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How Early-Stage Impact Investors Evaluate Social Impact Potential

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As the Impact Investing field grows, the need to understand how early-stage impact investors evaluate the potential impact of a social enterprise increases. This is relevant for three main reasons: (i) impact assessment is what sets impact investing apart from traditional investing, (ii) most assessment tools are used after investments are made, and (iii) only around one third of social enterprises measure their impact.

The article analyses the decision-making process ("cognitive processes") applied by early-stage impact investors to assess a social enterprise's potential impact.

The authors conclude that assessing social impact is a key decision factor for impact investors, who apply 18 different cognitive processes to evaluate impact potential. Rather than following standard measurement practices, investors rely on intuitive reasoning and heuristics to simplify complex information and make decisions under uncertainty and time constraints.

#impactinvesting #impactassessment #IMM #impactevaluation #VC

Background & Context

- Impact Investing requires that capital is allocated with the intention to create impact that is measurable, alongside financial returns. Previous research demonstrate that **impact investors prefer early-stage enterprises that promise high impact**.

- However, assessing the **impact potential of early-stage enterprises is rarely straightforward**, requiring impact investors to evaluate it using incomplete and uncertain information.

- Evidence is limited on **how early-stage impact investors assess an enterprise's social impact**, leading this study to explore the cognitive processes behind their decisions.

- To do so, **the authors selected and interviewed 20 impact investors located in Austria, Switzerland and Germany**. Investors were asked to do an initial screening of three pitch decks for a hypothetical new fund. In total 58 proposals were reviewed (two times investors stopped due to time constraints).
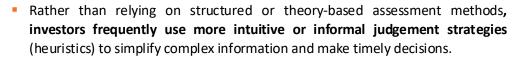
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Take aways & Learnings

- **Investors devote substantial attention to assessing social impact**, with nearly a quarter of all thought segments focused on this criterion (second only to financial considerations). In debriefings, over 70% of investors explicitly cited social impact potential as a key factor in their final decisions.

- The study identifies **18 cognitive processes** that investors use when assessing impact potential:

  - ➤ Around one third of statements focused on evaluating the *potential impact of the solution*

  - ➤ 28% on assessing the *social problem and its relevance*

  - ➤ 18% on analysing the *fit between problem and solution*

- Rather than relying on structured or theory-based assessment methods**, investors frequently use more intuitive or informal judgement strategies** (heuristics) to simplify complex information and make timely decisions.

- While heuristics allow for efficient decision-making, they can also introduce **systematic biases** (for example favouring ventures with more imaginable, short-term impact stories over those pursuing complex, long-term change) and lead to **less optimal investment decisions**.

- To improve decision quality, **impact investors need to strengthen their own impact assessment capabilities.** This includes investing in skills and frameworks that help recognise and mitigate biases during early screening.

- The authors recommend a **"Goldilocks approach"** to impact measurement in the pre-investment phase: using light, customised methods that balance rigour with practicality.

- Finally, **formalising the decision process,** by defining clear evaluation criteria and review steps, can help reduce heuristic-driven errors and ensure that intuitive insights are complemented by structured reflection.

- Together, these measures enable investors to balance intuition with structure, leading to **better, fairer and more evidence-informed investment decisions.**

Assessment of potential benefits	Assessment of problem relevance	Assessment of problem-solution fit	Drafting theories of change	Taking cues from document's characteristics	Impact is embedded as an organisational priority	Requesting further information	Interpretation of third-party signals

Cognitive processes applied by early-stage impact investor when assessing the impact of social enterprises

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