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IMPACT INVESTING

A Literature Review on the Effectiveness of Investor Impact Mechanisms

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Abstract

This paper explores the potential of different investor mechanisms to generate company impact. Our aim is thus, to provide a more systematic basis for the evaluation of the effectiveness of such mechanisms. By synthesizing prior literature and using the investor impact potential as an analytical tool, we evaluate stewardship, capital allocation and field building for their effectiveness. We lay out a range of potential for all three mechanism categories based on whether their deployment is direct or indirect. From our analysis, we find that significant theoretical and empirical gaps persist. The indirect effect that such mechanisms have, remains especially understudied while secondary market investments' impact potential is still questionable. We contribute to existing research by collecting, integrating and evaluating investor mechanisms based on their investor impact potential.

Keywords: *Impact investing, impact potential, investor impact, impact mechanism, capital allocation, engagement*

1. Introduction

Within the field of sustainability-related investments, impact investing is a relatively young investment strategy that aims to ‘generate positive, measurable, social and environmental impact alongside a financial return’ by utilizing various impact mechanisms ‘to positively influence targeted impact results (GIIN 2024, 56). Investors are deploying impact investing strategies across asset classes, but face uncertainty both in defining what constitutes true ‘impact’ and in determining how to measure their contribution to that impact. This difficulty stems from the absence of a harmonized, standardised framework (e.g., Caldecott et al. 2024) and the complexities associated with impact measurement, particularly regarding the ‘measurement and management of impact results’ (GIIN 2024, 49-50).

Calls for a re-orientation of impact measurement to better capture how investor actions impact the real world (Busch et al. 2021) and for an improved exploration of investor impact mechanisms (Caldecott et al. 2024; Kölbel et al. 2020; Wilkens et al. 2024) emphasize the need for clear conceptual foundations to support any impact assessment method (Busch et al. 2021; Caldecott et al. 2024; Kölbel et al. 2020; Wilkens et al. 2024). To this end, this paper conducts a literature review focusing on the impact potential of investor actions in driving meaningful change.

This review examines the effectiveness of investor impact mechanisms by analyzing how different investment strategies contribute to social and environmental outcomes through direct and indirect investor impacts. It categorizes investor impact mechanisms, such as stewardship, capital allocation, and field building, based on their impact potential (high, medium, or low) and explores the conditions under which these mechanisms can successfully create or influence company impact. Within this study, we elaborate on key determinants that shape the impact potential of the investor impact mechanisms. For example, next to investor size, other studies have highlighted the influence of cultural, experiential, or sector-specific factors on the

effectiveness of investor impact mechanisms (Caldecott et al. 2024; Bauer et al. 2023; Dimson et al. 2015; Slager et al. 2023; Wilkens et al. 2024). By synthesizing this academic research and practitioner insights, the review identifies key challenges in impact measurement and highlights gaps in the empirical evidence.

2. Materials and Methods

To embed this research into the broader literature on the effectiveness of investor impact mechanism, we first introduce the core concepts of impact, impact pathway and impact potential. Susequently, this chapter discusses the methodological approach of this study.

2.1. Impact

Kölbel et al. (2020) developed important conceptual foundations for reviewing the literature on investor impact mechanisms. They define impact as the 'change in a specific social or environmental parameter that is caused by an activity' (Kölbel et al. 2020, 556). This definition aligns with definitions from both regulatory authorities as well as practitioners.[1] [2]

Kölbel et al. (2020, 556) further differentiate impact between 'company impact,' i.e. 'the change that company activities achieve in social and environmental parameters,' and 'investor impact,' i.e. 'the change that investor activities achieve in company impact.' The authors suggest that 'investor impact' involves a shift or improvement of company impact directly or indirectly attributed to an investor's specific actions in the form of capital allocation, active ownership, engagement with investee companies, or other mechanisms. These actions can

[1] The European Sustainability Reporting Standards (ESRS) introduced this definition of impact: 'The effect the undertaking has or could have on the environment and people, including effects on their human rights, connected with its own operations and upstream and downstream value chain, including through its products and services, as well as through its business relationships. The impacts can be actual or potential, negative or positive, intended or unintended, and reversible or irreversible. They can arise over the short-, medium-, or long-term. Impacts indicate the undertaking's contribution, negative or positive, to sustainable development.' (European Commission 2023b, p. 269).

[2] The Impact Management Platform (IMP), a global collaboration between major providers of sustainability standards and guidance, whose goal is to mainstream the practice of impact management, defines impact(s) as 'The effect(s) of organisations' actions on people and the natural environment' (IMP 2024a).

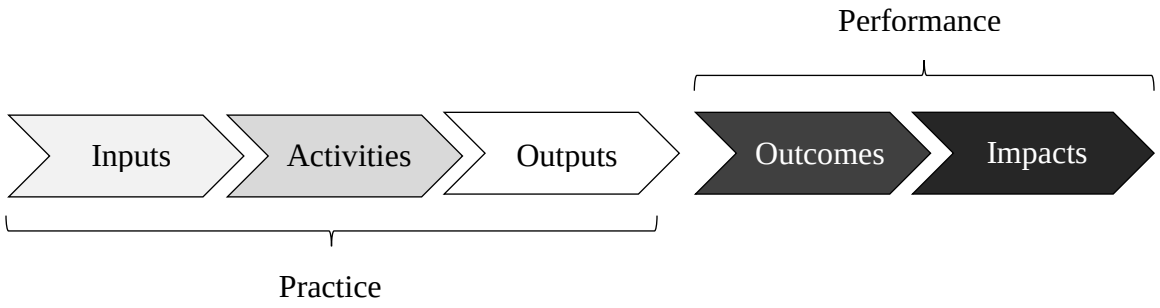
actively drive or contribute to changes in social or environmental outcomes at the company level, resulting in measurable impacts assessed through metrics (e.g., reductions in carbon emissions). In practice, the concept of 'investor impact' is often referred to as 'investor contribution.' For instance, the Impact Management Project (IMP) defines it as 'the contribution that the investor makes to enable enterprises (or intermediary investment managers) to achieve impact' (IMP 2024a). In this context, we use the terms 'investor impact' and 'investor contribution' interchangeably.

Drawing on the conceptual distinction between 'company impact' and 'investor impact,' Busch et al. (2021) identify two types of impact investments: 'impact-aligned investments' and 'impact-generating investments.' Impact-aligned investments are investments made in companies with a positive impact, but which do not necessitate that this company impact is causally influenced or initiated by the actions of an investor. In contrast, impact-generating investments are characterized by investors actively seeking to influence or create positive company impacts (Busch et al. 2021; ITF-Impact Taskforce 2021; McCreless et al. 2024).

2.2. Impact pathway

An important concept not yet systematically integrated in academic discussions is the **impact pathway**, which illustrates 'the sequence linking an organisation's actions to their effects on people and the natural environment' (IMP 2024a) (see Figure 1). Organizations can be companies but also investors. The impact pathway is conceptually helpful in two key ways. First, it clearly distinguishes organizational practices (inputs, activities, and outputs) from performance (outcomes and impacts).

Figure 1: The impact pathway (adapted from Busch et al. 2023 and IMP 2024b)



Organizations have a large degree of influence over their own practices, i.e. which inputs they use, which activities they implement, and which outputs they produce. However, they have varying influence on outcomes and their changes—which reflect social or environmental performance—as these are often influenced by external factors beyond the company's or investor's control.[3] Second, the impact pathway also helps distinguish between impact and outcome. By clarifying these terms, our approach avoids conceptual confusion and provides a clear distinction between 'outcome' and 'impact' (Busch et al. 2023). In this context, Hockerts et al. (2022) elaborate on the concepts of 'impact value chains' and 'theory of change,' presenting them as essential to understand how organizational activities translate into broader impacts. These frameworks closely align with the impact pathway concept, highlighting the need to account for external factors when analyzing organizational impacts. Impact measurement practices play a crucial role in linking outputs to outcomes and impacts while also adjusting for these external effects.

2.3. Impact potential

The impact pathway shows that investors' influence on outcomes and impacts varies, depending on the context and external factors that are beyond investors' control. Current literature has studied which investor impact mechanisms have been effective in the past, providing insights

[3] We adopt the IMP definition of 'outcome' as 'the level of well-being experienced by people or the condition of the natural environment that results from the actions of the organisation, as well as from external factors' (IMP 2024a).

into whether and how investors created impact ex-post. While these academic insights are valuable, measuring impact ex-post in the context of investment decisions is difficult, since impact is typically only realized over time. This poses a challenge for investors, as the effectiveness of their actions may not be immediately observable. Measuring investor impact ex-post is also challenging for a method that aims to assess the impact of financial products, which is why it is important to provide insights on how to measure investor impact ex-ante. Therefore, we use the concept of **investor impact potential** (IIP) to assess investors' potential to generate positive social and environmental impact ex-ante (Mangot and Koch 2023). Investor impact potential is determined by two key factors (McCreless et al. 2024): (1) the likelihood that an investor's action influences company impact and (2) the magnitude of that impact.[4]

We define investor impact potential (IIP) as:

$$IIP = L * M$$

where L represents the probability that an investor influences company impact, and M reflects the magnitude of that impact.

An example of high investor impact potential is a real estate fund that invests in its property portfolio in order to make it more environmentally friendly by replacing fossil-fuel-based heating systems with renewable energy-based heating systems. In this case, both the likelihood that the fund's investments lead to a positive environmental impact and the magnitude (scale and scope) of the impact are high, resulting in a high investor impact potential.

[4] 'Magnitude' refers to the scale and scope of the company impact. 'Scale' refers to 'how grave the negative impact is or how beneficial the positive impact is for people or the environment' (European Commission 2023b, p. 25). 'Scope' refers to 'how widespread the negative or positive impacts are. In the case of environmental impacts, the scope may be understood as the extent of environmental damage or a geographic perimeter. In the case of impacts on people, the scope may be understood as the number of people adversely affected' (European Commission 2023b, 25).

2.4. Methodology

While the research on investor impact mechanism has been growing in recent years, the effectiveness of such mechanism remains understudied (Caldecott et al., 2024; Bauer et al., 2023). Based on a few research articles that deal with elements of this field and identify fragments of the whole picture on impact mechanisms, this study aims to collect and connect these prior findings. From these initial reviews, a set of search terms was devised to structure the data collection process. To identify relevant academic literature for this study, we focused our search on online databases, namely JSTOR, ScienceDirect and Google Scholar. These sources were screened using the search query (‘impact investing’ OR ‘impact investor’) AND (‘impact mechanisms’ OR ‘impact potential’). The initial search yielded 520 articles, reports and working papers. We restricted the search to articles published since 2013 based on the seminal article of Brest & Born (2013) that represents a foundational source of information for large parts of the impact investing field. Further, the study excluded articles not written in English and those not relevant to the topic of impact investing. Additionally the study included several industry reports and working papers to account for conceptual strides made by practitioners.

The identified literature was subsequently analyzed for several key phrases. We screened for overarching mechanisms that describe how impact investors can exert influence on their investees, indications of the effectiveness of investor impact mechanisms and the concept of impact potential.

3. Results

Investor impact mechanisms describe how the actions of investors can create company impacts, encompassing actions that can be carried out individually by a single investor or collectively through coordinated efforts by several investors. These mechanisms include **stewardship**[5] activities such as **active ownership**[6] and **engagement**[7] (e.g., Caldecott et al. 2024; Kölbel et al. 2020; Mangot 2023a; Wilkens et al. 2024; McCreless et al. 2024), and **capital allocation**[8] (e.g., Kölbel et al. 2020; Mangot 2023b; McCreless et al. 2024). In addition, **field building**[9] can create investor impact by shaping the wider institutional context and market environment (e.g., Mangot 2023c; Marti et al. 2024) (see Table 1). Such mechanisms may yield positive impacts on specific companies but also influence broader industry norms.

3.1. Direct vs indirect investor impact

To analyze the effectiveness of investor impact mechanisms, we build on several academic papers and practitioner perspectives to distinguish between direct and indirect investor impact (Caldecott et al. 2024; Impact Frontiers 2024; Kölbel et al. 2020; Mangot 2024; Marti et al. 2024; McCreless et al. 2024; Wilkens et al. 2024). In a recent publication summarizing the main impact channels, Marti et al. (2024, 2189) differentiate between '(1) direct impact on

[5] **Stewardship** is defined as 'the use of investor rights and influence to protect and enhance overall long-term value for clients and beneficiaries, including the common economic, social, and environmental assets on which their interests depend' (CFA Institute et al. 2023, 14). It represents investors' responsibility to manage their investments in a way that generates real-world positive impact on society (Busch et al. 2021). Stewardship encompasses well-established strategies, such as active ownership and engagement—both individual and collective—as well as the provision of non-financial resources to investees. These include the provision of expertise, networks, and capacity building to support company growth.

[6] **Active ownership**, a form of stewardship, involves the use of shareholder rights, such as voting on shareholder resolutions at general meetings, proposing shareholder resolutions or joining the board of directors.

[7] **Engagement**, a form of stewardship, refers to the active involvement of investors in influencing investee companies' decisions, practices, and governance structures through actions such as direct dialogue and direct interaction with company management and boards of directors.

[8] **Capital allocation** refers to the distribution of financial resources by investors into specific investees, projects, or assets to achieve desired financial returns or social and environmental impact. 'Investors may either buy a company's financial assets, implicitly backing the company with their capital, or sell a company's financial assets, denying the company such backing. The latter is commonly referred to as 'exit' (Kölbel et al. 2020).

[9] **Field building** involves efforts by investors or organizations to shape the broader ecosystem in which companies operate. This includes stigmatization, endorsement, demonstration (Kölbel et al. 2020), establishing industry standards, or advocating for policy changes, promoting best practices, and creating a supportive infrastructure (e.g., ESG reporting standards) to encourage sustainable practices across an industry or sector.

companies, (2) indirect impact via other shareholders, and (3) indirect impact via the institutional context.' This distinction provides insights into how different investor strategies contribute to positive change.

Direct investor impact refers to changes in company impact resulting from an investor's direct interactions with a company or an asset. As such, the key investor impact mechanisms driving direct investor impact are stewardship and capital allocation, if they involve direct interactions with investees. Direct investor impact can exhibit high to low investor impact potential, depending on the context of the investment. For example, in primary market private equity investments, investors often have a high investor impact potential. Venture capital investors typically have high investor impact potential through the provision of liquidity, as they inject capital directly into impact-focused startups.[10] Without the investor, impact might not be created in such cases. Moreover, once established, start-ups can generate positive company impacts with high magnitude.

Stewardship actions, such as direct dialogue with management or active ownership through shareholder voting can also create direct investor impact. The investor impact potential of such actions varies from high to low, depending on the likelihood of the investor influencing the company's impact and the magnitude of that impact. For example, shareholders with significant equity stakes or large institutional investors engaging individually with a company's management to advocate for specific changes have a high likelihood of generating meaningful, large-scale positive impacts.

Indirect investor impact refers to changes driven by investor actions through interactions with markets or other stakeholders rather than direct interactions with companies or assets. This type of investor impact is created through mechanisms such as stewardship, capital allocation, and

[10] **Provision of liquidity** refers to '[i]nvestment in sustainable companies whose growth is restricted due to limited access to capital' (DVFA 2023, 8). We broaden this definition to include investments into economic activities or companies that are transitioning towards becoming sustainable.

field building. One example of indirect investor impact is the ability to influence corporate behavior through capital markets by changing the cost of capital (Caldecott et al. 2024).[11]

Stewardship strategies can also generate indirect investor impact when investors collaborate with other investors to influence investees. These kinds of engagements can successfully achieve engagement goals as the collaboration between investors increases the likelihood of influencing companies, even though the engagement is indirect (Dimson et al. 2021).

Field-building activities, such as media campaigns, collaboration with policymakers, and advocacy for policy and regulatory changes, can create indirect investor impact as well, for example by supporting regulatory shifts or changing consumer behavior (Marti et al. 2024). Field-building activities rely on indirect pathways that depend on intermediate actors, market dynamics, or societal responses to achieve their effects. As a result, the causal link between investor actions and company impacts is less direct and field-building activities are typically associated with low impact potential (Marti et al. 2024). While the scale of positive company impact is potentially high, the likelihood of the investor's actions directly driving changes in company impact is often very low.

[11] **Cost of capital** refers to the financial return a company has to offer to attract and retain external funding through equity and debt capital. It is influenced by the willingness of investors to allocate capital to sustainability-oriented companies. Investors can lower the cost of capital for 'green' companies, facilitating their growth, while increasing it for 'brown' companies, encouraging a shift towards more sustainable practices. 'These preferences can be expressed in traditional bond, loan, and equity markets, and in dedicated markets for sustainable products, including (e.g.,) sustainability-linked bonds and loans, with coupons or interest rates tied to the achievement of sustainability targets' (Caldecott et al. 2024, 2).

Table 1: Effectiveness of Investor Impact Mechanisms

INVESTOR IMPACT MECHANISMS	INVESTOR IMPACT POTENTIAL	KEY SOURCES
STEWARDSHIP 1. Active ownership 2. Engagement 3. Provision of non-financial resources	**1. Active Ownership (**exercise of ownership and voting rights) a) ***Direct investor impact*** with ***high*** impact potential → individual actions; occurs when investors have a large ownership stake, e.g., in primary/private markets b) ***Direct investor impact*** with ***low*** impact potential → individual actions; occurs when investors have a small ownership stake, e.g., minority shareholders in secondary/public markets c) ***Indirect investor impact*** with ***medium*** impact potential → collaborative effort to address companies with dispersed ownership and market capitalization; occurs when investors have a small ownership stake but are able to convince other shareholders; purpose is to pool resources, align goals, and present unified agendas	Dimson et al. 2021 Kölbel et al. 2020 Mangot 2023a Mangot 2024 Slager et al. 2023
	2. Engagement (dialogue with investees) a) ***Direct investor impact*** with ***high*** impact potential → individual actions; occurs when investors have large ownership stake, e.g., in primary/private markets b) ***Direct investor impact*** with ***low*** impact potential → individual actions; occurs when investors have a small ownership stake, e.g., secondary/public markets c) ***Indirect investor impact*** with ***medium*** impact potential → collaborative engagement efforts to address companies with dispersed ownership and market capitalization; occurs when investors have a small ownership stake but are able to convince other shareholders and stakeholders;	Broccardo et al. 2020 Caldecott et al. 2024 Kölbel et al. 2020 Mangot 2023a Mangot 2024 Slager et al. 2023

	purpose is to pool resources, align goals, and present unified agendas	
	3. Provision of non-financial resources ***Direct investor impact*** with ***high*** impact potential → individual actions; occurs when investors provide technical, managerial, or operational expertise, networks, and capacity building directly to address areas where internal capabilities are lacking	Brest and Born 2013 Heeb and Kölbel 2020 Mangot 2023f
CAPITAL ALLOCATION 1. Provision of liquidity 2. Cost of capital	**1. Provision of liquidity** a) ***Direct investor impact*** with ***high*** impact potential → occurs when the investment of the single investor is essential for providing a large amount of the required capital, typically in underserved markets and/or venture capital b) ***Direct investor impact*** with ***medium*** impact potential → occurs when the investment of the single investor is part of a bigger investment effort of several investors and, as such, not essential for realizing the investment's purpose , e.g., green bond issuance	Brest and Born 2013 Broccardo et al. 2020 Caldecott et al. 2024 Mangot 2023e Marti et al. 2024
	2. Cost of capital a) ***Direct investor impact*** with ***high*** impact potential → occurs by influencing the cost of issuers' access to capital by offering better (worse) financing conditions for (un)sustainable business practices, e.g., by sustainability-linked bonds b) ***Indirect investor impact*** with ***medium*** impact potential → requires collective effort by many investors; occurs by influencing the cost of issuers' access to capital by price signals and mechanisms on secondary markets c) ***Indirect investor impact*** with ***low*** impact potential → individual effort by small investors; occurs by selling	Caldecott et al. 2024 Kölbel et al. 2020 Mangot 2024

	and purchasing securities on secondary markets	
FIELD BUILDING 1. Stigmatization and endorsement 2. Demonstration 3. Lobbying 4. Establishing standards and benchmarks	**1. Stigmatization & endorsement** ***Indirect investor impact*** with ***low*** impact potential → occurs by publicly criticizing or praising a company's sustainability performance; typically following one's own investment decisions; seeking to influence third parties or other stakeholders' interactions with a company; success depends on stakeholders' uptake	Kölbel et al. 2020 Marti et al. 2024
	2. Demonstration ***Indirect investor impact*** with ***low*** impact potential → occurs when investors seek to encourage other investors to follow their lead; i.e. also to invest sustainably; success depends on investors' uptake	Kölbel et al. 2020
	3. Lobbying for policy and normative shifts ***Indirect investor impact*** with ***low*** impact potential → occurs through public campaigns, collaboration with policymakers, and advocacy for policy and regulatory changes, which result in industry-wide adoption of sustainability practices, ideally creating long-term structural shifts; success depends on public and political uptake	Brest and Born 2013 Caldecott et al. 2024 Mangot 2023c Marti et al. 2024
	4. Establishing standards and benchmarks ***Indirect investor impact*** with ***low*** impact potential → occurs when investors initiate and/or support the establishment of industry standards and benchmarks which in turn support the creation of positive company impacts; success depends on involved parties' uptake	Kölbel et al. 2020 MacLeod and Park 2011 Marti et al. 2024

3.2. Stewardship: Active ownership and engagement as key investor impact mechanisms

Our literature review demonstrates that stewardship is an effective mechanism for driving change within companies. Investors can influence corporate policies and practices directly or indirectly to create investor impact. This mechanism can be deployed individually or collectively, with varying degrees of influence and investor impact potential. The effectiveness of stewardship varies based on ownership stakes and engagement approaches.

3.2.1. Active ownership

Active ownership involves the direct use of shareholder rights in both public and private markets, such as voting at general meetings, proposing shareholder resolutions, or taking board seats. Based on prior work in the corporate governance literature dealing with the importance of shareholder voice (Hirschman 1970), Marti et al. (2024) highlight the importance of investors leveraging their 'private voice' to advocate for company-level changes, thereby increasing the likelihood and magnitude of their impact. By combining voices and aligning on shared goals, research suggest that investors can strengthen their ability to influence corporate policies and practices (Marti et al. 2024).

Direct investor impact

When investors hold substantial ownership stakes, active ownership by individual investors demonstrates high impact potential. Research shows that large shareholding positions increase the likelihood that active ownership is successful (Bauer et al. 2023; Kölbel et al. 2020; Dimson et al. 2021; Grote and Zook 2022). The literature indicates that larger ownership stakes by sustainability-oriented investors such as private equity funds can positively influence firms' ESG performance (Bauer et al. 2023; Wilkens et al. 2024). Furthermore, Broccardo et al.

(2020), Mangot (2023a), and Becht et al. (2023) underscore the effectiveness of voting as opposed to divestment strategies. Divesting from an investment also eliminates the possibility for an investor to influence the investee in the future (Krueger et al. 2020). Individual active ownership can also yield limited impact potential when investors hold minor positions. Small shareholders, despite having formal ownership and voting rights, face significant challenges in influencing corporate behavior through individual actions. This limitation is particularly evident in large, publicly traded companies where ownership is widely dispersed. Marti et al. (2024) and others further argue that the existence of organizational threats induces stronger receptiveness to shareholder demands (Barko et al. 2022; Dimson et al. 2015; Semenova 2023). While employing an active ownership approach has the potential to greatly impact an investee, this finding cannot be generalized since the success of this mechanism depends on specific conditions of market and ownership stake. The investor impact potential also depends on the type of active ownership that is practiced, as voicing concerns often yields a better outcome than divestment (Becht et al. 2023).

Indirect investor impact

Collaborative active ownership efforts to address companies with dispersed ownership and market capitalization show medium impact potential by aggregating smaller ownership stakes into meaningful voting blocks (Dimson et al. 2015). Research by Slager et al. (2023) indicates that coordinated voting strategies and joint shareholder resolutions can effectively influence corporate behavior, even when individual ownership stakes are modest. Similarly, Yang et al. (2018) find that companies receive shareholder proposals more favorably when they are supported by a large coalition of investors.

Currently, the early, sparse conceptual and empirical research does not allow generalizing when a significant effect of coalitions and partnerships among investors can be expected. However, it is assumed that the stronger the collaboration, the higher its investor impact potential.

3.2.2. Engagement

Engagement is a broader investor impact mechanism, which involves the gradual interaction with companies, often behind closed doors, through dialogue with management or boards to influence policies and practices (Becht et al. 2023). This strategy, which extends beyond voting to include dialogue-driven governance, relies on investors actively participating in meaningful discussions with management about sustainability strategies, governance practices, or operational policies. Such discussions can lead to significant impact, such as commitments to net-zero targets or improved social outcomes (Becht et al. 2023; Caldecott et al. 2024; Mangot 2024). Additionally, non-equity investors, such as bondholders, can engage directly with companies to encourage improved ESG practices (Caldecott et al. 2024).

Direct investor impact

Empirical studies show that individual engagement demonstrates the highest investor impact potential when backed by significant ownership positions, particularly in private markets. Studies by Dimson et al. (2015, 2021) and Bauer et al. (2023) show that substantial shareholders can effectively influence management through direct dialogue, often achieving concrete changes in corporate policies and practices. However, Bauer et al. theorize that the increase of engagement success with larger ownership is mostly due to 'changes in engagement characteristics rather than increased control' (2023, 75). The literature indicates that this approach is particularly effective in driving systemic sustainability changes, securing commitments to sustainability transitions and governance reforms (Marti et al. 2024).

For example, investors can advocate for companies to adopt transparent transition goals and monitor adherence to these commitments, ensuring alignment with sustainability objectives. This alignment is particularly crucial in transition contexts, where organized and purposeful voting allows investors to promote specific ESG priorities by influencing existing resolutions or proposing new ones (Becht et al. 2023; Mangot 2023a; Mangot 2024). Dimson et al. (2015)

and Slager et al. (2023) highlight that the effectiveness of such engagement increases significantly when investors hold substantial ownership stakes, as this enhances their ability to shape corporate governance directly. At the same time, individual engagement efforts by minor shareholders show limited impact potential in public markets. Research indicates that small stakeholders often struggle to secure meaningful dialogue with management or effect change through individual engagement efforts (Slager et al. 2023). This limitation is particularly evident in large-cap companies with dispersed ownership structures.

However, even moderate ownership levels can yield meaningful impact if multiple investors align their engagement strategies effectively (Mangot 2023a). Bauer et al. (2023) and Dimson et al. (2015) show that collaborative engagement of investors significantly increases the success rate of said engagement. This alignment is particularly crucial in transition contexts, where organized and purposeful voting allows investors to promote specific ESG priorities by influencing existing resolutions or proposing new ones (Becht et al. 2023; Mangot 2023a; Mangot 2024). Investors increasingly prioritize transition investments, reflecting a shift toward financing projects and entities committed to improving sustainability performance through credible, science-based transition plans (Caldecott et al. 2024; Ramos Muñoz et al. 2024).

The estimated cost of a reform also raises the likelihood that engagement efforts are effective in producing direct investor impact (Kölbel et al. 2020). Demonstrating the difference of cost associated with changes in environmental, social, or governance projects, Dimson et al. (2015) and Barko et al. (2022) find that engagement requests that entail costlier adjustments and reorganization are less likely to be successful than those requiring lower costs. The investor impact can thus vary in effectiveness depending on the cost of the engagement matter. Another success factor that mediates the effectiveness of engagement is the company's level of prior ESG or CSR experience (Marti et al. 2024; Barko et al. 2022). They find that previous successful engagements indicate an increased likelihood of future successful engagement.

Additionally, Barko et al. (2022) establish a positive correlation between engagement success and the change in ESG score of the engaged organization. Their findings indicate that firms with lower ex-ante ESG ratings are more likely to be targeted for engagement, and when these engagements are successful, they lead to significant improvements in ESG scores. Moreover, successful engagements yield tangible benefits, including increased sales growth and enhanced stock performance. A number of studies also examine the engagement success in relation to the investment theme. Dimson et al. (2015) find that corporate governance engagements are significantly more likely to succeed than efforts aimed at environmental and social issues. This finding is supported by Gillan and Starks (2000) and Aggarwal et al. (2014).

If investors share cultural traits, values, and backgrounds with the company of their engagement focus, the investor impact potential is also higher than without those compatibilities (Dimson et al. 2015). Additionally, Slager et al. (2023) find that an engagement with a target firm is greatly improved when the investor or a coalition member is present in the target firm's home country. Thus, geographical proximity (or local access) is another success factor for the engagement mechanism. While some authors have introduced other factors such as industry (Bauer et al. 2023), sales growth and market size (Barko et al. 2022), and reputational concerns (Dimson et al. 2015) as possible influences on the success of engagement, these have not been empirically shown to have such an effect.

The extant literature on the engagement mechanism provides a strong empirical foundation for assessing its investor impact potential. Depending on influential factors such as investor size, ESG experience, and cultural compatibility, engagement can be an effective strategy for impact investors to achieve their impact directly.

Indirect investor impact

Collaborative engagement initiatives demonstrate medium impact potential by leveraging collective influence to drive changes across companies and industries. The literature,

particularly work by Becht et al. (2023), Caldecott et al. (2024), and Slager et al. (2023), shows that coalition-led engagement initiatives and coordinated campaigns prove especially valuable in advancing sustainability goals. Exemplified by initiatives such as the investor-led initiative on climate change Climate Action 100+ and the PRI Collaboration Platform, collaborative shareholder engagement represents a 'nonconfrontational form of social activism' (Slager et al. 2023, 7696) where investors pool resources, align goals, and present unified agendas to corporate management.

These coalitions strengthen influence through mechanisms such as filing resolutions, conducting coordinated public campaigns, and targeting industry-wide norms. (Kölbel et al. 2020; Mangot 2024). In the context of combating climate change, collaborative engagement effectively targets high-emission companies and other key stakeholders while fostering systemic sustainability transitions (Slager et al. 2023). This approach is particularly valuable in secondary markets, where individual investor influence is limited but collective actions can shape industry standards and catalyze large-scale changes. When a critical mass of asset managers aligns their practices with ESG standards, it fosters systemic changes in financing norms and corporate operational decisions (Dimson et al. 2015).

In the context of the 'voice over exit' debate, Broccardo et al. (2020) argue that coordinated engagement generally proves more effective than divestment (exit) in achieving corporate change. They propose for example that the effectiveness of boycotting measures increases when multiple investors coordinate the boycott. Through these coordinated efforts, investors can maximize their influence and ensure a stronger and more sustained impact than isolated exit actions (Dimson et al. 2015).

The achievement of indirect investor impact is, thus, contingent on the concentration and alignment efforts of smaller investors. Collective engagement has shown to be effective,

especially in secondary markets. However, the empirical research remains insufficient to allow generalized findings.

3.2.3. Provision of non-financial resources

Direct investor impact

Beyond voting and direct dialogue, providing non-financial resources—such as expertise, networks, or capacity building—can further enhance a company's capacity for positive impact (Brest and Born 2013; Heeb and Kölbel 2020). This form of intervention allows investors to address specific gaps in internal capabilities, enabling investees to overcome barriers to sustainable growth and positive impact (Heeb and Kölbel 2020). The impact potential of this mechanism is usually high, especially in early-stage investments where investors' likelihood of influencing the company is also high (Heeb and Kölbel 2020). Such non-financial support allows investors to deepen their impact by directly influencing a company's operational and strategic decisions, specifically in the case of early-stage venture capital investments and private equity or debt portfolios (Proksch et al. 2017). In these scenarios, investors can deliver tailored support to enhance a company's ability to implement sustainable practices, address knowledge gaps, or navigate regulatory and market transitions (Heeb and Kölbel 2020). For example, such interventions can address gaps in knowledge, infrastructure, or market access that might otherwise limit a company's ability to implement sustainable practices (Proksch et al. 2017). This form of stewardship often complements financial capital by enabling companies to use that capital more effectively (Heeb and Kölbel 2020). Moreover, non-financial contributions can help companies navigate regulatory or market transitions, such as decarbonization efforts or the adoption of circular economy principles (Heeb and Kölbel 2020). For instance, an investor offering guidance on aligning operations with international

sustainability standards can help the company meet market or regulatory expectations while reducing risks.

This impactful mechanism can take several forms, depending on the relationship between the investor and the investee, as well as the specific challenges or opportunities faced by the company:

- Expertise: Investors can provide technical, managerial, or operational expertise to guide companies in adopting best practices (Proksch et al. 2017). For example, supporting the development of robust sustainability strategies or advising on supply chain optimization can lead to measurable improvements in environmental and social performance (Heeb and Kölbel 2020).
- Networks: Facilitating connections with other industry players, potential customers, or policy stakeholders can amplify the impact of a company's operations. Networks foster knowledge exchange and collaboration, enabling investees to adopt innovative solutions and scale their operations more effectively (CFA Institute et al. 2023).
- Capacity Building: Capacity-building efforts, such as training programs for employees or supporting governance improvements, can ensure that positive changes are not only implemented but sustained over the long term. These initiatives often have cascading benefits across a company's operations, workforce, and external stakeholders.

The relationship between the provision of non-financial resources and its investor impact potential is particularly evident in early-stage ventures. However, since the extant literature does not provide sufficient empirical research outcomes, the effectiveness of this mechanism in mature companies is more strongly debated.

3.3. Capital allocation

Marti et al. (2024, 2195) describe capital allocation as a tool for 'shaking up taken-for-granted assumptions,' highlighting how sustainable investing can challenge entrenched views about the viability of environmental practices. Supporting this, Yan et al. (2021) show that green investing prompts companies to reassess unfavorable assumptions about sustainability, influencing operational decisions and fostering improved practices.

Through strategic allocation decisions—such as funding, exclusion, or divestment based on sustainability criteria—investors can influence a company's cost of capital and provision of liquidity. These financial dynamics can indirectly shape corporate strategies and encourage improved sustainability practices (Caldecott et al. 2024; Kölbel et al. 2020; Mangot 2023b; Wilkens et al. 2024).

3.3.1. Provision of liquidity

Direct investor impact

The provision of liquidity demonstrates high impact potential in situations where investors offer capital, particularly in underserved markets and venture capital scenarios, since the likelihood that their capital is essential for maintaining or growing sustainable company activities is large in this context (Brest and Born 2013). Research by Marti et al. (2024) shows that in emerging sectors with limited traditional financing options, direct investor capital can effectively catalyze growth and support long-term sustainable trajectories. Similarly, Caldecott et al. (2024) emphasize that investments in illiquid assets, such as private equity, bridge critical financing gaps, providing stability for projects that promote social or environmental goals. In addition, improving liquidity in markets facilitating transition finance ensures that companies with viable transition plans have access to the financial resources necessary for their evolution (Ramos

Muñoz et al. 2024). Another means for investors to achieve a direct impact is by denying (re)entry into a project or company. This includes withholding future capital and refusing to refinance projects that do not align with investor expectations, goals, or values (Hoepner and Schneider 2022). This mechanism is applicable only in primary markets and reflects a high level of investor impact potential.

The impact potential decreases when the individual investor's capital is not essential for the completion of a project, such as in green bond issuance. This medium impact level typically occurs in more developed markets where multiple funding sources are readily available. Caldecott et al. (2024) detail this moderate level of impact potential by giving the example of large creditors whose willingness to lend can inhibit the ability of the investee to access capital. However, in these liquid markets, where alternative capital can be easily accessed, in most cases the investment serves to supplement rather than enable project funding, resulting in a reduced likelihood that an individual investor's impact is essential for creating positive company impact.

In summary, the provision of liquidity as a high impact potential mechanism has been demonstrated only in underserved and immature markets. While there is some early conceptual work on this topic, further empirical research is necessary to confirm this effect in a broader context, notably how and when significant effects can be expected in mature markets.

3.3.2. Cost of capital

Direct investor impact

Capital allocation can reach high impact potential by influencing the costs of capital. In these cases, investors can directly influence financing conditions through specific financial instruments and strategies, increasing the likelihood that their actions change company impacts. Sustainability-linked bonds, which offer preferential rates for sustainable practices, represent a prime example of this high-impact mechanism (Kölbel et al. 2020). The same is true for primary

market investments in financially constrained environments, particularly those targeting small firms in emerging markets or green innovation startups, where a single investor can have significant influence on the financing conditions. Heinkel et al. (2001) argue that the exclusion of unsustainable companies from green investors' portfolios leads to neutral investors having to hold more stock of unsustainable firms, which boosts demand for additional risk compensation and a lower share price. This results in an increase in the cost of capital of unsustainable firms.

Additionally, investors can influence the cost of capital by divesting from those companies that are unsustainable (Caldecott et al. 2024). A number of studies have demonstrated the negative effect of divestment on stock prices, both across the broader markets and specifically within the oil and coal industries (Cojoianu et al. 2020; IEEFA, 2019; Rohleder et al. 2022). However, most investors prefer integrating sustainability into pricing mechanisms, such as sustainability-linked loans, rather than relying on negative screening (Caldecott et al. 2024). While the effectiveness of exclusionary strategies in increasing the cost of capital of unsustainable firms is still hotly discussed (Landier and Lovo 2020), Pástor et al. (2021) demonstrate that by lowering the cost of capital of sustainable firms, unsustainable holdings will increase the cost of capital and become less attractive. Heinkel et al. (2001) propose that capital allocation decisions have greater impact in markets where traditional financing is limited or in cases where investments directly influence an investee's financial viability, such as microfinance. De Angelis et al. (2022) also argue that strategic investments in transition projects have proven especially effective in lowering costs for sustainability transformations.

Other key determinants of the degree of investor impact through capital allocation are the stringency of the regulatory environment and the sensitivity of the investor to climate impact (Caldecott e al. 2024). This relationship between the anticipation of tighter regulations and a reduction of a company's cost of capital is also argued by De Angelis et al. (2022). The investor

pressure to transform an organization towards less carbon-intensive technologies is thus more potent in contexts of regulatory change.

The influence that a single investor can exert on an investee's cost of capital is frequently discussed. While this effect might hold true for environments of financial constraint or large ownership stakes, this effect has not been confirmed in general. However, the extant literature has examined a number of conditions and determinants that may increase the likelihood that a cost of capital effect can be realized. Further research is required to establish a strong empirical foundation for these preliminary findings.

Indirect investor impact

The impact potential of changing the cost of capital is typically low for a single investor. This is especially true in secondary markets, where the cost-of-capital effect remains debated and individual trades rarely have an effect on overall market prices, leading to a low probability of a single investor influencing the cost of capital without coordination with other investors (Caldecott et al. 2024; Mangot 2024; Wilkens et al. 2024; Hartzmark and Shue 2023). The impact potential of changing the cost of capital can be increased, however, if investors collectively have the same capital allocation strategy (Mangot 2024; De Angelis et al. 2022). Through price signaling, this coordinated action can lead to a medium impact potential on secondary markets. These price signals can affect future bond issuance costs and market-wide shifts in financing preferences (Kölbel et al. 2020). Research by Caldecott et al. (2024) indicates that aggregate investor behavior can significantly influence broader market conditions, though this requires sustained collective action to achieve meaningful results. Despite some conceptual work on the impact of indirect investors on the cost of capital, empirical evidence of this effect is still lacking. Most authors agree, however, that coordinated efforts can have a moderate effect on the cost of capital

3.4. Field building

Indirect investor impact

Field building generally has a low impact potential because it influences companies indirectly through third-party reactions and broader market dynamics rather than direct engagement. This reduces the likelihood that investor actions are essential to induce change in company impacts. Instead, field building focuses on creating systemic change by lobbying for policy and normative shifts, market norms, institutional frameworks, and industry-wide practices that companies must respond to (Schneider et al. 2017). Unlike direct mechanisms such as engagement or capital allocation as provision of liquidly, field building operates at a broader level, shaping the context in which investors influence or create company impact.

Kölbel et al. (2020) identified indirect investor impacts, which involve influencing third parties or systemic factors, such as stigmatization, endorsement, and demonstration, effectively differentiating different types of field building. **Stigmatization** and **endorsement** involve publicly criticizing or praising a company's sustainability performance based on investment decisions (Ferns et al. 2022). These mechanisms operate indirectly by influencing third-party interactions with the company, such as discouraging consumers from purchasing products or enhancing the company's reputation to attract customers or employees (Marti et al. 2024). **Demonstration** refers to investors who encourage other investors to follow their lead and adopt sustainable investment practices. Pioneering actions or innovations by one investor can set a precedent, inspire emulation, and amplify sustainable investment practices (Kölbel et al. 2020). **Lobbying for policy and normative shifts** includes public campaigns, collaboration with policymakers, and advocacy for regulatory changes which are integral to aligning institutional environments with ESG objectives (Marti et al. 2024). These efforts promote industry-wide adoption of sustainability practices, creating long-term structural shifts (Brest and Born 2013;

Caldecott et al. 2024; Mangot 2024). Investors can play a critical role in **establishing standards and benchmarks**. Examples include developing voluntary frameworks like the Global Reporting Initiative (GRI) and supporting the emergence of ESG rating systems. These benchmarks offer consistent guidelines for corporate sustainability reporting, incentivizing companies to adopt and improve their sustainability practices (Marti et al. 2024; Kölbel et al. 2020). For all these mechanisms, it is unlikely that the actions of an individual investor will lead to changes in a company's impact. Consequently, the impact potential of investors' field-building activities remains low.

4. Discussion

This literature review offers an overview of how investors influence social and environmental outcomes and company impact. By examining the effectiveness of investor impact mechanisms—namely stewardship, capital allocation, and field building—we show that investors can create both direct and indirect investor impact with varying potential, depending on the specific context. For example, capital allocation has high impact potential when directly providing liquidity in primary private equity markets, medium impact potential in primary public bond markets, and low impact potential when indirectly influencing capital costs in secondary markets. Similarly, stewardship can have high investor impact potential when investors hold controlling ownership stakes but low impact potential when they hold small ownership stakes through secondary markets.

We find, however, that research on these mechanisms is in an early stage. Despite the insights provided, research gaps and limitations remain. While impact generation in private markets has been extensively examined, further research is required on impact generation in secondary markets, where its existence is still questionable. Additional empirical evidence is also needed to complete and refine the determinants of investor impact potential for the mechanisms of

‘capital allocation’ and ‘field building.’ Several authors emphasize that the field of impact investing lacks an adequate method to demonstrate the effectiveness of collective mechanisms. A few studies deal with the difficulties in coordinating collective actions among diverse investor groups, as differences in goals, constraints, and approaches can hinder cohesive and sustained efforts necessary for driving systemic change. Nevertheless, the long-term perspective in secondary markets remains understudied. While the direct investor impact has been studied more extensively within the literature and partially proven empirically, insights into the indirect investor impact are still sparse.

Another gap is the lack of empirical literature that investigates the negative investor impact, restricting our understanding of unintended consequences and trade-offs. This is particularly relevant when evaluating how investments in companies or assets with negative social or environmental impacts or engagement efforts counterproductive to sustainability goals may inadvertently worsen these issues. Addressing this imbalance requires a more comprehensive exploration of both positive and negative investor contributions.

We conclude that future research should prioritize the development of standardized metrics for measuring investor impact potential, especially in collective capital allocation and engagement efforts.

Despite these limitations, this review of the effectiveness of investor impact mechanisms highlights how the current literature helps specify the impact potential of different investor mechanisms. Differentiating levels of investor impact potential allows for a clearer distinction between investors operating across asset classes, investment vehicles, and both public and private markets. These insights can be used for academic analyses and practical applications alike.

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Declaration of Interest

No potential competing interest was reported by the author(s).

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Appendices

Glossary

Input	'The resources and relationships that organizations draw upon for their business activities, as well as the contextual elements that define their business activities' (IMP 2024a).
Activities	'Everything that organizations do, including operations, the procurement of inputs, the sale and provision of products and/or services, as well as any supporting activities' (IMP 2024a).
Output	'The direct result of organizations' activities, including their products, services, and any by-products' (IMP 2024a).
Outcome	Usage in this position paper: 'The level of well-being experienced by people or condition of the natural environment that results from the actions of the organization, as well as from external factors' (IMP 2024a). Additional meaning: '*A change* or *event* resulting from organizations' activities and outputs, providing a causal link between the activities/outputs and their impact(s) on people and/or the natural environment' (IMP 2024a).
Impact	ESRS: 'The effect the undertaking has or could have on the environment and people, including effects on their human rights, connected with its own operations and upstream and downstream value

	chain, including through its products and services, as well as through its business relationships. The impacts can be actual or potential, negative or positive, intended or unintended, and reversible or irreversible. They can arise over the short-, medium-, or long-term. Impacts indicate the undertaking's contribution, negative or positive, to sustainable development' (European Commission 2023b). IMP: 'The effect(s) of organizations' actions on people and the natural environment' (IMP 2024a).
Impact pathway	'The sequence that links organizations' actions with their effects on people and the natural environment' (IMP 2024a).