

IN-DEPTH ANALYSIS

Requested by the DROI subcommittee



Impact investing in the framework of business and human rights



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ABSTRACT

Impact investments are an emerging sustainable investment strategy and represent a small and medium enterprise-led approach to development. Impact investments are executed only when a positive financial return can be achieved alongside a measurable positive impact on an individual or societal level. Impact investors thus go beyond more established sustainable investment strategies such as exclusion or integration by explicitly aiming at impact, investing in business models that directly address social issues. Most impact investment funds invest in areas such as healthcare, education or employment and thus improve the situation of the target group. At the same time, however, there is no explicit human rights perspective integrated into the investment process yet. Given the rather small scale of investments which is usually in the range of EUR 200 000 to EUR 5 million per transaction, unintended negative consequences can occur, if only to a very limited extent. This in-depth analysis discusses the impact investing industry in the context of sustainable finance and analyses central aspects of the concept such as financing instruments, the impact measurement process or the impact logic of the investors. The analysis also discusses the limitations impact investing faces such as commercial boundaries of business models, and illustrates modified concepts to mitigate these challenges which are summarised as social finance.

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Table of Contents

List of Abbreviations	v
Executive Summary	vi
1 Introduction	1
1.1 General context	1
1.2 Structure of the study	2
2 Human rights in an investment context	2
2.1 Business and human rights in general	2
2.2 Financial markets and human rights	4
2.3 European Action Plans	6
2.4 ESG aspects in the investment process	8
3 Impact investments - Introduction	9
3.1 Investment rationale and historical development	9
3.2 Recent developments	10
3.3 Challenges in impact investing	10
4 Impact measurement	11
4.1 General framework and logic model	11
4.2 Challenges in impact measurement	12
4.3 Guidelines and standards in impact measurement	13
5 Investments, Funds and Instruments	14
5.1 Financing instruments	14
5.2 Impact investment funds	14
5.3 Examples of investments	18
5.4 Limitations of current impact investing funds	19
6 Social Finance: Expanding the toolbox	20
6.1 Social Finance as additional investment approach	20
6.2 Supply chain investments	20
6.3 Refugee investments	21
6.4 Media investments	22
6.5 Overview of social finance investments	23
7 Conclusion and recommendations	25
7.1 Conclusion	25
7.1.1 General Remarks	25

7.1.2	Geographical limits	25
7.1.3	Commercial Boundaries	26
7.1.4	Funding gap	26
7.2	Recommendations	27
7.2.1	Demand side of impact investments	27
7.2.2	Supply side of impact investments	28
7.2.3	Framework conditions for investment capital	28
	References	30

List of Abbreviations

BoP	Base of Pyramid
ESG	Environmental, Social and Governance
EU	European Union
EuSEF	European Social Entrepreneurship Funds
GIIN	Global Impact Investing Network
GRI	Global Reporting Initiative
ICCPR	International Covenant on Civil and Political Rights
ICESCR	International Covenant on Economic, Social and Cultural Rights
ICRC	International Committee of the Red Cross
IRIS	Impact Reporting and Investment Standard
MDIF	Media Development Investment Fund
OECD/DAC	Development Assistance Committee of the Organisation for Economic Co-operation and Development
SDGs	Sustainable Development Goals
SIBs	Social Impact Bonds
UDHR	Universal Declaration of Human Rights
UK	United Kingdom
UN	United Nations
UNDP	United Nations Development Programme
UNPRI	UN Principles of Responsible Investment
USA	United States of America
ZHL	Ziqitza Healthcare Limited

Executive Summary

Given the enormous size of today's financial markets, their global reach as well as their economic power mean that they exert a significant influence on global human rights issues. But despite the obvious link between business and labour rights as well as concerted efforts by various actors to form an institutional framework to address the interaction between corporations and human rights, few businesses understand the implications much beyond labour rights¹. Furthermore, most enterprises are either unaware or uninterested in the subject and some may even be benefitting from human rights transgressions.

The financial markets, as investors in these corporations, have only slowly and recently started to reflect upon integrating human rights issues into the decision-making process in the context of sustainable finance. For example, these considerations play a role when applying exclusion strategies in sustainable investing, where certain sectors are removed from the investment universe. Impact investing, as a sustainable investment strategy goes beyond the idea of investing into assets while trying to minimise the external effects that their operations generate by investing into business models whose primary objective is to address a social or environmental problem.

Impact investing is usually a small-scale approach to invest in non-public companies. It helps to capitalise these companies, brings financial discipline to operations and also helps to build stronger enterprises while fostering positive value for societies and stakeholders. Impact investors nowadays usually align their investment strategies with the United Nations' Sustainable Development Goals (SDGs). Roughly half of the indicators tracking the progress along the SDGs potentially include data relevant for monitoring specific human rights instruments; additionally, 10% have indirect human rights relevance and another 40 % will generate contextual information.² Thus, human rights are implicitly already part of the investment process. However, an explicit notion of investing to fight human rights breaches has not been developed by the sector yet.

The attractive combination of simultaneously generating financial returns and impact creation has its limits, though: For impact investments to happen there needs to be an investable commercial business model and an opportunity to repay the funding after a period of three to seven years.

Given these constraints, social finance has developed as a field with the same features and mechanisms but less emphasis on positive financial returns. Social finance investors often comprise public or philanthropic actors assuming certain investment risks and thus enabling private capital to step in as impact investments in a second step. This study will discuss various mechanisms and funds which are interesting to showcase in this context.

The recommendations within this study focus on the demand, on the supply side of impact investment capital as well as on developing the ecosystem for enterprises working on improving human rights. They include incubation support for these enterprises, an increased use of technological innovations, the promotion of human rights with guidelines, labels and codes of conducts as well as financial instruments to make impact investments more attractive.

¹ Numerous labour rights form part of the body of human rights comprised by the relevant international human rights instruments. At the same time, many general human rights are relevant for labour rights issues since they constitute the necessary precondition for the exercise of labour rights, including freedom of expression, the right to life, the right to personal integrity and liberty, and the freedom from torture (Ebert & Oelz, 2012).

² See also: <https://www.humanrights.dk/sdg-human-rights-data-explorer>.

1 Introduction

1.1 General context

While the discourse on sustainable investing has intensified on the investment as well as political level in recent years,³ there have been comparatively less discussions about the topics of human rights and impact investments specifically. This might be driven by the absence of cases known to the authors when impact investments violated human rights. They are providing access to healthcare, education or employment to beneficiaries and thus contributing to a better human rights situation. In addition, impact investors usually align their investment strategy with the Sustainable Development Goals (SDGs) which already incorporate human rights aspects.

However, although both approaches run in parallel, the point can still be made that a human rights perspective should be integrated more explicitly within the investment decision-making process of impact investment funds. To achieve this aim, the analysis needs to clarify many conceptual differences, for instance the difference between 'avoiding harm' and 'creating impact', which stands for two very different investment approaches, described in more detail in this study.

As laid out for the first time in the Universal Declaration of Human Rights (UDHR), 'everyone is entitled to all the rights and freedoms set forth in this Declaration, without distinction of any kind, such as race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status' (United Nations, 1948). Human rights include the right to life and liberty, freedom from slavery and torture, freedom of opinion and expression, the right to work and education, and many more. Everyone is entitled to these rights, without discrimination⁴. The Global Impact Investment Network (GIIN) defines impact investments as 'investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return.' This hints at the conceptual difficulties faced by the study as these concepts are discussed at different levels. While human rights represent universal values, impact investing is a sub-category of the investment industry also receiving funding from public development agencies. For example, KfW from Germany, CDC from the United Kingdom (UK) or the Austrian Development Bank OeB have all invested in impact investment funds over the last years.

Impact investments are a complementary approach in the development area focused on small and medium enterprises, independent of local governments with a clearly measurable impact for the target group. The definition makes it clear that there should be no investments made without a measurable positive impact. This is also in line with a global consensus on development which combines objectives regarding economic growth, equality, sustainability and protection of human rights (such as the SDG framework with specific targets and indicators or the EU Consensus on Development of 2017 as a response to the UNSDGs). The impact measurement process with its logics as well as its challenges will therefore also be described in more detail below.

The instrument of impact investing might sound like a magic bullet, but impact investments can contribute to solving only a small number of market and government failures across the world. Impact investors can provide commercial capital to fund enterprises with a sustainable business model creating a positive social

³ For example, with large investors now focusing on ESG standards complying companies in their portfolio which is driving the debate on a EU taxonomy.

⁴ Please see <https://www.un.org/en/sections/issues-depth/human-rights/>. Human rights are covered in the 9 core human rights treaties (include the International Covenant on Civil and Political Rights (ICCPR) from 1966, and the International Covenant on Economic, Social and Cultural Rights (ICESCR) from 1966, etc - <https://www.ohchr.org/EN/ProfessionalInterest/Pages/CoreInstruments.aspx>) as well as a number of other universal human rights instruments (<https://www.ohchr.org/EN/ProfessionalInterest/Pages/UniversalHumanRightsInstruments.aspx>).

impact for society. However, the approach is limited when commercial capital requiring a financial return is not a viable option. In this case, the investment toolbox needs to be expanded to include also social finance instruments.

1.2 Structure of the study

The authors were writing this study between December 2019 and May 2020.⁵ To the best of their knowledge, there is as of yet no study focusing on human rights and impact investments in general.⁶ Accordingly, this study will try to outline and establish some of the basic understandings of impact investments and link them to human rights. It provides some concrete recommendations and informs about the relevant human rights context (business and human rights, due diligence, etc.). We have structured the paper as follows.

Chapter 2 discusses the role of business and financial markets in human rights issues. It also discusses current developments in the investment industry and outlines the key objectives of two European Action Plans on the topic.

Chapter 3 introduces impact investments and discusses the investment rationales, developments in the field as well as challenges. Impact measurement is a central element of impact investments and is discussed in chapter 4. It presents the framework and the logic model, challenges in impact investment as well as existing guidelines and standards.

Chapter 5 takes a more detailed look at impact investments. It discusses the various financing instruments, presents a range of impact investment funds and illustrates the approach by presenting a few examples. These examples show the power and flexibility of impact investments but also demonstrate the limits of impact investing.

The limitations lead to a discussion of social finance in chapter 6. Social finance can be seen as an expansion of the funding toolbox when the requirement on financial returns for the investors is relaxed. We discuss various initiatives in the fields ranging from the supply chain to refugees and media. The closing chapter 7 includes a final conclusion and recommendations to support the development of impact investing as a tool to contribute to human rights promotion and protection.

2 Human rights in an investment context

2.1 Business and human rights in general

There are a number of initiatives and internationally recognised standards focused on human rights and investments or human rights and businesses in a broader sense. Notable examples are:

(1) the UN Guiding Principles on Business and Human Rights (2011): The UNGPs encompass three pillars describing how government and business should ensure respect for human rights in a business context and covering: The state duty to protect human rights (e.g. by implementing appropriate regulatory steps or taking additional measures to protect against human rights abuses by business enterprises that are owned or controlled by the State); the responsibilities and obligations for companies to respect human rights in their operations and supply chains; and access to remedy for victims of business-related abuses.

(2) the OECD Guidelines for Multinational Enterprises (ed. 2011): These incorporate concepts from the UNGPs, to ensure complementarity with UNGPs stressing the responsibility of businesses to respect human rights throughout their operations and broader value chains as well as adhere to human rights due

⁵ The authors are active in the field of impact investing and have used various personal interactions and meetings to discuss research-related questions. The list includes investment managers, researchers, ESG professionals and public officials.

⁶ Except the study by Park (2018) that focuses on one impact investment product, namely social impact bonds.

diligence. The chapter IV of the guidelines on human rights was added in 2011, strengthening the growing importance of human rights in the business context. The UNGPs as well as the ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy also contain due diligence recommendations, and the OECD Guidance can help enterprises implement them.

(3) the OECD Due Diligence Guidance for Responsible Business Conduct (2018)⁷, aiming to provide practical support to companies on the implementation of the OECD Guidelines for Multinational Enterprises by clarifying, for example, concepts and language concerning human rights due diligence recommendations and associated provisions.

Voluntary CSR guidelines for companies incl. human rights aspects		
Organisation	Name of guideline/principle	Description
United Nations (UN)	United Nations Guiding Principles on Business and Human Rights (UNGP)	<ul style="list-style-type: none"> • Instrument consisting of 31 principles on the issue of human rights and corporations • First comprehensive global standard for preventing and addressing the risk of adverse impacts on human rights linked to business activity
Organisation for European Economic Cooperation (OECD)	OECD Guidelines for Multinational Enterprises	<ul style="list-style-type: none"> • Definition of multinational principles and standards for socially and environmentally responsible business conduct • OECD member states are responsible for ensuring the implementation of the guidelines and companies can be subjected to a respective assessment, but they are not legally binding
Organisation for European Economic Cooperation (OECD)	OECD Due Diligence Guidance for Responsible Business Conduct	<ul style="list-style-type: none"> • Guidance providing practical support to companies on the implementation of the OECD Guidelines for Multinational Enterprises regarding human rights due diligence

Table 1: Voluntary CSR/SRI guidelines for companies regarding human rights

Source: Own illustration

While these initiatives try to prevent human rights violations from happening where they usually occur (i.e. within the commercial practices to deliver products or services along the supply chain of companies), that is at the source and thus at the most subsidiary level, they do mention investors only as an aside⁸. And although providing a platform for exchange and useful resources as well as advocacy for the subject, only a minority of companies integrates these policies in their practices; most of them are still unaware or uninterested in the impact of their business on human rights. The Alliance for Corporate Transparency, for example, demonstrates in its 2019 report on sustainability disclosure that 17.8 % of the companies consulted do not report any information on general human rights topics, 60.3 % describe or reference

⁷ <https://www.oecd.org/investment/due-diligence-guidance-for-responsible-business-conduct.htm>

⁸ Investors are treated as other companies (they have HRDD to conduct their work in a specific way) but they are also mentioned as a 'recipient' of the information by other companies – who should in their reports provide information on their non-financial aspects. Additionally, UNGP 9 raises the issue of the investments protection, UNGP 16 and 21 cite investors in the commentary.

policies and only 21.9 % specify key issues and objectives.⁹ Along the same lines, the Valuing Respect project criticises the inferior quality of available data that focuses mostly on inputs and outputs and not on achievements (i.e. outcomes).¹⁰ In terms of implementation, they are being criticised because of a lack of enforcement mechanisms relying rather on responsibility than on obligation on behalf of the corporations.

In addition, there are ILO standards and conventions addressing human rights aspects, especially covering core rights at work¹¹. While these conventions define obligations upon states, the ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy (MNE Declaration), adopted by governments, employers and workers in 1977 and amended last in 2017, also provides guidance on private companies on how to promote decent work, and is aligned with the SDGs and the UNGPs.

2.2 Financial markets and human rights

Regarding the financial markets more specifically, investors face fiduciary responsibilities to ensure that their portfolio companies respect human rights. A failure to do so might lead to financial losses, legal consequences or reputational harm. Investors commonly refer to this risk management approach as ‘value protection’.

However, it takes investors considerable effort to integrate a human-rights perspective in their investment strategies. To cite some examples, ensuring participation, accountability and non-discrimination are not easily implemented and usually translate into additional transaction costs for the asset manager. In order to intensive investors’ efforts in screening companies for potential risks stemming from human rights abuses, a variety of standards, initiatives and platforms have emerged.

Regarding global standard for investors, three initiatives that address the issue of financial markets and human rights are noteworthy: From the government side, the OECD Responsible Business Conduct for Institutional Investors addresses the context of institutional investments. Building upon the OECD Guidelines for Multinational Enterprises, they provide guidance on how to include responsible business conduct into an institutional investor’s due diligence process (OECD, 2017).

Within the context of recent trends towards the integration of ESG aspects into investment decision-making, the United Nations Principles of Responsible Investment (UNPRI) are trying to improve the level of responsibility in the financial sector and see human rights, modern slavery, child labour, working conditions or employee relations as examples for relevant criteria in the social dimension of ESG investing.¹²

Along these lines, the Equator Principles¹³, an initiative by the investment industry, constitute a risk management framework, adopted by financial institutions, for determining, assessing and managing environmental and social risk by providing a minimum standard for due diligence. Currently, 105 financial institutions in 38 countries have officially adopted the principles.

⁹ See also: <http://www.allianceforcorporatetransparency.org/>.

¹⁰ See for example: https://valuingrespect.org/wp-content/uploads/2019/09/ValuingRespect_TwoPager_Sept2019.pdf.

¹¹ Such as the eight fundamental Conventions: <https://www.ilo.org/global/standards/introduction-to-international-labour-standards/conventions-and-recommendations/lang--en/index.htm>.

¹² See <https://equator-principles.com/wp-content/uploads/2020/01/The-Equator-Principles-July-2020.pdf> and <https://www.unpri.org/pri/an-introduction-to-responsible-investment/what-is-responsible-investment>.

¹³ The Equator Principles (EPs) is a risk management framework, adopted by financial institutions, for determining, assessing and managing environmental and social risk in projects and is primarily intended to provide a minimum standard for due diligence and monitoring to support responsible risk decision-making.

Voluntary guidelines for investors		
Organisation	Name of guideline/principle	Description
Organisation for European Economic Cooperation (OECD)	OECD Responsible Business Conduct for Institutional Investors	<ul style="list-style-type: none"> Guidelines for institutional investors on how to implement the due diligence recommendations of the OECD Guidelines for Multinational Enterprises in order to prevent or address adverse impacts related to human rights, the environment or corruption.
Principles for Responsible Investment (PRI) Initiative	UN Principles for Responsible Investment (PRI)	<ul style="list-style-type: none"> UN-backed principles that serve as a voluntary guideline for SRI and are ready-to-use for investors and signatories. Signatories commit to follow six principles: Incorporation of ESG issues in business decisions, active ownership, disclosure on ESG issues, promotion of the PRIs, collaboration and reporting on activities
The Equator Principles Association	Equator Principles (EP)	<ul style="list-style-type: none"> Risk management framework to determine, assess and manage environmental and social risks in project finance Member companies of the EP Financial Institutions are committed to implement the EP internally and not to provide loans or financing for companies that do not comply.

Table 2: Voluntary guidelines for investors regarding human rights

Source: Own illustration

However, these principles are not legally binding documents but rely on the voluntary commitment and application by its signatories which is often not translated into practice. Also, these voluntary principles assume a certain subsidiarity of responsibility for human rights, meaning that they approach human rights risk in the financial sector as a derivative of the risks in corporate sectors, with investors relying on the reporting submitted to them (Dowell-Jones, 2013). Not one of these frameworks has been adopted industry-wide, none is mandatory for financial intermediaries and they address mainstream investors within ESG context rather than targeting impact investors in particular.

In order to facilitate the implementation of these standards, raise awareness and support the integration of human rights issues in the financial services industries, platforms such as the Investor Alliance for Human Rights offer training opportunities, capacity-building activities or events for investors.¹⁴

Another recent initiative to promote implementation is the The Corporate Human Rights Benchmark (CHRB), a collaboration led by investors and civil society organisations (e.g. Aviva investors). CHRB provides a yearly comparative snapshot of large companies, looking at policies, processes, and practises they have in place to systematise their human rights approach. The output helps investors to screen companies on the basis of i.a. the efficiency/quality of their HRDD, and thus addresses transaction costs involved in the assessment of the companies in the portfolio.

¹⁴ Please see <https://investorsforhumanrights.org/>; <https://www.ihrb.org/focus-areas/news-events/finance>.

It can also be observed that SDGs are increasingly reflected in the investment process as well as the reporting process across the investment industry. According to Sarah Rattray from the United Nations Development Programme (UNDP) ‘over 90 % of the goals and targets of the SDGs correspond to human rights obligations. As Member States make progress on the SDGs, they make progress on their human rights obligations – they are two sides of the same coin¹⁵.’ Comparable to the above-mentioned codices, application of the SDG framework is voluntary and does not as yet count as mainstream in the investment industry. Nevertheless, few reporting initiatives have also emerged including human rights aspects:

Voluntary reporting standards		
Organisation	Reporting standard	Description
Global Reporting Initiative (GRI)	Sustainability Reporting Framework	<ul style="list-style-type: none"> Implementation of a SRI reporting framework that includes SRI reporting guidelines as well as sector guidance
Global Impact Investing Network (GIIN)	Impact Reporting & Investment Standards (IRIS)	<ul style="list-style-type: none"> Approach to standardise reporting in impact investing to stakeholders

Table 3: Voluntary global initiatives, guidelines and standards

Source: Own illustration based on Kreibohm (2016)

2.3 European Action Plans

On a European level, there are two Actions Plans of relevance to impact investments in the framework of this analysis.

The Action Plan on Sustainable Finance¹⁶ adopted in early 2018, includes among the key actions at least some that are of relevance to all actors in the financial system/institutional investors:

- Establishing a clear and detailed European Union (EU) classification system – or taxonomy – for sustainable activities. This will create a common language for all actors in the financial system.
- Establishing EU labels for green financial products. This will help investors to easily identify products that comply with green or low-carbon criteria.
- Introducing measures to clarify asset managers' and institutional investors' duties regarding sustainability.
- Strengthening the transparency of companies on their environmental, social and governance policies. The Commission will evaluate the current reporting requirements for issuers to make sure they provide the right information to investors.
- Introducing a ‘green supporting factor’ in the EU prudential rules for banks and insurance companies. This means incorporating climate risks into banks' risk management policies and supporting financial institutions that contribute to funding sustainable projects.

The Action Plan has a focus on green finance. It aims to help to implement the Paris climate agreement and to transition towards a low-carbon economy. One cornerstone of the plan is to increase the transparency of companies. It remains to be seen how it will be implemented but it can be expected to contribute to a further validation of the understanding that companies have a role in society.

¹⁵ Please see <https://www.undp.org/content/undp/en/home/blog/2019/human-rights-and-the-sdgs---two-sides-of-the-same-coin.html>.

¹⁶ Please see https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en.

While the focus is on environmental objectives, the Action Plan also stipulates that economic activities have to meet minimum safeguards. It is rather a part of the approach of 'avoiding harm' and 'minimising risks' than 'creating impact':

The European Parliament and the Council established that for an economic activity to be Taxonomy-aligned, the activity should be carried out 'in alignment with the OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights, including the International Labour Organisation's ('ILO') Declaration on Fundamental Rights and Principles at Work, the eight ILO core conventions and the International Bill of Human Rights'.¹⁷

In general, it seems that industry participants expect that future regulations will include more criteria on social factors including human rights violations. This might help to shift financial flows to those companies who have better mitigation strategies.

The proposal for a new EU Action Plan for Human Rights and Democracy was published on 25 March 2020. The Action Plan has the following lines of action, of which some seem to be resonating well with impact investments¹⁸:

- Protecting and empowering individuals;
- Building resilient, inclusive and democratic societies;
- Promoting a global system for human rights and democracy;
- New technologies: harnessing opportunities and addressing challenges;
- Delivering by working together.

Impact investments could be an interesting option for empowering individuals and implementing new technologies. Empowering individuals includes promoting 'decent work and a human-centred future of work' as outlined in the EU Action Plan. This links well to impact investing which has a focus on employment and creating economic opportunities for a specific target group.

Impact investing is sometimes referred to as social venture capital. This hints at the possibility to link human rights with impact investing when it comes to the use of technology to advance human rights. There are many examples where investments are linked to new technologies. Examples throughout the analysis highlight how enterprises receiving impact investments ensure a high degree of accessibility of new technologies.

The Action Plan also reconfirms and announces to expand the EU's human rights-based approach to be included in all EU operational activities for development¹⁹ comprising the following aspects:

- Applying all rights (legality, universality and indivisibility of HR).
- Participation and access to the decision-making process (more than consultation or a technical step in project preparation; participation as a right and the basis for active citizenship).
- Non-discrimination and equal access (development interventions have to prioritise the most marginalised groups and avoid contributing to established patterns of discrimination).

¹⁷ Please see https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy_en.pdf.

¹⁸ Please see <https://ec.europa.eu/transparency/regdoc/rep/10101/2020/EN/JOIN-2020-5-F1-EN-MAIN-PART-1.PDF>.

¹⁹ https://ec.europa.eu/europeaid/sectors/rights-based-approach-development-cooperation_en#_blank, https://ec.europa.eu/europeaid/rights-based-approach-encompassing-all-human-rights-eu-development-cooperation-tool-box-commission_en, https://ec.europa.eu/europeaid/sectors/rights-based-approach-development-cooperation_en.

- Accountability and access to the rule of law (cooperation has to promote accessible, transparent and effective mechanisms of accountability at different levels, both donors and recipients have to be accountable to rights holders).
- Transparency and access to information (development programmes and projects have to be transparent, with information available in accessible formats, including for the marginalised groups).

These principles could also be relevant to guide any EU mechanisms to leverage or support impact investments in third countries.

2.4 ESG aspects in the investment process

There are different approaches within finance on how to integrate the broader categories of social and/or environmental aspects into the investment process. Social objectives relate to the improvement of a target group’s skills, behaviour or living conditions (Phineo, 2016). These can include but are not limited to human rights aspects. Investment strategies differ with respect to how much social and/or environmental aspects are integrated and what weight is given to the financial and social/environmental performance, respectively. In general, it is possible to distinguish ‘value-driven’ investment strategies prioritising financial returns as well as ‘values-driven’ investment strategies prioritising non-financial objectives (Adams, 2018). However, a lack of generally accepted definitions, stringent terminology and clear metrics continue to hamper the sector’s development.

The following figure shows the different investment strategies.

	VALUE-DRIVEN			VALUES-DRIVEN	
	Traditional	Exclusion	Integration	Impact	Philanthropy
Focus	No/rare consideration of ESG-criteria	ESG-risks	ESG-chances	social objectives	social objectives
Expected financial performance	maximum	market-rate	market-rate	0%-market-rate	-100%
Selection criteria	financial KPIs	negative screening	positive screening	social/environmental impact and capital preservation	mission, impact

Figure 1: Different sustainable investment strategies
Source: Own illustration based on Adams (2018)

Traditional mainstream investing is based solely on the rationale of financial risk and return aspects: Investors compare expected returns of different investment alternatives with the associated risks.

Among the sustainable investment strategies that integrate additional non-financial information, exclusion and integration are the two most widely known and used investment approaches. Non-financial information can relate to either environmental (E), social (S) or governance (G) aspects of the investment. Exclusion strategies consider financial risks stemming from ESG aspects and usually employ negative screening; in other words, these strategies exclude companies that sell harmful products (e.g. weapons) or produce them in an unsustainable way (e.g. surpassing certain emissions standards) from the possible investment universe based on a set of ethical values. Common screens exclude, for instance, fossil fuels,

weapons manufacturers or gambling. Exclusion remains the dominant sustainable investment strategy with over EUR 10 trillion assets under management in Europe, covering 48 % of Europe's professionally managed assets (Eurosif, 2018).

Integration strategies assume that ESG factors have financial relevance. Such strategies employ positive screens or best-in class selection, indicating that investors prefer sectors, companies or projects selected for positive ESG performance relative to their industry peers. Exclusion and integration strategies are usually being executed by investing in shares or bonds on traditional stock exchanges.

Impact investments prioritise non-financial objectives over financial performance by investing in business models whose main objective is to address a social and/or environmental issue. This can be done by way of thematic investments (for example, in microfinance funds) or impact-first investments that focus on areas where social or environmental needs require some financial or risk trade-off. Typically, these funds provide capital to social enterprises²⁰; furthermore, impact investments are generally smaller in volume and achieved by means of tailored propositions or private placement.

3 Impact investments - Introduction

3.1 Investment rationale and historical development

Throughout history, there have always been cases where investment strategies have been tied to social goals or convictions (Fowler & Hope, 2007). The notion of mobilising investment capital to support social change is thus certainly not novel but has experienced increased momentum of late. In addition, external investments usually bring financial discipline to a company and also help to build stronger, more sustainable companies. Social enterprises often report that investors helped them to build management systems such as budgeting, forecasting or impact measurement and improve their governance system.

Originating in 2007 when the term impact investing was first used by the Rockefeller Foundation (Harji & Jackson, 2012), it has developed into one of the most recent sustainable investment strategies. Although a universally accepted understanding of the concept has yet to emerge, this widely used definition by the Global Impact Investing Network (GIIN) describes impact investments as:

Investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return²¹.

Put differently, impact investments are characterised by the following three objectives (Höchstädter & Scheck, 2015):

1. Profit orientation: As with any other investment, impact investments aim for a benchmark-adequate financial performance. Depending on the specific risk-return-expectation of the investor, these financial expectations can range from market-rate returns ('finance-first investments') to below market-rate earnings ('impact-first investments'). Impact investments thus always take place in commercially viable business models which are able to repay investors. This aspect distinguishes impact investments from grant funding and philanthropy.
2. Impact intentionality: Impact investments are made with clear, previously defined goals to bring about positive social or ecological change. Hence, impact investments do not aim to reduce negative

²⁰ Social enterprises are companies that aim to solve a societal and/or environmental problem with an entrepreneurial approach. Their social mission addresses the improvement of skills, behaviours or the change in living conditions of their target group. That might include a human rights objective but can also address other issues vital to the target group's interests. Social enterprises often aim for financial self-sustainability in order to be able to provide their services and/or products independent of philanthropic support.

²¹ Published on the website <https://thegiin.org/impact-investing/need-to-know/#what-is-impact-investing>.

externalities by avoiding or reducing negative external effects, but rather to achieve a certain effect in a targeted, active manner by deliberately investing in 'social business models' (and not as a 'by-product').

3. Impact measurement: The ex-ante, pre-defined intended effect of the investment must demonstrably be achieved and measured.

3.2 Recent developments

The terms social impact investing, social investment or blended value investing are commonly used as synonyms for impact investing (Höchstädter & Scheck, 2015). But looking specifically at what the notion of 'impact' conveys, a consensus has recently emerged as to what is socially and environmentally desirable on a global scale as expressed by the United Nations' SDGs.

There are at least three reasons for impact investing's increased momentum:

1. **SDG funding gap and leverage of investment capital:**
UN experts estimate that the required funding need to achieve the SDGs in developing countries is as much as USD 3.9 trillion per year. Of this, public and philanthropic funds should be able to cover roughly USD 1.4 trillion, leaving an annual funding gap of USD 2.5 trillion (United Nations, 2014). This gap emphasises the demand for mobilising private capital to meet social and environmental needs. Rockefeller Advisors demonstrates that annually the United States of America (USA) philanthropy market comprises approximately USD 390 billion in donations, governments spend USD 3.9 trillion and capital markets (all debt and equity instruments) invest USD 365 trillion worldwide, thereof USD 65 trillion in the US and USD 300 trillion throughout the rest of the world. Consequently, a shift of only 1 % of the private assets towards impact investing could cover the outstanding USD 2.5 trillion SDG funding gap (Rockefeller Philanthropy Advisors, 2017).
2. **Low-interest rate environment:**
With unprecedented low interest rates for government bonds and other forms of investment being set to continue, investors are searching for other investment opportunities including social and/or environmental returns. The sometimes below-market rate return rates of impact investments are, therefore, not as unattractive in this context as they used to be.
3. **Growing evidence of success and increasing awareness:**
The impact investing field has seen some remarkable success stories (for example, the worldwide implementation of microfinance, funding of eye care facilities in India or solar energy solutions for low-income households) and lighthouse investments have made a proven case for this investment strategy. Prominent investors, from large foundations to successful entrepreneurs turned social venture capitalists are promoting impact investments as a way of combining money and mission, in other words aligning their investments with their values.

3.3 Challenges in impact investing

Impact investing is facing some challenges which can be illustrated at different levels.

Primary concerns comprise market structures and investment procedures. For example, most impact investments are still quite small (usually between EUR 200 000 and EUR 5 million), take the form of illiquid instruments (i.e. private placements) and have relatively high transaction costs. In order to address these market failures, a variety of public funding initiatives have been launched. These include the European

Commission's Employment and Social Innovation (EaSI) programme²² including for example a transaction cost support grant for social finance providers or the EIB and European Investment Fund (EIF) social/impact investing instruments (Impact Investing for Public-Private-Partnerships²³ and the EFSI equity social impact instruments²⁴). Nevertheless, there is still a funding gap regarding debt as well as equity impact capital across Europe estimated at an average of EUR 6.7 billion for the period from 2021 to 2027 (Spiess-Knafl & Scheck, 2020).

There are different challenges on the supply side (investors) and the demand side (investees). The absorption capacity of social enterprises which is the ability to take on larger sums of investment on the demand side is rather limited (UNPRI, 2018). That also means that investors have difficulties in allocating larger amounts of money which limits the options to develop sustainable fund models. Other challenges are related to a lack of a secondary market, a lack of organisational capacity and a lack of a market infrastructures.

Another threat stems from 'greenwashing' or re-labelling of investment products as impact investments in order to improve their sales prospects. A variety of funds have emerged claiming to pursue impact investing. However, when analysed according to the impact investing definition, only a minority of these products are 'true' impact investing vehicles (for example Klaiber et al., 2019). Broad scientific evidence on the subject does not exist. However, from the funds analysed in Klaiber et al. (2019), many investors that claim to be impact investors have no explicit social investment strategy or do not assess the impact of their portfolio. In addition, there is anecdotal evidence that tighter EU regulation on the taxonomy of sustainable investment products might lead investors to simply rename their investment vehicles. There have been significant efforts to introduce more clarity and transparency to the topic (e.g. by the OECD (OECD, 2019), the International Finance Corporation (IFC, 2019) or the Investor Alliance for Human Rights²⁵), assessing the market potential, demonstrating the positive correlation between an increased attention to human rights risks and financial performance or by presenting different approaches on how to address challenges such as impact measurement or commercial return expectations. However, unified definitions, standardisation or labels across the entire sector endorsed by a critical mass of investors are still missing.

4 Impact measurement

4.1 General framework and logic model

One of impact investing's defining characteristics is the assessment of the achieved social and/or environmental change. However, demonstrating this impact is methodologically complex and so far, no standard evaluation practises or mandatory requirements have been developed and adopted throughout the industry. In the field of development co-operation, impact evaluation has a long-standing tradition. According to Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD/DAC), the achieved effect of an intervention can be demonstrated by the impact value or results chain (based on the first letters of the single steps also called I-O-O-I logic (Spiess-Knafl & Scheck, 2017)), as shown below:

²² See also <https://ec.europa.eu/social/main.jsp?catId=1081>.

²³ See also <https://institute.eib.org/2018/04/impact-investing-for-ppps/>.

²⁴ See also https://www.eif.org/news_centre/publications/eif_efs_i_equity_en.pdf.

²⁵ See also <https://investorsforhumanrights.org/investor-toolkit-human-rights>.

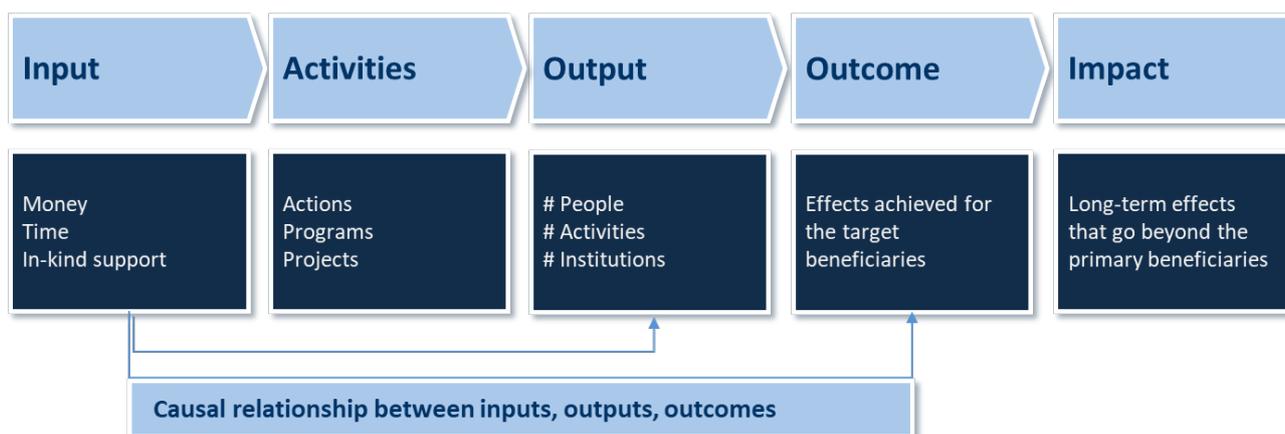


Figure 2: Impact value or results chain

Source: Own illustration

- Inputs are the resources an organisation uses for intervention in terms of financial resources, time or 'in-kind' support.
- Activities are the interventions carried out by an organisation in the form of actions, programmes or projects.
- Outputs are the tangible direct effects of activities that can be easily measured, for example in terms of the people affected ('number of lives touched'), the number of activities that have been carried out or the number of institutions where activities take place.
- Outcomes are the short and long-term social change/effects occurring for the target group as a result of the implemented intervention. In this context, different levels of outcomes do exist. These include (in ascending order) the beneficiaries' attainment of new attitudes and/or skills, changes in behaviour and, ultimately, changes in their living situations. Each level is a prerequisite for the next step to occur.
- Impacts are the long-term effects of interventions that go beyond the primary target group and reach additional beneficiaries, for instance families and communities. Impacts then lead to changes on an institutional or even systemic level.

However, there are other, deviating definitions for outcomes and impacts in use: Whereas the OECD/DAC terminology is widely used in Continental Europe, investors from the UK and the USA often define impact as the overall effects occurring on a societal level and outcome as the changes resulting from a particular intervention²⁶.

4.2 Challenges in impact measurement

Impact assessment is a very complex issue struggling with diverse challenges that hinder the development of the entire impact investing sector. One of the many issues researchers and practitioners find difficult to clarify is the problem of attribution. This refers to the necessity for demonstrating a clear link between a certain intervention and the desired effects. As it is usual for diverse interventions to take place at the same time addressing the same issues or target group, it is difficult to demonstrate the specific impact of an investment clearly and thus determine the social change achieved in monetary terms. Similarly, from a counterfactual perspective, a challenge remains to demonstrate (in a best case with a control group) what would have happened if an intervention would not have been undertaken.

²⁶ Chapter 3 will outline the implementation of these concepts using illustrative and simplified examples.

Additional challenges in the impact measurement field comprise: the lack of common methodologies and metrics; the poor data quality; and a misunderstanding or even ignorance of unintended consequences. While the investment industry has not started to consider unintended consequences from their investments, a discourse by human rights practitioners and advocates has started by discussing Business Model Red Flag Indicators, currently in a beta version²⁷. From an investor's perspective, impact measurements become even more complicated when trying to aggregate impact information at portfolio level. Even if impact assessment is carried out for a single investment /company, the collection and consolidation of data at fund level still remains unresolved.

According to the GIIN (Saltuk & El Idrissi, 2014) 95 % of impact investors manage to assess the impact of their investments in some way. Simultaneously, several methods have emerged which cover different aspects of the impact value chain²⁸. However, none of these methods has as yet emerged as an industry standard. They rather complement each other in providing a holistic view of the different effects achieved. The choice of method depends on the following influencing factors:

- Target audience: Different stakeholders require different information and thus might require different assessment methodologies.
- Assessment objectives: Impact information can serve various motivations, from reporting requirements to risk management, investment decisions or marketing purposes. Consequently, the type of information needed (quantitative, qualitative, etc.) might vary.
- Assessment scope: Impact happens on different societal levels (micro, meso, macro). In addition to different types and forms of social impact (e.g. with respect to sector, target group, time horizon), the scope of the intended assessment needs to be decided upon.

4.3 Guidelines and standards in impact measurement

In order to facilitate impact assessments, practical assistance services and tools have emerged. While the practice of ESG investing (see chapter 2.3) is focusing on minimising negative external effects of business activities (most prominent metrics here include the reduction of emissions, waste or water use), impact measurement focuses on the positive, added environmental and/or social impact of an investment for the target beneficiaries.

One of the most prominent tools currently used by impact investors is the Impact Reporting and Investment Standard (IRIS) covering SDGs 1-16²⁹ which provides many prevalent impact indicators from all sectors, yet none specifically on human rights. For example, for SDG 5 (gender equality) and the respective sub-targets 5.1.-5.6 investors have a total of 229 metrics in six impact areas at their disposal ranging from the number of active borrowers (clients) per loan officer at the organisation to working hour policy, indicating whether the organisation has policies in place to monitor, evaluate, and ensure appropriate working hours of employees, as well as a system to monitor compliance.

In addition, various software tools can support investors in data collection and reporting duties. However, no standard is applied yet universally, they are all based on voluntary application and do not explicitly address human rights aspects.

²⁷ Please see <https://valuingrespect.org/val-respect-focus-area/business-model-red-flags/>.

²⁸ See for example <https://measureresults.issueclab.org/>; <https://www.unpri.org/thematic-and-impact-investing/practical-guide-for-investors-in-inclusive-finance/4044.article>; <https://www.unpri.org/investor-tools/thematic-and-impact-investing>; https://www.ohchr.org/Documents/Issues/Development/DFI/OHCHR_Benchmarking%20Study_HRDD.pdf.

²⁹ Please see <https://iris.thegiin.org/>.

5 Investments, Funds and Instruments

5.1 Financing instruments

There are various financing instruments within the impact investment universe. They are structured like traditional capital markets financing instruments and the choice of instruments will depend on the cash flow profile of the company.

Equity capital

An equity investment is based on company shares. It means that an investor is taking a stake in the company with accompanying control and voting rights. The investor benefits from dividends and an increase in the value of the company. It also implies that the financial gains are realised only once an investor's stake in the company is sold (also termed as 'exit of the investment').

Debt Capital

Debt capital means that the investor is providing a loan to the company, which then pays back the loan with interest over a certain period of time. The investor has neither control nor voting rights and the financial upside is limited to the interest payments. The company which receives the loan should have a stable business model and the ability to repay the loan over time.

Other financial instruments

Other financial instruments include mezzanine capital, hybrid capital or revenue share agreements. Mezzanine capital is basically a combination of debt and equity capital as it combines the repayment elements of debt capital with profit-sharing elements of equity capital. A revenue share agreement is a contract where repayment is dependent on revenues generated by the company. Hybrid capital is defined in different ways, but we follow a definition which specifies it as a combination of debt capital, equity capital and grants (Achleitner et al., 2011). There are also other options, such as loans which can be converted into equity once certain criteria are fulfilled.

5.2 Impact investment funds

Data on impact investments is relatively sketchy and fragmented³⁰. This can be due not only to the concept's relative newness, but also the lack of commonly agreed metrics and definitions which would facilitate systematic data collection. Some time ago, a widely read study estimated the need for invested impact capital as ranging from USD 400 billion to nearly USD 1 trillion in emerging markets (O'Donohoe et al., 2010). However, on the supply side nine years later the GIIN estimated that 1340 organisations manage a total of USD 502 billion in worldwide impact assets (Mudaliar & Dithrich, 2019).

GIIN publishes the most extensive annual data on impact investments, following annual surveys of its members, with 266 participants having replied in 2019 (Mudaliar et al., 2019). These surveys have established that the sectors featuring most managed assets are (1) Energy, (2) Microfinance, (3) Financial Services, (4) Food & agriculture, (5) Water sanitation and hygiene, (6) Housing, (7) Healthcare, (8) Forestry, (9) Infrastructure and (10) Education.

In another study, Yum surveyed 32 family offices and found that the most active sectors within emerging markets in decreasing order are: access to finance, environmental conservation, sustainable consumer products, energy and resource efficiency, healthcare and wellness, water, employment and empowerment, agriculture and food, education and safety along with security (Yum, 2019). Spiess-Knafl and Aschari-Lincoln analysed a sample of 342 investments involving commercial as well as non-commercial capital and

³⁰ For example provided by OECD (Hassan & Mollah, 2018) (OECD, 2019); IFC (International Finance Corporation (IFC, 2019) or the GIIN (Saltuk, & El Idrissi, 2014).

found that most investments were made in education and employability, health services together with agriculture and handcraft (Spiess-Knafl and Aschari-Lincoln, 2015).

This overview of different sectors shows that there is a tendency to invest in energy, financial services, healthcare, agriculture and education. It has to be noted, though, that these sector distinctions are not fully accurate. For example, there might be financing schemes in the area of renewable energy or education activities within the healthcare sector.

Most funds have a rather general investment approach, meaning that they invest across many different industries as we will show below. Usually, they make small-scale investments involving amounts ranging from EUR 200 000 to EUR 5 million. However, there are exceptions to this rule as certain funds have raised billions for their impact investing vehicles, which consequently increases the average investment size.

The following non-exhaustive table shows ten different impact investments funds or investment managers running impact investing funds, which were selected to illustrate core features:

Examples of impact investments funds or investment managers running impact investing funds

Fund	Acumen	Capria Network	LGT Venture Philanthropy	Village Capital	The Rise Fund
Headquarters	New York	Seattle	Zurich	Washington, D.C.	San Francisco
Year of Foundation	2001	2015 (accelerator programme)	2007	2009	2016
Description based on the mission statement	Collecting donations to invest in companies	Network of 19 collaborating fund managers in emerging markets	Using grants and investments to support enterprises globally	Business angel investor in early-stage start-ups based on peer-selection	Investments in companies with measurable environmental impact
Assets under Management	USD 126 million	USD 350 million ³¹	not publicly available (n/a)	> USD 18 million	USD 4 billion
Number of Investments	126	157	51	110	25
Geographical focus	Globally (64 % in East Africa, India, Pakistan)	25 countries	Global	Global	Global
Fields	Agriculture, clean energy, education and healthcare	Across all sectors	Agriculture, Education, Employment and Skills, Energy, Health, Housing and information and communications technology	Agriculture, Health, Energy, Education, Financial Services	Across all sectors

³¹ USD 100 million are in a separate Capria Fund which invests in the fund managers.

Fund	Aavishkaar	Bamboo Capital	PG Impact Investments	Leapfrog Investments	XSML
Headquarters	Mumbai	Luxembourg	Switzerland	London	Amsterdam
Year of Foundation	2001	2007	2015	2007	2008
Description based on the mission statement	Investments in early-stage companies	Investments lead growth and social impact by anticipating major market trends.	Backed by one of the largest private markets' investment managers.	Investments in high-growth, purpose-driven financial services and healthcare businesses	Investments in SMEs
Assets under Management	USD 1 billion	USD 400 million	USD 210 million	USD 1 billion	USD 69 million
Number of Investments	68 investments	46 investments	6	n/a	~50-60
Geographical focus	India, Africa and Southeast Asia	Global	Global	Africa, Asia	Central African Republic, Democratic Republic of Congo, Uganda and the Republic of Congo
Fields	Across all sectors	finance, energy and healthcare	Financial inclusion, Housing, Energy, Agriculture, Healthcare, Education	Financial services, healthcare	Agribusiness, Education, Health, Hospitality, Retail, Services, Transport, Manufacturing

Table 4: Example of impact investments funds or investment managers running impact investing funds

5.3 Examples of investments

This sub-chapter will describe examples to illustrate the range of investments we observe in the market today.

Usually, an impact investor aims to start a reinforcing cycle of positive social effects, implying that an individual, family or small group of individuals such as a village will profit from a certain investment. That might take the form of better health, better education, cheaper and less polluting access to energy or income opportunities for those excluded from the labour market. These opportunities are considered to be a catalyst for a general positive societal development.

A typical impact investment is Mumbai-based Ziqitza Healthcare Limited (ZHL)³². The company provides emergency medical services and has raised USD 5.8 million in funding. A leading investor is the US-based Acumen Fund which first invested in 2007. The company was founded in 2004 with a single ambulance, but over the years additional investments have helped to expand its services. Other investors include Global Medical Response India, Housing Development Finance Corporation, Infrastructure Development Finance Company Limited and India Value Fund Advisors. The enterprise is currently operating 800 ambulances in 17 states and their social impact has been widely recognised. In addition, the company offers free health check-up camps for local communities.

Another example is Zipline³³. The enterprise is working in Rwanda as well as Ghana and has capacity of up to 500 drone deliveries per day. The drones can deliver blood and vaccines across the country and need on average 30 minutes to deliver an order. In 2019, they raised USD 190 million from TPG Growth's Rise Fund, Goldman Sachs and Temasek among others. To date, they have raised USD 225 million.

Impact investments often involve some kind of income generation for the target group. Examples include micro-entrepreneurship opportunities, new selling channels and access to data. For example, African farmers are offered various SMS-based services where they are informed of prices at local markets which helps them to negotiate better. Infrastructure-related investments often offer opportunities for franchises. This helps to ensure local ownership and long-term sustainability of sanitation, water or energy concepts. Some investments link local artisans with Western markets which offer better prices and higher income opportunities.

In the same field, LGT Venture Philanthropy invested in China-based MamaDaV.³⁴ This organisation offers a mobile platform helping mothers to sell products and services but also provides them with courses, training and workshops addressing thus the right to education and work and overcoming discrimination that they might otherwise face in accessing such educational/qualification raising programmes due to having to work from home. In 2018, they had 1.5 million mothers active as resellers on the platform.

LGT Venture Philanthropy also invested in a Colombian company, Lumni, which provides financing to students and operates on the principle of income share agreements.³⁵ Once the students finish their studies and find work, they repay their loans proportional to their income. It is a potentially difficult business model navigating the balance between profit and impact. However, the company has been widely recognised for its impact, with the World Economic Forum presenting the founder, Felipe Vergara,

³² All information was gathered from <https://www.zhl.org.in/>, <https://www.crunchbase.com/organization/ziqitza-health-care#section-funding-rounds>, <https://acumen.org/blog/press-releases/ziqitza-health-care-wins-social-impact-award/>, <https://acumen.org/investment/zhl/>, <https://www.zhl.org.in/ziqitza-corporate-broucher>.

³³ All information was gathered from <https://flyzipline.com/>.

³⁴ All information was gathered from <https://www.lgtvp.com/en/portfolio/portfolio-overview/mamadav>.

³⁵ All information was gathered from <https://www.lgtvp.com/en/portfolio/portfolio-overview/lumni>.

with the Social Entrepreneur for Latin America Award in 2011. Bloomberg Businessweek elected him as one of America's most promising social entrepreneurs in 2009 and he was also named an Ashoka Fellow in 2006.

Another example for education is Sudiksha which has received funding from Pearson Affordable Learning Fund and Village Capital. The company runs pre-schools in low-income urban neighbourhoods and the Center for Education Innovations describe it in the following way:³⁶

Sudiksha, through its Base of Pyramid (BoP) schools, seeks to cater to the needs of residents of urban and rural slums. The organisation employs a grassroots entrepreneurship and livelihoods model by training young entrepreneurs (including women) to run the schools as an enterprise. The program incentivises entrepreneurs to develop self-sustaining educational infrastructure in villages and slums. Most of the parents of the children are low wage earners in the informal sector. They include labourers, farm workers, vegetable sellers, and rickshaw drivers. Sudiksha's goal is to provide them with affordable options for quality education to cater to the bottom rungs of the Indian population that are often unreached by educational opportunities.

The ability of the poorer segments of the population to access quality public education services is too limited. Sudiksha aims to address this issue by building the entrepreneurial capacity of the target group. Of the 18 schools Sudiksha has set up, 12 are run by women entrepreneurs.

The examples show the power and flexibility of impact investing and it is hard to imagine how they could violate human rights. However, there could be a stronger rights-based view in analysing and selecting the investments. Investors could include some of the following illustrative questions in their due diligence process: What is the impact on the local stakeholders? Is there a risk of sexual harassment during the delivery of the services? Is the complete community engaged? Are some people at risk of losing their employment? Do the services contribute to inequality?

5.4 Limitations of current impact investing funds

The examples above also illustrate the potential trade-offs concerning impact investments and human rights: The business models described above need to generate revenue in order to meet the return expectation of the impact investors. That might lead to a situation where certain members of the most vulnerable target group could be excluded from the services. There are various pricing or allocation mechanisms to include those who are not able to pay for specific services (Spiess-Knafl et al., 2015) but there remains a need to see how beneficiaries are selected and how any potential discrimination is avoided.

Another limitation concerns the operations of an investor: Running such a fund is relatively expensive. The fund managers need to select the companies they want to invest in. Each investment needs separate contracts and a potential exit needs to be prepared ahead of time. In addition, the investors who placed capital in the fund might expect a certain return on such capital. This means that fund managers need to find investments which promise a certain return on their investment. This pressure needs to be balanced with the need to include the most vulnerable target groups which might have no or only a low ability to pay for the services. In addition, the comparatively small investment amounts in the sector further complicate the development of a profitable fund model.

³⁶ Please see <http://educationinnovations.org/program/sudiksha%E2%80%99s-base-pyramid>.

6 Social Finance: Expanding the toolbox

6.1 Social Finance as additional investment approach

Social finance is a complementary approach to impact investing and faces less restrictions. The main difference is that social finance has no focus on achieving commercially attractive returns but keeps the toolbox of the investment approach.

Whilst the previous chapter focussed on positive, reinforcing investments, we now turn to concepts which are aimed at investing in situations where human rights are actively suppressed or where establishing a commercially attractive business model is not possible and thus other financing solutions are needed.

The risks might be prohibitively high as there can be powerful counter-interests as some institutions or individuals even benefit from human rights violations. Consequently, interest of those institutions and individuals in collaborating to prevent and reduce human rights violations might at best be negligible. There is also the chance that business cases are less stable. Although counter-examples exist, a refugee population and its migration context might change quickly which complicates the development of sustainable business models.

These factors contribute to an observation that such investments are not very attractive for private investors and might therefore not be pursued as often as deemed necessary and with the same financial instruments as those illustrated above. Thus, this chapter will also look at other ways of supporting companies and entrepreneurs working on solutions in different focus areas.

6.2 Supply chain investments

Modern production relies on international supply chains. For instance, a shirt might have cotton from Uzbekistan, but be manufactured in Bangladesh. A smartphone might be assembled in China with certain minerals coming from the Democratic Republic of the Congo. Chocolate depends on cocoa from Western Africa and so on. In all those areas, incidents of systematic human rights violations including forced labour and child labour have been reported.

Corporate profits depend in some cases on these human rights violations. They can be related to a lack of safety or exploitative labour situations such as forced, child or slave labour. Clearly, if financial benefits could not be derived in this way, organisations would not pursue or tolerate such human rights violations.

There have been various approaches to how to deal with these situations. These approaches are usually based on greater transparency, higher regulation and tighter control of the supply chains already discussed above.

The Working Capital Fund is an example for a fund which invests in solutions to protect vulnerable groups in the supply chain³⁷. The five areas they have identified are (1) Worker Engagement, (2) Product Traceability, (3) Ethical Sourcing, (4) Risk Assessment and (5) Ethical Recruitment.

Their fund has invested in eight companies as of March 2020. Phylagen is a data analytics company which uses microbiomes to identify the origins of sources³⁸. They use the naturally occurring microbial fingerprint to better verify goods in the supply chain. OpenSC was co-founded by WWF and BCG Digital Ventures and helps organisations to verify claims about their supply chain on their platform.³⁹ For a company in the

³⁷ <https://workingcapitalfund.com/>.

³⁸ <https://phylagen.com/>.

³⁹ <https://opensc.org/>.

fishing industry, they have developed a machine learning algorithm combining multiple data sources to verify that the vessels only fished in certain areas.

These examples illustrate the potential investments across and along the supply chains of different industries. There is limited publicly available information on their investments. For OpenSC, public data state that the company has raised USD 4 million in a seed round in September 2019.

6.3 Refugee investments

Following the recent migration crisis, refugees as a beneficiary group are becoming more important for investors. Investments can be put in place to support:

- Refugee-owned or refugee-led enterprises,
- Refugee-supporting projects,
- Projects supporting host communities through infrastructure, employment, goods or services,
- Refugee lending facilities⁴⁰.

Mudaliar et al. (2019) stress impact investors' increasing interest in addressing refugee issues with 74 % of respondents confirming that they consider humanitarian issues in their policies and due diligence as well as 19 % investing in enterprises or vehicles providing assistance to refugees.

In terms of financing instruments, social impact bonds (SIBs) are currently being designed to address these issues. A typical SIB features four key players working in conjunction with one another: (1) A financial intermediary raises funds from (2) private investors and makes them available to (3) social organisations that directly work with the beneficiaries; this covers their operating costs. (4) Public authorities (or any other type of 'outcome payer', interested primarily in the proven achieved impact) then enter into contracts with the intermediary, committing to reimburse investors (including possible additional interest) if previously agreed upon impact goals are reached. The following figure illustrates the basic set-up of such a collaboration:

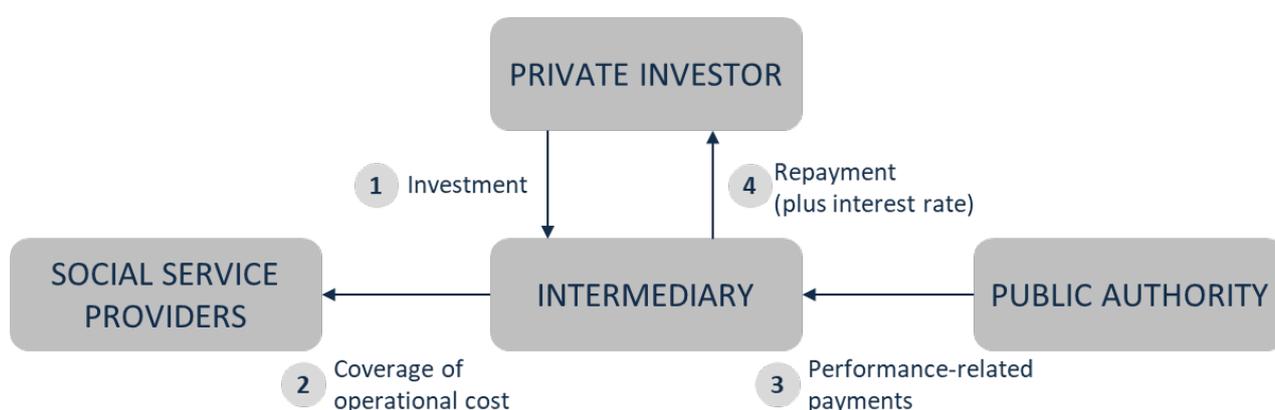


Figure 3: Basic structure of a Social Impact Bond

Source: Own illustration

For example, Brussels-based Kois Invest⁴¹ is currently developing such a financing vehicle together with the Ikea Foundation (as an outcome funder) to improve refugee livelihoods in Jordan and Lebanon. The targeted amount currently being raised is USD 20 million, which will be invested into two organisations

⁴⁰ See also: <https://refugeeinvestments.org/wp-content/uploads/2019/06/RINlens.pdf>.

⁴¹ See also: <https://www.koisinvest.com/>.

working to improve education and employment outcomes for Syrian refugees. If these organisations meet specific pre-defined impact targets (e.g. number of job placements), international donors and philanthropists will provide investors with a financial return.

Another example worth mentioning is the world's first Humanitarian Impact Bond launched in 2017 by the International Committee of the Red Cross (ICRC)⁴². The money raised (CHF 26 million) is aimed at supporting people with disabilities in conflict-hit countries. Specifically, the money is being used to build and run three new physical rehabilitation centres in Nigeria, Mali and the Democratic Republic of the Congo as well as providing the necessary training for staff. The 'payment-by-results' has been designed as a private placement (technically speaking, not a bond) where private investors (among others Munich Re Group and Bank Lombard Odier) pre-fund the ICRC's activities on-site for five years. At the end of the investment period, the outcome funders (governments of Belgium, Switzerland, Italy, the United Kingdom and la Caixa Foundation) will pay back not only the investors' capital in full or (depending on the results) with an additional return but also the ICRC according to the results achieved.

6.4 Media investments

There is a link between free media and human rights: Media freedom plays an important role in preventing governments from violating human rights, with torture, political imprisonment or rigged elections being more likely in countries with controlled media. Research on this topic is widely established (e.g. Whitten-Woodring 2009; Stier 2015).

Reporters without Borders found in the Press Freedom Analysis 2020 that only a quarter of 180 countries analysed enjoy proper media freedom, a finding which is corroborated by various other indices and evidence.⁴³ Investing in independent media is, therefore, not regarded as a very attractive proposition from a business perspective.

The Media Development Investment Fund (MDIF) is an example for a fund which invests in media companies around the world.⁴⁴ They describe their impact as follows:

MDIF provides affordable debt and equity financing to independent media in a range of countries where access to free and independent news and information is under threat. For more than 20 years, our financing and technical assistance have helped scores of media organisations build robust businesses, strong enough to hold governments to account, expose corruption and provide a platform for debate.

MDIF measures their clients' impact on society in categories which are (1) corruption and accountability reporting (2) reliable source of information with a focus on social issues (3) encouragement of democratic participation.

At the moment, they are managing five funds: Emerging Media Opportunity Fund (USD 12.9 million), MDIF Media Finance I (USD 6 million), MDIF Media Finance II (open to investors), MDIF General Fund (evergreen fund which invested more than USD 100 million since 1996) and Digital News Ventures (USD 3.8 million).

MDIF Media Finance I and II are interesting examples of hybrid funding structures. The Swedish International Development Cooperation Agency helped to attract private investors by providing a 55 % first-loss protection to investors.⁴⁵ This is an example of a mechanism to attract more investors for such funds.

⁴² See also: <https://www.icrc.org/en/document/worlds-first-humanitarian-impact-bond-launched-transform-financing-aid-conflict-hit>.

⁴³ See https://rsf.org/en/ranking_table.

⁴⁴ See <https://www.mdif.org/>.

⁴⁵ See <https://www.mdif.org/mdif-launches-blended-value-loan-fund-with-sida-backed-first-loss-protection/>.

6.5 Overview of social finance investments

This chapter has shown that there are different approaches to invest in more challenging environments. The following table shows the different organisations described above in more detail.

Overview of social finance investments

Fund	Media Development Fund	Humanity United	Working Capital Fund	ICRC Humanitarian Impact Bond	Kois Refugee investment impact bond
Headquarters	New York & Prague	United States	United States and United Kingdom	Switzerland	Belgium
Description	Investments for independent media	Foundation dedicated to cultivating the conditions for enduring freedom and peace.	Solutions to protect and empower vulnerable workers in global supply chains.	Providing services to person with a disability	Providing skills training and entrepreneurship support; targeted for refugees
Year of Creation	1995	2011	2018	2017	2020
Assets under Management	USD 111.6 million	n/a	n/a	CHF 26 million	USD 20 million
Number of Investments	119 clients and 368 projects across 42 countries	n/a	8	3	2
Geographical focus	Global	Global	Global	Nigeria, Mali and Democratic Republic of Congo	Target groups are Syrian refugees and vulnerable populations in Lebanon and Jordan
Fields	Media	Forced Labour & Human Trafficking, Peacebuilding & Conflict Transformation	Supply chain solutions	People with disabilities in conflict-hit countries	Education
Financing instruments	Equity, debt and hybrid capital	Grants	Commercial capital	Social Impact Bond	Social Impact Bond

Table 5: Overview of social finance investments

7 Conclusion and recommendations

7.1 Conclusion

7.1.1 General Remarks

Impact investing is an emerging sustainable investment approach. This trend can be seen against the backdrop of the need for mobilising private capital to reach the SDGs as they become increasingly important. Compared to other sustainable investment strategies such as exclusion or integration, impact investing goes beyond minimising negative external effects of investments to investing in business models that directly contribute to the solution of a social problem.

Human rights are clearly a topic of growing importance for impact investors. Nevertheless, this is not as yet an issue explicitly connected with impact investing, but rather addressed implicitly by using SDGs as a guiding compass for investment strategies. While there might be scope for a stronger, human-rights based approach in the due diligence process, i.e. when selecting investees, we believe that an additional category for investment specifically targeting human rights is not necessary and might even create confusion and thus reduce capital inflow in the field. In order to strengthen human rights in impact investments, it would rather need to be done more consciously, for example by defining human rights-based investment strategies or by tracking human rights indicators across the portfolio. Tracking indicators would keep human rights issues on the mind of the investment managers.

However, impact investments as a financing tool to address social issues are limited to commercial business models in order to achieve the positive financial return they require to be sustainable themselves. Thus, the scope of investable organisations and, consequently, the possibility to foster positive human rights outcomes make impact investing a quite specific problem-solving approach. Social finance can be seen as an extension of impact investing by using similar mechanisms but without the requirement to achieve financial returns (but they might generate some).

Although impact investing and social finance might only be relevant in specific circumstances, these approaches could be a blueprint regarding the protection of human rights in investments with regard to mainstream financial markets and might even serve as inspiration for more conventional investors.

In both constructs, there are less structural layers integrated than there might be in other development approaches and thus less potential for corruption. In addition, entrepreneurs have a strong local connection, know the needs of their target beneficiaries quite well and are accepted by the community which strengthens the problem-solving approach and its long-term viability.

A possible standardisation of impact assessment methods would allow for greater transparency in the sector and – as a consequence – a higher comparability between investors leading to the funding of the most-impactful companies and hopefully to greater capital inflow into the sector. However, such a standardisation of impact KPIs might be possible on a sector-level but the degree to which these indicators are quantifiable or even converted into a monetary measure will stay heterogeneous (e.g. it is easier in the area of employment but much more difficult, if not impossible, for topics such as inclusion or empowerment). Furthermore, aggregating this data on a fund level into one absolute measure will not be possible.

Thinking about a standard assessment process and reporting, however, might be promising and could constitute a first step towards a more efficient and effective capital allocation.

7.1.2 Geographical limits

Nevertheless, both approaches, impact investing and social finance face certain limits: There are certain states, for instance those that are armed-conflict-affected, failed or otherwise rather closed, where we

could not identify any impact investments. Examples include North Korea, Syria, Myanmar, Yemen, Afghanistan, South Sudan or Somalia. Investors might be unwilling to invest in these countries given the risks, the uncertainties or the lack of commercially viable investment opportunities.

Elsewhere, there are those countries with serious human rights issues, which can be identified, for example, via the Universal Human Rights Index Database⁴⁶. These include, for instance, China, Russia and Saudi Arabia that attract significant amounts of foreign direct investment, but leave little room for impact investment. While there are many foreign companies and investors, the number of impact investments remains limited.

Fund operators' experiences and logistical limits could also be influential. Investment managers usually prefer investments closer to their main or regional offices which could, for instance, rule out certain smaller countries in Central Asia which are logistically difficult to reach. Not only in this instance, developing or supporting locally owned financial institutions might be an interesting alternative.

However, there are always new frontiers for impact investing. Should a potential reunification of the Korean peninsula ever become reality, then impact investing could well be an effective way of helping the citizens. Industries also are continually changing, with some needing 'patient capital' by way of support, a type of proposition which may not be considered attractive by other lenders. Countries can also be expected to change over time. Some autocracies will open up and new opportunities will, therefore, be presented to help such countries during their transition into modern democracies.

7.1.3 Commercial Boundaries

A society depends on a range of interventions and mechanisms. Accordingly, it is hard to imagine that the needs of the poorest in a society can simply be satisfied through market mechanisms. There is still a continuing requirement for public services as well as philanthropy at the very bottom of the income pyramid. Impact investing cannot simply be a remedy for all profound market failures.

Even when companies offer inclusive and affordable educational or healthcare services, the costs might still be too high for the target group. In the best-case scenario, there can be cross-subsidisation but there will often be the need for public authorities to pay for at least some of the services.

The second dimension refers to a perception that social problems develop over time: The market for microfinance or solar energy might serve as a good example. Both industries needed decades to develop sustainable business models before they could be considered as investible. Developing these business models, testing and scaling them was done by non-commercial funders acting as catalysts. Nowadays, there are companies in these fields that offer sustainable services to millions of customers with a financially viable, investable business model.

7.1.4 Funding gap

There seems to be a funding gap for impact investments in human rights driven by the mechanics of fund management as well as the risk of certain business models. In these cases, social finance might provide adequate solutions to develop investable business models in these fields.

There is also a funding gap for smaller investment needs. A fund manager covers the costs out of a fee, which typically amounts to roughly 2 % of the invested capital. This fee could also be substantially higher in difficult circumstances. That means that funding operators need large investment sizes so that they themselves can produce sustainable business models. Experience has shown that funding organisations grow over time, eventually becoming more cost-efficient. Before this stage is reached, by and large early development is often funded by philanthropic start-up capital or grants. In some cases, it might be

⁴⁶ Please see <https://www.ohchr.org/EN/HRBodies/Pages/UniversalHumanRightsIndexDatabase.aspx>.

reasonable to invest only very small amounts in each organisation, but this is not feasible for impact investing fund organisations due to their cost structure.

7.2 Recommendations

The recommendations derived from our analysis can be summarised along three different dimensions reflecting the structure of the impact investing market: (1) Demand side of impact investments, (2) supply side of impact investments and (3) framework conditions for investment capital.

7.2.1 Demand side of impact investments

Supporting the demand side of impact investments for fostering human rights aims at increasing the number of social enterprises able to take on impact investments as well as fostering their investment readiness (i.e. their capacity in terms of business model and organizational structure to take on external funding). In addition, social enterprises need a conducive ecosystem to be able to develop, implement and grow their ideas.

Recommendation 1: Stimulating the creation of enterprises working on human rights issues

An interesting finding from this analysis was that there are only few investments in companies with a commercial business model focusing on specific human rights issues. There might be various reasons for this phenomenon. One reason might be that there is not enough absorption capacity on the demand side, i.e. enterprises are not able to take on investment capital.

Enterprises who work on human rights issues and would like to take on external funding need to be investment-ready and have systems in place to put the money to good use. Investment readiness is determined, for example, by knowledge about finance and accounting, the existence of a sound business model as well as functioning delivery models.

There are different organisations helping enterprises to achieve a certain investment-readiness and build up organisational capacity: Incubators and accelerators help enterprises to start or scale their business. Training, coaching and best-practice exchanges foster learning and network-building.

Possible actions: Launching pilot projects to support the ecosystem and infrastructure thus growing the number of enterprises and, consequently, investments in enterprises who work on human rights issues. These pilot projects could consist in start-up grant funding (e.g. via an award or public call for proposals) as well as incubation or accelerator programmes for human rights social enterprises. In addition, these programmes could focus on: specific industries closely linked to human rights abuses; specific geographical areas; or thematic issues for which impacts on human rights are more visible and measurable.

Recommendation 2: Leveraging technological innovations for human rights issues

There are many technologies which could be beneficial to improve specific human rights situations and many potential use cases already exist to illustrate this argument. The Blockchain technology has of late been a source of innovation for supply chain transparency. Examples include applications which trace the sources of certain commodities. Some enterprises are using drones or satellite imagery to better track developments on the ground. There is also a case for technology for personal identification. The new EU Action Plan on human rights and democracy also aims to 'support state authorities in providing legal identity for all' as outlined in the chapter on 'Protecting and Empowering Individuals'. The World Food Programme is testing an iris scan payment system in a Jordanian refugee camp, for the purchase of food instead of cash, vouchers, or e-cards.⁴⁷ However, these applications need to be vetted carefully to avoid any human rights risks.

⁴⁷ See <https://www.wfp.org/news/wfp-introduces-innovative-iris-scan-technology-provide-food-assistance-syrian-refu>.

This recommendation relates to the first one as it also addresses the potential for increasing the demand for impact investments by fostering the emergence of start-ups in this sector. If entrepreneurs observe that there is support available for the development and implementation of new technologies, it might be one hurdle less for potential entrepreneurs paving the way for an increased absorption capacity of funding.

Possible actions: Assessing the role of technologies in improving human rights situations and developing support mechanisms for carefully vetted technologies. The support mechanisms could include a third-party assessment for certain technologies or funding schemes with investments as well as grant funding for social start-ups in the sector.

7.2.2 Supply side of impact investments

Recommendation 3: Making impact investment in human rights more attractive for investors

Some business models might be very attractive regarding their potential social impact as they contribute to improving human rights, but the inherent risk could be prohibitively high for investors. Investors might be unfamiliar with human rights approaches or might shy away from certain regions.

There are various methods to lower the risk for investors: Guarantees, for example, are a proven and cost-efficient method to enable investors to take those risks. For debt financing instruments this can be a portfolio guarantee, while for equity investments it might be a first-loss piece as fund investor. Their main aim is to reduce the financial risk for private investors and attract more capital to the field.

In addition, the transaction costs in this field are relatively high. Enterprises which focus on human rights issues might operate in rural areas and might need more support. It might be worthwhile considering providing transaction cost support or operating grants for intermediaries in this space. They could then in turn help the enterprises on the ground with technical support, such as communication, but also building networks for collaboration and best-practice exchange.

Possible actions: Reducing the risks of impact investments in human rights by providing schemes such as guarantees or first-loss tranches or demonstrating commitment and feasibility by co-investments in respective funds.

7.2.3 Framework conditions for investment capital

Recommendation 4: Establishing guidelines and labels to avoid mission drift and promote more awareness

There is constant talk of ‘mission drift’ and ‘greenwashing’ in impact investing. Some investors might use the label ‘impact’ simply to attract capital while not pursuing impact afterwards. Hence, there might be the need for transparent criteria or even a binding categorization for social aspects of investments with a specific mention of human rights fostering standardisation. Funds that invest according to these criteria could be regulated on a European level. One example is the European Social Entrepreneurship Funds (EuSEF)-Regulation⁴⁸ which provides a label to organisations financing social enterprises. This can be a tool to channel additional capital to those funds.

Whilst impact investing professionals might in general terms follow an approach highly consistent with human rights issues, they may nevertheless not always be aware of them. Accordingly, it might be worthwhile to consider approaches which give more visibility and awareness to human rights issues in the investment process, for example with an industry-wide code of conduct or commitments. Any code of conduct should be developed by the industry but given the limited financial flexibility of the funds it might be worth considering funding such institutional work at a European level.

⁴⁸ See: https://ec.europa.eu/info/law/european-social-entrepreneurship-funds-eusef-regulation-eu-no-346-2013_de.

It could also be possible to build upon the EU Taxonomy on Sustainable Finance which is widely seen as an important milestone. Following the development of guidance on environmental objectives, the Commission's 2018 Proposal already foresaw the need to develop guidance on activities qualifying as contributing to social objectives (reflected in the Review Clause - Article 17 of this Proposal)⁴⁹. The text of the *Regulation on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088*, adopted on 18 June 2020, materialised the intent of such proposal. It established a concrete assessment review system that would expand the scope of the financial investments' classification and taxonomy system from environmentally sustainable economic activities to other sustainability objectives, including social objectives⁵⁰.

While the milestone is in principle accomplished, the path to an effective amplification of such objectives and the inclusion of human rights enhancement objectives in the classification of *sustainability objectives* remains uncertain. Accordingly, this now requires active involvement from the Parliament.

Possible actions: Considering actions to prevent greenwashing thus fostering credibility and visibility of impact investments in human rights issues. This could be done by playing an active role in directing the expansion of the scope of the EU Taxonomy on Sustainable Finance to target human rights objectives, strengthening the EuSEF label and/or by supporting industry initiatives to implement widely accepted codes of conduct.

⁴⁹ <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018PC0353&from=EN> at pgs 17 and 34.

⁵⁰ See https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CONSIL:PE_20_2020_INIT&from=EN at pgs 38; 76 and 89.

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