Impact Due Diligence: building trust and long-term sustainable investments

NewForesight
creating **shared** opportunities

The idea in brief

Problem

The complexity of the issues that the Impact Investors target necessitates thorough Due Diligence into the potential impact & risk of the investments.

Complication

High cost of conducting proper *Impact Due Diligence* drives investors to adopt crude alternatives, increasing the risk of (unintended) greenwashing. Unavailability of impact data, and yet immature science & practice of *Impact Due Diligence* further deter the Impact Investors.

Solution

Impact Due Diligence experts have identified certain best practices that can make the Impact Due Diligence effective as well as cost-efficient

Smallholder farmers need up to

$450 billion

to fully realise productivity and access to market.

By 2050, food production will need to rise by

70%

to support the 200,000 new people born every day

According to the Global Impact Investing Network, approximately

63%

of Impact Investors are investing in food and agriculture.

500 million

farmers produce food on less than

2 hectares.

These farmers supply more than 70% of the world's food and also represent some of the poorest and hungriest people in the world.

Impact investments in food and agriculture has grown at an annual rate of

32.5%

since 2013.

Undertaking an Impact Due Diligence is much more than simply understanding *impact*

For too long the traditional investment community believed that pursuing impact-oriented investments runs counter to providing value for shareholders. This is, simply, false. The investment community has since realised this line of thought is outdated. It is now time for the investment community to move beyond seeing Impact Due Diligence as a burden for accountability and start seeing it as an opportunity.

Tasked with achieving both a financial return on investment as well as generating a positive impact, Impact Investors have a tougher task than their less impact-focused counterparts. Whilst some organisations describe themselves as impact-first, Impact Investors aim to deploy market-based approaches to tackle some of the world's most pressing social and environmental concerns. But aiming for impact does not guarantee it.

Navigating the why, the what, and the how of impact investing can be a daunting process but Impact Investors have a higher duty than most to be rigorous and robust in their Due Diligence. As daunting and tricky as this process may appear, it should be seen as an opportunity that must be seized by every investor targeting social or environmental impact. Conducting a thorough and comprehensive Due Diligence for impact can aid in investor/ donor relations, safeguard against claims of greenwashing, mitigate risk, identify social and environmental impacts, and build the foundations for an impactful investment.

Engage and develop investor & donor relations

Conducting a Due Diligence is not simply a process of assessing the viability of a potential investee; it is an opportunity to include donors and investors in the decision-making process, and to regularly reassure them that you are living up to their expectations through transparent communication and justification of potential investments.

A thorough Due Diligence process inclusive of various stages of donor feedback and approval can build a strong, constructive relationship that facilitates future collaboration and potentially even attract further donors/ investors. These stages are essential to include those key individuals in decision making and to prove that as an investment advisor, you are safeguarding their best interests. It is a first step towards building trust in the relation and setting the bases of a successful collaboration.

Manage your risks

Impact Investors are inherently ambitious in targeting social and environmental impact. However, this ambition goes hand-in-hand with various risks - risk of failing to achieve those targets, risk of unintended impacts, risk of leakage effects, etc. These risks are particularly prevalent in the realm of impact investing. Failure to account for environmental and social risks can cause reputational damage to both the investor and investee. Failing to account for risks could eventually result in labels like 'impact-washing' or 'greenwashing' which undermine public and donor trust in the core mandate of an impact investor.

The first step in managing risk is identifying and understanding these risks. This is where proper Due Diligence can save an investor a world of trouble later in the investment cycle. By identifying and understanding risk, an investor gains the knowledge to make an informed decision on how to manage an investee's risks throughout the lifecycle of an investment and even whether or not to invest in the first place.

Building a strong foundation for execution

Lastly, thorough Due Diligence sets a strong and resilient foundation on which to build throughout the lifespan of the investment. This is essential as achieving impact over long-term investments requires regular monitoring and evaluation (M&E) of an investee's progress towards the intended impact. In this process, thorough Due Diligence identifies the areas to assess the impact and the areas of concern (risk) from which to build an integrated M&E framework. Developing such a holistic system for monitoring and evaluating risk is only possible if a Due

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Diligence process has both identified how impact will be made and how risk interacts in the project.

In addition to this, and by identifying the *baseline* of an investee's social and environmental impact, an investor can also identify areas to improve and thereby create additionality through their investment. By identifying these areas for improvement, an investor can target them effectively through Key Performance Indicators (KPIs), and later refer to them to communicate internally and externally as the positive impact enabled by its intervention.

Why an Impact Due Diligence is not straightforward

The science and the practice of performing Impact Due Diligence is still evolving. Without a common methodology to work from, Impact Investors are at risk of missing vital pieces of information and performing sub-optimal analysis, leading to missed opportunities and misjudged investment decisions.

While Due Diligence for Impact Investors can offer value, it is by no means a straightforward process. There are key challenges that must be considered prior to the beginning of any Due Diligence phase. Addressing these challenges before you encounter them is essential to make sure you are prepared for the obstacles along the way. Among the countless challenges that may be faced in the pursuit of a robust Due Diligence, the core issues that must be addressed are designing a comprehensive, integrated methodology for conducting Due Diligence, accounting for various levels of data availability, and planning for the necessary time and expense.

Methods are not standard

While more traditional, financial Due Diligence is a process with a long history and a well-documented methodology, the same cannot be said for Due Diligence aimed at creating *impact*. The science and the practice of performing Impact Due Diligence is still evolving. Without a common methodology to work from, Impact Investors are at risk of missing vital pieces of information and performing sub-optimal analysis, leading to missed opportunities or misjudged investment decisions. This is especially true in agriculture and food systems where supply chains are complex, hired labour is often informal, and accurate data is a rarity.

Due Diligence methodologies aimed at assessing potential for impact must align with frameworks for measuring, monitoring, and evaluating that impact throughout the lifecycle of the investment.

Data is not always available

One of the most commonly cited issues in the impact investing space is the relative lack of data. In areas like renewable energy this is less of a problem. But whilst investing in the global south in sectors such as agriculture, food, health, and conservation, clients and investees tend to be either unaware of investor's data expectations, or are simply unable to provide it.

As the realm of impact investing grows and becomes more prominent, clients will gradually become sensitised to the needs of investors and develop their technical capacity to match the data needs. At present, these issues are not always solvable, but they can be accounted for. Impact Investors must assess the availability of data in their sectors of interest and investigate alternative means of data and information gathering to complement the information that is available directly from the client.

DD processes can be costly and burdensome

Lastly, anyone that has spent any time doing Due Diligence is well aware that it is a long and costly process. With significant staff-time requirement, consultant expert fees, service provider fees, and travel requirement, a robust and comprehensive Due Diligence does not come cheap.

There are some areas of Due Diligence that can be optimised for efficiency. However, some costs are unavoidable. These must be seen as an investment that safeguards an investor from poor investments and financial, environmental, and social risks.

Markers of success: What makes a successful Impact Due Diligence?

Successful Impact Due Diligence begins with prioritization. Impact Due Diligence is not quick, easy, or cheap. However, if prioritized early in an investment, it can return real value to investment managers and reduce the effects of risk.

Impact Due Diligence is subjective by nature. An Impact Due Diligence must be adapted depending on where the investment is placed, its sector, and its political and economic climate. As such, a variety of factors could be relevant to determine its success. However, some success factors are universal: Experience and a good network, keeping data at the heart of the Due Diligence, developing a comprehensive methodology to fit the purpose of the entire lifespan of an investment, a level of flexibility in engagement with a potential climate, and, (perhaps most importantly) an investment of time and resources.

"Aiming for impact does not guarantee it"

Must have the right experience & network

Two key factors of a successful Due Diligence are having the experience to capitalize upon and having the connections necessary to gather the data you need. An extensive network and years of experience in a sector enable an investor to quickly, and efficiently identifying & assessing opportunities for impact and potential risks while engaging the right stakeholders to enrich the analysis. The benefits of having access to experience and an in-built network are twofold. Not only does it improve the quality of an Impact Due Diligence but also greatly reduces the time and cost necessary to achieve it.

Keep it data-driven

The art of Due Diligence comes down to how effectively an investor can gather the *right* information (in amount and quality) and synthesize actionable insights. This gathered information needs to be accurate and robust and needs to come from credible sources. Furthermore, the insights developed should facilitate effective investment decision making and strategy development.

More traditional investors will often speak of the *gut feeling* or the *hunch* they get when they 'just know an investment is right'. Unfortunately, this is not a luxury that can be afforded to the impact investing community. Money directed towards impact investments come with an expectation of deploying market solutions to achieve a positive impact but, as previously stated, aiming for impact does not guarantee it. In pursuit of impact, decisions at the Due Diligence stage must be as informed and evidence-based as possible.

Use a comprehensive methodology

A lack of a standardized framework that is accepted industry-wide is a core challenge in pursuing Impact Due Diligence. Without it, investors must dedicate time to ensuring that their internal methodology is fit for purpose This means the Due Diligence process should be extra-comprehensive to build the foundations for a robust M&E framework throughout the entire lifecycle of an investment. Furthermore, this methodology should also address attribution, so an investor is able to understand what is its return (e.g. impact per USD spent, Sustainable Return on Investment).

Lastly, methodologies for Impact Due Diligence should employ systems-based thinking to ensure holistic analysis that considers the intricate and interdependent relationships between the key risk and outcome drivers and the relevant stakeholders.

Keep a flexible engagement

A holistic Due Diligence process must also assess in advance what level of analysis is necessary and, from that, what research methods are suitable. In assessing these needs, the investee's geographic location, sector, important stakeholders, and intended impact must all be considered. Is basic modeling-based analysis enough/necessary? Does it also need supply chain analysis? Does a particular investment need satellite monitoring and geographic information systems (GIS)?

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These are the questions that must be answered before pursuing a Due Diligence project.

Based on the level of analysis needed, investors should also have a degree of flexibility in designing a Due Diligence process. This ensures they are able to accommodate the research methods that are necessary to collect the relevant data. For example, a multi-staged Due Diligence process may need to incorporate different levels of primary and secondary data collections (through expert interviews, on-site Due Diligence, and scientific literature) at different stages of investment opportunity funnelling.

NewForesight can be a partner in your journey

We are skilled in handling complex evaluations and Due Diligence processes. We have deep expertise in creating tailored impact assessment methodologies and analytical frameworks in the agricultural sector. As a result, we support the Due Diligence process of the Impact Investors in three ways:

1. **Methodology development:** Building Impact Due Diligence frameworks, processes, and tools tailored to your needs and your organization's strategy and vision; and building capacity in your team in developing ways to understand the impact.
2. **Data collection and management:** Clear identification and effective collection of the required data points; facilitating the understanding of requested data by the potential investee(s).
3. **Analysis & recommendations:** Conducting analysis to answer the key Due Diligence questions, and building up the evidence-base.

Our experts use a **systemic approach** to assess the impact at all levels. For instance, in agri-sector investments, considering all factors influencing the farm-system to ensure an in-depth and holistic analysis of the impact outcomes and risks. While analysing the business case of the investee's impact model, we include all the key partners engaging with farmers as part of the equation.

Employing our **network of experts and partners** we enable our clients to access real and relevant data points region as well as crop-specific insights effectively & efficiently. We can draw from our network to support us that includes a vibrant group of academics, researchers, freelancers, research institutes, universities, and data collection service providers across the globe

We help Impact Investors in conducting **a cost-effective and fit to the purpose of Impact Due Diligence**. We flexibly scope the breadth and the depth of the three service categories (mentioned earlier) in the Due Diligence scope based on the client's needs.

Our approach seeks an efficient way for our clients to design the Impact Due Diligence process by dividing it into sequential stages. The first stages involve a very high-level checklist-based first screening of investment opportunities. This is followed by a relatively less rigorous preliminary Impact Due Diligence to enable a second screening of a more promising impact investing opportunity. And finally, a detailed follow-up in case the client decides to pursue the impact investing opportunity further. **We stay agile and entrepreneurial to develop solutions tailored to our clients' needs in every stage of assessment**.

To learn how this could benefit your organization, as well as your investees, get in touch with the experts at NewForesight.

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About NewForesight

In a world that is confronted by increasing complex and global sustainability challenges, the question is not if you should deal with them, the question is how.

NewForesight Consultancy (est. 2008) is a strategy consulting firm specialized in turning world's toughest sustainability challenges into opportunities for all. From strategy to implementation.

In dedicated partnerships with our clients we initiate, shape, and drive the transformational strategies required for lasting impact.

Do you have a tough sustainability challenge to tackle?

Let's get in touch!

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