Integrated Profit & Loss Assessment Methodology (IAM): Supplement Impact Contribution

Version 1.0

IMPACT™ INSTITUTE

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One of the greatest opportunities of the 21st century is the realisation of the impact economy: an economy in which work, entrepreneurship, innovation, and technology engender a better world. To achieve this requires a global system shift that retains valuable components of the old market system while embracing new economic models. In turn, the shift to the impact economy necessitates a common language for impact that is integrated into every aspect of our economy.

Mission

Our mission at the Impact Institute is to empower organisations and individuals to realise the impact economy. We do this by creating a common language for impact through the publication of open source standards and by providing the tools, training, and services to implement those standards.

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1. Goal and Scope

1.1. Goal

1.1.1. The goal of the document is to provide a specific implementation of the impact contribution that respects all principles, as defined in the Integrated Profit and Loss Assessment Methodology: Core (IAM Core) document.

1.2. Scope

1.2.1. This document provides a methodology (definitions, principles and defining formulas) for a specific implementation of the impact contribution, as per IAM Core.

1.2.2. This implementation is not unique and contains specific choices.

1.3. Normative references

1.3.1. IAM Core is the basic reference for this document.

2. Four Types of Impact

2.1. Marginal and absolute impact

2.1.1. Section 2.3 of IAM Core distinguishes absolute impact from relative impact with regards to two types of reference scenarios: a no alternative reference scenario and a direct alternative reference scenario.

2.1.1.1 Impact that is derived using a no alternative reference scenario in the impact pathway is the absolute impact.

2.1.1.2 Impact derived using an alternative reference scenario in the impact pathway is the marginal impact.

2.2. Direct and indirect impact

2.2.1. In addition, Section 2.3 of IAM Core distinguishes direct impact from indirect impact, depending on the location of the activity that directly creates the impact.

2.2.1.1. Impacts that are created directly by the own operations of the organisation under review are the direct impacts.

2.2.1.2. Impacts that are created directly by other organisations' operations are the indirect impacts.

2.3. Four types of impact

2.3.1. As per IAM Core, two reference scenarios and two focus options for the activity give rise to the following four types of impact (see Figure 1):

Direct absolute impact

Direct marginal impact

Indirect absolute impact

Indirect marginal impact

2.3.2. **Requirement:** each of these four types of impact (i.e. direct absolute, indirect absolute, direct marginal and indirect marginal) must be part of the impact contribution.

		Type of reference scenario	
		Absolute impact	*Marginal impact*
Activity by organisation in scope or not	*Direct impact*	*Direct absolute impact*	*Direct Marginal impact*
	Indirect impact	*Indirect absolute impact*	*Indirect marginal impact*

Figure 1: Four types of impact

3. Defining the Reference Scenarios

3.1. Absolute impact

3.1.1. **Requirement:** the *no-alternative* reference scenario should be defined explicitly.

3.1.2. **Recommended approach:** it is suggested that in the *no-alternative* reference scenario the following criteria apply.

3.1.2.1. The organisation under review is not active.

3.1.2.2. Competing organisations do not take over any production.

3.1.2.3. The goods that the organisation produced, are no longer available in the market.

3.1.2.4. The price point in the market does not change.

3.1.2.5. The following are applicable to indirect impacts:

3.1.2.6. The activity of direct suppliers decreases in proportion to the share they sell to the organisation under review, while the activity of indirect suppliers decreases in proportion to the share of their sales that can be attributed to the organisation under review.

3.1.2.7. The activity of direct corporate clients decreases in proportion to the share of supply that the organisation under review contributes to their total sales, while the activity of indirect corporate clients decreases in proportion to the share of their total sales that can be attributed to the organisation under review.

3.1.2.8. It is assumed that all other factors for suppliers and customers are the same.

3.1.3. The *no-alternative* reference scenario need not be interpreted as completely realistic. Rather, it is meant to capture the impact of the activities of the organisation, irrespective of whether that organisation carries out the activities or if another organisation, such as a competitor, would do so (in exactly the same manner).

3.2. Marginal impact

3.2.1. **Requirement:** the *alternative* reference should be defined explicitly.

3.2.2. The *alternative* reference is characterised by the following properties:

3.2.2.1. The organisation under review is not active.

3.2.2.2. All activities that originally occurred when the organisation under review was active, are still expected to occur. They are however, performed in a different way, as defined by the reference.

3.2.2.3. The alternative reference can be a single representative scenario or a weighted average of possible plausible scenarios.

3.2.3. The *direct alternative* reference is characterised by the following properties:

3.2.3.1. For the organisation's own activities—and those relating to supply from its suppliers, or sales to its clients—the most reasonable alternatives for the activity become immediately applicable.

3.2.3.2. The reference scenario implies that for organisations with direct competitors that offer a very similar product or service, the competition will take over the volume initially produced by the organisation under review.

3.2.4. **Recommended approach:** the direct alternative reference is used as the reference scenario for marginal impact, with the following additional properties:

3.2.4.1. The weighting of multiple scenarios is approximated by assuming that the alternative producers produce in line with the sector average, even when the organisation under review has also contributed to that sector average.

3.2.4.2. It is assumed that the total quantity produced in the market does not change.

3.2.4.3. It is assumed that the price point in the market does not change.

3.3. Properties resulting from marginal impact

The following properties consequences result from the direct alternative reference:

3.3.1. Only differences between an organisation and the sector average are shown in the IP&L.

3.3.1.1. Where two organisations are alternates for each other, the sum of their marginal impacts is zero—i.e. the degree to which one performs better is exactly the degree to which the others perform worse.

3.3.2. In an IP&L Assessment, it can be assumed the marginal impact is zero *if*:

3.3.2.1. The organisation operates in a well-defined, well-functioning and competitive market.

3.3.2.2. Publicly available data about the sector shows that the organisation under assessment does not perform worse than the sector average.

3.3.2.3. There are no reasons to believe that the organisation performs worse than the sector average.

3.3.2.4. There are good arguments for believing that marginal impact is very close to zero.

3.3.3. **Requirement:** if a marginal impact has been assumed to be zero according to 3.3.2, then this should be clearly mentioned.

3.3.4. **Requirement:** if a marginal impact cannot clearly be assessed as zero but is expected to be relatively small compared to the associated absolute impact, the marginal impact can (to an extent) be excluded from the assessment. However, this should be clearly stated.

4. A Pragmatic Formula for Impact Contribution

4.1. Principles for impact contribution

4.1.1. Paragraph 2.4.2 of IAM Core specifies the following five principles for the impact contribution:

4.1.1.1. **Principle of conservation of impact.** The combined impact contribution of all organisations should represent the total impact on society. The impact contribution should not be overcounted or undercounted.

4.1.1.2. **Principle of additivity of impact.** The impact contribution of two independent organisations should represent the sum of the impact contributions of both organisations.

4.1.1.3. **Principle of sensitivity to impact.** The impact contribution of an organisation should increase (or decrease) if any of its impacts increases (or decreases) and the other impacts remain constant.

4.1.1.4. **Principle of sufficient resolution.** The impact contribution should have sufficient resolution to show differences between organisations with differing impacts.

The principle of sufficient resolution states that when two organisations with differing impacts (even if, on an absolute scale, these impacts may be similar), these differences should still be sufficiently clear in the impact contribution.

4.1.1.5. **Principle of co-responsibility.** Impact is part of an organisation's impact contribution if, and only if, that organisation is co-responsible for that impact.

4.1.2. Paragraph 2.4.1 of IAM Core suggests the impact contribution be a linear combination of the four types of impact specified in 2.3.1, above.

4.1.3. Recommended approach: the following implementation principle can guide the linear combination.

4.1.4. Impact equivalence: where impacts of two types can be included, but neither is more significantly important than the other, then they should both be included in the impact contribution with equal weight.

4.1.5. Consequences of impact equivalence are that:

4.1.5.1. Marginal and absolute impact are equally weighted in the impact contribution.

4.1.5.2. Direct and indirect impact are equally weighted in the impact contribution when they can both be defined and are both relevant.

In this context, equally weighted means that, averaged over a representative sample of organisations, direct and indirect impact contribute equally to the impact contribution.

4.2. Specific implementation for direct and indirect impact

4.2.1. An IP&L Assessment considers a wide range of impacts that affect a wide range of stakeholders.

4.2.2. Impacts are internal if the stakeholder affected has freely agreed to the action or transaction leading to the impact, and the organisation causing the impact (insofar as it is not the organisation affected) received financial costs or benefits proportional to the impact on the affected stakeholder.

4.2.3. Impacts that are not internal are external, and are also referred to as externalities.

4.2.4. In reality, impacts are often partly internal and partly external. For practical purposes, impacts are classified as follows:

4.2.4.1. Predominantly internal impacts, or internalities, if the internal component is clearly the largest part.

4.2.4.2. Predominantly external impacts, or externalities, if the external component is clearly the largest part.

4.2.4.3. Where feasible, impacts that have substantial internal and external components should be split into two—a predominantly internal impact and a predominantly external impact.

4.2.5. The principle of co-responsibility means that direct and indirect impacts should not be weighed the same for each impact.

4.2.5.1. It is generally assumed that businesses have full responsibility for impacts that are internal.

4.2.5.2. It is assumed that businesses have primary but not full responsibility for externalities they cause. Furthermore, it is generally assumed that businesses have some degree of value chain responsibility for externalities that are caused primarily by another responsible organisation in the value chain.

4.2.5.3. When a primary responsible organisation cannot be defined businesses are assumed to have a degree of value chain or system responsibility for externalities caused in the value chain or system.

4.2.6. **Recommended approach**: three categories of impacts be defined (See Table 1).

4.2.6.1. Category 1 consists predominantly of internal effects, for which:

- Responsibility resides only with the business that creates them in the first place.
- Examples include salaries paid, dividends paid and investments in fixed assets.
- There is no need to apportion responsibility.
- The organisation whose own operations caused the impacts get all of the impact. Other organisations get none.
- Only direct impact is taken into account in the impact contribution.

4.2.6.2. Category 2 comprises externalities with primary responsibility and value chain responsibility.

- Externalities that occur during the operations of one of the organisations in the value chain form a second category.

Examples include carbon emissions during production and human rights violations, such as forced labour.

These impacts need to be re-attributed. In doing so, it is important that the organisation at whose own operations the impacts occur always gets the largest share. Its value chain partners should also get a share, but the total should of the impact should sum to 100%.

- Impact equivalence suggests that direct and indirect impact are ` weighted in the impact contribution. Practically, this can be done by attributing in two steps:

  In a first step, 50% of the impact should be attributed to the organisation to whose operations this is linked.

  In a second step, the other 50% of the impact should be distributed among all others in the value chain, based on how influential they are. (See Section 4.3 for a suggested approach for this step.)

4.2.6.3. Category 3 comprises effects without primary responsibility.

- For certain impacts at a consumer level, there is no organisation that is primarily responsible.

  Examples include carbon emissions from the car of a consumer, negative health effects of a food product, well-being from having access to electricity and well-being from having access to cash infrastructure.

  While these impacts are clearly relevant for various supply chain actors, they cannot be assigned a primary responsibility as in Category 2. Instead, they are fully re-attributed over the value chain. See Section 4.3 for a suggested approach.

- For these Category 3 impacts, direct impact cannot be defined; only indirect impact contributes to the impact contribution.

Type of impact	Responsibility	Attribution
Predominantly internal effects	Resides only with the business; no need to re-distribute	No re-attribution over value chain
Externalities with primary responsibility and value chain responsibility	Shared among value chain partners. Most responsibility to the organisation where the impact actually occurs	Impact equivalence • 50% to organisation at which the impact initially occurs • 50% re-attributed over value chain
Effects without a primary responsibility	Shared among value chain partners Not possible to identify a specific partner to give primary responsibility to	Fully attributed over value chain

Table 2: Different attribution suggestions for different forms of impact

4.3. Relative influence of value chain partners

4.3.1. As specified in the previous section, the impact for Category 2 and 3 impacts should be (re-)attributed over value chain partners.

4.3.2. The principle of co-responsibility indicates that this should be done in line with the degree to which organisations are responsible for the impact.

4.3.3. **Recommended approach:** a pragmatic implementation links the degree of influence of an organisation in the value chain to value added1 (or added value): a large share of added value in a value chain represents a large degree of influence.

4.3.4. During this implementation, value chain impact takes the role of indirect impact. Full value chain impact is re-distributed across the various organisations (including those that contribute to it in the first place).

During this implementation, value chain impact is multiplied by the share of value added of the organisation under review to the value added by all organisations that contribute to the indirect impact.

4.4. Resulting formulas for impact contribution

4.4.1. **Recommended approach**: The following formulas give the impact contribution of the organisation under review for category I impacts:

$$\begin{aligned}&Impact\ contribution\ (Category\ I\ impacts)\\&=\ Direct\ Absolute\ Impact\\&+Direct\ Marginal\ Impact\end{aligned}$$

4.4.2. **Recommended approach:** The following formulas give the impact contribution of the organisation under review for Category 2 impacts (were AV stands for Added Value):

$$\begin{aligned}&Impact\ contribution\ (Category\ 2\ impacts)\\&=\frac{1}{2}\times Direct\ Absolute\ Impact\\&+\frac{1}{2}\times\frac{AV\ of\ organization}{Total\ AV\ in\ value\ chain}\\&\times Absolute\ Value\ Chain\ Impact\\&+\frac{1}{2}\times Direct\ Marginal\ Impact\\&+\frac{1}{2}\times\frac{AV\ of\ organization}{Total\ AV\ in\ value\ chain}\\&\times Marginal\ Value\ Chain\ Impact\end{aligned}$$

4.4.3. **Recommended approach:** The following formulas give the impact contribution of the organisation under review for Category 3 impacts:

$$\begin{aligned}&Impact\ contribution\ (category\ \mathrm{III}\ impacts)\\&=\frac{AV\ of\ organization}{Total\ AV\ in\ value\ chain}\\&\times(Absolute\ Value\ Chain\ Impact\\&+\ Marginal\ Value\ Chain\ Impact)\end{aligned}$$

[1]"Value added reflects the value generated by producing goods and services, and is measured as the value of output minus the value of intermediate consumption. Value added also represents the income available for the contributions of labour and capital to the production process." OECD (2018), National Accounts of OECD Countries

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