POLICY PAPER

ETHICAL FINANCE'S VIEWS ON SOCIAL IMPACT AND MEASUREMENT

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Introduction

Social impact is a complex and multifaceted concept that is often difficult to define. However, it is generally understood to be the positive or negative changes that occur in the lives of individuals, groups, or communities as a result of an intervention.

Especially in the last few years, social and solidarity-based organisations, financial players and responsible businesses are increasingly required to provide evidence of the changes that occur in society as a result of their activities (OECD, 2023). Moreover, there is a growing number of public policies that focus on creating and measuring social impact (OECD, 2023).

However, the current discourse on social impact and social impact measurement can distort the good use of this practice, which is more often a requirement than a thoughtful process.

Since its inception, ethical finance has sought to be a supportive ally within the social and solidarity economy, demonstrating that creating positive impact should be an integral part of an organisation's internal structure.

This policy paper outlines ethical finance's position on social impact and its measurement. The first section sets out the background. The second section looks at the challenges of social impact and measurement from an ethical finance perspective. The third section outlines ethical finance's approach to social impact and its measurement. Finally, the paper concludes with recommendations for policy and action.

Background

The concept of impact revolves around the intricate interplay of inputs and activities. Inputs are the resources that are used in an intervention, such as money, time, and people. Activities are the things that are done in an intervention, such as providing services, conducting research, or advocating for change. The outputs of an intervention are the immediate results of the activities that are undertaken. Outcomes are the longer-term changes that occur as a result of the outputs. Impacts are the ultimate changes that occur in the lives of individuals, groups, or communities as a result of the intervention.

The notion of impact is deeply embedded in the realm of (development) evaluation literature. Evaluation is the process of determining the value of an intervention. It involves gathering data to assess the effectiveness of an intervention and its impact on its intended beneficiaries.

The Group of Experts of the European Commission on Social Entrepreneurship (GECES, 2014) defines social impact as "the reflection of social outcomes as measurement, both long-term and short-term, adjusted for the effects achieved by others (alternative attribution), for effects that would have happened anyway (deadweight), for negative consequences (displacement) and for effects declining over time (drop off)".

The OECD defines social impact as "the positive or negative changes that occur in the lives of individuals, groups, or communities as a result of an intervention." (OECD, 2015). The OECD's 2015 Policy Brief on Social Impact Measurement identifies three key aspects of social impact:

Economic and social value created	Value experienced by people affected	Changes that occur in the short or long term
This refers to the benefits that an intervention generates for society, both in terms of economic output and social well-being. (Emerson et al., 2000; Kolodinsky et al., 2006).	This refers to the changes that people experience in their lives as a result of an intervention, both positive and negative. (Wainwright, 2015).	This refers to the time frame over which social impact is measured. Social impact can be measured in the short term, such as immediately after an intervention, or in the long term, such as years or even decades after an intervention. (OECD, 2015).

At the EU level, social impact measurement is gaining momentum. Specifically, there is a strong public and private interest in promoting and developing this practice as the gold standard in the social and solidarity sector as well as in the emerging sustainable finance and impact investing industry.

Although the transformative role of the social and solidarity sector is widely recognised, since 2012 the EU Commission has started to emphasise the importance of developing a methodology to measure the impact of social enterprises in its Single Market Act II. This approach is linked to two trends in the social sector. The first is the idea that the social sector should improve its performance and efficiency. The second is related to a better allocation of limited financial resources (Arvidson & Lyon, 2014a).

The emergence of impact investing and so-called impact investors has brought the concept of impact measurement and related metrics to the forefront of the discourse. The term impact investing was introduced in 2007 by the Rockefeller Foundation and defined by the Global Impact Investing Network (GIIN) as “investments made into companies, organisations, and funds with the intention to generate measurable social and environmental impact alongside a financial return.”

The challenges of the current approach

The current social impact measurement framework is a complex and contested practice - for different reasons - creating pressures and challenges for all the actors involved. Following this, we will explore some of the aspects that are controversial from the perspective of ethical finance.

Definition. The absence of a clear definition of social impact creates discomfort and complicates the process of measuring it. Concepts like social value, social performance, and social accounting have all been used to approach the notion of social impact, but they do so from different angles. The lack of a common framework and methodology adds complexity to the measurement process and places an additional burden on social economy sectors in particular.

This lack of clarity not only hampers the measurement itself but also poses challenges in communicating and comparing social impact across different industries, initiatives and organisations. Consequently, addressing this definitional gap is a crucial step toward enhancing the effectiveness and coherence of social impact measurement within the social and solidarity economy sector.

Ultimate purpose of the social impact measurament. The motivations to measure the impact created can be different: from external accountability, to gain legitimacy and attract funds, but also to comply with funders' expectations.

Data and information resulting from impact measurement may be used for improving efficiency, internal organisation, staff motivation and assessing internal resources.
The choice of measurement can create tensions with those who require evidence of the impact created because the process could be understood as the result of "power structures and normative social pressures" (Nicholls, 2009). In recent years, social impact measurement serves as a requirement for funders to evaluate their investments. In this sense, the process of measurement is understood as a means of 'control' of social enterprises by funders, which creates discomfort (Arvidson & Lyon, 2014).

In summary, gaining insight into the motivations behind social impact measurement allows organisations to approach the practice strategically, authentically and effectively. It enables them to use measurement not only as a compliance requirement, but also as a process to rediscover the true vision and mission, leading to a deeper understanding of the organisation's purpose.

Theory of Change (ToC). There is currently a growing demand (particularly from donors and funders) for social organisations to develop their own theory of change to explain how their work should work and how their impact should be achieved.

Indeed, despite its name, a Theory of Change is not a traditional theory but a tool used in programme planning and evaluation. According to the Centre for Theory of Change, it is best described as “a description and illustration of how and why a desired change is expected to occur in a particular context.” Essentially, it is a model that visually represents the logical framework, underlying assumptions, causal connections, and expected outcomes of a specific programme or initiative. This approach serves a purpose by enabling the testing of the model against real-world processes and results. It achieves this through the collection and analysis of performance data, allowing organisations and initiatives to assess whether their activities are aligning with their intended outcomes and make necessary adjustments to improve their impact.

In our view, this tool has some limitations and distortions, especially when it comes to creating and measuring impact in the financial and banking sector. Some of these limitations include an excessive focus on metrics and outcomes, which can inadvertently prioritise metrics over real change. Additionally, there can be an excessive emphasis on the process itself, potentially overshadowing the value created. ToC may struggle to accommodate interventions that defy easy measurement or are complex in nature. Furthermore, it may lack the contextual depth needed to address systemic change adequately. Finally, there is a risk of oversimplifying complex issues by portraying them as linear cause-and-effect relationships.

Beyond Impact: the vision of ethical finance

Ethical finance recognises the transformative power of money and deliberately directs it to initiatives that promote the well-being of the society, economy and environment. By giving priority to sectors that struggle to access finance, such as social economy organisations, real economy, and green initiatives, ethical finance plays a key role in reorienting the economy.

To pursue this transformational vision of our economic system, ethical finance advocates a radical reconfiguration of ownership, participation and distribution of profits, especially within financial institutions. This adjustment places a core emphasis on establishing the priority of the interests of the wider community and the environment, reflecting a profound change on the ‘business as usual’ approach.

Ethical finance considers governance and culture as inherently fundamental aspects of the impact management creation and process. In fact, the notion of 'impact' goes beyond the creation of measurable results. It encompasses the broader desire to transform and reorient the economic system inspired by principles such as transparency, democracy, participation, good use of money, and integrity. Consequently, the conventional concept of 'impact,' which often refers to the quantifiable outcomes of specific interventions, can be over-simplicisitic when applied to ethical finance. Indeed, measuring social impact goes far beyond metrics and results. While it is true that the practice is a valuable tool for organisations, enabling them to set realistic goals, monitor progress, make informed decisions and secure funding, it has a deeper meaning. Thus, social impact measurement could also be understood as the outcome of an organisation's values, ethics and principles.

The existing discussion on impact and its measurement tends to provide a single-size framework that does not fully capture the unique characteristics of each sector. This is an action call for the development of a more nuanced and industry-specific conceptual framework for understanding and assessing impacts.

Ethics in the impact creation and measurement. From the ethical finance point of view, the ongoing discussions on the creation and measurement of impact(s) must incorporate ethical considerations. Instead of focusing solely on the *ex-post* outcomes, it is essential to introduce preliminary reflections on what really is the impact to create and how to measure this (or these) impact(s) taking into account that the ultimate goal is the maximisation of the common well-being. An example of this kind of reflection could be the "impact appetite framework" developed by Banca Etica.

Values and measurement. In addition, the evaluation of results should include an assessment of their alignment with the organisation's core values. Thus, the core values and principles of the organisation must be woven into the entire impact generation and measurement process and should result in the outcome generated.

Holistic approach. It is also important to recognise that not all initiatives and activities can be measured or evaluated effectively using traditional quantitative methods. Some may need a more comprehensive approach that includes alternative and qualitative methods, such as observations and interviews with target groups and relevant stakeholders. Other initiatives may not be measurable at all due to their interconnected and complex nature, or may require time and consideration of the effects of spillovers.

Collective impact. In the field of ethical finance, impact is generated through collaborative efforts and cooperation between the public, private and civil society sectors. Therefore, the impact generated by ethical finance organisations is not always the result of individual activities, but of the collective efforts of all those involved. It is therefore time to reflect on the value of undertaking an individual impact measurement when the final outcome is the result of external forces and collective participation (AICCON, 2023).

Prerequisites for impact. To achieve truly transformative change, it is imperative to lay a solid foundation through proactive measures that not only serve as prerequisites, but also guide the overarching business model. For example, ethical financial organisations:

- Strategically refrain from engaging in specific sectors, consciously excluding activities such as arms production, environmentally detrimental projects, human rights violations, exploitative labour practices, non-organic intensive animal agriculture, marginalisation of populations, unethical scientific research, and enterprises related to the commodification of sexuality and gambling. This principled choice reflects a firm stance against harmful endeavours.
- Place ethical principles at the heart of the organisation's governance and management. In this sense, ethical principles are not just an add-on, but permeate every aspect, from the board of directors to management. In addition, they are proactively applied to salary limits in order to maintain fair compensation structures. Strong internal controls are carefully aligned with external regulations and internal ethical standards. Transparency, accountability and firm alignment of management and business activities with stated values are a priority. Within ethical finance organisations, integrity is part of the governance structures, with checks and balances that leave no room for anything other than an unwavering commitment to ethical standards.
- Conducting a comprehensive ex-ante evaluation process for loan applications that considers the financial, social and environmental viability of the initiatives being funded. This triple assessment ensures that funds are used in a manner consistent with ethical values.
- Empowering clients by providing a range of tools to meet the diverse needs of their clients, thereby enhancing their ability to make ethically sound financial decisions.
- Promote synergy by encouraging the cross-fertilisation of ideas and practices within and beyond their organisational boundaries, fostering an environment of continuous growth and shared learning.

Approach to impact measurement. The measurement and evaluation of the 'impact' produced should be a collaborative and iterative process involving strategic objectives and key drivers of value creation. This process should involve stakeholders to determine a global 'impact' appetite and internal and external factors that may affect this profile. Of course, this process requires not only data, measurements, goals, but also flexibility to update the framework in a way that can reflect changes that may occur. This also means not sticking to a particular methodology.

Proportionality. It refers to the idea that the depth and complexity of measurement efforts should be proportional to the size, significance, and potential impact of the organisation, project or intervention being assessed. In simpler terms, not every project requires an exhaustive impact assessment; the level of measurement should match the project's scale and potential impact.

Conclusions and policy recommendations

Finally, the debate on social effects and their measurement has become more prominent in recent years due to growing demands for accountability and the need to demonstrate the effectiveness of interventions. However, this practice is not without its challenges and complexities. The current approach to measuring social impact faces challenges such as definition ambiguity and oversimplification risks.

Ethical finance provides a unique perspective on measuring social impact, emphasising the need for a more nuanced and industry-specific approach. Ethical financing recognises that impact measurement is not just a technical exercise, but a reflection of an organisation's values, ethics and principles. It goes beyond the quantification of results, stressing the transformative power of finance in promoting social well-being. Ethical finance gives priority to the alignment of core values, holistic evaluation methods and the collective nature of impact creation.

Motivations for Measurement: Encourage organisations to clearly define their motivations for measuring social impact. Promote measurement as a strategic tool to realise the mission and values of an organisation, not simply a compliance requirement.

Theory of Change: Recognise the limitations of the ToC approach and explore alternative models that can capture the complexity of impact generation, especially in the financial and banking sectors.

Customised impact indicators: Encourage organisations, especially in ethical finance, to develop customised impact indicators that correspond to their specific missions and activities. Avoid a one-size-fits-all approach to impact measurement.

Transparency and Accountability: Promote transparency and accountability in impact reporting. Encourage organisations to provide comprehensive reports that highlight not only successes but also challenges and areas for improvement (for example, to report also the negative impact of the rest of the activities).

Cooperation and Cross-Pollination: Foster cooperation and knowledge sharing between ethical financial institutions and other sectors. Encourage cross-pollination of ideas and practices in order to promote continuous growth and common learning.

Proportionality: Emphasis on proportionality in impact measurement efforts. Adjust the depth and complexity of the measurement to the size and potential impact of the project or organisation, avoiding unnecessary burdens on smaller initiatives.

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Annexes

Ethical Charter of FEBEA - https://febea.org/our-charter/

FEBEA – the European Federation of Ethical and Alternative Banks and Financiers – is a non-profit association based in Brussels. It gathers 33 financial institutions whose aim is to finance social and solidarity economy (SSE) and projects with social, environmental and cultural value in 17 European countries, serving more than 700,000 people.

Its objective is to support the exchange of experiences and promote cooperation between social economy and social finance practitioners.
Each FEBEA member is integrated in the SSE Sector in its country, focusing on mobilising savings and equity from responsible citizens and using these funds to finance sustainable development and local communities. FEBEA is member of GECES, the European Commission's expert Group on Social Economy and Social Entrepreneurship and of Social Economy Europe, the main European network of social economy practitioners.

FEBEA members finance:

- The creation of jobs, social employment in particular;
- Social enterprises and social economy;
- The non-profit sector and participatory economics;
- New forms of social entrepreneurship
- People or groups of people who are victims of social or professional exclusion or are unbanked;
- Sustainable development: renewable sources of energy, organic farming, biodiversity, etc.;
- International solidarity and fair trade.

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