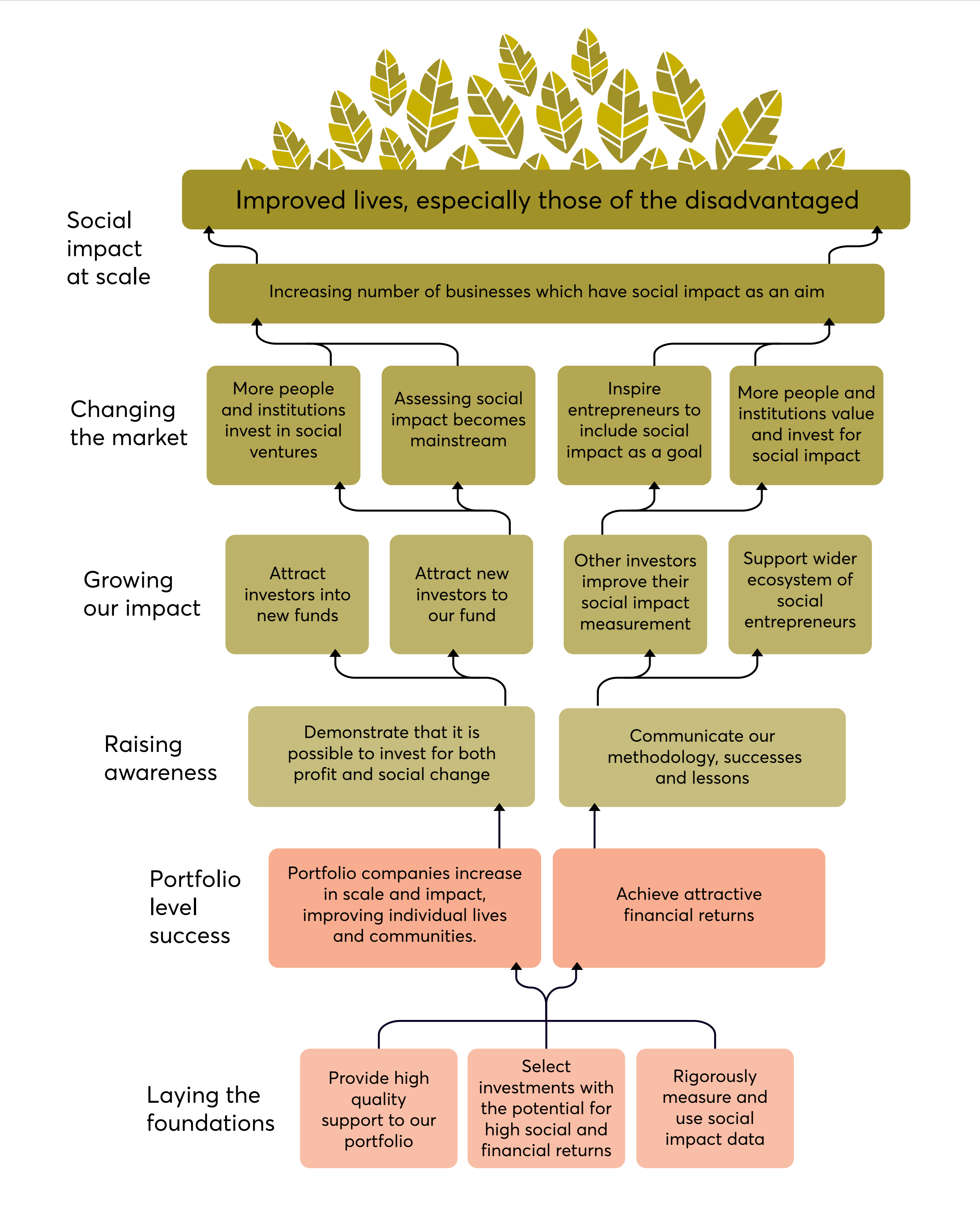
Learning questions for year 1 implementation

- Can we build a coalition of impact investors to undertake a larger and more valid survey of portfolio companies?
- Is reporting on risk and return compelling for investors?

Oomph!

Annex 1

Nesta Impact Investments' theory of change



Annex 2

Impact requirements

Requirement	Description
Alignment	Alignment between commercial activities and social impact is such that increasing the social impact of a product or service is core to the commercial strategy of the business. This maximises the sustainability of impact and reduces the risk of conflict with financial priorities.
Commitment	Commitment to social impact through management processes, personal and corporate behaviour, governance, and structure.
Inclusion	Inclusion of disadvantaged groups through either tackling problems felt most intensely by the disadvantaged or that have a proportionate reach or higher for relevant disadvantaged groups. We also look for evidence that disadvantaged groups are included in the design of the product or service.

Annex 3

Definitions of impact risk and impact return

Measures of impact risk

Risk		Definition
Commitment to measuring impact		Achieving social impact is difficult. The ability to measure impact and learn from the results is important for maximising impact, as well as meeting requirements for accountability. While businesses do not need to be measuring impact when we invest in them, we see those businesses with higher commitment to measurement as lower risk.
	1	The business has improved services through an exceptional use of impact data and user feedback.
	2	The business has learned and improved services based on impact data and user feedback.
	3	The business has invested resources into understanding its own impact through data and user feedback.
	4	The team is thoughtful about how impact will be measured and user data will be collected.
	5	The team has never done any thinking about impact measurement or user feedback collection.

Risk		Definition
Evidence-based		We invest in ventures that can articulate a credible theory of change. The credibility of the theory of change rests on evidence. We judge the quality of this evidence using the Nesta levels of evidence. Less evidence or lower quality evidence increases impact risk, which can be mitigated through plans to generate more evidence over the life of the investment.
	1	Each step in the theory of change is supported by good quality Level 2 evidence or above and the most important assumptions are supported by Level 4 evidence or above.
	2	Each step in the theory of change is supported by good quality Level 2 evidence or above and the most important assumptions are supported by Level 3 evidence.
	3	Each step in the theory of change is supported by good quality Level 2 evidence or above.
	4	The most important assumptions in the theory of change are supported by good quality Level 2 evidence or above.
	5	The business has a clear and logical theory of change (Level 1 in Nesta standards of evidence) and, where relevant, the business has used the existing evidence base to design its products and services.

Risk		Definition
Stability in relation to external events		Some social problems are heavily influenced by external events. The ability of a venture to deliver a social impact may be more or less sensitive to external shocks. Vulnerability to external events increases impact risk, which can be mitigated through good data collection.
	1	
	2	The social impact of the business is extremely unlikely to be affected by external events.
	3	The social impact of the business might be affected by external events.
	4	The social impact of the business is likely to be affected by external events.
	5	

Risk		Definition
Reliance on others		Social problems are often complex and rely on a range of actors to solve them. A venture can often be influencing just one small part of this system, enabling others to work smarter or more efficiently. While an increased reliance on others increases impact risk, it can also be an indicator that the venture could be contributing to systemic change.
	1	The business works directly with those who will feel and value the social impact and requires no behaviour change from others.
	2	The social impact of the business relies on changing the behaviour of individuals who do have incentives to change (e.g. directly helping a doctor to achieve better patient outcomes).
	3	The social impact of the business relies on changing the behaviour of a system or group of people that do have incentives to change (e.g. improving activities in a care home).
	4	The social impact of the business relies on changing the behaviour of individuals who may not have incentives to change (e.g. a Job Centre official who is paid by the number of jobs placed rather than the quality of jobs).
	5	The social impact of the business relies on changing the behaviour of a system or group of people that may not have incentives to change (e.g. an electronic hospital booking system).

Risk		Definition
Delivery of outcomes		Successfully delivering the intervention requires more than just the management team. A venture can fail to deliver the intended impact if they are unable to successfully source the right inputs. A successful delivery of social impact may depend on attributes like the social networks of the team or their technical expertise.
	1	The team has very strong connections and technical expertise, likely acquired from previous roles in the industry. They have demonstrated an ability to acquire the necessary resources to deliver social impact.
	2	The team has good connections and expertise, likely acquired from previous roles in the industry. They have demonstrated an ability to acquire the necessary resources to deliver social impact.
	3	The team has some connections and expertise. They have a sound plan in place to compensate for any shortcoming that could prevent them from acquiring the necessary resources to deliver social impact.
	4	The team is either lacking connections or expertise, but not both. There is some expectation that they will acquire the necessary resources to deliver social impact.
	5	The team has weak industry connections and technical expertise and are thus unlikely to be able to deliver the expected social impact due to an inability to source the necessary inputs.

Risk		Definition
Accountability and transparency	1	Despite the best efforts of a venture to focus on positive outcomes, it may also have a negative impact if it does not comply with best practices for accountability and transparency. NII expects its investees to have assessed and managed these risks, preferably through a recognised scheme such as B Corp. The scoring here relates to the B Corp process but can be substituted with another recognized scheme.
	2	The company has achieved B Corp status and may have an in-house employee charged with ensuring continued compliance with B Corp criteria.
	3	The company has a process in place to achieve the minimum required 80 points on the B Corp assessment. The board has given its approval to change the articles of association.
	4	The company is formalising policies to provide benefits to employees, promote environmentally friendly behaviour, and strengthen corporate governance. They may have completed a B Corp assessment or applied for Pending Certification, but they score below 80 on the assessment.
	5	The company has practices/behaviours that promote good corporate governance, employee benefits and protection, environmentally friendly behaviour or charitable aims. These practices are likely not formalised in documentation yet. They have not completed a B Corp assessment.
		There is an inherent conflict that will prevent the company form achieving B Corp status. We do not invest in businesses scoring a 5 in this dimension.

Measures of impact return

Impact return definitions	Definition	0	1	2	3
Scale	Scale will differ by company. In essence, scale captures the total number of ultimate beneficiaries of an intervention in one year, which may or may not be the same as the users of an intervention.				
Quality	Impact can only be achieved if the service is delivered with consistent quality. Quality is a ratio between 0 and 1 that measures how consistently a company is able to deliver their product or service at a sufficient level to drive impact.				
Depth	**Depth is the product of need and effectiveness**				
Need	The target groups receiving an intervention will come from different life circumstances. Need is one part of determining how important this intervention will be to a particular target group. The need of a target group will be considered on the basis of how far they are from the average person, and how likely they might be to receive alternative forms of support.	The group are average to above average and either do not need the intervention or can afford an equivalent intervention independently.	The group are not far from the average and would not suffer much disadvantage without the intervention.	The group are disadvantaged in relation to this outcome and would likely not be able to reduce this disadvantage without this intervention.	The group are extremely disadvantaged in relation to this outcome, and without intervention the consequences for this group are likely to be dire.
Effectiveness	The effectiveness of an intervention is the second part of determining how important this intervention will be to a particular target group. Effectiveness will measure the impact of the intervention on the quality of life of the target group. We expect that effectiveness for most interventions will be consistent across all target groups, however, there may be exceptions.	The intervention has no positive impact on the intended outcome	The intervention provides individuals with increased access to an intervention that has been shown to have a positive impact on the intended outcome.	The intervention has a demonstrable positive impact on the intended outcome.	The intervention is personal and has a dramatic positive impact on the intended outcome.

The scoring for need and effectiveness necessarily involves some subjective judgement. In order to improve our consistency of application, we will build up a bank of examples over time of how we have classified different interventions and target groups.

Annex 4

Nesta's standards of evidence

Level	Our expectation	How the evidence can be generated
At Level 1	You can give an account of impact. By this we mean providing a logical reason, or set of reasons, for why your product/service could have impact on one of our outcomes, and why that would be an improvement on the current situation.	You should be able to do this yourself, and draw upon existing data and research from other sources.
At Level 2	You are gathering data that shows some change amongst those using your product/ service.	At this stage, data can begin to show effect, but it will not evidence direct causality. You could consider such methods as: pre- and post-survey evaluation, cohort/panel study, regular interval surveying.
At Level 3	You can demonstrate that your product/ service is causing the impact, by showing less impact amongst those who don't receive the product/service.	We will consider robust methods using a control group (or another well justified method) that begin to isolate the impact of the product/service. Random selection of participants strengthens your evidence at this level; you need to have a sufficiently large sample at hand (scale is important in this case).
At Level 4	You are able to explain why and how your product/service is having the impact you have observed and evidenced so far. An independent evaluation validates the impact you observe/generate. The product/ service delivers impact at a reasonable cost, suggesting that it could be replicated and purchased in multiple locations.	At this stage, we are looking for a robust independent evaluation that investigates and validates the nature of the impact. This might include endorsement via commercial standards, industry kitemarks, etc. You will need documented standardisation of delivery and processes. You will need data on costs of production and acceptable price point for your customers.
At Level 5	You can show that your product/service could be operated by someone else, somewhere else and scaled-up, whilst continuing to have positive and direct impact on the outcome and remaining a financially viable proposition.	We expect to see use of methods like multiple replication evaluations, future scenario analysis, fidelity evaluation.

Annex 5

Data quality checklist

To monitor data quality across our portfolio, we propose using USAID's Data Quality Checklist (see below) as a framework. We will adapt the framework over time as we continue to learn and improve our impact measurement process.

Data quality category	Description
Alignment	The data should clearly and adequately represent the intended result.
Reliability	The data should reflect stable and consistent data collection processes and analysis methods over time.
Timeliness	The data should be available at a useful frequency, should be current, and should be timely enough to influence management decision-making.
Precision	The data have a sufficient level of detail to permit management decision-making; e.g. the margin of error is less than the anticipated change.
Integrity	The data collected should have safeguards to minimise the risk of transcription error or data manipulation.
Lack of data	If no data are available, we should endeavour to understand why, what corrective actions are being taken, and when we can expect data to be reported.

Annex 6

Impact due diligence questions

When discussing impact with potential investees, we consider a number of factors in our due diligence. We will work with companies to design a theory of change, or review the one they have already designed. Below is a selection of questions that we may ask.

1. How does what you do create impact?
2. Who are the ultimate beneficiaries of the product/service?
3. How important is the impact you are trying to achieve to these beneficiaries?
4. Who are the primary users of the product/service?
5. How is achieving impact core to the commercial strategy?
6. Would your business still be successful even if you didn't have a positive social impact?
7. How many users do you currently have, and how many do you think you can reach in three to five years?
8. How often and over what period of time do the users need to interact with the product/service in order to receive the impact?
9. How does the intervention reach the ultimate beneficiaries?
10. What else is available to consumers that delivers similar outcomes?
11. How does your product/service deliver impact over and above what is already delivered by the market or public services?
12. What do you view as the primary risks to impact?
13. How does this intervention help the ultimate beneficiaries?
14. What evidence do you have that demonstrates the impact of this, or a similar intervention?
15. What evidence have you used in the development this product/service?
16. How have beneficiaries been included in the design of this product/service?
17. How do you insure that your business model is inclusive?
18. How will you measure the effectiveness of this intervention on an ongoing basis?
19. What metrics do you currently measure, or would you like to measure, that are useful for the business and also demonstrate the effectiveness of this intervention?
20. How do you know that you are delivering a good quality service? What metrics do you currently measure, or would you like to measure, that are useful for the business and also demonstrate the scale of the intervention?

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