A Collective Call To Mainstream Impact Management

Input paper to the Impact Taskforce (ITF) produced by the Impact Management Platform (IMP)

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Introduction

The 2021 report by the Impact Task Force (ITF) was a clear acknowledgement that industry leaders recognise the urgent need for business and finance to embrace the pursuit of environmental and social impact. The report makes a pertinent call for action that recognises the critical role and interest of global financial markets in generating systemic changes. It recognises the need to improve access to the data on impact that investors urgently need for aligning capital allocation with global sustainability objectives. It also argues for the use of both proven and new instruments that can allow capital to flow to where it can have the biggest impact.

With its report, the ITF vocalised industry support for a different way of doing business and allocating capital. Recently, a group of standard-setters and international organisations known as the 'Partners' of the Impact Management Platform have made a complementary call for the 'imperative for impact management'. In their recent thought piece, the Partners argue that there is a need for the widespread uptake of impact management[1] as a mainstream business discipline. The mainstreaming of impact management by business and finance is necessary to achieve the ITF's core recommendation of mobilising more capital towards positive impact. This is a salient call made in the 2021 report, as well as the need for 'transparency of information on impact', which is a fundamental component of good impact management.

In support of their call to mainstream impact management, the Partners of the Impact Management Platform have launched a set of outputs that reflect their consensus view on the *need* for impact management and the *actions* that make up its practice. These outputs provide responses and bring additional nuances to the ITF's calls by conveying the following messages:

1. **The Imperative for Impact Management: The need to go beyond narrow approaches to sustainability-related risk management and adopt impact management**

   The Partners of the Impact Management Platform argue that narrow risk-focused approaches to managing sustainability issues are not sufficient for operating sustainably. Such an approach undermines collective environmental and social goals, as well as economic and financial outcomes. The Partners make the case for '**The Imperative for Impact Management**' in a recent thought piece, which sets out the relationship between impact, system-wide risks and financial outcomes.

[1] Collectively defined by the Partners as "the process by which an organisation understands, acts on and communicates its impacts on people and the natural environment, in order to reduce negative impacts, increase positive impacts, and ultimately to achieve sustainability and increase well-being".

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Critically, Partners argue that **impact management needs to be a mainstream practice for all types of businesses, investors and financial institutions**, because they all have negative and positive impacts. In their thought piece, the Partners distinguish between 'sustainability-aligned'[2] and sustainability-focused[3] organisations. Mainstreaming impact management is necessary for the large-scale mobilisation of capital in the direction of positive social and environmental impact, which the ITF identified as an urgent need. This involves socialising the pursuit of impact not only among impact investors, but across mainstream business and finance.

2. **The Partners' resources and consensus view of impact management: A rich set of resources and norms for enterprises, investors and financial institutions**

The Partners and other voluntary and regulatory sustainability-related initiatives are already providing the market with an important set of norms and resources to support the implementation of impact management. These resources are evidenced by the System Map and Resource List; two resources that the Platform Partners have developed to navigate the landscape of impact management resources.

There is also growing consensus on what constitutes impact management, as illustrated by the Actions of Impact Management and Key Terms and Concepts, which reflect the Partners' consensus view. The 'Actions' and associated 'fundamental characteristics of impact management' describe the steps enterprises, investors and financial institutions[4] need to take in order to contribute to improved social and environmental outcomes. The 'Key Terms and Concepts' provide definitions and explanations related to impact management.

Impact transparency, a key pillar of the ITF's recommendations, is an integral part of the 'Actions of Impact Management', as embodied in the 'Communicate' action. This action breaks down the ways in which organisations can explain and disclose their impact management practices and performance to its stakeholders. It should be emphasised, however, that **impact management goes beyond disclosure** and involves robust processes for embedding impact in governance, strategy, and all aspects of business practice, including through the holistic identification of sustainability topics, as well as through implementation and action.

3. **The Partners' shared work programme: A collaboration to clarify the practice of impact management and to work towards a complete and coherent system of impact management resources**

The Partners recognise that differences in terminology and usage of key concepts across different impact management norms and resources has led to confusion and lack of action among businesses and investors. The Partners of the Impact Management Platform - as the leading providers of sustainability and impact management standards, frameworks, and resources - are working together to:

- build consensus around key terms and concepts
- seek complementarity and interoperability between their frameworks and resources
- engage with the broader community of sustainability related initiatives, standard-setters, policy-makers and regulators.

[2] To operate sustainably and within social boundaries.
[3] To work towards solving environmental and social problems, and increasing people's well-being.
[4] These actors are commonly referred to as 'organisations' throughout this paper.

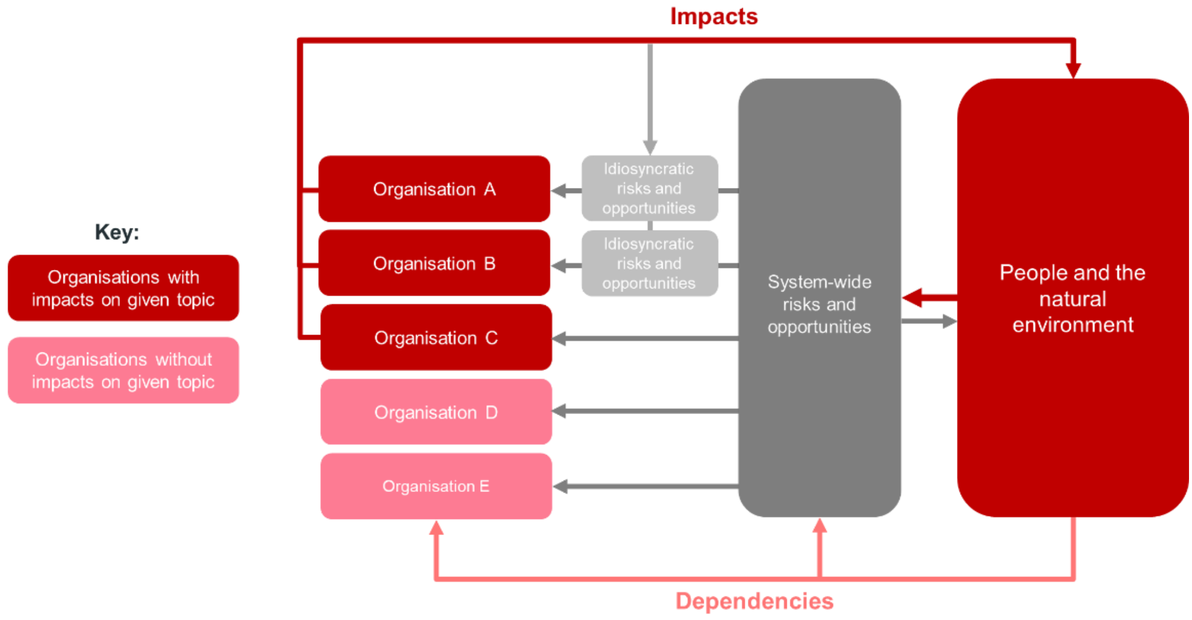
The following sections will provide some more insight into each of these key messages and highlight some of the Partners' recent work.

1. The Imperative for Impact Management

Currently, many enterprises, investors and financial institutions approach the management of sustainability issues primarily from the perspective of idiosyncratic (or 'entity-specific') risks and opportunities. In doing so, organisations may mitigate the impacts of those risks, be they reputational, regulatory, operational and technological. For example, oil spills have negative impacts on people and the natural environment, but they also give rise to reputational risks for the oil company. Such reputational risks could drive down demand, or generate substantial costs associated with legal risks.

What remains underappreciated, however, is the fact that impacts also represent contributions to 'system-wide' risks and opportunities, even when they do not (yet) pose quantifiable entity-specific risks. Figure 1 below illustrates how all economic activity as we know it is permanently embedded within and dependent on environmental and social systems. As a consequence, enterprises, investors and financial institutions depend on the viability and stability of these environmental and social systems for their sustained financial performance. Mounting evidence supports the idea that sub-optimal environmental and social outcomes undermine overall economic performance, and thereby undermine corporate and financial returns, since economic growth and corporate profits tend to go hand-in-hand.

Figure 1: Organisations' impacts lead to idiosyncratic risks and opportunities but also represent contributions to system-wide risks and opportunities.



In the environmental area, the possibility that cumulative impacts on climate and ecological systems could result in system-wide collapse is now well understood by enterprises and financial markets. Already between 1992 and 2013, anthropogenic extreme heat has been estimated to have cost between USD 5 trillion and USD 29.3 trillion globally.[5] Recent research suggests that climate tipping points are considerably more likely to be breached than previously assumed, and such tipping points

[5] Callahan & Mankin, 2022, Globally unequal effect of extreme heat on economic growth, Science Advances.

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can cascade through to social and economic systems over timeframes that would defy societies' ability to adapt, and undoubtedly wreak economic havoc.[6]
It has been shown that sub-optimal people-related outcomes, such as excessive inequalities, also depend on macro-level economic and financial outcomes. For example, across an average of selected OECD countries, the increase in income inequality between 1985 and 2005 was estimated to have resulted in 4.7 percentage points of missed cumulative growth between 1990 and 2010.[7] There is also a relationship between inequalities and financial sector shocks. The Global Financial Crisis of 2008 to 2009 is thought to have been made more likely and severe due to the accumulation of inequalities in income and wealth.[8] Inequalities also have the potential to lead to social capital erosion and social instability. Indeed, occurrences of social unrest have increased significantly over past decades, at a time of increasingly high levels of inequalities of income and wealth.[9]

Recognsing the link between impacts and risks and opportunities, the Partners of the Impact Management Platform outline the imperative for impact management in their latest thought piece. It argues that the widespread uptake of impact management by enterprises, investors and financial institutions is not only a human and environmental imperative, but also critical for the sustained economic and financial performance of the market as a whole. As such, the paper provides a comprehensive answer to the question of "why" organisations should manage impacts, namely to:

- achieve sustainability and promote well-being
- manage idiosyncratic (or 'entity-specific') risk
- prevent the accumulation of system-wide risk.

This three-fold motivation for managing impact means there are reasons for all types of organisations to go beyond a narrow focus on managing sustainability-related risks. Enterprises, investors and financial institutions need to recognise that entities' impacts on people and the natural environment are often the source of sustainability-related risks, and to take into account the linkages between impacts and risks in environmental and social systems.

This observation also provides reasons to refine a collective understanding of financial materiality and consider the relevance of information on impacts for sustainability-related financial disclosures. Current interpretations of financial materiality do not always recognise the importance of information on entities' contributions to the accumulation of system-wide risks. The Partners' thought piece argues that investors' exposure to and interest in managing system-wide risk means that information on entities' impacts and impact management processes may well affect their decision-making, possibly rendering information on impacts material. Building on these observations, the Partners made a call to action to a range of actors that can support the mainstreaming of impact management:

- **Enterprises, investors and financial institutions** need to go beyond a narrow focus on sustainability-related risks and adopt impact management.
- **Governments** should encourage and enable the mainstreaming of impact management in order to achieve global policy objectives including the Paris Agreement and the 2030 Agenda.
- **Standard-setters and international organisations** should collaborate to provide clarity and build a consensus view of impact management.
- Because of its financial materiality, **standard-setters of sustainability-related financial disclosures** should include information on impact and impact management in disclosure recommendations.

[6] OECD, 2022, Climate Tipping Points: Insights for Effective Policy Action, OECD Publishing
[7] OECD, 2015, In It Together, Why Less Inequality Benefits All, OECD Publishing.
[8] Čihák & Sahay, 2020, Finance and Inequality, IMF Staff Discussion Note.
[9] Barrett, 2022, Reported Social Unrest Index: March 2022 Update, IMF Working Papers.

The following section provides some more information on how the Partners of the Platform are indeed collaborating to provide clarity and coherence in the system of impact management resources.

2. The Partners' resources and consensus view of impact management

The ITF report made a critical recommendation on the need to mobilise capital towards positive impact. Mainstreaming impact management would allow organisations to redirect more resources in the direction of positive impact and away from negative impact. The Partners' call for the widespread adoption of impact management, across all types of enterprises, investors and financial institutions, therefore directly responds to the ITF's recommendation.

The past decade has seen a rapid uptake of sustainability issues in business and finance, primarily through the adoption of sustainability-related risk management approaches, including ESG integration and sustainability-related disclosure. Entity-specific (or "idiosyncratic") risks have become harder to ignore due to increasing demands by consumers and other stakeholders for organisations to address their negative impacts. While such practices may contribute to the uptake of sustainable practices, they do not equate with a holistic and systematic approach to impact management.

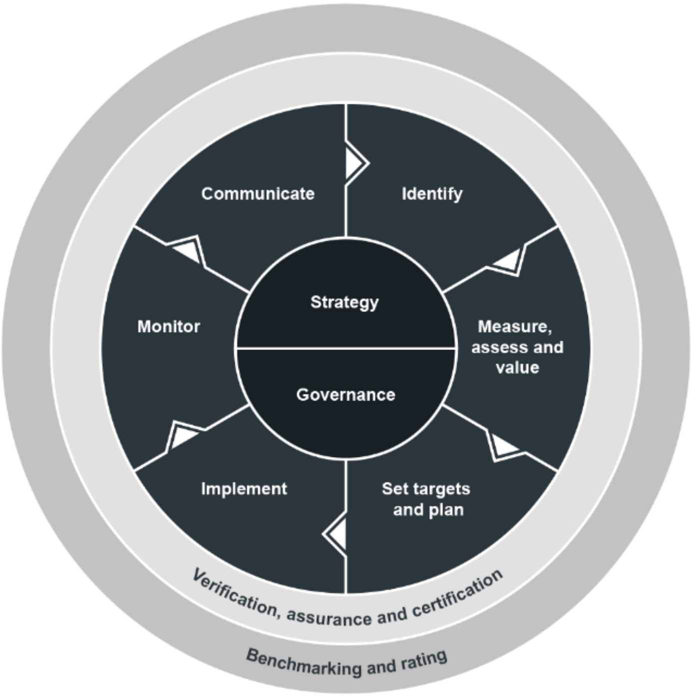
Impact management is collectively defined by the Partners as 'the process by which an organisation understands, acts on and communicates its impact(s) on people and the natural environment, in order to reduce negative impacts, increase positive impact(s) and ultimately to achieve sustainability and increase well-being'. It stands out from other approaches to managing sustainability-related issues, which are articulated by the Partners of the Impact Management Platform as the 'fundamental characteristics of impact management'. According to the Partners, impact management involves:

- Taking action to, **at a minimum, operate sustainably**.
- **Holistic** consideration of impacts.
- Consideration and engagement of **stakeholders** and **affected parties**.
- Consideration of **context**.
- **Integration** across strategy, governance and activities.
- An **iterative** and **evidence-based** process.
- **Transparency** on practice and performance.

In order to arrive at a common understanding of what the practice of impact management involves, the Partners of the Platform have also developed the 'Actions of Impact Management'. The actions portray a consensus view of the practice of impact management, broken down into a set of steps that can be carried out by any enterprise, investor or financial institution. Each action is explained in detail and points to the existing body of resources that can help implement that action.

Critically, impact management is a multi-step process, as illustrated by the 'Actions of Impact Management' visual (see Figure 2 below). An interactive version of this 'wheel' sits on the Platform website. As is evidenced by the action 'Communicate', impact transparency is a critical step of this process. However, impact transparency needs to build on robust impact management 'practice'. This starts by embedding a consideration of impacts into the organisation's strategy and governance, by conducting thorough processes to identify potential impacts, before measuring, assessing and valuing them. Importantly, impact management involves organisations taking action to implement new and to adjust existing activities, in order to operate sustainability.

Figure 2: The 'Actions of Impact Management'



Organisations may already carry out aspects of the actions for a sub-set of sustainability topics. This may be in an ad-hoc manner or according to a specific impact objective. However, a holistic approach to impact management, as portrayed in the 'Actions of Impact Management', is necessary for addressing both risks (idiosyncratic and system-wide) and opportunities, to achieve sustainability and to promote greater well-being.

3. The Partners' shared work programme

The Partners of the Platform will continue to advance their shared objective of striving towards clarity and coherence in the system of impact management resources. These objectives will further contribute to the recommendations set out by the ITF. Concrete actions that respond to the ITF's recommendations include:

1. **Working towards further clarity and coherence in the system of impact management resources, including across sustainability-aligned and sustainability-focused organisations.**

   The Partners continue to work together to build a clear and coherent consensus view of impact management, both in terms of the required actions of impact management common to any type of organisation, and in terms of the resources to support organisations in implementing the actions. While different audiences (e.g. businesses and investors; large and small businesses; impact investors and mainstream asset owners) may benefit from tailored guidance, the Partners of the Platform are working to create further common ground across impact management resources, as well as important concepts and terminology. Such efforts

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will continue to advance the coherence, complementarity and interoperability of the Partners' resources.

2. **Mapping the nomenclature of sustainability topics and examining the use of industry classification.**

   Through the Platform's research and development agenda, the Partners aim to address barriers to achieving a complete and coherent system of norms and resources for impact management. These barriers cannot be addressed by any single organisation, but requires the concerted action of all Partners, as well as additional organisations with specific areas of expertise. The Partners' joint 'R&D agenda' includes the following two on-going projects:

   - **Nomenclature of sustainability topics**: Classifications of sustainability topics are a fundamental and cross-cutting building block of impact management. The terminology and definitions that refer to the measurement and management of sustainability topics vary significantly from organisation to organisation. This proliferation of nomenclatures can be found throughout the resources of the Platform Partners, as well as other providers of standards, guidance and frameworks, and have contributed to a lack of connectivity between different norms and resources. In the near-term, the Partners intend to provide clarity on the existing system of nomenclatures used in impact management resources.

   - **Sector nomenclature and classification**: This is likewise is key for impact management. However, as with sustainability topics, the existence of multiple sector nomenclatures and classifications, create obstacles to impact management, limiting resource usability, relevance and interoperability of management resources for practitioners. To address these challenges, the Partners will be working to clarify how sector nomenclature and industry classifications are used by impact management practitioners and norm-builders. In doing so, they will examine how a clearer and more connected system of nomenclature and classifications can further drive sustainability in the economy and promote effective impact management across the value chain.

3. **Engaging with policymakers and regulators to embed impact management in mandatory sustainability initiatives.**

   While organisations have an inherent interest in managing their impacts, actions by governments remain indispensable to encouraging and enabling organisations to operate sustainably and contribute to solutions. Governments have an incentive to encourage and enable impact management, given that impact management by enterprises, investors and financial institutions is a critical lever for achieving social and environmental policy objectives, including the Sustainable Development Goals (SDGs). Based on their work on clarification, interoperability and system coherence, the Partners aspire to engage with and inform governments and policymakers, and to act as a source of inspiration on how to embed impact management into policy and regulation.