

Position paper #03 [short version]

# Impact Due Diligence Principles

This paper presents key principles for impact due diligence [IDD] processes in impact investing, as defined by the Bundesinitiative Impact Investing [BIII, 2022]. It emphasizes the importance of IDD alongside financial analysis, acknowledging its growing significance in investor ratings and decision-making. Its principles are aimed at guiding a wide range of impact investors, helping them meet asset allocator expectations and informing stakeholders and potential investments about IDD processes. It seeks to encourage an impact-driven investment approach in the German investment market and aims to establish standardized IDD practices across Europe.

The paper distinguishes IDD as a critical and integrated component of the general investment due diligence process. Unlike traditional due diligence, which focuses on commercial, financial, and legal assessments, IDD evaluates social and environmental impacts.

Thus, this collaborative process, mandatory for impact investors, investigates both the direct effects of the investment and its contribution to the overall impact of the investor's portfolio.

The IDD Principles outlined in this paper are designed to complement existing laws and regulations, ensuring they align with the obligations of institutional investors. They adhere to mandates like ESG, CSRD, and SFDR, by, for example, incorporating double materiality, which considers the mutual influence between an impact investment and its external factors. They are aimed at providing a broader context and deeper impact analysis, enhancing consistency in impact measurement and the planning of impact management. While the sector has not yet uniformly implemented them, the goal is to establish the IDD Principles as a practical approach driving substantial real-world impact.



### **IDD Principle 1 Strategy:**

IDD roots in the investment strategy of impact investors.

Integration of IDD into the investment strategies of impact investors involves conducting thorough evaluations, managing impact planning, and reporting social and environmental outcomes for each potential investment to ensure alignment with the investor's overall impact objectives. This approach highlights the importance of baseline metrics, impact Key Performance Indicators [KPIs], and milestones. Additionally, IDD relies on established theoretical or normative frameworks.



### **IDD Principle 2 Team involvement:**

IDD involves multiple levels of an impact investing organization.

The IDD process involves multiple levels within an impact investing organization. The active collaboration across organizational levels achieves a unified approach in impact assessment and decision-making. Essential to this process is defining clear roles and responsibilities, fostering structured collaboration, and ensuring organization-wide alignment with the impact mission.



### **IDD Principle 3 Ecosystem involvement:**

IDD adapts to, integrates, and incorporates the multi-faceted aspects of its external environment.

IDD adapts to the diverse aspects of its external environment, including environmental, social, cultural, economic, and institutional elements. This involves impact investors being deeply committed to understanding local nuances and engaging directly with external stakeholders, such as beneficiaries or environmental experts, for insightful impact assessments. Additionally, this approach advocates for integrating ESG considerations and stakeholder involvement from the planning phase, fostering investment ownership and commitment.



### **IDD Principle 4 Net-positivity:**

IDD captures the expected net positive impact.

IDD ensures net-positivity by assessing if the overall net impact is or will be positive. According to the Bill, net-positivity requires considering all relevant effects, including unintended and long-term ones, to ensure they are ethically justifiable and predominantly positive without significant unmanaged negative impacts. Assessing net-positivity is thus key in mitigating risks of greenwashing and impact washing, where false claims of positive impact are made.



### **IDD Principle 5 Impact assessment:**

IDD aligns with the type of capital invested, the development phase, and the impact sector of a potential investment.

IDD aligns with the capital type, development phase, and impact sector of potential investments. This acknowledges that IDD methods, criteria, and processes vary depending on the asset class, with different impact expectations and risk profiles for each capital type. Impact assessment within IDD also considers the maturity levels of investments, requiring different approaches for early-stage investments than for more mature ones. Furthermore, it emphasizes tailoring IDD to each impact sector's unique challenges and dynamics.



#### IDD Principle 6

##### Time frame:

IDD has a long-term orientation.

The IDD process is long-term in nature, which means that it necessitates a strategic focus that extends beyond immediate outputs, committing to the lasting nature of investments and their ongoing impact on social and environmental spheres. This long-term approach applies to both individual investments and the collective impact of an investor's portfolio. It involves demonstrating long-term impact achievements to asset allocators and aligning impact Key Performance Indicators [KPIs] and milestones with sustainable, long-term goals.



#### IDD Principle 7

##### Impact risks:

IDD explores potential impact risks and their potential consequences.

IDD explores potential impact risks and their consequences. This involves assessing the likelihood of outcomes deviating from intended impact goals, considering various risk types like external risks and those associated with stakeholder participation. Furthermore, the assessment of impact involves analyzing how these risks might affect individual investments and the broader portfolio, leading to risk ranking based on potential consequences. It also captures strategies to minimize these risks, such as enhancing data collection.



#### IDD Principle 8

##### Exit planning:

IDD involves meticulous planning of possible exit strategies.

The IDD process involves the meticulous planning of responsible exit strategies. This emphasizes the importance of ensuring a lasting positive impact post-exit, integrating the long-term orientation and impact risk assessment principles outlined in IDD Principles 6 and 7. Thus, IDD guides the development of exit strategies aimed at balancing immediate financial goals with sustainable, long-term impacts.



#### IDD Principle 9

##### Impact management:

IDD plans impact management after the initial IDD process.

IDD plans impact management beyond the initial IDD process. This establishes a systematic and ongoing dialogue between investors and their investments, fostering a dynamic approach to impact management. Furthermore, planning impact management enhances accountability, adaptive learning, and continuous social and environmental impact. This is reflected in a clear framework for evaluating impact milestones and feedback loops within the IDD.



#### IDD Principle 10

##### Transparency:

IDD findings are communicated with utmost transparency.

The IDD process's results are communicated transparently to promote the impact investing sector's growth. This fosters openness, trust, and collaborative engagement among all relevant stakeholders. Moreover, this approach encourages investors to openly discuss their IDD methodologies, facilitating the exchange of experiences and practices, which can improve decision-making and increase social and environmental impacts.

## CONCLUSION AND OUTLOOK

The IDD Principles provide a detailed framework for thorough and effective IDD, adaptable to various types of impact investments. These principles assist investors in establishing comprehensive impact assessments, effectively planning impact management, and transparently communicating outcomes. They are aimed at standardizing high-quality IDD practices

and encouraging traditional investors to adopt impact-oriented strategies, contributing to meaningful, real-world impact. The principles are dynamic and should continuously evolve in response to global challenges and market shifts. This adaptive approach ensures their relevance and effectiveness in the ever-changing landscape of impact investing.

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The cooperative project IMMPACT helps impact founders and impact investors to unleash their full impact potential. We strengthen their competencies and establish uniform evaluation standards in the German impact-oriented startup ecosystem – thus making impact measurement and management [IMM] more accessible.

A collaboration between the Bertelsmann Foundation, PHINEO, the Bundesinitiative Impact Investing, and the Social Entrepreneurship Network Germany [SEND].

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