

SOCIAL FINANCE TAXONOMY IN TRANSITION TOWARDS A MORE SUSTAINABLE ECONOMY

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Abstract. *The successful development of a sustainable economy and society in together with the Sustainable Development Goals (SDG-2030) requires comprehensive and coordinated efforts of governments, businesses and civil society in order to establish unified and clear rules and regulations for economic activity. In order to reach this goal the European Union begun the development of EU sustainability taxonomy, which is to ensure an equal understanding of the content of activities of enterprises, projects and investments that meet sustainability criteria. So as to realize the potential of the market for social investments and loans, unification of approaches for understanding the main concepts of the social financing process is necessary.*

The purpose of the study is to develop proposals for the classification of subjects and objects of the subsystem of social finance consistent with sustainability taxonomy. The research applies methods of induction and deduction, scientific abstraction of theoretical generalization and comparative analysis while studying definitions, best practices of social investment and for developing the classification of social impact investments and social enterprises. The article provides coherent analysis of the formation of social entrepreneurship and finance in Ukraine. Based on the results of the study, the most relevant classification features of social enterprises and investments were developed and recommendations were made for integrating social finance taxonomy into sustainability taxonomy. The results of the research are of both theoretical and practical value.

Keywords: *social finance, social impact investing, taxonomy.*

Introduction

The world is changing as swiftly as it has never before and moving in the direction of creating the economy and society on the principles of sustainable development.

The adoption of the coordinated Program of Action by 2030 in 2015 at the 70th session of the UN General Assembly, which identifies 17 goals of sustainable development of economy and society (SDG-2030), was the impetus for further approval of the sustainable development imperative. The achievement of these goals requires coordinated efforts of Governments, businesses and civil society to establish unified and clear rules and regulations for conducting fruitful economic activity. In order to reach this goal the European Union adopted the Action Plan for Sustainable Development Financing and began developing EU sustainability taxonomy (European Commission, 2018). Its purpose is to ensure equal understanding of the content of companies activities, projects and investments that meet the criteria of sustainability. It gives opportunity to investors and creditors to have a clear idea of the investment strategies choice adequate to determine sustainable investments. Such measures lead to further transformation of the financial system together with the requirements of sustainable development and provide better financing for sustainability projects and companies.

However, the publications over the last three years have shown a gradual shift in trend. The essence of this trend is that more and more academics and practitioners (Wilson, 2016; Daggars & Nicholls, 2016; OXFAM, 2017; PRI, 2018) are paying attention to the rapid development of such a component of sustainable finance as social finance. Social impact investment market is rapidly growing in size and prevalence in various areas of activity (PRI, 2018; Eurosif, 2018). It is argued that it is impact investment, which is best suited to the needs of SDG-2030 (Eurosif, 2017). This allows us to express supposition that the strategies of investing in a positive impact just turn into mainstream (PRI, 2018), while strategies for responsible and sustainable investing are already regarded as traditional - "must do".

The purpose of the study is to develop proposals for the classification of subjects and objects of the subsystem of social finance so as to be consistent with sustainability taxonomy. The study applies methods of induction and deduction, scientific abstraction of theoretical generalization and comparative analysis while studying definitions, best practices of social investment and for developing the classification of social impact investments and social enterprises. The paper is structured as follows. The first section provides review of basic theoretical approaches to understanding the essence of the fundamental concepts. The second section observes the author's conceptual approach to social finance taxonomy and proposes the classification of social impact investments and social enterprises. The third section examines the state of social entrepreneurship and its financing in Ukraine.

The Concept of Social Finance - A Critical Appraisal

The term “social finance” is generally used in the context of the provision of funds by organizations targeted at solving socially significant problems by financial market participants. In simplified terms, social finance is understood as an allocation of capital aimed at obtaining social and environmental returns, as well as financial returns (Nicholls et al., 2015). According to a research from Charity Bank “social finance is an approach to lending or investing that deliberately looks to create social benefits ... Social lenders and social investors can be distinguished by social issues they take into account in their investment or loan decisions” (Charity Bank, 2017). Private banking institutions specialize in social banking whose general mission is defined in following way: “providing financial and banking services aimed at creating a positive contribution for developing all the people’s potential today and in future” (Institute for social banking, 2018). As F. Relano emphasizes, their main goal is “not to maximize profits but to strengthen a positive impact on society” (Relano, 2015). Apparently, social finance incorporates a list of socially-oriented financial activities such as social investment and social banking.

Despite the fact that positive investment has become mainstream, there is still no unified concept for social financing (Evenet & Richter, 2011). The study of academic and practice-oriented publications covering the problem revealed that the most common approach is to recognize the terms "impact investment", "social investment" or "social impact investment" as similar concepts (Evenett, & Richter, 2011; OECD, 2015, Eurosif, 2018) and interpret them in the same way as “social finance” implying provision of capital to organizations with the explicit expectation of measurable social as well as financial returns (OECD, 2015; Big Society Capital, 2016; GIIN, 2017). The Global Sustainable Investment Alliance (GSIA, 2016) broadens the concept and defines “impact investing as targeted investments, typically made in private markets, aimed at solving social or environmental problems. Community investing, whereby capital is specifically directed to traditionally underserved individuals or communities, is included in this category, as is finance that is provided to businesses with an explicit social or environmental purpose” (GSIA, 2016). There is a similar definition in the materials provided by the Center for Social and Sustainable Products and it looks as follows: investing in impact seeks to find market solutions to overcome problems that may affect society and the environment (CSSP, 2014).

According to Bridges Ventures (Bridges Ventures, 2015) and Wilson K.E. (Wilson, 2016) social impact investments can be implemented in different countries, sectors and asset classes. Moreover, it is emphasized that social investments, especially in the environmental field, can provide a sufficient level

of profitability (GIIN, 2018). Several types of investors frequently provide diverse forms of capital (Wilson, 2016; GIIN, 2017). Social investment provides such capital as loans, underwriting, or equity.

A. Nicholls, R. Paton, & J. Emerson (Nicholls et al., 2015) interpret the meaning of "social finance" in a broader context than its prevailing understanding as social investment, and considers the social investment market to be a part of the social finance market. The authors proceed from the following considerations: on the one hand, it is hybrid or blended finance, which combines philanthropic motives and commercial interest, capital of the public and private sectors, equity and debt capital, structured according to different methods and sources, etc.; on the other hand, social finance is more focused on beneficiaries than on owners, and the creation of blended value (environmental / social and economic ones) is a criterion for providing capital to recipient companies.

Despite the fact that the motives for social impact investments are the creation of both social and environmental impact, together with financial returns, it is obvious that the notions of social investment and the impact investment should be distinguished. Thus, the impact investment is believed to come from the desire of investors to maintain their capital and receive financial returns along with the creation of positive effects, while social investments are based first of all on intentions to gain positive impact ("Impact first" approach) (OXFAM, 2017; Bridges Fund Management, 2015). A similar view of the essence of social investment is expressed by J. Dagers & A. Nicholls, who point out that the criterion for differentiating investment strategies on impact investing and social investing is that impact investing focuses on the behavior and motivation of investors, while social investing is more targeted at capital recipients, who are primarily motivated to create social or environmental impacts (Dagers & Nicholls, 2016). At the same time, a number of publications suggest that only social enterprises and social sector organizations (SSOs) should be classified as social finance in order to maximize their potential for social benefits (Evenett & Richter, 2011; Dagers & Nicholls, 2016) and those who solve the social problems of bottom-of-the-pyramid populations (Wilson, 2016) from emerging markets.

Impact investments can be made by various methods, for example, through social models that create blended value and are small in size, by using a traditional model aligned with the theory of change (PRI, 2018; Wilson, 2016). Otherwise, they can focus on large or medium-sized companies that create products or services in accordance with sustainable development, and thus provide benefits for society and the environment. Therefore, there is an urgent necessity to systematize and classify different approaches to social finance and impact investments in order to stimulate positive changes in the economics and society.

A study of the conceptual approach of social finance taxonomy for sustainable development

Taxonomy as a component of systematics involves the definition and grouping of certain features of objects and phenomena. In this context, social finance taxonomy requires the development of a classification of both the objects of the financing process, mainly social investments, and entities such as enterprises and organizations that fall under the indications of social entrepreneurship. This gives opportunity for a clear interpretation of all components of the social finance system and facilitates investors' decision making process concerning their investment preferences and values. According European Commission's Action Plan "Financing Sustainable Growth" establishing a common language requires appropriation of the EU classification by market participants through its integration into process guidelines and assessment (product and process) standards (European Commission, 2018).

Impact investment covers a wide range of social issues, aspects, industries, areas and challenges both in developed and developing markets, which are divided into two categories.

1. Sustainable development projects, such as access to drinking water, renewable energy, food, agriculture and forestry, etc. This category is heavily focused on developing markets.
2. Social integration, for example, affordable housing, health care, education, finance, financing of social enterprises, etc. (UNDP, 2016; PRI, 2018).

A recent study (Bridges Fund Management, 2015; PRI, 2018) reveals that the aggregate impact investments are conventionally divided into two approaches, which differ in certain ways: the first one is the approach of "mainstream (thematic) impact investment", which is carried out in various spheres of activity on the subject of sustainable development in order to obtain financial return on capital, along with the creation of a positive social / environmental impact; the second one is the approach of "social (impact) investment", which focuses primarily on the creation of positive social / environmental impacts, and only in the second turn on receiving financial income or capital return (Impact First Approach).

As a rule, when taking the first direction for projects, the strategy of thematic impact investing in sustainable development, which is aimed at obtaining financial returns at or above the market level together with a positive social and / or environmental impact, is generally chosen. When choosing finance projects related to social integration, an investment strategy that aims primarily at obtaining a positive social and / or environmental outcome, even at the expense of financial returns (Impact First Approach) is mostly used. The term "social

investment” is frequently applied to indicate this area of investment. It is most often used in European investment practice.

The analysis of publications (Daggers & Nicholls, 2016; OECD, 2015; UNDP, 2016) gave opportunity to highlight common and peculiar features of two approaches to impact investment (Table 1). A common feature for all impact investment is focusing on the long-term investment horizon, creating measurable social and environmental impacts, covering all classes of assets, and others. The distinction between investment approaches includes the following key features: investor motivation (focusing on financial return or positive impact), financing philosophy (results-based financing, outcomes-based approaches, market-based solutions) and benefits regarding expected level of financial return (at the market level, below or above it) and others.

Table 1 Common and peculiar features of impact investing strategies (summarized by the authors based on Daggers & Nicholls, 2016; Evenett & Richter, 2011; OECD, 2015; UNDP, 2016)

<i>Impact investing as a broad approach</i>	
Mainstream impact investment	Social impact investment
<i>Thematic Investing</i>	<i>Impact first Investing</i>
<i>Common features</i>	
1) Explicit expectation of social or environmental impact of investments. 2) Investors are expected to generate social or environmental impacts along with financial returns. 3) Investments are to generate returns that range from below market to risk adjusted market rate. 4) Investors are committed to measuring and reporting on social and environmental impacts. 5) Long-term investment horizon. 6) Investments are made in all types of assets.	
<i>Peculiar features</i>	
1) The thematic impact investments target businesses such as listed equity firms and large privately-owned companies that can have impact at scale and primarily expect to obtain financial return. 2) Investments are to generate returns which range from market to above market rate. 3) They are more attractive to institutional investors and mainstream investors. 4) Market-based solutions, results-based financing.	1) Investment objects are mainly social sector organizations, whose missions are primarily indicated as the creation of social or environmental impacts, regarding financial return only in the second turn. 2) Investments are to generate return of capital or returns that range from below market to market rate. 3) They are more attractive to socially oriented institutions of the financial sector of the economy, which position themselves as social finance. 4) Results-based financing, outcomes-based approaches.

In general, investors differ in their preferences concerning goals and missions, which determines their behavior in the financial market, including the choice of investment strategies. Basing on our research, we proposed a more detailed classification of impact investments according to the common key features that reveal their essence (Table 2). Other characteristics may also be selected to distinguish particular types of impact investments.

Table 2 Classification of impact investments (summarized by the authors based on Dagers & Nicholls, 2016; Evenett & Richter, 2011; OECD, 2015; UNDP, 2016)

№	Classification principle	Types of investments
1.	According to type of assets	Investments cover all classes of investment assets (cash, public equity, fixed income assets, private equity and venture capital funds, etc.)
2.	According to the target direction	Investments targeted at creating social value; ecological value or blended value
3.	According to investing method	Direct and indirect investments
4.	According to legal status of recipient companies	Investments in public, private companies and social sector organizations operating on a commercial basis
4.	According to expectations regarding results	Social and / or environmental impact together with financial returns or priority receiving of social / environmental impact (“Impact first” approach)
5	According to expectations regarding the level of financial return	Capital return higher than market level, at the market level, lower than market level
6.	According to basis of market development	Investments can be made both in developed and emerging markets
7.	According to a possibility of measuring the social / environmental impact	The social and / or environmental effect can be measured directly, that is, what is measurable; the social and / or environmental effect has the nature of impact, and can not be measured directly
8.	According to financial instruments and products	Both traditional (equity, bonds), and specially created hybrid products with characteristics of several tools (charity bonds, debt with the characteristics of equity capital, first losses capital, etc.)

Recipients of social investments are various socially oriented companies, including social enterprises and organizations. The peculiarity of social enterprises can be called the social and / or environmental focus of the mission, which is oriented on solving various social problems. Social enterprises cause social change through market mechanisms. For investment purposes the whole

number of such companies can be classified according to the following features (Table 3).

Table 3 Classification of Social Enterprises (summarized by the authors based on Nicholls et al., 2015; OECD, 2015; UNDP, 2016)

Classification principle	Types of social enterprises
According to direction of investment in positive impact	Enterprises contributing to social integration; those which contribute to solving problems of sustainable development
According to nature of activity	Traditional activities for solving social problems (health care, education, affordable housing, etc.); marginal activities (promoting rehabilitation and socialization of former prisoners, people with special needs, etc.)
According to the stages of the life cycle	Early stage; stage of growth, stage of maturity
According to risk level in achieving investment goals and obtaining financial returns	High, average, low risk level
According to the organizational form adapted for the mission	Social Business, social hybrids (e.g., Benefit corporations (USA), Community Interest Companies (UKs)), market-oriented social organizations (e.g., trading charity)

Each of the chosen classification groups requires its investment approaches and has its own circle of investors, who can also be classified according to the distinguished features. Thus, investors who are motivated to receive financial returns at or above the market value while receiving social and / or environmental benefits are targeted at investing in corporations that run a sustainable, socially viable business and are at the stage of maturity. Correspondingly, such investors are beneficiaries of a variety of socially oriented investment funds involved in sustainable development (for example, Generation IM's Climate Solutions Fund, Triodos Renewables Europe Fund). A part of socially motivated investors who want to invest primarily in creating positive impact will be participants of a variety of social enterprise funds (for example, the Bridges Ventures Social Entrepreneurs Fund, DoH - Social Enterprise Investment Fund (SEIF)). Investors with high expectations of positive impact and low expectations of financial returns can be socially motivated especially by members of social investment funds (for example, the Bridges Ventures Social Impact Bond Fund). Investors ready for high risks and having high financial return expectations are focused on investing in corporations at early stages of development, respectively, selecting venture capital philanthropy funds (for example, Bridges Ventures Sustainable Growth Fund).

Furthermore, the financing of the activities of socially-oriented companies is carried out by a variety of investors who are also oriented towards creating a positive impact, for instance, foundations, angel investors, venture philanthropists, social venture funds, social banks, etc. They can obtain a new alternative investment class with a large potential for growth.

For further development of the social finance taxonomy it is necessary to provide an expanded classification of criteria and attributes for which companies, projects and investments must meet the definition of social (environmental) ones by analogy with the typology of the thematic impacts investments (PRI, 2018). To form such a classification system it is expedient to apply the features of the above investment groups and enterprises.

Social entrepreneurship and impact investing in Ukraine

The emergence of social entrepreneurship in Ukraine has a short history (since the beginning of the 2000s) and very little experience in both functioning and financing. Only over the last five years owing to the active international support of international organizations and projects, the activity of social entrepreneurs and volunteers has intensified, and the term "social entrepreneurship" has entered an academic discourse. The main obstacle is considered to be legal uncertainty of the concept of "social entrepreneurship" and lack of its regulatory and legislative regulation. Besides, as a consequence of the post-Soviet past, Ukrainians have almost lost charity mentality and their philanthropy skills atrophied and have not yet restored as a components of the cultural code of the nation. According to surveys (Corestone Group & GFK Ukraine, 2017), philanthropy in the context of organizations is most often attributed to the support of religious organizations (19%), charity associations and other organizations (8%). Among funding sources for charitable organizations, private donations amount to 39%, donations from international donors provide 33% and donations from businesses count for 17%. In addition, 83% of the charitable organizations have more than one source of funding. Most of them receive donations from private individuals (57%), business donations (37%) and donor funds (37%) (Corestone Group & GFK Ukraine, 2017).

However, in society there is still no comprehension of the nature and possibilities of a social entrepreneurship tool in addressing urgent needs of society and environment and the achievement of the SDG. Thus, according to the survey conducted by respondents (Gusak, 2016), the vast majority of active social enterprises (the sample covered 55 entities) is created for solving social problems (about 70%), such as improving the quality of life of vulnerable groups, developing local communities and providing healthy lifestyle. Environmental goals are not prioritized (less than 30%) and are aimed mostly at

recycling garbage and toxic waste, economical use of resources and development of green tourism. The corresponding surveys revealed that 50% of respondents were the only source of funding for their commercial activities, less than 50% of enterprises received grants, about 25% of the start-up capital had the founder's funds, and 20% of social enterprises had access to credit resources. In order to fulfill their social mission, enterprises allocate from 5 to 100% of net profit, from 20 to 100%, is directed to reinvestment and from 10 to 40% of net profit is used for other purposes (Gusak, 2016).

Financing of social enterprises by financial institutions has not been widely spread, only few certain programs of support from international funds and organizations are known, in particular, the Western NIS Enterprise Fund (WNISEF) Social Investment Program. It is aimed at supporting private enterprises and individual entrepreneurs in order to achieve social and environmental impact in Ukraine through the creation of a mechanism for affordable lending in cooperation with banking institutions (Oschadbank, CredoBank). In particular, in 2016 the loans issued at low interest rates counted for the amount of 69857 USD (5% - 10%) and in 2017 they amounted to 392424 USD. Financed companies have already invested 11220 thousand UAH or 48.98% of the total loans received in social projects (WNISEF, 2017). According to experts, the main drawback for impact-investors in Ukraine is having virtually zero or even negative profitability of socially-transformative projects (Grebennikov, 2017). The reasons that hinder the development of social entrepreneurship and the impact of investment are certain to be lack of legal regulation and incentive programs, including tax; insignificant activity of state bodies and local communities; low awareness of the general public about the essence and possibilities of social entrepreneurship; low standard of living and citizens' inertia, etc.

Conclusion

Recent years are characterized by the fact that sustainable development is considered to be not a threat as it used to be, but a business opportunity. Taking into account the factors of sustainable development, corporate business models are formed and management decisions are made, and social impact investing strategies are gradually being transformed from hype to mainstream. In order to achieve the goals of sustainable development and implementation of the social finance market potential, unification of approaches to understand the basic concepts of the social investment process is required.

According to the study results, the most relevant classification features were identified as follows: 1) social investments are differentiated by type of assets, target orientation, investment method, expectations of priority and level

of results and financial returns, financial instruments and products; 2) social enterprises are classified according to the life cycle, the organizational-legal form, the mission, the risks of its implementation, etc. Possible ways of perfecting the social finance taxonomy, such as Impact Investing Market Map (PRI, 2018), are considered. The creation of a classification of financial instruments, in particular hybrid ones, with a description of their capabilities to meet the problems of sustainable development on its different issues and needs of social enterprises requires separate study.

An assessment of the experience of social entrepreneurship establishment and the impact investments in Ukraine revealed a low level of their development due to a number of reasons.

Summary

The successful development of a sustainable economy and society in together with the Sustainable Development Goals (SDG-2030) requires comprehensive and coordinated efforts of governments, businesses and civil society in order to establish unified and clear rules and regulations for economic activity. In order to reach this goal the European Union begun the development of EU sustainability taxonomy, which is to ensure an equal understanding of the content of activities of enterprises, projects and investments that meet sustainability criteria. Besides, it gives opportunity to investors and creditors to have a clear idea of the investment strategies choice adequate to determine sustainable investment, which, in its turn, results in better financing for sustainable development. Transformation of the financial system in accordance with the requirements of sustainable development affects such an important component as social finance (investment and lending), which has its own characteristics, due to the specifics of each country.

The purpose of the study is to develop proposals for the classification of subjects and objects of the subsystem of social finance so as to be consistent with sustainability taxonomy. Taxonomy as a component of systematics involves the definition and grouping of certain features of objects and phenomena. A common feature for all impact investment is focusing on the long-term investment horizon, creating measurable social and environmental impacts, covering all classes of assets, and others. The distinction between investment approaches includes the following key features: investor motivation (focusing on financial return or positive impact), financing philosophy (results-based financing, outcomes-based approaches, market-based solutions) and benefits regarding expected level of financial return (at the market level, below or above it) and others.

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An assessment of the experience of social entrepreneurship establishment and the impact investments in Ukraine revealed a low level of their development due to a number of reasons. The reasons are certain to be lack of legal regulation and incentive programs, including tax; insignificant activity of state bodies and local communities; low awareness of the general public about the essence and possibilities of social entrepreneurship; low standard of living and citizens' inertia, etc.

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