Unlocking the potential of impact investing in Scotland

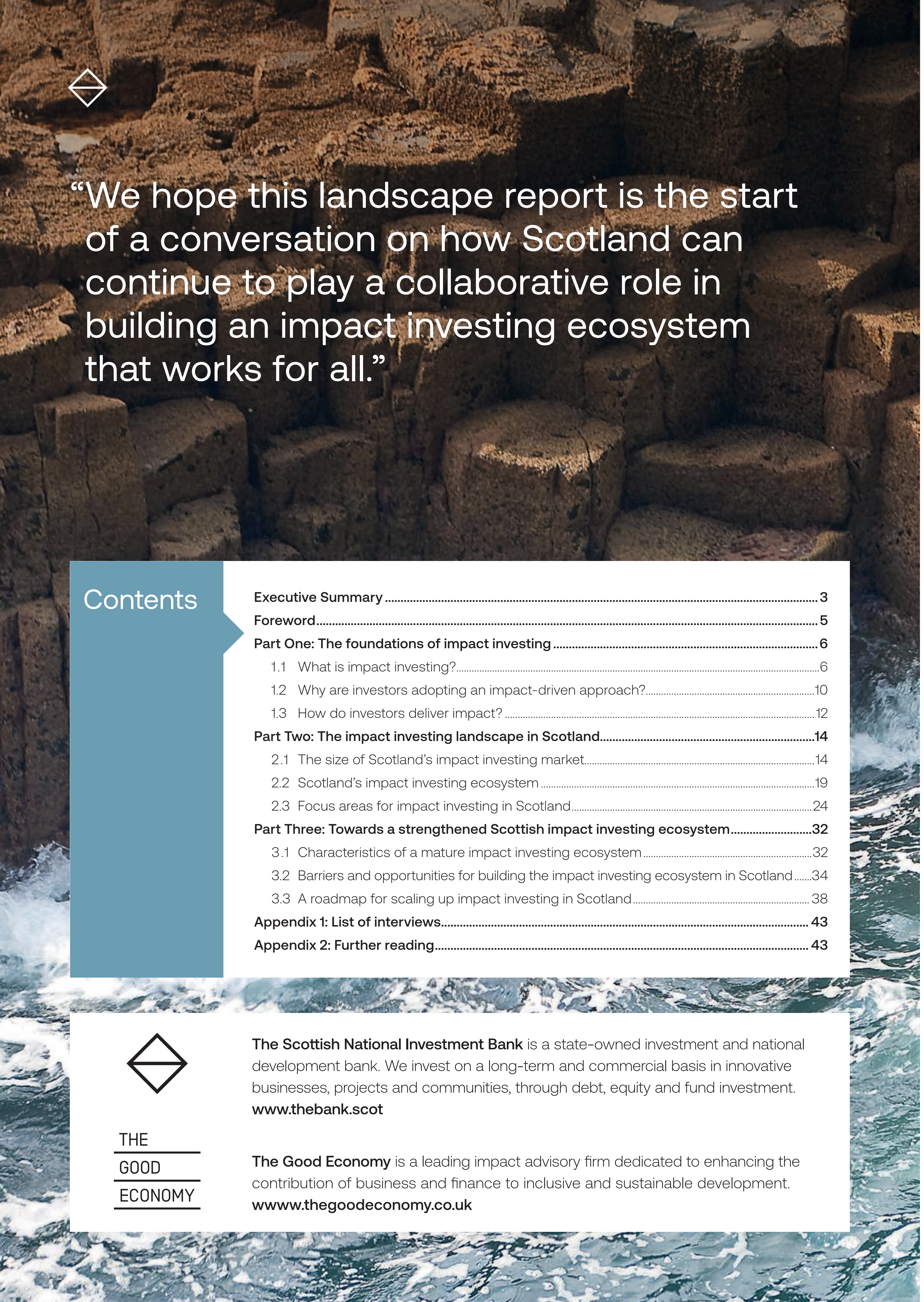
A landscape review

November 2022

The Scottish National Investment Bank

In partnership with

THE GOOD ECONOMY



"We hope this landscape report is the start of a conversation on how Scotland can continue to play a collaborative role in building an impact investing ecosystem that works for all."

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Executive Summary

Interest in impact investing - investments made with the intention to generate positive, measurable social and environmental outcomes – is at an all-time high. With over one trillion dollars of impact assets now under management globally, momentum is being driven both by social and environment needs, as well as market opportunities. On the one hand, growing awareness of the urgency of climate action and inequalities fuelled by Covid-19 have brought sustainability issues to the forefront of debates about the role of private capital in the 21st century. On the other, over a decade's track record of investing for positive impact alongside financial returns is coinciding with an ever-increasing number of business and investment opportunities that are innovating to provide solutions to both global and local challenges.

This report aims to explore what impact investing means for Scotland. First, it unpacks key definitions and debates around what impact investing is and is not. Second, it provides a high-level mapping of the impact investing landscape in Scotland, highlighting key roles as well as making a first attempt to size the market. Third, it sets out a potential roadmap to scale impact investing in Scotland, identifying the role that impact investments can play in helping drive positive outcomes.

It is clear that public sector investment alone will not be enough to respond to the range of challenges facing Scotland both now and in future. Significant pools of aligned capital will be needed to support a successful economic, social and environmental transformation. Scotland is well-positioned to support the transition to a low-carbon future, with a quarter of Europe's offshore renewable energy potential. However, reducing Scotland's heat demand at the same time as accelerating energy efficiency and the decarbonisation of heat will be some of the most challenging elements of achieving net zero – and areas where impact capital can play a catalytic role. On the social side, improved business dynamism can create employment opportunities and drive quality job creation, both of which are critical as Scotland seeks to become a Fair Work Nation. Tackling the underlying causes of inequality to improve life chances will mean directly targeting structural drivers of exclusion and poverty, as well as meeting a range of local needs, from housing to health. There is a clear and present opportunity for impact investment to drive the creation of positive outcomes that otherwise would not have been achieved at the same scale, pace or depth.

To harness these opportunities and meet the needs of people, places, and planet, Scotland's impact investing ecosystem needs to be strengthened and scaled up. At present, the impact investing market in Scotland is characterised by relatively small deal sizes and a high cost and time complexity of finding and making deals. There is not yet a specific impact investing identity or community in Scotland – or a set of supporting services and actors to help those interested in adopting an authentic impact approach. Bearing in mind the absence of fixed, agreed boundary definitions between 'sustainable investment', 'responsible investment', and 'impact investment', we estimate the size of Scotland's impact investing market to be approximately £1.8 billion based on tighter definitions of impact, up to £6.4 billion under a broader definition that incorporates what some may view as sustainable or responsible investment. This leaves us with a mid-point estimate of approximately £4.3 billion for the impact investment market in Scotland.

Executive Summary continued

Scotland is already a leading centre of investment activity with a large investment management industry and a track record in responsible investing. What would it take to make Scotland a leading hub for impact investment?

Paraphrasing the *Business Purpose Commission for Scotland's* recent call to action, a vision could be that by 2030, all investors in Scotland will have become purposeful investors which profit from supporting solutions for people, places and planet. Doing this will require risk, return and impact to be routinely integrated into investment decisions as the 'normal' way of doing things within the financial sector. It will also require the support of an active, thriving impact investing ecosystem.

Building off a clear and consistent policy direction, as well as the embrace of sustainable investment within financial services more broadly, this report identifies four aims for a future, mature ecosystem for impact investing in Scotland:

- Clarity on what impact investing is in the context of Scotland, with clear principles and standards of practice
- Better flow of impact capital that meets the risk-return-impact expectations of a range of investees and investors
- Specialised tools and services that support the incorporation of impact into the analysis, allocation and deal-making activities of investors
- All actors across the ecosystem are empowered and improve their competencies and capacities to originate and make impact investments

Scotland is at a critical juncture for meeting its climate commitments and realise the bold ambition to reduce emissions by 75% by 2030 and reach net zero by 2045. The cost of living crisis is deepening place-based inequalities by the day. The time for action – and investment – is now.

Foreword

Last year, the eyes of the world were on Glasgow as 120 global leaders gathered at COP 26. Central to negotiations was the question of how to finance the transition to a low-carbon future, and the role that both public and private investment needs to play in accelerating climate action.

The urgency of getting on the path to sustainability, as encapsulated in the United Nations Sustainable Development Goals, is being driven in large part by the climate crisis. But it is also being driven by renewed attention to social issues, not least those highlighted by Covid-19. Together, the business and finance community is focusing as never before on what it means to live within – and invest in line with – planetary boundaries and what it will take to end poverty and inequality.

In Scotland, these global challenges are amplified by a range of national needs, from better health and housing to improved work opportunities and well-being. To achieve successful social and environmental transformations, not least to become Net Zero by 2045, Scotland will need to draw on significant pools of aligned capital. Harnessing investment flows to more intentionally target positive outcomes can be a way to deliver on Scotland's vision of a wellbeing economy with fair work and inclusive growth at its heart.

While Scotland's impact investing market may be nascent, there are significant opportunities and a strong foundation to build on. Scotland is home to a financial centre of global importance with a track record in responsible investment. A history of social investment rooted in local communities, pro-active position on climate leadership, and a supportive investment and policy environment all provide encouraging signs that Scotland is well-placed to become a leading hub for impact investment.

As a mission-led impact investor, the Scottish National Investment Bank has an important role to play as a catalyst for change. The vision is of a dynamic, diversified impact investing ecosystem in Scotland, where ever-greater flows of impact capital are being managed to meet national needs and bring global benefits. The theme of COP 26 was 'Together for Our Planet', a reminder that this vision will only be realised if the public sector, private sector, civil society and communities can work together. Indeed, as one investor interviewed for this report noted, "impact investing cannot be done in isolation".

We hope this landscape report is the start of a conversation on how Scotland can continue to play a collaborative role in building an impact investing ecosystem that works for all.

Willie Watt
Chair
Scottish National Investment Bank

Sarah Forster
Co-Founder and CEO
The Good Economy

Part One: The foundations of impact investing

This section provides an explanation of how impact investing is defined, how it differs from other sustainable investment approaches and the drivers behind the rapid growth in the impact investing market. It ends with a summary of ways in which investors can contribute to positive social and environmental change through their knowledge, networks and capital.

1.1 What is impact investing?

The past decade has seen a rising tide of interest in impact investing, defined by the Global Impact Investing Network (GIIN) as "investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return".[1]

Despite the term first being coined a little over 15 years ago, the roots of impact investing can be traced back decades to ethical and socially responsible investing.[2] The recent growth in impact investing has come alongside widespread investor interest in considering environmental, social and governance (ESG) factors. A third of global assets now integrate ESG considerations into investment decision-making, often through screening out companies that under-perform on ESG factors relative to their peers. As impact investing has matured, so has its supporting infrastructure (Figure 1).

While impact investing is a relatively small market niche – by some estimates, 2 percent of global assets under management (AUM) – it is seen as having the potential to increase in scale. Not least because of the potential of impact investments to contribute to the achievement of the Sustainable Development Goals (SDGs), relative to the size of need. The global SDG financing gap is estimated to stand at $4.2 trillion as of early 2021, a near-doubling from the estimated $2.5 trillion gap pre-Covid-19.[4]

Figure 1: Key milestones in the global emergence of impact investing[3]

2007
The Rockefeller Foundation convened investors, entrepreneurs and philanthropists in Bellagio, Italy, and coined the term 'impact investing'.

2009
Establishment of **The Global Impact Investing Network (GIIN)**, a non-profit membership organisation aiming to build industry infrastructure and supporting activities, education, and research that help accelerate the development of impact investing.

2012
Morgan Stanley becomes the first major financial institution to launch a wealth management platform solely dedicated to sustainable and impact investing.

2015-2017
17 Sustainable Development Goals (SDGs) of the 2030 Agenda for Sustainable Development adopted by world leaders at a UN Summit.

2016
The Impact Management Project (IMP) launched as a multi-stakeholder forum for building global consensus on how to measure, assess and report impacts.

TPG launches the **Rise Fund**, the first global alternative asset manager to develop an impact investing business with more than $1 billion in assets under management.

2022
The GIIN estimates that the **impact investing market has surpassed the $1 trillion figure** (as of end 2021) for the first time.

Box 1: Sizing the global and UK market

According to the GIIN, the size of the global impact investing market was $1.164 trillion AUM as of end 2021.[5] The International Finance Corporation (IFC), the private sector finance arm of the World Bank Group, estimates that the pool of assets being managed for real-world outcomes is even larger, at $2.3 trillion in 2020, equivalent to 2 percent of global AUM.[6] In the UK, research commissioned by the Impact Investing Institute estimated the size of the UK impact investing market to be £58 billion in 2020.[7] Big Society Capital estimates that the social investment segment of this market has grown ten-fold over the past 10 years.[8]

Arguably, every investment has an impact. The aim of impact investors is maximising the positive and minimising any negative effects associated with their investments. Impact investments therefore have a number of distinguishing features:

- An ***intention* to create positive social and/or environmental outcomes**. Identifying an unmet need or under-served population and building credible strategy to help improve these outcomes. Impact considerations are elevated alongside financial considerations as a key driver of investment decision-making.
- **Contributing to solutions in a way that is *additional***. In other words, creating benefits that would not have happened without the investment. Impact investors do not seek to own already impactful assets and preserve the status quo, but want to make a difference to the depth, duration, or scale of outcomes.
- A system to ***measure and manage* impact** that links the intention of the investment to change in outcomes. The ongoing collecting data on social and environmental performance, and using the information to drive decision-making, is a hallmark of impact investing.

Figure 2 overleaf provides a useful way of distinguishing impact investing from other approaches to ESG investing. At one end of the spectrum, investors consider environmental and social issues as a financial risk management tool. At the other, impact investors pursue opportunities to address specific and defined goals, such as 'helping end homelessness' or 'tackling the education gap'.

1. GIIN, What You Need To Know About Impact Investing, 2022.
2. According to Trelstad (2016), the Quakers and Methodists had long advocated that investors should avoid business practices or companies that might be socially harmful and the first screened investment fund was created in 1928 "when an ecclesiastical group in Boston created the Pioneer Fund".
3. IFC and Impact Investing: A Brief History.
4. OECD UNDP, Closing the SDG Financing Gap in the COVID-19 era: Scoping note for the G20 Development Working Group, 2021.
5. GIIN, Sizing the Impact Investing Market, 2022.
6. IFC, Investing for Impact: The Global Impact Investing Market 2020. The IFC estimate includes both investments made with the intention to generate impact – but not measured in line with the GIIN definition – as being 'intended impact' or more broadly as invested for impact. Investments made in line with the GIIN definition are 'measured impact' or simply impact investments.
7. Impact Investing Institute, Sizing the UK's Impact Investing market.
8. Big Society Capital, 2020 Market Sizing.

Part One: The foundations of impact investing continued

Figure 2: The global spectrum of capital: From mainstream to impact[1]

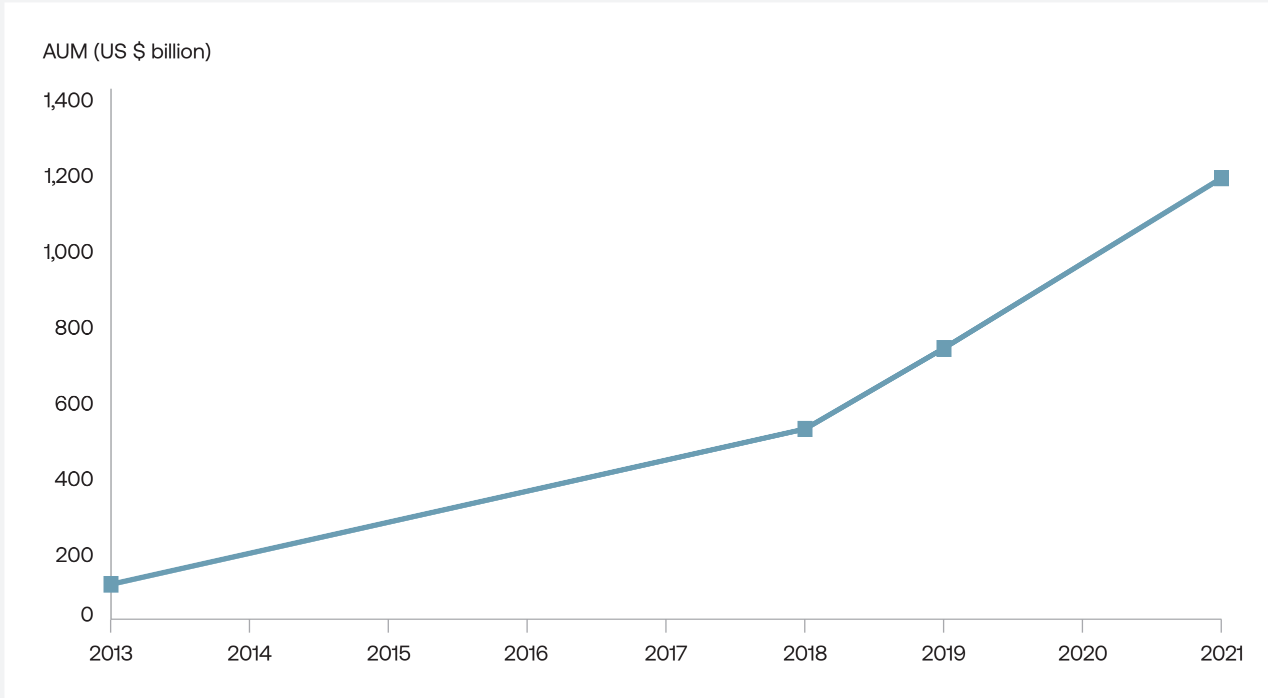
$112 trillion				Size of market
	$35 trillion			
		$1.16 to $2.28 billion		
	Responsible	Sustainable	Impact	Style of investment
No or limited consideration of ESG factors	Mitigate ESG risks to protect financial value	Align with progressive ESG themes that may enhance financial value	Address societal challenges that drive a twin financial and impact return	Strategy pursued
	Avoid Harm	Benefit Stakeholders	Contribute to Solutions	Spectrum of intentionality

Impact investing is a big tent that straddles a number of themes, geographies and asset classes; as well as encompassing a variety of return expectations, from concessionary to market-rate. This reflects the fact that investors target diverse impacts, as well as having different missions and institutional requirements such as fiduciary duty. Developments in recent years have clarified the misconception that impact investing necessarily means sacrificing returns (Myth 1): Research conducted by the GIIN and Cambridge Associates, for example, shows that impact investors seeking market rate returns can achieve them.[2]

Myth 1: Impact investing means below market rate returns.

Reality: The majority (67%) of impact investors target risk-adjusted market-rate financial returns. The remaining third (33%) of investors provide concessional finance as a matter of choice, making a decision to 'trade off' between impact and financial returns. While robust benchmarks to objectively assess the financial performance of impact investments remain scarce, the vast majority (88%) of GIIN respondents said their investments are performing in line with or better than their financial expectations.[3]

Figure 3: 10-Year Growth of the Global Impact Investing Market[4]



1. Sources: BCG, 2022; GSIA, 2021; IFC Investing for Impact, 2020; GIIN, 2022.

2. According to the GIIN, across various strategies and asset classes, top quartile funds seeking market-rate returns perform at similar levels to peers in conventional markets. https://thegiin.org/assets/2017_GIIN_FinancialPerformanceImpactInvestments_Web.pdf

3. GIIN's Annual Impact Investor Survey 2020.

4. Figures based on GIIN research to size the impact investing market, apart from 2013 which uses data from the GIIN's annual impact Investor Surveys. The figure on total investment activity of the sample of respondents to the GIIN survey is typically half of the total market size estimated by GIIN. For 2013, we have doubled the GIIN survey-reported figure of $46 million to arrive at an approximation of the market.

Part One: The foundations of impact investing continued

1.2 Why are investors adopting an impact-driven approach?

There are a number of reasons why interest in impact investing is at an all-time high.[1] While the appeal of impact investing may vary according to different investor types, seven mutually re-enforcing drivers can be identified.

Driver one: Awareness of global challenges

There is less than eight years to go to meet the 2030 target for achieving the Sustainable Development Goals (SDGs), which Scotland was one of the first signatories. These far-reaching and inter-dependent set of 17 global goals provide a yardstick for worldwide progress towards a more sustainable future. At the moment, the world is off-track to meet the SDGs, but the scale of global challenges remains vast. SDG-related needs exist across almost every country and nation, with regular news media reporting on the acuteness of planetary challenges – not least the climate crisis – bringing social and environmental issues to the forefront of people's mind.

Driver two: Pressing national needs

Covid-19 and the current cost of living crisis have both moved tackling inequalities to centre stage of policy debate. In Scotland, the Government's *Covid Recovery Strategy* recognised the most disadvantaged have suffered disproportionately from ill health, financial insecurity and limited education opportunities.[2] The *National Strategy for Economic Transformation* sets outs structural challenges facing Scotland, such as lagging productivity.[3] The most recent measurement of well-being progress against the *National Performance Framework* shows positive improvements being made for only 17 out of 59 indicators, with worsening performance being seen in several areas including health outcomes and poverty levels.[4]

Driver three: Changing regulatory environment

Requirements on businesses to act responsibly continue to strengthen. From an investor perspective, initiatives such as the EU's Sustainable Finance Disclosure Regulation (SFDR), and the UK's forthcoming Sustainability Disclosure Requirements (SDR) aim to strengthen the integrity of ESG factors. Where once regulations were cited as potential barriers for unlocking assets to support impact investment, they now provide an opportunity. A key obstacle to increased impact investing activity by pension funds, for example, is perceived incompatibility with fiduciary duty – being addressed with landmark reports such as 'A legal framework for impact' established that investors are able to pursue sustainable impacts if they are an effective way of achieving financial goals.[5] An earlier report by the same law firm – the so-called 'Freshfields report' – concluded that investors are permitted, and arguably required, to integrate ESG factors into their analysis.[6]

Driver four: Shifting public opinion

Societal expectations about the role investors should play in the 21st century as responsible stewards of capital are also changing. Calls for businesses to be managed for the interests of all 'stakeholders' rather than a narrow group of 'shareholders' have gone hand-in-hand with questions about 'who pays' for the social and environmental costs created by economic activities.[7] Responsibilities for these externalities are shifting, with societal pressure for the private sector to be part of the solution, rather than part of the problem, leading many investors and businesses to re-assess their purpose and reflect on what type of society they want to live in, and what planet they want to leave behind.

Driver five: Strong client demand

Among retail investors, post-pandemic surveys have shown rising levels of interest in impact investing, especially in the UK, with climate change and environmental sustainability cited as the major issue of concern.[8] A survey of over 6,000 UK savers commissioned by the UK government found that 68% want their investments to consider impact on people and planet alongside financial performance.[9] Demand was particularly strong among those with investable assets over £25,000 and 'millennials'. Institutional investors such as pension funds and insurance companies are increasingly setting up bespoke mandates in order to increase their exposure to impact investing.[10]

Driver six: Longer investment horizons

Many investors are adopting a longer-term approach in their investment strategies. The world's largest asset managers are engaging with their portfolio companies noting that a myopic short-term focus can be a barrier to growth.[11] This approach is highly compatible with an impact lens, especially as investors are becoming more aware of how systemic environmental and social crises, such as climate change and inequality, can increase the volatility of returns and decrease the resilience of portfolios. For many, a natural progression is to not just decreasing exposure to these trends but also actively supporting solutions to them.[12]

Driver seven: Growing market opportunity

The *Business Purpose Commission for Scotland* found that businesses in Scotland can both weather the current economic climate and seize market opportunities by being purpose-driven, making a positive impact on economic prosperity, social wellbeing and environmental sustainability.[13] The Commission's vision is that by 2030, all businesses in Scotland will have become purposeful businesses which profit from finding solutions for people and planet. Investors can tap into this rising demand for mission-aligned capital by financing progressive companies who, in turn, can tap into the growing consumer demand for products that make a positive difference in the world.

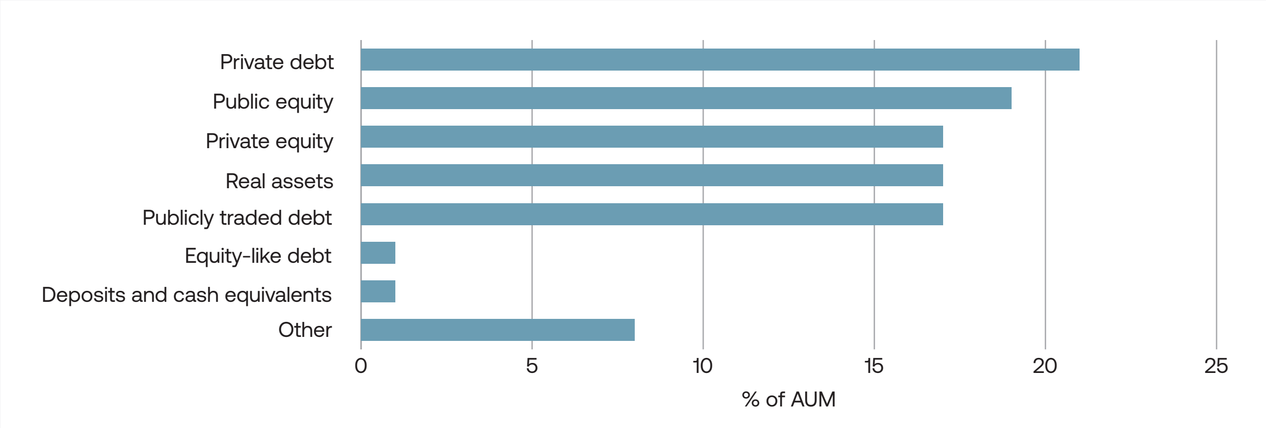
1. Markets Media, Interest in Impact Investing at All-Time High, May 2022.
2. Covid Recovery Strategy: for a fairer future.
3. National Strategy for Economic Transformation.
4. As of October 2022.
5. A legal framework for impact: Sustainability impact in investor decision-making.
6. A legal framework for the integration of environmental, social and governance issues into institutional investment.
7. Business Roundtable Statement (2019).
8. American Century Investments, The Growing Appeal of Impact Investing, 2022.
9. HM Government, Investing in a Better World: Understanding the UK public's demand for opportunities to invest in the Sustainable Development Goals, Sep 2019.
10. New Private Markets, Why investors are choosing tailored mandates over impact fund investments, 2022.
11. https://www.greenbiz.com/article/why-worlds-largest-asset-managers-are-pushing-long-term-thinking
12. A UNPRI report with Harvard found economic inequality negatively impacts long-term investment performance, including by changing company risk profiles, affecting the universe of investment opportunities; and destabilising the financial system within which investors operate, threatening bottom lines.
13. Business Purpose Commission for Scotland, Putting Purpose at the Heart of Scottish Business. 2022.

Part One: The foundations of impact investing continued

1.3 How do investors deliver impact?

Impact investors focus on finding investment opportunities that deliver social and/or environmental outcomes alongside financial returns. Impact investments are made across a diverse range of asset classes: What was once dominated by private market investments has evolved to an industry where 36% of global impact capital is now deployed into public equities and fixed income (Figure 4).[1]

Figure 4: Allocation of global impact AUM by asset class[2]



Myth 2: Impact investing is an asset class.

Reality: Impact investing is an approach that can be used across asset classes but is not a separate asset class itself. As an approach – or investment style – impact investments can be made into fixed income, real estate, public equities, private equity investments that make an intentional, measurable contribution to improved outcomes for people, places, and planet.

Ultimately, impact investors seek to make a difference to real-world outcomes – which means understanding how they can contribute to impact using both financial and non-financial means. Box 2 summarises the different roles that investors can play to support the impact of the companies they invest in, as well as broader field-building.

In order to achieve their goals, impact investors often seek to be catalytic: Making investments to increase the speed and scale of capital to projects and activities that offer solutions to environmental or social problems, especially in previously underserved markets or to address observed market failures.[3] Establishing investor contribution is core to the framework developed by the Impact Management Project (IMP), a collaboration of over 2,000 investors, enterprises and practitioners who came together to set norms for impact measurement (box 2).[4]

1. In 2011, for example, less than 1 percent of the number of impact investments reported – and less than 1 percent of the amount of capital invested – went into publicly listed instruments, according to a survey by JPMorgan and GIIN. By 2020, the same survey showed publicly traded debt comprising 24 percent of the impact capital invested, and public equity making up another 10 percent. GIIN's Annual Impact Investor Survey 2020. 2. Data is based on the GIIN's Annual Impact Investor Survey 2020, including 289 respondents to the survey. 3. Sustainability Disclosure Requirements (SDR) and investment labels. 4. The IMP's resources migrated to Impact Frontiers following the IMP's conclusion in 2021.

Box 2: Spotlight: Four ways investors can deliver impact

A core input is **financing**, which can be used to participate in new or previously overlooked opportunities. This may involve lending or investing directly into companies to support their growth, the acquisition of physical assets, or for working capital. It can also involve financing social or environmental infrastructure projects. Investments are also made into financial vehicles, such as funds and investment trusts, or other innovative products like litigation finance.[5]

Many investors can deploy capital in a way that brings about **indirect effects**, such as to signal the importance of a new theme or to stimulate new markets. These investors can play an active role in helping crowd-in finance, for example as a cornerstone investor, or deliberately targeting emerging or first-time fund managers.

Post-investment, investors can **engage** with their investees to proactively support or advocate for companies to reduce their negative and increase positive impacts. This can leverage an investor's operational expertise and networks, as well as by brokering access to – or directly supporting – technical assistance facilities. Investors can stimulate change by playing a active role on Boards, or use incentivise to impact creation, for example by linking the achievement of impact objectives or metrics to covenants or reduced interest margins.

By participating in industry-level or regulatory efforts to promote considerations of impact considerations in financial markets, investors can contribute to **field-building**. This can lift up standards across sectors and industries, leading to additional capital being allocated towards addressing social and environmental outcomes.

Box 3: Impact Management Norms

According to the consensus-based definitions by the IMP, impact is a change in an outcome caused by an organisation. An outcome, in turn, is the level of well-being experienced by a group of people, or the condition of the natural environment, as a result of an event or action.

To enable a proper understanding of impact, investors need to understand the impact of their investments across five dimensions:

What	The outcome(s) the enterprise is contributing to, whether they are positive or negative, and how important they are to stakeholders.
Who	Which stakeholders are experiencing the outcome and how underserved they are in relation to the outcome.
How much	How many stakeholders experienced the outcome, what degree of change they experienced, and how long they experienced the outcome.
Contribution	Whether an enterprise's and/or investor's efforts resulted in outcomes that were likely better than what would have occurred otherwise.
Risk	The likelihood that impact will be different than expected.

5. Litigation Finance Journal, Make no mistake, Litigation Finance IS Impact Investing, 2020.

Part Two: The impact investing landscape in Scotland

This section contains an analysis of the impact investing landscape in Scotland. It starts with a first attempt to 'size' the current volume of impact investing activity in Scotland. It then maps out the roles and players in the impact investing ecosystem, before examining the intersection between social and environmental challenges in Scotland and priority areas for impact investing. This includes highlighting a number of case studies of how impact capital is being deployed into key sectors and thematic areas in Scotland.

2.1 The size of Scotland's impact investing market

To-date, no concerted effort has been made to size the impact investing market in Scotland. Last year a study commissioned by the Impact Investing Institute estimated the UK impact investing market at £58 billion.[1] A 2020 report by the Ethical Finance Hub analysed the broader Scottish responsible investment market for the first time, sizing it at £9.5 billion – equivalent to 11% of the UK's responsible investment market.[2]

We have conceptualised Scotland's impact investing market to consist of all impact capital being managed in or deployed for the benefit of Scotland.[3] In practice this means including:

- **Domestic investors:** Scottish investors active in Scotland, and Scottish investors active elsewhere
- **National investors:** UK investors active in Scotland
- **International investors:** International investors active in Scotland

Bearing in mind the absence of fixed, agreed boundary definitions between 'sustainable investment', 'responsible investment', and 'impact investment', we estimate the size of Scotland's impact investing market to be approximately £1.8 billion based on tighter definitions of impact, up to £6.4 billion under a broader definition that incorporates what some may view as sustainable or responsible investment. This leaves us with a mid-point estimate of approximately £4.3 billion for the impact investment market in Scotland. (see Box 4).[4]

These figures should be read as the starting point for a discussion about how to best describe and size the Scottish impact investing market. Attempts to put a figure on the volume of impact capital are difficult due to the challenge in identifying what counts as an impact investment, especially as investors may make impact-aligned investments but not always label themselves as an 'impact investor' or market their funds as 'impact'. There are also data limitations as most investments are made into private markets where publicly available information is scarce. Rather than providing a definitive answer, therefore, our aim is to kick-start a debate about the most appropriate methodologies and assumptions that can be used to provide a baseline for tracking future growth.

Figure 5: The spectrum of capital in the UK and Scotland: From mainstream to impact[5]

£9.4 trillion				Size of market: United Kingdom
	£86 billion			
			£58 billion	
	Responsible	Sustainable	Impact	Style of investment
No or limited consideration of ESG factors	Mitigate ESG risks to protect financial value	Align with progressive ESG themes that may enhance financial value	Address societal challenges that drive a twin financial and impact return	Strategy pursued
	Avoid Harm	Benefit Stakeholders	Contribute to Solutions	Spectrum of intentionality
			£1.8 billion to £6.4 billion (£4.3 billion mid-point)	Size of market: Scotland
	£9.5 billion			
£690 billion				

1. As of 2020. Due to the way data was collected, figures were not able to be accurately disaggregated by nation. Of the 38 survey respondents who contributed to the Impact Investing Institute study, 5% stated they invest in Scotland. However, this figure represents the sampling frame rather than a full appraisal of the Scottish impact investment landscape. Further geographical disaggregation of the underlying data was not possible.
2. Ethical Finance Hub, Mapping the Responsible Investing Landscape in Scotland, 2020.
3. This definition is consistent with the mandate of the Scottish National Investment Bank, which seeks to ensure that any investment it makes benefits the Scottish economy, focusing on businesses or projects located within Scotland or with a strong connection to Scotland.
4 These figures do not mean that this volume of capital is actually invested in Scotland, as a portion of the money being managed by domestic investors is deployed outside of Scotland. Even funds deployed in Scotland and generating local benefits (such as employment in life sciences and innovation around offshore wind) may ultimately deliver impact outcomes across UK and globally, not just in Scotland.
5. Sources: Investment Association, Ethical Finance Hub, own analysis, Impact Investing Institute.

Part Two: The impact investing landscape in Scotland
continued

Box 4: A preliminary estimation of the size of Scotland's impact investing market

With the Impact Investing Institute estimate of £58 billion as a base, we used other secondary sources to provide a best estimate for Scotland's likely share of the UK's overall impact investing market.

Lower value estimate

Data source:	Big Society Capital (BSC)
Rationale:	BSC publishes a number of data sets about the social impact investment market, which represents investments into charities, social enterprises and social purpose organisations.
Data:	BSC's Market Data (2021) estimates the value of the UK's social impact investment market to be £7.9 billion. BSC also release their own underlying portfolio data from investee managers who have chosen to contribute asset level information, this covers 66% of BSC's total portfolio commitment. Of the £1.3 billion over the last five years (2017 - 2021), 3.1% has been committed in Scotland.
Assumption:	Scotland's share of the UK's social investment market is the same proportion as Scotland's share of the UK's total impact investing market.
Limitations:	Social property funds account for the largest portion (45%) of the social impact investment market. Scotland has less exposure to these funds as, unlike in England and Wales, for-profit companies are not permitted to register as providers of social housing in Scotland. Using Scotland's share of the UK's social investment market is therefore likely to be an under-estimate.
Calculation:	A 3.1% share of UK's £58 billion market equals **£1.8 billion**.

Lower mid-range value estimate

Data source:	Investment Association
Rationale:	The Investment Association (IA) provides an annual assessment of the state of the industry, and the volume of assets being managers by IA members.
Data:	As of 2022, the total investing market of the UK is estimated to be £9.4 trillion. Total assets managed in Scotland reached £690 billion (7% of the UK's investment market).
Assumption:	Scotland's share of all assets under management in the UK is the same proportion as Scotland's share of the UK's total impact investing market.
Limitations:	Other studies have shown Scotland's share of the UK's responsible investment market to be greater than Scotland's share of the UK's overall assets under management. The 7% may therefore be an under-estimate.
Calculation:	A 7% share of UK's £58 billion market equals **£4.1 billion**.

Upper mid-range value estimate

Data source:	Beauhurst
Rationale:	The Beauhurst platform is a searchable database of the UK's fastest-growing startups and scaleups. They provide a list of impact funds in the UK.
Data:	Of the 46 impact funds listed, 8.7% of funds are managed by Scottish-based funds.
Assumption:	Scotland's share of all impact funds in the UK is the same proportion as Scotland's share of the UK's total impact investing market.
Limitations:	Beauhurst data focuses on accelerators, venture capital and private equity-related data. Given Scotland has a large asset management footprint outside of alternative investments, especially in terms of banks and equities, multi-asset and fixed income, the 8.7% may therefore be an over-estimate. The figure also refers to the number of funds, rather than the volume of their assets under management.
Calculation:	An 8.7% share of UK's £58 billion market equals **£5 billion**.

Upper value estimate

Data source:	Ethical Finance Hub
Rationale:	2020 report, 'Mapping the Responsible Investing Landscape in Scotland', examined the responsible investment market in Scotland.
Data:	Of the total UK Responsible Investment market, worth £86 billion, Scotland's share is 11% with a total of £9.5 billion AUM managed by 18 asset managers.
Assumption:	Scotland's share of the UK's responsible investment market is the same proportion as Scotland's share of the UK's total impact investing market.
Limitations:	The £86 billion figure used to estimate the UK's responsible investment market means the overall share of industry funds being managed responsibly in the UK is 6.5%. Given the global estimate is for almost one third of assets to be integrating ESG factors, the total UK market size may be an under-estimate.
Calculation:	An 11% share of UK's £58 billion market equals **£6.4 billion**.

The mean of these estimates is **£4.3 billion**.

Part Two: The impact investing landscape in Scotland
continued

Myth 3: Impact investing is about supporting social enterprises.

Reality: Impact capital can be deployed into any type of company: investees do not have to share the investor's impact intentionality. Many businesses may be generating positive impacts through a fully commercial strategy, where the products and services they produce are shown to address an unmet need. Other businesses may have a mission at the heart of their operating model, for example through a legally-binding mission statement, or by a commitment to re-invest profits. Financing for social enterprises and charities is known as 'social investment', and currently represents approximately 14% of the UK's overall impact investing market.[1]

Box 5: An analysis of social investment data in Scotland

To date, the only comprehensive data set on underlying impact investments made within Scotland is Big Society Capital (BSC) portfolio data.[2] While social investment into mission-driven organisations is a small subset of the total impact investment universe – see Myth 3 above – the data provides some insight into the location of investments, as well as the primary outcome areas.

Figure 6 shows the flow of social impact investment in the last 5 years between Scotland and the rest of the UK. The level of investment from Scotland and level of investment in Scotland both account for 3% of all UK investment. However, investment from Scotland into Scotland accounts for less than 0.6% of all UK investment.

Almost half (48%) of investment made into Scotland occurs within the Central Belt with the majority going to Glasgow (24%) and Edinburgh (22%). The Highlands and Islands receive 33% followed by Dundee with 19%.

The primary outcome area for over a quarter of investments committed in Scotland is Housing and Local Facilities, in particular housing to benefit people who are homeless. Outcome areas with the lowest levels of investment in Scotland are Employment, Training and Education and Health and Well-being.

Figure 6: BSC investment flow to and from Scotland

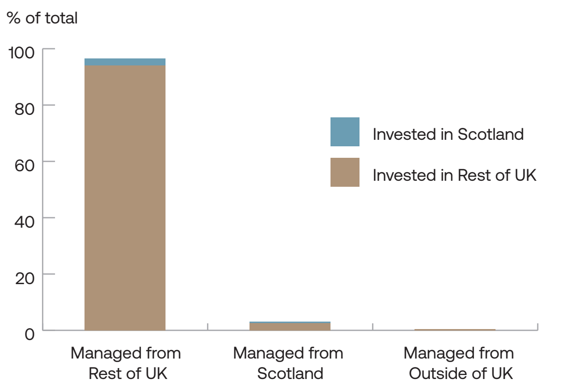
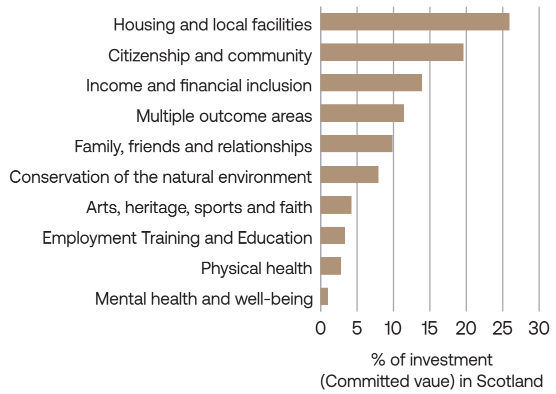


Figure 7: BSC investment by Outcome Area



Data source: Big Society Capital: Where we invest (accessed 25/10/2022).

2.2. Scotland's impact investing ecosystem

Given the diverse goals, strategies and types of investment being pursued, impact investment is best framed not as a cohesive 'sector' or 'industry' but as an ecosystem of actors, united by their intention to put capital to work to contribute to solving social and environmental challenges.[3]

The Global Steering Group (GSG) – the successor to the Impact Investment Taskforce established under the UK´s presidency of the G8 - has identified five pillars of the global impact investing ecosystem. These segment actors in terms of their five main roles in the ecosystem: *the supply of impact capital, demand for impact capital, intermediaries, enablers, and governments.*[4]

The following section provides a brief overview of these roles within the context of Scotland. Individual actors are mentioned to provide insight into real-world products and practices, but do not represent an exhaustive list of everyone active in the space.

Figure 8: A mapping of roles in Scotland's impact investing ecosystem

1. Based on £7.9 billion in social investments (Big Society Capital) out of an overall UK impact investing market size of £58 billion (Impact Investing Institute).
2. https://bigsocietycapital.com/portfolio/
3. Guide for Mapping the Entrepreneurial Ecosystem - ANDE (andeglobal.org).
4. GSG.

Part Two: The impact investing landscape in Scotland continued

Pillar 1: Supply of impact capital

This pillar includes actors that provide funding, directly or indirectly, to impact businesses. These include institutional investors, high net worth individuals and retail investors.

Scotland is home to some prominent insurance and pension firms, such as Edinburgh-based Scottish Widows. The Scottish Widows Master Trust is one the UK's largest pension funds, with 3.6 million members and over £77 billion assets under management.[1] Scottish Widows already has a responsible investment framework to understand and manage the ESG risks associated with its portfolio. It is also beginning to undertake work to understand the contribution of its loan portfolio to achieving positive, place-based impact.

There are 11 Local Government Pension Schemes in Scotland who hold assets of around £57 billion, paying pensions totalling over £1.18 million annually.[2] Strathclyde Pension Fund, for example, launched its Direct Impact Portfolio (DIP) in 2009. This is an internally managed c.£1.9 billion portfolio which specifically targets investments with a positive local, economic or ESG impact. The portfolio's geographical mandate is to invest in the UK; with opportunities in the UK's regions, particularly those in the north and/or Scotland having additional attraction.

With the highest number of top-ranked universities per head of population in the world, Scotland's higher education institutions play a prominent role in academic life. They also play a role in the investment landscape through their endowment funds. The University of Edinburgh, for example, has an endowment fund with £1 billion of investments under management, includes £8 million which is allocated for social impact investment.[3] This has included commitments to four social impact funds managed by; Big Issue Invest, Social and Sustainable Capital and Social Investment Scotland. These investments are intended to make investments locally and to contribute to social and economic prosperity within Edinburgh and the surrounding area.

Pillar 2: Impact capital intermediaries

Actors in this pillar facilitate the exchange of impact capital between the supply and demand side. Many are managing money on behalf of clients to whom they have a fiduciary duty, such as asset managers, funds (often venture capital, growth funds or fund of funds).

Scotland is home to a number of asset management companies of global importance as well as some specialist impact investment managers. According to the Ethical Finance Hub,[4] 99% of responsible AUM in Scotland is concentrated among 4 asset managers: Aegon Asset Management, Abrdn, Stewart Investors and Baillie Gifford. These managers invest across asset classes including multi-asset, equities, fixed income, real estate and private markets, with a small but growing allocation to impact.

Mainstream private equity and/or venture capital funds may not always label themselves as impact investors, but their focus on innovative companies often mean a degree of over-lap with the type of businesses solving for social and environmental issues which are the focus of impact investors (see section 3). Scottish Equity Partners, for example, is a venture capital company headquartered in Glasgow that invests in high-growth technology companies, using its capital to make a positive impact as well as to achieve returns for stakeholders.[5] In terms of earlier stage financing, Equity Gap is an Edinburgh-based angel investment syndicate which invests in growing businesses based in Scotland. A number of UK private equity houses make growth capital investments in Scotland, and some have offices and a strong presence in Scotland, such as BCF.

1. Scottish Widows.
2. Scottish Local Government Pension Scheme Advisory Board Annual Report 2020-21.
3. SC, The University of Edinburgh Endowments.
4. Ethical Finance Hub, Mapping the Responsible Investing Landscape in Scotland, 2020.
5. See SEP ESG Report 2022.

Box 6: Example impact strategies managed in Scotland

SIS Ventures	Part of the Social Investment Scotland Group, SIS Ventures was formed in 2018 to invest equity into mission-driven businesses which contribute to positive social and environmental outcomes. SIS Ventures operates as a wholly-owned impact investing subsidiary of Social Investment Scotland, placing strong impact governance alongside financial returns. As of February 2022, SIS Ventures' Impact First Fund had invested £1.3 million into eight companies, all based in Scotland.[6]
Circularity Capital	A private equity firm headquartered in Edinburgh with a specialist mandate to invest in companies operating in the circular economy. To date, Circularity Capital has raised two funds. Its latest funding round closed in April 2022 having raised €215 million for its Circularity European Growth Fund II. The company has a pan-European focus and has made a total of 12 investments to date. Circularity Capital has also made one investment into a Scottish company, having invested in energy efficiency specialist Green Home Systems in 2020.[7]
Mid-Market Rent Fund	An affordable housing fund managed by PfP Capital, the fund management business established by Places for People. The Mid-Market Rent Fund was established in 2018 with a target to deliver over 1,000 mid-market homes in Scotland. As of October 2022, the fund has completed development at five sites, delivering 481 new homes for affordable rent. The Fund will also seek to support the communities in which it operates in collaboration with Places Impact which assists group companies in their delivery of positive social impact. The Fund has total commitments of over £180 million.[8]
Baillie Gifford Positive Change Fund	Baillie Gifford launched its Positive Change Fund in 2017. This is a global equities fund which seeks capital appreciation from investing in companies whose products or behaviour have a positive impact on society and/or the environment. Companies in the portfolio must be assessed as contributing to at least one of the following themes: Social Inclusion and Education, Environment and Resource Needs, Healthcare and Quality of Life, Base of the Pyramid that target low-income populations. The Fund is invested globally, with nearly half the portfolio invested in North America, approximately a quarter in emerging markets and Europe respectively, and a small exposure to Asia Pacific and the UK. As of October 2022, the fund size is £2,313 million.[9]
RM Infrastructure Income	Managed by RM Funds, who have offices in Edinburgh and London, RM Infrastructure Income is an investment trust which specialises in secured social and environmental infrastructure lending, with over £297 million invested since 2016.[10] RMII targets SDG-related needs in the UK centred on housing, health, education and climate action by financing a 'missing middle' of businesses whose funding requirements are often too complex for traditional bank lending and too small for institutional direct lenders.

6. Insider, SIS Ventures. Scottish impact investor launches fresh £5 million fundraise, 2022.
7. Circularity Capital, 2022.
8. Places for People, PfP Capital, 2021.
9. Baillie Gifford Positive Change Fund, 2022.
10. RM Infrastructure Income Plc Impact Report 2022.

Part Two: The impact investing landscape in Scotland continued

Pillar 3: Demand for impact capital

In this pillar are actors who provide impact solutions and have financing needs in order to carry out those solutions. Typically, these are companies ranging in size from large to smaller, as well as organisations involved in the design and delivery of projects, such as affordable housing, regeneration projects and essential infrastructure.

Small and medium enterprises (SMEs) play a pivotal role in the Scottish economy, contributing to almost half of national turnover and a near-two thirds of employment. Given impact investing predominantly takes place in private markets, these SMEs and mid-market corporates are often the main destination for impact capital. However, as noted in Scotland's capital investment plan, SMEs are often reluctant to use finance to grow and expand.[1] According to the 2019 Scottish SME Access to Finance Survey, SMEs prefer to finance via self-funding or bank debt.[2] A study in the same year on business-led inclusive job growth in the south of Scotland similarly found that business owners were wary of taking on equity, some based on bad experience with private equity investors.[3] Others, however, were interested in patient equity investors who could bring expertise, strategic support and patience to support and help businesses grow - a strategy which aligns well with the approach adopted by many impact investors.

Because of its relatively small size, however, Scotland's entrepreneurial ecosystem - including investors from business angel networks to early-stage financing – has been characterised as dynamic.[4] At the next stage of growth, unlocking larger flows of capital to help businesses scale is a core part of Scotland's plans on inward investment and private capital investment.[5] In 2021, £895 million was invested by BVCA members into 88 Scottish companies.[6] For impact, this presents a strong opportunity to harness these innovations to not just align with, but actively contribute towards the SDGs. A study by the British Business Bank found that smaller businesses in Scotland are the least likely in the UK to find 'carbon jargon' difficult to follow, indicating a progressive attitude towards embracing social and environmental issues.[7]

Pillar 4: Ecosystem enablers

Enablers are the actors who facilitate the growth and functioning of the impact ecosystem, without necessarily providing capital. They range from research centres and academic institutions, to advisory firms, educators and professional services such as lawyers and auditors, as well as industry associations and business and investor networks.

Specialised infrastructure, networks and expertise are often necessary to build the impact investing ecosystem. While many advisory and professional service firms have a presence in Scotland, few have a dedicated focus on impact. Within the broader responsible and ethical finance space there are some advocacy, advisory and research organisations, such as the Global Ethical Finance Initiative (GEFI); and a number of topic-specific platforms for Scottish business leaders to work collaboratively, like the Scottish Circular Economy Business Network. Scottish Financial Enterprise are the representative body for Scotland's financial services industry, with a vision to create a stronger, more inclusive and sustainable industry that can play its part in solving the big challenges of our time, both locally and globally.

However, organisations we interviewed as part of this landscaping paper felt that debates and discussions on impact that take place in the rest of the UK, and especially London, often flowing from the advocacy of organisations like the Impact Investing Institute or individuals like Sir Ronald Cohen, do not have the same influence in Scotland. As noted by Social Investment Scotland "this advocacy has not really reached Scotland in an obvious way. It hasn't been aligned with our ecosystem and Scotland's' investment market is quite different and distinct to the rest of the UK". As a result, as one interviewee stated, it is hard to "think of anyone who really drives the impact investing ecosystem in Scotland in a connected way".

Pillar 5: Government and public institutions

Governments can catalyse the ecosystem through policy making, regulations and public investments. They can do this either by direct financing, or setting up and funding operationally independent organisations, such as development banks.

The Scottish Government has a clear aim to create opportunities for all by growing the economy in a sustainable way. This vision has been articulated in roadmaps set out in Scotland's Economic Strategy, integrating strong social components in order to increase competitiveness and tackle inequality, while respecting the environmental commitment to reach carbon neutrality by 2045.

Scotland's enterprise agencies all play a role in the impact ecosystem. Scottish Enterprise is the national economic development agency and seeks to drive business innovation and encourage investment in business, alongside two economic and community development agencies for the Highlands and Islands of Scotland (HIE) and South of Scotland Enterprise (SOSE), responsible for Dumfries and Galloway and the Scottish Borders.

The Scottish National Investment Bank is Scotland's publicly-owned investment and national development bank. The Bank was established by the Scottish Government to invest in businesses, projects, and communities to deliver positive environmental and social impact alongside financial returns for the people of Scotland.

Since its launch the Bank has concluded 22 investments, committing a total of £300 million of investment via debt, equity and external funds, with a particular emphasis on patient investment. A further £550 million of capital from third parties has been committed alongside the Bank's investments. The Bank can invest on a scale from £1 million to £50 million and has a particular emphasis on supporting companies to scale their operations.

The Growth Investment Team within Scottish Enterprise invest in and support early-stage Scottish companies. This includes providing loan funding through the Scottish Loan Scheme as well as co-investment funding through its Scottish Co-Investment Fund and Scottish Venture Fund.

Finally, alongside these public organisations, the Scottish Government has initiated a number of taskforces explicitly focused on providing routes for impact capital, such as the Green and Sustainable Finance Taskforce and the Green Heat Finance Taskforce.

A single regulatory framework operates across the UK, with regulated financial services firms supervised by the Financial Conduct Authority (FCA) and, in certain circumstances, the Prudential Regulation Authority (PRA). The regulatory and disclosure landscape for ESG and sustainability impacts is evolving rapidly. Last year the FCA became the first securities regulator to introduce mandatory disclosure requirements for asset managers and asset owners to align with the Taskforce on Financial-Related Climate Disclosures (TCFD), and are currently consulting on a product labelling regime that would make use of word 'impact' a protected term.

1. Investing with Purpose: global capital investment plan.
2. 2% of Scottish businesses use equity investments for growth. British Business Bank, Finance Survey, 2019.
3. Business-led inclusive growth in the South of Scotland.
4. Ambitious Entrepreneurship in Scotland – Unlocking Ambition.
5. Shaping Scotland's Economy – Inward Investment Plan.
6. Nations and Regions Scotland: Private Equity and Venture Capital Creating Public Value. BVCA (November 2022).
7. British Business Bank, Smaller businesses and the transition to net zero, 2021.

Part Two: The impact investing landscape in Scotland continued

2.3 Focus areas for impact investing in Scotland

Impact investments are designed to contribute to solving social and environmental challenges. This means impact opportunities need to be driven by the needs of Scotland, in line with the vision for a national well-being economy based on the principles of prosperity, equality, sustainability and resilience.

Some of these needs and services – for example, the delivery of health and education services – may be met through funding from public sector investment.[1] However, public sector investment alone will not be enough to respond to the range of challenges facing Scotland both now and in future. Increasing the flow of private capital has the potential to create positive impacts that can support Scotland's economic, social and environmental transformations.

The Scottish National Investment Bank has been established to focus on three 'grand challenges' for impact investing in Scotland: **achieving a net zero economy; addressing the innovation and productivity challenges facing the nation;** and **tackling place-based inequality**.

This section reflects on conversations with investors and ecosystem actors as to what these mean for investors using the dual lens of commercial and impact potential.

Challenge: Achieving a net zero economy through decarbonisation

The Chair of the Scottish National Investment Bank has called the transition to net zero as "the most important industrial revolution that the planet has ever seen".[2] There is a prominent role for private capital to finance this transition, but a vast amount of work is required in order to develop technologies and crowd in private capital. The need to increase investment to meet Scotland's net zero ambitions is immediate, but a number of elements of the transition are not yet commercially viable or haven't passed proof of concept. The catalytic nature of impact investing can here play a key role.

Scotland is well-positioned to undergo the transition and meet its ambition of a Net Zero economy by 2045. With a quarter of Europe's offshore renewable energy potential, a number of interviewees spoke about the volume of opportunities in renewable **energy generation** and **supporting technology** such as energy storage. A new generation of major offshore windfarms in Scottish waters are in development and posed for commercialisation. Impact investors can support the scale-up of innovations such as floating offshore wind – Scotland having deployed the first floating array in the world – as well as helping local supply chains both absorb and accelerate the capacity to rapidly deploy renewable infrastructure.

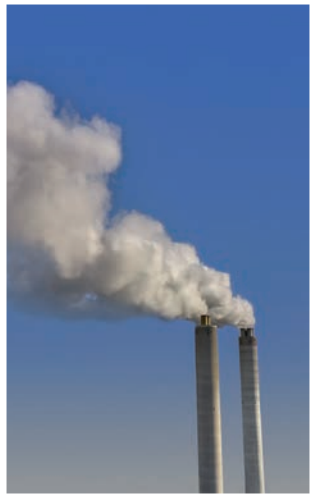
Reducing Scotland's heat demand at the same time as **accelerating energy efficiency** and **decarbonising heat** are some of the most challenging elements of achieving net zero. The volatility of global energy markets has once again highlighted the need for property owners, both residential and business, to better insulate buildings to reduce the amount of fuel needed to heat them. Impact investments can be made directly into solutions such as heat pumps and storage as well as the infrastructure, such as heat networks, required to deploy them. Large-scale heat decarbonisation is, however, not yet commercially viable and retrofitting existing building stock is particularly complex and expensive. Here, innovative funding approaches and new market models or financial products aiming to drive down the costs of decarbonising the heat in buildings are required.

The transport sector is currently the greatest contributor to Scotland's emissions. **Accelerating the decarbonisation of transport** requires policies and incentives to encourage behaviour change and demand-side, particularly with regards to private vehicle usage. It also needs innovation in technologies and infrastructure required to accelerate the uptake of more environmentally friendly alternatives such as electric vehicles, both in terms of affordability and easy access to the charging stations required for these to be a viable consumer option.

Alternative fuels such as hydrogen can provide a sustainable alternative to burning fossil fuels. Some investors interviewed for this report saw that green hydrogen in particular has the potential to play a key role in accelerating the decarbonisation of the transport sector. One investor spoke about the appetite to make investments in hydrogen technology, given Scotland is well placed to produce and export significant quantities of renewable hydrogen from its wind resources and potential tidal power. However, there are concerns about the economic and commercial viability of the business model, and further innovation is likely required to explore the market mechanisms that can best support hydrogen production and use.

1. As stated in the Scottish Government's "Investing with Purpose: global capital investment plan.
2. Unleashing the Positive Power of Impact Investing.

Part Two: The impact investing landscape in Scotland
continued



Myth 4: Every impact theme is currently investable.

Reality: Most impact investors seek commercial returns while producing a positive impact, and there are many examples of where this has been done successfully. However, many of the challenges facing the world cannot currently be 'solved' whilst making market-rate returns. Research into the Netherland's carbon cost curve shows that just under 50 million tonnes of the required 2050 emission reduction target of 160 million tonnes will be profitable without a change in policies or significant technological gains.[1] The research concludes that a future in which investment does not require reducing profits in favour of impact requires changing the rules of the game – through carbon pricing, subsidies or regulations – so there are a greater number of opportunities where it would be profitable to reduce carbon emissions.

Box 7: Example investment responding to the net zero challenge

Circularity Capital acquired a 50% stake in Green Home Systems in 2020. Green Home Systems is a Scottish-headquartered business specialising in the installation of energy efficiency measures to domestic properties living in fuel poverty. The Green Home Systems mission in Scotland is "to eradicate fuel poverty and end climate change by making communities' energy efficient and carbon-neutral, and doing this by creating warm, healthy, and happy homes."

Around 3.2 million properties across the UK currently live in fuel poverty. Furthermore, 70% of all UK homes (19 million) are below the target EPC C standard required to reduce carbon emissions, with 18% of all UK carbon emissions derived from residential properties. Fuel poverty is devastating for low-income families. Green Home Systems, works with people who otherwise wouldn't be able to afford home upgrades. Through the use of insulation and heating, they aim to provide a warm environment for families in Scotland who need it most, helping improve the quality of life for homeowners.

Green Home Systems is also supported by the UK's long-term commitments to both reducing the carbon emissions from domestic properties and tackling fuel poverty. It operates within the regulatory backed Energy Company Obligation (ECO) market that obligates UK energy companies to deliver targets across fuel poor households by funding the installation of appropriate measures.

Green Home Systems offers thermal insulation, smart heating systems, renewable energy technologies and electric vehicle charge points. Their energy saving solutions help households save money by reducing heating bills, increasing the level of comfort in homes, reducing noise and improving the wellbeing of Scottish residents.

Circularity Capital's investment in Green Home Systems is aligned with its strategy to invest in business delivering premium financial returns alongside measurable positive environmental impact versus business as usual.[2]

Challenge: Innovation and productivity

Scotland's productivity is below both the UK average and the median productivity for Organisation for Economic Co-operation and Development (OECD) countries. According to research by the University of Glasgow, the breaks are being put on Scotland's productivity potential are in part due to a digital technology skills gap and a lack of innovation stemming from new products and services. Scotland has one of Europe's most highly educated workforces, but it also has the highest number of adults without any qualifications in the UK.

Low levels of business dynamism can limit employment opportunities and quality job creation – both of which are critical as Scotland seeks to become a Fair Work Nation. If Scotland's productivity matched that of the OECD top quartile, average annual wages would be almost 10% higher.[3]

Too few good ideas are turned into businesses, and too few Scottish new businesses are scaling up successfully according to the National Strategy for Economic Transformation, which identifies health & life sciences, digital, and high value manufacturing as the sectors that are the most likely drivers of future economic demand in the economy.[4] Scotland already has one of the biggest life sciences clusters in Europe, with over 40,000 people working on medical technologies and pharmaceutical services, precision medicine, advanced therapies, digital health and care, industrial biotechnology, animal health and agritech.[5] This sector offers particular opportunities for impact investors, with a growth of investing in areas that address some of the health inequities revealed by the Covid-19 pandemic.[6]

Sources of financing for small and medium enterprises (SMEs) have shifted in recent years. Bank lending has been increasingly difficult to access following the Global Financial Crisis, particularly for businesses with financing needs between £100,000 and £1 million. The private debt market, according to the British Business Bank, "is often the only, or most viable funding solution for SMEs… who require flexibility in terms of a financing structure".[7] In Scotland, there is an opportunity for impact investors to direct SME lending towards SDG-aligned businesses and to meet social and environmental infrastructure needs.

Scotland has a low rate of business start-ups, lagging behind the rest of the UK by 150 companies per 10,000.[8] Seed-stage venture firms focus on building a vibrant community of technology entrepreneurs and companies. In Scotland, interviewees were divided, with some saying that Scotland has always had a very strong venture capital space and others agreeing with recent studies – such as the Scottish Technology Ecosystem Review – that it is now much weaker.[9]

1. Harvard Business Review, Impact Investing Won't Save Capitalism, 2020.
2. Circularity Capital invests in Green Home Group, 2020.
3. Scotland's National Strategy for Economic Transformation, 2022.
4. Ibid.
5. Life Sciences in Scotland.
6. Business Wire, Acclaimed Life Sciences Leaders Launch Impact Investment Firm to Accelerate Health Equity, 2022.
7. British Business Bank, UK Private Debt Research Report 2020.
8. The Productivity Institute, Scotland's Productivity Challenge, 2021.
9. See the findings of the Scottish technology ecosystem review.

Part Two: The impact investing landscape in Scotland continued

One of the challenges to a thriving venture capital space in Scotland is the collaborative based nature of technology start-ups and the need to have a strong ecosystem where success breeds off others. Another challenge was simply the fact that the market size in Scotland pushed many growing businesses out of Scotland and into the south of the UK – predominately London - where there is greater access to talent, capital and customers that can support the next stage of a company's growth. A recent survey of Scottish tech sector start ups found that despite the overwhelming majority (93%) of respondents saying that Scotland is a good place to launch a startup, 88% said they were seeking investment outside Scotland to their growth trajectories.[1] There is an acknowledged funding gap for scaling businesses in Scotland, particularly those with financing needs in the £3 million to £20 million range.[2]

Box 8: Example investment responding to the productivity and innovation challenge

SIS Ventures invested £100,000 in Manus Neurodynamica in 2020. This was part of a £1.2 million funding round alongside investors including the North East Innovation Fund and Old College Capital, the venture fund of the University of Edinburgh. An earlier financing round of £750,000 was led by the Edinburgh-based venture capital investor Par Equity, alongside support from the investment arm of Scottish Enterprise.[3]

Manus Neurodynamica is a medical technology company based in Edinburgh which aims to change the way neuromotor impairments are diagnosed. The company has developed its patented NeuroMotor Pen which provides early warning signs of Parkinson's disease and other neurological conditions.

Patients use the pen to perform standardised handwriting and drawing tasks on a tablet computer. The pen contains an analytical engine system and decision support system which non-invasively records parameters of minute limb and hand motions to enable diagnosis and monitoring of neuromotor impairments.


Image courtesy of manusneuro.com

With around 145,000 people living with Parkinson's in the UK, Manus Neurodynamica has significant impact potential. The technology could improve the efficiency of patient diagnosis and monitoring, leading to reduced costs and greater convenience for clinicians, as well as improved experience and quality of life for patients.

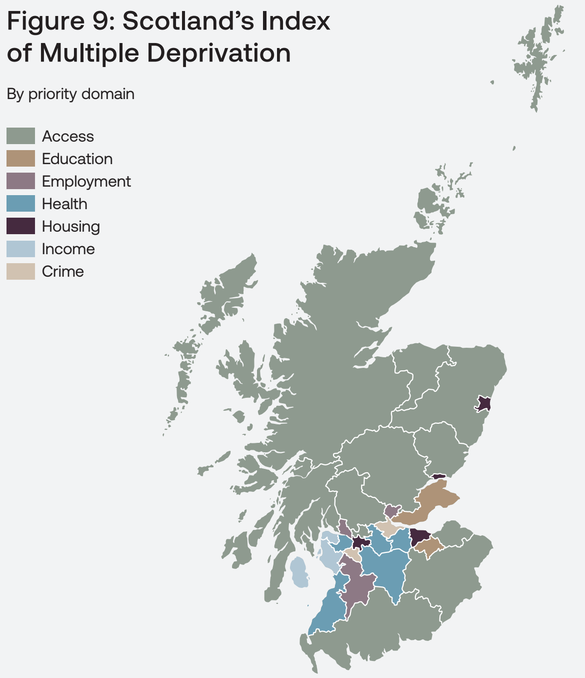
The NeuroMotor Pen has now been launched in the UK and Benelux markets, and work is underway to secure regulatory approval to start selling in the US. In addition, the pen has passed clinical trials with the NHS in Scotland and the North East of England, and is currently being used by Northumbria NHS Foundation Trust.

Challenge: Inequalities around place

Deep-seated regional inequalities exist across Scotland. The Scottish Index of Multiple Deprivation provides a data-driven insight into the different social needs that exist across the country. Figure 9 shows issues such as Housing (overcrowding and conditions) as being the greatest indicator of deprivation in urban areas; with Education, Employment, Income and Health also prominent in the Central Belt; and the more rural, remote and less densely populated areas having greater priorities in terms of geographical accessibility to basic services.[4] The same analysis at the neighbourhood level demonstrates that needs also vary locally within local authority areas, as they do across local authorities.

Figure 9: Scotland's Index of Multiple Deprivation

By priority domain



Contains OS data @Crown copyright and database right (2022).
Data source: Scottish Index of Multiple Deprivation.

Tackling the underlying causes of inequality in Scotland and providing economic opportunity is vital in order to improve life chances. However, the structural nature of these inequalities can make it difficult for investors to find opportunities to address inequality directly. Impact investors can focus on improving outcomes in a specific place – an emerging paradigm of place-based impact investing in Box 9 – and thematic issues that are associated with drivers of inequality.

For example, Scotland urgently needs more affordable homes across the country, but especially in areas of high demand like Scotland's major cities and certain rural communities. Building secure and affordable housing can contribute to real societal benefit as well as generating sustainable returns. Deprived areas of Scotland suffer from low levels of health and life expectancy, access to quality education and social care – especially in the context of an aging population. All of these themes which associated with impact investing opportunities, from innovations that meet the health needs of under-served populations, to businesses that provide training and employability services, to affordable aged care facilities.

Beyond social issues, the natural environment is under threat in many parts of Scotland. Greater investment in nature-based solutions, to protect and enhance Scotland's stocks of natural capital, can offer a long-term, cost effective and sustainable way to lessen the impact of climate change and societal pressures. The Green Finance Institute estimates that between £15 billion and £27 billion, in addition to current public funding, is needed over the next 10 years to restore nature across Scotland.[5]

1. Scottish Tech Sector Startup Survey 2022.
2. See Invest2Scale.
3. SIS Ventures, Manus Neurodynamica.
4. Issues include accessibility to public transport, excessive travel times to key services (GP surgeries, schools, retail centres, post offices and petrol stations) and digital connectivity.
5. Nature Scot, More than £500K announced for natural capital projects, 2022.

Part Two: The impact investing landscape in Scotland
continued

Box 9: Place-based impact investing as a strategic framework for scaling-up impact investing in Scotland

In May 2021, The Good Economy published a landmark White Paper on Scaling Up Institutional Investment for Place-Based Impact in partnership with the Impact Investing Institute and Pensions for Purpose.

We defined place-based impact investment (PBII) as: *Investments made with the intention to yield appropriate risk-adjusted financial returns as well as positive local impact, with a focus on addressing the needs of specific places to enhance local economic resilience, prosperity and sustainable development.*

We presented an original conceptual model of PBII that brings together places and investors around five 'pillars', underpinned by a solid social and financial rationale for investing. This was subsequently increased to six pillars to include natural capital. The pillars are dual structures. On the one hand, they represent policy objectives and priority areas in local and regional development strategies. On the other hand, the pillars are real economy sectors and investment opportunity areas that fall within institutional investment strategies and asset classes and have the potential to deliver risk-adjusted financial returns in line with institutional investor requirements.

Central to PBII is creating an alignment of interest and action among all stakeholders in shared impact creation for the benefit of local people and places. Stakeholder consultation and engagement is indeed fundamental to PBII. This type of investing is about 'boots on the ground rather than eyes on screens'.

The white paper defined five traits that define and distinguish PBII as an investment approach:

1. **Impact intentionality**
2. **Definition of place**
3. **Stakeholder engagement**
4. **Impact measurement, management and reporting**
5. **Collaboration.**

The PBII approach is well-suited to Scotland given its strong place identity and tradition of community engagement and place-based development approaches. We see place-based impact investment as a new paradigm or lens for investors more generally – combining an impact lens with a place lens. Such an approach could be used as a strategic framework for the scaling-up of impact investing in Scotland. We recommended five areas of action to scale up PBII: raise awareness and strengthen the identity of PBII as an investment approach, increase capacity and competency among both local stakeholders and investors, promote place-based impact reporting, connect investors and PBII opportunities, and scale up institutional grade PBII investment products. We envision a confluence of capital flows from private markets, government programmes and social investment into local economies and communities that could build on place-based strengths and create opportunities for all.

Box 10: Example investment responding to local specialist housing needs

Specialised supported housing (SSH) is a form of accommodation which is specially adapted to meet the needs of individuals with care and support needs (including learning and physical disabilities and mental health problems) who require specialised care and support to enable them to live independently in their communities. Demand for SSH across local commissioners is high due to a number of factors including the growing population of people with learning disabilities and government policy, which promotes moving people out of institutional settings to community-based housing alternatives that promote independent living. The social value proposition for SSH is widely accepted – it can deliver better social outcomes and can offer value for money for the public purse. In Scotland, it is estimated that there is a need to provide an additional 13,600 units of supported housing between 2015 and 2030.[1] However, there is no government capital grant available to traditional housing associations to deliver additional SSH to meet this demand. Therefore, private finance has an increasingly important role to play to meet the shortfall.

Heron Court is a 24-unit specialised supported housing (SSH) facility in Leith, Edinburgh. The scheme was forward funded by Triple Point Social Housing REIT Plc (SOHO), a specialist UK social housing fund with a focus on SSH which launched in 2017 and has to date, grown to provide over 3,400 homes across over 490 properties throughout the UK.

The scheme, which became operational in April 2019, is one of the first of its type to be delivered in Scotland. It was commissioned by Edinburgh City Council to provide homes for local people with long-term disabilities, including for those moving out of long-stay hospitals. All apartments are self-contained, meaning residents have their own front door, and the scheme is integrated into the community, located just over a mile from Edinburgh city centre. Each apartment also features specialised adaptations and integrated technology to enable residents to be as independent as possible. These features include wider doorways and hallways for accessibility, a centralised call system and adapted bathrooms.

Residents are referred into the scheme by the Edinburgh Health and Social Care Partnership, based on a significant level of local demand. Care services are provided to residents by Lifeways, while housing management services are provided by Inclusion Housing.

"Accessibility and technology are two important features of the design of the building which will enable residents to live more independently. Many of the residents will have keys to their own front door for the first time, which will provide a tremendous boost to their independence and have a positive impact on their lives."

Judith Proctor
Chief Officer of Edinburgh Health and Social Care Partnership[2]

1. Personal Social Services Research Unit, Projected Demand for Supported Housing in Great Britain 2015 to 2030, March 2017.
2. Social Care Today, Residents move into new supported housing development in Leith, June 2021.

Part Three: Towards a strengthened Scottish impact investing ecosystem

This section explores what a robust impact investing ecosystem in Scotland could look like. It then summarises the barriers and opportunities towards realising this vision. It ends with the outline of a roadmap to scale Scotland's impact investing market in a way that places the wellbeing of current and future generations at its core.

3.1 Characteristics of a mature impact investing ecosystem

Greater amounts of capital are required to make the most of the clear and present opportunity for impact investing to contribute to addressing the social and environmental needs outlined in Section 2. Given the volume of assets already being managed in Scotland - almost £700 billion – a core challenge will be to scale-up the allocation of investments that aim not just to 'do no harm' but actively seek to 'do good'.[1]

Echoing the Business Purpose Commission for Scotland's recent call to action, a vision for the investment community could be that by 2030, all investors in Scotland will have become purposeful investors which profit from supporting solutions for people, places and planet.[2] Doing this will require risk, return and impact to be routinely integrated into investment decisions as the 'normal' way of doing things within the financial sector. It will also require the support of an active, thriving impact investing ecosystem. Scotland is undoubtedly starting from a strong position, but much remains to be done to overcome constraints to scaling-up the impact investing market, especially related to size of deals and the current cost and time complexity of making an impact investment.

Box 11 summarises what a future mature, multi-stakeholder impact investing ecosystem might look like in Scotland. The remainder of this Section then unpacks what needs to happen to reach maturity. It is based on a series of key informant interviews with practitioners and market participants, and also draws on secondary sources across academic, government and investment literature.

Box 11: The key elements of a robust impact investing ecosystem:[3]

Characteristics of the current youthful impact investing ecosystem in Scotland		Characteristic of a mature impact investing ecosystem in Scotland
Niche market, with mostly social investment (into social enterprises and charities), angel capital and early stage venture capital, with some project and asset finance in renewable energy and nature-based finance	>	Diverse range of impact investments across asset classes incl. alternative investments, real estate, infrastructure and public markets
Mostly small investments, sub-scale for crowding in institutional capital	>	Full range of investments from small to very large, with more crowding in of institutional investment
Difficult to discover impact opportunities - high transaction costs and lower density of investable companies	>	High discoverability of impact opportunities - with investable prospects brought to market through new intermediations services, products, funds and innovative blended finance models
Uneven understanding of impact among segments of financial services industry and 'ESG-savvy' investors	>	High level of comfort and familiarity across the financial services industry as to what impact investing is, and how it differs from other responsible and sustainable investing approaches
A lack of market standards, regulation or norms to mitigate the risk of impact-washing or product mislabelling	>	A set get of guardrails to protect the integrity of impact investing, as assets scale drawing on established global norms, including the Impact Principles and Impact Management Project
Little differentiation between the range of approaches to ESG and sustainable investing with nascent infrastructure and ecosystem services to support impact	>	Specialised infrastructure, networks and expertise to help all actors adopt and scale impact investing strategies

1. As of 2021, Investment Association data. Note that a mix of responsible, sustainable and impact investing strategies will likely always be required. As argued by Tideline, if more companies avoided harm through responsible business operations, fewer impact investments would be required.
2. Now is the time for purpose: Putting purpose at the heart of Scottish business.
3. Adapted from Scottish Technology Ecosystem Review (2020).

Part Three: Towards a strengthened Scottish impact investing ecosystem continued

3.2 Barriers and opportunities for building the impact investing ecosystem in Scotland

Barrier 1: Small transaction sizes. The average size of impact investing deal-making in Scotland is smaller than the UK average.[1] In part this reflects the strong focus of activity in social impact investing and early-stage (seed and pre-series A) rather than larger later stage growth rounds - as explored further below. Data from Big Society Capital shows that the average value of social investment deals across the UK is 3.7 times larger than deals in Scotland.[2] While no data exists for the entirety of the impact investing landscape in Scotland, this pattern is likely to match the trend seen across financial assets more generally. For example, according to KPMG analysis of PitchBook data, the average venture capital deal size in Scotland in 2022 to-date is $3.6 million, broadly comparable to the European average median deal size for early-stage VC ($3.4 million), but less than half that of later stage, Series A and B, investments ($8.8 million).[3] Analysis by the British Business Bank shows that whilst Scotland's share of the total number of UK equity deals is broadly in line with its share of UK businesses and business births, its share of the total value of UK equity deals is considerably smaller.[4]

However, many investors - especially those managing institutional assets - gravitate towards larger deals as they are easier to finance, both in terms of economies of scale and to meet client mandates. This creates a mismatch between 'ticket sizes' – the minimum amount that an investor is prepared to put into a company – and investment opportunities. As one asset manager told us: *"If I am looking for a client who has given us a lot of money, and there's a choice between ten £10 million deals or a £100 million deal… you'd probably go for the 100 million deal. But my guess is if we aggregate up the impact of 10 deals, it is probably much more beneficial to Scotland than the single £100mn deal".*

> *"Impact funds often struggle to get LP capital. A reason for this is because most impact funds are emerging (less than a billion of AUM). Investors prefer to invest in large well established fund managers for all kinds of reasons. But impact investing is overwhelmingly undertaken by emerging managers. This creates both a need and opportunity for investors. Scottish based and focused impact managers suffer from a double challenge, they tend to be emerging managers and as the bulk of impact managers and investors are in London, they are the ones that get seen and tend to get the available capital."*
>
> **Zamo Capital**

Barrier 2: (In)Adequate deal flow. Depending on where interviewees sat in the impact value chain, they either saw a healthy pipeline of investment opportunities, or a lack of impactful deals. Those who were more bullish tended to invest at the earlier stage, often with more of a social investment focus, and noted a lot of entrepreneurial activity in Scotland that could be considered impactful. Initiatives to identify and support Scotland's up-and-coming, innovative companies - like Scottish EDGE - were seen to be throwing up a lot of "impact ideas", even if not explicitly designed to do so. Those who were more bearish tended to be investors focusing on larger deals and looking to deploy at scale across asset classes such as private debt, equity and real assets. From these respondents, we heard a sentiment that Scotland has been disproportionately good at starting up companies, but bad at developing them - creating a 'missing middle' between promising start-ups and a few very large companies.

1. According to Scotland's global capital investment plan, equity investment deals in Scotland tend to be lower on average compared to the UK average. In 2018, for example, Scotland secured 7% of all UK deals but only 3% of value.
2. Based on TGE analysis of BSC portfolio data, at an average deal size in Scotland of £229,000 compared to £864,000 across the UK (and £1.316 million in London).
3. Venture Pulse Q1 2022 (assets.KPMG) and Scottish innovators attract half a billion during first – KPMG United Kingdom (home.kpmg).
4. Regions and Nations Tracker: Small Business Finance Markets, 2021, British Business Bank.

Barrier 3: High origination costs. Potential deals need to be identified in order to flow into the investment pipeline. Investors spoken to were realistic that, outside of a social investment context, they would not be able to find enough deals to be able to develop an impact investment product or deploy capital with a focus solely on Scotland. The practical implications of a pan-UK, pan-European or global strategy, however, are that impact opportunities in Scotland may be being missed - especially outside of urban centres like Aberdeen, Edinburgh and Glasgow given the dispersed nature of Scotland's population. This deal 'origination', in investment jargon, requires an investor to have either 'boots on the ground' themselves to identify regional opportunities, or to access a network or service identifying opportunities on their behalf. Neither of these are well-developed in Scotland for impact at present. As noted in Scotland's global capital investment plan, the nation's topography, population density and location mean there is a lower density of investable propositions in Scotland, creating higher transaction costs to source them.[5] We often heard from interviewees that there is a lack of deals being originated from Scotland that fit both their commercial and impact criteria.

> *"Unless you've got a very specific regional or national remit, you don't restrict your investment horizons. My fiduciary duty to my clients is to find the best investment opportunities available to them. If those investment opportunities happen to be in Scotland that's win-win, but I would say on the balance of probability the chances of that win-win are not that high, given the current size of the market in Scotland."*
>
> **William Gilmore, Time Partners**

Barrier 4: Lack of identity. The consensus among all interviewees is that there is not yet a specific impact investing identity or community in Scotland. Aside from the strong social investment scene, driven by organisations such as SIS, Edinburgh is seen as having a relatively small ecosystem around impact investing, largely connected to universities like Napier's research on Scottish impact investors, or from the decisions of Edinburgh University to allocate a portion of its endowments towards impact.[6]

Initiatives to define what it means to be an impact investor have to date been led by the market itself through industry trade bodies or initiatives.[7] However, regulatory bodies have recently expressed an interest in establishing criteria for the use of the 'impact' label, often building on these market standards and to counter rising concerns over "impact and SDG washing". This challenge is not unique to Scotland, but is being felt across all jurisdictions. The EU's sustainable finance architecture, especially SFDR, is seeking to provide some clarity with regards to disclosures. The FCA recently issued a set of Guiding Principles, setting out that a fund should only be described as an 'impact' fund if it is seeking a "non-financial (real world) impact, and if that impact is being measured and monitored".[8] The UK's Sustainable Disclosure Requirements (SDR) – currently open for consultation – are designed to streamline sustainability-related reporting requirements, as well as setting out a product labelling regime for what can be marketed as 'impact'.

5. Scotland's global capital investment plan.
6. Impact investment (napier.ac.uk) and The University of Edinburgh | Big Society Capital.
7. For example the GIIN and the Impact Principles.
8. High-level features of an impact-labelled product are expected to be further refined as part of the UK's upcoming investment product labelling regime.

Part Three: Towards a strengthened Scottish impact investing ecosystem continued

Barrier 5: Gaps in market infrastructure. Scotland has a well-developed infrastructure for financial services, home to leading banks, asset managers, fund administrators, investment consultants and insurance companies. In modern economies, the majority of investment activity is intermediated - that is, carried out via financial advisers. Interviewees noted that there is a lack of awareness and understanding of impact among these advisers. Asset owners who want to invest for impact can be prohibited from doing so if the 'gateway' between capital and impact investment opportunities is not open. The lack of an effective intermediation function between capital supply and demand was repeatedly mentioned during interviews as a barrier to bridging the gap between impact potential and practice. This applies both upstream (capital owners looking to invest) and well as downstream (managers looking to deploy capital). As noted by Abrdn, "if we're looking for a Scottish investment, we need to know where to go". Again, this a challenge facing the global impact investing sector, but in the context of growing Scotland's nascent market, it creates particular barriers to scale.

> *"A challenge for Scotland is that there is a perception of a lack of available scale-up finance for the commercial development of exciting new technologies coming out of Scottish universities. These technologies can often be funded through the early stage university phase however beyond that and then there is felt to be a gap in terms of the availability of scale-up funding. The Northern half of the UK is considered to be disproportionally underserved by access to such development funding given the opportunity set in the North."*
>
> **Strathclyde Pension Fund**

Opportunity 1: Impact is moving from the margins to the mainstream. "Every fund has an impact", says Jamie Broderick of the Impact Investing Institute, "but not every fund is labelled as impact". As noted in section one, there is a growing interest among asset owners and asset managers to understand how their investments are impacting on people and planet. Many of these managers are on a journey to shift from 'ESG' (primarily focusing on social and environmental risks that are material to financial returns) to 'impact' (focusing on the range of effects a business and an investment has on people and planet - so-called stakeholder materiality). This interest is partly driven by wider consumer trends, with the next generation of investors more interested in where their money is going and what it is doing.

Some market participants are starting to make a distinction between investing for impact - where outcomes are deliberately and explicitly pursued - and investing *with* impact, where any positive effects are a by-product of business-as-usual (for example, investing in a wind farm because it is a growth sector). There is a growing interest among asset managers in understanding and measuring the real-world impact of their investments. As they do this, it is likely that more investment strategies will shift from having an incidental impact towards those that more intentionally contribute to solving social and environmental challenges.

> *"There is a distinct difference between impact investing and all that comes with that, and understanding the impact of our investments. How can we better measure the outcomes of our investments even if they are not fully-fledged impact investments? We want to know if they are having an impact with a small 'i'."*
>
> **Dan Grandage, Abrdn**

Opportunity 2: Scotland is already a financial hub and has already at the forefront of responsible investment, so is particularly well-positioned to participate in this shift. Edinburgh is ranked in the top ten financial centres in Europe in the latest Global Financial Centres Index (GFCI 32). Glasgow was ranked in 17th place, a rise of 9 places compared to the previous year.[1] Scotland has already successfully embraced ethical and sustainable investment in part thanks to the research and leadership of the Ethical Finance Hub based in Scotland. Their research found that Scotland-based investment funds manage 11% of the UK's responsible investing market, compared to a 7% share of the conventional market. The move to impact can therefore build on Scotland's heritage in responsible investing and its prudent management of capital.[2]

> *"One of the benefits that Scotland has is Edinburgh's history as a financial hub and innovator. It has a reputation for prudent management of capital and a strong focus on sustainability so there is an opportunity to position Scotland as a real centre of excellence for circular economy. I think the government can play a role in supporting this, and that is likely to require a broader indication of its long-term commitment to supporting the investment ecosystem in Scotland more generally."*
>
> **Circularity**

Opportunity 3: For Scottish investors, place matters. Many interviewees spoken to as part of this report are asset managers and investment houses with headquarters in Scotland, but not necessarily lending or making investments in Scotland. However, all emphasised a strong connection to Scotland, and there was clear appetite for directing capital towards positive outcomes in "our own backyard". For many, reinforcing these Scottish links is seen as an important differentiator, as part of their founding values, and something that individuals in their institution – from staff to the Board – deeply cared about. This does not necessarily mean, however, that both sides of the capital supply-demand transaction have to be located in Scotland. As one interviewee noted: *"If the Scottish investment opportunity is good enough it will attract capital - that capital is as likely to come from south of the border as it is from Scottish sources".*

Opportunity 4: Scotland has a supportive environment for impact investing – perhaps more so than the rest of the UK. All of the ingredients in terms of support from government, consistency of policy direction and clarity of strategic vision that were so beneficial to the development of the social enterprise sector in Scotland could likewise be harnessed to build momentum around impact investing. Scotland's values centre around a net zero economy with the principles of fair work and sustainable, inclusive growth at its heart are highly aligned with themes pursued by impact investors.

1. SFR, Edinburgh, Glasgow Rise In Financial Centres Index, 2022.
2. Ethical Finance Hub, Mapping the Responsible Investing Landscape in Scotland, 2020.

Part Three: Towards a strengthened Scottish impact investing ecosystem continued

3.3 A roadmap for scaling up impact investing in Scotland

Scotland is at a critical juncture for meeting its climate commitments and realise the bold ambition to reduce emissions by 75% by 2030 and reach net zero by 2045. The cost of living crisis is deepening place-based inequalities by the day. And without improvements in a broad range of education, health and well-being outcomes alongside greater business dynamism, Scotland's productivity and innovation potential will remain locked. The time for action – and investment – is now.

Scotland is already a leading centre of investment activity with a large investment management industry with a track record in responsible investing. What would it take to make Scotland a leading globally established hub for impact investment? The starting point for what could become, over time, a roadmap to building out and scaling up Scotland's impact investing market is set out in Box 12.

Box 12: Stakeholder-informed solutions for addressing constraints to a mature, scalable impact investing ecosystem in Scotland[1]

Barrier(s)	Aim	Potential solutions
Lack of identity	Clarity on what impact investing is, and is not, in the context of Scotland – with clear principles and standards of practice	◆ **Shape.** Public agencies and industry bodies can play an active role in helping shape, frame and contextualise emerging impact standards and principles with reference to Scotland's challenges and opportunities. ◆ **Signal.** Investors can become an early adopter of these emerging practice standards and impact management norms, thereby signposting wider market participants towards good practice. For example, SIS Ventures is the first Scotland-based signatory to the Impact Principles, and the Scottish National Investment Bank will formally adopt them by the end of 2022. ◆ **Convene.** Establish a Scottish 'community of practice' and alliance of impact investors across the spectrum of capital; build networks with SMEs and project originators at the local level so as to create an impact ecosystem and networked marketplace. ◆ **Specialise.** Position Scotland as a centre of excellence for high-potential themes such as the just transition or the circular economy – building on and linked to wider initiatives within the sustainable finance community such as the Scottish Task Force for Green and Sustainable Financial Services. ◆ **Champion.** Recognising that 'success breeds success', curate a series of high-profile case studies that show what good impact investing looks like and the benefits it can bring.

1. Inspired by GIIN Roadmap.

Box 12 continued

Barrier(s)	Aim	Potential solutions
Small transaction sizes; deal flow	Better flow of impact capital that meets the risk-return-impact expectations of a range of investors	◆ **Innovate.** Develop impact investing products suited to the needs and preferences of a spectrum of investors, from institutional to retail, and across the business life cycle from seed to scale. ◆ **Catalyse.** Seed impact strategies that address new themes, and help emerging Scottish impact managers build track record. Explore how public financing could be deployed in blended models and to unlock new capital – for example through the cornerstone role often played by development banks. ◆ **Scale.** Design mechanisms to bring transactions in scope of wider institutional investors, whilst simultaneously delivering outcomes for Scotland. This can include pooling or developing fund structures that allow for the aggregation of smaller investments into scalable investment products. Earmarking and carve outs could allow investors exposure to opportunities in Scotland. ◆ **Mobilise.** Raise awareness and attract the interest of a broader range of Scottish asset owners in developing impact investing allocations, for example local government pension schemes and universities.
High origination costs; Gaps in market infrastructure; deal flow	Specialised tools and services that support the incorporation of impact into the analysis, allocation, and deal-making activities of investors	◆ **Research.** Undertake a rigorous market sizing exercise to baseline the size of the impact investing market in Scotland, and identify all investors and actors who are – or who have the potential to be – part of the market. ◆ **Share.** Develop a market map laying out key impact and commercial potential for different themes. Open-sourcing 'oven ready' impact theses could lower the barriers to entry to those new to the approach. ◆ **Uncover.** Improve the discoverability of impact opportunities – with investable prospects brought to market through new intermediaries, services, products, and platforms that facilitate deal flow and smooth the origination of impact opportunities. ◆ **Engage.** Engaging with government, local authorities, universities, and with a broad tent of investors in Scotland and beyond to help the facilitation between impact opportunities and capital.

Part Three: Towards a strengthened Scottish impact investing ecosystem continued

Box 12 continued

Barrier(s)	Aim	Potential solutions
Gaps in market infrastructure; deal flow	All actors across the ecosystem are empowered and improve their competencies and capacities to originate and make impact investments	◆ **Build.** Help those acting at a local level, including mission-driven enterprises, to develop the skills and build the capacity they need to develop investable proposals and understand financing requirements of impact investors. ◆ **Signpost.** Create awareness of the wealth of ecosystem resources that already exist on impact investing – from low-cost training to online learning hubs (see Appendix 2) – and make use of these to upskill those already in the financial services industry. ◆ **Leverage.** Build links to Scotland's strong higher education and skills development providers to create a mutually reinforcing education ecosystem in support of the next generation of impact investing professionals. ◆ **Strengthen.** Build the capacity and presence of impact advisers to be able to offer value-added support and help impact investing scale with integrity.

Box 13: The role of national development banks in catalysing an impact investing ecosystem

National development banks play a key role as both a participant in the impact investment market and as a catalyst, encouraging other players to enter the impact ecosystem or increase their activity within it.[1]

As a *market participant*, development banks support the impact investment ecosystem through the commissioning and procurement of impact products and services. This reflects emerging thinking on the role that development banks – as well as public institutions more widely – can play in shaping and creating markets, rather than just 'fixing' market failures. Banks are developing new financial tools that also help to reform the financial system from within, addressing issues of short-termism and signalling the viability of new products, strategies and themes with their 'skin in the game'. As the long history of international development banks demonstrated, the aim is to unlock an underserved market where the private sector is not yet investing – but has the potential to do so in a way that brings about high development impact.

As a *market facilitator,* development banks can help create the systems to enable and educate on impact. Typically, this involves becoming a centre of expertise on specific sustainability issues, commissioning research, or convening field-building activities – such as conferences or training courses.

Development banks seek to lead by example. A core group of development finance institutions, for example, were among the first signatories to the Impact Principles, a set of market how to manage investment portfolios towards impact, which now has over 100 signatories including large commercial institutions such as BlackRock.

Prominent national development banks include The Canadian Infrastructure Bank, Green Bank of Connecticut and Invest NL of Holland, founded at the same time as The Scottish National Investment Bank. The most frequently cited example of a pioneering development bank is KfW, which has transformed from an institution for German reconstruction into a nationally and globally active bank working for sustainability. Over seven decades it has provided more than €1.7 trillion in loans,[2] now raising virtually all fundings through the issuance of debt obligations in international capital markets, rather than relying on how it started with public funds.

1. Based on GSG NAB guidance.
2. KFW, Celebrates 70th Anniversary.

Conclusions

The findings of this report reflect what we have seen and heard in the market since The Scottish National Investment Bank was set up two years ago: that the types of social, environmental, and economic challenges that require impact investing are clear and present in Scotland, as are the opportunities to address these challenges through investment.

Through expert interviews and analysis we can now understand the Scottish market better, having built an estimate of c. £4 billion of funds already invested in impact businesses and projects. But, as this paper sets out, there are significant volumes of funds that could be further deployed towards impact investment with the right understanding and motivation to do so.

Key to this will be overcoming the barriers that are currently inhibiting the growth of the impact investment market in Scotland. These can be summarised as:

- A need to broaden the size and timing of impact investments: today, they are concentrated in earlier-stage businesses, whereas institutional investors are seeking (and often struggling to find) larger-scale opportunities to deploy capital in Scotland. This also includes a need to increase the size of impact investment funds, if institutional-level capital is to be unlocked.
- The time, complexity, and therefore cost, of making impact investments needs to come down. Deepening understanding of how impact investment works – including establishing a definition and narrative for the market, as well as agreed standards – amongst both the financial services and broader business communities is key to this.
- The ecosystem around impact investing – from providers of capital, through to business and projects, consultants and advisors, and policy makers – needs to be built out further and become mutually reinforcing. No single actor or sector can make the market grow and thrive; it depends on a broad range of interdependent players to coalesce around a shared vision and understanding of the objectives and opportunities for impact investment in Scotland.

As we look to the future, The Scottish National Investment Bank is keen to play a central role in bringing together and broadening the impact investment community in Scotland. Through this, we hope to grow and strengthen the network of individuals and organisations that are working together to deploy capital at scale and with impact, leveraging finance to address some of the major challenges facing Scotland today and in the years to come.

Appendix 1: List of interviews

- Abrdn
- Big Society Capital
- Circularity Capital
- Edinburgh Napier University
- Global Ethical Finance Hub
- Green Angels Syndicate
- RM Funds
- Scottish Enterprise
- Social Investment Scotland
- Strathclyde Pension Fund
- Time Partners
- Zamo Capital

Appendix 2: Further reading

The following are intended as useful resources to understand and build knowledge of impact investing, and practices such as impact measurement and management.

- **Impact Frontiers:** A peer learning and market-building collaboration, developed with and for asset managers, asset owners and industry associations
- **Impact Principles:** A market standard for impact investing in which investors seek to generate positive impact for society alongside financial returns in a disciplined and transparent way
- **GSG Resources:** Brings together leaders from finance, business and philanthropy to solve some of the world's most pressing social and environmental challenges.
- **GIIN Case Studies:** The GIIN aims to bring greater transparency to the market by sharing diverse examples of impact investments
- **Impact Investing Institute Learning Hub:** Resources designed to accelerate the growth and improve the effectiveness of the impact investing market in the UK and internationally.
- **UK SIF:** A membership organisation for those in financial services who are committed to growing sustainable and responsible finance in the UK.
- **GEFI (The Global Ethical Finance Initiative):** A hub for conversations and research within ethical finance.

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