# WHEN STATES BUILD MARKETS: POLICY SUPPORT AS A DOUBLE-EDGED SWORD IN THE UK SOCIAL INVESTMENT MARKET

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**Abstract**

Markets are the outcomes of political and institutional struggles where policy support plays a major role, but research to date falls short in explaining how the breadth of available interventions can have contradictory effects on the process of market formation. This article explores the consequences of policy support in the context of the nascent UK social investment market, between 2000 and 2015, when the government was a key actor in building the market infrastructure. I track the effects of a portfolio of policy interventions, including new regulation, direct investment, and convening efforts. I show that, while policy support stimulated the market by driving supply and intermediation, it also led to an increase in contestation from the social sector. I link those intended and unintended consequences to the top-down features of the policy support (supporting the dominant logic, reinforcing hierarchical relations, and optimistic rhetoric), hence showing when and how policy support can become a double-edged sword. The article contributes to the literature on policy support in market formation by showing the mechanisms through which top-down policy interventions can have important unintended consequences, especially when shaping the boundaries and features of markets that emerge at the intersection of financial and social sectors.

**Keywords**: Social investment, impact investing, policy support, market formation, market infrastructure, unintended consequences

## Introduction

Markets are the outcomes of political and institutional struggles (Mair et al., 2012) in which different actors compete in the process of establishing clear product definitions, shared norms, and relational structures (Beunza & Ferraro, 2019; Slager et al., 2012). The literature on policy support (Georgallis et al., 2018) has studied how state actors intervene in nascent markets, not only addressing market failures (Skocpol, 1985) but also directly influencing the development of new markets (Dobbin & Dowd, 1997; Georgallis & Durand, 2017). However, while researchers have mainly studied intended consequences of policy support such as driving market growth (Russo, 2001; Swaminathan, 1995), it is not clear how those positive effects are combined with negative unintended consequences such as contestation from market actors. As Mazzucato (2013, p. 15) pointed out, "it is necessary to build a theory of the State's role in shaping and creating markets".

I argue that the concept of policy support needs to be extended to capture how state actors build market infrastructure and establish the general rules of the game (Fligstein, 1996) through different interventions such as regulating, investing, convening, or endorsing certain practices. This complements existing literature that has mostly focused on new regulations or tax benefits and their effects on stimulating market formation (Georgallis et al., 2018; Pacheco et al., 2014; Swaminathan, 1995). Moving beyond market growth and exploring how state actors both intentionally and unintentionally shape the meanings, boundaries, and relations in nascent markets allows us to gain a deeper and more accurate understanding of policy support.

The emergence of the social investment market in the UK, where investors focus on generating positive social impact as well as a financial return, is a good example of a nascent market where policy support has played a major role through building market infrastructure

(Schwartz et al., 2016). My findings show how policy support resulted in two opposite kinds of consequences. On the one hand, the *intended* consequence of stimulating the market through the mechanisms of demarcating meanings, building market infrastructure, and endorsing new practices. On the other hand, the *unintended* consequence of increasing contestation through the mechanisms of neglecting relevant actors, reducing flexibility, and setting unattainable expectations. Furthermore, I suggest that it was the top-down nature of the policy support – through supporting the dominant logic, reinforcing hierarchical relations, and having an optimistic rhetoric – which made it into a double-edged sword.

The paper contributes to the literature on policy support in nascent markets (Santos & Eisenhardt, 2009; Sine & Lee, 2009) by delving into the role played by state actors in shaping processes of market formation (Dobbin & Dowd, 1997; Georgallis & Durand, 2017). Specifically, I provide a broader understanding of policy support that shows how the top-down interventions from state actors can lead, simultaneously, to the growth of the market and to a significant increase in contestation, and I point to the mechanisms behind both sets of intended and unintended consequences. I also contribute to the specific role that policy support plays in markets that emerge at the intersection of financial and social practices (Arjaliès & Durand, 2019; Yan et al., 2021), suggesting that the unintended consequences of policy support can end up reinforcing inequalities if state actors do not consider less hierarchical and more inclusive approaches to policy design.

## Theory background

*The active role of the state in nascent markets*

Nascent markets are sites of struggle and ambiguity (Lounsbury et al., 2003; Santos & Eisenhardt, 2009). Seminal work in economic sociology underscores how states are central actors in processes of market formation (Fligstein, 1996), emphasizing that a common resolution in nascent markets is "the imposition of a settlement by state actors" (Fligstein & McAdam, 2011, p. 10). Because of their regulatory power and resources, state actors are often able to set the rules of the game by shaping the boundaries of what is legal, legitimate, or profitable (Dobbin & Dowd, 1997; Fligstein, 1996).

Recent research on policy support has shown how policymakers create the conditions for certain markets to flourish (Georgallis & Durand, 2017) and grant legitimacy to new practices and organizational forms (Swaminathan, 1995; York et al., 2018), pointing to a more active role of the state. The case of social investment also shows how making the role of the state explicit helps understand the process of market formation (McHugh et al., 2013; Nicholls & Teasdale, 2017), as policy support can reorient inter-field relations and dependences (Furnari, 2016; Sinclair et al., 2014).

Despite the increasing attention that organizational theorists have paid to the role of the state in processes of market formation, most of this research has studied thin policy interventions that are focused on tax relief or similar policies that seek to indirectly affect prices and organizational foundings (Georgallis et al., 2018; Swaminathan, 1995). Policy interventions are sometimes portrayed as 'environmental jolts' or "shocks to the system" (Schneiberg & Soule, 2005, p. 127; Sine & David, 2003) that are external to the new market. This perspective portrays markets as a relatively stable combination of supply and demand actors that are suddenly affected by an

external event, but the reality of nascent markets is often messier (Casasnovas & Ventresca, 2016). Activists, incumbents, entrepreneurs, regulators, consumers, and intermediaries interact with each other as they make sense of the emerging meanings and practices and try to steer the resulting structure in their favour (Morgan, 2008; Rosa et al., 1999; Santos & Eisenhardt, 2009; van Wijk et al., 2013). For this reason, a more comprehensive approach to the role of policy support in nascent markets should include the diverse ways in which state actors can build and influence the material, cultural, and relational infrastructure of those markets.

*Policy support through building market infrastructure*

The literature on policy support has tended to analyse the effects of states' interventions on market growth by studying numbers of organizational foundings (Dobbin & Dowd, 1997; Russo, 2001; Swaminathan, 1995) and growth of new ventures (Georgallis & Durand, 2017). However, nascent markets are, by definition, still in the process of defining their boundaries (Grodal, 2018; Santos & Eisenhardt, 2009) and dominant categories (Granqvist et al., 2013; Grodal et al., 2015). It is therefore important to inquire about policy support beyond market stimulation and to understand how it demarcates the boundaries of those nascent markets (Santos & Eisenhardt, 2009).

In addition, recent research has identified the mutual influence between states and other actors in processes of market formation, for example "viewing regulators as an audience" (Georgallis et al., 2018, p. 3) or studying the coevolution among regulations, social movements and market actors (Pacheco et al., 2014). This provides an opportunity to further explore the insider role of the state, looking at policy interventions that go beyond regulation (which has been the main focus of this literature so far) and include direct investments, convening efforts (Dorado, 2005), or the building of cultural and material infrastructure (Casasnovas & Ferraro, 2021). As Georgallis

and Durand (2017, p. 497) suggested, "future research should also examine combinations of different policy instruments and how they impact … industry development"; Kourula and colleagues (2019) called specifically for a better understanding of the forms and benefits of policy interventions in markets.

In that sense, governments' active role in market development can be carried out by, for example, modifying restrictions, shaping preferences, providing knowledge and resources, or empowering third parties (Schneider & Scherer, 2019). Giamporcaro and colleagues (2020) studied this active role of the state by analysing policy interventions in the field of Socially Responsible Investment (SRI) in France, which moved from deregulation to regulation, and showed how different policies interact with each other. Building on Osborne and Gaebler's (1992) nautical analogy of state actors being in charge of *steering* and non-state actors in charge of *rowing*, Giamporcaro and colleagues (2020, p. 290) noted the French government also practiced what they called *delegated rowing*, meaning "the mobilization of state-controlled organizations to change market actor behavior". This line of inquiry merits further development, moving beyond regulation and its effects on firm behaviour to focusing on how states champion new markets through different interventions aimed at building the infrastructure of the market. Incorporating this broader understanding of state intervention in nascent markets, we can define policy support as *the different types of interventions that governments implement to stimulate and shape the formation of new markets*.

Market infrastructure can take many forms (Casasnovas & Ferraro, 2021; Lee et al., 2018), such as a specific market architecture for mobile payments (Ozcan & Santos, 2015) or resource endowments and other institutional arrangements in the case of a medical device like cochlear implants (Van de Ven & Garud, 1993). We also have different examples in markets that have emerged at the intersection of financial and social logics (Yan et al., 2018): Gond and Piani

(2012) showed how the Principles for Responsible Investment backed by the United Nations enabled institutional investors to increase managerial attention to environmental, social, and governance issues, and Slager and colleagues' (2012) study of the FTSE4Good highlighted how it had evolved from being a stock index to be used as a standard with regulatory power in the responsible investment industry. As Addis (2016, p. 452) pointed out in her analysis of social finance markets, governments "have a unique position to contribute to enabling and encouraging the market by using the tools available well beyond regulation and direct funding alone".

Furthermore, this focus on how policy interventions shape market formation by building market infrastructure needs to be attentive to the unintended consequences of such support (Espeland & Sauder, 2007; Hiatt et al., 2009). Recent research has shown that policy support can have contradictory effects (Berrone et al., 2016), even resulting in failed markets (Vermeulen et al., 2016), and therefore scholars have called for a better understanding of how nascent markets react to strong support from states (Yan & Ferraro, 2016). With the aim of furthering our understanding of policy interventions in processes of market formation, I ask: *What is the effect of policy support in nascent markets through the building of market infrastructure?*

**Methods**

Market emergence is a "socially, politically, and temporally situated, dynamic process" (Durand et al., 2017, p. 5). Therefore, the complexity of studying such market formation processes demands a focus on a limited space in terms of activity and geographic location, in which the researcher can capture the social construction of meanings as well as the interrelation among networks, culture, and power. Following researchers who have called for in-depth studies of single countries when

studying policy support (Georgallis et al., 2018), I have studied the early stages of the social investment market in the UK from 2000 to 2015.

*Research context*

Social or impact investment refers to the practice of targeting both financial returns and social impact when making investment decisions. In the UK and globally, different approaches to the practice of blending financial returns and social impact have coexisted since the early 2000s (Hannigan & Casasnovas, 2020; Mair & Hehenberger, 2014). Some actors, following the model that emerged in the United States, label it 'impact investing' and focus on large investments that seek to maximize financial returns while having significant social impact, often by financing projects in developing countries (Mudaliar et al., 2018). Others use the label 'social investment' and focus on financing social enterprises in their domestic markets, often giving up some financial returns to maximize the social impact (Lyon & Baldock, 2014). The latter was predominant in the UK during the period of study, and therefore will be the focus of this paper. However, some organizations, in the UK and elsewhere, also spoke about 'social impact investment', showing that the boundary between the two approaches was still blurred.

The intention of achieving a social mission through businesslike or financially sustainable means is not new (Sepulveda, 2015), nor is the idea of investing with a specific social motivation (Nicholls, 2010). In fact, the UK has a long tradition of pioneers who invested in business activities to achieve public good (Davies, 2016). There is, however, evidence that activity and discourse around social investment in the UK have increased and changed in focus and intensity since the turn of the millennium (Nicholls, 2010; Sepulveda, 2015). Exploratory interviews with industry participants and initial archival data collection showed that, indeed, the year 2000 is seen by many as a turning point in the social investment sector in the UK: "If you look at the whole history of

how the market has developed, you go right back to the Social Investment Taskforce" (I22, Advising Firm[1]).

The chronology of the social investment market shows that, while this nascent market has gained increasing attention from different sectors, the role of the UK national government was especially prominent, and its interventions were at the origin of many developments in the field. It passed important regulation for the sector, it provided resources by co-investing and establishing its own funds, and it led or participated in different task forces.

*Data collection*

The data collection strategy for this study combined semi-structured interviews, archival data, participant observation, and other online sources (see the summary in Table 1).

INSERT TABLE 1 ABOUT HERE

I conducted 37 semi-structured interviews with people working in senior positions at social investment funds (SIF), advising firms, government departments, foundations, and social enterprises, most of whom had been involved in the sector from its diverse beginnings, to whom I gained access through industry connections and snowball sampling. Following prior research that suggests the importance of paying attention to actors' diverse interests and knowledge bases, as shared meanings are collectively "negotiated and construed" (Durand et al., 2017), my aim was to capture variation rather than focusing on a specific approach to social investment. As such, I included different types of actors (investors, investees, intermediaries, regulators) as well as different approaches (more socially or financially driven, more or less critical of the government's policies). This broad perspective enabled me to understand the field dynamics that

[1] Quotes from interviews are referenced with an ID and the type of organization.

took place between 2000 and 2015, and especially to explore processes of agreement and conflict after 2010. Because of the seniority and previous experiences of the interviewees, and because the market was in its nascent stage, most of them knew each other and could speak to the developments of the market beyond the specifics of their own organization. As two of the interviewees revealed:

> "I was in very close contact with pretty much all of the social investors who were active at that time" (I22, Advising Firm)
>
> "I know pretty much everybody who is active in this marketplace" (I21, Social Enterprise)

The interviews were conducted between 2012 and 2015 and gave me an insider perspective on current events and past developments in the market, as well as access to a wide range of personal and organizational accounts of the field's evolution during that fifteen-year period. One of the risks of doing retrospective interviews is the possible bias of respondents when remembering facts and perceptions, but in this case most of the important events and personal experiences took place shortly before the interviews were conducted, and to understand what happened in the early 2000s I relied mostly on archival material. When interviewees referred to more distant past events, I triangulated the information with other interviews and industry reports. Interviews were recorded and transcribed, lasted between 45 and 75 minutes, and were designed through a guarantee of anonymity to elicit transparent accounts of the events and interviewees' individual perspectives.

Archival data is often a key source for the study of organizational and institutional processes (Ventresca & Mohr, 2002), and hence another important source of information for this project has been 90 reports (representing a total of more than 4000 pages) that were published in the UK after 2000 and which focus specifically on the social investment market. Some of those were policy documents published by the Cabinet Office about their strategy for the growth of the social investment market, and others were sponsored by government-related organizations such as Big Society Capital and the Big Lottery Fund. Furthermore, I have triangulated this information

with news about social investment that appeared in general and specialized journals. These news articles were especially helpful to better grasp the language used during the first decade of the period analysed, and to see what actors and practices were referenced most often.

My participant observation consisted of attending different field events between 2012 and 2015, where I could hear different accounts and perspectives of the developments of the social investment market. I joined industry conferences that annually gathered many of the relevant market actors and interested parties, as well as sessions on social and impact investment that were part of broader events. I also attended international events where UK actors were present, organization-focused events, and research conferences. These settings (which represented a total of 150 hours of observation) were good opportunities for informal talks with many insiders of the UK social investment market; they also allowed me to learn about organizations working at the fringes of the sector and to hear about developments in other countries and their relation to what was happening in the UK. I usually took notes on site, which I then reviewed and completed soon after the event was over.

Finally, I used other data sources (webinars, blogs, online articles) for triangulation and to be up to date on the development of the field during the period of the study, especially to access speeches and interviews from politicians and other main figures in the social investment landscape. The construction of this unique dataset of the field dynamics in the UK social investment market enabled me to capture the variation in actors and practices as well as the contested nature of the empirical context.

*Data analysis*

***Stage 1: Periodization.*** With the purpose of gaining a broad view of how social investment developed in the UK during that period of 15 years, I examined the data through the lens of

periodization or "temporal bracketing" (Langley, 1999, p. 703). The goal was to understand how the structure of this nascent market had changed over time and what events or actors had contributed to its transformation from a fragmented space to a more coherent field. I paid special attention to chronological information, so I coded the data for practices, ideas, and developments that were assigned to a year or period. With all this information, I created a chart that represented how the market had evolved over the period 2000–2015, which helped me see patterns across the data (Miles & Huberman, 1994).

I identified two clear periods: before and after 2010. During the first decade of the 2000s, although there were some activities that tried to combine financial and social returns, the various actors did not yet recognize a common market. Around 2010, the market experienced an increase in activity and relevance; this was marked by not only the launch of the first social impact bond and the industry association Social Investment Forum, but also especially the fact that Big Society Capital was about to be set up and already in everybody's mind. Figure 1 provides a brief description of each period and details of the different policy interventions and other important events.

INSERT FIGURE 1 ABOUT HERE

***Stage 2: Data coding.*** After creating a broad map of how social investment had developed from ambiguity to settlement and contestation between 2000 and 2015, I then coded the data with a focus on those issues, with the purpose of unravelling the mechanisms that triggered and drove the different processes. I realized that the state played a central role by building market infrastructure, and hence focused the coding on understanding the characteristics and effects of that policy support. I used the theory-development technique of coding the words of the interviewees and the other data sources and then grouping them in broader concepts and themes (Charmaz, 2006; Glaser

& Strauss, 1967), in order to see commonalities among different accounts and interpretations but without losing the details of the story. The initial codes were largely descriptive and mostly retained the voices of the interviewees (Miles & Huberman, 1994). During the analytical process, I adjusted them to incorporate the nuances of the coded data, until it became clear that they captured a common and important topic in the data. I then used axial coding to group those first-order concepts according to commonalities in the topics they referred to, resulting in second-order constructs that were "more abstract, theory-rich constructs" (Mair et al., 2012, p. 827). Second-order constructs were identified in a recursive process of going back and forth between data and theory, and they provided the labels for understanding the mechanisms through which policy support influenced market development. Finally, I aggregated those constructs into two dimensions that helped explain the effects of policy support on market formation: market stimulation and increased contestation. Figure 2 shows a stylized version of the coding process, and examples of interviewee quotes for the different codes are available from the author upon request.

INSERT FIGURE 2 ABOUT HERE

***Stage 3: Process model.*** Finally, I again analysed some specific data sources (policy documents, primary and secondary interviews, speeches by politicians) to better understand the *characteristics* of the policy support that had driven the observed *effects* on the market. By again going back and forth between the data, my analytical codes, and the literature, I identified three features of the policy support (i.e., supporting the dominant logic, reinforcing hierarchical relations, and optimistic rhetoric) that were central in producing, through the mechanisms previously determined, the intended and unintended consequences on the nascent market. The fact that these three features are in line with sociological approaches to markets (political, relational, and cultural perspectives) was reassuring about the centrality and relevance of these characteristics of policy support. I tried

different visualizations (Miles & Huberman, 1994) and shared those figures with field experts, arriving at a theoretical model that reflects the developments of the social investment market in the UK and also provides a useful, more general understanding of how top-down policy support can become a double-edged sword in nascent markets.

## Findings

My research on the initial stages of development of the social investment market in the UK has provided a unique window of observation for understanding the effects of top-down policy support in nascent markets. In this section, I give an account of how this policy support was carried out through diverse efforts to build market infrastructure – such as passing new regulations, convening actors, and making direct investments – and its consequences with regard to market stimulation and increased contestation. In the model section, I theorize why this process took place and how policy support can become a double-edged sword.

### *Policy interventions in market infrastructure*

The successive UK governments between 2000 and 2015 carried out a portfolio of policy interventions to build the infrastructure for a social investment market, focused on providing repayable finance – both equity and debt – to social sector organizations. The establishment of the Social Investment Task Force (SITF) in February of 2000 symbolized the starting signal for convening those individuals and organizations interested in using the tools of the financial sector to improve the lives of the most disadvantaged people in the country[2]. Being announced by the

[2] Its official remit was: "To set out how entrepreneurial practices can be applied to obtain higher social and financial returns from social investment, to harness new talents and skills to address economic regeneration and to unleash new sources of private and institutional investment. In addition, the Task Force should explore innovative roles that

government, which had observer status (Social Investment Task Force, 2000), and chaired by Sir Ronald Cohen, one of the founding fathers of the venture capital industry in the UK, it soon earned legitimacy in the public and private spheres. By the second half of the decade, the Commission on Unclaimed Assets was set up to offer recommendations as to how to employ the "monies that have been untouched by their owners in financial institutions for a considerable period of time" (The Commission on Unclaimed Assets, 2006, p. 1). Also chaired by Sir Ronald Cohen and with members from the financial and social sectors, it put social investment at the center of the public debate. The new market then started to focus on providing funding to social sector organizations, which are defined as those that "exist wholly or mainly to provide benefits for society or the environment" (*Big Society Capital*, 2018), including charities and different forms of social enterprises.

Interestingly, the change in office in 2010 (from Labour to Conservative-Liberal) did not produce a significant change in the policy approach to social investment, for example regarding its flagship organization, the wholesale bank Big Society Capital (BSC): "That didn't really change policy towards the wholesale bank. The new government was just as keen on it, and so pushed forward on that" (I24, Social enterprise). The launch of BSC in 2012 stands out in the process of building market infrastructure, as it was funded by the Coalition government with £400m from 'unclaimed assets' and £200m from an agreement with the UK's main commercial banks. BSC's aim was to provide funding for social investment funds and other elements of market infrastructure such as research projects, capacity-building funds, and advisory organizations. Due to its size and 'market championing' role, BSC became very influential in the market. Although statutorily it was supposed to act at "arm's length from government" (I16, Platform) and there was

the voluntary sector, businesses and Government could play as partners in this area." (Social Investment Task Force, 2000, p. 3)

a Board of Trustees monitoring its activities, interviewees agreed that the connection was very close: “It’s the mouthpiece of the government” (I22, Advising Firm).

The new regulation, direct investments, and convening efforts led by successive UK governments (detailed previously in Figure 1) effectively built the main blocks of market infrastructure: “So you’ll think of places where you can go find listed equities, you have a social stock exchange. You would think about providers of capital where you have social investment funds, and you have social investment fund managers. You increasingly are seeing advisors and arrangers who specialize in providing services to the social economy” (I23, Government).

*Market stimulation*

The top-down building of market infrastructure had a clear effect of stimulating the market for social investment, especially supply and intermediation: “Big Society Capital … had the effect that they wanted it to have, which was to stimulate the market” (I14, SIF). The market increased from £202m in 2011 to £427m in 2015 (*Growing the Social Investment Market: Landscape and Economic Impact*, 2013; *The Size and Composition of Social Investment in the UK*, 2016), a significant 20.6% compound annual growth rate over that period. In terms of new funds, the data also show an increase from less than one per year during the first decade to an average of more than three between 2011 and 2014. There were three mechanisms through which policy support drove market stimulation: demarcating meanings, building centralized infrastructure, and endorsing new practices.

**Demarcating meanings.** The new market infrastructure built through policy support helped clarify the main concepts of the nascent market. Most reports published after 2010 used the language of social investment, indicating that by that time market actors were familiar with that

term and its associated meaning: “A field that references itself as a social investment market, would seem to be over the past five or six years” (I23, Government). Another example of this clarification was with the topic of the fiduciary duty of large foundations and charitable trusts, for which the government made clear that such institutions could invest their endowments in impact-related businesses that were in line with their mission.

Another way of demarcating the meanings of the new market was by drawing a red line in the use of grant money. After 2007, there was a push for financing the social sector through repayable finance, against grants or subsidies that came from the state. As a social entrepreneur suggested, “in 2009–2010, there was a concerted effort to take the word ‘grant’ out of any discussion” (I21, Social Enterprise). For example, in the launch of Big Society Capital, Sir Ronald Cohen argued that “philanthropic giving and government help are not good models for scaling an organization, for innovation, for risk taking” (*Transcript: Press Conference Launching Big Society Capital at the London Stock Exchange*, 2012), suggesting that private capital in the form of repayable finance was necessary for the social sector to achieve larger impact. This narrow understanding of the tools that social investment should use was acknowledged by social sector activists, who stated that there was a “growing orthodoxy amongst some in the social investment sector that grants are bad because they ‘distort the market’ for investment” (Floyd, 2013, p. 1), and helped attract attention from the financial sector. This meant giving preeminence to the financial features: “[Social enterprises] predominantly seek risk capital on sub-commercial terms... [while] what is on offer from investors is larger asset-backed capital on near commercial terms” (Gregory, Hill, Joy, & Keen, 2012, p. 41).

**Building centralized infrastructure.** Another important mechanism by which policy support stimulated social investment was by building the market infrastructure in a centralized way, both

providing resources for financial intermediaries and becoming a 'market champion'. This started in the early 2000s with the Labour government and was reinforced in 2010 by the coalition between Conservatives and Liberal-Democrats, who took advantage of the momentum that social investment was gaining and pushed on with the efforts towards building the market. Over this period, "the government put lots of money into that, so people have stepped in to take that money" (I24, Social Enterprise). The Labour administration invested £20m in Bridges Ventures' pioneer fund, and it also launched different funds that targeted social enterprises, healthcare providers, and community organizations. The coalition government continued this role of resourceful investor, first by "using every penny of dormant bank and building society account money" to establish Big Society Capital (Cameron, 2010, p. 1) and then by financing the spread of social impact bonds and support organizations such as the Investment and Contract Readiness Fund. Altogether, those "support structures and various bits of funding and programmes [were] designed to stimulate and support the market" (I24, Social Enterprise).

The government intervened not only as the main investor in the social investment space, but also as a dedicated market champion, because they saw "building the market and getting a market working as their priority" (I24, Social Enterprise). The building of market infrastructure, which included direct public investments (e.g. through BSC), new regulation (e.g. the Social Investment Tax Relief), and convening efforts (e.g. through the Social Investment Research Council), was key for this continued supply of resources to the nascent market.

**Endorsing new practices.** One of the challenges for the growth of social investment was the fact that potential demand (social enterprises) and potential supply (investors with social impact objectives) were often unaware of, or confused about, the nascent social investment market. In this context, policy support increased awareness by putting emphasis on communication and on

generating momentum. The work of BSC was very important for fund managers, who had found it very difficult to raise money from investors because the latter were unfamiliar with social investment. The growth of the Good Deals conference, which started in 2008 and soon became a key reference for those interested in social investment, was another sign of the increased awareness around the topic. Furthermore, "[BSC] set up the Social Investment Research Council with four or five other organizations, and they're partly accepting proposals to do research on the market" (I6, SIF).

Apart from the general awareness, policy support also supported the new hybrid approach associated with social investment, because in the beginning there was significant skepticism: "Right up until BSC existed … [w]e had a property fund that could generate double digit returns, was going to have a massive social impact … they all just went, ten percent return? No, it's not good enough. I went, what is there not to like?" (I14, SIF). The government endorsed the creation of the industry association Social Investment Forum, an industry association to lobby for and provide information about the market. It also created a strong movement around social impact bonds as a tool for social investment and participated in many industry events: "[BSC is] thinking about starting to sponsor awards and stuff as well so potentially some of the SE100 awards ... they also speak at lots of events so they get lots of speaker requests" (I6, SIF).

The endorsement through discourse and investment made by the government was hence positive for raising awareness and stimulating market activity: "[Social investors] weren't really publicly celebrated or accepted until 2007. So, in my view, it took five years of deal happening before you didn't feel guilty about doing them, or you didn't expect to be shouted at for trying" (I14, SIF).

*Increased contestation*

Together with the stimulation of supply and intermediation of capital for social investment, policy support had the unintended consequence of raising contestation among social sector activists and small social enterprises, which meant that by 2014 "the market was nowhere close to hitting projected volumes of investment" (Daggers et al., 2021, p. 13). This was driven by three mechanisms: neglecting relevant actors, reducing flexibility, and setting unattainable expectations.

**Neglecting relevant actors.** By focusing policy support on the needs of financial intermediaries, the government neglected other relevant market actors and decreased the legitimacy of the social investment model. The early 2010s was a time when the effects of the financial crisis were hitting the social sector through cuts in public budgets, and hence many organizations were reluctant to adopt practices precisely from the financial sector. There was a "growing atmosphere of discontent and anger within the social enterprise and voluntary sectors about the direction that this bigger, shinier social investment market appeared to be taking" (Floyd, 2013, p. 1). Social sector organizations felt that social investment advocates "came with an investment mindset from a very different world" and that they "were trying to apply that methodology and those techniques in the social space, but without properly understanding the social enterprise part of it" (I22, Advising Firm). This wariness towards financial actors and practices clearly contributed to the lack of legitimacy of the social investment model. Such doubts were reinforced by the understanding that the market infrastructure was mimicking financial practices, as BSC's Chairman stated that "the venture capital and private equity industry, … I see as our closest parallel" (*BSC Annual Report and Financial Statements 2012*, 2013, p. 5).

Another factor that decreased the legitimacy of the market was that, for policymakers, "social investment [was] seen as the end rather than the means to an end" (I28, Industry Association), which led many social sector organizations to feel neglected and disengage from that model supported by the state, as it focused on building a market rather than financing social enterprises. While they acknowledged that "all this infrastructure stuff has been growing fast" (I24, Social Enterprise), the focus on supply and intermediation also meant that "they're not paying anywhere near enough attention to the demand side of the market …, which essentially is demand from social enterprises" (I22, Advising Firm).

In the words of social sector practitioners, the government "seemed to have decided that social investment was a good way [to finance the social sector] before they started" (I22, Advising Firm), without giving voice to the social enterprises that were seeking funding. Social investment had become "in policy terms, the big matter, the big issue on the policy landscape, particularly in the post-2010 period" (I24, Social Enterprise), and hence some actors in the social sector associated the strong push for social investment with part of a broader political agenda. Not only was the market "being very heavily influenced by the government and the Cabinet Office" (I22, Advising Firm), but also "the narrative [was] one of 'social investment' which looks top-down from the point of the investor" (Davison, 2013, p. 10).

**Reducing flexibility.** The reaction of the social sector, especially those representing small and medium-size charities and social enterprises, was of skepticism towards the government-led model of social investment. Among the targets of their critiques were the inadequate financial products that were promoted by state actors and became mostly used by social investors. Sometimes it was because they were copying the financial models of the private equity industry, and social activists claimed that "you can't put a classic financial model into the world of social enterprise" (I21,

Social Enterprise). Other times it was because investors were mostly offering debt funding, while "crowdfunding, community shares, loans, angel investment, and a whole range of other things are much more likely to be relevant" (I28, Industry Association). Many social sector organizations actually needed a combination of grants and other instruments, and hence the relation between investor and investee was graphically summarized by one interviewee as "you want fish and I'm a butcher" (I21, Social Enterprise), showing the disconnect between the supply and the potential demand.

Another point of critique was Big Society Capital itself, as the rigidity of this central piece of market infrastructure was seen as if "they've really got at least one hand tied behind their back, if not both hands" (I22, Advising Firm). BSC found it difficult to cater to the needs of most social sector organizations, because their own statutes said that they had to be financially sustainable and not give away their funds ("we need to cover our operating costs and any losses from the return on our investments, as well as earn a small financial return" (*BSC Annual Report and Financial Statements 2012*, 2013, p. 13); this meant they needed to be highly selective and not lower the bar of their expected returns. The consequence was that funding was not 'going out the door' fast enough and hence "capital [was] not making its way to frontline social sector organizations" (I32, SIF).

The criticism from the social sector also targeted the *intermediation structure* of the market, which was seen to be growing faster than the actual demand for those financial products from social sector organizations. On the one hand, their often-expensive structures contributed to increasing the financial cost borne by the investees. On the other hand, they were seen as trying to "apply their investment banking methodology to the social sector … using language and jargon and complicated funding techniques that the market is just not ready for, and they don't understand what's going on" (I32, SIF).

**Setting unattainable expectations.** The high expectations that came from the investments in market infrastructure and the promises made by the government, compounded with the fact that the years 2010–2013 were times of 'austerity' policies, brought a sense of unfulfilled hopes for many in the social sector. The social investment market supported by the state was becoming "certainly not the model that social enterprise organizations thought they were signing up for when they supported the idea towards the end of the 2000s" (I24, Social Enterprise). The notion that promises made by the government had been broken was important, because the fact that hundreds of millions of pounds coming from public funds were sitting in different intermediaries created "a lot of disillusionment" (I22, Advising Firm). The government had promoted the idea that the funds made available by the Dormant Bank Accounts Act would be relevant for a large number of social sector organizations, but in the end "those expectations [had] not been met" (I32, SIF).

At the same time, the government was saying that social investment could be a replacement for the public subsidies that were being cut down. Prime Minister David Cameron's words were that "while direct grants from government might be going down, the money available to charities and social enterprises is actually going up" (*Transcript: Press Conference Launching Big Society Capital at the London Stock Exchange*, 2012, p. 1). As a social sector commentator said, they were implying "that a bigger social investment market [would] directly ameliorate the effects of massive public sector cuts" (Floyd, 2013, p. 1). This strategy was also clear in policy documents: "The Government's plans to open up and decentralise public services offer new opportunities for social ventures to deliver public contracts and to help people purchase community assets" (*Growing the Social Investment Market: A Vision and a Strategy*, 2011, p. 7). By 2015, the narrowing of the sector was leaving aside many social sector organizations: "most of

the [social] sector now knows that [social investment] is entirely irrelevant to them" (I28, Industry Association).

The reality was that social investment was not addressing the needs of the social sector, which demanded smaller amounts, lower expectations of financial returns, and less risk-averse intermediaries. This mismatch between supply and the expectations from the demand side meant that social sector organizations (especially small and medium-size ones) became frustrated, especially because they saw "£500 million still sitting there at a time when the whole sector is fighting to survive" (I28, Industry Association). For many, the problem was that BSC was interested in its own sustainability "rather than meeting the needs of charities and social enterprises" (I24, Social Enterprise). The rigidity of the model was driving contestation towards its proponents, as social activists said that "you talk to people who've been around social enterprises a lot, and they won't have anything to do with social investment" (I22, Advising Firm).

**Policy support as a double-edged sword**

The deployment of the government's model for social investment led to a market that started to be recognized by many actors within and outside its boundaries. The market focused on lending relatively high amounts to large social enterprises through asset-backed lending (less risky than the unsecured lending often demanded by smaller organizations), a model that addressed the needs of social investment intermediaries. Part of this recognition also came from the steady creation of market infrastructure, which by 2014 saw many of the necessary building blocks – financial intermediaries, industry association, conferences, capacity-building funds, and the like – already in place.

However, while certain actors such as financial intermediaries and large social enterprises benefitted from the newly created infrastructure, the nascent market experienced significant contestation. Social sector organizations – the potential demand of the market and an important collective for balancing the broader socioeconomic system – were being excluded. They voiced their disagreement through publications and by forming bodies such as the Alternative Commission on Social Investment, launched in 2014. The policy support carried out through the building of market infrastructure proved to be a double-edged sword, as it stimulated the market but also led to increased contestation. As depicted in Figure 3, I suggest that this was due to the type of policy support, which I label as 'top down' because it was done by supporting the dominant logic, reinforcing hierarchical relations, and making an optimistic rhetoric – three features that I explain below.

INSERT FIGURE 3 ABOUT HERE

**Supporting dominant logic.** By giving preeminence to the financial features of the market and mimicking the venture capital model, policy support was able to clearly demarcate the meaning of social investment and its associated practices, but it also decreased the legitimacy of the market by neglecting social sector organizations and aligning with the dominant logic of the financial sector (Davis & Kim, 2015): "The model that we ended up with was based on Ronnie Cohen's vision [of] people coming from the financial services industry and their vision of what this kind of institution would look like" (I24, Social Enterprise). The sense in the social sector was that the market had been built for the benefit of financial intermediaries, and that "benefits to society accrue[d] only as spillover effects" (Addis, 2016, p. 394).

This distrust from social sector organizations was due in part to the policy focus on 'building the market', which for them was supposed to be just a means to an end, and also in part to

the predominance of financial practices at a time when financial markets were being challenged by certain parts of society. By questioning the goals of the actors in the public and financial sectors, social sector actors challenged the sociopolitical legitimacy of social investment (Aldrich & Fiol, 1994), something especially relevant in moral markets that are supposed to serve social goals (Georgallis & Lee, 2020).

**Reinforcing hierarchical relations.** The different policy interventions reinforced the top-down relation between the government and the financial and social sector organizations that were demanding their resources. This meant that many organizations in the social investment market were dependent on the government for the provision of funding, especially since the creation of Big Society Capital: "There aren't really many people who aren't on the payroll in some way, and that creates a real difficulty" (I24, Social Enterprise). While the allocation of £600m (through BSC) in a market that was only a third part of that generated an increase in activity, it also limited the flexibility of dependent organizations because the hierarchical positions were very clear: "You don't bite the hand that feeds you" (Field note 13/02/2015, SIF manager speaking about their relation with BSC). This also happened through the support of capacity-building funds and social impact bond funds, which made many advisors and financial intermediaries dependent on government funds. The hierarchical approach was also evident in the process of designing BSC. For example, the Directory of Social Change, an activist group linked to small charities and voluntary organizations, complained about the consultation process, saying that "the proposal is rife with arrogant and condescending phrasing", and pointing at the "lack of evidence" and "lack of understanding of the sector", among other things, from that policy initiative (Kennedy, 2009, p. 3).

Although having a centralized building of market infrastructure can be a positive feature in processes of market formation (Lee et al., 2018), we see here that it can also lead to the disengagement of potentially relevant market actors. If policy support makes the market 'too rigid too soon', it may reduce experimentation and hinder the necessary flexibility that allows new markets to iterate between different approaches before settling on a dominant design (Suarez et al., 2015). The cognitive legitimacy that drives convergence (Aldrich & Fiol, 1994) might hence come at a price when a nascent market is still developing..

**Optimistic rhetoric.** The third characteristic of the top-down policy support is optimistic rhetoric (Gamson & Meyer, 1996) about what social investment could mean for social sector organizations. Indeed, "the extraordinary level of hype deployed by government ministers and some social investment leaders during the post-2010 period" (*After the Gold Rush*, 2015, p. 82) created unrealistically high expectations for the market. Key personalities such as Cohen held the discourse that "the power which we've unleashed for the benefit of economic profit needs now to be unleashed for dealing with social issues" (*Transcript: Press Conference Launching Big Society Capital at the London Stock Exchange*, 2012, p. 1), and one observer charged that "the government deliberately promoted the idea that Big Society Capital and social investment would be relevant to a large number of charities and social enterprises" (I24, Social Enterprise).

While the market 'hype' helped increase awareness, it also created cognitive dissonance (Vermeulen et al., 2016) in those small social enterprises that were expecting a different type of social investment market. This mechanism points to the importance of managing expectations in processes of market formation and the need to strike a balance between creating momentum and the risk of disappointing certain segments of the population, who may then turn their backs on the new market and become fervent critics. Rhetoric is clearly a mechanism that influences market actors'

views and opinions (Leibel et al., 2017; Suddaby & Greenwood, 2005), so it is important for policymakers to anticipate what effects it will have on the different audiences.

**Discussion**

Market formation processes are not a 'quest for efficiency', but instead the outcome of complex and 'messy' contexts in which multiple factors influence the eventual shape of the market (Giamporcaro & Gond, 2016; Grodal et al., 2015; Mair et al., 2012). Although the role of the state in such processes is widely recognized (Dobbin & Dowd, 1997; Mazzucato, 2013; Yan & Ferraro, 2016), this paper contributes to this literature by studying the effects of policy support through the building of market infrastructure. First, it shows the mechanisms by which top-down policy support can be a double-edged sword in shaping nascent markets. Second, it shows the consequences of policy interventions when building markets at the intersection of social and financial practices.

*The role of policy support in shaping nascent markets*

This article extends research on the role of policy support in nascent markets by advancing the literature in two directions: broadening our understanding of policy support and analysing the consequences of top-down policy support on the process of market formation.

First, in order to capture the broad effects that policy support has on nascent markets, I have studied the full range of material, relational, and discursive elements that are part of what we understand by policy support. So far, the literature has focused on material aspects such as tax benefits or feed-in tariffs (Georgallis et al., 2018; Pacheco et al., 2014; Swaminathan, 1995), but my focus on the building of market infrastructure has allowed me to also include relational and discursive aspects. For example, at the relational level, the hierarchical nature of policy support

(reflected in the design of Big Society Capital or the policy strategy to grow the social investment market) was seen by social sector organizations as an imposition of a specific form of social investment, reinforcing incumbent–challenger relations and driving its subsequent lack of legitimacy. This complements Grodal and O'Mahony's (2017) research, which showed how the mobilization of a field by central actors can lead to the displacement of the initial goals of the field because of the misalignment of interests among diverse actors. At the discourse level, the promises made by state actors and other social investment advocates, as well as their resulting hype, led to unfulfilled expectations when social sector organizations realized that the new market was not addressing their needs. This points to the importance of analysing the role of policy communication and other market information regimes (Anand & Peterson, 2000) to better understand the unexpected consequences that changes in discourse and market categories can have on the demand side and the industry structure. This broader understanding of policy support connects to research that studies how relations and meanings are structured in nascent markets (van Wijk et al., 2013), showing the central role that state interventions can play in those contexts.

Furthermore, whereas previous literature on policy support has mostly focused on its direct effects on nascent markets by looking at size effects such as organizational foundings and growth (Georgallis & Durand, 2017; Russo, 2001), my focus on the building of market infrastructure turns our attention to how policymakers can shape the features of nascent markets, promoting some ideas while suppressing others (Hehenberger et al., 2019). This complementary focus is important because size effects are often the intended consequences of policy support – including in the case of social investment, where the UK government was able to stimulate the creation of new funds and attracting new investors. This increase in activity would appear on the surface to be a success of the policy support, but studying the evolution of other market features points at how such support also

drove the unintended consequence of significant contestation from important market actors. This is because shaping market boundaries creates winners and losers, those that benefit from the policy interventions and those that are left aside because they cannot profit from the new tax relief, direct investments, or capacity building efforts.

This also points to the need for understanding longer-term effects when studying policy support. Certain policy interventions may have positive short-term consequences by stimulating specific market segments, but they may also hinder sustained and sustainable market growth by limiting the potential of other segments or by antagonizing important actors early on.

Second, my conceptual model connects policy interventions with their effects on market formation processes. Taken together, the three mechanisms – supporting the dominant logic, reinforcing hierarchical relations, and having an optimistic rhetoric – show how state actors can use their powerful position to impose certain meanings in a nascent market, but also how policy support can become a double-edged sword when those meanings are contested by other market actors. For example, supporting the dominant logic by mimicking the practices of the venture capital industry helped demarcate the meaning of social investment, but it also drove a decrease in legitimacy in the view of many social enterprises that felt neglected by the government. Despite the benefits of top-down and state-driven resource provision, more collective and participatory approaches would be beneficial to rally interest around societal challenges (Ferraro et al., 2015) and "to mobilize to take collective action" (Aldrich & Fiol, 1994, p. 656). While most research has focused on how policy support gives legitimacy to nascent markets (Sine et al., 2005), Lee and colleagues (2017) showed that this legitimacy can also have unintended effects. In their case of standard certification for organic farming, this was about the difficulty of maintaining a shared identity (see also Grodal & O'Mahony, 2017). In the case of social investment, the decrease in

legitimacy came from the increasing contestation among those social sector actors that had been neglected in the design of the policy support.

In another example, the hierarchical approach to market building allowed for quick and significant investment in state-led infrastructure, but it also reduced the necessary flexibility to incorporate a broader set of financial instruments and organizations to the nascent market. More flexible or ambiguous approaches have proved to lead to more innovative outcomes (Gioia et al., 2012; Sgourev, 2013), as well as to further and more diverse collective engagement (Ferraro et al., 2015), something that is valuable in those early stages of market formation when the link between supply and demand is not yet clear (Rosa et al., 1999).

Future research should further inquire as to how different types of policy support (top-down vs inclusive, short-term vs long-term, funding vs convening) may have different effects on the process of market formation, and how they interact with other factors such as collective identity and goal displacement (Georgallis & Lee, 2020; Grodal & O'Mahony, 2017; Lee et al., 2017). Scholars could also study other types of market infrastructure beyond the regulation, direct investment, and convening processes that are emphasized in this case, as well as how specific state actors or policy interventions drive particular consequences on the process of market formation.

*Building markets at the intersection of social and financial practices*

The second contribution of the paper is to the specific case of building markets at the intersection of social and financial practices, such as impact investment (Höchstädter & Scheck, 2015), venture philanthropy (Mair & Hehenberger, 2014), socially responsible investment (Arjaliès & Bansal, 2018), or microfinance (Casasnovas & Chliova, 2020). Whereas most research on these markets has looked at contexts where social movements have played a central role (Arjaliès, 2010), the UK social investment market is a case of a policy-driven market (Addis, 2016; Nicholls & Teasdale,

2017). This paper adds to our understanding of how these markets are built and what the consequences of top-down policy support in their early stages can be. In these markets that emerge at the intersection of multiple fields (Zietsma et al., 2017), policy support will be judged differently by market actors that have different notions of success or visions for the market, so that some frames will be supported and become dominant while others remain neglected (Furnari, 2017; Hehenberger et al., 2019). I argue that, in such contexts, policy support can tilt the emergence of the market to more directly address social challenges or to buttress existing structures.

Willingly or not, by supporting specific practices in nascent markets, governments can disrupt the roles and relations among different sectors. Although the unintended consequences can sometimes be positive, such as the creation of data infrastructure that can then be leveraged by other market actors (Yan & Ferraro, 2016), it is important for policymakers to understand the indirect effects of their support and minimize potential drawbacks.

One solution is to offer more inclusive policy support, in which diverse stakeholders (especially vulnerable ones) have a say in the design of new policies. As we have seen in the case of social investment, by implementing relational structures based on top-down hierarchies, policymakers can reinforce the inequalities that they supposedly set out to mitigate (Amis et al., 2019). Interestingly, in the years that came after my period of study, policy support in the UK social investment market became more inclusive as the government learned from some of its critics (*After the Gold Rush*, 2015). Examples of this are the creation of the Access Foundation in 2015, which leveraged funding from Big Society Capital to provide a mix of loans and grants to social sector organizations (Daggers et al., 2021), and the appointment of executives with experience in the social sector to run central organizations such as BSC and Social Investment Business (Casasnovas & Ferraro, 2021). Especially when intervening in social finance markets, it seems important that ‘inclusiveness’ and ‘stakeholder engagement’ be two of the “guiding principles to

be taken into account in framing policy and regulations" (Addis, 2016, p. 411). For example, in the development of SRI in France, industry representatives worked in coordination with the French government and asked that it actively regulate the market (Arjaliès & Durand, 2019). This case points to how more horizontal approaches to policy support can be beneficial for the legitimacy of the nascent market.

In this sense, it is important to acknowledge that the framing of issues changes over time and is often connected to broader societal discourses (Litrico & David, 2017); this opens the way for social investment to become more inclusive in the future, and for the blending of financial and social practices to be less contested. Therefore, it is important to understand how the battle over meanings and ideas that takes place in the early stages of social investment and other moral markets (Hehenberger et al., 2019; Weber et al., 2008) is instantiated in material devices (Beunza & Ferraro, 2019), market infrastructure (Casasnovas & Ferraro, 2021), or product categories, which can "function as questioning devices that encourage market actors to reflect on their purposes" (Arjaliès & Durand, 2019, p. 886).

The social investment market in the UK experienced its growth in the socioeconomic context of the financial crisis of 2008, which reduced public trust in financial institutions (Carruthers & Kim, 2011) and made the social sector more wary about using financial market instruments in a period of 'austerity' measures that had a significant impact on access to funding by charities and social enterprises. Although some of my interviewees suggested that the emergence of social investment would have been similar without the context of the financial crisis, others referred to the influence of the financial industry as "toxic thinking" (I14, SIF) – paraphrasing the idea of 'toxic lending'. What many interviewees agreed upon is that policymakers did not pay enough attention to the demand side – that is, the real needs of social enterprises, their expectations and their ground-level knowledge.

Future research should complement this study by focusing on different geographies, because the emergence of new markets and fields is “inherently bound to the context in which it unfolds, where experiences, meanings, and identities play a key role in assessments” (Durand et al., 2017, p. 13), and hence. Particularly interesting would be to study the role that policy support for social and impact investing can play in low-income countries, as these processes can hold important differences across sectors and countries (Gond et al., 2011). In conclusion, policymakers and market intermediaries need to carefully consider the design and scope of policy interventions in nascent markets, in order to stimulate supply and demand while minimizing potential unintended consequences.

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## Tables and Figures

### Table 1: Summary of data sources

| Source | Amount | Examples |
|---|---|---|
| **Interviews** | 37 | · Social investment fund managers<br>· Trade associations<br>· Government<br>· Advising firms<br>· Social enterprises |
| **Industry reports** | 63 | · Financing Civil Society (CAF, 2008)<br>· Bridges Ventures 10 Year Report (2013)<br>· Social Finance in the UK (Design Council, 2014) |
| **Policy documents** | 27 | · Big Society Capital: Vision, mission and activities (2012)<br>· Growing the Social Investment Market: Landscape and Impact (HM Government & City of London, 2013)<br>· Speech on the Big Society (Cameron, 2010) |
| **Industry events** | 150 hours | · Good Deals 2015<br>· Skoll World Forum, 2013 & 2014<br>· Ethex Annual Gathering, 2014 |
| **Other** | n/a | · G-8 Task Force Webinars<br>· Seminars and lectures<br>· Blogs and newsletters<br>· Social Media |

**Figure 1: Periodization of the Social Investment Market in the UK, 2000–2015**

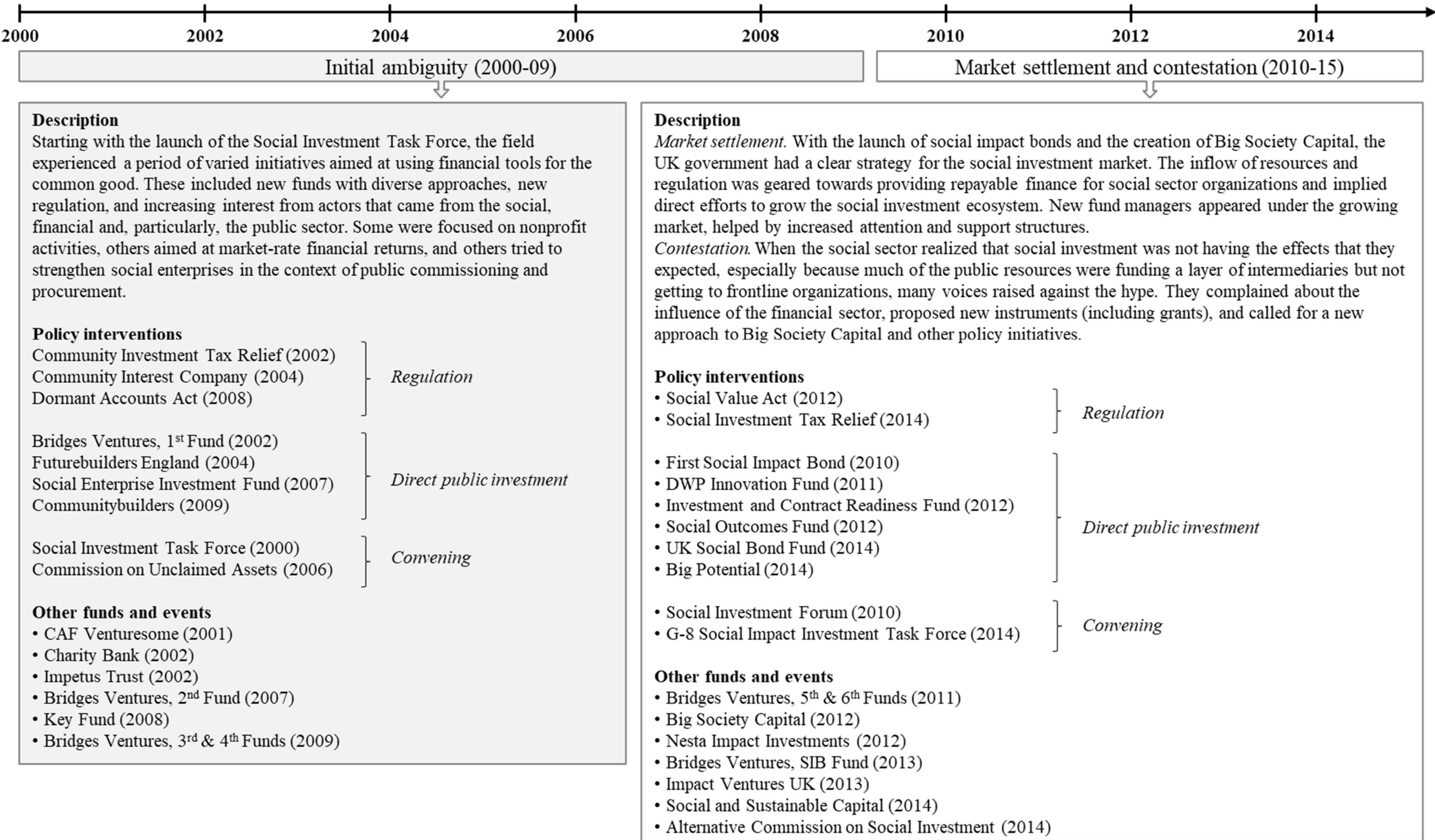


**Figure 2: Stylized process of data coding**

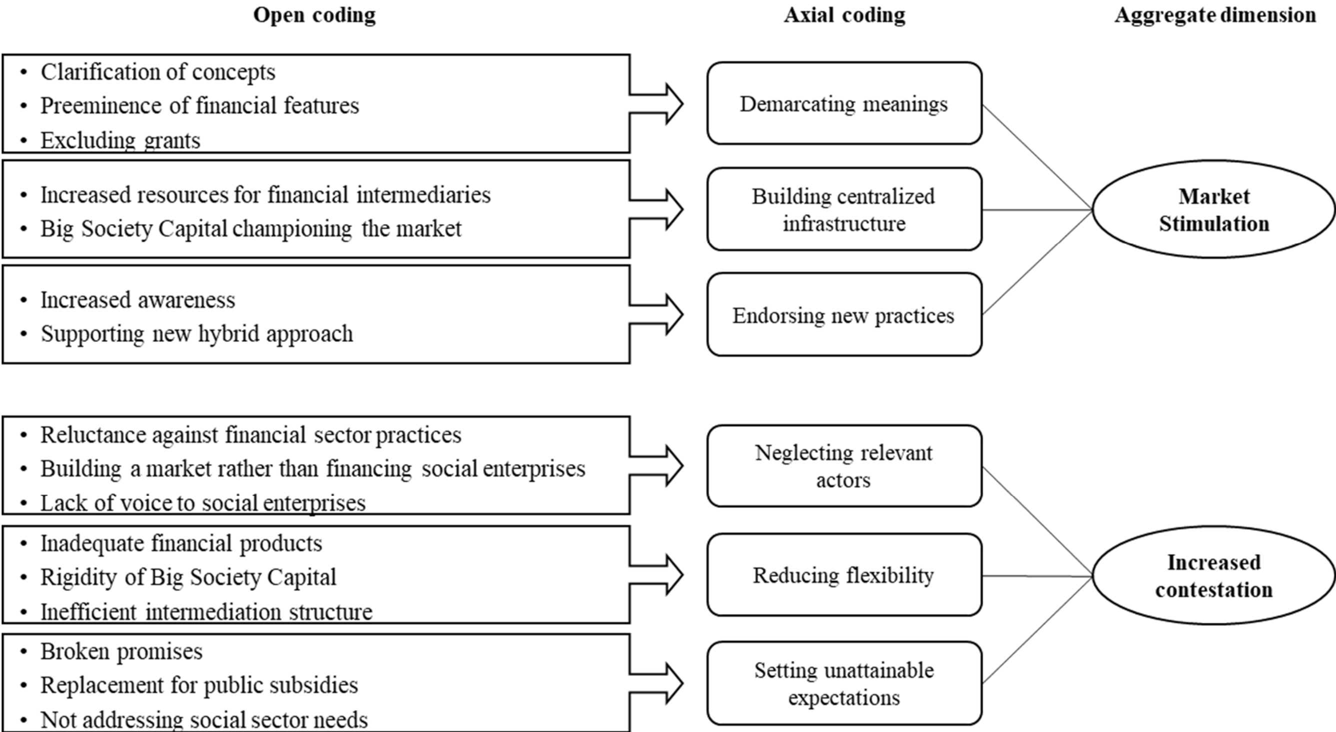
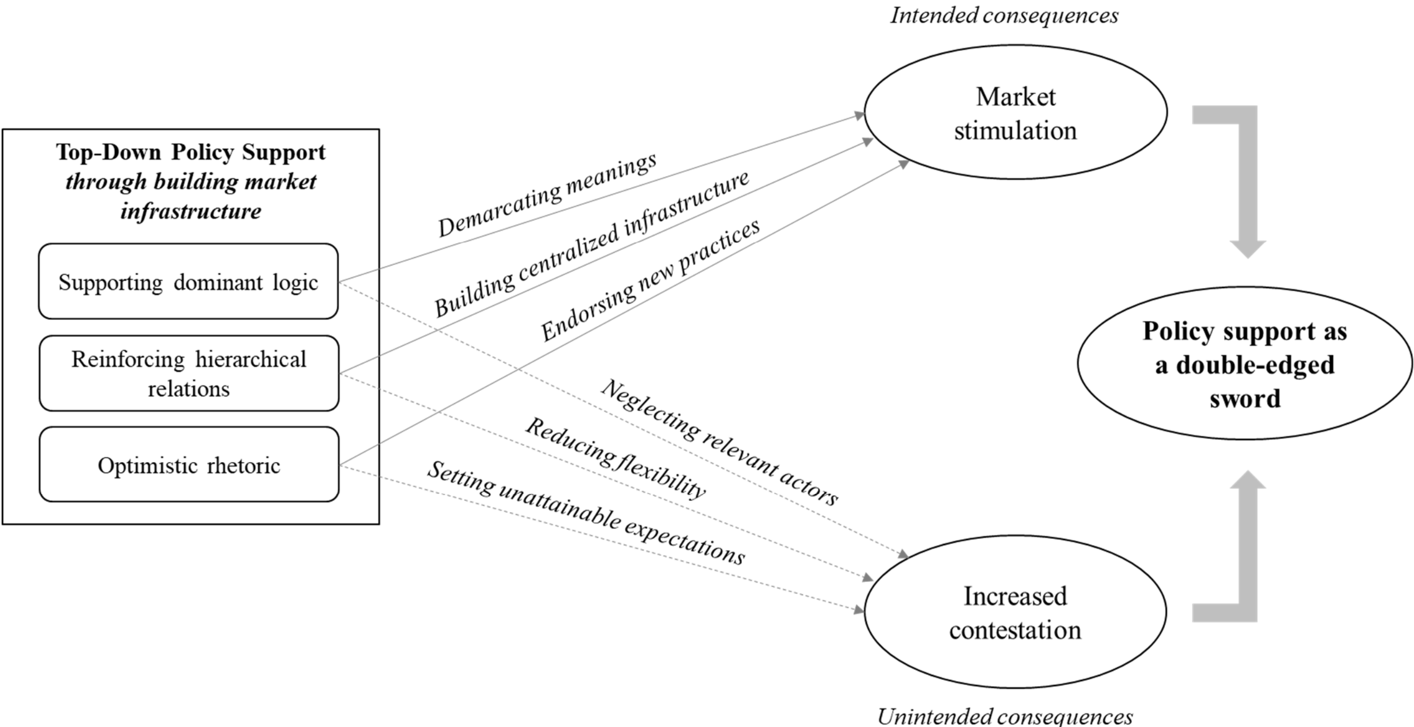


**Figure 3: The effects of top-down policy support in nascent markets**



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