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# **THE POTENTIAL FOR DEVELOPING A SOCIAL IMPACT INVESTMENT MARKET IN LATVIA**

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# **The Potential for Developing a Social Impact Investment Market in Latvia**

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## **List of abbreviations**

EU - European Union

GIIN - Global Impact Investing Network

LatBAN - Latvian Business Angel Association

LIAA - Investment and Development Agency of Latvia

LLC- Limited Liability Company

NGO - Non-Governmental Organisation

OECD - Organisation for Economic Co-operation and Development

PBO - Public Benefit Organisation

SDGs - Sustainable Development Goals

SE - Social Enterprise

SEAL - Social Entrepreneurship Association of Latvia

SIB - Social Impact Bond

SIF - Social Investment Forum

SII - Social Impact Investment

SRI - Socially Responsible Investing

SSX - Social Stock Exchange

TONIIC - Global action community for impact investors

TBL - Triple Bottom Line

UK - United Kingdom

UN - United Nations

WCED - World Commission on Environment and Development

WEF - World Economic Forum

## **Abstract**

Over the past decade social impact investment [SII] has evolved as a new form to address the increasing social and environmental problems in the markets. The level of awareness about the SII and its potential to bring positive change in Latvia is only emerging, and this is the first study to evaluate the potential SII ecosystem and key stakeholders of it.

The aim of the study is to identify the main challenges and gaps that need to be addressed for the SII market development in Latvia. A cross-sectional method for data gathering and analysis is applied and semi - structured interviews with the key existing and potential stakeholders of the SII ecosystem in Latvia have been carried out. Moreover, a comparative design method is applied to benchmark and study the links among different SII ecosystem dimensions in the UK, currently the most developed SII market in Europe, as it provides the widest set of ecosystem players to study and learn from and, as a result, supports identification of parts of the system that could potentially be transferred to the reality of Latvia. The gathered information is structured according to the SII Market Framework developed by the Organization for Economic Cooperation and Development [OECD]. In addition, the authors apply an assessment of the scale of readiness of the demand, supply and intermediaries' dimensions of the potential SII ecosystem in Latvia.

The findings of the study confirm the hypothesis defined by the authors at the beginning of the research that the SII market does not exist in Latvia yet, however an awareness and interest among the potential stakeholders about the SII is increasing. Key challenges that need to be addressed include the development of scalable social businesses that have a business focus at the core of their activities. Furthermore, an intermediary as the link to all dimensions should appear in the market. Finally, government and local governments play a critical role and can significantly promote the development of the SII market, if a respective focus on resources and priority is there.

# 1 Introduction

Over the past decade, Social Impact Investment [SII] has evolved as a new and innovative form to address the increasing social and environmental problems in the markets. The challenges society faces today are too large to be left to governments and the social sector and there is a clear need for innovative and efficient solutions to approach them. According to the World Economic Forum [WEF] (2013), private investors can have a considerable influence on generating positive change within society, as governmental and charitable organisations cannot do that alone. SII is developing fast as it is seen as significant contribution in reaching the United Nations [UN] Global Sustainability Goals [SDGs]. Similar to conventional investing, impact investing involves the provision of financial resources for a financial return. Yet, the financial return is not the sole objective as impact investing also aims to have a measurable social and/or environmental impact (GIIN, 2016). SII is an investment, not a grant or donation, and in this way it clearly differentiates from philanthropic activities. In order to achieve the social impact, an interplay of various actors of the market is important, that together define and shape the SII ecosystem. SII Market Framework developed by the Organisation for Economic Co-operation and Development [OECD] consists of five dimensions - social needs, demand side, supply side, intermediaries and enabling environment - that together build the SII ecosystem (OECD, 2015). SII is a new approach and is developing fast, with more and more countries looking into the opportunities it can bring. Among the European markets, the UK has been at the forefront in the development of the SII ecosystem, providing new innovative solutions to the industry and serving an example for other markets to follow. The development of the SII market in the UK has been strongly supported by the UK government. Furthermore, the creation of strong and diverse SII intermediaries has enabled the development of the market and allowed the UK to take the leading position in the industry. Other markets are learning from the UK experience and positive results achieved there. There are different models used by countries to promote SII for wider public involvement. For example, in France social investment is a part of a strong “Solidarity Finance” idea, offering variety of opportunities and financial products for individual investors to participate. Italy has used a crowdfunding approach for specific social and environmental project support that have been assessed beforehand by the social bank's subsidiary

Banca Prossima for their viability. Netherlands is promoting SII by granting tax incentives called “The Green Funds Scheme” to individual investors for environmentally based initiatives.

Denmark is doing it through direct project contribution within the renewable energy field (Parke & Rowell, 2016). According to the Impact Invest Scandinavia (n.d.), SII is only emerging in the Nordic countries and the region is looking to learn from the experience of other countries with a more developed SII market.

There is a wide scope of social issues in Latvia that need to be addressed. Current social public support in Latvia is low relative to other OECD countries. The estimate on public social funding in Latvia for 2016 was only 14.5% of total GDP in comparison to the average of 21% of GDP for OECD markets (OECD, 2015). The low level of public social support particularly highlights a great need for private sector participation. The authors see the potential of having SII as a new approach within the investment market to bring a positive change in Latvia. For this reason, the authors take the UK market as the benchmark for studying the links among different SII ecosystem dimensions. Since the UK has the most developed and active SII ecosystem, it provides the widest set of players to study and learn from and, as a result, supports identification of parts of the ecosystem that could potentially be transferred to the reality of Latvia.

The aim of the research is to contribute to raising SII awareness in the society and among potential key stakeholders, and to provide a broad context for the SII ecosystem development in Latvia. The authors describe the SII ecosystem based on the OECD SII Market Framework and provide a comparison with the development of the SII ecosystem in the UK.

The research question is: *What are the main challenges and gaps that need to be addressed for the SII market development in Latvia?* The authors base their research on the hypothesis that the SII market in Latvia is either fragmented or does not exist. A cross-sectional method is used for data gathering and analysis. Based on data collected from semi - structured interviews with key existing and potential stakeholders of the social impact ecosystem in Latvia and representatives of SII intermediaries in the UK, the various dimensions of the SII ecosystem in Latvia are assessed according to a scale of readiness and development. This allows the authors to respond to the research question, and to identify gaps in the SII ecosystem in Latvia and potential development areas.



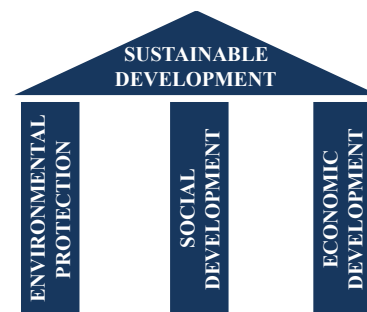
## 2 Literature review

### 2.1 Development of sustainability theory

Sustainability is a widely used term. I. Scoones (2007) explains that it originally was used by Hans Carl von Carlowitz in 1712 talking about long-term forest management and only at the end of 1960s and 1970s with the raise of environmental movement did it acquire a broader meaning. The sustainable development definition used by the UN today was outlined by Gro Brundtland, former Prime Minister of Norway in the mid - 1980s. His explanation appeared in the World Commission on Environment and Development [WCED] report “Our Common Future” (1987) and since then it became widely accepted. In this report, sustainable development is defined as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs” (WCED report, 1987, p.41). With the growing attention to sustainability and consecutive new policy development, businesses started to take a central role in the debates and implementation of initiatives in this field. As a result, a need for measurement systems to assess the progress and further institutionalization emerged. Quality measurement and certification systems were further developed. With the aim to measure sustainability performance from the accounting perspective in the mid-1990s John Elkington introduced an accounting framework called the triple bottom line [TBL]. His TBL framework was based on looking at the investment and shareholder value creation from a broad perspective, linking performance to interdependencies of three dimensions: profits, people, planet. (Slaper & Hall, 2011). Basic principles of TBL are applied in the current sustainability reporting standards, like GRI G4 (2013) introduced by Global Reporting Initiative.

For the long-term sustainable development, on September 2015 during the UN general assembly in New York the resolution “Transforming our world: the 2030 Agenda for Sustainable Development” was adopted, that includes 17 SDGs and 169 targets to address social, environmental and economic issues. As a global call for action it came

**Figure 1: The Pillars of Sustainable Development**



*Source: UN definition, picture made by authors*

into force on January 1, 2016.

Discussion on sustainability is well summarized by Visser (2015), who explains that human well-being and existence is strongly linked to finding a balance between economic, social and environmental development, that together form sustainability. All three dimensions combined - environmental protection, economic and social development - are called the pillars of sustainable development and were reinforced during the World Summit on Sustainable Development in Johannesburg, South Africa in 2002 (UN, 2002) (see Figure 1 for illustration).

### **2.1.1 Environmental sustainability**

Environmental sustainability is one of the three sustainability pillars and it looks at the natural resource use linked to the human well-being and the damaging effect of economic activities on the ecosystem from two perspectives: resource use and waste (Goodland, 1995). Hart (1997) calls the development of environmental sustainability ‘the environmental revolution’ that made companies change their way of doing business after the period of denying a negative environmental impact in the 1960s and 1970s. A sustainable development strategy was first formulated by the World Conservation Strategy of the International Union for Conservation of Nature and Natural Resources. The strategy document identified issues such as resource limitations, destructive short-term human actions and global dependencies, and it provides a theoretical and practical framework for conservation actions (IUCN 1980).

UN Earth Summit in Rio de Janeiro, 1992 established the first ground rules for both businesses and national governments, influencing also all further sustainable development initiatives. As the outcome of the Summit, the following documents were prepared: Agenda 21, the Rio Declaration on Environment and Development, the Statement of Forest Principles, the UN Framework Convention on Climate Change and the UN Convention on Biological Diversity. Agenda 21 focuses not only on environmental aspects, but also on social and economic challenges, as the specific sustainable development action plan proposition (UN, 1992). From the environmental sustainability perspective, the current UN SDG’s (2015) challenge businesses to go further and take environmental responsibility beyond regulatory compliance requirements, especially in the areas such as climate change, energy, biodiversity, agriculture and water.

### **2.1.2 Social sustainability**

Assessment of all the three sustainability pillars indicate that social dimension is the least developed, lacking any clear common understanding and definition. Vallance, Perkins, and Dixon (2011) explain that social sustainability has been looked at by some social scientists from a basic human needs satisfaction perspective, while others add responsibility and ethics to it. There is also the third view that looks at social sustainability from potential conflicts linked with changes related to culture and traditions. Missimer, Rob and Broman (2016) relate social sustainability with Brundtland's sustainable development definition, putting a human being in the centre, where human needs and capabilities to satisfy them are not hindered by external environmental or social factors. According to Goodland (1995) environmental protection is the basis for social sustainability. Furthermore, Goodland looks at poverty reduction not through the perspective of economic growth, but from a thoughtful and responsible approach towards consumption, waste, energy and other resource use. According to the World Bank report (2016), poverty still is a significant global issue with 767 million people in the world still living below the internationally accepted critical poverty line (below 1.9 USD per person/ day). McKenzie (2004) has a broad perspective on basic wellbeing that includes access to health services, education, housing, influence on environment, culture, politics, generational aspect and other. The World Bank (2013) focuses on sustainable development that improves the wellbeing of the poorest, thinking of inclusion and empowerment. The UN Global Compact Organisation (2016) talks about social sustainability from the effects businesses have on people and on society at large. Human rights are the basis for the social dimension of corporate responsibility, covering areas such as gender equality, labour rights, diversity, poverty, health and education. Also, the first five UN SDG's (2015) are focusing on social issues: poverty, hunger, health, education and equality.

### **2.1.3 Economic sustainability**

Economic development is the third pillar of sustainable development. Economics for ages have been valued in money terms. From sustainability perspective, however, natural capital is also included into the equation. (Goodland, 1995). In a very simplified way, economic sustainability for companies means staying in business. Chouinard, Ellison, Ridgeway (2011) show the strong

dependence of business viability on environmental and social sustainability, linking profit making with negative impact reduction and sustainability as a new business standard.

Financial efficiency should also be the focus of socially oriented businesses. Osberg and Martin (2015) note, that financial sustainability is a key for social business viability to avoid constant dependence on non-guaranteed external financing such as donations, grants, government subsidies, and other.

Finally, the financial viability of businesses is also critical for national economies as it provides employment and contributes with tax payments. The growth of a national economy is measured in GDP, however this measurement does not reflect an improvement of society's well-being. Daly (2002) explains that economic growth as a mean for poverty elimination is not working due to environmental limitations and the social effect it has, particularly what concerns the relative income growth. The same is confirmed by Hoeller, Joumard, Pisu and Bloch (2012), who conclude that upper incomes have grown faster than others and poverty continues to be the top issue. UN SDG's (2015) link sustainable economic growth with the importance of employment and its quality.

## **2.2 Evolution of Social Impact Investment**

Investments to solve various social needs have been made by governments, religious, Non-Governmental Organisations [NGOs], charities and other organisations for centuries. In discussions on inequality and addressing poverty the term 'bottom of the pyramid' is often used. Prahalad and Hart (2002) look at the opportunities companies could have if they focused on finding ways to adapt to the needs of the poor and bringing them out of poverty instead of focussing attention only on addressing the needs of the limited amount of wealthy population in developing countries. They promote the idea that the poor can be a part of the market economy, challenging companies to look at new business models, innovation and technology as means for reaching that aim. Linked with the same idea, new models for social and environmental value creation are emerging. According to Olsen and Galimidi (2009), Social Enterprise [SE] is a new type of business which focuses on positive social and environmental impact creation and has an effect on the economy this way differentiating itself from charitable activities. In line with the evolution of SEs, new social securities through financial tools are being developed. Nicholls

(2010, March) proposes to look at social investment as an innovation in terms of investment practices and investor motivation, since it is a multidimensional transaction, focusing not on the financial outcome alone, but also on the positive social or environmental impact. This way it provides an opportunity for investors to base their decisions on a different rationale.

### **2.2.1 Evolution of investment market**

With the increased awareness of social and environmental issues, raising demand for transparency and responsibility within financial markets, there has been transformation in perception on the use of capital, that can bring not only financial profits, but also generate social or environmental good (Daggers and Nicholls, 2016). Dichter (2014) looks at the history of economics and points out the fact that in order to solve social issues public and private capital should be involved (explained in section 2.2) and there is a growing trend for investors to look into such direction. To see how private capital and private investments can contribute on a broad scale the link can be made to the UN SDG's to better understand the investment return in relation to the global sustainability objectives.

Traditionally, investment decisions were made on the basis of financial return. Grabenwarter and Liechtenstein (2011) explain that investment is measured according to the financial return it brings, built on the capital asset pricing model introduced in 1960s. Particularly after the financial crises of 2008-2009, investors have raised serious concerns about conventional investment performance evaluation and its sufficiency for making an informed decision, since it proved to be incomplete. Therefore, the importance of the investment market that doesn't focus purely on financial measures is increasing. There is strong pressure to have accountability measures combined with the broad view on value creation in contrast to focus on financial return only.

Traditional investors are interested in looking for new options on how to diversify their portfolios. Grabenwarter et al. (2011) list these options in the following way: corporate social responsibility [CSR] investing, responsible investing, social investing, responsible investing based on environmental, social and corporate governance standards and impact investing. There is a clear distinction between impact investment and socially responsible investment. Impact investment is focused on creating positive outcome for the underprivileged or supporting

environmental initiatives while the socially responsible investment prioritizes minimization of harm and is sometimes even called ethical investment that excludes negative impact businesses like firearms, alcohol, oil, etc. According to Freireich and Fulton (2009), new approaches to investment are particularly attracting a younger generation of investors who are looking for meaning and seeking to bring public good besides the gain of financial return.

### **2.2.2 Social Entrepreneurship**

Over the last three decades, SE has evolved as an innovative business model for meeting social and economic objectives (OECD, 2015). Started as a local approach to address social needs, social entrepreneurship has influenced policy making and even the development of the market economy (described in section 2.1.2). SE is an important part of social development and is growing fast globally. Kerlin (2010), who has analysed the concept and context of SE across various regions and markets of the world, broadly defines SE as “the use of nongovernmental, market-based approaches to address social issues that often provides a ‘business’ source of revenue for many types of socially oriented organizations and activities” (Kerlin, 2010, p. 3).

A variety of literature is available on social entrepreneurship, looking at it from different perspectives: from the positive change it brings to the diminishing public responsibility.

Helmsing (2015) describes four types of SEs: the first type is based on collective collaboration focusing on more conventional goods and services; the second type are ‘self-help enterprises’ that work on voluntary principles usually backed by local communities; the third type has business-like approach and are called social business ventures; and the fourth type is the partial or full combination of the previous three.

One of the first entrepreneurs to establish social business principles as we know them today was the US educated, Nobel Peace Prize winner, Muhammad Yunus from Bangladesh. In 1983 he established Grameen Bank and introduced loans for the poor as the means to help themselves to move out of the poverty (Nobel Prize 2016). Yunus (2006) looks at capitalism from a wider perspective, not just from profit making, but also from the social dimension and sustainable business creation, that not necessarily bring profit - most importantly that it sustains itself and is not loss generating.

Social objectives can be reached in many ways; by giving away one's time, money, knowledge, skill, etc. The moment the social entrepreneur manages to cover the costs from the activity the enterprise stops being a charity and turns into business, becoming part of the economy. A study of the Skoll Award for Social Entrepreneurship winning enterprises done by Osberg et al. (2015) has confirmed that combining both social purpose and staying financially sustainable is not easy. At the same time many companies succeed in doing that and even increase the scale of their activity. Skoll (2006) calls social entrepreneurs “the practical dreamers” (Skoll, 2006, p.V), as they are people who are looking for solutions to social problems in order to make human lives better versus having their sole focus on profit making. Skoll describes these entrepreneurs as the trigger and support for necessary changes in society, not waiting for the governments or communities to make the first move. Nicholls (2006) looks at social entrepreneurship as an alternative created by social advocates and leaders, combining a business approach with charity and social cause scaling the impact, due to the inability of traditional institutions to effectively manage social and environmental issues. Social ventures are leading job creation in several countries and having a positive impact on social behaviour.

### **2.2.3 Social Impact Investment**

The term “impact investment” was established by the Rockefeller Foundation’s Bellagio Centre in 2007 during a business and philanthropy leaders’ meeting as an innovative financial solution to human problems in order to attract private capital to support social and environmental impact initiatives, as philanthropic and government funds alone are not sufficient in doing this (The Rockefeller Foundation, 2016). This marks the switch from a low-scale activist approach towards a more scalable one. Enhanced by the increased interest from investors, impact enterprises now have a wider access to capital through conventional financial institutions (Monitor Deloitte, 2015).

JP Morgan (2010) calls impact investment an ‘emerging asset class’ and draws attention to the fact that investors are willing to combine both: getting return and supporting the cause, instead of having to choose between one or the other. The World Economic Forum [WEF] (2013) in contrast does not look at SII separately as an alternative asset class, but as a new approach to the investment and development of financial market. The OECD (2015) looks at wide SII ecosystem

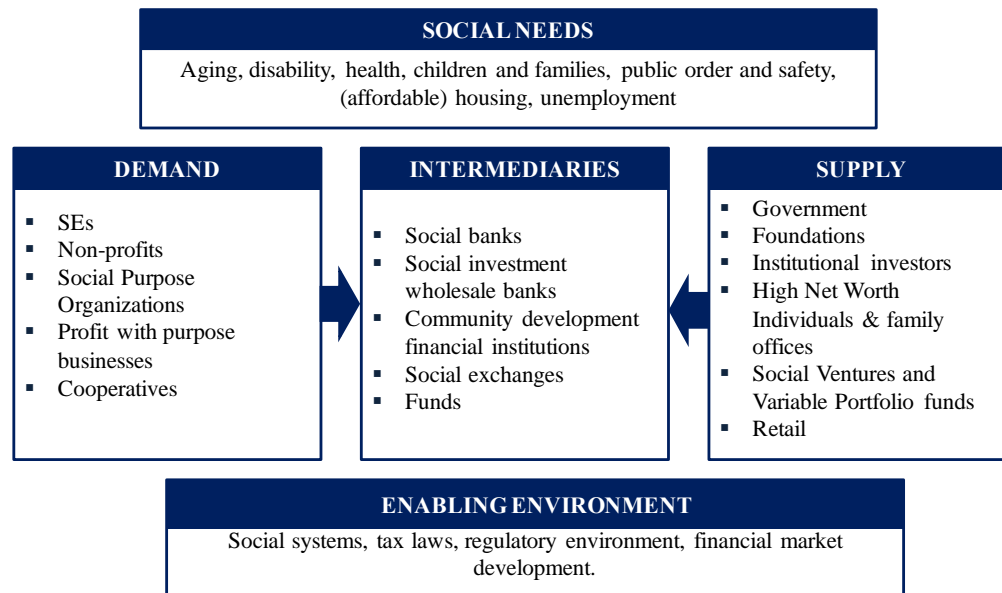
from five dimensions: social needs, demand-side, supply-side, intermediaries and enabling environment, and particularly makes an emphasis on measurable social and financial returns of SII.

Impact investments are made in different forms - as private or public debt and equity, guaranties, deposits and other. Furthermore, it should be added, that impact investment requires new assessment tools for evaluation of social performance and impact in addition to the traditional investment valuation.

### 3 Theoretical Framework of Social Impact Investment Ecosystem

A SII ecosystem is built by a diverse group of actors and through their interplay the desired goals are reached. The SII Market Framework developed by the OECD (See Figure 2 below) describes the social impact ecosystem from five dimensions.

**Figure 2: Social Impact Investment Market Framework adapted from OECD (2015)**



Source: OECD (n.d.)

First of all, it is the *social needs* that exist in the society and should be addressed like disability, ageing, health, children and family related, unemployment and other needs.



Second, it is the *demand-side players* like SEs, community organizations, NGO's, social purpose organizations and other forms of service delivery organizations that are the key drivers in addressing the social needs in the society.

Third, it is the *supply-side players* including governments, foundations, high net-worth individuals and families, institutional investors and other capital providers that are increasingly interested in SII as a way to diversify their investments and pursue social, as well as financial, goals (OECD, 2015). According to the assessment of the WEF the most active capital providers in the impact investment sector in the global arena are the high-net-worth individuals and family offices, who have more autonomy in their decision making process than other capital providers (WEF, 2013). Furthermore, development finance institutions and foundations are recognized to be among the other leading capital providers in the impact investment market (WEF, 2013).

Fourth, it is the *intermediaries* that can take different forms from the regular commercial banks, investment banks, independent financial advisors to more specialized social banks, social exchanges, community development financial institutions and other. In terms of functions provided, intermediaries can be split into two major groups: the financial intermediaries or wholesalers that act as medium between the capital providers and the capital receivers; and the advisory institutions that provide consultancy services to the investors in this market (Nicholls, 2010). Intermediaries have a pivotal role in the social impact ecosystem, linking the capital providers with the investees as well as providing innovative new solutions to improve efficiencies in the market (OECD, 2015). Effective intermediaries can deliver several functions to the market: they create liquidity and provide a payment mechanism which in turn allows the reduction of risks and lowering of transaction and other costs in the market (WEF, 2013). In their report on the impact investing industry, Jackson and Associates, however, note that the role of intermediaries is in a very early stage of development, as is the impact investment industry itself. There is a need to build new impact investment intermediaries, as well as to strengthen and provide additional incentives to the existing financial intermediaries to become more engaged in this sector (Jackson and Associates, 2012). Besides the just described national level intermediaries that focus on SII industry support on a market level, there are also global organizations like Global Impact Investing Network [GIIN] working on SII market development across the world. Established in 2009 as an independent non-profit organization, GIIN has built a

strong network of investors and supported development and awareness building of the emerging impact investing area around the world (GIIN, n.d.). If GIIN mainly focuses on institutional impact investors, the other global network - the global action community for impact investors [TONIIC] - unites high net worth individuals, family offices and foundations to promote impact investing among them (TONIIC, 2016).

Finally, the fifth dimension in the framework is the *enabling environment*, where government plays a pivotal role. Government can directly influence the development of impact investment in the market, by creating policies and environment that fosters rather than hinders investment for social development. Their means and tools include taxation, subsidies and procurement, corporate legislation and investment rules. It can also encourage impact investment through targeted co-investment initiatives and capacity developments that enable the efforts of other actors of the social impact ecosystem (Jackson and Associates, 2012).

It is important to note that an impact investment ecosystem can be best described and understood, when analysed on a market level, taking into account the specifics of each individual market. This allows identification of exact interlinks and connections between the various actors of the ecosystem, therefore allowing identification of opportunities and gaps in the area. This will be the focus of the sections 5 and 6, where an overview of the social impact ecosystem in the UK and Latvia will be made.

## **4 Methodology**

In order to answer the research question, identify gaps and areas for improvement for the SII development in Latvia, the authors apply cross-sectional method for data gathering and analysis. Qualitative data is collected from semi - structured interviews with the key existing and potential stakeholders of the social impact ecosystem in Latvia (the list of questions asked can be found in Appendix B). Qualitative data from these interviews is supplemented with quantitative data gathered from the databases and websites of the institutions that these stakeholders represent. Moreover, a comparative design method is also applied in the study, as the potential SII ecosystem in Latvia is structured and benchmarked with the much more developed social impact market in the UK. Information on the UK market is gathered through publicly available sources

on the SII market development in the UK as well as through semi-structured interviews with representatives of the field (list of questions asked can be found in Appendix C).

The following steps are carried out to cover both theoretical as well as empirical parts of the research:

- 1) Literature review on the SII industry development worldwide;
- 2) Analysis of information and statistics available on the SII ecosystem in the UK;
- 3) Semi-structured interviews with representatives from key SII intermediaries in the UK;
- 4) Analysis of information available on topics and areas related to the SII in Latvia;
- 5) Semi-structured interviews held with key stakeholders of the potential social impact ecosystem in Latvia (full list with the stakeholders interviewed is available in Appendix D).

The aim is to cover the five dimensions of the framework of social impact ecosystem:

- a) Representatives from governmental institutions including the Ministry of Welfare of the Republic of Latvia and the Ministry of Economics of the Republic of Latvia to describe the primary social issues in Latvia as well as to illustrate the supportive environment for the development of a social impact ecosystem in Latvia;
- b) Representatives of the SEs and NGOs active in the social impact area in Latvia, that represent the demand-side of the SII framework;
- c) Representatives of commercial banks including SEB, Swedbank and DNB; Latvian Business Angel Network Latvia, state-owned development finance institution Altum, Investment and Development Agency of Latvia [LIAA] - all representing the potential supply side of the social impact ecosystem in Latvia;
- d) Representatives of existing or potential intermediaries in Latvia - Social Entrepreneurship Association of Latvia [SEAL], foundation DOTS and platform for social innovations New Door;

The gathered information is structured according to the SII Market Framework. In addition, based on the collected input, the authors apply an assessment of the scale of readiness of the demand, supply and intermediaries' dimensions of the potential SII ecosystem in Latvia and present that in a graphical summary. Indicators for the scale of readiness are developed based on

the principle used in various Response Hierarchy Models that are widely applied in the field of marketing to explain the response consumers have to communication during a purchase process of a product or service. There are several models that employ the same principles: they have a cognitive stage first based on awareness and knowledge, followed by an affective stage that is sometimes split into two steps- creation of interest and attitude forming, and finally the behavioural stage, when the action is taken (Kotler & Keller, 2012, p. 481.). For the purpose of SII market study, authors split affective stage into two separate parts and define all stages in the following way: 1) Level of Awareness; 2) Level of Interest; 3) Level of Consideration and 4) Actual activity and involvement. For each of the stages, a three colour scale is applied, where red stands for “does not exist”, yellow stands for “starting to develop/ early development stage” and green implies “developed and working”.

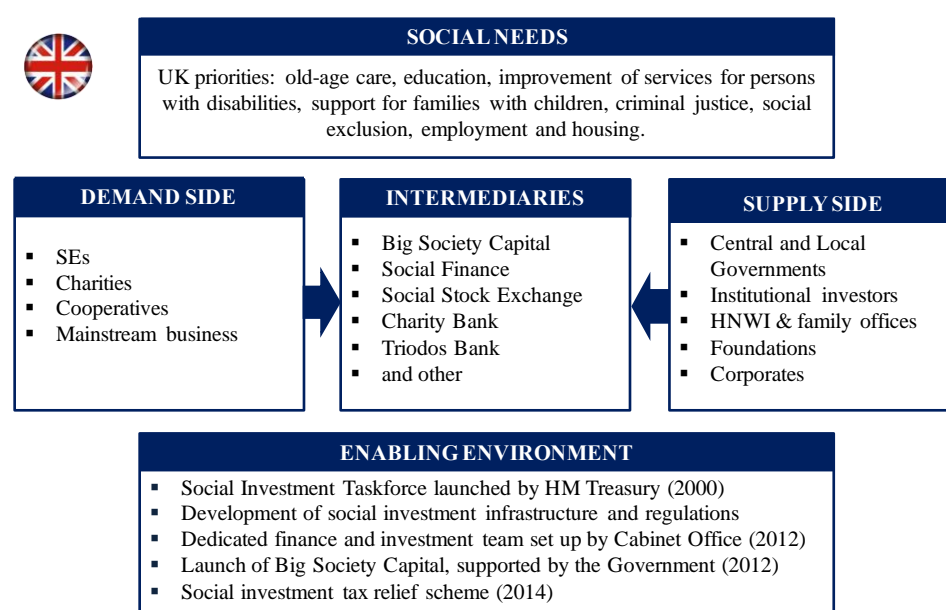
The gathered data provides a comprehensive picture on the potential SII ecosystem in Latvia as well as identifies its possible key stakeholders, thus enabling the authors to answer the research question. It also allows the authors to make comparisons and draw conclusions, benchmarking the situation in Latvia with that of the UK. Information gathered throughout the research will be available to the various stakeholders of the SII ecosystem for further research and analysis.

## **5 Evaluation of Social Impact Investment Ecosystem in the UK**

The United Kingdom [UK] is recognized to be at the forefront in the development of an SII ecosystem, providing new and innovative solutions to the industry. Nicholls (2010, March) refers to the strong traditions of civil society and non-profit organizations in the UK providing the roots for the strong development of the SII market. The UK is also recognized for its developed financial sector and active political support for the social investment market - both factors strongly promoting the development of the SII market in the country (Hazenberget al, 2014). A critical triggering point for the UK SII market development was the Social Investment Taskforce that was launched as an independent body by HM Treasury in 2000. The Taskforce acted as a catalyst in bringing together key stakeholders of the industry to make recommendations and set a clear agenda for policymakers for implementation within next ten years (UK National Advisory Board, 2014). Over the next decade, the UK indeed developed to

become the leader worldwide when it comes to SII. In the context of the UK's G8 presidency in 2013, the UK hosted a G8 SII Forum in London with the aim to catalyse the development of the SII market internationally (HM Government, n.d.). The Taskforce brought together government officials and senior figures in finance, business and philanthropy from across the G8 markets and as a result produced a series of objectives and recommendations for the policymakers that are crucial for the development of the SII sector. A summary of the UK SII ecosystem with its key participants is depicted in the Figure 3.

**Figure 3: Social Impact Investment Ecosystem in the United Kingdom**



*Source: developed by authors based on the OECD SII market framework*

## 5.1 Social needs

There are numerous social needs in society that need to be addressed, but the degree to which any investment can make an impact depends on the type and extent of the need. Analysis of government spending by amounts in various sectors can potentially be used as a proxy to assess the size and priority of different SII targets (OECD, 2015). Eurostat data on total government expenditure by function reveals that the highest share of spending, or 37.5% of total UK Government expenditure in 2014, was devoted to social protection (Eurostat, 2015a). From the total social protection expenditure, the largest shares in 2014 were devoted to old-age care

(mainly pensions) that constitute 19.3% of the total government expenditure, sickness and disability payments constitute 6.3%, payments to families and children 3.7%, payments to persons who are socially excluded or at risk of social exclusions constituting 3.7% of the total spending, housing 3.1% and unemployment 0.5% of total government expenditure (Eurostat, 2015b). Other groups that make up a large part of government spending are health with 17.3% of total UK government spending in 2014 and education with 11.8% of total government spending (Eurostat, 2015a). As a result, the UK government spends around 67% of its budget over the three sectors: social protection, health and education.

Government expenditure is typically devoted to meet critical needs in society, however it is more challenging to shift government spending also to preventive services. Social Finance identifies several reasons for this: firstly, government still needs to pay, if the intervention in preventive activities does not work; secondly, it is hard to estimate the true cost of social problems, as a result it is hard to estimate, when the intervention is needed; and thirdly, there is often limited motivation for the service providers to offer new solutions, since they are typically paid to deliver a set of services instead of delivering an actual result (Social Finance, n.d.a). This has led independent organizations in the UK active in the social impact area to search for new innovative solutions that would support the prevention of various social issues as well as address the existing issues. Among the new social impact instruments, the Social Impact Bond [SIB] should be highlighted, that was for the first time launched in 2010. SIB is a financial mechanism in which investors provide financial capital to improve a social outcome and if the pre-defined goals are reached the government repays the investors their investment plus a return for the financial risks they took (Social Finance, n.d.b). This instrument allows separation of payment for the delivery of an intervention from the payment for achieved goals from that intervention (Social Finance, n.d.a). According to the Social Finance Impact Bond Global Database, there were in total 31 SIBs launched in the UK market by the end of 2016 raising in total £35 million and touching the lives of more than 46K in the country (Social Finance, n.d.c). SIBs that are launched address various social issues including, for example, provision of rehabilitation services to short-term prisoners; provision of support programs to children who display anti-social, offensive behaviour; supporting the search of employment to people with mental illness;

provision of support to young homeless adults in search of a stable place to live; and other initiatives.

## **5.2 Demand side**

The demand side is represented by organizations delivering social services or products; they include social enterprises, charities, NGOs and cooperatives. The demand-side dimension of the social impact ecosystem in the UK has experienced substantial growth in the last few years. The UK Cabinet Office 2014 Small Business Survey data reveal that there were an estimated 741K SEs in UK in 2014, an increase of around 58K since 2012 (UK Cabinet Office, 2016). The SE sector employed 2.27 million people in 2014 (or around 7% of the active labour market), an increase of about 300K since 2012 (UK Cabinet Office, 2016). Nicholls in his study on the institutionalization of social investment identifies that a start-up capital for the SEs is typically a diversity of public, private and charitable sources and that income is earned either from government contracts or from competing in the regular markets (Nicholls, 2010, March). Howard (2012) in the report on opportunities and challenges in social finance in the UK list an important issue on the demand-side of social investment which is the limited number of SEs and charities that are actually investment-ready and can turn their small businesses into scalable, commercially successful enterprises. This is confirmed, by the representatives of the UK intermediaries interviewed, who have stressed the importance of developed demand side as the prerequisite for SII market development. As described by the Stephen Muers, Head of Strategy and Market Development at Big Society Capital, it is critical for social businesses to have a sufficient sustainable business model and experience shows that this is among the key challenges in the SII market. Even more so, the experience of Big Society Capital indicates that many impact businesses need to add some form of external financing - either through grants, guarantees, government subsidies or other - to maintain their business activity.

## **5.3 Supply side**

The supply side dimension is represented by the capital providers that include individual and institutional investors; individual and institutional philanthropists; foundations and charities; public sector grant-givers and procurement contractors; publicly funded venture funds; and

public sector investment funds. In his report on the social impact landscape in the UK, Nicholls summarizes that investors can be categorized into “conventional investors with little interest in social impact who have identified social - or environmental-purpose organizations that offer above market return opportunities to individuals or institutions that aim specifically for social- or environmental-impact investing, even if this produces sub-market returns” (Nicholls, 2010, December, p. 4). The Social Investment Taskforce in its report “Social Investment Ten Years On” provides a summary illustration of various supply side initiatives in the UK with their investment focus types and expected market returns, highlighting the different forms of investment and expected returns by social investors (see Attachment A).

#### **5.4 Intermediaries**

Recognized by the UK National Advisory Board, the strong focus on building robust and diverse intermediaries has been among the key reasons for the significant development of the UK SII market (UK National Advisory Board, 2014). In his report on the social impact landscape in the UK, Nicholls notes that besides specialized social investment finance institutions, there is an increasing interest in social investment from mainstream financial institutions like investment banks (Nicholls, 2010, December).

Social investment intermediaries in the UK have gathered under the Social Investment Forum [SIF]. Since its establishment in 2010, it has been the place to share best practices and learning, ensure a collective voice for social investment, agree on industry standards and other aspects of importance (SIF, n.d.). Members of SIF include Big Society Capital, Charity Bank, Royal Bank of Scotland, Social Finance, Social Stock Exchange, Triodos Bank and others – in total 19 members (SIF, n.d.). A study by Hazenberg et al. on intermediaries in the social investment market in the UK has concluded that the majority of social investment intermediaries in UK have raised capital through consumer-based investor deposits (ethical banks), private-sector investor deposits (social venture capital funds), endowment funds and donations (social venture philanthropy organizations), as well as government investment (Hazenberg et al., 2014).

Besides the development of individual intermediaries of various forms, the UK has been the first market in the world to launch a large wholesale investment bank that supports development of intermediaries in the market as well as acts as champions to raise awareness of SII among the



public, stakeholders and investors. The UK Government (2012) announced the launch of Big Society Capital that was set up as an independent organization with a total capitalization of £600 million, £400 million coming from the unclaimed cash left dormant in bank accounts and £200 million coming from the UK's four largest high street banks: Barclays, Lloyds Banking Group, HSBC and RBS. This initiative identifies strong commitment and support from the government and the commercial institutions to support and develop social entrepreneurship and the social investment market in the UK and sets a unique example for other markets. Big Society Capital serves two roles in the SII market in the UK: first, it promotes and raises awareness of social impact investing by engaging charities, SEs from one side and investors from the other side into the market as well as by supporting development of social impact measurement tools; second, it acts as an investor providing funding to social investment intermediaries, who then further distribute the money to the demand-side participants like SEs and charities (Big Society Capital, n.d.). By the end of 2015, Big Society Capital had invested £261 million, matched by £322 million from co-investors (HM Government, 2016). Big Society Capital also plays an active role in market education and information provision to the different stakeholders.

A key intermediary in the UK that partners with government, investors and social organizations is Social Finance, established in 2007 with the aim of developing the social investment market in the UK and initially funded by a group of five philanthropists (UK National Advisory Board, 2014). Social Finance UK is a not for profit organization that focuses on the development of funding models to tackle social problems in the market (Social Finance, n.d.). Among its most innovative and well known products is the development and launch of the first in history SIB (more information on SIBs in section 3.1.1). This product well illustrates the intermediate role the Social Finance acts, delivering financial solutions and mechanisms to the market that provide the critical links among the key stakeholders of the SII market. Since its establishment, Social Finance has raised over £100 million of investment and supported the start of numerous social programs (Social Finance, n.d.b).

Finally, among the various intermediaries of the UK it is important to highlight the Social Stock Exchange [SSX] that was officially launched in 2013 as part of the G8 Summit hosted by the UK Government. The SSX is the world's first public social stock exchange, providing social impact businesses of various sizes access to the public capital market (Social Stock Exchange, 2015).

The SSX brings together impact businesses with the investors provided first with greater access to capital while enabling investors to “identify, transact and realise their social, environmental and financial goals” (Social Stock Exchange, n.d.). As a result, the SSX aims to establish an efficient public marketplace that enables investors and businesses to achieve greater impact either through capital allocation or through capital raising (Big Society Capital, 2016). Members of the SSX are the social purpose businesses that need to comply with a rigorous set of criteria including the preparation of an annual impact report before they apply and pay a fee for the membership in SSX (Big Society Capital, 2016). In 2015, the SSX consisted of 35 members that in total raised more than £400 million (Social Stock Exchange, 2015).

Representatives of the UK intermediaries interviewed revealed that it is important to consider the financial sustainability of the intermediary itself, when the SII infrastructure is built. As described by Stephen Muers, Head of Strategy and Market Development of Big Society Capital in the UK, intermediaries in the UK have very different business models and typically ones that manage the fund flows receive the fees from transactions and in this way ensure strong cash flows for their business, while intermediaries that focus only on advisory services often struggle and are in search of external financing to maintain their business operations. Furthermore, as described by the CEO of the SSX Tomás Carruthers, the experience of the SSX, that recently closed a successful crowdfunding campaign for its own organization, shows that crowdfunding can be an efficient form of financing for intermediaries themselves.

## **5.5 Enabling Environment**

The government role in the development of SII market in the UK has been indeed significant, since government has taken a leading role in many of the initiatives at their early stages - as a builder of institutions, steward of regulations and commissioner of services (UK National Advisory Board, 2014). Nicholls admits that since 1997 the New Labour government has been a world-leader among policymakers in the social impact area pursuing a range of policy agendas to promote the development of a social investment market; a particular focus being put on new forms of social investment that support innovation in meeting priority public needs (Nicholls, 2010, December).

In his report on the social impact landscape in the UK, Nicholls identifies three stages of development for the UK social investment policy: a first stage (1999 onwards) focused on direct funding on intermediaries; a second stage (2001 onwards) focused on development of SE sector; and a third stage (2009 onwards) marked with the creation of the idea and later development of a social investment wholesale bank (i.e. Big Society Capital described under section on Intermediaries above) (Nicholls, 2010, December). Furthermore, as of 2012 the Cabinet Office set up a dedicated social investment and finance team with staff drawn from across government, social and private sectors. The team's main focus is on market building and they have been involved in activities as diverse as the creation of a social investment bank, development of social investment tax relief<sup>1</sup>, creation of a social investment trade association and a market research council (Social Investment and Finance Team, n.d.). Furthermore, institutions directly addressing social issues in the UK are the Department for Work and Pensions, the Ministry of Justice and Department for Communities and Local Government (UK National Advisory Board, 2014).

The importance of government support and advocacy of the SII industry by senior government ministers as a critical triggering factor for the industry development has also been stressed by the SII intermediary representatives interviewed. They also highlighted the added value of the dedicated team on SII development and promotion in the government institutions.

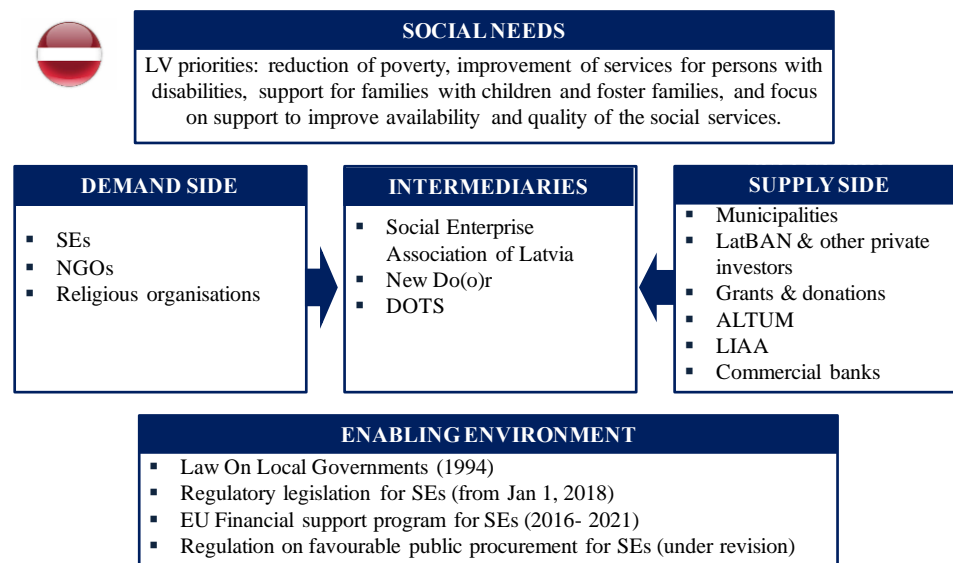
## **6 Evaluation of Social Impact Investment Ecosystem in Latvia**

To provide a comprehensive picture of the SII Ecosystem in Latvia, OECD framework (described in Section 3) with five dimensions is applied. Authors described all dimensions in the following subsections with additional assessment for readiness added to the dimensions “demand-side”, “supply-side” and “intermediaries”. Figure 4 provides visual summary of the SII ecosystem in Latvia.

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<sup>1</sup> Social investment tax relief (SITR) scheme, enacted in the Finance Act 2014, implies 30% reduction on investment on income tax bill, if a qualified investment in a SE, including a charity, is made; it defers Capital Gains Tax charge if profits are reinvested into a SE; and it lets selling or giving away SITR-qualifying investments that have gained in value, without paying Capital Gains Tax (Government UK, 2014).

**Figure 4: Social Impact Investment Ecosystem in Latvia**



*Source: developed by authors based on the OECD SII market framework*

## 6.1 Social needs

Latvia has one of the lowest of public social support among OECD countries that only highlights the importance and need for social support in the market. Since 2009 social public spending has been around 21% of GDP on average across OECD countries, while in Latvia the estimate on public social funding for 2016 is only 14.5% of total GDP (OECD, 2015). Latvia's social policy priority areas for 2017 are the reduction of poverty and inequality (that include improvement of minimum income support system, revision of pension sufficiency and other); improvement of services for persons with disabilities; support for families with children and foster families; and focus on support to improve availability and quality of the social services (Ministry of Welfare, 2017). Law on Social Services and Social Assistance (2002) regulates the social service provision and financing in Latvia.

As discussed in the section 5.1 government spending can be used as a proxy to identify the size and priorities of various SII target areas. The Eurostat data on the total government expenditure by function reveals that in 2014 the Government of Latvia spent 30.7% of total government expenditure on social protection (Eurostat, 2015a). In Latvia, as in other EU markets, the largest share of the total social protection expenditure or 19.9% was spent on old-age care (mainly

pensions), followed by sickness and disability payments that constitute 5.2% of the total spending, payments to families and children with 2.4% of spending, unemployment constituting 1.1% of the total spending, payments to persons who are socially excluded or at risk of social exclusions made 1% of the total government expenditure (Eurostat, 2015b). As in other EU markets, a significant share or 15.8% of the total government spending in Latvia is devoted to education that is one of the highest indicators among the EU markets with the average for the EU 28 being 10.2%. In contrast, with 10.2% of total Latvia's government spending in 2014 devoted to health, it is one of the lowest indicators in this sector in comparison to other EU markets, with the average for EU 28 being 15% (Eurostat, 2015a).

The Commission Expert Group on Social Entrepreneurship (2016) have made policy recommendations for European Commission and Member States that emphasize the government responsibility and importance of public funding for social service delivery. Comparison of the social public spending within EU highlights the existing gaps and the need for additional financing in Latvia.

## **6.2 Demand side**

Demand side of the SII ecosystem in Latvia currently consists of SEs (though legally they are not recognized as SEs yet and typically are registered as limited liability companies [LLCs]), NGOs and religious organisations. Social entrepreneurship is only evolving in Latvia and the number of SEs with significant social impact is limited. The study by the Latvian Chamber of Commerce and Industry in 2013 surveyed more than 1000 small and medium size enterprises in Latvia and only 3% confirmed to be active as SEs (Linde, 2013). The research centre Providus estimates that there are no more than 100 SEs in Latvia (Lešinska, 2015). Majority of SEs surveyed by Providus are active in providing services or education to certain groups of society or other activities (Lešinska, 2015). Production is organized only by very few SEs in Latvia. According to the Director of the SEAL Madara Ūlande, SEs providing services are typically more sustainable financially than production oriented ones. That is linked to cooperation with local governments that can ensure regular revenue streams for the social service providers, when they outsource social service provision in their territories. On the other hand, it is easier to attract financing and try to scale the business and look for the export possibilities if the enterprise is

focused on production. The survey by Providus has identified that only some of the SEs in Latvia have permanent employees, the majority are organizing their work with the help of volunteers (Lešinska, 2015). The same survey identified that only a few of the SEs are able to earn profit with their business and the majority are financing their businesses with funds acquired through grants and various competitions (Lešinska, 2015).

Also the NGOs have a significant role in providing positive social impact in Latvia. The report done by Civic Alliance - Latvia (2015) indicates that not for profit organisations have unclear legal status limiting their commercial activities and putting them in a possibly conflicting position with the State Revenue Service. According to the report, there are in total more than 20 thousand NGOs in Latvia. Furthermore, 24.5 thousand entities are registered as Public Benefit Organisations [PBOs]<sup>2</sup>. The PBO status provides them important support through relieved attraction of external financing, as contributors to the organizations receive income tax reductions.

On December 15, 2016, the Social Entrepreneurship Law was adopted by Saeima in the first reading (The Republic of Latvia Saeima, 2016) (described in detail in the section 6.5). This is the first attempt to formalize social entrepreneurship to be a specific form of LLC with special tax and other benefits (described in more detail in section 6.5).

Interviews with representatives of enterprises and NGOs that have social mission as their priority reveal main challenges that are linked to the SII development in Latvia. According to Fionn Dobbin, Creative Director and Co-Founder of social enterprise MAMMU Production, social business idea should be scalable. He looks at the current impact business development in Latvia more as a grassroots movement where entrepreneurship first starts with “searching for the meaning”, social activism and enthusiasm and trying to step into the areas where the State does not provide comprehensive solution. Only then the business approach follows. As stressed by representatives of different dimensions interviewed, to scale the impact it is not enough to run the initiative as a side project, but one needs to be completely involved and devoted to the social business development. Furthermore, Andris Bērziņš, Director of NGO “Samaritan Association of

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<sup>2</sup> According to the Public Benefit Organisation law (2014) PBO status is granted to NGOs, religious organizations and their related organizations that have social benefit provision stated in their mission that are operating in this field and not using their income for commercial activity. The status grants tax benefits and reliefs for the organizations and donors up to 20% from the annual income tax.

Latvia” (Latvijas Samariešu Apvienība), that is among the most successful impact businesses in Latvia, stresses that private sector can provide better and more efficient solutions to social problems in contrast to taking an administrative approach.




Attraction of financing is also an important aspect for the development of impact businesses and SII has not been explored in Latvia yet. With only a few exceptions, enterprises and NGOs with the focus on social impact are operating on a small scale in Latvia and therefore are not attractive from the investment perspective. The majority of stakeholders interviewed as a part of this research, stress the lack of business focus and thinking among the current SEs and NGOs in Latvia and voiced the crucial role of financial viability, investment readiness and the need of clear understanding that the impact business model cannot rely on grants and donations on the long run. Potential loss of freedom is mentioned as the main barrier for equity financing by the demand side representatives and more openness towards the financing through loans is expressed.

Based on the input gained through the interviews with the representatives of the supply side of the SII market in Latvia, the authors summarize the status of the dimension “Demand-side” in Table 1.

**Table 1: Assessment of the SII ecosystem dimension “Demand side” in Latvia**

Indicators	Assessment		Description of the indicator
Level of Awareness		Yellow	Recall and recognise the term SII and have some knowledge about the basic idea. Have some perception about the concept.
Level of Interest		Yellow	Demonstrate active interest in SII, have the opinion about the topic. Express interest in gaining wider information and knowledge of the field, evaluate its potential.
Level of Consideration	Red		Evaluate SII development possibilities in Latvia. Convinced about the need of SII in Latvia. Evaluates own role in SII market.
Actual activity and involvement	Red		Actively involved in SII ecosystem development in Latvia, support it and promote the concept of SII.
<b>Demand side overall evaluation</b>		Yellow	Social Enterprises exist and are gradually developing in Latvia. With the changes in values and increasing public responsibility within society there is a growing interest in the field. Majority of the social projects are of a small scale at the moment however, run with the eagerness to fix some social issue and provide own help, while focus on business development is limited or does not exist. As a result the number of investment ready SEs is indeed limited.

 does not exist	 starting to develop/ early development stage	 developed and working
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*Source: developed by authors based on principle of Response Hierarchy Models*

### 6.3 Supply side

The potential participants of the supply side of the SII ecosystem in Latvia consist of government, local governments, commercial banks, private investors (many of whom have united in the Latvian Business Angel Network [LatBAN]<sup>3</sup>), grants and donations coming from commercial and non - governmental institutions, state-owned financial institutions including the development finance institutions Altum and LIAA. The presence of active foundations (both private and institutional), that are typically active players of the SII ecosystem in other markets, are currently lacking in Latvia.

The potential supply side representatives demonstrate a relatively diverse mix of participants, but they all share the same level of indeed limited involvement and cooperation with the impact businesses so far. As confirmed by the representatives of commercial banks that authors interviewed, at the moment SEs in Latvia are treated as any other enterprises, when they approach the financial institutions for funding. Also the chairman of the board of LatBAN Jānis Rancāns confirms, that the association currently does not focus or specially recognizes the social impact area, when the project is evaluated for potential funding. The same principle applies from the public funding and support issued by Altum or LIAA. Representatives of both institutions confirm, that in their experience so far they have provided funding to several impact businesses. The fund issue process, however, has gone through the regular project revision scheme and no attention has been paid to impact and social aspects of the business. As a result, none of the interviewed representatives of the supply side recognize actual cooperation with impact businesses. If cooperation with impact business has happened so far, it has been more a matter of coincidence rather than a targeted focus area for the supply side representatives. Among the key reasons for limited activity in the impact area, representatives of the commercial banks, first of all, list the lack of legislation that would define the SEs and responsibilities of different stakeholders of the potential SII market. And secondly, all representatives of the supply side interviewed stress limited business focus among the existing social businesses in Latvia, leading to the lack of scalable impact businesses that would be investment ready.

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<sup>3</sup> The Latvian Business Angel Network was founded in 2014 and currently unites 75 members. The association has reviewed over 450 projects and so far has invested over 1.95M EUR (LatBAN, n.d.).



Local governments are responsible for social service provision in their territories, however they are free to decide what services and who provide them. This leads to different service levels and forms of cooperation across Latvia (more on section 6.5). Local governments that are outsourcing the provision of social services (and are in minority in the market at the moment) are among the key customers to the social businesses maintaining regular revenue streams for their business activity. For example, local government of Sigulda was repeatedly mentioned as a good example during the interviews as it has developed strong and successful cooperation with the local NGOs for social service outsourcing (i.e. local government is buying the service of day care centre for children with disabilities from the local NGO Cerību Spārni). Opinion from the representatives of impact businesses and ministries interviewed prevail that dedicated organisations can provide more efficient and better quality services than the local governments themselves.

Important changes in the funding area are to happen with the opening of the first EU fund program devoted to the development of SEs in Latvia, that will be administered by Altum and the Ministry of Welfare of the Republic of Latvia - first being responsible for evaluation and monitoring of the financial indicators of the applicants, while the second being responsible for the assessment of the impact of the projects. In the time period of 2017 - 2022 total of 19 million EUR will be distributed through grants. In total the program expects to support around 200 projects. As stressed by various stakeholders interviewed, this is the first time in the history of Latvia when such a significant funding will be devoted to the development of social impact businesses. Therefore, all parties involved are expecting this program to be a strong stimulus and catalyst for impact industry development in Latvia.

Although, the support from the EU funds is expected to be significant for the industry development, there is currently limited understanding of the possible financial solutions to support the development of impact businesses in Latvia after the EU grant program will finalize. As it is stressed by the Administrative Director of foundation DOTS Egita Prāma, it is very important already now to think about the possible financing forms and financial instruments, when the grant funding will end. At the moment, there are no alternatives developed in Latvia. As a viable option, several of the interviewees mention the crowdfunding that is a relatively low-cost model with strong potential, but is almost not applied in Latvia at the moment.

Based on the input gained through the interviews with the representatives of the supply side of the SII market in Latvia, the authors summarize the status of the dimension “Supply-side” in Table 2.

**Table 2: Assessment of the SII ecosystem dimension “Supply side” in Latvia**

Indicators	Assessment			Description of the indicator
Level of Awareness				Recall and recognise the term SII and have some knowledge about the basic idea. Have some perception about the concept.
Level of Interest				Demonstrate active interest in SII, have the opinion about the topic. Express interest in gaining wider information and knowledge of the field, evaluate its potential.
Level of Consideration				Evaluate SII development possibilities in Latvia. Convinced about the need of SII in Latvia. Evaluate own role in SII market.
Actual activity and involvement				Actively involved in SII ecosystem development in Latvia, are active stakeholder of the SII ecosystem.
<b>Supply side overall evaluation</b>				Fund providers potentially exist and include wide spectrum - from commercial banks to private investors and state owned institutions, but at this stage social impact is not among their priorities, it is in no way measured and identified. Additionally there is limited interest and no activity is happening in the area as no appropriate infrastructure and legislation exist.

	does not exist		starting to develop/ early development stage		developed and working
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*Source: developed by authors based on principle of Response Hierarchy Models*

## 6.4 Intermediaries

At this stage, there are no special intermediaries developed or set to serve the traditional role of mediators between the social impact investors and investees in Latvia. This is confirmed in the European Commission’s report on SEs ecosystem in Latvia, which states that there are no specialist intermediaries or financial products catering to the specific business models and/ or needs of SEs (Wilkinson, 2014). Several organizations that serve the role of information provision, however, have emerged in Latvia and can be attributed the role of information intermediaries with focus, though, mainly on the demand side of the ecosystem. Foundation DOTS (previously Soros Foundation - Latvia) has been an active contributor to the development of SEs in Latvia through initiation of first grant programs devoted to SEs in Latvia<sup>4</sup>. Foundation has also played an important role educating and consulting different sides of the ecosystem, including SEs, governmental and non-governmental institutions, in respect to impact business

<sup>4</sup> In collaboration with the Latvian Centre for Contemporary Art, program “Brigāde” was organized in the time period from 2010-2013, that in total financially supported 45 initiatives. The aim of the program was “to support creative, sustainable entrepreneurship, based in art and culture, which deals with social issues and contributes in raising the quality of life of local communities” (Brigade, n.d.)

development in the market. In 2015, foundation DOTS together with other four organizations founded the Social Entrepreneurship Association of Latvia [SEAL] that has entered the marketplace to provide a united voice of the demand side and potentially serve the role of information intermediary. SEAL at the moment unites 45 members – NGOs, foundations, SEs and area activists. The primary objective of SEAL is the advocacy of social entrepreneurship and development of supporting eco-system for it in Latvia. The objective is targeted through active cooperation and support to governmental institutions in the development of policies in social entrepreneurship as well as providing expertise and consultancy to SEs in areas such as legal, finance, grant writing, media, communications and other (SEAL, n.d.). Given its brief history and limited capacity, SEAL is yet on its way to establish its role and stronger presence in the market. As confirmed by the Director of the SEAL Madara Ūlande, SII is not the primary target and focus area of the SEAL at the moment. SEAL first needs to focus on increasing the number of members as well as develop its capacity, that could allow the organization evolve in its functions to potentially become a SII information intermediary that on the one hand supports the demand side organizations to become investment ready and on the other hand provide the information about its members to the potential fund providers.

One of the founding members of the SEAL, is the New Door Riga that is an international platform of social innovations with the centre of activity in Riga. The New Door was established in 2013 and its primary aim is support and development of new social entrepreneurs (the New Door Riga, n.d.). During the three-year period, around 50 social enterprises have gone through the training program organized by the New Door. The organization focuses on provision of practical skills to current and potential social entrepreneurs through workshops, feedback and mentorship - all with the aim to develop the necessary business skills and change the mind- set of the participants to ensure focus on developing self-sustaining SEs vs continuous reliance on external funding and grants. The New Door also puts particular focus on networking and community building among the social entrepreneurs that according to the New Door program director Diana Lapkis is an important factor for the development of social entrepreneurship industry in other markets, but is not developed and practised in Latvia. Through educational and consulting activities that the platform provides to the new enterprises, it can be attributed the role of information intermediary to the newcomers to the industry.

Based on the input gained through the interviews with the representatives of the institutions to potentially serve the role of intermediaries in the SII market in Latvia, the authors summarize the status of the dimension “Intermediaries” in Table 3.

**Table 3: Assessment of the SII ecosystem dimension “Intermediaries” in Latvia**

Indicators	Assessment			Description of the indicator
Level of Awareness				Recall and recognise the term SII and have some knowledge about the basic idea. Have some perception about the concept.
Level of Interest				Demonstrate active interest in SII, have the opinion about the topic. Express interest in gaining wider information and knowledge of the field, evaluate its potential.
Level of Consideration				Evaluate SII development possibilities in Latvia. Convinced about the need of SII in Latvia. Evaluate own role in SII market.
Actual activity and involvement				Actively involved in SII ecosystem development in Latvia, are active stakeholder of the SII ecosystem.
<b>Intermediaries overall evaluation</b>				Few intermediaries with focus on information provision have recently emerged, however none exist to provide full service spectrum in the market. Current focus is on capacity building, activities mainly focused on the demand side and some cooperation with the state institutions.

	does not exist		starting to develop/ early development stage		developed and working
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*Source: developed by authors based on principle of Response Hierarchy Models*

## 6.5 Enabling Environment

The enabling environment dimension in Latvia at the moment consists of the development of regulatory legislation, EU financial support program devoted to the development of SEs and local governments that are responsible for social service provision in their territories, current taxation system and other entrepreneurship related activities and reforms on the state level. Experience of the UK show, that government support in fund provision and establishment of legislation has played a critical role in the development of SII market (as described in section 5.5), that is also confirmed by the representatives of the SII intermediaries in the UK interviewed.

In Latvia, the Cabinet of Ministers reviewed the concept of “Social entrepreneurship introduction possibilities in Latvia” in October, 2014 and it was approved in the same month (the Cabinet of Ministers of the Republic of Latvia, 2014). The Ministry of Welfare with the support of the Ministry of Finance prepared the EU fund SE support program with the initial pilot project from January 1, 2016 through December 31, 2018. The program includes midterm results evaluation for effective development of enabling environment for the SEs (the Cabinet of Ministers of the

Republic of Latvia, 2014, October). The Ministry of Welfare and Altum will start the program administration mid 2017 (support program is explained in section 6.3). Ingeborga Linde, Project Manager, Labour Market Policy Department, ESF Project “Support for Social Entrepreneurship”, the Ministry of Welfare of the Republic of Latvia, explains that the program is a pilot project to understand the market potential for social entrepreneurship in Latvia. She stresses that social entrepreneurship is only forming and the prerequisites for its further development should be assessed.

The first step to introduce legal framework for social entrepreneurship in Latvia has been made with the new law On Social Entrepreneurship that has been accepted in the first reading in the Parliament of Latvia on December 15, 2016 and will come in force on January 1, 2018 (The Republic of Latvia Saeima, 2016). According to the new law, SE is an enterprise that as a result of its economic activity brings positive impact into the following areas: the development of social services, inclusive civil society, accessible education, science development, environmental protection and conservation, animal protection or provision of cultural diversity. The Ministry of Welfare of the Republic of Latvia is the responsible institution that will also overlook the SE status provision through a special commission. The benefits of SE will include: 100% income tax exemption, favourable terms for receiving donations, special real estate tax conditions, allowance to use assets given by public persons without compensation and allowance to use voluntary work except for work linked with company's governance (The Republic of Latvia Saeima No. 12, 2016). According to the new law On Social Entrepreneurship all profit earned by the SE should be reinvested back into the organization, that is seen as an obstacle from the perspective of equity investors potentially interested in the SII market. Furthermore, another issue in relation to the new SE law raised by the demand side representatives interviewed is the lack of transition period and existing legal obligations, including succession of agreements on public social service provision. The new SE law places NGOs that currently provide social services to local governments and participates in public procurement processes into unfavourable situation, and for that reason transition period for the legal status change should be planned and introduced into the process.

Furthermore, the Ministry of Finance of the Republic of Latvia has prepared new regulation for public procurement that includes simplified tendering application process for SEs (Civic

Alliance - Latvia, 2015). However, the new regulation has not been approved and introduced yet. According to the information posted by the Civic Alliance - Latvia (2015) there is an open discussion in the government regarding this. Favourable conditions for the SEs in public procurements is mentioned as a strong enabling factor by potential investors and the demand side representatives.

According to the law On Local Governments (1994) local governments<sup>5</sup> have the autonomous functions' obligation to provide social care for underprivileged and socially vulnerable and social care services can be either outsourced or provided by local governments themselves. The law as a result provides significant independence for local governments to decide what services they provide and who delivers them (i.e. local government itself or private establishment).

Furthermore, according to the legislation of the Republic of Latvia each local government has its own regulation that defines its operations. This leads to significantly different forms of cooperation and services provided among different local governments of the country. The necessity for alignment in this matter was stressed during the interviews. Demand side representatives, furthermore, highlighted the importance of close cooperation and mutual understanding between SEs and local governments. Finally, the necessity of cooperation among various governmental institutions including the Ministry of Finance, the Ministry of Economic, the Ministry of Education, the State Revenue Service and other was constantly brought up during the interviews. Also the importance of ongoing dialog among other stakeholders plays a significant role. From the long-term perspective, the importance to educate society from an early age about the need and role of civic responsibility and actual meaning of social entrepreneurship, has been mentioned repeatedly by all organisations and institutions interviewed.

## **7 Discussion of Results**

Study of the different dimensions of the SII ecosystem in Latvia has showed that SII industry is in an early stage of development with awareness and interest among the key stakeholders raising, while actual activity and focus on impact investment does not exist in Latvia at the moment.

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<sup>5</sup> Local Governments by the law on Local Governments (1994) consist of city or municipality councils and their institutions. Local Governments act independently within their competence areas and law, when acting on State delegated functions Local Governments are under Cabinet of Minister's subordination.

Key potential stakeholders are only starting to emerge and a lot still has to be done for actual investments in the industry to be made. Social enterprises are gradually evolving and there is a significant number of NGOs active in the impact area, however, at the moment majority lack true business focus and understanding. Many either stay small or rely on external financing to sustain their operations, instead of searching for the means to ensure independent, sustainable businesses. Experience of the significantly more advanced market of the UK, show that the development of strong and sufficient impact businesses is the prerequisite for the SII ecosystem. Representatives of the UK intermediaries, have stressed, that the funding nowadays is not the primary concern, as there are many international funds and investors that would be keen to invest in promising businesses also outside the UK. Furthermore, the EU fund program focused on SE development in Latvia that will open in summer 2017, will provide grant funding to SEs in unprecedented amount for Latvia market, thus potentially serving an important catalyst for the development of the demand side of the market. Additionally, the legal status of the impact businesses is not yet clear in Latvia. The majority of social businesses are currently operating as NGOs or regular LLCs. The new law On Social Entrepreneurship that will come in force as of January 1, 2018 will identify the SEs as a special form of enterprise with particular benefits, however the new law also implies that all the profits of the SE are reinvested back into the company being an obstacle for the potential SII investors in the future.

It is important that the other dimensions of the ecosystem develop in line with the demand side. Although, it is not clear yet, what direction the market will take as the result of the EU funding, it is important to think, from the supply side, already now about the possible future financing solutions. Interviewees of the supply side share opinion, that it is indeed challenging and almost impossible to turn the “classical” investor into SII investor. It is much simpler to turn people and institutions currently active in charities and philanthropy into impact investors. The challenge of Latvia is that there is indeed a limited number of such individuals and institutional investors or funds overall. For that reason, it is important to look for alternative sources of financing. Among the most viable solutions, stakeholders from Latvia and the UK mention the crowdfunding that is potentially the simplest low-cost model that Latvia market could start from.

The role of intermediaries in the development of the UK SII ecosystem is significant. Latvia currently does not have any intermediary that would serve the typical functions of a mediator

between the demand and supply side, preparing the demand side to be investment ready and then linking it with the capital providers. There are a few organizations emerging that provide the information intermediary role. The focus, however, is primarily on the demand side players and some cooperation with the governmental institutions. Given the small market size and nascent stage of development of the industry, it is important that functions of the potential intermediary are not split and divided among many different institutions. In the ideal setup, one intermediary should emerge in the market that would serve the role of information provision to all stakeholders of the ecosystem and would potentially bring together the demand and supply side. It would be important that this intermediary provide advisory services to the impact businesses, supporting them to get investment ready. Experience of the UK intermediaries show that it is important to consider the financial sustainability of the intermediary itself as well and crowdfunding can be an efficient form of financing also for the intermediaries.

The study has also identified that the understanding and appreciation of the potential the impact businesses can bring to the economy of Latvia is just emerging among the state sector institutions. The institutional and legal base is in the development stage at the moment and the success of the EU fund program devoted to the SEs is expected to be an important identification for the potential of the sector in Latvia. The UK experience shows that the government can play a significant role in the development of the SII market serving multiple roles at the same time - being an investor (either through direct investments in the development of the SII ecosystem in the market or subsidies and grants to the impact businesses directly); providing a guarantee in SIB projects; being the key customer for many SEs through accessible and open procurement processes; being a strong advocate of the SII market (with committed and dedicated SII team working on the agenda); and providing the legislative base for the SEs. Furthermore, local governments have an important role and influence in the development of the social area, being responsible for the social service provision in their territories and having full authority to decide on the form these services are provided within their region. Current legal framework provides a lot of space and independence for each local government to set what services are offered and who delivers them within the given region. Necessity for more streamlined approach and regulations when it comes to public social services provided by the local governments has come out as important finding. If provision of public social services were available and promoted to be



delivered by private institutions in all local governments (rather than being an exception as it is currently), it would be a strong enabling factor for the development of SEs in the market.

Furthermore, as argued by many of the interviewees, the quality and efficiency of the services would only improve.

Finally, it is important to stress the necessity of an ongoing constructive dialog and cooperation among all involved stakeholders. This needs to come hand in hand with an active external communication, sharing best practice and educating the society. Throughout this research, limited understanding of the role and potential of social impact businesses in society has been highlighted, that if changed, can bring strong positive stimulus to the development of the industry. Additionally, it would be very important to develop key social impact indicators and start the measurement and assessment of the social impact. That is currently not done by any of the impact businesses in Latvia. Surprisingly, even the demand side representatives at this stage see it more of a burden and extra requirement vs the potential of positive communication, education and support from the society such measurements could bring.

## **8 Conclusions**

The purpose of the study was to answer the following research question: *What are the main challenges and gaps that need to be addressed for the SII market development in Latvia?* In order to achieve that, the available information on the SII ecosystem was studied and semi-structured interviews with the existing and potential SII ecosystem stakeholders in Latvia were organized. Furthermore, the SII ecosystem in the UK was reviewed and semi-structured interviews with representatives of the UK intermediaries were organized to study the links between various dimensions of the SII ecosystem and learn from the experience of the most developed market in the area.

The study has identified that the SII market in Latvia does not exist at the moment, confirming the hypothesis defined by the authors at the beginning of the research. At the same time, it is concluded that awareness and level of interest about SII is rising among the potential stakeholders from all the dimensions of the SII ecosystem, yet there is no actual activity in the area.

The presence of SEs with business focus is the prerequisite for the development of other dimensions of the SII ecosystem. At the moment, there are only a few scalable, business oriented SEs in Latvia that would be investment ready, which is the key challenge that should be addressed for further industry development. A significant support and boost of activity among SEs is expected with the opening of the EU funding program in 2017 devoted to the development of SEs in Latvia. The results of the program are expected to be an important indicator of the potential of the SE development in Latvia.

Representatives of the supply side in Latvia are only building awareness about the potential of the SII and current focus is predominantly on the financial return. Impact projects and businesses are treated as any other business, when potential investment is assessed. Local governments have strong influence and can potentially become important promoters of the social business development in the market, as they are responsible for the social service provision in their territories. At the moment, however, only a few local governments in Latvia provide the social services through private entities, while many keep the service provision in-house. Furthermore, there is a clear gap on the intermediary side as there is no intermediary that would serve the typical functions of a mediator between the demand and the supply side.

Finally, the institutional and legal base for the SEs is currently being developed, while the understanding and appreciation of the potential impact businesses can bring to the economy of Latvia is just emerging among the state sector institutions.

Research of the SII ecosystems in Latvia and the UK lead to following recommendations for further SII market development in Latvia. Mentoring and support to SEs on business aspects is indeed necessary. Furthermore, provision of information and education of society on the role and impact of the SEs is critical. These functions could be owned by intermediary linking various stakeholders of the ecosystem. Currently there is a gap for it in the market. Market should also seek new financing models to support its activity. Crowdfunding has been identified as a low-cost, relatively simple to introduce a model that could fit both the demand side as well as be the financing solution for the potential intermediary. Finally, central and local governments have a critical role in the development of the market. Clear commitment and dedicated resource on the government side would be needed for the promotion of the SII market in Latvia.

Since the activity in the SII market has been indeed limited, the SII field in Latvia has not been studied before. Being the first paper to analyse the various dimensions of the SII ecosystem in Latvia, the research has contributed to increased awareness of the topic among the various potential players of the market. Current research does not go into detail describing the social needs and actual requirements in the market with the aim to evaluate the potential of sustainable social change. The research done by the authors also does not investigate or provide evaluation of the potential scope of solutions the impact businesses could provide to the existing social issues in Latvia. These are the suggested areas of a separate research.

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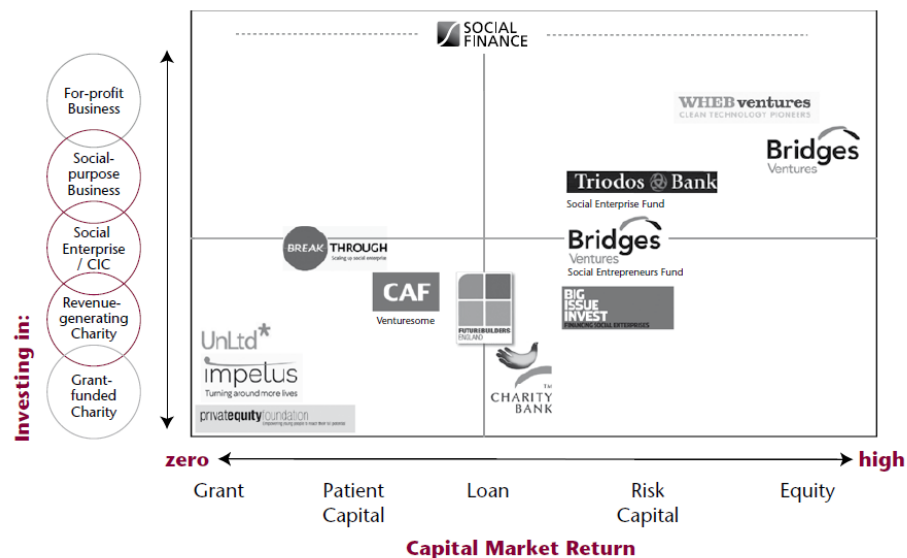
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## Appendices

### Appendix A: Example of supply-side representatives in the UK market (Social Investment Taskforce, 2010)

Examples of new initiatives across the social investment spectrum\*



### Appendix B: List of questions of the semi-structured interviews with the key stakeholders of the SII ecosystem in Latvia

1. What is your view on the development of social enterprises/impact business in Latvia?  
Please describe the role of your institution in it.
2. What is the role of social enterprises/impact business in solving the social issues that exist in the country? Does it have the potential for growth and development?
3. In your experience/ opinion - can social enterprises be profitable?
4. What are the main factors and key institutions that should be involved for the SII development in Latvia?
5. What are the main obstacles for the SII development in Latvia?
6. Do you think investors in Latvia are interested and ready to invest in social impact enterprises? What are the prerequisites for this to happen?
7. What, in your opinion, is the role of state institutions in the development of SII?

**Appendix C: List of questions of the semi-structured interviews with the representatives of the intermediaries of the SII ecosystem in the UK**

1. Please briefly describe, from your view, the role that your organization has played in the development of the UK SII ecosystem. What have been some of the key milestones?
2. The role of the UK government in the development of the SII market has been significant. In your opinion, what type of policy support is the most important for the SII development in the market?
3. What other factors are critical for the development of the SII market?
4. What, in your opinion, are the main challenges and obstacles for the development of an SII industry?
5. How transferable are the existing practices of the SII industry of the developed markets like the UK to the reality of the small markets like Latvia?
6. Where might other countries start in developing their own market?

## Appendix D: List of interviewees

<b>LATVIA</b>				
<b>Dimension of the SII ecosystem in Latvia</b>	<b>Institution</b>	<b>Name, Surname</b>	<b>Position</b>	<b>Date of interviews</b>
<b>Social needs &amp; Enabling environment</b>	Ministry of Welfare of the Republic of Latvia	Maksims Ivanovs	Social services department head	February 6, 2017
	Ministry of Welfare of the Republic of Latvia	Ingeborga Linde	Project Manager, Labour Market Policy Department, ESF Project “Support for Social Entrepreneurship”	February 27, 2017
	Ministry of Welfare of the Republic of Latvia	Alite Grobiņa	Senior Expert, Labour Market Policy Department, ESF Project “Support for Social Entrepreneurship”	February 27, 2017
	Ministry of Economics of the Republic of Latvia	Ieva Jaunzeme	Head of Administration	March 2, 2017
<b>Demand side</b>	Social enterprise MAMMU	Andris Rubins	Co-founder and Investor	December 12, 2016
	Social enterprise MAMMU	Fionn Dobbin	Co-founder and Creative Director	February 16, 2017
	Social enterprise HOPP	Madara Makare	Founder	February 6, 2017
	Latvijas Samariešu apvienība, NGO	Andris Bērziņš	Director	February 22, 2017
	Cerību Spārni, NGO	Eva Viļķina	Chairman of the board	March 7, 2017
<b>Intermediaries</b>	The Foundation for an Open Society DOTS	Egita Prāma	Administrative Director	February 13, 2017
	Social Entrepreneurship Association of Latvia	Madara Ūlande	Director	February 13, 2017
	New Do(o)r	Diana Lapkis	Program Director	March 16, 2017

<b>Supply side</b>	Latvian Business Angel Network Latvia	Jānis Rancāns	Chairman of the Board	February 15, 2017
	SEB	Diāna Blumate	Head of marketing	February 16, 2017
	SEB	Georgs Rubenis	Marketing Project Manager	February 16, 2017
	Swedbank	Adriana Kauliņa	Public Affairs Manager	February 20, 2017
	DNB	Marine Krasovska	Head of Business Solutions department	February 9, 2017
	Altum	Andrējs Buhārins	Project manager, Program development department	February 21, 2017
	Altum	Ilona Beizītere	Credit and warranty department analytic	February 21, 2017
	LIAA	Linda Grīnfelde	Head of Customer Service department	March 13, 2017
<b>UNITED KINGDOM</b>				
<b>Key SII intermediaries in the UK</b>	<b>Institution</b>	<b>Name, Surname</b>	<b>Position</b>	<b>Date of interviews</b>
	Social Stock Exchange	Tomás Carruthers	Chief Executive	March 2, 2017
	Big Society Capital	Stephen Muers	Head of Strategy and Market Development	March 3, 2017
	Social Finance	Meg Brodie	Graduate Analyst	March 1, 2017