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Impact Learnings Series | January 2020

Monetizing Impact

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Monetizing Impact

Should we put a financial value on the impacts an enterprise has on people and the planet? Yes. Let's talk about why and how.

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Impact monetization is an indispensable tool for making better management and investment decisions. It has a long history—as a cornerstone of social return on investment (SROI) and enshrined in the steps of cost-benefit analysis and regulatory analysis more broadly—yet is only now moving towards the mainstream.

Our aspiration is for investors, entrepreneurs and corporate leaders at all levels of their organization to be able to target social and environmental impacts with the same rigor, discipline and sophisticated tools that they currently use for situations where the objective is financial returns. Monetization matters because it is a critical, perhaps even essential, means to achieving this.

Monetization forces us to make explicit both our assumptions and our values. This clarifies trade-offs with a richness beyond yes/no, provides a common language to discuss and manage impact, and brings the tools of modern finance and management to bear on social and environmental goals. Monetization is not without its challenges, including the need to grapple with uncertainty, the danger of false precision, the difficulty of comparing impacts across sectors or geographies, and the challenge of valuing outcomes that are not naturally monetized, like healthier children. But monetization does not create these issues. It can, however, make them lucid and transparent. In doing so, it supports better decisions about impact, which is what we are all aiming for.

The rest of this piece walks through each of these points in more detail, first describing what monetization is and why we do it. It then describes some of the perceived challenges to monetization and how addressing them can help achieve our goal: better decisions about impact.

What it is and why we do it

At one level, the basics of monetization are simple: first, multiply the breadth of impact (e.g., household solar arrays installed) by the depth of that impact (e.g., each array reduces CO_2 emissions by about 12 tons per year). Then, multiply this by a value factor (e.g., $100 per ton of CO_2). The result is the monetary value of impact for this activity. You can add it up, model risk, test sensitivity to various assumptions, etc. In short, you can work with it as you would work with other business or financial measures. Of course, it can get complicated quickly, so it is good to start with why we do it.

Impact is not binary

Imagine if your pension plan only reported whether it was up or down for the year. You would very quickly find a new manager. You may pick an investment based in part on a categorical score, like a Morningstar Rating, but ultimately you would want to know the balance in your account. While impact measurement will never reach the precision of financial accounts, we need to move in this direction. This isn't just a question of scorekeeping. Nor is it all about a single, precise value itself. Rather, it is about encouraging better decision making, understanding the drivers of impact and uncertainty, and allocating our resources more efficiently.

Speak a common language

Monetization provides a common language that enables conversations across the finance, management and impact communities and sharpens discussions within the impact community itself. When we all have different metrics, it is far too easy for someone focused on, for example, education to glaze over at the mention of disability-adjusted life years or biodiversity. Even within education, the targets of primary schooling may seem arcane to someone focused on vocational training.

Translating impact to a common unit—be it dollars or donuts—harnesses our common drive to compare ourselves to others. When my health investment reports $20m of impact against $30m from your alternative energy provider, we are both inclined to ask thoughtful questions about the carbon intensity of the grid or whether the health effects of particulate matter are included in the social cost of carbon.

For those of us who aren't experts in public health or energy production and transmission, such questions seem impenetrable. And that's the point. We won't all be experts. But we want to bring those experts into our decisions. To challenge and refine assumptions. To get better at targeting and managing for positive impacts. The common language of monetization lets us all join the conversation.

Harness the machinery of business and finance

Monetizing social and environmental impacts can harness the tools of operations management, capital budgeting, and modern portfolio theory. I'll leave it to the cognitive scientists to explain why putting a dollar sign in front of a value seems so effective, but it is. We want those who have spent a lifetime delivering impact to be able to plug their experience and insights into management and financial tools that will allow them to scale effectively and efficiently.

If we in the impact community can deliver measures of impact in a form that makes sense to the larger investor and business world, they can then readily apply the tools of their trades. We want deeply experienced managers, investors and entrepreneurs to bring to impact the same skills they have honed focusing on financial outcomes. What are those skills? First, "financial types" sweat quantitative details, evaluate risk and challenge assumptions with a rigor that one doesn't often see in other organizations. Second, rapid innovation: we want corporate managers, investors and entrepreneurs to bring to impact skill and tools that are only now being developed in other areas. The pursuit of financial gains spurs tremendous innovation and orientation towards scale.

Understanding monetization challenges allows better decision making

The value of values

There are two steps to converting real outcomes, e.g., number of vaccine-preventable illnesses averted, into monetized values ($ or € or £, etc.). First, one needs to understand the research and evidence base, where available. This includes understanding the range of views on the social cost of carbon; how the World Health Organization and others use disability-adjusted life years to value morbidity reductions; and the principle of diminishing marginal utility of income ($100 is worth more to a household living on $3 per day than to one making $100,000 per year). These establish reasonable ranges—think of them as guardrails—for the value of various impacts.

For the second step, we need to distinguish between management accounts—which provide (hopefully useful) information for an enterprise's internal use—and external impact reports, the impact equivalent of financial statements—which provide information about the enterprise to an outside audience.

For management accounts, the decision maker needs to set the enterprise's values, respecting the guardrails, with the aim of fostering good decision making, planning and allocation of resources. In the impact context, that means, for example, that the Global Innovation Fund, which focuses on improving the well-being of those living on less than $5 per day, does not directly consider benefits accruing to those higher in the income distribution in its own assessment of value realized. An enterprise focused on African employment and jobs growth may not include the benefits to a relatively well-off consumer who enjoys higher-quality and lower-cost products as a result of its investments in its consideration of value. A global, multi-sector investment fund would want to be explicit in whether it intends to consider—and value—income gains, carbon abatement, access to medical care, and any other social or environmental outcome that fits within its purview.

In this vein, critics claim that monetization is essentially subjective. Absolutely. Monetization is subjective. But so is any approach to making decisions about complex social and environmental issues. The danger comes from conflating objective measures, e.g., a careful evaluation shows this program increases graduation rates by 10 percentage points, and the subjective valuations of these impacts, e.g., we value each additional student graduating at $25,000. Different stakeholders may well value outcomes differently. Monetization makes these differences transparent and provides a medium for decision-making, comparability and accountability.

Not perfect, but more than good enough

These values need not be exact. Rather we need what Jeremy Nicholls, founder of Social Value UK, described as “Enough precision for the decision.” If, for example, your decision would be the same whether you value carbon at $50 per ton or $120, you do not need to decide on a precise value. And what if the cut-off point sits within an enterprise’s range of values? Finance and management professionals are used to dealing with uncertainty about the future. Monetization makes it possible to incorporate uncertainty about impact directly into the decision. In a future piece, we will talk more about how to do that.

Like financial statements, external impact reports are intended for investors and, increasingly, regulators. Impact accounting standards and coordination will streamline production of these statements and facilitate comparability. A number of organizations—including the Impact Management Project, the Impact Weighted Accounts Initiative, SASB, SDG Impact, Social Value International and the Value Balancing Alliance—are working hard to build towards these standards. We should, however, be realistic about the goal. In financial accounting, GAAP standards continue to evolve, and notes to financial statements provide essential detail for myriad nuanced calculations underlying income statements, balance sheets and statements of cash flows. We should embrace similar sophistication in our approach to impact accounting.

We should also abandon any fantasies about living in a fully certified world. We understand this for forward-looking statements. For example, a careful analysis and review of the evidence can help us predict the number of children that will be vaccinated in a new medical facility next year, but that prediction is inherently uncertain, and we will need to make decisions with the best information we have.

For impact—monetized or not—some uncertainty persists even when we are evaluating the past. While the number of vaccines we will distribute next year will ultimately be known, we will never learn with certainty the impact of those vaccines. Careful measurement and evaluation will narrow our range, but we need to operate knowing that we will never see the alternative universe—the counterfactual—where those vaccines were not provided. This sort of ambiguity is a fact of impact life. Monetization allows us to address this ambiguity and incorporate uncertainty into our decisions. The result: better decision-making insights leading to better outcomes.

Priceless valuation

Valuing outcomes for which there is no market—e.g., reduced inequality or cleaner oceans—is challenging. Therefore, an additional concern about monetization centers upon the specifics of how value is determined. Should one use methods of revealed-preference (that is, observe real-world, market behaviors, like how much someone pays for an air filter or side-impact airbags, and infer their value for the underlying non-market good—clean air or a reduced chance of injury) or stated-preference methods (ask individuals, perhaps in a sophisticated way, how they value the good)? It is true that these methods often fail to capture the “full” value of an outcome. Markets are imperfect, so observed behaviors do not capture, for example, the value of biodiversity or even education when poverty and broken credit markets can lead us to mistake ability to pay with willingness to pay.

While we can and should acknowledge these limitations, to make progress let's take a step back. It may seem obvious, but the primary goal of any strategy for any impact-oriented management strategy—be it for impact investing or enterprises seeking to improve their environmental and social impact performance—should be to make better decisions about these impacts. To be useful, this system must help inform tradeoffs. Should we invest in a company that provides hospital care in sub-Sharan Africa or one that builds solar arrays in India? Support EdTech for secondary schools or early childhood education? Spend $500,000 per year to switch to post-consumer recycled packaging? These decisions all involve value judgments. And if we can make the decision that we prefer A to B, we can express this idea quantitatively: the value of A > the value of B.

Quantifying impacts allows us to express our values and the assumptions behind them more clearly. This process can be hard, though not because it requires challenging math or laborious calculations. It is hard because the mere contemplation of tradeoffs that touch on the sacred or taboo makes us all uncomfortable (Tetlock, 2003). As Tetlock notes, tradeoffs between the secular and the sacred can be particularly difficult. We bristle at putting a monetary value on certain impacts (biodiversity, equality, etc.) because it feels like a price. If, for example, you conclude that the value of preserving a particular species of tree frog is $25 million, does that mean that if someone were willing to pay you $25.1 million, they could merrily proceed with a plan for frog extermination? No. Emphatically no. Instead, the monetary value enables a constructive dialogue around trade-offs and alternatives, enabling us to make a better decision.

Quantification allows us to evaluate tradeoffs more explicitly. Suppose, for example, an enterprise was building a chain of clinics that would provide $100 million of otherwise unavailable health benefits but that initial plan involved destroying the frog's habitat. The net benefit of this plan would be $75 million, but that doesn't mean this plan is optimal. The world would, in fact, be better off if the enterprise spent $24.9 million to relocate the clinics and preserve the frogs. And what if you say we should be willing to spend more to save the frogs? Then reflect that in your values and use it to make the better decision.

Beware the One True Number

The fact that quantification can express these tradeoffs and support good decisions about impact doesn't mean that it will. There is a risk that monetization will improperly collapse all of an enterprise's impacts to a single number, thereby hiding tradeoffs. Not just overlooking, but obliterating, nuance. While worthy of consideration and conscious efforts to avoid this pitfall, the reality is that this a concern with any approach to decision-making. Used carelessly, monetization can cloud rather than clarify. But used correctly, monetization forces us to spell out our values, making trade-offs explicit, highlighting negative impacts and distributional issues, and allowing us to express risk, uncertainty, and how we weigh future costs and benefits against the present. Ultimately, this allows enterprises and investors to make better decisions about impact and to effectively communicate the drivers of those decisions to their stakeholders.

Those of us working to implement impact monetization should, however, pay careful attention to this criticism. The fact that many critics see monetization as opaque and inflexible makes it clear we have work to do in how we convey it. That’s our lift.

Some of these thoughts were previously shared on the Harvard Business Review’s excellent Idea Lab conversation about impact monetization.

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