Operationalizing Impact: An Analysis of Impact Investing Fund Practices

Impact Investing Research Lab
ESG Initiative

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The research findings we report in this brief are based on survey data collected by the Impact Finance Research Consortium (IFRC), a collaboration among the Wharton School, Harvard Business School, and the University of Chicago Booth School of Business to advance academic research on impact investing. We are grateful to Shawn Cole, the John G. McLean Professor in the Finance Unit at Harvard Business School, and Jessica Jeffers, Associate Professor of Finance at HEC Paris, for their support in this research effort.

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Introduction

Impact investing seeks to deploy capital in ways that generate financial returns as well as positive social or environmental impacts. Reflecting this duality, many impact investing funds claim to emphasize both returns and impact in their marketing and communication. To date, though, we have little insight into how this two-pronged focus manifests in funds' internal practices and reward structures. While there has been some research on how impact funds organize their governance practices and incentive structures, much remains to be known.[1] We believe this is an important knowledge gap since it is unrealistic to expect that funds will generate strong returns and meaningful social impacts unless they train and reward their personnel to do both.

This report uses data from a large-scale impact investor survey to show how funds operationalize their commitment to financial performance and social impact creation. By looking beyond stated intentions and focusing on concrete practices, we gain insight into the real-world dynamics of this rapidly growing field.

Our results show that, in their marketing and communication, funds tend to place slightly more emphasis on their commitment to impact versus their commitment to financial performance. However, there is a clear shift toward prioritizing financial concerns in training and compensation practices suggesting that, while most funds adopt the rhetoric of impact investing, many struggle to "walk the talk."

> "Our results show that, in their marketing and communication, funds tend to place slightly more emphasis on their commitment to impact versus their commitment to financial performance.

1. Geczy, Christopher, Jessica S. Jeffers, David K. Musto, and Anne M. Tucker. "Contracts with (social) benefits: The implementation of impact investing." Journal of Financial Economics 142, no. 2 (2021): 697-718.

Methods

This report is based on survey data from 222 impact investing funds managers across the world. The survey data are part of the Impact Finance Database (IFD), a comprehensive database on impact investing funds, particularly in venture capital and private equity.[2] The survey items for this report focus on how individual investment funds prioritize financial returns and social impact creation in both their internal practices and external communication.[3] For financial returns the survey asks respondents to report their degree of agreement or disagreement with the following statements on a scale ranging from "strongly disagree" (1) to "strongly agree" (5).

1. The fund's marketing materials to potential investors emphasize the fund's dedication to achieving strong financial returns.
2. The fund's partners emphasize how important it is that this fund achieve strong financial returns.
3. To earn the trust and respect of the senior managers who work on this fund, it helps to have strong expertise and experience related to finance.
4. Employees who work on this fund are extremely well trained in how to assess the financial performance of potential or actual portfolio companies or projects.
5. The more employees contribute to the fund's financial performance, the more likely they are to be rewarded with bonuses or promotions.
6. Carried interest is linked to the financial returns the fund's investments generate.

Later in the survey, respondents viewed the same six statements in reference to impact creation, rather than financial performance. For example, the first survey item above was reworded as follows to focus on impact creation: "The fund's marketing materials to potential investors emphasize the fund's dedication to achieving strong social and/or environmental impact." Respondents rated how much they agreed to disagreed using the same five-point scale.

2. Topics explored in the IFD survey include financial goals and investment characteristics, due diligence practices, impact measurement, relationships with limited partners, impact reporting, engagement with portfolio companies, the use of catalytic capital, and more. We identified impact investors through varied sources, including lists of past impact investor surveys fielded by the Global Impact Investing Network, lists of impact investing firms compiled by PitchBook and Preqin, and member directories of leading impact investing trade associations. We reached out to firms that we identified as impact investors, with a total of 877 outreach emails. Our efforts yielded 222 completed surveys (a 25 percent response rate).

3. These items comprise scales that we refer to as "climate for financial performance" and "climate for impact," though here we focus on the constituent items rather than the overarching scales.

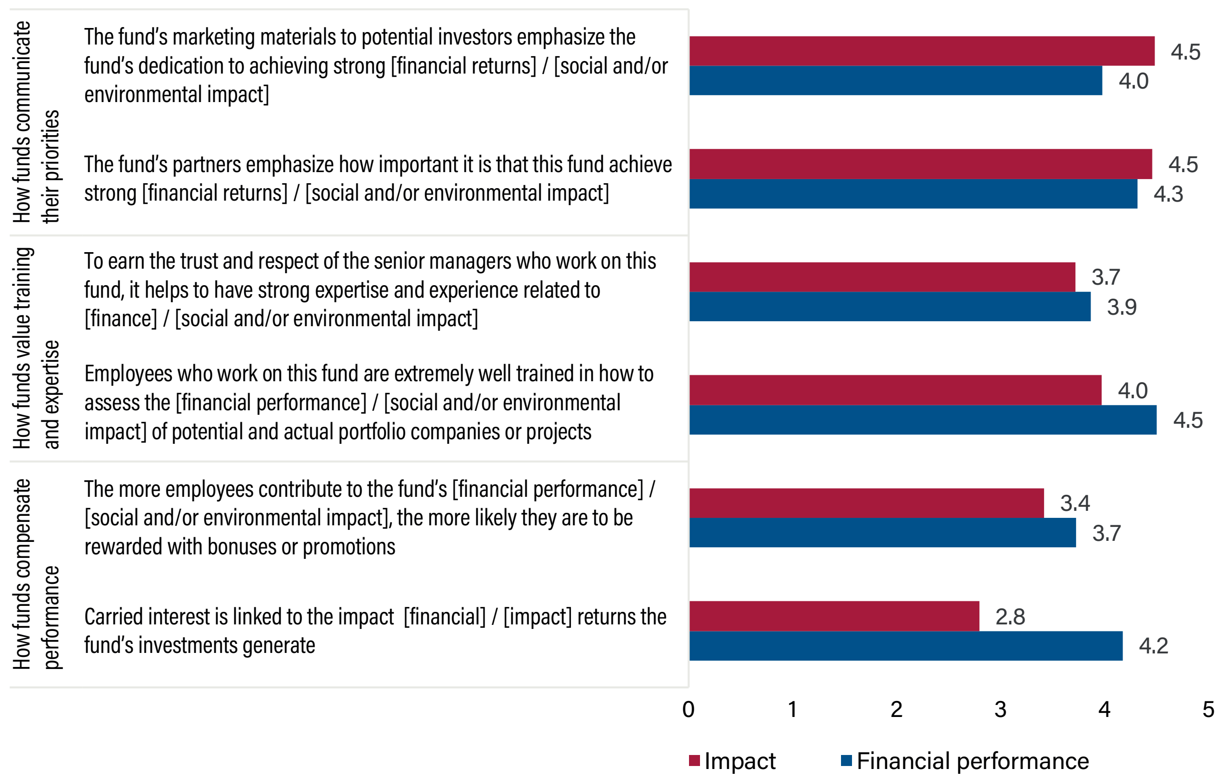
We group these items (for both financial performance and social impact) into three thematic groups:

1. **How funds communicate** their financial performance (impact) goals. Statement 1 and 2.
2. **How funds value training and expertise** that relates to financial performance (impact). Statements 3 and 4.
3. **How funds compensate** personnel for contributing to financial performance (impact). Statements 5 and 6.

Findings

Our data reveals a contrast in how impact investment funds prioritize financial returns and social impact in their communications versus practices. Notably, the magnitude of these differences varies across different aspects of fund operations.

FIG. 1 **How funds prioritize financial performance and impact**



How funds communicate their priorities

Results show that, on average, funds emphasize their commitment to impact slightly more than their commitment to financial performance when they communicate their goals. The difference is greater with respect to marketing materials (statement 1) than partner communications (statement 2), but both differences are statistically significant ($p < .05$).

These findings suggest that impact investors may be cognizant of the growing demand for socially beneficial investments and tailor their communications accordingly. However, as discussed in the following sections, the emphasis that funds place on financial returns in their internal practices indicates they are still grappling with how to balance these dual objectives, perhaps reflecting the fiduciary nature of investing, and/or the challenges of integrating impact goals into traditionally finance-focused organizational cultures.

How funds value training and expertise

Next, we consider training and expertise and see that there is a clear shift toward financial concerns versus social impact. On average, respondents report that financial expertise commands more trust and respect within their fund than impact expertise (statement 3). However, the difference is only marginally significant ($p < .1$). The same pattern is amplified with respect to employee training (statement 4) where respondents report that fund personnel are better trained to assess and predict financial versus impact performance. The difference is statistically significant ($p < .001$).

The emphasis that funds place on financial expertise and training highlights an important operational reality for impact investors. While funds publicly champion their commitment to impact, internal practices suggest that they emphasize financial acumen. This discrepancy may relate to several factors. For instance, while there are well-established financial analysis metrics and methodologies, impact measurement is more complex and less standardized. Funds also have pressure from investors to generate financial returns, and most fund managers have traditional finance backgrounds.

“While funds publicly champion their commitment to impact, internal practices suggest that they emphasize financial acumen.

How funds compensate performance

Finally, we consider differences in how funds compensate personnel for their contributions to financial versus impact performance. As with training and expertise, bonuses and promotions tend to reflect contribution to fund financial performance over contributions to social impact creation (statement 5) ($p < .05$). The pattern is even more stark for carried interest (statement 6), which is much more likely to be tied to financial returns ($p < .001$).

The pronounced emphasis on financial performance in compensation structures reveals a critical misalignment between the stated goals of impact investing and the incentive mechanisms in place. Such compensation structures may steer managers and employees toward prioritizing financial returns over impact, potentially undermining the core mission of impact investing. This finding raises important questions about how to design incentive systems that genuinely balance financial and impact considerations, and highlights the need for innovation in impact measurement and reward structures.

Discussion

> "The findings paint a nuanced picture of the impact investing landscape, with notable contrasts between funds' external messaging and internal practices.

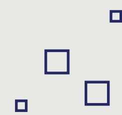
This report shows how impact investment funds prioritize financial returns versus social impact in their communications and practices. The findings paint a nuanced picture of the impact investing landscape, with notable contrasts between funds' external messaging and internal practices. To summarize, we find that impact investors highlight their dedication to social impact somewhat more than financial returns in their marketing and high-level messaging. However, we see clear patterns where funds prioritize financial acumen in deal assessment skills and experience, and reward employees for their contributions to financial performance versus impact creation.

Two primary factors may contribute to the patterns we observe. One explanation is that some impact investors engage in "impact washing" — i.e., they proclaim a strong commitment to impact in their external communication but fail to integrate this commitment into their internal practices and incentive structures. However, another factor may be the inherent challenges in measuring and assessing impact. Unlike financial returns, which have well-established metrics and assessment methods, impact outcomes are often complex, long-term, and challenging to

quantify accurately. This measurement difficulty may make funds hesitant to link financial rewards directly to impact achievement.

The patterns we observe likely result from a combination of these factors, along with other forces that are not captured in our analysis. More research is needed to identify the constellation of influences that contribute to the findings we surface in this report. Such research has important implications for understanding how impact investors pursue their commitments to social impact and financial returns, as well as for how to identify and promote best practices for doing so.

About the Impact Investing Research Lab at the Wharton ESG Initiative



The Impact Investing Research Lab conducts rigorous research to assess and advance impact investors' effectiveness in generating financial value alongside positive societal impact. Informed by this research, we offer 10+ courses that MBA and undergraduate students can assemble into the Social and Governance factors for Business (SOGO) major or concentration, over a dozen co-curricular experiences, four Executive certificate programs, and an expanding array of industry and policy convenings. We advance Wharton's best-in-class education of current and future leaders, equipping them with the tools, skills, and perspectives needed to navigate a world in which investing for impact is increasingly prominent.