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RESEARCH ARTICLE

Impact investing: A review of the current state and opportunities for development

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Abstract

United Nations Sustainable Development Goals (SDG) are a universal call for action to protect the planet, end poverty and inequality in the world. Government and philanthropy resources are not sufficient to achieve these goals and financial resources from capital markets must be directed to them. Impact investments are "investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return" and can act as a catalyzer to canalize the needed capital to achieve SDG targets by 2030. This paper investigates this emerging financial paradigm, impact investment. History of impact investment and how it differs from socially responsible investment is presented. Several countries have taken initiatives to develop a regulatory framework to support social enterprise financing. Major actors in the impact investment market are private investors, institutional investors, private foundations, banks, development finance institutions, and nongovernmental organizations. Innovative financial structures are developed among these actors along the risk-return spectrum. Impact investing will thrive if ecosystem actors work against the barriers and use the opportunities well. More academic research and training programs are needed to contribute to the development of the impact investment field.

Keywords

Impact investing, Social finance, Social enterprise, Social enterprise financing

Introduction

The Paris Agreement and the Sustainable Development Goals (SDG) call for taking action against depressing environmental and social challenges such as global warming, hunger, poverty, environmental problems, and social inequality. This action is necessary more than before while the world is going through the COVID-19 pandemic and health and economic crisis hits the disadvantaged people more (Bonnici & Raja, 2020). Social innovators or disruptive innovators who are brave enough to tackle problems that others could not solve are sought actors. There is a specific call for investors to channel financing towards solutions to these environmental and social problems. To achieve the SDGs in developing countries, the financing gap is estimated to be US$2.5–3 trillion per year, according to the United Nations.

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Government and philanthropy resources are not sufficient to solve the most critical challenges in the environment, healthcare, unemployment, housing, and education and financial resources from capital markets must be directed to them. Impact investing can act as a catalyzer to canalize the needed capital for innovative social entrepreneurs that seek to provide market-based solutions to these numerous challenges and achieve SDG targets by 2030 (Martin, 2013). This paper investigates this emerging financial paradigm, impact investment.

Impact investments are investments for 'blended value' and aim for social, environmental, and financial returns (Emerson, 2003). They are made in social enterprises (profit, non-profit or hybrid organizations) that provide market-based solutions to environmental or social problems that the investor wants to address (Johnson et al., 2018). Impact investees intentionally create as well as measure environmental or social values and not have them as side effects (Nicholls & Daggers, 2016). In other words, expected impact returns are apriori defined and measured ex-post (Calderini et al., 2018). Impact investments require the payment of principal with a potential return and can take place as equity, debt, or a hybrid of these investments. Impact investment differs from government funding or philanthropy with its financial return aim and differs from a traditional investment with its positive impact aim (Nicholls, 2010).

Daggers and Nicholls (2016) note that the academic research in impact investment lags practitioner research led by networks like Global Impact Investing Network (GIIN). According to the network, impact investment is a movement in the sense that the role of money is redefined and positive impact is integrated into the decision-making processes of individuals and organizations. The social or environmental positive impact will be an important criterion for individuals' economic choices, business conducts, and investment evaluations. They define impact investing as an industry comprising investors, support institutions, and field builders who will contribute to the development of the market by developing new financial assets, impact measurement, and management tools.

Shareholder wealth maximization has long been challenged as a key purpose of businesses and replaced by stakeholder value maximization in the long term. Businesses and investors are not only accountable to shareholders but multiple stakeholders, namely customers, employees, suppliers, community, and the environment (Asher et al., 2005; Friedman & Miles, 2002; Harrison & Freeman, 1999). Every investment has a short and long-term impact on society and the environment and investors who finance these investments contribute to this impact. In this respect, businesses and investors have utmost responsibility in society while making investment decisions and channeling funds to the most effective solutions (*Principles of Responsible Investment Annual Report*, 2018). GIIN has been leading impact investment field-building and suggests that there is a need for a significant change in the role of money and investors' responsibilities (Bouri et al., 2018). With this new paradigm and role for finance, capital will support essential sustainable growth and flow to organizations that create

a positive social or environmental impact (Martin, 2013). In this respect, businesses will also make sure they create a positive impact not only on financial returns.

In the next section, a brief history of impact investment is discussed followed by regulatory background. Section three reviews the impact investing ecosystem. Section four reviews why impact investment matters for social enterprises. Innovative financing structures are introduced in section five. Section six discusses opportunities for the development of the impact investment markets followed by the conclusion.

History of Impact Investment

In recent decades, there has been a shift toward consideration of nonfinancial factors in investment decisions. Socially responsible investments (SRI) are also called sustainable investments or ethical investments. They have emerged in the 1970s when investors started to avoid specific industries or companies that may have significant negative effects on people and the planet. As an investment approach, SRI integrates social, ethical, and environmental concerns into investing decisions. In contrast to traditional investments, SRI screens investments based on social, ethical, corporate governance, or ecological criteria. SRI brings shareholder activists and local communities on board to expedite corporations to incorporate these criteria in the corporate strategies (Renneboog, Host, et al., 2008). Initially, investors avoided companies that sell harmful substances such as guns or tobacco and sought ones engaged in sustainable activities like clean technology and energy efficiency. Through time Environmental, Social, and Governance (ESG) criteria have become the major foundation of SRI (Widyawati, 2020).

SRI grew from 8.7 trillion dollars in 2016 to 12 trillion dollars in 2018, a 38% increase in the United States alone. This corresponds to 1 for every 4 dollars of assets invested under professional asset management in the USA, according to US SIF. Impact investment lags with 502 billion dollars invested in impact investing assets worldwide in 2019, but the marketplace is growing (Mudaliar & Dithrich, 2019). In the SRI literature, financial performance is a popular research topic. This literature analyzed the returns of mutual funds, portfolios, and trusts, but the results are mixed. Some studies show that SRI portfolios do not significantly differ from traditional portfolios in terms of financial performance (Derwall & Koedijk, 2009). Alternatively, there is evidence that SRI portfolios outperform (Kempf & Osthoff, 2007) and underperform (Renneboog, Horst, et al., 2008) traditional portfolios.

Impact investing builds on these responsible investment approaches, and besides financial returns, impact investors are looking for impact in investment decisions. In other words, investors look for enterprises or organizations that make a positive impact on people's lives or environment. Impact investors must intend to contribute to the solution of the world's ut-

most critical environmental and social challenges. This is one critical respect of how impact investment is different from ESG investing or SRI (Harji & Jackson, 2012; Nicholls, 2010; Ormiston et al., 2015) and investors can select a thematic focus such as providing scalable solutions to underserved people or regions. While working with these challenges, impact investments still expect a financial return, and this is their key difference from philanthropy.

Targeting specific social or environmental objectives, intending to create a positive and measurable impact besides a financial return, and measuring the attainment of both are key actions that differentiate impact investments from conventional investments (Social Impact Investment Taskforce, 2014). Together with prominent impact investors in the world, GIIN defines four basic principles of impact investing. First, impact investors must intend to contribute to positive environmental and social impact. They will not only set financial goals but set an investment agenda for social and environmental threats that they want to address and strategies on how to realize these. Second, they must integrate impact evidence and data in their investment design. Based on quantitative and qualitative data, they must set targets for how they will contribute to the challenges that they aim to address. They need to use evidence and impact data to measure performance against these targets and their impact. Third, they must manage impact performance, identify and assess potential risks and negative consequences and mitigate these. Impact reports are then disclosed to investors and investees. Finally, they need to contribute to the growth of impact investing. They must be transparent in investment practices and share their positive and negative lessons that are not private with the investment community.

The United Kingdom is one of the leaders in the development of impact investing. In 2000, the UK treasury built a social investment task force to attract private capital into social enterprises, especially in deprived areas. This was later followed by the establishment of Big Society Capital, a financial institution set up in 2012 to build and develop the UK's impact investment market. It helps social enterprises and charities to find fitting repayable finance to tackle social and environmental problems and increase their impact on society. G8 under UK's presidency, then established Social Impact Taskforce in 2013, to catalyze impact investments worldwide. As the successor to this task force, the Global Social Impact Investment Steering Group (GSG) was formed in 2015 with a wider membership. The group currently has 18 countries and the EU as members.

Around the world, there have been several policy developments to build the impact investment market. The UK also pioneered in modeling tax incentives for social investors and introduced the Social Investment Tax Relief (SITR) program in 2014. SITR offered a 30% tax break of investments (loans or equity) made to social purpose organizations. SITR has helped entities such as social enterprises, charities, community benefit societies, community interest companies, and social impact contractors that have difficulty in raising funding through tradi-

tional finance at reasonable costs. France is another country that has developed a regulatory framework to support social enterprises. France introduced the first 90/10 bill in 2001 and obliged companies to offer their employees a socially responsible savings scheme. Companies can invest between 5 and 10% of their savings into organizations and activities with a 'solidarity label' voluntarily. In 2008, France made these investments compulsory and these savings present a considerable source of patient capital as direct investments to social enterprises or through 90/10 Solidarity Funds. Corporate Social Responsibility (CSR) is another way businesses can contribute to sustainable development. India is one of the first countries that made CSR mandatory for companies with the Companies Act in 2014. Businesses that meet certain criteria are obliged to allocate 2% of their net average profit in the last three accounting years to CSR activities in rural development and environmental sustainability.

The prime target of impact investors are social enterprises, and their legal structures affect the type of financing they can access. Legal structures are critical in getting tax benefits and types of funding options for social enterprises. Different legal structures for social enterprises have been created around the world. United Kingdom established Community Interest Company (CIC) in 2004. CIC is a company formed for social or community benefit, and even though limited dividends can be distributed to the investors, surpluses are mainly reinvested in the business (Reiser, 2011). The United States introduced 'low profit limited liability company', a hybrid business form that combines a socially oriented mission with a for-profit business entity. B Lab also certifies a corporation that has a dual mission of creating a social or environmental impact and making profits as "B Corp" since 2006. Another form of a business corporation is "benefit corporation" and it has three distinctive features: (1) it has a business objective to create a positive substantial impact on the environment and society; (2) managers need to take into consideration stakeholders' interests besides shareholders' financial interests; and (3) reporting on the environmental and social performance using independent third-party standards that are transparent, comprehensive and credible that is required every year (Clark & Babson, 2012).

Impact Investment Ecosystem

The chief actors of the impact investing ecosystem are investors (supply side), investment seekers, mainly social enterprises (demand side), financial intermediaries, support organizations, and governments. On the supply side, several actors have been working to fuel the flow of funds to social enterprises that need funding to develop and grow. Investors' expectations for financial return and impact return may be different and based on their objectives they are characterized as 'financial first' or 'impact first' investors (Freireich & Fulton, 2009). 'Financial first' investors, usually because of their fiduciary duties, aim to generate market rates of return from investments with a social or environmental impact. These investors mainly

include banks, development finance institutions, pension, and wealth funds. 'Impact first' investors intend to maximize environmental or social returns with a minimum obligatory financial return. Many foundations and family offices prefer to be 'Impact first' investors. If impact return is sufficient, these investors are satisfied with below-market-rate financial returns (Thornley & Dailey, 2010). Impact first investments have shown that they could generate market-rate returns and generating impact not necessitates below market rate returns (Lyons & Kickul, 2013). Investors with diverse preferences regarding the return, impact, and risk may co-invest in hybrid structures (Lyons & Kickul, 2013). Such hybrid designs can attract profit-oriented capital toward impact investment and increase the availability of funds for social entrepreneurs.

Investor diversity is an important feature of vibrant impact investing ecosystems (Roundy, 2019). Investor diversity means investment interests will cover a wider set of impact themes, geographical focus, business models, life cycle stages, and returns. In more diverse impact investing ecosystems, the likelihood that a match between a funder and fund seeker resulting in completed deals is higher (Roundy, 2019). Besides individual investors, corporations, and governments, the following are the major actors on the supply side:

Institutional investors

Institutional investors entered the impact investing market in 2014. Several biggest investment funds in the world such as Blackrock started offering sustainable investment funds. Pension funds have also started making impact investments, and if the number increases, they can be a critical source of capital for social enterprises. For instance, the world's biggest pension investment fund belongs to the Japanese Government, and the fund invested 8.9 billion dollars to businesses that have strong ESG practices (Sano, 2017). Because of fiduciary duties, these mainstream investors look for the minimum market rate of return for their investments (World Economic Forum, 2013). Besides institutional investors, angel investors and professional investors are also providing capital and business expertise support.

Development Finance Institutions (DFIs)

DFIs are development banks or subsidiaries formed in economically developing countries to support the advancement of the private sector. National governments usually own them and national/international development funds mainly fund them. According to OECD, this helps them raise large sums of money from international capital markets and offer competitive financing. This is a critical source of funding for social enterprises. For example, the European DFIs together manage a portfolio of impact-oriented investments totaling about $50 billion in developing and frontier markets. The DFIs in Europe have been leading responsible financing to enable sustainable development. They have profound experience in impact investment and have long been committed to measuring impact for SDGs effectively.

Non-Governmental Organizations (NGOs)

NGOs have mainly relied on donations and grants for funding. Trends in capital markets have also changed NGOs' funding sources and how they design interventions. Many donors expect their financial contributions to be used strategically in solving root causes of challenges in society. This is a key difference between charity and philanthropy. The primary reason many NGOs have created or are looking to create their impact investment funds is to increase their access to this private funding.

Philanthropic Investors

Foundations are one of the critical actors leading the development of the market by providing capital, supporting capacity building to increase deal flow, sharing best practices, and reducing transaction costs (Martin, 2013). Several charitable trusts, foundations, and family offices are making impact investments in line with their missions, and this helps them increase their endowments. Family offices and wealthy individuals have been the most active among impact investors because of their high level of autonomy and flexibility in investment decisions (World Economic Forum, 2013). Ford Foundation set aside one billion dollars from its endowment to achieve social and environmental good besides financial returns (Lim, 2017). Foundations have also taken part in 'blended finance' deals and provided catalytic capital. OECD definition for blended finance involves using development finance tools strategically to mitigate risk in order to mobilize additional capital towards sustainable development in economically developing countries. The purpose in blended finance is to support high impact projects that cannot attract private sector financing initially but have high potential for success. One approach is to blend 'concessional financing' and traditional financing. Concessional financing provides more favorable terms than traditional financing, for example, interest rates lower than market rates or longer grace periods.

Demand for impact investment is mainly from impact-oriented businesses, cooperatives, and non-profits generating income, and these entities are referred to as 'social enterprises' (Martin, 2013). These entities may have different legal forms, but they have one thing in common: they seek to achieve both a social impact and a financial return. Usually impact objectives are in line with the business model and financial and impact returns are compatible (World Economic Forum, 2013). Charities also find impact investing as a beneficial funding option and consider setting up a social enterprise in their expansion plans (Big Society Capital & ACEVO, 2015). Impact investment has become a critical source of funding, especially for the social innovators who aim to solve critical environmental or social problems and have difficulty accessing mainstream capital markets (Clarkin et al., 2014; Harji & Jackson, 2012; Mendell & Barbosa, 2013; Nicholls & Murdock, 2012; Ormiston et al., 2015; Roundy, 2019).

The increase in the number of social enterprises contributed to the development of the impact investment market (Wilson, 2014). Social enterprises have difficulty in accessing ma-

instream financial markets, and the impact investment market has grown to address these financing needs. The reason social enterprises may have more difficulty in accessing mainstream financial markets than traditional or commercial enterprises may be because of the following differences. First social entrepreneurs are committed to social benefit creation (Dacin et al., 2010; Zahra et al., 2009) and address social needs that commercial enterprises do not attend to (Mcmullen, 2011). For this reason, they may appear less appealing to investors and lenders regarding earning money (Doherty et al., 2014; Lumpkin et al., 2013). Social entrepreneurs employ market-oriented methods to find solutions to social as well as environmental problems (Grimes et al., 2013). They are hybrid organizations, and their biggest challenge is the contradiction between the institutional logics of the market and social welfare (Pache & Santos, 2013). Wealth accumulation is not their priority, and they reinvest profits toward the growth and achievement of their social mission (Hartigan, 2006; Haugh, 2006). Financial returns are necessary for sustainability and social entrepreneurs have to balance financial and social concerns well (Dacin et al., 2010). Because of their social concerns, social entrepreneurs have access to community-based resources such as grants, individual contributions, and government funds (Austin et al., 2006). Unlike traditional entrepreneurs, social entrepreneurs are also accountable to such outside stakeholders and most important of all to their communities (Domenico et al., 2009).

Besides the supply and demand side of the capital, the impact investment landscape also includes government, networks, financial intermediaries, support organizations, and professional service providers who have significant roles in the market building. Support organizations like accelerators and incubators provide investment readiness programs and other resources such as office space, mentoring, connections, and investor meetings that enterprises need to scale up (Casasnovas & Bruno, 2013). In case they cannot provide resources directly, they serve as bridges between enterprises and the broader ecosystem resources (Goswami et al., 2018). They contribute to the development of connections and the deal flow in the ecosystem. Support organizations can also contribute to the ecosystem by organizing impact investment awareness-raising and educational activities for the ecosystem participants.

Financial intermediaries link investees and investors and contribute to the ecosystem by providing liquidity and facilitating payments. Intermediaries may include banks, social exchanges, and financial advisors.

Social Banks/Private Banks

Social banking targets positive social or environmental impact through finance. The private banking sector has begun establishing units for impact investing in 2008. Banks can also offer microfinance loans, green bonds, and private equity funds of funds for impact investment. In 2007, JP Morgan set up a Social Finance unit to co-invest with impact funds and

in 2012, Morgan Stanley established its 'Investing with Impact' platform that offers various investment assets that provide both impact and financial return (World Economic Forum, 2013). Credit Suisse, Swiss Bank, Triodos Bank, Deutsche Bank, and UBS are some of the largest banks that have made impact investments.

Crowdfunding Platforms:

Crowdfunding is raising small amounts of capital from many people via online platforms. It has emerged as a viable funding option for traditional finance and comes in investment and non-investment models. Investment models include debt or equity models and non-investment models include reward-based and donation crowdfunding models (Yasar, 2021). Social and environmental orientations affect the funding success of reward-based campaigns (Yılmaz & Yasar, 2021). Cambridge Centre for Alternative Finance discusses the different models and assesses the global market in a recently published report (CCAF, 2020).

Exchanges and Platforms:

Exchanges and platforms facilitate the identification of and access to impact investment opportunities for impact investors. Social stock exchanges are regulated platforms where social enterprises that aim to provide solutions to the social challenges of the "base of the pyramid", can raise funds from impact investors (Wilson, 2014). The first social stock exchanges were established in the United Kingdom, Canada, Singapore, and South Africa. Besides access to investment opportunities, platforms provide information resources and searchable databases. For example, ImpactBase is an online global platform where accredited impact investors can search for funds to invest in line with their investment preferences for impact themes, geographic focus, asset classes, fundraising status, investment size, and other criteria. The development of a coherent impact investing ecosystem depends on the contributions of all the ecosystem actors and coordination and cooperation among themselves.

Global networks such as GIIN and Impact Investing Policy Collaborative (IIPC) contribute to the ecosystem by market-building activities. Impact Reporting and Investment Standards (IRIS) and the Global Impact Investing Rating System (GIIRS) work on developing common standards and metrics for impact measurement and reporting. Common standards and metrics enable comparing and contrasting impact investments in terms of impact features. Besides assessing financial benefits using traditional due diligence practices, impact investors, need to screen for impact. Afterward, they need to check whether they achieve their impact objectives, such as access to energy/medicine/clean water/education/technology/affordable housing/financial services or reduction of carbon emissions/harm to the environment. Hence, impact measurement and management are a critical part of impact investing. IRIS+, together with Impact Management Project (IMP) defines dimensions for impact description and measurement: 'what', 'who', 'how much', and 'risk'. Under the 'what' dimension, investors, and

enterprises use data to distinguish the outcomes that they contribute to and the significance of these outcomes to the people or the planet. Some example IRIS metrics are direct greenhouse gas emissions, average agricultural yield, or student transition rate. Under the 'who' dimension, data related to the stakeholders that are affected by the intervention and how underserved they are regarding the generated outcomes is collected. Some example IRIS metrics are target stakeholder socioeconomics or demographics. 'How much' dimension measures the scale or the number of individual clients affected by the outcome, the depth or the level of change in outcome over time, and the duration of the outcome. Risk measures how much the enterprise contributes to the outcome versus what would have happened.

Governments play key roles in the regional ecosystems to foster an enabling environment and catalyzing market development (Wilson, 2014). They have dual roles in the ecosystem as both capital providers and facilitators. Governments can facilitate investment products with impact and financial returns, as well as provide tax incentives to stimulate impact investing markets. On the supply side, governments can increase the amount of capital for impact investing via development policies such as direct investment, co-investment, or risk-sharing (Martin, 2013). On the demand side, governments can advance demand development policies such as promoting capacity-building activities to increase the number of investment-ready enterprises.

Why Impact Investment Matters for Social Enterprises?

British Council documents the financing gap in Turkey (British Council, 2019) and many other countries for social entrepreneurs. Accessing financing has been a challenge for most enterprises seeking to make it through the "valley of death" and grow. Getting debt and equity finance has become even harder after the credit crisis in 2007 (North et al., 2013). Financing challenge is more pronounced for some of the impact enterprises which aspire to address societal and environmental challenges and create a positive impact (Castellas et al., 2018; Emerson et al., 2007; Nicholls, 2010). Social entrepreneurs may experience difficulty in raising money because they neither fit into traditional for-profit nor into non-profit models (Chertok et al., 2008). What social entrepreneurs choose as a legal structure for their enterprises affects funding options from philanthropy and traditional investors (Lyons & Kickul, 2013). Reasons early stage enterprises may have difficulty in accessing finance and why some impact enterprises may find financing tailored for their needs even more challenging than traditional enterprises are discussed below.

Insufficient collateral and lack of a trading record are common factors that create a disadvantage for early-stage enterprises that apply for debt financing (North et al., 2010). The main reasons impact enterprises cannot access banks' loans are their higher perceived credit risks and lack of collateral. In this respect, available loans to impact enterprises are limited

and may have higher interest rates. Early stage enterprises often do not have established relationships with banks again limiting their access to traditional financial instruments. In terms of equity investment, exit strategies observed in traditional enterprises might not be suitable for social entrepreneurs. An "exit" is investors' means of getting the return on their investment, including their profit and their original capital. Common exit strategies for commercial enterprises are via initial public offering or selling the enterprise to a bigger company. Social entrepreneurs aspire to continue their enterprises' missions and may avoid any structure that will dilute their ownership and voting rights. He/she may not want to transfer the company to a third party who may not come from the same community or be fully committed to the impact mission sought.

Impact enterprises may not attract angel investors or venture capitalists because of lower potential returns. Some of the impact enterprises serve the geographies where the market potential is very limited or the poorest at the base of the pyramid and the beneficiaries may not pay for the product or service directly (Godeke & Bauer, 2008; Lyons & Kickul, 2013). While they may create a high impact, the financial return may not be satisfactory for the investors who are only looking into financial returns. Another challenge in impact enterprise financing is the non-alignment of time horizons of impact investors and enterprises (Lyons & Kickul, 2013). Traditional venture capitalists have to make exits and return the money to their investors within seven to ten years. Impact enterprises, on the other hand, may require longer time horizons to achieve profitability and create the impact they aim for. They address the most challenging problems of the world, and most often they operate in tough and traditionally overlooked markets. Moreover, having two missions, creating financial returns for investors and social returns for beneficiaries, can create conflicts that can impede enterprises' growth (Rottenberg & Morris, 2013). In this respect, expecting impact enterprises to achieve business development and meaningful returns in time horizons comparable with commercial enterprises may be unfair in certain cases. This creates a barrier to attract traditional investors who expect to receive a financial return to compensate for the risk they take (Lyon & Owen, 2019). The tradeoff between financial goals over social goals more likely result in a faster path to scale. Impact enterprises that seek equity investing need to devise a business model that aligns social and financial goals as closely as possible to lessen tradeoffs (Rottenberg & Morris, 2013).

Another reason impact investing is critical for social enterprises and why they need innovative financial assets tailored for them is the broad range of contexts in which they operate. As Armeni and Ferreyra de Bone 2017 frame it, some impact businesses may scale up and become very profitable while others can look like nonprofit organizations. Because of the wide-ranging contexts they operate in, funding mechanisms of social entrepreneurs must be innovative and broad. Social enterprises range in operational size and it would be unjust to expect investment terms that have funded Uber, Instagram or Snapchat would serve their ne-

eds as well. Traditional methods such as debt or equity only may not suit the financing needs of early and growth stage impact enterprises. In this respect, experimentation in deal structuring and innovation in financial assets are needed to improve the impact investing field.

1. Innovative financing structures

Fund managers and experts in the field have been experimenting with new financing structures including equity, debt, and grants to accommodate the capital requirements of impact enterprises. Foundations, impact investors, development agencies, and other funders share their innovative models at global summits and workshops organized throughout the world. These financing structures include a mix of traditional debt and equity in line with the needs and stages of impact enterprises. Needs of impact enterprises differ based on their expected time to profitability, cash flow generation, risk, potential, exit opportunities, and preferences of the entrepreneurs. The type of capital demanded by most social entrepreneurs is patient capital, capital that is long term and risk-tolerant (Lyons & Kickul, 2013). According to the Acumen Organization, patient capital's main traits are risk tolerance, long investment time horizons, flexibility to meet social entrepreneurs' needs, and unwillingness to give up on end customers' needs for the benefit of shareholders. Some of the innovative financial instruments used in these structures are as follows:

Revenue-based loans: These flexible debt instruments allow organizations to remit periodic payments as a percentage of revenues, cash flows, or profits rather than periodic fixed payments as in traditional debt instruments. Payment times are flexible and include grace periods. There are no strict collateral requirements. One type of revenue-based loan is 'convertible revenue loans' which can be converted to equity after a percentage of the loan has been paid off with revenues.

Revenue-based equity investments: In these alternative models, dividends and payments to investors are made as a percentage of profits or revenues. Unlike traditional equity models, where exits usually happen through mergers, acquisitions, or initial public offerings, in these models, investors are more likely to sell shares back to the business. Gradual equity redemptions are also possible, and entrepreneurs can redeem shares gradually at a predetermined price.

Social impact bonds: Social impact bonds are introduced in the United Kingdom and they are called 'development impact bonds' in emerging markets. This structure changes how governments fund social interventions. A non-government funder, most often a private investor who can be an individual, foundation, philanthropy, or another funder, finances upfront the social service intervention. If the intervention is successful and reaches the target outcomes agreed at the beginning, then the government pays the funder. If the intervention is unsuccessful, then the funder takes the loss. These structures are called 'Pay for success' in the

United States because not all structures are bonds and social service providers are paid only if their interventions are successful. Green bonds are a special case of impact bonds and finance projects that have a specific positive environmental impact such as reduction of carbon emissions, renewable energy, energy efficiency, or sustainable agriculture. Charities or social enterprises may issue charity bonds if they have revenue streams and the financial capacity to repay the bondholders.

Recoverable grants: Recoverable grants differ from traditional donations in terms of repayment possibilities, i.e. the grant can be repayable if the entrepreneur gets an investment or fails to achieve the target impact. Innovations in grant structures are highly different from traditional financing. Donors to charity are looking for more strategic use of their financial contributions, and there is a shift of charity dollars to philanthropic capital. Philanthropic investors are interested in the created impact but also aim for recycling their capital. In new structures, philanthropic capital appears side by side with debt or equity.

Opportunities for the Development of Impact Investing

Impact investment definition is still not clear cut and can represent different meanings to different people. GIIN draws attention to the need for defining a common set of characteristics of an impact investor (Bouri et al., 2018). The field will benefit from identifying and framing impact investing and developing a common language. The impact investing research is emerging and there is yet no marked theory or substantial datasets (Nicholls & Daggers, 2016). In collaboration with practitioners, academic research can contribute to the development of impact investing as the impact investing market needs a critical assessment of the current path and new financial models, investment products, tools, and services. Traditional finance theory and models are based on risk and return expectations. The critical question is how to value a financial asset that provides social/environmental return besides a financial return (Nicholls et al., 2015).

The theoretical models need to be revised to incorporate social or environmental impact besides risk and return. In line with these models, new investment products need to be introduced for investors with different risk appetites and investment time horizons (Wilson, 2014). The capital needs of entrepreneurs at different stages must be taken into consideration while developing products. Financial products must also differ for institutional investors and retail investors. So far several impact investing funds which invest in a variety of themes such as healthcare, aged care, clean energy, housing, sanitation, education, and financial services and geographies, have been established. Several established traditional asset managers also entered the market and started their impact funds. However, investment banking services are still limited. To develop the market, innovating financing mechanisms and flexible products that meet different investors' needs and preferences are critical. Such innovative products that

provide exit strategies or a secondary market are also important for ensuring liquidity in the market (Mendell & Barbosa, 2013). Investors can use these assets for portfolio diversification. If institutional investors implement a 'financial-first' strategy then they will also fulfill their fiduciary duties (Ormiston et al., 2015). Building a track record of impact investments is critical for engaging more investors and the development of the field.

There is a gap in how investors implement impact investment strategies and how they overcome challenges (Ormiston et al., 2015). The field can use publicly available data and case studies to benchmark. Sharing the experience in designing and implementing financing mechanisms/structures is critical for the field. These good practices can be replicated or adapted in other places. This will also pave for potential collaboration opportunities among actors across the world. In this respect, networks and platforms are precious for learning collaborations and improving the deal flow. Different deal structures are tested all around the world and information on the results is valuable for other parties looking into possible deal structures. Impact Terms Project has contributed significantly to the field by opening a platform where experts share their innovations, experience, and best practices. A framework approach could also help as a starting point. Decision trees that direct the user to the best suitable deal structure considering the startup's stage, industry, revenue generation capability, revenue seasonality, and other traits would be very useful (Armeni & Ferreyra de Bone, 2017).

Impact investing can be complicated and not knowing the market well and insufficient financial literacy on unconventional financing structures present significant barriers for investees in impact investing (Newmark & Pena, 2010; Phillips & Johnson, 2019; L. M. Salamon, 2014). Most often they assume they have to go to traditional venture capitalists when they need to raise financing. Accelerators and incubators may also not know new financing structures. For these reasons, raising awareness about alternative deal structures among entrepreneurs and support organizations and educating them on these alternative models would contribute to the development of the demand side of the market. Investment readiness and institutional capacity are other challenges for social enterprises, non-profits, and charities on the demand side (Nicholls & Schwartz, 2014; Phillips & Johnson, 2019). Institutional capacity is critical for investees to execute their innovative business models as well as manage complex projects, financing, and corresponding financial risks (Phillips & Johnson, 2019). The number of high-quality investments that require larger capital is limited (Wilson, 2014). Social Impact Investment Taskforce Interim Report 2019 draws attention to the need for capacity-building support to enhance the number of social enterprises that are investment-ready. Accelerators, incubators, innovations labs, higher education institution-based centers are some organizations that support impact enterprises in terms of capacity building.

Measuring social impact and quantifying performance is another challenging area for social enterprises, and they need support (Mair & Martı, 2006). Impact measurement is critical

to reflect the social and environmental value that the enterprise is creating to stakeholders and investors (Ormiston & Seymour, 2011). Once the investment products are developed, supporting tools and services need to be introduced. Financial intermediaries need to extend their services to include impact investment assets. There are rating institutions to rate assets and audit companies to audit financial statements, but nothing to rate impact and audit impact reports. Several tools are developed for investors to measure, report, and manage their investments' environmental and social impacts. As discussed above, one of these tools is the IRIS+ framework, developed by GIIN to measure and report impact. A universal method of measuring social impact for example means using the same tools, for example to measure poverty and hunger (Hadad & Găucă, 2014). Adoption and acceptance of standard metric sets in the field are critical to increasing data transparency and comparability. Developing and sharing best practices of impact management, measurement and reporting is a must.

Raising awareness among financial advisors and educating them is critical to developing the field. Impact investment market grows rapidly with new tools and assets that generate financial returns besides social and environmental returns. Most of these tools and assets were geared toward institutional and big investors, and now the market must grow to embrace retail investors. Next-generation of the wealthiest retail investors will be millennials, as there will be a significant wealth transfer, around 30 trillion dollars from baby boomers to their children (Accenture Consulting, 2015). Women are forecasted to control 75% of disposable personal income in the world by 2028 (Ernst & Young, 2016). Women and millennials care for sustainability and impact in their investment choices more than the general population (Morgan Stanley Institute for Sustainable Investing, 2019). Financial advisors are key actors to shape the portfolios of these wealthiest future retail investors and grow the marketplace. Investors state that many financial advisors are familiar with ESG mutual funds and ETF offerings, but they are not very familiar with the spectrum of assets that impact investors can use (Conway, 2019). Individual investors turn to financial advisors for guidance to allocate funds for impact investing. The biggest challenge for these investors is difficulty in accessing reliable investment advice (Rockefeller Foundation, 2019). Financial advisors need to understand social impact investing and communicate investment alternatives that are relevant to investors' aspirations. Investors may target to help a specific group, for example, disabled people or refugees. Their choice may also differ in terms of scale: some may like to invest locally, while others may be interested in national or global projects. Financial advisors have a powerful role in making sure investors choose the right products in line with their impact concerns. Aligning investments and investors' values is one thing robo-advisers are not able to do yet.

Policymakers have a crucial role in the advancement and progress of the impact investment market. Governments can help create a favorable regulatory environment and encourage more transparency for impact investing (Wilson, 2014). Several countries have passed tax relief programs for impact enterprises and special organization structures for social en-

terprises. However, more policy efforts in directing funding for innovative finance structures are needed to develop the impact capital markets. In blended finance impactful deals, risk-tolerant capital gets the first loss and is used to attract commercial capital. Governments and development institutions can also support the system by taking part in such deal structures as first-loss partners to attract private investors to the deals. On the other hand, complex deal structures increase transaction costs. Improving the facilitative and transactional infrastructure is critical to decreasing transaction costs in impact investing (Calderini et al., 2018; Schwartz et al., 2015). OECD reports that the number of blended finance deals is limited because of high costs and the required time to structure the deals. If blended finance deal structures are standardized, a higher number of enterprises can benefit from them for smaller amounts of capital.

Conclusion

The responsibilities of businesses and financial markets are questioned and the norms about their roles are changing. Consumers demand more transparency in business practices and businesses are not only held responsible for shareholders but the planet and their multiple stakeholders. On the financial market side, the quest for social and environmental impact when providing capital is gaining traction. The world's problems are challenging and neither governments nor charities or philanthropists have the resources to overcome them. Businesses and investors have an important responsibility to focus on value creation in the long run and allocate resources accordingly. Financial markets are critical in providing the financial means for solutions to the most important threats the world is facing. Impact investors are integrating environmental and social impact into investment decisions. The role of capital in society is changing, and businesses looking for capital must ensure they are creating a positive impact for society. As the number of impact investors with a track record of successful investments increases, the demand for impact investment will increase.

Traditional finance theory focuses on risk and return and a new financial model that accounts for impact is needed. Products for investors across the spectrum of risk and return must be developed to grow the impact investing market. Future research can reveal the underlying dynamics of the impact investment decision-making process. Especially empirical research on which criteria impact investors use to screen potential investees and whether they are effective would be very useful. Concerning demand for impact investments, research on whether current financial assets match social entrepreneurs' needs and business models is very valuable. Another research question to explore is what would help social entrepreneurs choose and find the best suitable financing. Moreover, the investment readiness of social impact investors and capacity building needs must be investigated. Results of such research can be used to design and develop better screening criteria and financing structures in the

field. This research can also be used to develop education and training for main actors in the ecosystem. Raising awareness among financial advisors and educating them about impact investing products is crucial to develop the impact investment marketplace. Academic research and training programs are critical for the progress of the impact investment field.

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