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EXECUTIVE SUMMARY OF THE THESIS

Uncovering barriers and drivers in the development of impact investing: a focus on the Italian market

TESI MAGISTRALE IN MANAGEMENT ENGINEERING – INGEGNERIA GESTIONALE

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1. Introduction

The social and environmental challenges that the world is facing require effective and sustainable solutions, which cannot be achieved solely through traditional philanthropy or government aid. Impact investing is emerging as a promising approach to address these challenges by leveraging private capital for positive impact. However, the market size for impact investments remains limited, prompting the question of why investment in impact remains relatively low.

2. Literature review

The concept of impact investing emerged from socially responsible investment and corporate responsibility movements of the last quarter of the twentieth century (Bugg-Levine & Goldstein, 2009, p.32). It offers an alternative strategy for channeling large-scale private capital into social and environmental initiatives while combining the values and goals of traditional investing with those of philanthropy. The ultimate goal of impact investing is to generate social benefits that can be assessed through both quantitative and qualitative measures. Despite not being an asset class, it is an investing strategy that may be employed across various asset classes. Currently, over 3,349 organizations managing $1.164 trillion in assets are involved in impact investing (Hand et al., 2022). However, it is necessary to distinguish it from other investment strategies such as microfinance, venture philanthropy, and social impact bonds, among others, as each serves a unique purpose. (Agrawal & Hockerts, 2019).

The EU has recently implemented the Sustainable Finance Disclosure Regulation, requiring EU financial market participants to disclose ESG risks and sustainability objectives. Although the growth of impact investing has led to a focus on impact measurement and management to understand both financial and social return, challenges remain in measuring social impact outcomes. Risks related to the lack of appropriate capital, the sophistication of impact measurement and management, and suitable exit options also pose challenges for impact investing (Hand et al., 2020).

Overcoming barriers to impact investing is essential for the market to flourish and have a positive effect on society. In this regard, it is crucial to focus on financial-first investments, establish due diligence practices, diversify portfolios, and collaborate with networks. However, other obstacles, such as problematic business conditions, a lack of intermediaries, access to financing, a lack of knowledge and understanding, privacy concerns, and measuring social impact, also hinder the expansion of the market. In Italy, the impact investing market faces several obstacles, including a lack of financial culture, attractive investment opportunities, public support, foundation-specific expertise, policy support, and coordination.

The growth of impact investing has led to a focus on impact measurement to understand both financial and social return. Governance frameworks, such as the GRI Standards, the Impact Management Project, and the Operating Principles for Impact Management, have been developed to measure and manage the impact. Impact investing involves analyzing the specific risks and conventional risks of investing, with impact investments often viewed as riskier than conventional investments due to unfamiliarity.

The accomplishment of multiple goals in impact investing is viewed skeptically from a behavioral perspective, as it may decrease perceived quality or instrumentality (Caseau and Grolleau, 2020). Potential investors may also believe that those resources invested in one aspect automatically lead to a loss in other areas. To overcome these barriers, a high level of collaboration between for-profit and non-profit sectors has been the main driver of growth. Increasing the sophistication and standardization of impact measurement and management is crucial for measuring outcomes (Hand et al., 2020). Impact investing also serves as a means of financing sustainable development, but no country is on track toward achieving Sustainable Development Goals. While impact investing organizations typically operate in their own country or invest in developing countries, an international focus leads to additional costs and management complexities (Balbo et al., 2018).

3. Research question

The topic of the barriers that limit the growth of the impact investing market has been partially studied in the literature, also considering some actors operating in the industry. However, it seems that not sufficient progress has been made so far. Therefore, this dissertation focuses on understanding whether these barriers have remained the same since those studies and proposing drivers that can help overcome these challenges. The analysis initially focused on the European impact investing market, but we later shifted its focus to the Italian context due to its unique characteristics. In particular, the research aims at understanding the barriers that the Italian impact investing market faces and exploring potential solutions to overcome them by conducting semi-structured interviews with Italian impact investing operators. Therefore, in our thesis, in order to fill the gap present in the literature, we will answer the following research question:

Which barriers is the Italian impact investing market facing and how can the actors operating in it overcome them?

4. Methodology

Our master thesis is composed of two main components: a literature review exploring the characteristics of the impact investing market, and a comprehensive data analysis. The data analysis consisted of three parts, namely the EVPA survey, desk research, and interviews.

4.1. Literature review

The literature review was conducted through a narrative approach, utilizing a total of 53 relevant articles that were selected based on a combination of different keywords such as "impact investing" and "social impact", as well as their year of publication (mostly ranging from 2019 to 2022). Out of the 53 articles, 36 were academic and 17 were from practitioner sources.

4.2. EVPA Survey

The data collection started with the analysis of the data resulting from the European Impact Investment Survey. This survey, conducted by the European Venture Philanthropy Association (EVPA), was completed by a whole host of organizations operating in the impact investing market across Europe. The collaboration with EVPA turned out to be crucial since the association shared with us data regarding Italy, which we decided to use in our analysis since that was our focus.

4.3. Desk Research

To ensure comprehensive data gathering, we made the decision to conduct additional desk research on Italian organizations that provided incomplete survey responses. This involved scouring web pages, articles, and other online sources to supplement the information provided by these organizations.

4.4. Interviews

A total of 11 organizations agreed to participate in our semi-structured interviews. These organizations were chosen mainly out of those who were asked to respond to the EVPA survey but did not. These interviews were designed to delve deeper into the challenges that limit the growth of impact investing and explore potential solutions. We covered a wide range of topics during these interviews, including the unique features of each organization and the hurdles that limit their activities.

Considering all types of data collection (EVPA questionnaire, desk research, and interviews), the total number of organizations that took part in the study is 39.

5. Results

The analysis of the results is crucial for understanding the current Italian context. The topics that were evaluated are several, ranging from the kind of organization that the respondents support to the kind of impact measurement and management initiatives they employ.

In particular, two important aspects that were analyzed are barriers and drivers.

The barriers that were cited the most are, in order, a lack of transparency and/or impact measurement communication, insufficient management capabilities of (potential) investees, the regulatory framework, a lack of understanding of (potential) investors, an inadequate financial structure, a lack of standardized impact measurement and management, problems regarding white/green washing, and a lack of demonstration and/or comparability of impact measurement.

The drivers that participants consider most crucial for market growth are: an increased presence of institutional investors, an increased managerial capacity of the entrepreneurial third sector, increasing public sector presence through regulatory support and facilitation, establishing an investment approach more aligned with demand needs, the development of a standardized impact measurement and management methodology, and strengthening the ecosystem through multi-stakeholder collaboration.

6. Discussion

6.1. Comparing barriers found in literature and data

Each barrier that was identified from the review of the literature was studied and compared to the ones emerging from the collected data. This association led to the finding that most challenges (all but one) that the study's participants reported had already been studied by the papers' authors. It is worth mentioning that although these challenges were recognized by both the literature and the respondents, they still persist in the market, indicating they have not been addressed yet.

6.2. Connecting drivers and barriers

Through engaging with market actors, valuable insights were gained regarding effective strategies to address the challenges impeding growth within the impact investing industry in Italy. This firsthand knowledge was particularly valuable given that these individuals operate within the market on a daily basis. Analyses were conducted to determine which barriers each proposed driver could help overcome, revealing that all but one barrier could be addressed. Additionally, a comprehensive examination of how the various drivers interconnect and support one another was undertaken, recognizing that they do not exist in isolation but could have a synergistic effect.

6.3. Leveraging the drivers for the development of the market

Considering all the information analyzed until this moment, a series of proposals to support organizations in overcoming the provided challenges are presented.

Standardized impact measurement and management is a must, particularly for the measurements regarding social impact. Regulations should be established to make impact measurement and reporting mandatory, and external validation of impact claims should be encouraged. To ensure the impact is maintained, it should be integrated into the mission and business models of investees, and a long-lasting relationship with them should be established. Since the role of the public is believed to be crucial, more communication and public attention are needed to reduce misunderstandings about impact investing and increase investor interest.

Moreover, training programs are necessary for organizations lacking the capacity to manage impact investments, which, according to the respondents, are abundant.

Clear and comprehensive information, education, and engagement with regulatory bodies and governments are essential to address the lack of understanding surrounding investments. This will promote awareness of the positive impact that investments can have, ultimately working towards solutions to improve the issue. Moreover, investor distrust and lack of interest can be overcome with transparency, engagement, and involvement of third-party professionals.

Lastly, collaboration and coordination, tailored regulations, and increasing managerial skills and knowledge can help overcome the inadequate financial structure.

Considering each of these actions in isolation would not be appropriate, as there is no single solution that can drastically transform the market. Instead, a series of smaller actions must be implemented in conjunction to bring about meaningful change.

7. Conclusions and future development

Based on the results of our empirical analysis, we managed to identify a considerable number of challenges the Italian impact investing market is facing - many of which were also outlined in the existing literature. In response to these findings, we put forth recommendations that offer tangible solutions to address these issues. Our proposals include the establishment of a global standard for impact measurement, mandatory regulations for impact measurement and reporting, as well as training programs.

However, our research presents some limitations that have the potential to lead to future advances.

The low number of analyzed papers on market barriers, the qualitative nature of the collected data, and the limited number of organizations examined may be potential weaknesses of our investigation, together with the fact that only the Italian scenario was considered. Extending the study to more countries, both in Europe and beyond, as well as focusing more future academic research on the topic of barriers to impact investments are some potential suggestions for future research aimed at advancing the knowledge of the subject offered by this study.

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