IMPACT PRIVATE EQUITY

THE IMPORTANCE OF PERFORMANCE MEASUREMENT TO SIGNAL LEGITIMACY AND AVOID MISSION DRIFT IN EMERGING FUNDS

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Impact Private Equity – The Importance of Performance Measurement to Signal Legitimacy and Avoid Mission Drift in Emerging Funds

Abstract:

This paper elaborates on the research of performance measurement systems in the private equity field. By conducting a qualitative single-case study of an impact investment firm, this paper investigates the limitedly researched field of what role performance measurement systems play for emerging hybrid organizations, operating in a setting where the financial logic is inherently strong. Through the theoretical lens of institutional theory and structural differentiation, the study indicates that performance measurement has a vital role in gaining legitimacy towards potential investors and reducing the risk of impact washing. Our paper proposes that 1) organizations can make an effort in designing the performance measurement system in a way so that the logic that is traditionally non-dominant in the field becomes more dominant, to avoid the traditionally dominant logic in the field taking over, and 2) using performance-based managerial compensation is an option for hybrid organizations to avoid mission drift, but that it should be based on all relevant logics to the organization.

Keywords:

Performance measurement systems, impact private equity, hybrid organizations, institutional theory, structural differentiation

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1. Introduction

"You have to show results, also on the impact side, not only on the financial side. It is not possible to only rely on storytelling anymore, but the market has matured and there are demands from others, not just those who invest in Article 9. [...] If you don't measure and show, there is a risk of greenwashing." – CEO and fund manager of Impact Invest

Firms operating under two competing institutional logics, commonly defined as "the socially constructed, historical pattern of material practices, assumptions, values, beliefs, and rules by which individuals produce and reproduce their material subsistence, organize time and space, and provide meaning to their social reality" (Ocasio & Thornton, 1999, p. 804), are referred to as hybrid organizations (Besharov & Smith, 2014). Although combining two institutional logics is nothing new, they have started to exist in new sectors, such as the finance industry (Battilana et al., 2012). A challenge for these hybrid organizations is to avoid "mission drift", meaning that one logic is moved away from pursuing financial objectives (Battilana et al., 2012). Multiple studies have been done to study how different institutional logics interact with each other in hybrid organizations. Besharov & Smith (2014) found the amount of conflict between different institutional logics to depend on the degree of compatibility, defined as "the extent to which the instantiations of logics imply consistent and reinforcing organizational actions" (p. 367) and the degree of centrality, defined as "the extent to which more than one logic is core to organizational functioning" (p. 369). Lower compatibility and higher centrality increase the risk of conflict. Furthermore, Battilana & Dorado (2010) found in their study of microfinance organizations that it is important for new types of hybrid organizations to strike a balance between the institutional logics in the organization so that a common organizational identity can be created. If organizations fail with this, subgroups may emerge, increasing the tension between the different logics.

Something that many single case studies about hybrid organizations have in common is that a conflict between financial logic (which also implies a business or commercial logic, but hereby will be referred to as "financial logic") and another type of logic is described (for example: Christiansen & Skærbæk, 1997; Ezzamel et al., 2012; Carlsson-Wall et al., 2016). In the examples listed, however, the hybrid organization operates in an industry in which the financial logic is not found to be traditionally strong. Instead, it appears as if most of the literature done about conflicting institutional logics, where one of the logics is a financial one, have been made about organizations in which a financial logic has been introduced as a complement to an already existing logic. However, there is not as much research about conflicts between institutional logics in organizations that operate in fields in which the financial logic has traditionally had a very dominant position. One exception to this is a study of the Norwegian Government Pension Fund incorporating a human rights logic, on top of the already incorporated financial and governance logics (Kreander & McPhail, 2019). It found that the human rights logic became suppressed in favor of the financial logic in many situations. Thus, it can be of interest to further study how organizations operate to ensure that the financial logic does not dominate the "emerging" logic, as many of these types of organizations may have to fully adhere to the emerging logic to obtain legitimacy (Greenwood et al., 2011). Specifically, the use of performance measurement systems can be of interest to study as these systems can be used to control that managers and employees adhere to all relevant logics rather than just one.

One example of a field in which financial logic has held a very dominant position is the private equity field, as financial measurements have been the main measurements used to measure performance (Snow, 2007). However, there is one emerging investment strategy within private equity that is not solely adhering to a financial logic; impact investing (Peterson, 2012). Impact investing can be defined as "investment made with the intention to generate positive, measurable social and environmental impact alongside a financial return" (Global Impact Investing Network, N.D.). This implies that impact investing is not only guided by the financial institutional logic found in traditional private equity but also an impact logic (Battilana & Dorado, 2010). Over the past decade, the impact investment market has grown rapidly and was estimated at USD 1.164 trillion in assets under management in 2022 (Hand et al., 2022). The strategy has gained worldwide traction as a method of solving development challenges related to the Sustainable Development Goals of the 2030 Agenda for Sustainable Development and has been recognized among companies as a way to discover new business opportunities by opening up to new revenue streams and enhance sustainability, which ultimately generates value for the business (UNDP Belarus, 2019).

Although the impact investment industry is growing rapidly, it does face a number of challenges as an emerging market, in particular, related to impact measurement (Raaphorst & Van Raak, 2020). Contemporary research indicates that the industry lacks standardized frameworks to measure and report impact on an organizational level, compared to economic impact in which generally accepted accounting principles have been established, such as the US GAAP and the IFRS. Although some impact investors seem to link their performance goals to the SDGs, the majority seem to not set specific targets, and struggle to select relevant KPIs.

However, to the knowledge of the authors, few studies have been made investigating the role of performance measurement systems in the emergence of hybrid organizations that are in a setting where the financial logic is inherently strong. Studying performance measurement systems in an emerging impact investing fund could thus add insight into what role performance measurement has in a hybrid setting, as well as in a hybrid setting in which the financial logic has traditionally been strong, compared to a setting in which the financial logic has not traditionally played a large role. Furthermore, this paper could be of interest to those working with setting up performance measurement systems in an impact investing setting, as they may want to ensure that both financial logic and impact logic are taken into account.

The empirical setting for this paper constitutes a single-case study of Impact Invest (a fictitious name), a Swedish impact venture capital firm. Impact Invest is a 20 million euro pre-seed fund based in Sweden, targeting Nordic and Baltic start-ups that generate positive, measurable social and environmental impact, alongside financial return. At this point, Impact Invest has made two investments and has raised 10% of the capital before it closes its first fund.

To study what role the performance measurement systems have and what the ideas behind them are, we have interviewed key individuals involved in Impact Invest. This includes founders, board members and employees. Furthermore, we have studied documents containing information about the fund and its performance measurement systems.

Based on the findings of this paper, we make two propositions in the field of performance measurement systems in hybrid organizations. The first proposition suggests that in order to make sure that multiple institutional logics get considered in a field which traditionally is dominated by financial logic, the organization can make an effort in designing the performance measurement system in a way so that the alternative logic(s) are more dominant. This is based on the finding that Impact Invest, which operates in a private equity field dominated by financial logic, has a phase which excludes financial logic in order to make sure that financial logic does not dominate the emerging impact logic. Making one logic dominant in the performance measurement systems may in other situations lead to mission drift for the organization, but if one logic is already dominant in the field it may prove necessary to avoid mission drift. The second proposition suggests that using performance-based managerial compensation is an option for hybrid organizations to mitigate mission drift, but that it should be based on all relevant logics to the organization, and that it can act as an assurance to stakeholders that all logics are being considered. This is based on the finding that Impact Invest has a performance-based managerial compensation system which is based on both logics. This system was then used to communicate to investors that they are taking both logics seriously.

The rest of this paper is structured as follows: chapter 2 reviews previous literature within the areas of our research, and develops a theoretical framework underpinning this paper. Chapter 3 describes the methodology and research design. Chapter 4 presents the empirical findings, leading into chapter 5 which discusses the main conclusions drawn from the empirical findings, as well as limitations of the study and suggestions for future research.

2. Literature and Theory

This chapter presents the earlier literature that has been done in the areas of our research. The chapter is divided into two sections: Literature Review and Theoretical Framework. Introduced in the first section is a review of the earlier literature on performance measurements systems in hybrid organizations. This is narrowed down to a compilation of performance measurement systems in private equity firms and impact investing firms and concluded with an assessment of identified research gaps. The second section presents relevant theories that will be used as a framework for our discussion.

2.1 Literature Review

2.1.1 Performance Measurement Systems in Hybrid Organizations

"What gets measured gets done" is a popular saying among managers and employees alike (Hartmann et al., 2021, p. 308f). In a performance measurement system, there are sets of metrics and processes used to evaluate and monitor the performance of the organization (Behn, 2003). Behn argues that the true purpose of performance measurements is to improve performance. He explains that there are other purposes of performance measurements as well, such as motivating employees and learning what is working, but that those purposes are just means to accomplish the true purpose; improve performance.

Because hybrid organizations have to take multiple institutional demands into account, they tend to have multidimensional goal structures (Grossi et al., 2017). This means that it is often harder to measure performance compared to an organization that primarily relies on one institutional logic. Hybrid organizations have to provide more performance information as they can not only rely on metrics of financial performance, as measurements regarding the achievement of their other logic(s) will be of importance to their stakeholders. This tension and confusion over what goals to set up can become a headache for boards and managers. Performance measurement systems in hybrid organizations is thus a topic that has attracted attention from scholars recently (for example: Chenhall et al., 2013; Carlsson-Wall et al., 2016), reviewing how performance measurement systems can include several different logics and how the logics interact with each other.

Chenhall et al. (2013) have contributed to the research on performance measurement systems and hybrid organizations by showing that accounting and performance measurements can play a major role in developing compromises in organizations with several evaluative principles. In their single case study of a volunteer organization that focuses on building educational capabilities in poor and undeveloped countries, they find that performance measurement systems can function as compromising accounts if they allow for a productive debate between the logics. By making visible what is important to the organization via performance measurement systems, you can facilitate discussion and create "concurrent visibility" in the organization, meaning that employees in the organization see the importance of all logics. For this to happen, it is important that all attributes that are important to the organization are visible in the accounts and that no evaluative principle comes to dominate the others. This confirms to stakeholders in the organization that their logic is indeed relevant and needed for the organization.

There is research that shows that performance measurement systems can be used to manage multiple logics. For example, Carlsson-Wall et al. (2016) studied a football club which had to consider both sports logic and business logic. It found that managers used different measurements to manage the different logics. Measurements included both their financial result and their league table position, meaning that measurements related to both logics were included. Van Dooren (2017) argues that performance measurements can be used by hybrid organizations to cope with the complexities of dealing with multiple demands. This is explained by the fact that organizations can use their performance measurement system to decouple less important demands, which Van Dooren argues is necessary when an organization deals with multiple demands. Grouleff Nielsen et al. (2019) also find that performance measurement systems can be useful in hybrid organizations. They can have a mediating role if they incentivize employees to focus on both logics. On the other hand, they also find that performance measurement systems can have a disruptive role if they are not adjusted to fit a hybrid organization, for example, if the performance measurement system only includes one logic. They can also have a disruptive role if they increase tensions, although the authors mention that the logics often correlate rather than there being a clear trade-off between the logics. A third role that Grouleff Nielsen et al. argue performance measurements can take on is the role of a symbolizer, enhancing the legitimacy of the organization by informing stakeholders that they are prioritizing several logics. It is worth noting that the three roles that Grouleff Nielsen et al. bring up are not mutually exclusive, performance measurement systems may have multiple roles simultaneously.

Performance information in a performance measurement system can be used to determine monetary compensation for staff with the intention of motivating them, although it is debated among scholars whether this is actually effective or not (Engbers & Perry, 2009). Financial measurements are commonly used to determine employee compensation in certain fields where the financial logic is strong, such as in private equity (Snow, 2007). An example of how private equity funds use performance-based managerial compensation is carried interest, which will be further discussed in section 2.1.2. In fields where the financial logic is less strong, such as public organizations, performance-related pay is less common (Reichard & van Helden, 2016). Based on this, Grossi et al. (2017) suggest that hybrid organizations shall be careful in using performance information as a basis for monetary compensation. Performance-related pay may be less appropriate in certain cultures, as well as the fact that it may prove difficult to know what to measure when there are multiple demands and how to balance them.

2.1.2 Private Equity as a Hybrid Organization

The term p*rivate equity* can broadly be defined as "the investment of equity capital in private companies" (Snow, 2007, p. 2). Distinctive for private equity is that it typically refers to an investment in unlisted companies and implies a time-limited investment horizon, in the sense that the investor has the objective of divesting the investment in the foreseeable future, normally within 3-7 years (Nyman et al. 2012). Regarding the delimitation between private equity and venture capital, Nyman et al. explain that there are no internationally accepted definitions. Oftentimes, private equity and venture capital are used interchangeably. Sometimes, the distinction is made that venture capital is attributed to earlier-stage companies, such as pre-seed and seed-funding, whereas private equity refers to later stages, such as management buyouts and management buy-ins, etc. However, the most common practice in Europe is to make the demarcation so that venture capital is part of the private equity market, whereby venture capital refers to investments that take place in earlier stages, while investments in later stages are referred to as "buy-outs". We have therefore employed the wider definition of private equity as an umbrella term for investments in unlisted companies in all stages, as suggested by Nyman et al. (2012) and most commonly used in

Europe.

Private equity firms raise capital from external sources through a private equity fund and then purchase stakes in companies, hoping to realize a return when they exit the company and return the money to their investors (Snow, 2007). Those who manage the fund get income from fees, referred to as management fees. These are usually around 2%. Typically, private equity firms also implement performance-based managerial compensation structures, allowing for additional compensation to the general partners (Berk & DeMarzo, 2017). This is usually based on a percentage of any profit generated by a fund, referred to as carried interest. Carried interest is usually 20% of the profit. This implies that if a fund raises $300 million, invests it, and then sells it for a value of $500 million, the fund will have made a profit of $200 million and the general partners will be getting carried interest of $40 million. The value of the investments thus serves as an important account for the general partners, as they impact how large their financial compensation will be.

Most private equity firms implement mechanisms for strict governance of the acquired companies, in order to gain oversight of financial and strategic priorities including growth, profitability and strategic initiatives (Kaplan & Strömberg, 2009). Because of these controlling mechanisms and managerial compensation structures in private equity firms, performance measurement systems become vital. Ultimately, measurements are used to evaluate the financial performance and returns of the investment upon exit. Standard measurements used in private equity are often cash-focused, giving center stage to money-in, money-out and money outstanding, while disregarding nuances of other values of an investment (Bachman et al., 2009). To capture the health or overall return of an investment, a commonly used measure is ratios, often known as multiples. These ratios are as mentioned almost always financial, although indicators for early stage venture companies often are non-financial until the company matures (Bassen et al., 2006). Ratios are also commonly used for benchmarking with universe comparisons, for instance prior to the investment to assess performance compared to similar peers (Bachman et al., 2009).

For private equity firms that have to consider both financial and strategic results, such as Corporate Venture Capital (CVC), Bassen et al. (2006) insist that both results are important to measure with key performance indicators and should therefore both be regarded in the performance measurement framework. Such performance measurement frameworks can serve as an important information base for reports to different types of stakeholders, or be used for performance-based compensation. It is important that the selected measuring instruments support all different stakeholder views, as these can be both internal and external, such as investors, corporate senior managers, business units and ventures. Bassen et al. (2006) argue that an example of such a performance measurement system is the balanced scorecard because it has the capability of including both strategic and financial indicators in one integrated framework, which facilitates performance to be analyzed from different management perspectives.

One emerging type of private equity is impact investment, which aims to generate a positive financial return as well as a positive social and environmental impact (Global Impact Investing Network, N.D.). These types of funds are characterized by hybridity, as both a financial logic and an impact logic have to be taken into account. As of current, there are no standardized requirements to call yourself an impact investor, nor any standardized frameworks on impact reporting (Raaphorst & Van Raak, 2020). In reality, social impact is mostly communicated by investors through non-financial and qualitative information, such as sustainability reports or statements about corporate social responsibility. Whereas generally accepted accounting principles, such as the US GAAP and IFRS, are established to measure and report economic impact at an organizational level, quantifying the social and environmental impact on society of impact investments is a more difficult task because corresponding frameworks are lacking. Although the development of social impact metrics is progressing, Raaphorst & Van Raak (2020) argue that impact measurement is still one of the biggest challenges for the industry. In fact, the study shows that not many institutional investors seem to set targets for their impact investments. Although many link their goals to the Sustainable Development Goals (SDGs) of the United Nations (UN), few define specific desired outcomes and struggle to select relevant KPIs because of a lack of standardization.

Chen & Harrison (2020) elaborate on impact investing measurement in practice. They conclude that practitioners seldom use tools that are commonly found in the academic literature, such as Economic Rate of Return (ERR), the theory of change, and regression discontinuity design. Instead, investors rather use appraised frameworks from international organizations, such as the earlier mentioned SDGs by the UN, due to their visual aesthetics and easy accessibility. Chen & Harrison (2020) also argue that the binary view about the trade-off between social or environmental purpose and financial profit is misleading. They mean that it is not an “either-or", but a “both-and". The study implies that two sets of impact measurement practices are used among impact investors who are investing in social entrepreneurs. These practices are transactional (including tracking performance, strategic decision-making and impact reporting) and relational (focused on building long-term strategic relationships with social entrepreneurs, by conducting dialogue). These practices complement each other. In fact, Chen & Harrison (2020) argue that the tensions between purpose and profit do not arise from fundamental differences in the underlying logics, but from only using transactional practices, as it easily foresees important aspects within impact, such as the significance on people. To resolve the tension, investors thus implement relational practices. Concludingly, Chen & Harrison (2020) emphasize that relational practices are important to cultivate long-termism and avoid mission drift in investments since it improves the alignment between asset owners and managers.

There is a limited amount of research on the clash between different institutional logics in impact investing. However, Kreander & McPhail (2019) studied a field which could be considered similar when they looked into the dynamics between different logics in the Norwegian Government Pension Fund. This is not considered to be an impact investing fund, but similarly to impact investing, it does not adhere solely to financial logic. In 2004, a council of ethics was introduced in order to exclude companies that violate human rights. Kreander & McPhail found that there was a human rights logic which became suppressed in favor of the financial logic in many situations. For example, the asset management arm of the fund did not want to exclude assets that the Council of Ethics recommended. This paper thus shows some of the problems that can arise when establishing another logic in a field where the financial logic is already strong, it might be hard to adhere to it fully.

Another challenge concerning many external stakeholders in the industry is the risk of impact washing. Impact washing, which can be defined as “when fund managers or bond issuers overstate or falsely claim an investment’s positive impact on the environment or society” (Cote, 2022), is mentioned to be a major challenge in the market of impact investing (Varada, 2022). One solution to this problem that Varada brings up is “impact-linked carry”, meaning that carried interest is linked to the impact goals. In the Swedish impact venture fund Norrsken, for example, 50% of the impact goals have to be achieved for some carry forward to be paid out. If more than 50% of the impact goals have been achieved, more carry forward gets paid out. With this method, the impact goals serve as an important account for general partners as their compensation will depend on it. However, one limitation of the study by Varanda is that it does not investigate the dynamics and implications of implementing "impact-linked carry" for the organization on a profound level.

2.2 Theoretical Framework

2.2.1 Institutional Theory

A central topic in the study of accounting systems is *institutional theory.* Institutional theory is a framework in organizational studies that seeks to explain how organizations interact with their environments and are shaped by cultural expectations and social norms (Meyer & Rowan, 1977). It emerged as a distinct field in the 1970s with articles from Meyer & Rowan (1977) and Zucker (1977). Meyer & Rowan argued that there are institutionalized rules, defined as "classifications built into society as reciprocated typifications or interpretations" (Meyer & Rowan, 1977, p. 341). These social processes, obligations and actualities can get a "rulelike status in social thought and action" (Meyer & Rowan, 1977, p. 341). Counter to just focusing on how organizations respond to market pressure, institutional theory sought to understand how organizations are influenced by social and cultural forces.

2.2.1.1 Legitimacy

Compared to a few decades ago, most companies today with a poor social and environmental performance record may find it increasingly difficult to obtain the necessary resources and support to continue operations within a community that values a clean environment (Deegan, 2009). A key concept of institutional theory is legitimacy, which assumes that society allows the organization to continue operations to the extent that they meet society's expectations. Organizations thus need to attain legitimacy to be able to compete in the business environment and to obtain societal support (Suchman, 1995). There are many different definitions of legitimacy that have been used in research on the topic. Perhaps the most common one, according to Bundy et al. (2017), is the one from Suchman: "Legitimacy is a generalized perception or assumption that the actors of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" (Suchman, 1995, p. 574). The background behind why legitimacy is something that organizations need to consider is that Meyer & Rowan (1977) found that organizational success does not only depend on productive efficiency. Instead, they propose that organizations that adopt the same structures and practices as their peers are more likely to gain legitimacy from stakeholders and increase their resources. Legitimacy should thus be a foremost priority for organizations, as few stakeholders will want to engage with organizations without legitimacy (Bundy et al., 2017). Additionally, organizations regarded as legitimate can avoid being questioned by society and will thus have more freedom to pursue their activities. It is hence argued that organizational survival is enhanced by legitimacy. Evidence to support this includes Baum & Oliver's (1991) of child care services in Toronto, Canada. It found that organizations with institutional linkages had an increased survival rate, suggesting that institutional relations significantly increase the likelihood of organizational survival.

2.2.1.2 Institutional Logics

Another important concept in institutional theory is the concept of *institutional logics.* It has been studied how institutional logics impact organizational actors' beliefs and actions, as well as how the logics emerge in organizations (e.g. Ocasio & Thornton, 1999). Institutional logics can be defined as "the socially constructed, historical pattern of material practices, assumptions, values, beliefs, and rules by which individuals produce and reproduce their material subsistence, organize time and space, and provide meaning to their social reality" (Ocasio & Thornton, 1999, p. 804). These assumptions, values, beliefs and rules can inform decision-makers in organizations. When the dominant logic shifts, the political dynamics in an organization can change dramatically (Ocasio & Thornton, 1999).

Many organizations rely primarily on one institutional logic, but there are also organizations that rely on two or more conflicting institutional logics (Besharov & Smith, 2014). These organizations are often referred to as hybrid organizations. A challenge for these hybrid organizations is to avoid "mission drift", meaning that one logic is moved away from in order to pursue financial objectives (Battilana et al., 2012). Multiple studies have been done to study how different institutional logics interact with each other in hybrid organizations. Besharov & Smith (2014) found the amount of conflict between different institutional logics to depend on how the degree of compatibility, defined as "the extent to which the instantiations of logics imply consistent and reinforcing organizational actions" (p. 367) and the degree of centrality, defined as "the extent to which more than one logic is core to organizational functioning" (p. 369). Lower compatibility and higher centrality increase the risk of conflict. Furthermore, Carlsson-Wall et al. (2016) found in their study of a hybrid football organization that the relationship between "business logic" and "sports logic" could be cooperative or competitive depending on the situation. When there were conflicts between the two logics, situation-specific compromises were made. Battilana & Dorado (2010) found in their study of microfinance organizations that it is important for new types of hybrid organizations to strike a balance between the institutional logics in the organization so that a common organizational identity can be created. If organizations fail with this, subgroups may emerge, increasing the tension between the different logics. Battilana et al. (2012) argue that it could be easier to create a common organizational identity by hiring candidates without work experience, as it means that they are not already trained to adhere to one logic only. These studies about organizations with conflicting institutional logics tell us that different types of organizations are prone to different amounts of conflict, but whether there is conflict or not can depend on the situation at hand. Furthermore, they show that the organization can make active decisions to create a common organizational identity with the purpose of lowering the amount of conflict.

2.2.2 Structural Differentiation

As a way of handling conflict between different institutional logics in hybrid organizations, firms may apply *structural differentiation*. The concept of structural differentiation is derived from a study of American employment agencies (Blau, 1970). It implies that as organizations grow larger, there comes a need for increasing subdivisions with different responsibilities to ensure more efficient coordination. Blau proposes that this differentiation makes the organization more complex, which creates problems of coordination and communication. This causes the administrative costs to increase. In more recent studies, structural differentiation has been found to be used as a strategy by hybrid organizations (for example: Bouten & Hoozée, 2022 and Carlsson-Wall et al., 2016), showing that structural differentiation is not just a strategy that is used when an organization grows. It could also be a key strategy used by hybrid organizations no matter the size. In a study of a football club which had to take two institutional logics into account, the tensions were relieved with structural differentiation (Carlsson-Wall et al., 2016). By having one compartment that had to respond to a "business" logic and one compartment that had to respond to a "sports" logic, the organization made it so that the employees were less likely to have to consider more than one logic in their day-to-day operation. Here we can see that structural differentiation was used as a strategy to lower conflict between the institutional logics by avoiding making organizational actors have to take both logics into account when making decisions. Another example of structural differentiation can be seen in the healthcare system of Alberta, Canada. In their study, Hinings & Reay (2009) highlighted how tensions between the medical professionalism logic and the business-like healthcare logic were managed. They found that one of the mechanisms which was used to balance the two logics was to separate medical decisions from other decisions made by the Regional Health Authorities. This ensured that physicians remained the authorities in regard to medical decisions without influence from business-like healthcare logic.

Examples of types of organizations that use structural differentiation as a strategy include hospitals and universities (Greenwood et al., 2011). Greenwood et al. argue that some of these types of organizations are expected to be structurally differentiated in order to obtain legitimacy. Being structurally differentiated can be a means to balance different institutional logics. On the other hand, one challenge with structural differentiation is that the different institutional logics will eventually need to be integrated (Carlsson-Wall et al., 2016). For example, the actions of one unit could impact another unit. They will also be compared when considering how to allocate resources between the units. Another challenge is that structural differentiation can cause conflict between the different compartments (Battilana & Dorado, 2010). Structural differentiation can be contrasted with a blended structure, which seeks to combine different logics (Greenwood et al., 2011).

3. Method

The following chapter outlines the research methodology of this study. Introduced first, in section 3.1, is a motivation for the choice of a qualitative single case and potential limitations of conducting such a study. Further, a description of the study and the data collection process is provided in section 3.2. The chapter is concluded with an elaboration on the analysis of the data in section 3.3.

3.1 Research Design

3.1.1 Qualitative Research in a Single Case Study Setting

This paper aims to investigate the role of performance measurement systems in emerging impact investment funds, operating in a setting where the financial logic is inherently strong, while simultaneously inquiring into the implications of competing institutional logics on the design of such systems. This study takes on the perspective of investigating the design phase of the performance measurement system, rather than the use phase. This is because as an emerging fund, data was rather limited to this phase.

The study is a single case study of an impact investment firm in Sweden. Our aim is to get a deeper understanding of that particular firm's use of performance measurement systems, thus it is appropriate to use a qualitative method (Strang, 2015). The rationale for this is based on the fact that the research question is of explanatory character, implying that it aims to investigate "How?" and "Why?" impact investors assess and evaluate portfolio impact and financial return. We want to know not only how the performance measurement systems are designed in the organization, but also the intentions, feelings and thoughts about the performance measurement system. Because these questions require a deeper understanding of organizational and managerial structures and processes, rather than mere frequencies or incidences, a qualitative research strategy is usually preferred, as it "retains the holistic and meaningful characteristics of real-life events". (Yin, 1994, p. 2).

3.1.2 Possible Objections and Limitations Towards Research Design

Yin (1994) points out that the case study strategy has not always been considered an adequate scientific method. The main criticism regards the adequacy of making scientific generalizations from a single case only, as it may be too situational-specific. However, Yin (1994) argues that the case study should not be regarded as a sample of a population appropriate for statistical generalization, but rather is appropriate for making analytical generalizations such as expanding and generalizing theoretical propositions. Another common critique of case studies pointed out by Flyvbjerg (2006) is that they contain a verification bias or give the study too much room for the researcher's own interpretations.

3.2 Data Collection

Interviews have been used as the primary data source for our study. Our first interviewee was contacted via email conversation and done via an online meeting in Microsoft Teams. Our main way of getting in contact with the new interviewees was to ask those whom we have already interviewed who they think we should interview next, referred to as "snowball sampling", taking advantage of social networks to find interviewees (Atkinson & Flint, 2001). All interviews were scheduled via email and done via the digital meeting platforms in Microsoft Teams and Google Meet. The fund manager and the impact manager were interviewed multiple times. The reasoning for this was that Impact Invest is a small firm with few employees. Those two individuals possessed a lot of knowledge about their performance measurement systems that other people, such as the board members, did not have. This made it relevant to interview them more than once to be able to gather as much information as possible.

Our first interview with the CEO & fund manager, hereby referred to as the "fund manager" was an informal conversational interview (Patton, 2002, p. 349) as the purpose was mainly to introduce ourselves and to tell her about what we want to do, as well as getting more information about the firm and her experiences. The other interviews were all semi-structured, which is a common method for collective qualitative data in accounting research (Lee & Humphrey, 2006). This allows the interviewee to ask spontaneous questions (Coughlan, 2009), as well as there being questions prepared in advance of the interviews. The questions were not the same for all interviewees, they depended on what position the interviewee had in the firm. Both researchers were present at all interviews, asking questions and taking notes. The interviews were also recorded to make the collection of findings easier. The interviewers were aware of the fact that it is important to be active listeners and communicate this through non-verbal and verbal cues, for example nodding and humming (Coughlan, 2009). Below is a summary of the interviews that were conducted.

Interview	**Role**	**Location**	**Duration**	**Date**

number			(minutes)	
1	Fund manager	Microsoft Teams, digitally	34	2023-02-24
2	Fund manager	Microsoft Teams, digitally	63	2023-03-06
3	Chairperson of the board	Microsoft Teams, digitally	55	2023-03-16
4	Impact manager	Microsoft Teams, digitally	66	2023-03-16
5	Board member	Microsoft Teams, digitally	58	2023-03-28
6	Fund manager	Microsoft Teams, digitally	75	2023-04-19
7	Impact manager	Google Meet, digitally	51	2023-04-28
8	Fund manager	Google Meet, digitally	23	2023-05-09

To complement our interviews, we also included three documents as data for our study. In qualitative research, document analysis is a procedure that can be used for reviewing documents (Bowen, 2009). The four documents we analyzed were created by the team at Impact Invest without intervention from us. The first document analyzed was a presentation that is used when pitching to investors. This serves as a good complement to the interviews as it shows us how the fund presents itself to potential investors. The second document analyzed was a presentation that presents their strategy and how the fund will create impact. It also provides basic information about how the companies that they invest in are chosen. The third document analyzed was a preliminary investment agreement. This is to be signed by investors. The document provides us with information about topics such as capital structure, fees and the distribution of profit.

Below is a summary of the documents that were studied. In section 4, the documents will be referred to as “Document 1”, “Document 2”, and “Document 3”.

Document number	Title	Date sent to us	Number of pages
1	Investor presentation	2023-03-06	21
2	Impact strategy	2023-04-19	5
3	Investment agreement	2023-04-19	39

3.3 Data Analysis

After the interviews, summaries were written based on the notes taken. Additionally, we listened to the interviews again and transcribed the most relevant parts that we had an interest in writing about in section 4. The authors discussed the most relevant findings and connected them to relevant theories that are brought up in this paper. As the study takes on an abductive approach, the theoretical framework for analyzing data has been evolving dynamically and simultaneously with the empirical process. The main reasoning for this approach is based on Ahrens and Chapman's (2006) argument that qualitative studies require continuous reflection on the data to be able to identify relevant theoretic frameworks that serve to explain the empirics in relation to the research question. This implies that the development of the theory has been dependent on the data received.

4. Empirical Findings

This chapter presents the empirical findings drawn from interviews and documents, built upon the theoretical framework that was developed in section 2.2. Provided first in section 4.1. is a brief background of the case firm, followed by a passage about the importance of legitimacy to stakeholders, in section 4.2. Section 4.3. presents the process of screening and due diligence, and section 4.4. elaborates on the role of KPIs to manage hybridity in the organization.

4.1 The Case Firm

Impact Invest is a 20 million euro pre-seed fund based in Sweden, targeting Nordic and Baltic start-ups that generate positive, measurable social and environmental impact, alongside financial return. This is achieved by contributing to some of the SDGs defined by the UN in the areas of food, nature, and quality of life. The fund was set up by an incubator and investor connected to a Swedish university (the "Supporting Partner"). In Impact Invest, the Supporting Partner operates as a limited partner with a 20% stake in the management company in the current fund. However, Impact Invest operates independently from the connected university.

The team of Impact Invest consists of a fund manager, one impact manager, one investment manager, and two venture partners. In Figure 1, the company management and their respective ownership have been illustrated. The fund manager of Impact Invest was hired because of her experience raising funds. The chairperson of the board explains "She's great at setting up funds, knowing the inner workings of it, and talking to investors" (Interview 3). Additionally, she has had 20-30 years working in the private equity field, with experience sitting on 30-50 boards. The chairperson of the board noted that she did not have much experience working with sustainability, but that she was passionate about topics regarding sustainability. Based on her background, however, one could conclude that she had more experience working along the lines of a financial logic rather than an impact logic. The financial logic implies an ambition to achieve financial success through high returns on their holdings. The chairperson of the board notes that since it is a smaller fund, they can not hire that many people. Thus, they made sure to hire one person that was knowledgeable in private equity and one person that was knowledgeable about sustainability and impact. This person's role was to be the impact manager. The impact manager has experience being a co-founder of a nonprofit working with innovations against poverty and has worked in that organization for about ten years doing impact assessments. Thus, she is more used to impact logic rather than financial logic. The impact manager defines impact as "a positive change for the planet or people, that we can measure as well and is lasting" (Interview 4). Hence, impact logic will be defined as the willingness to achieve just that. These two individuals (impact manager and fund manager) can be seen as representing two different logics and are the ones ultimately responsible for the investments made.

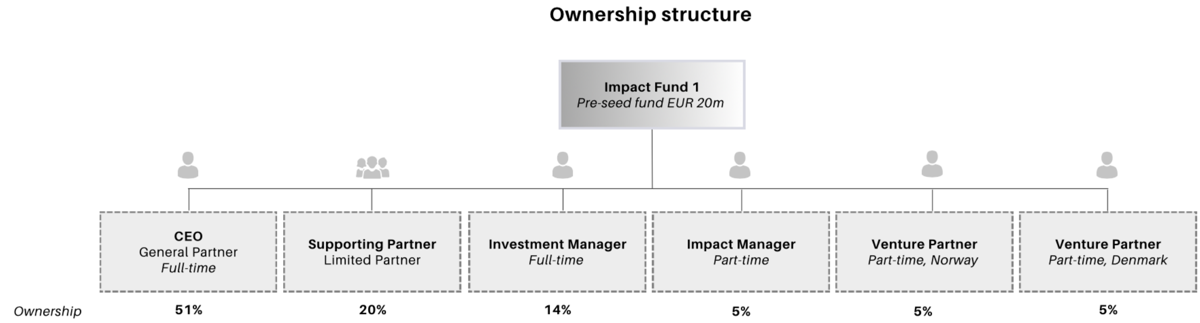

Figure 1. Ownership structure

The impact logic is explicitly integrated into Impact Invest's investment strategy, which aims to be aligned with 1) the 6 UN Principles for Responsible Investments (PRI), for incorporating ESG issues into the investment practices, 2) the UN Global Compact 10 Guiding Principles on Business and Human Rights, Labour, Environment and Anti-Corruption, and 3) the EU Taxonomy Regulation, to integrate sustainability risks and impact into the process (Document 2). The EU Taxonomy is a classification system for environmentally sustainable economic activities and is integrated into the European Union's Sustainable Finance Disclosure Regulation (SFDR). Although the fund is not yet registered, it is aiming to be registered as an Article 9 fund, which is considered the "dark green" label within the SFDR, as it is most tightly connected to the EU Taxonomy (Deloitte, 2021). Being an Article 9 fund implies having to adhere to the SFDR by committing to having sustainable investment objectives, and monitoring and publishing impact indicators in order to maintain the label (Morningstar, 2023). In order to implement these principles in practicality, Impact Invest integrates the focus on impact throughout the full investment process.

4.2 The Importance of Legitimacy for Fundraising

As of this point in time, 10% of the money has been raised for the first fund, implying that the fund is not closed but in an emerging phase. The capital invested will primarily come from institutional investors, as well as high-net-worth individuals and family offices. The fund manager mentions having a large network in the Nordics from her professional experience as well as from her time as an MBA student at a top-tier Nordic business school, in which these investors can be found. However, in Interview 8, the fund manager expresses the difficulty of raising money in the current challenging macroeconomic environment, which is the reason why fundraising is still an ongoing process. Although some investors reject the investment opportunity due to the current macroeconomic situation, or because they consider the investment to be too risky, the fund manager explains in Interview 8 that investors are attracted to Impact Invest because of its impact focus and because of the fund manager's solid experience in the private equity field.

Although the frameworks that Impact Invest has integrated into their investment strategy are voluntary to adopt, we see that this is something that they communicate to prospective investors as a means to increase transparency and signal legitimacy to these external stakeholders who value impact (Deegan, 2009). In their investor pitch (Document 1), we can see that there are two pages dedicated to explaining which SDGs they are working with and why they are important. Additionally, they present the firm they have invested in by explaining how it creates impact. This signals to external stakeholders who care about impact that Impact Invest is serious about the issue. These stakeholders and their respective degree of influence over, and interest in, Impact Invest have been illustrated in Figure 2. This is because legitimacy can increase resources, in this case, financial means, and thus be beneficial for organizational success (Meyer & Rowan, 1977). One of the board members of the Supporting Partner explains in Interview 5 that they are looking for investors who truly care about making an impact, not the types that just want quick profit. He further explains that the potential investors that Impact Invest is pitching to tend to be highly critical, asking tough questions to make sure that the fund would really create an impact. Being able to verify the impact that Impact Invest creates is thus important to be able to compete in the business environment, showing investors that they are trustworthy and competent (Suchman, 1995). They do this not only by talking to potential investors about their want to make an impact but also by communicating that impact is part of their performance measurement system (Document 1). Whether carried interest is paid out depends on whether they achieved the impact goals or not, which will be further discussed in section 4.4.2.

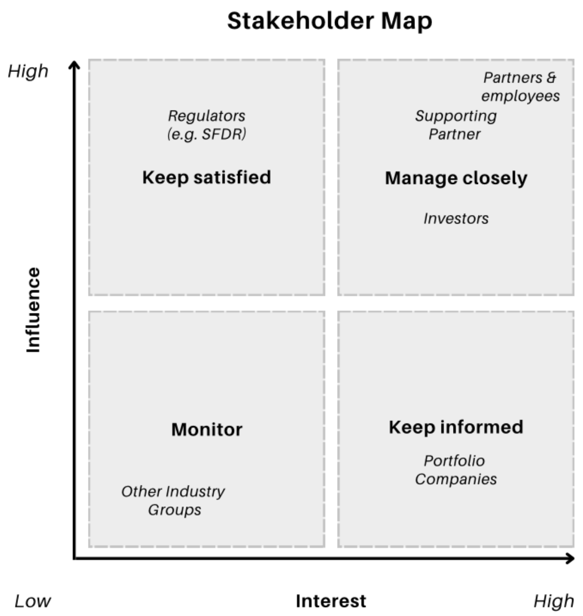

Figure 2. Stakeholder Map

The fund manager elaborates on the importance of legitimacy for fundraising and explains that the institutional investors presuppose that they are an Article 9 fund and that it is a prerequisite in order for them to invest, implying that few investors want to participate without legitimacy (Bundy et al., 2017). "To get money from these institutional investors, you have to be an impact company, however, if you are an Article 8 or Article 9 fund matters less" (Interview 6). Additionally, when talking to the board member (Interview 5), it becomes apparent that obtaining legitimacy is not just important for commercial reasons. He mentions that it would be a big accomplishment for the Supporting Partner to get recognition for starting a successful fund with a sustainability focus. Hence, it appears as if there are both financial and non-financial reasons why it is important for Impact Invest to obtain legitimacy from external stakeholders.

4.3 Managing Hybridity Through Structural Differentiation in The Investment Process

At this point in time, Impact Invest has invested in two companies. When Impact Invest looks for investments in its fund portfolio, they undergo a predetermined investment process. The entire investment process is summarized visually in Figure 3, and is initiated by a screening process, followed by a due diligence process. During these initial stages of the investment process, there is a distinct separation between the impact logic and the financial logic, which will be further described in sections 4.3.1-4.3.2. This separation is enhanced by the specific roles that the fund manager and the impact manager have, as the former is exclusively responsible for the financial logic and the latter is mainly responsible for the impact logic. As explained in 2.2.2., this separation can be referred to as structural differentiation (Blau, 1970; Carlsson-Wall et al., 2016; Bouten & Hoozée, 2022). The implications of this structure are further analyzed in section 4.3.3.

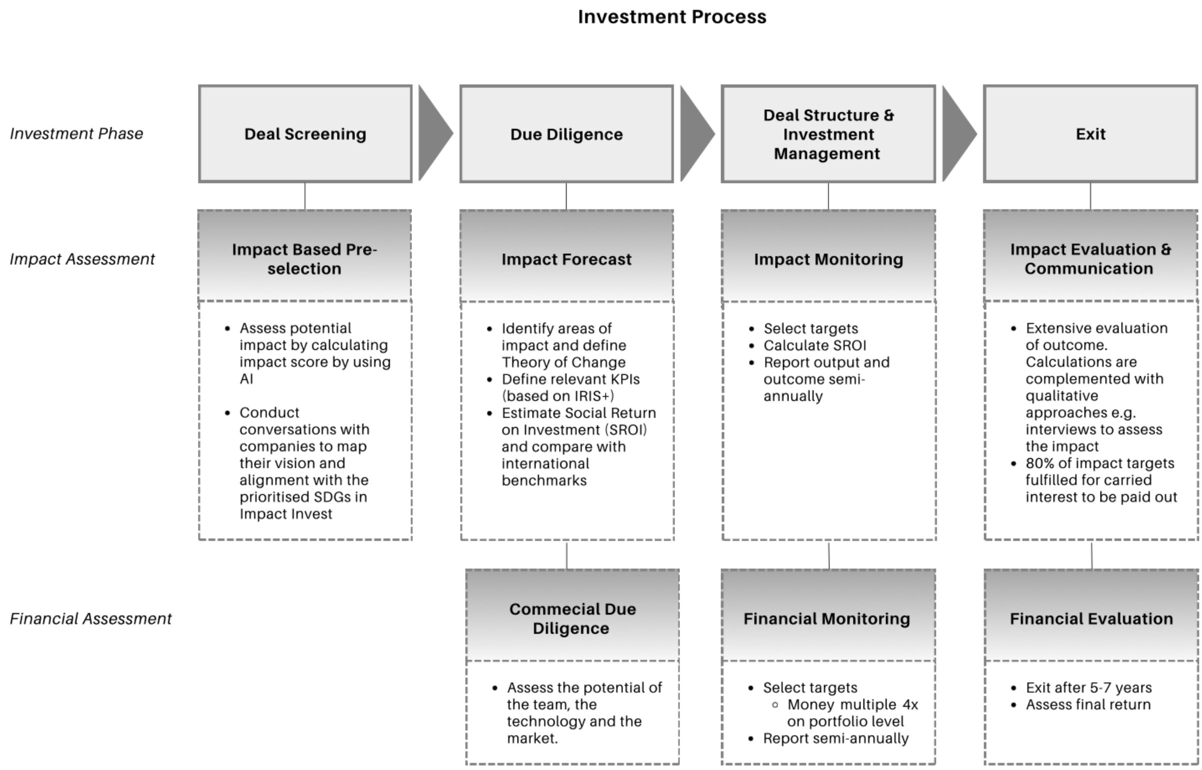

Figure 3. Investment Process

4.3.1 Impact Screening

The investment process is initiated by screening potential investments, which is exclusively influenced by the impact logic. The potential for financial return is thus not taken into account at this stage. Instead, only the impact logic is considered. The only thing that is taken into consideration by the impact manager is the potential for impact, defined by the impact manager as "companies that can bring a change, a positive change for the planet or people, and a change that is positive but we can measure as well and is lasting" (Interview 4).

In order to deliver impact results that align with the investment strategy described in 4.1, Impact Invest has chosen to focus on six of the 17 SDGs by the UN when looking for investments: Zero Hunger (goal number 2), Good Health and Well-being (goal number 3), Clean Water and Sanitation (goal number 6), Decent Work and Economic Growth (goal number 8), Responsible Consumption and Production (goal number 12) and Life on Land (goal number 15). According to the chairperson of the board, a lot of work went into choosing these goals in particular. She explains that these goals were chosen because they thought that companies working towards these goals needed more resources and that there are a lot of potential innovations that can help solve these problems.

The first step of the deal screening process is finding companies for the portfolio that score highly on environmental and social factors. This is done by the impact manager. First, the impact manager talks with the companies interested in an investment to see whether there is a match between Impact Invest and the company, “I interview companies to see if we’re aligned, for example, I ask them about the SDGs, what it is the vision they have, what are the risks their companies could pose to the environment or the society and soon. [...] Also, I explain our impact process to the companies because we are not a normal investment fund” (Interview 4). She further explains that it is important to weed out the companies that are not aligned with Impact Invest, for example, those with little potential for impact or those that can be harmful to the environment or society. The impact manager assesses which SDGs she thinks the company can contribute with a positive change to and the solutions they offer that can lead to potential behavioral changes in society for this specific SDG. As the fund focuses on early-stage companies, this can often be equivalent to ideas from social and environmental entrepreneurs that have just concluded a customer agreement for their product.

However, the impact manager mentions that it can be time-consuming to evaluate companies manually. Impact Invest has thus implemented an AI-based digital software tool to assess the impact of their investments. The rights to the system were purchased from an external developer, but the tool is currently being customized internally by the impact manager to fit the needs of the organization. ”We put in a lot of effort in evaluating the companies and the success is really, really high, but time-consuming. So in this case, we wanted to optimize” (Interview 4). With the use of the digital tool, a company that is interested in getting an investment from Impact Invest can go to Impact Invest’s website and fill in the information, which the digital tool will calculate their impact score. The digital tool does this by aggregating social, environmental and economic impact generated by businesses by connecting these indicators to SDGs and ESG indicators by the use of algorithms. This impact score helps determine whether the company will pass the screening process or not. The digital tool brings value to Impact Invest, as it calculates a score which includes several different factors, as well as saving time for the impact manager. However, the impact manager mentions that she takes a look at the data put in by the company seeking an investment to verify that it appears reasonable.

4.3.2 Impact & Commercial Due Diligence

The second stage of the investment process is the due diligence, which is divided into two parts. The first part is only influenced by the impact logic, whereas the second part is influenced by the financial logic. However, this is the stage where both logics ultimately become more influential and integrated, as it is the overall picture generated from both the financial forecasting and the commercial due diligence that matter for the investment decision.

4.3.2.1 Impact Due Diligence

When conducting impact due diligence, Impact Invest assesses the potential impact. First, the impact manager will conduct workshops with the companies, where they collaboratively define a Theory of Change (that is define an impact hypothesis based on the company's vision and activities) and elaborate on the monitoring framework by starting to select impact KPIs and possible targets. This process will be further assisted by using the digital tool. For each company, the tool can help in identifying its unique areas of impact and define relevant KPIs for each of them. The digital tool is based on IRIS+, which is a generally accepted system developed by the Global Impact Investing Network (GIIN) for measuring, managing, and optimizing impact. IRIS+ offers a catalog of metrics based on a theme or SDG (GIIN, 2023). From this point, they can calculate an impact forecast of the Social Return on Investment (SROI), based on the selected KPIs and respective targets, and assess the direct contribution to the selected SDGs. The impact manager describes the SROI metric as "very useful" (Interview 4), as it is a means of translating e.g. units sold into impact, in terms of for instance quality of life or reduction in CO2 emissions. The SROI forecast is then compared to international benchmarks within the same industry or for similar projects, in order to assess the investment's relative potential impact and assure that the KPI targets are not too low. The impact manager believes that the digital tool is a valuable asset to Impact Invest because it allows comparisons of companies from different sectors. "That's a way also for us to be able to compare companies from different sectors. Because how do you compare tons of CO2 avoided with, I don't know, people using a health app? It's difficult to compare but if you can estimate a social return on investment for both companies then that is a monetized number, a value, that we can compare and then select the company that has more potential." (Interview 4).

4.3.2.2 Commercial Due Diligence

The other part of the due diligence concerns more commercial aspects of the prospectus investment and is entirely conducted by the fund manager. Because the companies that Impact Invest seeks are in an early stage or growth stage, financial historicals are often not available and other factors have to be evaluated instead. However, if the management of the company can provide financial estimations of e.g. sales, these can be used as a base for financial forecasts. In that case, the fund manager may conduct a discounted cash flow analysis, or compare multiple ratios with public peers or precedent transactions, in order to estimate the enterprise value of the company. For instance, for software as a service (SaaS) companies, monthly recurring revenue is calculated and translated into multiple ratios on a yearly basis. Additionally, as a general guideline, Impact Invest wants to see the potential of the investment returning 6–10 the money invested (money multiple of 6-10x) in order to proceed with the investment. In fact, Impact Invest has higher requirements on the estimated money multiple during the due diligence process than during the evaluation, to mitigate the risk of underperforming the target, which has been set to 4 times the money invested. However, because the management's forecasts are based on guesses and predictions, they are uncertain. It is therefore more valuable for Impact Invest to conduct a qualitative valuation by assessing the potential of other factors, which requires dialogue and individual judgment. These factors are:

1) The team composition and individual competencies. The fund manager looks at the team members' previous experience within the industry, the degree of competence, and whether or not the team members complement each other in terms of function and capabilities.

2) The product or technology, for instance, if there is any protection in terms of a patent for instance, and whether it solves any social or environmental problem or not. What Impact Invest ultimately seeks are companies in which the impact is embedded within the business idea, that is innovations or technology that contribute to solving global challenges connected to the selected SDGs by conducting sales. This can for instance be a company that sells a

product that reduces food waste or a company that produces solar panels – the more they sell, the more impact they generate.

3) The market potential and whether the company has already established relationships with customers or signed customer agreements.

4.3.3 Structural Differentiation to Mitigate Mission Drift and Obtain Legitimacy

As mentioned, the distinct separation between the impact logic and financial logic in the screening and due diligence process, enhanced by the specific roles of the impact manager and fund manager respectively, implying that Impact Invest applies structural differentiation (Blau, 1970; Carlsson-Wall et al., 2016; Bouten & Hoozée, 2022).

One reason why Impact Invest has decided to structure it this way appears to be to obtain legitimacy. As one of the board members explained in Interview 5, many of the potential investors they are talking to have high requirements regarding the impact. By having the impact logic to be independent of the financial logic in the screening and due diligence phases, Impact Invest ensures that all companies they invest in will have passed the impact requirements. In Interview 8, the fund manager explains how they use their screenings and due diligence processes for fundraising by presenting this work as a record, or implication of, impact performance, in order to attract investors (Deegan, 2009; Suchman, 1995).

A further explanation for this structure is to avoid "mission drift" (Battilana et al., 2012). As noted, Impact Invest conducts the due diligence in two parts, with each part representing one logic. An alternative way could have been to have a blended structure where the fund manager and the impact manager conduct the due diligence together and determine which companies they want to take to the next steps, based on both financial logic and impact logic. Instead, the fund manager and the impact manager each conduct their own due diligence based on the logic that each understands the best. Constructing the organizations in this way is a means of balancing the impact logic and the financial logic, as well as lowering the conflict between the two, because the managers do not have to take both logics into account when making decisions (Greenwood et al., 2011). However, for a company that seeks an investment by Impact Invest, it has to "pass" both of the due diligence processes. If a company only passes one of the two, Impact Invest will not invest in it. Here, we can see that one of the challenges of using structural differentiation addressed by Carlsson-Wall et al. (2016), which is that coordination and integration of the logics eventually will be required through communication, has been resolved and that the logics are equally important when they are integrated. The impact manager explains in Interview 4 that if it is not taken seriously, people involved might prioritize high financial returns over impact, causing it to not be real impact investing. She mentions that a negative aspect of impact investing as a concept she can see is the potential for impact washing, that funds pretend to care about impact while really just caring about high financial return. If that occurs, there is a risk of consequently affecting the legitimacy negatively as well. However, she does not think that is likely to occur at Impact Invest since they have a screening process as well as a due diligence process which is not influenced by the financial side of impact investing.

4.4 KPIs to Manage Hybridity and Obtain Legitimacy

4.4.1 Monitoring and Reporting as Part of The Investment Agreement

When Impact Invest decides to proceed with an investment after the due diligence process, the company and Impact Invest collaboratively establish the KPIs and the KPI targets and include these, as well as requirements on reporting, into the investor agreement. Companies will report on KPIs, ESG risks and financial valuations semi-annually. The impact manager mentions that the output the company generates from the implemented activities and the changes that the output can provide is easy to measure on a short-term basis, but that impact is more complicated and may still need to be forecasted at this point in time. “Impact will take a lot of time to measure, especially when we are talking about earlier-stage companies.” (Interview 7). To conclude the reporting from the companies, Impact Invest will produce impact reports and interactive maps on an annual basis.

As addressed in section 4.2, potential investors value that Impact Invest is aiming at being an Article 9 fund. However, as the impact investment industry grows, the fund manager stresses the importance of screening, measuring, and reporting impact, even if the fund was not to be registered as an Article 9 fund. "You have to show results, also on the impact side. It is not possible to only rely on storytelling anymore, but the market has matured and there are demands from others, not just those who invest in Article 9. [...] If you don’t measure and show, there is a risk of greenwashing” (Interview 6). Hence, the role of performance measurement and informing potential investors about this process is crucial in order to create legitimacy (Deegan, 2009). The chairperson of the board also argues for the importance of performance measurement in impact investing and how it distinguishes impact investing from other sustainable investments, "What is distinctive about impact investing is that you can measure impact. You have a KPI, you have something to measure carbon dioxide, you can precisely measure the impact it has" (Interview 3). This is different to other sustainable investors which may simply work with negative screening, such as choosing to refrain from companies that operate in the tobacco or porn industry.

4.4.2 Carried Interest to Reconcile Institutional Logics

Similar to how traditional private equity firms generate profits, Impact Invest levies a management fee of 2% of assets under management and lets the employees have a share of the profit through carried interest, which is equal to 20% of the investment return at exit (Document 3). The carried interest is paid out to all owners of Impact Invest. However, there are certain limitations for carried interest being paid out. First, there is a hurdle rate of 8%, meaning that for the carried interest to be paid out, the investors first need to get repaid with a return of 8%. Secondly, carried interest is dependent on the employees' commitment. The fund manager is considered a key person, implying that she is obligated to work within the fund for 10–12 years. Although not fully decided yet, other employees may leave after 4 years for instance but still receive carried interest (Interview 7). Thirdly, as an Article 9 fund, carried interest has to be connected to the impact goals. In the case of Impact Invest, 80% of the expected SROI on an aggregated portfolio level, based on selected impact targets, has to be achieved for the full carried interest to be paid out. Decided between investors and Impact Invest, there may be lower hurdle rates in order for some of the carried interest to be paid out. However, if the full carried interest is not paid out, the money will stay in the fund, or if agreed upon between investors and Impact Invest, be donated to other projects or other similar activities. By linking carried interest to impact goals, the organization is implementing a management control mechanism where profit in the financial logic is positively correlated with profit in the impact logic. Because the logics become more compatible by integrating them through reinforcing organizational actions, the amount of conflict is lowered and consequently the potential problem with "mission drift" in hybrid organizations is mitigated, as explained in 2.2.1.2 (Besharov & Smith, 2014; Battilana et al., 2012). This way, investors are assured that Impact Invest takes appropriate actions to pursue both desired logics.

5. Discussion

5.1 Comparing Impact Investing to Traditional Private Equity

In order to examine the identified research gaps within the academia of performance measurement systems and impact investing, this paper employs a single case study of an impact investing firm (Impact Invest) to assess the structure, practices, and role of performance measurement systems in emerging funds. As described in section 4.1, Impact Invest obtains capital from investors and acquires stakes in existing firms. The fund generates revenue by levying a management fee of 2%, as well as paying out a percentage of the profit generated by the investments to its owners (carried interest). This way of operating is very much in line with how regular private equity funds operate (Berk & DeMarzo, 2017; Kaplan & Strömberg, 2009; Snow, 2007). However, unlike many private funds, Impact Invest does not only consider financial logic. As an impact investment fund, they are also concerned with making a social and environmental impact. Similar to what Chen & Harrison (2020) and Raaphorst & Van Raak (2020) found in their studies of impact investment funds, Impact Invest links impact goals with SDGs. The fact that Impact Invest has to consider financial logic, as well as impact logic, implies that they are a hybrid organization that deals with a multidimensional goal structure. In line with what Grossi et al. (2017) have written about performance measurement systems in hybrid organizations, more information is required for Impact Invest to measure performance. As they consider both financial logic and impact logic, measurements relevant to both logics need to be included and equivalent information needs to be gathered. This is in line with what Carlsson-Wall et al. (2016) found in their case study of a hybrid football organization, which used different measurements relating to different logics. To measure how well they are doing in regard to the financial logic, traditional evaluation methods in private equity are used such as discounted cash flow analysis and universe comparisons, as well as assessment of non-financial commercial factors such as the team, product, and market. To measure how well they are doing in regard to the impact logic, impact measurements are used. These include individually selected KPIs from the IRIS+ catalog developed by the Global Impact Investing Network (GIIN), which are then translated into the social return on investment (SROI) metric. Additionally, management compensation is determined both by how high the financial return is and the share of impact goals achieved, which will be further discussed in section 5.3. Accounts thus include relevant measurements to both institutional logics. This is in line with conclusions drawn by Grouleff Nielsen et al. (2019); performance measurement systems can have a mediating role in an organization by incentivizing employees to focus on both logics. In general, it appears as if it is highly important for Impact Invest to include both logic to make sure that both are considered. This goes against Van-Dooren's (2017) view that the purpose of performance measurement systems in hybrid organizations is to decouple less important logics.

5.2 Balancing Logics When The Financial Logic is Traditionally Strong

In the case of Impact Invest, it has been found that their stakeholders care about the impact logics being taken seriously. Based on the interviews held, it appears as if it is indeed a prerequisite for many of their potential investors. Their ambition to make an impact thus needs to be taken seriously for investors to have interest in them, making it important for them to signal legitimacy by communicating that both logics are part of their performance measurement system. This is in line with the findings of Grouleff Nielsen et al. (2019), performance measurement systems can be used to signal legitimacy. Impact Invest does this by communicating to potential investors that they care about impact and that they have integrated impact as part of their performance measurement system.

As found in section 4.3.3, Impact Invest separates the two logics at the beginning of the investment process as there is one financial due diligence performed by the fund manager and one impact due diligence performed by the impact manager. This is an example of structural differentiation, as described in section 2.2.2. By separating the two logics, the likelihood of mission drift is reduced as prospective investments made by the fund will have “passed” both a financial and an impact due diligence. This reassures prospective investors that no investments made are ones that just have a potential for high return, without having impact potential. The likelihood of impact washing, which Varada (2022) mentions being a problem, is thus reduced.

An important finding from Chenhall et al. (2013) is that for performance measurement systems to function as compromising accounts, all relevant evaluative principles should be included in the performance measurement system and no evaluative principle should dominate the others. This is in line with what we see in the structurally differentiated due diligence phase of Impact Invest. On the other hand, the screening phase excludes the financial logic. Performance measurements in later phases include both impact logic and financial logic, but since the financial logic is not part of one of the phases, it appears as if the impact logic is slightly dominant. This could partly be explained by the way the impact manager talks about the financial logic at times, that it could “take over” if they do not set up a proper system. On the other hand, the fund manager does not talk about the impact logic in a similar way. This can be explained by the fact that it can be easy for financial logic to dominate other emerging logics in hybrid organizations operating in fields where the financial logic is strong. This is seen in a study of the Norwegian Government Pension Fund (Kreander & McPhail, 2019). A contribution this paper makes is thus:

Proposition 1. In order to make sure that multiple institutional logics get considered in a field that traditionally is dominated by financial logic, the organization can make an effort in designing the performance measurement system in a way so that the alternative logic(s) are more dominant. Making one logic dominant in the performance measurement systems may in other situations lead to mission drift for the organization, but if one logic is already dominant in the field it may prove necessary to avoid mission drift.

5.3 Using Performance-Based Managerial Compensation to Reduce Mission Drift

Behn (2003) concluded that the ultimate purpose of performance measurement systems is to improve performance. In the case of Impact Invest, performance is related to the financial return their fund generates as well as to what extent the impact goals are achieved. As a private equity fund, it would be natural to have performance-based managerial compensation as this is typical for the industry (Snow, 2007). Carried interest is usually paid out to general partners of private equity firms if the fund makes a profit, based on how large the profit is. In the context of hybrid organizations, however, Grossi et al. (2017) argue that hybrid organizations should be careful using performance-based managerial compensation as it can be difficult balancing multiple logics, potentially leading to mission drift. Yet, Impact Invest has chosen to pay out carried interest to the general partners if the financial return is high enough, similar to regular private equity funds. However, there is also an impact hurdle rate similar to what Varada (2022) brings up. In order for full carried interest to be paid out, 80% of impact targets on an aggregated portfolio level must have been reached. Hence, employees are incentivized to consider both logics as the personal gain from obtaining carried interest is higher the better the investment performs from both a financial and an impact perspective. It can also work as a tool to increase legitimacy, as we can see that the fund manager communicates this performance measurement system to potential investors when trying to appeal to them.

Proposition 2. Using performance-based managerial compensation is an option for hybrid organizations to mitigate mission drift, but should be based on all relevant logics to the organization. This can act as an assurance to stakeholders that all logics are being considered.

5.4 Limitations

A limitation of this study is that it was done in a small firm, meaning that there were not a lot of people to interview about the performance measurement system. Most of our findings came from information given to us by two individuals; the fund manager and the impact manager. This means that their interpretation of the performance measurement systems at Impact Invest carried a lot of weight. It is also possible that the interviewees did not give us all the relevant information. For example, they may have chosen to not tell us things that could put Impact Invest in a bad light.

Additionally, the findings are interpreted by the authors. Our perception and biases may thus have impacted the findings, which further would have impacted the conclusions we draw from the study.

The case firm is in an early phase, meaning that there is little information about how the performance measurement systems have actually functioned in practice. This is not necessarily a weakness of the paper, as this paper is focusing on the design phase of performance measurement systems. However, readers should be aware of the fact that this paper does not contain conclusions about how performance systems actually function in a use phase.

5.5 Future Research

The authors consider the private equity field to be an interesting subject for studying performance measurement systems. However, as this study explores the role of performance measurement systems from the perspective of an emerging impact investor, future research could be dedicated to exploring this but from the perspective of a more mature impact investor. Whereas this study investigates the design phase, a more mature company can provide more information regarding the use phase of performance measurement systems in impact investing. In general, it could be valuable to perform similar studies in other impact investing funds to determine whether similar conclusions could be drawn from those studies as well.

6. References

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