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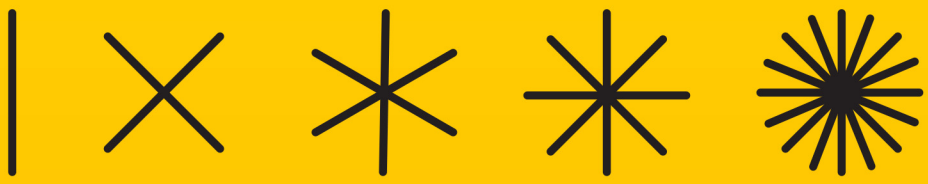

SOCIAL ECONOMY SCIENCE

transforming the economy & making society more resilient

edited by GORGI KRLEV * DOMINIKA WRUK * GIULIO PASI * MARIKA BERNHARD

Social Economy Science

Transforming the Economy and Making Society More Resilient

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Alex Nicholls and Jarrod Ormiston

Introduction

The social economy in the European Union (EU)[1] represents an important element of the overall economy both in terms of its economic impact (13.6 million jobs, 8% of GDP across the EU)[2] and its wider social impact in terms of innovations designed to address intractable social, community, and environmental issues (Amin, Cameron, & Hudson, 2002). The social economy aims to generate a positive—measurable—social impact together with economic impact. Moreover, the social economy embodies and promotes the fundamental values of social solidarity and civic engagement. In this context, discourses of the social economy also have the potential to change the wider debates concerning the purpose of organizations and the structure and objectives of the economy more generally—such as issues of shareholder priority, equity, and the short-termism of investment—as a form of transformative social innovation (Nicholls & Ziegler, 2019). Today, in the EU, the social economy is of relevance to a range of policy fields, including climate and the environment, education, health, energy, financial stability, technology, and research and innovation.[3] In the COVID-19 and post-COVID-19 world, the social economy offers an alternative economic model—connecting actors from government, not-for-profits, and for-profit organizations—that may provide important insights into how to increase the resilience and heterogeneity of business ecosystems more generally and reduce the risk of exogenous shocks to the economy as a whole.

In the EU context, social enterprise has been framed as a key component of the wider social economy (Borzaga & Defourny, 2004).[4] The EU defines social enterprise as an entrepreneurial organization trading in the social economy whose

[1] The social economy in the EU consists of 2.8 million social enterprises, mutual and co-operative associations, and foundations: see https://ec.europa.eu/social/main.jsp?catId=1537&langId=en

[2] See: https://ec.europa.eu/social/main.jsp?catId=1537&langId=en

[3] For example, DG CLIMA Climate and DG ENVIR Environment; DG EAC Education, Youth, Sport and Culture; DG SANTI Health and Food Safety; DG ENER Energy; DG FISMA Financial Stability, Financial Services and Capital Markets Union and DG ECFIN Economics and Financial Affairs; DG CONNECT Communications Content, Networks, and Technology; DG RTD Research and Innovation.

[4] See: https://ec.europa.eu/growth/sectors/proximity-and-social-economy/social-economy-eu/social-enterprises_en

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main objective is to have a social impact rather than make a profit for their owners or shareholders and which uses its profits primarily to achieve social objectives.[5] While the development of innovative tools and entrepreneurial organizations to address social problems is nothing new, historically such ventures have operated outside of the market in the voluntary, charitable, or not-for-profit sectors. Social entrepreneurship emerged as a new field of action in the early 2000s, blending market and non-market approaches (Nicholls, 2007). Social entrepreneurship refers to a broad range of actors, and there is no single legal form for social enterprises in the EU: social enterprises can be work integration co-operatives, private companies limited by guarantee, or not-for-profit organizations such as provident societies, associations, voluntary organizations, charities, or foundations.[6] Social enterprises are driving social change across Europe in the fields such as employment, education, and well-being (Baglioni, 2017). Despite their importance for economy and society, social enterprises face the challenge of acquiring sufficient financial resources to help them in developing their businesses and scaling their impact (Castellas, Ormiston, & Findlay, 2018; Doherty, Haugh, & Lyon, 2014). This chapter explores how the new field of impact investment can contribute to the growth of social enterprises across Europe.

Impact investment has emerged over the past few decades as an alternative approach to investing that intentionally seeks to create social and/or environmental returns alongside financial ones (Nicholls, 2010; Hehenberger, Mair, & Metz, 2019; Höchstädter & Scheck, 2015). Policy-makers have been heavily involved in the development of impact investment markets (Casasnovas, 2022; Casasnovas & Ferraro, 2022; Spiess-Knafl & Achleitner, 2012). In the UK, for example, policy-makers were seen as drivers of the social impact investing market (Casasnovas & Ferraro, 2022). Governments are viewed as playing a critical role by creating an enabling environment for impact investment (Phillips & Johnson 2021). Governments can shape impact investment markets through regulation, direct investment, co-investment, and intermediation (Casesanovas, 2022; Schmidt, 2022).

This chapter focuses on how policy-makers can support impact investment and funding for social economy enterprises across the EU. Hehenberger (2020) recently reviewed the trajectory of EU policy supporting impact investment. Since 2011, the European Commission has launched a series of initiatives to support social enterprises and impact investment in the social economy such as the Social Business Initiative, the Expert Group on Social Entrepreneurship (GECES), the Expert Group on Social Economy and Social Enterprises (also GECES), the European Social Entrepreneurship Fund (EuSEF) regulation, the Programme for Employment and Social Innovation (EaSI), and the European Investment Fund (EIF). The policies have contributed to the legitimization of impact investment across Europe (Hehenberger, 2020). The importance of impact investment in supporting the social

[5] See: https://ec.europa.eu/growth/sectors/proximity-and-social-economy/social-economy-eu/social-enterprises_en

[6] See: https://ec.europa.eu/growth/sectors/social-economy/enterprises_en

economy in Europe was strengthened in the Social Economy Action Plan published in 2021.[7] One of the key pillars of the plan focuses on creating an ecosystem for the growth of social enterprises and other social economy enterprises that supports them accessing finance and scaling up. This chapter contributes to this pillar by setting out the landscape of impact finance specifically available to social enterprises and other social economy enterprises. It also makes a series of policy recommendations for the EU impact investment market based on an analysis of relevant policy innovations in the United Kingdom and elsewhere.

Defining impact investment

A fundamental challenge for the ongoing development of the impact investment market relates to the contested nature of its boundaries and terminology. Before the widespread adoption of the term 'impact investment', the market for impact finance was defined as, variously, 'social finance',[8] 'social impact investment',[9] or 'social investment'.[10] This shift from 'social' to 'impact' was driven by two factors: first, a concerted attempt to integrate with the mainstream financial system, for whom 'social' was typically associated with Socially Responsible Investment (SRI) that negatively screened out poorly performing investments against good-governance guidelines rather than actively seeking positive social impact deals/funds; second (as evidenced by the formation of the Impact Management Project),[11] a focus on measuring, managing, and reporting the social and/or environmental impact of investments, potentially as a new 'alpha' of all investments. Casasnovas and Ferraro (2022) highlight these competing terms by contrasting the emergence of 'social investment' in the UK, with a tendency to focus on domestically oriented social economy organizations, and the emergence of 'impact investment' in the US, with a stronger focus on for-profit firms with a social and/or environmental mission. Another significant discourse of impact investment, *contra* the various 'social' definitions, was to reject the assumption of a social–financial trade-off in investments, where an increased social 'return' required an impairment of financial return. Despite these efforts to demarcate and define the impact investment market, contested definitions remain—most notably in terms of 'venture' philanthropy and 'sustainable' investment.

Venture philanthropy (VP) emerged in the USA in the early 2000s, as a consequence of the substantial wealth that accrued to Silicon Valley venture capital and technology billionaires being directed towards a 'new' philanthropy (Moody, 2008; Van Slyke & Newman, 2006). The Roberts Enterprise Development Fund (REDF)—founded by George Roberts, joint founder of the private equity firm KKR—pioneered this new form of philanthropic giving that aligned venture capital principals with

[7] See: https://ec.europa.eu/social/main.jsp?catId=1537&langId=en
[8] See, for example: https://www.socialfinance.org.uk
[9] See, for example: https://www.oecd.org/dac/financing-sustainable-development/development-finance-topics/social-impact-investment-initiative.htm
[10] See, for example: https://www.sibgroup.org.uk
[11] See: https://impactmanagementproject.com

grant making.[12] This VP model was based on long-term (multi-iteration) grant making linked to pro-bono venture development support and robust impact metrics, specifically the Social Return on Investment model that attempted to monetize social impact.[13] Subsequent to REDF, a number of other VP organizations emerged, including New Philanthropy Capital[14] in the US and UnLtd[15] in the UK. In 2004, a coalition of European VP organizations came together as the European Venture Philanthropy Association.[16] The EVPA now has more than 270 members from more than thirty countries that connect through events and activities to share best practices and a common vision. Following the same model—and founded by the same entrepreneur, Doug Miller—the Asian Venture Philanthropy Network (AVPN) was established in 2011. By 2020, the AVPN had 615 member organizations in 16 markets across Asia.[17] Finally, in 2019, the Africa Venture Philanthropy Alliance (AVPA) was established.[18] The majority of VP members are now also actively engaging with the notion of impact investment to define their work.

'Sustainable investment' typically uses various types of social or environmental data to help investors make better decisions around asset performance and improve long-term results. More recently such investment has been reframed as Environmental, Social, or Governance (ESG) finance. Within ESG finance there are two categories (discussed further later in the chapter): *positive* ESG finance, which provides direct growth or start-up capital to high-impact projects often aligned with the UN Sustainable Development Goals (SDGs);[19] and *negative* ESG finance, which deploys capital according to a set of screening criteria—'to do no harm'—typically in secondary markets. Sustainable investment does not typically take an 'ethical' stance or represent particular investor values or beliefs.[20] As discussed below, the majority of negative ESG sustainable investment falls outside the scope of impact investment, whereas positive ESG sustainable investment aligns with the concept of impact investment.

SRI[21] extends the ESG principles of negative screening to make more proactive investment choices (sometimes using ESG data) that align with an investor's personal, environmental, or social values and beliefs (Yan, Ferraro, & Almandoz, 2019). Typical categories of SRI are sustainability and clean technology with the strongest sectoral focus being on 'green' finance (Meng, Newth, & Woods, 2022).[22] A distinction between ESG and SRI, for example, would be, in the former, to screen out

[12] See: https://redf.org
[13] See: http://www.socialvalueuk.org/resources/sroi-guide/
[14] See: https://www.thinknpc.org
[15] See: https://www.unltd.org.uk
[16] https://evpa.eu.com/about-us/what-is-venture-philanthropy
[17] See: https://avpn.asia/about-us/
[18] See: https://avpa.africa
[19] See: https://sdgs.un.org
[20] See, for example: https://www.rbcwealthmanagement.com/en-eu/insights/the-growth-of-impact-investing-building-wealth-with-positive-outcomes
[21] See, for example, https://www.investopedia.com/terms/s/sri.asp
[22] Bloomberg sized the market for the Green Finance assets under management at $32 trillion in 2019, see further: https://www.bloomberg.com/graphics/2019-green-finance/

tobacco companies from a portfolio and, in the latter, to invest in healthcare that addresses lung disease.[23]

Finally, it is important to note the curious absence of co-operative and mutual finance from discussions of the impact investment market, despite such finance being an analogous, though distinctive, market of capital deployed for social impact (Michie, 2015). This is likely a product of two factors: first, the impact of co-operative and mutual finance is largely internal and a function of its organizational structure as membership organizations designed to address market failures or pattern of monopsony in markets; second, because co-operatives and mutuals are largely absent from mainstream financial markets since they do not issue equity or raise market debt, being instead typically self-funding or relying on retail bank finance. Nevertheless, co-operatives and mutual organizations play a key role in several impact sectors, including housing,[24] agriculture,[25] health,[26] work integration,[27] insurance,[28] and banking.[29] Many of these sectors are substantial. For example in 2017 the global market share of mutual and co-operative insurers stood at 26.7 per cent across more than ninety countries with assets worth $8.9 trillion. This market employs more than 1 million people and serves 960 million people as members or policyholders.[30] Similarly, in 2018 the global co-operative banking sector had assets of EUR 7.4 billion (McKillop et al., 2020).

Consistent with the development of social entrepreneurship, the allocation of money for social good is also nothing new, though the term 'impact investment' only emerged recently. There is a centuries-long—typically faith-based—tradition of providing resources for the community or the poor and more formalized charity and philanthropy goes back almost 200 years (Nicholls, 2010). However, over the past twenty years a new model of finance-for-good has emerged: impact investment. The Global Impact Investment Network (GIIN)[31]—a not-for-profit dedicated to building the infrastructure of the field via convening and research—has defined impact investment as 'investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return'.

[23] See, for example: https://www.rbcwealthmanagement.com/en-eu/insights/the-growth-of-impact-investing-building-wealth-with-positive-outcomes

[24] See, for example: https://ldn.coop/wp-content/uploads/2015/01/Financing_Co-operative_and_Mutual_Housing-1.pdf. Also, note Big Society Capital's strategic focus on investment in the social housing sector and housing associations: https://bigsocietycapital.com/how-we-work/focus-areas/homes/

[25] See, for example: https://www.agweb.com/opinion/agricultural-cooperatives-around-world

[26] See, for example: https://www.un.org/development/desa/cooperatives/wp-content/uploads/sites/25/2019/03/190326_ihco_EGM-nairobi.pdf

[27] See, for example: https://www.eurofound.europa.eu/publications/report/2019/cooperatives-and-social-enterprises-work-and-employment-in-selected-countries

[28] See, for example: https://www.thenews.coop/136824/sector/banking-and-insurance/co-operative-mutual-insurers-outperform-insurance-sector-market-share-growth/

[29] See, for example: https://economics.rabobank.com/contentassets/95274037ebc548bc99ae02abadf18489/cooperatiestudie-200910_tcm64-94102.pdf

[30] https://www.icmif.org/publications/financial-insights/global-mutual-and-cooperative-market-infographic-2016

[31] Established in 2009, the Global Impact Investment Network (GIIN) is a not-for-profit membership organization with 280 members across 41 countries building industry infrastructure and supporting activities, education, and research that help accelerate the development of the impact investment industry. See further: https://thegiin.org

More recently, the Global Steering Group for Impact Investment (GSGII)[32]—a transnational coalition of thirty-three National Advisory Boards supporting the development of the impact investment field globally—has extended this definition: 'Impact investment optimizes risk, return and impact to benefit people and the planet. It does so by setting specific social and environmental objectives alongside financial ones and measuring their achievement.'

This change of focus reflects a wider agenda to mainstream impact investment by engaging more closely with the language and logics of conventional finance. One of the main distinguishing features is that measuring and reporting impact are central to impact investment (Barman, 2015; Lehner, Nicholls, & Kapplmüller, 2022; Ormiston, 2019; 2022).

Drivers of impact investment

The drivers behind the emergence of impact investment cut across the three sectors within most liberal democracies: the private sector, the public sector, and the social economy.

In the private sector there has been an increasing interest in a range of 'sustainable' or 'responsible' investments. This has been driven by investor preferences, notably of millennials, who will benefit from the largest transfer of inherited wealth in history over the next decade.[33] In addition, institutional investors, such as pension funds and insurance firms, are recalibrating their long-term investment risk models to include social and environmental factors as material for their investment portfolios.[34] Much of this new investment takes the form of 'screened' funds that incorporate ESG factors into their investment selection criteria. Some estimates put the ESG/SRI market at approximately 45 per cent of all assets under management.[35] Attendant on this market has been the development of new measurement and accounting systems such as the UN Principles for Responsible Investment,[36] Global Reporting Initiative, and Social Accounting Standards Board (SASB). However, despite this substantial growth in finance linked to ESG/SRI factors, the market has been widely criticized for having limited—or poorly measured—impact on environmental or social ills, primarily

[32] The GSGII was established in August 2015 as the successor to, and incorporating the work of, the Social Impact Investment Taskforce established under the UK's presidency of the G8. The GSGII currently has thirty-two countries plus the EU as members. See further: https://gsgii.org

[33] According to Forbes, millennials will inherit more than $68 trillion from their baby boomer parents by the year 2030. See further: https://www.forbes.com/sites/jackkelly/2019/10/26/millennials-will-become-richest-generation-in-american-history-as-baby-boomers-transfer-over-their-wealth/#3dcc954b6c4b

[34] See, for example: https://www.institutionalassetmanager.co.uk/2020/05/19/285756/esg-will-be-industry-standard-within-five-years-say-institutional-investors

[35] The MSCI Index estimated the total ESG market in 2020 to be $40.5 trillion. See further: https://www.pionline.com/esg/global-esg-data-driven-assets-hit-405-trillion. BCG estimated that total global assets under management were approximately $89 trillion in 2019. See further: https://image-src.bcg.com/Images/BCG-Global-Asset-Management-2020-May-2020-r_tcm23-247209.pdf

[36] See https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment

because many funds simply screen out poorly performing companies rather than targeting new investment in high-impact sectors.[37]

In terms of the public sector, since the 1980s a range of policy innovations based on the theory of New Public Management have innovated public spending regimes around new models of privatization and public–private partnerships (Osborne and Gaebler, 1992; Osborne, 2007). This significant policy shift has created a new market for private providers of public services as well as—more recently—refocusing public spending more generally on effectiveness and efficiency via outcomes-driven spending and contracting models (Warner, 2013). In both cases, significant private capital has moved into the provision of public goods. While being less obviously 'social' than ESG, such capital has helped to grow a sector of social economy organizations.

In terms of the social economy, there has been increased engagement with private capital by the social economy organizations driven by the shortfall of grants and philanthropic capital to match the pressing global, social, and environmental needs. This has also driven social economy organizations to develop new, for-profit, models that engage with private capital.

At the trans-national level, the establishment of the United Nations' SDGs[38] in 2015 required significant financing across its seventeen areas of action. As of 2019, it has been estimated that there will be a shortfall of between $2 trillion and $4 trillion annually—roughly 50 per cent of the total needed—to achieve SDGs by 2030.[39] Impact investing thereby provides an avenue for investors to contribute to the SDG agenda (Castellas & Ormiston, 2018).

Taken together, across all sectors of the global economy, these forces are driving the emergence of impact investment as a tool to finance social economy activity.

The spectrum of impact investment

The following sections of this chapter, on the spectrum of impact investment, global market size, and financial returns, were previously published in a report by the lead author entitled 'Sustainable Finance: A Primer and Recent Developments'.[40] The earlier report was prepared for the Asian Development Bank to inform the report 'Asian Development Outlook 2021: Financing a Green and Inclusive Recovery'.[41]

Considering impact investment as a spectrum highlights that multiple types of capital are brought together in the impact investment market (Moran &

[37] See, for example, critiques of ESG ratings systems—https://www.economist.com/finance-and-economics/2019/12/07/climate-change-has-made-esg-a-force-in-investing—as well as warnings over 'greenwashing' funds: https://www.ftadviser.com/investments/2020/07/16/be-critical-of-esg-credentials-to-avoid-greenwashing-funds/

[38] The Sustainable Development Goals (SDGs) were established in 2015 by the United Nations General Assembly as a part of the '2030 Agenda' UN Resolution. The SDGs represent a set of seventeen interlinked goals designed to be a 'blueprint to achieve a better and more sustainable future for all', see further: https://www.un.org/sustainabledevelopment/sustainable-development-goals/

[39] https://www.sustainablegoals.org.uk/filling-the-finance-gap/

[40] See: https://www.adb.org/sites/default/files/institutional-document/691951/ado2021bp-sustainable-finance.pdf

[41] See: https://www.adb.org/publications/asian-development-outlook-2021

Ward-Christie, 2022). The spectrum of impact investment includes all types of private capital that are deployed for social impact, including: grants; foundation assets deployed as Programme-Related Investment (PRI) or Mission-Related Investment (MRI); sub-market and market return investments (though not typically fully risk-adjusted); development finance; and positive ESG. The spectrum reflects both 'broad' and 'core' impact investment.

Figure 6.1 sets out the spectrum of impact finance organized by three categories: impact only; impact first; finance first. These correspond to different expected returns (not typically risk-adjusted). The figure also shows the estimated global market size and estimated returns for each type of capital. Given the absence of any consolidated financial performance data sets on most of the types of finance in the spectrum, the returns have been estimated from publicly available sources and should be seen as indicative.

The following sub-sections unpack the elements of the spectrum of impact investment and outline the available insights on market size and financial returns.

Grants

In terms of grants, the global market can be estimated at $75 billion. This is approximated from 5 per cent of total foundation assets globally—the legal requirement for charitable status in the USA, though not elsewhere.[42] This figure also excludes government grants to social enterprises, although these may be quite substantial sums. For example, the UK government has deployed in excess of £1 billion of public money to support the development of the social enterprise sector and impact investment infrastructure since 2010.[43]

With respect to returns, grant capital is deployed with the assumption of 100 per cent loss. As 100 per cent loss finance, grants play an important role both as start-up risk capital and as concessionary sustainable finance within blended finance structures and deals.

Programme-Related Investment

Programme-Related Investment (PRI) and Mission-Related Investment (MRI) form a part of a foundation's overall invested assets by using endowment capital to generate impact.

[42] Calculating the total value of philanthropic assets globally is difficult, since there is no single data set available. This figure is, therefore, an estimate based upon P. Johnson (2018) *Global Philanthropy Report* (Hauser Institute for Civil Society) valuation of global foundation assets at $1.5 trillion, see https://cpl.hks.harvard.edu/files/cpl/files/global_philanthropy_report_final_april_2018.pdf. This is likely to a larger figure in 2020.

[43] This figure includes: the endowment of UnLtd (£100 million); grants from the Futurebuilders (£215 million) and Investment and Contract Readiness (£60 million) Funds; co-investments with Bridges Fund Management (>£20 million); unclaimed bank account assets to the Reclaim Fund (>£850 million) of which Big Society Capital has deployed >£600 million to 2019.

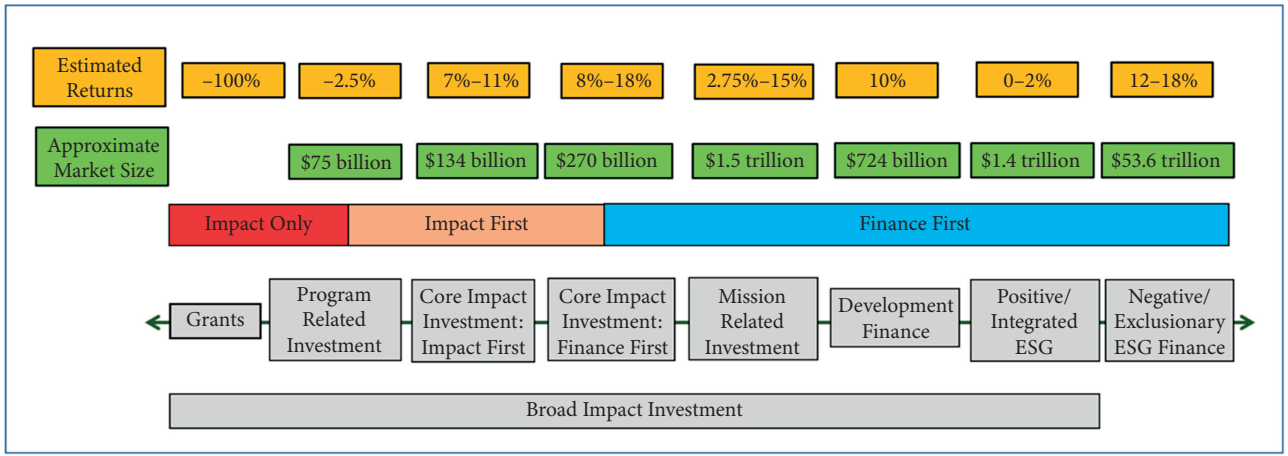

Figure 6.1 Spectrum of impact investment

PRIs typically take the form of debt capital to fund programmatic activities, often in concert with grants, and expect the return of capital only.[44] In the USA, PRIs can be included in the annual 5 per cent allocation of 'grant' capital.

The returns to PRI are estimated to vary between capital preservation and some loss-making. For example, KL Felicitas Foundation—with aims to invest 100 per cent of its assets as impact—reported a −2.5 per cent p.a. loss on its PRIs.[45] Moreover, under the US Internal Review Code for charity tax regulation, PRIs can be included in the minimum 5 per cent of total assets per annum which should be dispersed as grants, suggesting that they are expected to make some level of loss (Brest, 2016).

Core impact investing

Following the definition noted above, in the 2020 annual report, the GIIN estimated the 'core' impact investment market size at $404 billion.[46] However, the survey data will, likely, underestimate the total market size as it is based on a sample of only 290 respondents. In terms of sectors, the GIIN data suggested that the categories of impact investments were evenly spread between energy (16 per cent of all investments), financial services (12 per cent), forestry (910 per cent), food and agriculture (9 per cent), and micro-finance (8 per cent). In terms of instruments, private debt (37 per cent) and publicly traded debt (24 per cent) accounted for more than half of all capital invested, with private equity the third largest at 16 per cent and publicly traded equity the fourth largest at 10 per cent.

Impact investment can be either impact-first or finance-first depending on the structure of the fund/deal and investor expectations; expected returns vary between capital preservation and sub-market return (impact first) and risk-adjusted market returns (finance first).[47] In terms of expected financial returns, foundations, not-for-profit asset managers, and family offices were largely 'impact first' and would accept some sub-market rate investments. On the other hand, pension funds, insurance companies, for-profit asset managers, and development finance institutions were 'finance first' and generally expected risk-adjusted market returns.

In terms of impact investment returns, the GIIN 2020 survey separated out the data into either 'developed market' or 'emerging market' categories and then by

[44] See, for example, UK government guidelines: https://www.gov.uk/government/publications/charities-and-investment-matters-a-guide-for-trustees-cc14/charities-and-investment-matters-a-guide-for-trustees

[45] See: https://www.thinknpc.org/wp-content/uploads/2018/06/In-pursuit-of-deep-impact_NPC_KLF-Digital-1.pdf

[46] The GIIN Annual Impact Investor Survey 2020 included data from 290 impact investors who had deployed $404 billion. See: https://thegiin.org/assets/GIIN%20Annual%20Impact%20Investor%20Survey%202020%20Executive%20Summary.pdf. However, this does not include all impact investors, so is likely an under-estimate for the entire market.

[47] The GIIN Annual Impact Investor Survey 2020 included data from 290 impact investors. In terms of returns, 67% of this sample suggested that their investments achieved risk-adjusted market returns, 18% achieved below risk-adjusted market rate returns (but close to the market rate), and 15% achieved below risk-adjusted market rate returns (closer to capital preservation) see: https://thegiin.org/impact-investment/need-to-know/%23s2

type of finance (as annualized, realized, gross returns).[48] In developed markets, the average actual return with an expected, risk-adjusted, market rate return was 16 per cent from private equity, 13 per cent from real assets, and 8 per cent from private debt. In emerging markets, the average actual return with an expected, risk-adjusted, market rate return was 18 per cent from private equity, 10 per cent from private debt, and 8 per cent from real assets. While these returns look broadly in line with the typical risk-adjusted returns on mainstream private equity[49] and private debt,[50] there remain important empirical questions concerning whether these returns are properly risk-adjusted given the—typically non-financialized—impact risk variable in the overall capital structure.[51] Across the GIIN 2020 survey sample, more than 50 per cent of respondents saw a 'severe' or 'moderate' financial risk in several categories of performance, including business execution and management risk (23%+54%); country and currency risk (18%+40%); macro-economic risk (17%+49%); financing risk (13%+46%); and market demand and competition risk (9%+44%).

In developed markets, the average actual return with an expected below-market rate return was 10 per cent from private equity and 7 per cent from private debt. In emerging markets, the average actual return with an expected below-market rate return was 11 per cent for private equity and 8 per cent for private debt. In both below-market scenarios, real assets did not expect a sub-market return. The GIIN data also suggested that the majority of its sample investors' financial returns were either 'in line with' or 'outperforming' expectations, with only 12 per cent reporting that they were 'underperforming'.

Mission-related investment

MRIs take the form of debt or equity and typically aim to further the foundation's missions and make a competitive financial return (Henriques et al., 2016). The potential market size of MRI investments could, potentially, equal the total assets of all foundations, or roughly $1.5 trillion globally.[52]

[48] The median age of inception of the investments in the sample was 2011.

[49] Average returns globally from 2009 to 2019 were 15.3%, see: https://www.marketwatch.com/story/private-equity-returns-have-gone-up-that-may-not-last-2020-06-18

[50] The average return in private debt globally from 1998 to 2016 was between 10% and 15%, see: https://www.ipe.com/research-the-rise-of-private-debt/10012090.article. However, the COVID pandemic will likely severely affect more recent returns, see: https://www.fnlondon.com/articles/private-debt-funds-set-for-worst-performance-since-the-global-financial-crisis-20200807

[51] Interestingly, however, there is some data that suggests that impact finance outperforms the market. This may be for several reasons including: overall better risk management (ESG funds, see: https://www.ft.com/content/733ee6ff-446e-4f8b-86b2-19ef42da3824); exploiting new, growth markets (green finance, see: https://www.bloomberg.com/graphics/2019-green-finance/); lack of correlation with market risk (micro-finance, see: https://www.triodos.co.uk/ethical-investments/microfinance-fund/LU0842307588).

[52] For pioneers in using MRI as 100% of assets see: KL Felicitas Foundation, https://klfelicitasfoundation.org; FB Heron Foundation, https://www.heron.org; T100, https://toniic.com/t100/; and the Ford Foundation's decision to engage in MRI, https://www.marketplace.org/2020/07/02/ford-foundation-darren-walker-charitable-organizations-philanthropy-economy-social-bonds/.

MRIs, as was noted above, typically seek market returns.[53] However, *contra* this assumption, KL Felicitas Foundation's overall endowment—aside from PRIs—returned only 2.75 per cent p.a. as MRI, so this could be seen as indicative of a lower threshold for MRI returns.

Development finance

A further important impact finance sector is development finance.[54] This sector includes multi-national agencies, such as the Asian Development Bank, Inter-American Development Bank, and International Finance Corporation (IFC); regional agencies, such as the European Bank for Reconstruction and Development; and national agencies, such as CDC in the UK. There is no single data set for all development finance, but in 2019 the IFC suggested that the twenty-five Harmonized Indicators for Private Sector Operations signatory DFIs could be seen as impact investors with total assets under management of $742 billion.[55]

Development finance returns can be estimated from some of the larger players in the market. For example, IFC recorded an average return on assets in a range of 0.1 per cent to 1.6 per cent between 2015 and 2019,[56] whereas CDC returned an average 10.3 per cent between 2012 and 2016.[57] Furthermore, an analysis of the equity returns on IFC, European Bank for Regeneration and Development (EBRD), and FMO showed an average of 10 per cent between 2003 and 2015.[58]

ESG

An additional category of impact investment is capital deployed thematically for an ESG purpose. Such ESG finance can be categorized as either positive/integrated or negative/exclusionary. An important distinction between negative and positive ESG finance is in terms of the additionality of impact, which relates to the 'Double Delta' of sustainable finance.[59] The Double Delta analysis distinguishes

[53] As a benchmark, the average market returns over ten years to June 2020 were S&P 500 14.7% and Dow Jones Industrial 15.04%: https://www.wealthsimple.com/en-us/learn/average-stock-market-return.

[54] In earlier estimates of the size of the impact investment market, development finance was typically excluded, see, for example, the GIIN Annual Impact Investor Survey 2019: https://thegiin.org/assets/GIIN_2019%20Annual%20Impact%20Investor%20Survey_ExecSumm_webfile.pdf. The 2019 GIIN report estimated the market to be $239 billion, whereas the 2020 report estimated the size to be $404 billion. The large increase appears, at least partly, to be a consequence of the inclusion of some development finance institutions in the 2020 survey sample for the first time.

[55] See: https://www.ifc.org/content/dam/ifc/doc/mgrt/the-promise-of-impact-investing.pdf

[56] See: https://www.ifc.org/wps/wcm/connect/corp_ext_content/ifc_external_corporate_site/annual+report/financials

[57] See: https://www.devex.com/news/financial-returns-likely-to-go-down-over-next-5-years-says-cdc-chair-92943

[58] See: https://publications.iadb.org/en/comparative-study-equity-investing-development-finance-institutions

[59] See: https://www.credit-suisse.com/media/assets/microsite/docs/responsibleinvesting/the-double-delta-of-impact-investing.pdf

between the additionality of impact at the investee/enterprise level and the additionality of impact at the investor/capital level. From this perspective, ESG capital that is invested by buying listed equity or debt in the mainstream markets has no additionality in terms of impact,[60] whereas new investment into new impact enterprises or to grow innovations has double additionality in terms of impact.

In 2018, the global total of assets under management that followed some form of ESG thematic approach amounted to approximately $60 trillion—or more than half of all assets under management.[61] All of the major investment banks now manage ESG funds, as well as many specialist fund managers.[62] Accurate data on the exact size and scope of each category is not publicly available. However, some broad conclusions can be drawn from what is available. The evidence suggests that the vast majority—more than 95 per cent—of ESG finance falls under the negative/exclusionary category that screens investments by a variety of ESG criteria including corporate practices, best-in-class comparators, norms-based analysis against global standards (ILO, UNCEF, OECD), and level of ESG integration in corporate strategy (see Table 6.1).

The data also suggests that the majority of ESG investing is in public equity and fixed income debt—categories that indicate a focus on mainstream businesses that are publicly listed. Following the logic of the Double Delta model noted above, these ESG investments are not materially impactful.[63] In terms of geography, the European ESG market is focused mainly on an exclusionary approach, whereas the US market is focused more on ESG integration.[64]

Table 6.1 ESG finance allocated by theme 2018

Theme	*Negative/exclusionary*	*Positive/integrated*
Negative screening	19.8	
ESG integration	17.5	
Corporate engagement	9.8	
Norms-based	4.7	
Best-in-class	1.8	
Sustainability-themed		1.0
Community focus		0.4
TOTAL $ Trillion	**53.6**	**1.4**

Source: Bloomberg[a]

[a] See: https://www.bloomberg.com/graphics/2019-green-finance/

[60] While there is a plausible argument that 'active' equity ownership may affect positive impact via changing corporate strategy or policy in listed companies, there is little evidence of this in practice.

[61] See: https://www.bloomberg.com/graphics/2019-green-finance/

[62] See: https://www.bloomberg.com/graphics/2019-green-finance/

[63] See: http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf

[64] See: http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf

Positive/integrated ESG

Positive/integrated ESG investment deploys additional capital to create additional investee impact aligned with the SDGs, most notably as green or social bonds. It is focused on private markets and early stage, high potential impact companies. Therefore, this category of ESG finance fulfils the broad definition of impact investment. However, negative/exclusionary ESG investment deploys capital thematically through a screened investment analysis aiming to 'do no harm' via investments that are typically made in large, publicly listed companies via secondary markets. While negative/exclusionary ESG finance does provide additional capital, it does not create additional impact at the investee level and, as such, it does not fulfil the definition of impact investment. However, in order to capture the full range of sustainable finance deployed for environmental and/or social impact, the spectrum sets of impact investment acknowledge both the positive/integrated and negative/exclusionary ESG categories.

The following sub-sections unpack the positive ESG categories of green bonds and social bonds, as well as the returns on negative ESG investing.

Green bonds

The green bond market has been growing rapidly.[65] In 2019, $257.7 billion of green bonds were issued globally—growth of 51 per cent on the 2018 total of $167.3 billion. Of these, Europe accounted for 45 per cent while the Asia-Pacific market issued 25 per cent, with China the largest Asian issuer.[66] Some estimates suggest that this market could account for up to $1 trillion in new issuances by 2021.[67] In 2019, the largest cumulative issuers of green bonds were the US Federal National Mortgage Association ($22.8 billion); the German Reconstruction Credit Institute ($9.02 billion); the Dutch State Treasury Agency ($6.66 billion); the Republic of France ($6.57 billion); and the Industrial and Commercial Bank of China ($5.85 billion).[68] Moreover, in a 2019 survey of 135 hedge funds in thirteen countries—with assets under management of $6.25 trillion—84 per cent reported 'an increased interest in ESG-orientated funds and strategies over the last 12 months.'[69] All the major global stock exchanges have listings for green bonds as public debt.[70]

The data on the pricing of green bonds remains mixed (Liaw, 2020). Some analysis suggests that the pricing does not typically reflect any sort of risk premium.[71] As such, returns are typically close to conventional bonds, which have been between

[65] See: https://www.msci.com/esg-ratings
[66] See: https://www.climatebonds.net/resources/reports/2019-green-bond-market-summary
[67] See: https://expertinvestoreurope.com/green-bonds-forecast-investments-to-break-through-1trn/
[68] See https://expertinvestoreurope.com/green-bonds-forecast-investments-to-break-through-1trn/
[69] See: https://www.cnbc.com/2020/02/14/esg-investing-numbers-suggest-green-investing-mega-trend-is-here.html
[70] See: https://www.forbes.com/sites/brendancoffey/2019/11/12/esg-stocks-are-having-a-fantastic-year/?sh=6fd53e352fbb and https://www.climatebonds.net/green-bond-segments-stock-exchanges
[71] See: https://blogs.cfainstitute.org/investor/2019/10/08/green-bonds-vs-traditional-bonds

zero and 2 per cent over the past five years.[72] For example, in 2020 Barclays issued a £400m, six-year green bond to support climate-related products and initiatives, with an annual yield of 1.70 per cent.[73]

Social bonds

Social bonds are also emerging as a new market for positive/integrated ESG finance. The first social bond was issued by the Instituto de Credito in Spain in 2015. It focused on offering sub-market loans to small and medium-sized organizations in deprived areas with the aim of accelerating economic growth and creating local jobs. The three-year social bond raised EUR 1 billion from a range of international investors. This was followed by a second EUR 1 billion Spanish social bond—also in 2015—issued by Kutxabank to provide affordable housing in the Basque country.[74] In 2017, the IFC launched a Social Bond Program that offered investors an opportunity to allocate social bond investments focused on the SDGs with a triple-A rated credit risk. Finance from the bonds focused on supporting banking for women and inclusive business programmes, which benefit under-served populations in emerging markets, including women and low-income communities with limited access to essential services such as basic infrastructure and finance. By 2020 the IFC had issued thirty-nine social bonds, raising $3.1 billion.[75]

In 2020 the SDG Impact project, within the UNDP, launched a set of SDG Impact Standards for SDG Bonds.[76] These standards contained six standards under four topic areas: strategic intent and impact goal setting; impact measurement and management; transparency and comparability; and context and governance. By 2020, total issuance had reached $33.1 billion, up from $6.2 billion in 2019. This accounted for 28 per cent of the total sustainable finance bond market.[77]

While the available data is more limited for social bonds, they seem to follow a similar pricing profile to green bonds without any risk premium. For example, in 2020, Assura issued a £300 million, ten-year social bond with an annual yield of 1.5 per cent.[78]

[72] See, for example: https://www.climatebonds.net/files/reports/cbi_gb_pricing_2h2018_08052019.pdf

[73] See: https://home.barclays/news/press-releases/2020/10/barclays-raises-p400m-through-second—green-bond—issue-/

[74] See: https://www.gbm.hsbc.com/-/media/gbm/reports/insights/social-bonds.pdf

[75] See: https://www.ifc.org/wps/wcm/connect/corp_ext_content/ifc_external_corporate_site/about+ifc_new/investor+relations/ir-products/socialbonds

[76] See: https://sdgimpact.undp.org/assets/SDG-Impact-Standards-for-Bonds_First-Public-Consultation-Draft.pdf

[77] See: https://cib.bnpparibas.com/sustain/capital-markets-and-covid-19-have-social-bonds-come-of-age-_a-3-3503.html

[78] See: https://www.investegate.co.uk/assura-plc/rns/pricing-of—300m-social-bond/20200908161950384 6Y/

Negative ESG investing

In terms of the returns on negative/exclusionary ESG finance, the available data suggests that the top performing stocks had a return of 12–16 per cent in 2018–2019.[79] This compares to 29 per cent growth in the S&P 500 for the same period.[80] However, Barclays' analysis of the ESG performance of its funds between 2013 and 2020 showed rough parity between ESG and non-ESG equity returns, averaging approximately 18 per cent annual growth.[81]

Learning from policy innovation in the UK

Maduro et al. (2018) provided an extensive overview of the social impact investment landscape in the EU and noted that the UK has the most developed market infrastructure. Over the past decade, the UK government has been a global pioneer in terms of policy innovation for impact investment, launching several key policy innovations to support the growth of the market (Nicholls & Teasdale, 2017; Nicholls & Teasdale, 2020).

In 2010, the UK Cabinet Office published a strategy to grow the social investment market.[82] Subsequent to this, in 2013, the Cabinet Office established a Social Impact Investment Task Force (SITF).[83] Established by the UK government in 2013 and coordinated by the Cabinet Office, the SITF was given the remit to grow the impact investment market globally. Members of the Taskforce included representatives from the UK, Canada, the EU, France, Germany, Italy, Japan, USA, and Australia, as well as several development finance institutions. The SITF established a range of topic-specific working groups to agree key principles and approaches, provide relevant examples and draft papers to produce recommendations for policy-makers. Working groups were set up in the areas of impact measurement, asset allocation, international development and impact investment, and mission alignment. In addition to the working groups, the taskforce oversaw the preparation of a report on the global social investment market by the Organisation for Economic Co-operation and Development (OECD). The OECD published its report in 2015.[84]

The SITF members also each developed a national advisory board (NAB) to examine ways of accelerating the growth of the impact investment market in their own country/region. These boards brought together leaders of organizations active in impact investment, philanthropic foundations, social enterprises, and mainstream

[79] See: https://www.ftadviser.com/investments/2019/10/10/esg-investing-provides-strong-returns/
[80] See: https://markets.businessinsider.com/news/stocks/sp-500-2019-annual-return-for-year-best-since-2013-2019-12-1028790061?
[81] See: https://www.investmentbank.barclays.com/our-insights/3-point-perspective/esg-funds-looking-beyond-the-label.html?cid=paidsearch-
[82] See: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/61185/404970_SocialInvestmentMarket_acc.pdf
[83] See: https://www.gov.uk/government/groups/social-impact-investment-taskforce#members-of-the-taskforce
[84] See: https://www.oecd.org/sti/social-impact-investment-9789264233430-en.htm

investment organizations. Each NAB produced an annual report, including policy recommendations. In 2015, the SITF was superseded by the GSGII (discussed earlier). In addition to deploying public finance as start-up capital for the sector (noted earlier), the UK government used a range of other policy levers to support the market. These included regulation, legislation, fiscal policy, and public spending innovations such as Social Impact Bonds.

Regulation

With respect to regulation, in 2005 the UK government launched the first new legal form of incorporation for more than 100 years, specifically aimed at social enterprises: the Community Interest Company (CIC). By mid-2020, more than 19,000 organizations had registered as CICs.[85] To be eligible to register as a CIC, an organization must already be a Company Limited by Guarantee (CLG); a Company Limited by Shares (CLS); or a Co-operative, Mutual, or Industrial and Provident Society (a form of mutual company). Registered charities are excluded. The policy objective of the CIC model was to facilitate more investment into social enterprises as a recognized legal entity that would ensure an impact focus. In addition, every CIC is required to file an annual report to the Regulator setting out some details of their social impact. A number of legal requirements are built into the CIC model: an asset lock, that does not allow for a CIC to be bought out to realize an asset such as property; a dividend payment cap (for CLSs) of 35 per cent of net annual profits; a performance-related interest loan cap of 20 per cent of outstanding debt (for CLGs).[86] These requirements were designed to discourage organizations that took a finance-first rather than impact-first approach registering as CICs. In addition, any investment in a CIC attracts Social Investment Tax Relief (discussed later in the chapter). Despite these factors, it still remains unclear how much new capital has actually been raised by CICs.[87]

In terms of building the supply side, an important policy innovation in terms of regulation was the Public Services (Social Value) Act.[88] Introduced by the UK government in 2013, this Act aimed to grow the social enterprise sector by increasing the scope for access to public sector contracts. The Act required all public sector commissioners to *consider* social value when evaluating tender applications for contracts above £111,676 (central government) and £172,514 (for other bodies). However,

[85] See: https://communityinterestcompanies.blog.gov.uk/2020/09/09/annual-report-2019-to-2020-community-interest-companies/

[86] See: https://www.isonharrison.co.uk/blog/how-could-a-community-interest-company-meet-your-enterprise-needs/

[87] For example, see the rather nebulous comment 'A solid number of CICs are already receiving social investment and this market has grown significantly': https://www.accountingweb.co.uk/business/finance-strategy/community-interest-companies-funding-for-growth/

[88] See: https://www.gov.uk/government/publications/social-value-act-information-and-resources/social-value-act-information-and-resources

takeup has been limited. By 2015, only 11 per cent of local authorities had applied the Act in their commissioning process and only 27 per cent of those which tendered for contracts were chosen on their superior social value criterion.

Legislation

With respect to legislation, the UK government has introduced two Acts aimed at developing the impact investment market both in terms of the supply side and the demand side. In terms of a supply-side measure, in 2005 the UK government set up a Commission on Unclaimed Assets, tasked with exploring how unclaimed assets in dormant bank accounts—specified as having had no transactions for fifteen years or more—could be reclaimed to benefit society. Following the recommendations of the Commission, in 2008, as a supply-side measure, the government introduced the Dormant Bank and Building Society Accounts Act.[89] The act specified that retail bank account assets that were dormant—again, defined as being without any transactions for fifteen years or more—should be transferred to a new, non-statutory body, the Reclaim Fund, for 'good causes'.[90] The Reclaim Fund was administered by the Co-operative Banking Group as a 100 per cent shareholder; it released funds via the National Lottery Community Fund to each of the four administrative areas of the UK.[91] Participation by banks and building societies was voluntary. Nevertheless, twenty-two did agree to release their dormant assets annually, including the four big high street banks—HSBC, Lloyds, Barclays, and the Royal Bank of Scotland. By 2020, £1.35 billion in dormant bank account assets had been transferred from 118,000 accounts; only £93 million had been reclaimed by customers, or roughly 7 per cent. From these dormant assets, the Reclaim Fund allocated £745 million to the National Lottery Community Fund to disburse.[92] In 2015, the UK government launched a Commission on Dormant Assets to explore other sources of dormant assets from pension and insurance funds and investment and wealth management portfolios. The Commission reported back in 2017 and suggested that a further £1.6 billion of unclaimed assets could be accessed.[93] However, as of 2020, none of its recommendations have been implemented.[94]

Of the various 'good causes' to which dormant assets have been directed, the most significant is Big Society Capital (BSC). In 2008, when the Dormant Bank and

[89] See: https://www.legislation.gov.uk/ukpga/2008/31/contents

[90] See: https://www.reclaimfund.co.uk/about-us/. By 2020, 15,000 'good causes' had been funded across the UK.

[91] See: https://www.reclaimfund.co.uk

[92] See: https://fr.zone-secure.net/-/Reclaim_Fund_Annual_Report_and_Accounts_2019/-/#_page=1&page=1

[93] £715 million from investments and wealth management; £550 million from the pensions and insurance sectors; £150 million from securities; £140 million from banks and building societies. See: https://www.gov.uk/government/news/2-billion-boost-set-to-transform-charity-and-voluntary-sector-funding

[94] See: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/727189/Tackling_dormant_assets_-_recommendations_to_benefit_investors_and_society__1_.pdf

Building Society Accounts Act passed, one of its three specified purposes focused on creating a 'Social Investment Wholesaler' with the objective of building the supply of capital to impact investment funds by co-investment with other asset managers, while not making direct investments itself. In 2011, as part of the 'Merlin Agreement' that specified the terms of the financial bail-out between the UK government and the major UK high street banks, a commitment was included that the four largest banks should each contribute £50 million in equity into the 'Big Society Bank'. The combination of unclaimed assets and the Merlin Banks' equity capitalized BSC. In 2012, BSC was launched as the world's first wholesale impact investment intermediary.[95] By 2019, BSC had signed £2 billion in commitments with other investors, of which £1.3 billion had been drawn down. In these deals, BSC mobilized £626 million of dormant assets to achieve greater than 3x leverage of its assets.[96] Following an initial phase of opportunistic co-investment, BSC now focuses on three categories of impact: early interventions in health and education; place-based investment, focused on areas of deprivation; homes and social housing.

In terms of building the demand side, in 2015 BSC created the Access Foundation in collaboration with the National Lottery Community Fund and the UK government's Cabinet Office (responsibilities now transferred to the Department for Culture, Media and Sport, DCMS). The Access Foundation's objectives were to support charities and social enterprises in England 'to become more financially resilient and self-reliant, so that they can sustain or increase their impact'.[97] Specifically, the aim was to drive the economic development of charities and social enterprises such that they could diversify their income base and become investment-ready to access impact investment and providing a pipeline of potential deals for a BSC co-invested fund. The Access Foundation's capital structure consists of a £60 million endowment from DCMS and £45 of 'blended growth' capital split equally between BSC and the National Lottery Community Fund.[98] This combination of endowment and blended capital allows the Access Foundation to combine grants with sub-market loans in various deal structures to address a capital gap in terms of investment readiness in the social sector. At the same time, it aims to create new investment opportunities for the funds with which BSC co-invests. The Access Foundation developed three programmes to address its objectives:[99]

- *The Growth Fund*: launched in 2015 as a co-investment fund, the £45m Growth Fund offered a range of grants and small-scale unsecured loans to charities and social enterprises to bridge a gap in the market for small-ticket, sub-market finance. By 2018 it had co-invested with sixteen other funds (with fifteen social investors) totalling £50m in capital allocated to 250 small social organizations

[95] See: https://bigsocietycapital.com
[96] See: https://bigsocietycapital.com/investment-numbers/
[97] See: https://access-socialinvestment.org.uk/us/what-we-do/
[98] See: https://access-socialinvestment.org.uk/us/the-story-so-far/
[99] See: https://access-socialinvestment.org.uk/us/the-story-so-far/

(<50-% with turnover >£250k) with an average investment size of £64k. This contrasts with the median investment size of c. £250k.

- *The Reach Fund*: launched in 2016, the Social Investment Business was selected to run the Reach Fund to build investment capacity in social enterprises. By 2018, more than 220 grants totalling more than £3m had been made. The median turnover of the grantees was >£100k. Seventy of those grantees went on to raise investment to a total value of more than £17m.
- *The Impact Management Programme*: Launched in 2017, and delivered in partnership with New Philanthropy Capital, the programme provided £1.8m of grants to build impact management skills and capacity in charities and social enterprises who are seeking impact investment or new government contract opportunities.

In addition to these core programmes and in collaboration with BSC, the Access Foundation also developed the Good Finance website[100] in 2016 as a resource to provide advice and examples to help social enterprises access finance. In the first three years the website was used by 74,000 users who engaged with eighty investors and advisors. In 2017, the Access Foundation also created the Connect Fund—in partnership with the Barrow Cadbury Trust—as another initiative to build the impact investment infrastructure. By 2019, the Connect Fund had supported more than fifty projects around the UK with capacity building, data sharing, building networks, developing standards and templates, and sharing market information. Finally, in 2018, the Access Foundation launched the Enterprise Development Programme (EDP), to support early stage social enterprises as a twelve-month pilot scheme. The EDP worked with the Social Investment Business to manage two grant products—feasibility grants and larger enterprise development grants—and with the School for Social Entrepreneurs to manage social enterprise learning in two cohorts of experiential programmes for leaders working on homelessness and youth training. During the pilot phase, ninety-two grants were made, totalling £1.25m.

Fiscal policy

With respect to fiscal policy, in 2014 the UK government introduced Social Investment Tax Relief (SITR).[101] The new tax relief was specified in three ways: income tax relief of 30 per cent on annual investments of up to £1 million with a carry back relief to the tax year preceding the year of investment; deferral that matched the investment to capital gains made in the three years prior to, or one year following, the date of the investment; exemption of gains on subscribing for shares realized on their disposal (which will not be subject to tax providing that a claim for income tax relief

[100] See: https://www.goodfinance.org.uk
[101] See: https://www.gov.uk/guidance/venture-capital-schemes-apply-to-use-social-investment-tax-relief

is made three years after the date of the investment). In terms of the requirements to apply for SITR, investments must be made into a specified set of organizations—charities, CICs, Community Benefit Societies (with an asset lock of fewer than 500 employees and less than £15m in assets), and Social Impact Bonds (as agreed by the Department for Culture, Media and Sport—discussed further presently)—up to a maximum, per organization, of £1.5 million over the life of the organization. For the individual investee, the maximum investment is capped at £1 million per year. The take up of SITR has been surprisingly modest—by 2016/17 only £5.1million of investment had been subject to the tax relief, against a UK Treasury projection of £83.3 million.[102] This is perhaps because of a lack of infrastructure—as of 2018, there were only four SITR funds available to investors.

Public spending innovation: Social Impact Bonds

In the context of this broad range of UK government support for the impact investment market, perhaps the most innovative initiative has been the development of Social Impact Bonds (SIBs) (Edmiston & Nicholls, 2018).[103] SIBs are not, in fact, bonds of any sort. Rather, they are a form of contingent future liability contract—or, more simply, a payment-by-results contract[104]—between an investor, an outcomes payer, and a service provider, where the returns to the investor are directly linked to clear measures of social impact. In 2010, the UK launched the world's first SIB focused on reducing re-offending by ex-prisoners at Peterborough Prison (Nicholls & Tomkinson, 2015). The Peterborough SIB was broadly considered to be a success and the UK government committed to develop a number of further SIBs. By 2020, the UK had seventy-six SIBs in development or under way, mobilizing £44.7 million. Moreover, SIBs are now a global phenomenon. In 2020 the global total of impact bonds was 195 mobilizing £441 million in twenty-six countries.[105] The UK continues to dominate the SIB market, but a range of other countries have also launched several SIBs, including the US (31), Kenya (13), the Netherlands (13), and Australia (9). Across the EU (excluding the UK), there are forty-eight SIBs. In terms of sectoral focus, the largest sectors for impact bonds are employment and training (32%), homelessness (17%), health (16%), and child and family welfare (15%). The outcomes-based investment model has also been applied to other impact

[102] See: https://www.sibgroup.org.uk/sites/default/files/files/What%20A%20Relief%20-%20SITR%20research%20report.pdf

[103] See: https://www.socialfinance.org.uk/what-we-do/social-impact-bonds; https://www.gov.uk/guidance/social-impact-bonds; https://golab.bsg.ox.ac.uk/the-basics/impact-bonds/; https://www.brookings.edu/series/impact-bonds/

[104] In the US these are typically known as 'pay for success' contracts. See: https://www.air.org/resource/pay-success-social-impact-bonds/

[105] Data varies slightly, but there are three important impact bond resources. See: https://sibdatabase.socialfinance.org.uk; https://golab.bsg.ox.ac.uk/knowledge-bank/indigo-data-and-visualisation/impact-bond-dataset-v2/; https://www.brookings.edu/series/impact-bonds/

areas, including international development,[106] the environment,[107] conservation,[108] and humanitarian aid.[109]

In principle the SIB model can be applied to any intervention that satisfies three conditions: the outcome is measurable and can be given an agreed financial value; there is an outcomes payer; there are investors. This has made impact bonds very attractive to the impact investment community since they seem to offer an elegant model by which to 'price' impacts in the market, build robust outcomes data, and offer the potential of reaching substantial scale. Furthermore, and perhaps more significantly, the outcomes logic of impact bonds seems to be having an important effect in public services commissioning more generally, particularly in healthcare and pharmacology.[110] For example, in the UK in 2015, payment-by-results contracts accounted for more than £15 billion of public spending.[111]

The state of impact investment in the European Union

In the EU context, various institutions have supported the development of impact investment, including the European Commission (EC), the European Investment Bank (EIB), and the EIF. The European Union NAB is a joint initiative of the EC, the EIB, and the EIF, headquartered in Luxembourg. The objective of the NAB is to mobilize more than EUR 1 billion, with EUR 370 million already committed by the EIF.[112]

The EIF has focused on what is calls 'social' impact investment into projects working on social cohesion. EIF is the only impact investment wholesaler developing a pan-EU strategy. In 2020 EIF managed $1.1 billion currently invested in micro-finance and social enterprise.[113] The fund has provided support to develop the intermediary space to address a market failure in the access to finance for social enterprises. Specifically, the EIF developed a Social Impact Accelerator (SIA)[114] and the EFSI Equity Instrument.[115]

The SIA is a fund-of-funds wholesaler managed by EIF and invests in other social impact funds which target social enterprises across Europe. The SIA closed in 2015 at EUR 271m across nineteen funds with 3.5x leverage. The SIA brought together

[106] See: https://qualityeducationindiadib.com
[107] See: https://www.goldmansachs.com/media-relations/press-releases/current/dc-water-environmental-impact-bond-fact-sheet.pdf
[108] See: https://www.ft.com/content/2f8bf9e6-a790-11e9-984c-fac8325aaa04
[109] See: https://www.icrc.org/en/document/worlds-first-humanitarian-impact-bond-launched-transform-financing-aid-conflict-hit
[110] See, for example: https://golab.bsg.ox.ac.uk/toolkit/technical-guidance/awarding-outcomes-based-contracts/; http://www.pmlive.com/pharma_news/greater_manchester_backs_move_to_outcome-based_payment_1279006
[111] See: https://www.nao.org.uk/report/outcome-based-payment-schemes-governments-use-of-payment-by-results/
[112] https://gsgii.org/nabs/european-union/
[113] https://gsgii.org/reports/country-profile-european-union/
[114] https://www.eif.org/what_we_do/equity/sia/index.htm
[115] https://www.eif.org/what_we_do/equity/efsi/index.htm

resources from the EIB Group and external investors, including Credit Cooperatif, Deutsche Bank, the Finnish group SITRA, and the Bulgarian Development Bank (BDB).

The EFSI Equity Instrument was a joint venture between the European Commission and the EIF to fund further innovations in the fields of artificial intelligence, blockchain, space technology, impact investment, and blue economy. Within this, and in common with the SIA, the EFSI Equity Instrument focused on supporting the intermediary sector to provide more capital to social enterprises. Across the EU there is also a significant green finance sector with a sustainability and climate focus.[116]

The EIF is also responsible for managing the EaSI programme, which was launched in 2014. Within the EaSI there are three impact investment initiatives: the EaSI Guarantee ($446.1 million); the EaSI Capacity Building Investment Window (EUR 16 million); and the EaSI Funded (Debt) Instrument (EUR 220 million). Each aims to increase the flow of capital to social enterprise by building the intermediary sector and de-risking impact investments. As of 2015, fifteen EU countries had enacted some form of regulation that specifically targets social enterprises.[117]

The EBRD is another institution catalysing the growth of the impact investment markets. In 2015, the EBRD committed to allocate 40 per cent of its annual investment (by 2020) into a Green Economy Transition (GET) via direct green investment, technical support, policy advocacy, and concessional co-investment.[118] By 2019 the EBRD had issued EUR 5.2 billion in ninety-two green bonds, including a $700 million, five-year Climate Resilience Bond. In 2020 the EBRD issued a new set of GET objectives for 2021–2025.

Despite this wide range of initiatives, the Maduro et al. (2018) overview of the social impact investment landscape in the EU demonstrated that the landscape of social impact investment is highly heterogenous across the region. Similarly, the Expert Group on Social Entrepreneurship (GECES, 2018) noted the importance of improving access to finance for social enterprises in Europe, highlighting the need for increased public investment in capacity building for investment readiness and supporting the development of impact investment infrastructure and co-investment as catalytic capital in blended models with private finance. These observations suggest that a more coherent overall policy agenda from the European Commission would be beneficial for future market development and growth across the EU.

Policy recommendations for the EU context

The market for impact investment is growing in the EU and providing increasing capital to social enterprises for both start-up and growth. However, the market remains incomplete, fragmented, and inefficient. Policy can play a central role in developing

[116] See, for example, https://impact-investment.eu/en/
[117] https://gsgii.org/reports/country-profile-european-union/
[118] See: https://www.ebrd.com/what-we-do/get.html

the market. There is clearly a value in developing specific policy agendas across the EU to grow the impact investment market in the region. Reflecting on similar policy innovations in the UK, these opportunities can exploit a range of policy interventions, including direct investment, co-investment, regulation, fiscal policy, legal forms, and knowledge management. These would identity and address gaps in the existing market infrastructure in terms of the supply side, the demand side, and intermediation (see Table 6.2).

Increasing the supply side of impact investment

- **Develop public procurement social value legislation:** In 2019, the European Commission reported that there are a range of examples of public procurement policies in place across twelve countries in the EU that support social enterprise access to public contracts and include 'social clauses' in contracts, reserved contracts, exclusion contracts, and social labels.[119] In addition, in 2018 the EIB established a set of framework guidelines for procurement that included a recommendation that tenders should be 'encouraged to contribute to the protection of the environment, human well-being, human rights, gender equality, combating climate change and promotion of sustainable development'.[120] These initiatives could be further developed as a consistent pan-European policy to increase the incentives for outcomes-based commissioning and payment-by-results contracts following the regulatory model set out in the UK Public Service (Social Value) Act. By implementing such a policy at EU level, issues around national state aid should be avoidable.
- **(Co)-invest in impact bonds and outcomes funds:** Consistent with this policy agenda, the EU could deploy capital directly and indirectly (by co-investment) to develop impact bond investment and outcomes payment funds to leverage other types of capital into social and environmental impacts around its broader policy agendas concerning the climate crisis, economic development, and the resilience of social infrastructure. Where such funds develop a robust—and market-contingent—connection between impact and financial value (returns), they would also increase both the efficiency and effectiveness of the allocation of public capital.
- **Co-create evergreen impact funds:** EU direct investment could also provide capital to co-create 'evergreen' social and environmental funds that roll over capital to avoid the traditional limited-life structures with arbitrary exit timelines of conventional funds. Evergreen funds typically offer more flexibility for fund managers and social enterprises with multiple liquidity events throughout the fund's life. However, they can prove hard to raise in the

[119] See: https://op.europa.eu/en/publication-detail/-/publication/3498035f-5137-11ea-aece-01aa75ed71a1

[120] See: https://www.eib.org/attachments/strategies/guide_to_procurement_en.pdf at p. 9.

mainstream market, given their complexity and relative novelty. De-risking and proving such funds with public capital could leverage mainstream capital into impact.[121]

- **Create tax incentives for impact investment:** In terms of fiscal policy, tax incentives for impact investment are already in place in two EU countries: in France, with investment into SCICs; and in Italy, with investment into government specified social enterprises. Such policies could be extended to the EU as a whole, with some provision to local market contexts.

Building the demand side of impact investment

- **Create a common EU social enterprise form of incorporation:** Currently, sixteen EU countries have some form of legislation that recognizes and regulates social enterprise activity—including both new legal forms and transversal legal status that cuts across existing organizational forms of incorporation dependent on pre-defined social criteria.[122] The majority of these recognize the social cooperative type of organization that has played an important role in the social economy for many years. In terms of this form of legislation, the EU could move further towards establishing a common legal form of incorporation for social enterprises such as the CIC in the UK or the Benefit Corporation in the US. Such an approach would allow impact investors better to identify legitimate social enterprises in the market for capital, thus decreasing the transaction costs of finding potential investees.
- **Provide capacity-building grants to social enterprises and support capacity-building infrastructure**: Another market failure in the current impact investment landscape is the relative lack of investment-ready social enterprises. The EU can play a catalytic role to address this issue by direct investment in capacity building in the investee sector. This would allow social enterprises to move away from a reliance on grants towards accessing investment. In addition, this would help drive innovation and scalability in the best-performing social enterprises. This policy could follow existing examples such as the UK Investment and Contract Readiness Fund, discussed previously.
- **Build networks of best practice in investment readiness:** Linked to direct investment, the EU could also build networks of investment readiness expertise—leveraging, for example, the EVPA and EU NABs—to share best practice and models.

[121] For example: I(x) Investments represent a permanently capitalized holding company. I(x) was founded by Warren Buffett's grandson, Howard W. Buffett. I(x) Investments makes equity investments with longer timelines than standard investment funds to seed other equity investments: https://ixnetzero.com/

[122] https://ec.europa.eu/social/BlobServlet? docId=12987&langId=en

Building impact investment intermediaries

- **Establish dormant accounts legislation:** Supporting the creation of an impact investment wholesale bank could represent an important policy innovation in terms of building the intermediary infrastructure. In 2016 a question was raised in the European Parliament concerning legislation to release dormant bank accounts to capitalize such wholesalers (following the example of BSC in the UK and an initiative in Switzerland),[123] but as yet no policy has been established.
- **Expand non-financial disclosures and co-create a 'Bloomberg' for Impact platform:** The lack of a robust reporting and disclosure framework for the social impact of capital represents another significant obstacle to the development of an efficient impact investment market. EU policy has made progress in terms of potential regulation around company-level non-financial and environmental disclosure.[124] The next step would be to develop a similar approach to impact disclosure likely linked to current work by the SDG Impact project,[125] the IFC,[126] and the IMP.[127] Such disclosure would also generate the impact performance data sets that are currently lacking in the market. EU investment in a 'Bloomberg' platform for impact data would be a transformational contribution towards reducing information asymmetries, increasing market efficiency, and growing the flows of capital to the social enterprises that deliver the most impact.
- **Invest in impact data technologies:** Investment in impact technology represents another important opportunity to build the intermediary infrastructure. The EU could deploy grant and investment capital to support the development of lean data technologies, big data collection, and AI algorithmic data analysis focused on environmental and social impact.[128] Such action would not only support other regulatory strategies to improve disclosure and the availability of impact data, but also create employment and contribute to the development of the European technology sector.

Future research opportunities

These policy recommendations for the EU context also indicate fruitful avenues for future research opportunities.

[123] See: https://www.europarl.europa.eu/doceo/document/E-8-2016-004628_EN.html
[124] See: https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting_en
[125] See: https://sdgimpact.undp.org
[126] See: https://www.impactprinciples.org/9-principles
[127] See: https://impactmanagementproject.com
[128] See, for example: https://www.60decibels.com

Table 6.2 Policy innovations for the European Union impact investment market

	Supply side	Demand side	Intermediation
Direct investment	Impact bond outcomes funds	Capacity-building grants	Impact data technologies
Co-investment	Impact bond co-investment funds Co-investment in impact evergreen funds	Capacity-building infrastructure	Co-create a 'Bloomberg' for impact platform
Regulation	Public procurement Social value legislation		Dormant accounts legislation Expand non-financial disclosure
Fiscal policy	Impact investment tax relief		
Legal forms		Single EU social enterprise form of incorporation	
Knowledge management		Build networks of best practice in investment readiness	

Research on direct and co-investment

Social economy researchers should explore the effectiveness of capacity of building programmes for social economy organizations. Insights on the effectiveness of these programmes will provide insights on how to connect social economy organizations with the impact investment market. Building on the growing research on SIBs (Edmiston & Nicholls, 2018; Fraser, Tan, Lagarde, & Mays, 2018; Ormiston, Moran, Castellas, & Tomkinson, 2020), future research could identify a broader range of impact domains where impact bonds and outcomes-based commissioning could be implemented. Research could also explore the role of catalytic capital deployed by governments to generate additional private capital into impact investment markets (Ormiston, Charlton, Donald, & Seymour, 2015). Finally, research should also explore how the beneficiaries in impact investment and social economy action can be embedded in the design and implementation of impact investment products (Casasnovas & Jones, 2022).

Research on regulation and fiscal policy

Future research should explore the relationship between social procurement policies and impact investment to understand whether building public markets for social economy organizations increases impact investment capital. Exploring this link would contribute to growing work on the impact of social procurement policy for social economy organizations (Cutcher, Ormiston, & Gardner, 2020; Denny-Smith, Williams, & Loosemore, 2020; Furneaux & Barraket, 2014). Building on the work of Katelouzou and Micheler (2022) future research could also explore the

effectiveness of impact investment tax relief in incentivizing more capital across the impact investment spectrum.

Research on investment readiness

Future research should explore the investment readiness of a wide range of social economy organizations across the spectrum of impact investment. Previous research has only explored investment readiness for a limited range of investment products (Hazenberg, Seddon, & Denny, 2015). Understanding the investment readiness of social economy organizations across the spectrum will provide insights on how to support social economy organizations to take advantage of the increasing appetite of impact investors.

Conclusions

This chapter has set out the range of impact capital available to support the development of social entrepreneurship globally and in the EU context. The spectrum of impact investment ranges from grants to ESG finance and offers returns from 100 per cent loss to market or above market returns. Taken as a whole, this capital is equivalent to more than half of all assets under management globally. In terms of available capital, the spectrum is dominated by the two types of ESG capital noted previously. However, even if negative/exclusionary ESG capital is excluded, the total market size remains substantial at roughly $22 trillion. While the core impact investment sector (as defined by the GIIN) is growing, it remains a small proportion of the whole at roughly $400 billion. Going forward, two key opportunities for the future growth of impact investment will be accessing foundation assets and negative/exclusionary ESG finance.

In the case of foundation assets, there is a huge opportunity to leverage more capital for impact. Generally speaking, foundation assets are not invested for impact. For example, historically, the Rockefeller Foundation has invested only approximately $68 million (or 1.8 per cent of its total endowment) in MRIs focused on renewables, clean energy and technology, and sustainable forestry. Moreover, only $85 million (or 2.2 per cent) of the endowment is invested in negative/exclusionary ESG.[129] This leaves roughly 96 per cent of assets invested in the mainstream (non-impact) markets. In a response to this in-balance between the impact focus of foundation assets and grant making, in 2017, the Ford Foundation made a strategic decision to commit $1 billion of its endowment to MRIs.[130] However, this was still only 8 per cent of its total endowment of $12.4 billion. Total foundation assets are estimated to be $1.5 trillion (see above). Assuming the same MRI investment as the Rockefeller Foundation, this

[129] See: https://www.rockefellerfoundation.org/wp-content/uploads/Rockefeller-Foundation-Social-Investing-Guidelines.pdf.pdf

[130] https://www.fordfoundation.org/the-latest/news/ford-foundation-commits-1-billion-from-endowment-to-mission-related-investments/

would mean that 96 per cent of these assets—or an additional $1.44 billion—could be made available for impact finance as MRIs going forward.

In terms of ESG finance, since more than 95 per cent (or roughly $53.5 trillion) of this finance falls under the negative/exclusionary category that does not conform to the Double Delta model, there is an important opportunity to leverage this capital into positive/integrated ESG investment. For example, if 50 per cent of this investment were directed towards providing additional capital to fund the SDGs, then the current shortfall would disappear.[131]

As has been set out in this report, innovative policy has played an important role in developing the impact investment market to date. Going forward, EU policy-makers can use regulation pro-actively to scale and shape this market, better to address the social and environmental issues that currently need such urgent attention.

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[131] See: https://www.bloomberg.com/graphics/2019-green-finance/

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