Bridges Ventures

Bridges' Impact Methodology

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Bridges Ventures

Bridges Ventures is a specialist fund manager focused exclusively on sustainable and impact investment – using a variety of investment strategies to help solve some of society's biggest challenges. Founded in 2002, Bridges now has almost $1 billion under management across its growth, property and social sector funds. Bridges is committed to maximising the impact of its funds and to growing the wider industry in which they operate. They therefore established Bridges Impact+, to equip Bridges' internal teams with best practice and to leverage that practitioner experience to support a wide range of external clients – from investors to governments to corporations to charities. Their approach combines research and development of frameworks and products with hands-on advisory services, all rooted in practical experience. For more information, visit bridgesventures.com.

Bridges' Impact Methodology

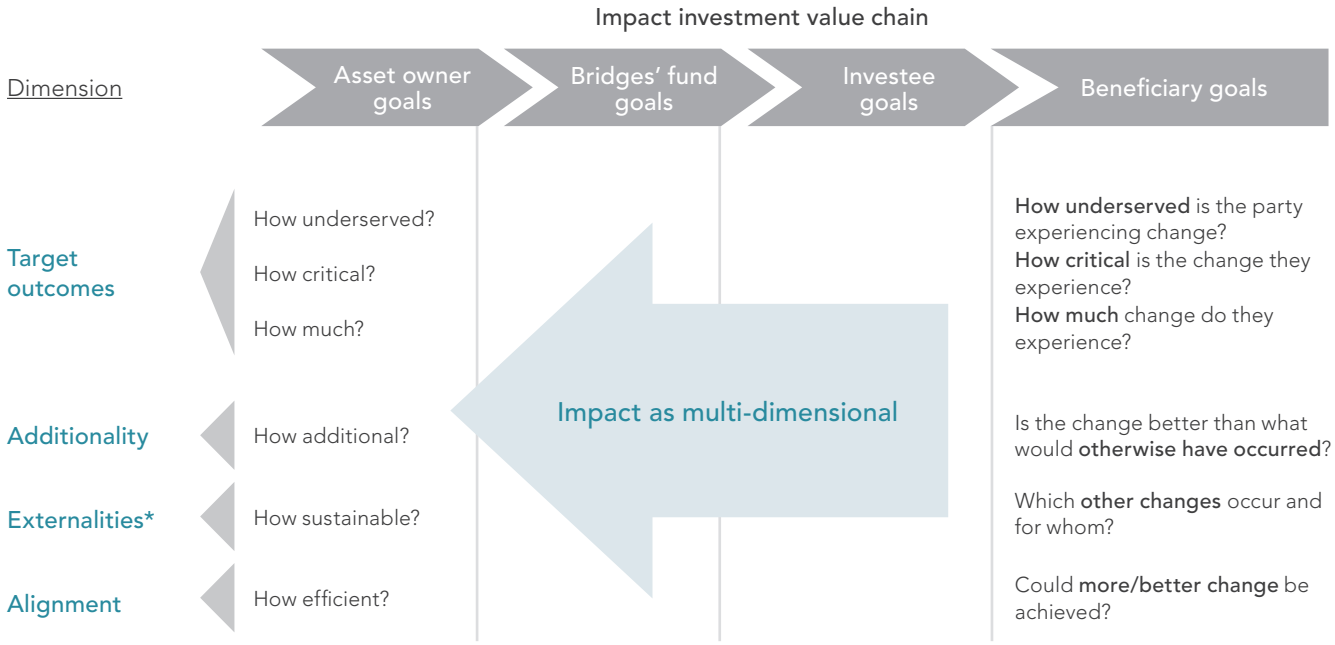
We call our investment approach 'impact-driven' because we use impact as a lens to select and engage with our investments. Over the years we have developed an approach that helps us to make informed decisions within the bounds of what is practical (both proportional and affordable) and useful (allowing us to select and manage investments to create societal value on a day-to-day basis).

Designing the Impact Radar

The **Impact Radar** evolved as a tool to describe (and therefore help improve) the change experienced by those we are trying to benefit, including the additionality, sustainability and efficiency of that change. Working backwards from the beneficiary perspective, Bridges sought to 'unpack' impact into discrete dimensions that could be consistently assessed and managed – across a wide range of preferences (outcomes, beneficiaries, geographies, etc.).

Bridges then defined a range for each dimension. That range allows us to plot an investment's **impact return** (achievement if performance is as expected), as well as **impact risk** (probability that performance will be different than expected), which then becomes a framework for managing impact performance (i.e. increasing impact return/reducing impact risk in line with the risk/return threshold for each fund).

Fig 1. 'Unpacking' impact into discrete dimensions



* We use the terms 'ESG' and 'Externalities' interchangeably on our Radar, as the traditional investment community is used to the term ESG.

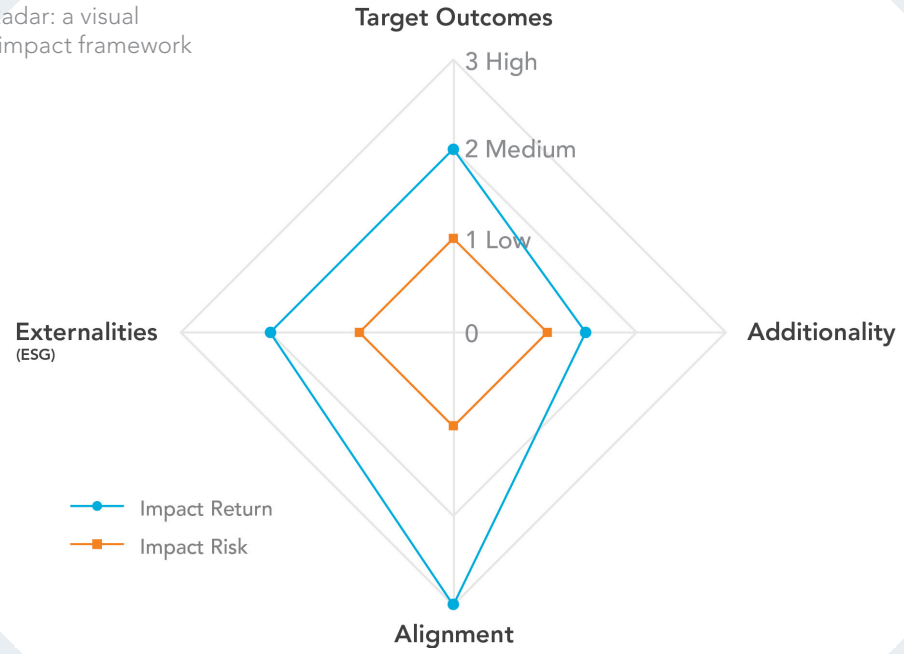
Target Outcomes

'Target Outcomes' analysis begins with identifying who is being affected by the problem (target beneficiary), what they need, the barrier to improvement and what the current response is. This helps plot the Theory of Change and accompanying Logic Model (specific steps necessary to deliver the Theory of Change). From a **return** perspective, the Logic Model is used to assess how underserved the party experiencing change is, how critical the change they experience is (depth) and how much change they experience (scale), including wider or systemic positive change, such as additional cost-savings to society, a positive influence on policy, or a 'ripple effect' in the broader market (including price disruption and copy-cat models). Across its health and education themes, Bridges applies an 'inclusive' lens to ensure that the investments are, at a minimum, creating positive change for the population at-large (*including* the previously underserved), rather than only the wealthiest segments of society. Bridges' Social Sector Funds typically back models that focus on very underserved beneficiary groups. From a **risk** perspective, Bridges pressure tests the causal links in the Logic Model in order to assess the likelihood that the investment's activities and outputs will not translate into Bridges' target outcomes.

Additionality

Additionality analysis asks whether the target outcomes will occur anyway, without Bridges' investment. Additionality **return** analysis considers whether, at a minimum, Bridges' alignment with the investee's social or environmental agenda will create non-monetary benefits that generate additional social value. More often, additionality is due to Bridges' integral role in structuring or even incubating businesses in-house (in which case, the investor- and enterprise-level additionality become one and the same). For Bridges Social Sector Funds, investor additionality is readily assumed, since such investees could not rely on the mainstream capital markets to support their growth due to their business model design/structure. Nevertheless, in co-investment situations, Bridges considers the extent to which it leads the development of the investment (and therefore the leverage of additional capital), which signals an even higher level of investor-level additionality. Additionality **risk** analysis considers *enterprise*-level additionality — analysing the likelihood of the investee will deliver a greater quantity or higher quality of outcome than would otherwise occur. An investment could be creating new positive outcomes, or it could be preventing negative outcomes from otherwise occurring (for example, by saving jobs).

Fig 2. Bridges Impact Radar: a visual expression of Bridges' impact framework



Externalities

Recognizing that every investment has the potential to generate externalities (intended or unintended, positive or negative societal outcomes), Bridges tries to assess the holistic impact of each portfolio company, beyond just their intended theory of change. From a **return** perspective, Bridges works with its investees to identify opportunities to improve societal and business performance simultaneously. While each situation is unique, thematic expertise enables Bridges to recognize high-potential areas, such as creating employment access through apprenticeship schemes. While some ESG opportunities are defined pre-investment, many emerge during the investment period, through regular interaction with the company. To assess externalities **risk**, Bridges uses a materiality lens to identify and grade risks as a high, medium, or low priority, and record the results on a risk register. For each material risk, Bridges agrees a mitigation plan before making an investment, which then forms part of the 100-day plan developed immediately post-investment. Thereafter, ESG issues are reviewed regularly at Board meetings with investee companies, as well as at firm-level portfolio review meetings. ESG issues are tracked annually through the Impact Scorecard.

Alignment

Bridges' funds differ in terms of the types of business models they back, and the impact and financial returns they generate. From a **return** perspective, Bridges analyzes the alignment between an investment's ability to meet its impact goals and its financial goals. Both the Bridges Sustainable Growth Funds and the Bridges Property Funds look for an investment's impact and its generation of competitive financial returns to be in 'lock-step' — in other words, that impact will automatically scale as investors make attractive financial returns. The Bridges Social Sector Funds look for investments that are capable of generating impact alongside a sustainable, rather than fully commercial, financial return — from early-stage social ventures seeking social equity (requiring high-risk capital, but offering a below-market return) to established social enterprises whose business models (such as cross-subsidy schemes or co-operatives) need what Bridges increasingly calls 'social mezzanine' financing (lower-risk/lower-return financing with an innovative exit structure that will preserve mission). From a **risk** perspective, Bridges analyzes the underlying business model of the investee: the alignment between the model's business success factors and the impact it seeks to create. While the funds differ in terms of the financial returns they generate for investors, all funds share a focus on spotting business models whose ability to generate impact creates a competitive advantage.

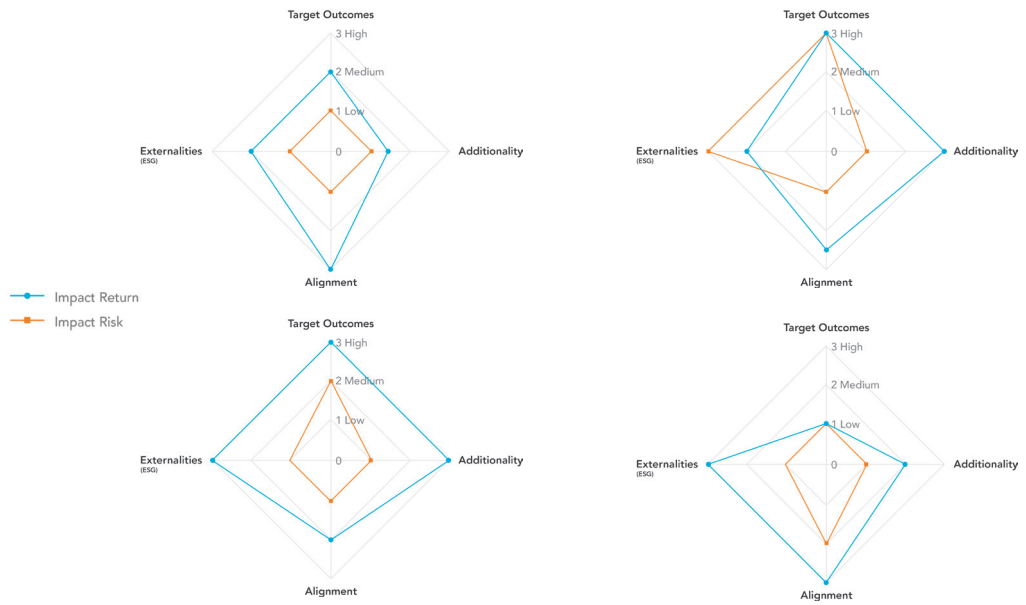
Applying the Impact Radar

We plot an investment's Impact Radar by scoring impact risk and return potential. Our scoring approach is subjective and indicative, rather than categorical (see Appendix for Scoring Guide).

Throughout the investment cycle...

Pre-investment, the Impact Radar informs our due diligence of an opportunity, usefully summarising our investment team's due diligence, in order to provide a basis for constructive discussion. By selecting opportunities based on what we will achieve when performance is as expected (impact return) as well as the probability that performance will be different than expected (impact risk), Bridges is starting to see clusters of investments with similar impact risk/return characteristics – suggesting a series of impact risk/return combinations that "make sense", much like the emergence of asset classes in traditional finance.

Fig 3. Identifying patterns: a path to allocation 'norms' (*Illustrative*)



Post investment, the Radar acts as a portfolio management tool, enabling the team to reflect on performance against impact goals (at both individual investment and fund-level) and to support investees to improve their impact risk/return profile. In order to track an investment's performance against the Impact Radar, Bridges works with each investee to determine the most appropriate key performance indicators (KPIs), which are then recorded on an Impact Scorecard. If they get this right, the impact KPIs tracked as an investor are smart business KPIs for the investees, demonstrating their positive contribution to society and their protection and enhancement of value for investors.

...and across the value chain

Bridges originally designed the Impact Radar as a tool for selecting and engaging with investees: to calibrate a prospective investment's risk/return profile with the impact risk/return threshold of the relevant Bridges' fund and to support the investee to manage impact performance (increase return, decrease risk). This has made it an equally helpful tool for asset owners at the other end of the impact investment value chain. While investors back Bridges' various funds on the basis of pre-determined thematic/geographic/demographic (and other) impact preferences, the Impact Radar is a useful further lens, providing a sense of the level of impact return achievable (or achieved) within an investor's impact preferences, as well as the risk that it might not be achieved..

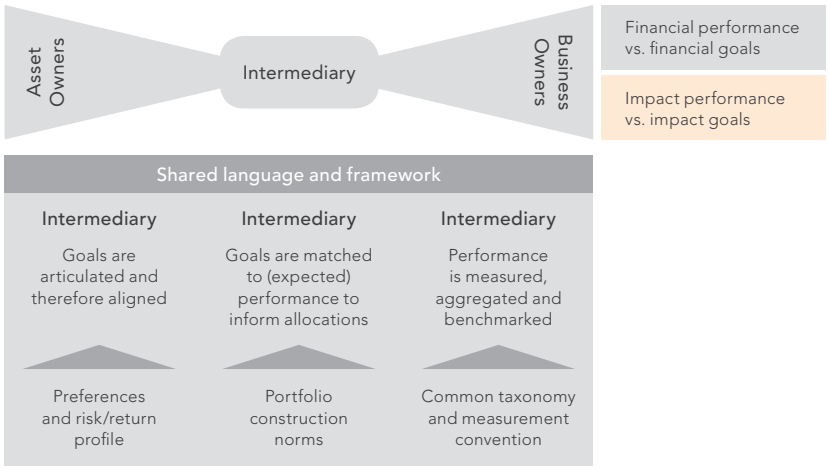
For example, an investor's preferences may include "improving well-being for elderly citizens in the UK" and the Radar then provides a basis for discussion about: how critical an investment is to achievement of that well-being; how underserved the citizens it reaches are; how strong the evidence base is that the desired improvement takes place; whether positive or negative externalities occur in the process; how likely it is that the positive change would not have happened without their investment; and how aligned the generation of impact is with the investor's financial goals.

Moving beyond impact preferences (e.g. outcome(s), beneficiary group, etc.) to a more granular conversation about the risk/return profile achievable (or achieved) within each preference matters because it allows Bridges to demonstrate our logic in constructing an optimal portfolio – one that can best meet an investor's impact and financial goals, within the current market context.

Looking forward

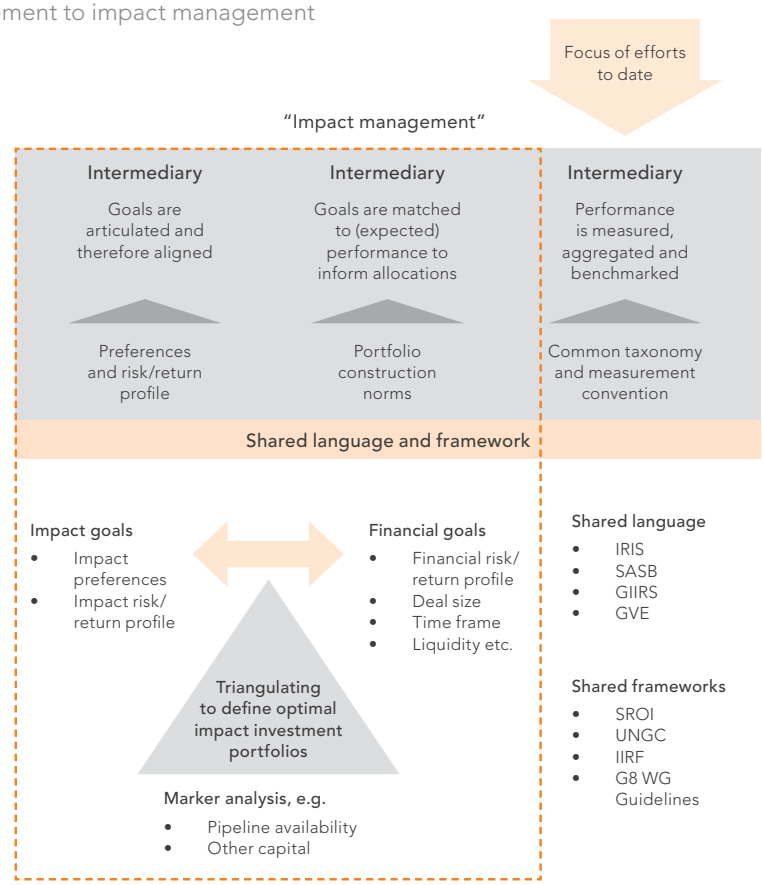
The need for a shared language and framework to align the goals of beneficiaries, investees, intermediaries and asset owners has precedent in traditional finance: investment value chains function (and the investment management industry has grown) not just because we have common currencies and accounting standards but because we have evolved a shared language (financial risk, return and liquidity) and framework (asset classes and portfolio construction norms) to articulate – and therefore to align – respective goals for all parties involved.

Fig 4. Articulating – and therefore aligning – respective goals



Over the last decade, there has been an industry push to measure impact performance. While this is unquestionably urgent and essential, the focus on measurement has meant that it has not been immediately obvious that we are also lacking an industry-wide language and framework for articulating impact goals in the first place, as well as norms for constructing a portfolio to achieve them.

Fig 4. From impact measurement to impact management



Appendix

Bridges Impact Radar – Scoring Guide

		SCORING GUIDE		
	KEY QUESTIONS	3 / HIGHER	2 / MEDIUM	1 / LOWER
I. TARGET OUTCOMES	**RETURN ANALYSIS**: Does the investment create depth and/or scale of impact? Does the investment benefit an underserved beneficiary group or society at large? What systemic/wider impact will occur from the investment?	Scale and/or depth, plus: a focus on a very underserved beneficiary group and/or potential for systemic change	Scale and/or depth for society at large	Neither scale nor depth
	RISK ANALYSIS: How well tested are the causal links in the logic model?	Credible secondary research evidences causality (in a different, but comparable, context)	Credible secondary research evidences causality (in a comparable context), plus primary research supports causality (that is, investee's own quantitative and qualitative assessment)	A scientific study (for example, RCT or longitudinal study) evidences causality, demonstrating that the investment is generating impact
II. ADDITIONALITY	**RETURN ANALYSIS**: Is Bridges integral to the development/ performance of the investment?	Bridges is incubating the business	Bridges is the sole or lead investor in an opportunity overlooked by mainstream investors*	The business is already well established with other (competing) investors, but Bridges' non-monetary support can drive increased impact
	RISK ANALYSIS: Does the investment lead to outcomes that would not otherwise occur?	Likely displacement of comparable societal benefits (for example, simply stealing market share with no impact value-added)	Unlikely displacement of other comparable societal benefits due to increased quantity or quality addressing current market failure	Very unlikely displacement of comparable societal benefits due to increased quantity or quality addressing current market failure
III. EXTERNALITIES	**RETURN ANALYSIS**: Does the investment generate positive externalities?	Significant positive externalities	Some positive externalities	No positive externalities
	RISK ANALYSIS: Can risk of negative externalities be mitigated?	Negative externalities cannot be mitigated	Negative externalities can be mitigated	Minimal risk of negative externalities
IV. ALIGNMENT	**RETURN ANALYSIS**: How aligned is the investment's generation of impact with its ability to deliver competitive financial returns?	'Lock-step' between generation of impact and competitive risk-adjusted financial returns	Ability to generate sustainable, risk-adjusted financial returns	Inability to re-pay capital
	RISK ANALYSIS: How aligned is the business model of the investee with its generation of impact?	Many business success factors are not aligned with impact success factors	Some business success factors are not aligned with impact success factors	All/most business success factors are impact success factors

See further information on Bridges' assessment methodology at www.bridgesventures.com

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