Basic Guidelines on Impact Investment (Impact Finance)

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Financial Services Agency

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(1) Purpose of the Basic Guidelines

Impact investment is an investment that intends to realize "social or environmental impact," at the same time to secure "financial return." In addition to generating a certain level of financial returns as "investment," it is characterized by identifying specific social or environmental impact that should be realized through an individual investment, as well as strategies and causal pathways to realize the impact.

As social and environmental issues diversify, from decarbonization, biodiversity, social diversity, demographic decline and other locally specific challenges, impact investment is gaining popularity as a methodology that would specifically focus on each issue and understand and evaluate the growth potential of companies and businesses that are not necessarily fully grasped and supported by the existing ESG investment methods. At present, however, impact investment record in Japan and overseas is still in the process of expansion, and practices are in the process of development and dissemination.

The purpose of this Guidelines is to foster common understandings on basic concepts and processes for, and further elaborate markets and practices on impact investment, by clarifying the basic elements expected for impact investment that fund-raisers, fund-providers, and other participants in impact investment markets could refer to when structuring, financing, and promoting collaboration for investment projects through their ingenuities and approaches. The Guidelines are expected to encourage investment practices and dialogue among investors, financial institutions and companies, which may consequently further enrich their experiences and expertise.

Unlike green or social finance guidelines, this Guidelines does not comprehensively indicate the practical conditions that shall be satisfied to be qualified for “impact investment.” Therefore, the FSA does not primarily assume that external organizations or internal divisions evaluate or develop opinions on the consistency of an impact investment with this Guidelines. It would be, however, beneficial to deepen discussions on the ideal form of investments based on the elements shown in this Guidelines, as engagement with internal and external organizations and departments is beneficial for identifying, measuring, and measuring impacts and understanding negative secondary effects, etc.

Although "impact investment" differs from the investment methods such as "integration" and "screening" that are currently more common in ESG investment[1], it shares the objective of enhancing the growth and sustainability of businesses by addressing social and environmental issues. Therefore, promoting impact investment widely as one of the areas of sustainable finance could carry profound implications, as it may contribute to solving social or environmental issues and improving business viability through

[1] When formulating investment decisions based on ESG evaluation, as typical in investment practice seen in ESG integration, investors generally integrate overall evaluations on companies' ESG efforts into their financial analysis, and then select investment targets or ratios in accordance with the ESG evaluations. In the case of screening either, both in "negative screening" that focuses on “negative” elements of a company's industry, business, governance and decides not to invest in companies with particular problems, and "positive screening" that evaluates a company's ESG efforts and select investee companies or group of companies, do not necessarily take into account the effects individual investments have onto each investee company or business. For details, please refer to *the Report on Impact Investments* (30 June 2023)

investment, then strengthening the foundation and sustainability of our societies and economies.

Impact investment is considered to be able to identify and utilize a wide range of social and environmental issues across sectors, such as decarbonization, biodiversity, social diversity, demographic decline and other locally specific challenges. Given that ranges of issues classified into “green,” “social,” or other sustainability labels are increasingly correlated with each other, impact investment’s possibility to flexibly and comprehensively capture those issues irrelevant to existing label classifications may be an advantage.

As investment practices have yet to be fully developed, *elements* presented in this Guidelines need to be flexibly improved and expanded through dialogues with market participants so as to encompass market developments, rather than being static. Therefore, the FSA will consider updating the *elements* periodically.

In addition, as technology is rapidly evolving and materializing social changes that go beyond past expectations, general discussions on social issues or agendas is becoming more important as a precondition for a positive feedback loop of impact and long-term returns. As diverse ideas on social issues are basis of investor’s or investee’s "intention" in impact investment, they need to be well discussed profoundly by stakeholders.

In light of the characteristics of a growing market, the Guidelines is formulated as general and principle-based to encompass and encourage a wide range of efforts, creativity, and ingenuity by market participants.

(2) Scope of the Basic Guidelines

Impact investment is an investment that intends to realize "social or environmental impact," at the same time to secure "financial return." Therefore, as far as investee and intended impact are specifically specified and committed, impact investment can be applied across sectors.

Based on the understanding that the fundamental concept of investment that realizes both social or environmental impact and financial return would in principle be the same regardless of investees, investors, or asset classes, the Guidelines incorporates a broad range of impact investments without limiting the scope.

Investees include a wide range of industries, sizes, life stages including listed and unlisted companies, operating areas and so on. The scope of investors is not limited either, as various entities such as asset owners, financial institutions, venture capitals, private equity funds, and foundations have entered the market. Asset classes can also vary, such as equity (listed or unlisted), debt (loan or bond) and real assets, depending on the investors' strategies and the characteristics of investees' businesses. Thus, the term "investment" or “finance” used here is not limited to listed or unlisted markets, and includes loans and other financial products.[2]

Although this Guidelines is intended to serve as elements that fund-raisers, fund-providers, and other participants in impact investment markets could refer to when structuring, financing, and promoting collaboration for investment projects, it primarily

[2] This Guidelines is prescribed referring to and in accordance with discussions on international impact investment, in which investees or asset classes are in principle not limited, although some targets and investment methods may be emphasized relative to the others.

focuses on fund-providers' finance processes as a documentation on how finances achieve impact.

In any case, appropriate combinations of businesses areas, investees, asset classes, and supporting measures according to the level and balance and timeframe of social or environmental impact and financial return would be important. Diverse considerations by market participants would be essential in this regard.

Many social and environmental issues are intricately linked to economic and social factors and constraints, and therefore, it is often subconsciously assumed that projects that address social and environmental issues are generally more costly in terms of both time and funds, and less profitable in terms of business and investment than other projects.

As interest in social and environmental issues grows and business models and technologies are innovated, however, social or environmental impact and business potentials would presumably complement and strengthen one another and become mutually compatible (positive feedback loop) through various ingenuity and creativity.

Particularly in Japan, which faces varieties of social or environmental issues and sustainable growth challenges, realizing this positive feedback loop through investment would be indispensable for enhancing potentiality and sustainability for businesses and the economy, as well as for contributing to resolving social and environmental issues in a sustained manner.[3][4]

Therefore, including for raising issues that business transformation linking social and environmental impacts to growth opportunities and realizing a virtuous circle is essential, the Guidelines specifically identifies helping create or accelerate changes in markets and customers, *element 4*, as one of four *elements*, along with *elements 1 to 3* that are directly related to investment processes.

Business transformation by investment would of course have considerable ranges, and diversified approach by varieties of entities, including existing one, would be valuable and should be respected. Based on this premise, this Guidelines does not set specific requirements for, or thereby reducing the ranges of, impact investment, but rather underscores the necessity of business transformation as a desirable element from the perspective of realizing virtuous circles and providing sustainable solutions.

Targeted financial returns by impact investment would also vary, from those that aim to realize a rate of return equal to or higher than the market rate to those that do not aim the market rate, such as so-called concessional finance commonly found in development finance, and similarly, any objective and initiative would be valuable and should be respected.[5]

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[3] Realizing a virtuous circle would also be important for broadly appealing to institutional investors who pursue impact as a means to realize investment returns based on fiduciary responsibilities stipulated in regulatory framework of each jurisdiction.

[4] For example, in a report published in 2021, PRI categorizes "Investing For Sustainability Impact" (IFSI), or investments that intend to promote sustainability, largely into: "instrumental" investments, where the realization of social or environmental benefits is an important "means" to protect the value of the investment through the protection of the basis of economic activity, or "purposeful" (i.e., addressing sustainability issues is itself the "ultimate ends") investments. It then states that the former, which pursues impacts for investment returns, would be considered possible under the fiduciary responsibility generally imposed on asset owners, taking into account the laws and regulations of each jurisdiction.

[5] Therefore, there are certainly impact investments that target a rate of return below the market rate or allow that rate as a return by its portfolio as a whole. In the public consultation, it was pointed out that concessional finance has in fact played important roles in improving financial profiles for general investors in impact investments.

Given this understanding, in order to provide substantial focus and contributions on areas most private sector investors and financial institutions would participate in, this Guidelines does focus on impact investment or impact finance that aims to achieve a certain level of financial return as an investment or finance and does not include funds or investments for which financial return is not expected from the beginning (such as donations).

There are various social or environmental impact that can be realized through investment. For example, in some regional economies, amid the rapidly aging society with low birth rate, revitalizing local livelihood, employment, or the economies themselves would be an urgent social issue. Even in this case, clarifying in advance investors' intention to achieve "impact" would be necessary for the investment to proclaim to be an "impact investment;" after all, retroactively recognizing social or environmental impact after the execution of investment would not be the purpose of this Guidelines.

(3) Principles for Impact Investment

In order for an investment to achieve "social or environmental impact," it is necessary to clarify in advance what impact are to be achieved through the investment, realize concrete "impact" from the investment, and confirm these impact even after the investment and take ongoing actions ("identification, measurement, and management").

Furthermore, various business reforms that could reduce the costs associated with generating social or environmental impact and reconcile or integrate the impacts and returns would be expected, such as introducing ideas, implementing or expanding technologies, transforming business models, and presenting ingenuity that differentiates from traditional markets.

Businesses also do and should widely range, from unicorns that are aiming for rapid growth in response to global challenges, listed companies that place the realization of impacts at the core of value creation, small and medium-sized enterprises (SMEs) seeking to redevelop business models that leverage local traditional values, and locally born start-ups that focus on the issues and needs of specific regions and niche markets and expect moderate but sustainable growth.

Based on diverse possibilities, through the entire investment processes of "intention," "contribution," and "identification, measurement, and management," engaging in sufficient dialogue among investors, financial institutions, and companies to deepen understanding on how the business develops and cultivates the market and realizes tangible impact in both social/environmental and financial aspects would be essential, as well as to identify and support the business's characteristics and advantages that enable and accelerate changes in the market and customers.

This Guidelines is intended to foster a common understanding on the basic concepts of impact investment and to promote the development of markets and practices, and it does not define detailed investment requirements or to regulate or restrict varieties of ingenuity of market participants who are currently pursuing efforts.

As seen in the public consultation, the basic concepts of this Guidelines are in principle compatible with the discussions in various guidance on impact investment that have been provided by international organizations or initiatives. On the other hand, domestic and international norms and standards, including basic concepts that could be seen this Guidelines or practical implementation steps and standards that are not necessarily prescribed in this Guidelines, are both still in the process of discussion. Therefore, it is essential to consider with global and local stakeholders in forward-looking and collaborative manner, given the evolving nature of the markets and standards.

Practical methodologies and benchmarks on investment are not necessarily discussed in this Guidelines, and further discussions and elaborations are rather desirable including the above-mentioned guidance still in progress internationally.

Element 1 (intention): intended "social or environmental impact" is clarified

➢ As an investment that aims to realize "social or environmental impact" at the same time to secure financial returns, clarify the social or environmental impact intended to be realized through the investment. ➢ Present strategies and policies for investment to achieve intended target. In addition, through dialogue based on the strategies and policies, specify how the business of the investees will expand, develop, or cultivate markets, or gain their support, and realize social or environmental impact and financial returns, including cases where those would be realized over the long term. ➢ When establishing an investment fund for the purpose of creating social or environmental impact, clarify such strategies and policies for intended impacts and markets on a fund-by-fund basis. ➢ Cleary the intended targets of investments in relation to the business strategy and investment policy of investors and financial institutions. ➢ Confirm that the business intentions of an investee is basically consistent with those of investors and financial institutions, and examines policies for follow-ups with the investee. ➢ When making investment decisions, consider significant negative secondary effects on other social or environmental impacts that differ from the "intention" of the investment.

<Approach>

■ **Setting Intention**

"Impact investment" aims to realize social or environmental impact at the same time to secure financial return through investment.[6] Therefore, it is important for investors and financial institutions to clarify in advance their intention on what impact they realize through investment. As every investment usually leads to social or environmental impact to some extent through the provision of funds, impact investment is premised on the existence of the intention to realize the impact concretely and proactively.

In particular, it would be important to specify the strategies(*) of how the investment and business contribute to changes in society or the environment, and to ensure that, as the intention at the time of investment, the relationship between the intended "impact" and the business strategy such as market and business prospects is understandable.

(*) This strategy is generally referred to as the "Theory of Change" among others, and explaining in detail processes investments produce social or environmental impacts, or the mechanisms they realize changes is considered to be important.[7]

There may be cases where impact and financial return are to be realized for the fund as a whole by investing in multiple businesses through funds or other means. Beyond creating impacts by investing in various individual companies and businesses that address

[6] Including cases where investors aim to ultimately secure financial return through realizing “social or environmental impact.”

[7] For example, the ESG fund disclosure regulation by the UK FCA defines the theory of change as "a comprehensive description and illustration of how and why a desired change is expected to occur."

social or environmental issues, it is also possible to specify the impacts that the fund as a whole intends to realize and clarify the strategy to realize those impacts.[8]

In either case, it would be necessary to clarify the targets and intentions on the social or environmental impacts that the fund as a whole aims to realize in accordance with each fund's strategy.

As with other general investments, the level of intended financial return would depend on elements such as asset classes (stocks, bonds, loans, etc.), corporate characteristics, investment strategies, and so forth, with methodologies to count the level also diversified, including whether or not to take into account funding costs. In any case, it would be important to ensure that, as investment strategy, the relationship between the intended impact and financial return is understandable.[9]

■ **Relationship with Business Strategy**

In order for market participants to accurately understand the certainty of the targets to be achieved through investment, it is important that intended "impacts" is organized in an easy-to-understand manner in the investors' or financial institutions' business strategies (including mission and purpose) or overall investment policies.

This does not necessarily imply that investors and financial institutions engaging in impact investment have to perform other investment or business activities that directly take into account social or environmental impact. However, that investors and financial institutions appropriately explain how they align an individual social or environmental impact they aim for through the impact investment in their overall business strategies will facilitate stakeholders' understanding of the intention of the investment. In addition, there are some cases where investors and financial institutions are trying to change their entire business and investment to be impact-oriented, in which case, understanding and leadership by management is particularly important.

■ **Policies for Dialogue**

The "Intention" in this Guidelines refers to the "intention" of investors, financial institutions and other fund providers. At the same time, as an ultimate entity to realize impact is an entrepreneur or a business, it is important to confirm that the entrepreneur or the business has its own intentions to resolve issues and realize business potential that would be basically consistent with the fund providers' intentions.

Although intentions of an investor and an investee need not to completely match, their basic consistency would be important for achieving impact and return the investment intends to realize. It is important for the fund provider to clearly state its own intentions and to confirm through dialogue and other means, investee's management philosophy ,or purpose, strategy, business plan, or intensions behind them. It is especially important to have a constructive and careful dialogue on whether the entrepreneur's or business's

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8 In the public consultation, it was pointed out that in recent years, there have been funds that intend to realize certain social or environmental impacts in their portfolios as a whole and invest in a group of companies that could be involved in realizing those impacts, e.g., focusing on certain products or technologies that would have an impact and promoting their mobilization by strategic and broad investing in existing and emerging companies that provide functions such as research, component supply, or infrastructure development, etc.

9 In the public consultation, it was pointed out that clarifying how impact would change risk-return profiles for investors would be important for this reason.

intention to solve social or environmental issues is reflected in its business plan in a way that leads to the creation of corporate value. Fund providers may need to examine their policies for dialogue, so that they could continue thereafter to understand diverse pathways for companies' value creation and to realize the objectives.

■ **Consideration of unintended "impact"**

Apart from social or environmental impact investors intend to realize, there may be secondary effects of investments, such as adverse effects on other environmental issues as projects progress (e.g., the introduction of a new large-scale facility may reduce greenhouse gas (GHG) emissions, but the facility will have an unavoidable impact on the ecosystem).

There are various types of secondary effects, such as those related to fundamental human rights, those that could be substantially reduced by alternative measures, those that are easy to quantify or not, or those that are not directly caused by the investments. In any case, it is necessary to gain the understanding of stakeholders concerned that comprehensive and sufficient social or environmental impact would be obtained through the investment, and if there are serious negative impact, to mitigate or prevent the negative impact, without offsetting with intended positive impacts.

As a precondition for making an investment, it would be important to understand from a bird's eye view what positive and negative impacts the investment or project will have on society, and to proceed with measures to deal with such impacts.

Element 2 (contribution): investment contributes to realizing impact

> - Specifically expect investee's "social or environmental impact," which would not otherwise be foreseen without the investment, including cases where they are realized over the long term.
> - Consider and endeavor appropriate measures, which include not only financial supports but also non-financial supports such as engagement.

<Approach>

■ **Generating impact through investments**

In order to fulfill social or environmental impact, an investment needs to make a concrete contribution to investee company's or business's impact creation and business enhancement that otherwise had not been realized without the investment.

To this end, it is important to consider in a concrete manner how the investee's businesses develop into the market and lead to the achievement of the intended social or environmental impact, as well as how these will lead to business prospects including cases where they will be realized over the long term.

On the other hand, there are various channels for realizing the impacts and business prospects by individual investment, and it is not necessarily easy, at least at present, to rigorously demonstrate hypothesis-testing on the investment's impacts, compared to those in the absent of the said investment.

Time frame necessary to realize the objectives, or an ultimate growth potentials vary from company to company and from business to business.[10] Similarly, how "social or environmental impact" lead to business prospects would also vary, depending on business areas and growth stages of the company, and would even evolve over time.

Therefore, it is important to take into account both the characteristics of funds and businesses and companies and consider appropriate ways of contribution such as financial supports and engagement, and to specifically identify and explain investors' own actions and how they would contribute to realize the intended objectives.

Contributions by investors and financial institutions can be made through a variety of means. Contributions through financing are said to include, for example, strengthening the capital base and providing liquidity by supplying funds in primary investments, providing refinancing and exit functions by supplying funds in secondary investments, and lowering financing costs by mobilizing various financing methods including blended finance. Contributions through engagement are said to include, for instance, deep individual dialogue including loans and non-listed investments markets, active and wide-range dialogue including listed markets. Collaboration with other investors, financial institutions, industry organizations, and public and private stakeholders to disseminate and raise issues is also counted to be an important contribution.

Potential methods vary, but in any case, it would be important to clarify how to contribute overall, depending on the investment' or the fund's characteristics.

[10] In the public consultation, it was pointed out that projects related to social issues in particular would often take a certain amount of time to realize social or environmental impacts and to business potential.

■ **<u>Dialogue to materialize investment impact</u>**

Through dialogue with investees in practice, it is important to proceed to implement financial and non-financial support planned in advance.

Since an ultimate entity to realize impact is an entrepreneur or a business, effective dialogues and supports that fit to the individual characteristics and value creation paths of each business would be important, as they would likely lead to actions in practice. Dialogue with investees to materialize the intended impact and business targets would preferably need to consist of comprehensive points of view, including a company’s business strategies, intended impact and profitability, and ways to cooperate with the company’s stakeholders so as to induce effective value creation by the company.

"Contribution through investment" can include, as non-financial supports, for instance, offering broad perspectives on capital strategy, investment plans, and other management or financial issues, or addressing companies’ shortages of human resources or expertise and offering other professional advices. When deemed beneficial for creating additional impact or promoting business potentials, cooperating with other investors and financial institutions in engagement may be of further help.

Since an investee’s presenting intended impacts on its dialogue with ranges of stakeholders could help it to formulate or expand its business strategy, secure human resources, or raise funds or awareness, investor’s assistance in terms of investee’s stakeholder-dialogue could also be a distinctive contribution as an investor.

Element 3 (Identification, measurement, and management): Identifying, measuring, and managing impact

> - "Identify, measure, and manage" in quantitative or qualitative terms impact to be realized through investment.[11]
> - Specifically, identify the characteristics, size, and potential of the market, and measure and manage "social or environmental impact" on an ongoing basis, including after investment.
> - Appropriately consider ways to ensure that the method used for identification, measurement, and management, such as indications, is objective, for example, by utilizing or considering an internationally established framework.
> - In order to enhance dialogue among stakeholders, share information among the stakeholders on relevant indicators and methods and results of identifying, measuring, and managing the impacts of investment.

<Approach>

■ **<u>Approach to Identification, Measurement, and Management</u>**

In order to realize the objectives of impact investment, it is necessary to continuously measure and manage after the investment whether financial and non-financial support planned in advance has actually been provided to the business, whether there has been any achievement in business enhancement of impact creation.

Therefore, it is important for investors and financial institutions, at the individual investment or investment fund level, to identify before investing what and how major impact investee business would materialize, identify quantitative or qualitative indicators to measure these impact, and continue to manage these indicators after investment and engagement. While profitability is usually captured quantitatively, there are various quantitative and qualitative indicators for social or environmental impact, which require creativity and ingenuity in each field.

From the perspective of ensuring objectivity, it is desirable to explore the possibility of identifying, measuring, and managing quantitative indicators (KPIs) and if possible, use quantitative ones as far as practically possible.[12] Nevertheless, given administrative burdens on businesses and the availability of data, as well as the fact that there are some social issues that are not sufficiently fit for quantification, dialogue between businesses and investors/financial institutions would be desirable on what indicators should be used to identify "impacts," while taking into account the progress of various policies and measures related to information and data.

In general, co-deliberation as necessarily on how to set effective indicators both in terms of driving impact and ensuring feasibility would be expected.

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[11] It is sometimes pointed out that distinguishing and organizing in identification, measurement, and management is important between outcomes, or changes that a business or organization aims to produce, and output, or goods or services provided to produce those changes.

[12] For example, the Japan Business Federation (Nippon Keidanren) has provided specific examples of impact indicators when engaging in dialogue with investors regarding their long-term strategies. *Using 'Impact Indicators' to Promote Purpose-Driven Dialogue* (June 2022)

When qualitative indicators are used, referring to or combining as necessary relevant figures or logics such as statistics or other literatures would be important to ensure objectivity in understanding the impact and provide balanced overall pictures. It is also important, as with the case with other general investments, to have a long-term perspective that looks ahead after investment by setting quantitative measures for profitability and business feasibility and confirming that the impact will also gradually expand as the business expands.

■ **Ongoing management**

It is important to continuously monitor the identified quantitative or qualitative indicators after investments and engagement and along with business growth, and utilize them for next actions. There may be cases where intended "impact" are achieved but not accompanied by realizing business potential, or cases where business has grown but the intended "impact" on society or the environment have not been realized. In any case, "management" is necessary that identifies factors that hinder intended impact or financial return, and considers timely decision making to promote and engage on ways to realize impact and financial return subsequently.

After the investment, apart from the social or environmental impacts intended to be realized, various secondary impacts may occur due to the progress of the project, which should preferably be grasped and responded accordingly.

■ **Sharing information**

In order to make the identification, measurement and management of investment impacts more effective, a dialogue among the parties involved in the investment or project would be beneficial regarding the overall identification, measurement, and management processes, such as whether supports set in advance has been provided, whether specific impacts has been achieved, or whether further improvement measures could be taken.

In order to enhance the dialogue among stakeholders, it is important for investors and financial institutions to appropriately share information among the stakeholders on relevant indicators and methods and results of identifying, measuring, and managing the impacts of investment. And for this purpose, it is also important for investee companies to share necessary information with investors and financial institutions.

Element 4 (innovation/transformation/acceleration): Support transforming or accelerating transformations in markets and customers

- Identify and assist the characteristics and advantages of investee companies and businesses that could create or accelerate changes in the market and customers, so that investees could generate tangible social or environmental impact and foster business potential.
- Conduct dialogue with investees in a manner that could harness investees' potential to expand, develop, cultivate, or gain supports from the market.

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■ **Transformation to create a positive feedback loop of social or environmental impact and returns**

Social and environmental challenges are diverse, such as decarbonization, biodiversity, social diversity, demographic decline and other locally specific challenges, and arise from a complex combination of various economic and social factors and constraints. Generally speaking, solving problems takes time and is often accompanied by certain levels of costs. Therefore, it is often subconsciously assumed that projects that address social and environmental issues are generally more costly in terms of both time and funds, and less profitable in terms of business and investment than other projects.

As interest in social and environmental issues grows and business models and technologies are innovated, however, social or environmental impact and business potentials would presumably complement and strengthen one another and become mutually compatible (positive feedback loop) through various ingenuity and creativity. Particularly in Japan, which faces varieties of social or environmental issues and sustainable growth challenges, realizing this positive feedback loop through investment would be indispensable for enhancing potentiality and sustainability for businesses and the economy, as well as for contributing to resolving social and environmental issues in a sustained manner.

Various innovations and ingenuity to turn impacts into sustainable growth may largely vary, from ideas and technologies, changes in business models, and originality to differentiate from conventional markets. More specifically, these would include, for instance, introducing distinctive ideas to provide characteristic products and services, continuously improving production processes to offer existing products with affordable prices in wide-ranging geographies, extensively installing infrastructure facilities to enable the mobilization of others companies' impact-driving products, and utilizing unique local resources to respond to social issues and differentiate in the markets, etc.

There are also cases where multiple businesses in collaboration produce significant overall impact and opportunities (open innovation), such as when those local companies, organizations, and municipalities collaborate with one another, or when a listed company collaborates with local start-ups or SMEs in their technologies.

There are a variety of characteristics and approaches that could generate or accelerate transformations in markets and customers, and it is important to explore and share a variety of measures rather than limiting the possibilities.

■ Dialogue between investors / financial institutions and companies

In order to materialize these relationship, it is essential to identify and implement strategies for realizing the objectives, to determine what transformations and ingenuities an investment may create and how to achieve impact and corporate value enhancement

Therefore, what counts for impact investors and companies alike would be, to observe diverse possibilities and medium- to long-term perspective, identify strategies and casual pathways on how an investee's business would realize impact and link it to business value, and to engage with mutual dialogue to elicit potential. For example, if business feasibility can be established over time due to long-term growth, examining ways to evaluate long-term profits at the present time would be one expected theme of mutual dialogue.

It is also important that investors and financial institutions appropriately evaluate and support investees' practical ability to convert the creation of social or environmental impact into the improvement of corporate value.

In order to realize a positive feedback loop in which "social or environmental impact" and "financial return" complement and strengthen each other, it is necessary not only to consider intentions and strategies for the realization, but also to have good birds-eye for competence and ingenuity to actualize the upward cycle. Identifying, measuring, and managing the important social significance or impact of a project by itself does not necessarily ensure the sustainability of the project. Therefore, investors and investees would preferably need to progress effective dialogue that would expand, develop, cultivate, or gain supports s from markets.

Business projects are carried out by investee companies based on their own judgment and responsibility. An investor could in parallel improve the sustainability of their own investment by encouraging improving the "impact" and "financial return" of the project through financial support and engagement.

Investors and financial institutions are thus expected to actively engage in dialogue and other efforts to support the ingenuity of businesses. In doing this, since the strategies and causal pathways and timeframes for achieving the intended "social or environmental impact" and "return" vary depending on each business model, it is desirable to take appropriate approaches accordingly to an individual company.

Such client support is actually planned and implemented according to each stage of the investment process listed in *elements 1 to 3* of this Guidelines, and thus in this regard there is an overlap between these three *elements* and this *element 4*. However, this *Element 4* is particularly and independently noted including for raising issues that business transformation linking social and environmental impacts to growth opportunities and realizing a virtuous circle is essential.