IMPACT INVESTING IN THE CEE REGION

OVERVIEW OF **THE IMPACT INVESTING SECTOR** IN THE CEE REGION

CEE Impact Survey 2022

POST MILTON FRIEDMAN ECONOMY: **IMPACT INVESTING IN PROGRESS**

THBE SOCIAL IMPACT INVESTORS ASSOCIATION

Overview of THE IMPACT INVESTING SECTOR in the CEE Region

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INTRODUCTION

In the last decades the importance of sustainability, social attentiveness became more and more important meanwhile we saw that buzz words like climate change or global warming sometimes have lost their importance as we have already gotten used to the fact that there are constant changes in the "hottest" (no pun intended) topics in the environmental and social related problems.

Starting with a very globalist view: the Sustainable Development Goals (SDGs), also known as the Global Goals, were adopted by the United Nations (UN) in 2015 as a universal call to action to end poverty, protect the planet, and ensure that by 2030 all people enjoy peace and prosperity. The 17 SDGs are integrated—they recognize that action in one area will affect outcomes in others, and that development must balance social, economic, and environmental sustainability.[1]

As the UN states: "the creativity, knowhow, technology and financial resources from all of society is necessary to achieve the SDGs in every context".

To contribute to these SDGs in the business world, we now have ESG (Environmental Social and Governance) which refers to the three key factors when measuring the sustainability and ethical impact of an investment in a business or company, and we started to do impact investing which very generally means an investment strategy or investment type that also focuses to generate financial returns while also creating a positive social or environmental impact.

ESG is a trending topic with its certain necessity but unfortunately, we see signs that it may not reach its initial goals and there is a possibility that the evolving measurement and rating systems won't be able to fulfill the intended role.

If we would like to contribute to the SDGs in the best possible way we can, our job in the venture capital and private equity sector is to make impact investing something visible and evolve it to its best possible form.

The goal of this study is to support this process by knowing more about the actual status of impact investing in our central and eastern European region, by getting to know each other in this sector, learning from our neighbors' methods, gain insight to each other's mindsets and investment strategies which certainly will help this forming ecosystem to be more focused and competitive for the sake of not just the investors or the founders but for the whole planet.

[1] https://www.undp.org/sustainable-development-goals

METHODOLOGY

The survey has assessed the responses of 13 participants from five countries in the CEE Region **("Region")** and aims to present the actual status and trends of impact investing in the Region.

Understandably the pool of participants is not wide enough to cover all segments and every important contributor of the sector but gives an interesting overview and shows typical issues which could be treated and improved in the future with joint efforts. As you can see in the list of contributors besides "typical" VC actors the survey contains insights from angel investors, accelerators, family office managers etc., which enables to merge opinions about impact investing from different angles and point of views and regarding different phases of the investing process.

The survey looked at impact investing from several aspects and the approach of the survey was more pragmatical and not statistical, with more subjectivity according to the participants personal and corporate experience. The list of questions aimed at to be answerable from the different positions, as mentioned above.

The findings of this study are based on the responses of the participants regarding the following questions:

- How do you measure the impact of your investments? Has the impact KPI`s clarification or methodology you are using, changed since your first investment?
- Do you have a specific approach towards the project companies in your pipeline, do you have a special "this is it" factor you look for? Are there any specific activities or areas you prefer to invest?
- Would you consider useful and/ or possible to set up a "standardized" measurement system for impact investments? if yes, please share some thoughts how it would work.
- What are the main trends you are expecting in the impact investments sector in the CEE region?
- Where do you think there is still room for improvement in the impact VC sector?
- Is there a story or anecdote you would like to share which could give us a little insight into your investment style/policy?
- Have you met companies trying to do "impact washing"? is it something we need to be more aware of?
- If you could give me an example (anonym of course), when you finally decided not to invest in a company which first seemed potentially a good fit, what was the reason not to go on with the investment.

THE VISIBILITY OF IMPACT INVESTING IN THE REGION

The main reason behind this study, was that when I started to look into major impact reports, I found out that the Region was very underrepresented. I reviewed several studies and general information available online, also the very comprehensive 2020 Annual Impact Investor Survey[2] of the Global Impact Investing Network (GIIN) and realized that the CEE region was almost invisible in these reports. Of course, we cannot compete with the U.S. or with the different regions of Asia, but basically Europe is only represented by countries located in WNS Europe which considering the statistical numbers seems logical but misses out a territory with huge growth potential.

I truly hope that if the contributors of the impact investment sector in the Region join their forces and start to collaborate more with each other the outcome could be a stronger, a more visible and more attractive ecosystem worthy to include in the future's global impact reports.

I would love to think of this survey as an initiative to cooperate and the start of a conversation between the actors of this sector and hope that these findings would open new ways of communication and would lead to further partnerships between them.

THE FINDINGS OF THE SURVEY

A. Measuring impact – can we/should we standardized it

If we would like to talk about impact, we should be able to measure it. The results of impact investment are more diverse than those of classic venture capital or private equity investments that is why it's harder to measure it. From a personal perspective I saluted the fact that I received diverse responses from the participants about their measurement policies, and there were different opinions about standardization too.

[2] https://thegiin.org/research/publication/impinv-survey-2020/

Let's see some examples of the methodology impact VC funds and accelerators are using:

- For the Prague-based **Tilia Impact Ventures ("TILIA")** impact measurement and management is essential to their investment strategy, however, identifying the best suitable impact KPIs and following them over the entire investment period is rather a tool to accomplish that. TILIA have a structured screening process for their projects and impact is a key component of this. There is a clear criteria when looking at the impact potential:
  - Intentionality of impact generation and a clear societal problem the project aims to resolve
  - Theory of Change and impact thesis
  - SDGs alignment
  - Impact depth
  - Impact scale
  - Alignment between business model and impact generation

- **Silke Horáková, Co-Founder and Partner at TILIA** described that the Theory of Change explains a project's path to achieving its final intended impact goals by outlining the desired outcomes and the causal linkages between them. In an ideal case (which would score 3 in their screening process), the founders deeply understand the root causes for a societal problem and aim to change this at a systemic level. In the following due diligence phase, they apply the framework of the impact management project https://impactmanagementproject.com, which has five dimensions and helps them to better understand the impact potential of the project as well as the risks, reflecting the likelihood that impact outcomes may be different than expected. Together with the investees, they discuss and set the impact strategy for the anticipated investment period, as well as two to five (output and outcome based) KPIs to measure the progress of its implementation.

  Silke, added that "The core of our impact management methodology has not changed over time, but we are constantly improving our approach based on best industry practice and our own experience. We started to analyze and aggregate our entire portfolio impact two years ago.

- **Katalista Ventures,** who accelerate early-stage startups – from idea or prototype phase until the proof of concept and landing their first clients. At such stage, they look at their potential to have a positive impact on the Triple Top Line – people, planet, and profit, if they solve global grand challenges and can do so at scale. They take a tailored approach with each startup to identify the areas of impact they affect the most and help them identify the relevant metrics and actions that can provide the maximum impact.

- **Elena Salamandîc-Alijošienė, partner at Katalista Ventures** mentioned that: "While the idea of a standardized impact measurement system can be appealing in terms of efficiency, there is no "one size fits all". Take carbon footprint for example. The CO2 footprint of a B2B SaaS company is different from that of a company manufacturing supplies. A materiality assessment is a starting point for companies to identify the areas relevant to them in their sector, followed by action to manage that impact."

- **Jacek Ostrowski, managing partner at Simpact Ventures** shared that they use their own methodology for determining impact KPIs, however, they rely on methodologies and materials published by organizations such as The Global Impact Investing Network or the European Venture Philanthropy Association. As he explained: "Our "theory of change" boils down to finding, first and foremost, a solution to a relevant problem, which at the same time meets the basic conditions for a traditional VC fund, i.e. it is scalable and replicable, and at the same time can generate financial revenues that will allow a return on investment at the level of the entire fund for investors."

- **Impact Ventures,** the Hungarian, Budapest-based dedicated impact fund, prepares an Impact Thesis. Which consist of the following parts: 1) the specific global social/economic challenge the startup solves; 2) strategy & solution of the startup to solve the challenge; 3) SDGs that it relates to; 4) Impact Value Chain, including the KPIs that measure the impact; 5) the value of the KPIs forecasted for 4-5 years; 6) Impact Risk Assessment.

  In the Impact Value Chain, they measure the impact directly on the Output & Outcome levels and indirectly on Impact level. The KPIs defined should always be directly connected to the startup's business model. Usually, they define 2-3 KPIs to measure. These can change depending on the development roadmap of the startup's product.

- **Elemér Eszter CEO** of the fund management commented that the basic structure of the Impact Thesis hasn't changed since their first investment, however, the depth of the assessments has; the new Impact Theses are more detailed, and they started to include an impact development plan for the companies which map out areas of improvement in KPI quality, data uncertainties and risks, to which actions are assigned so a continuous improvement can be achieved.

- **Warsaw Equity Group** focuses on what they call sustainability investing. In each project they look at various financial, but also impact metrics related to topics such as the environment or positive impact on society.

- **Arvin Khanchandani Head of Sustainability Investing of Warsaw Equity Group** indicated that the main impact KPI they take into account, is the potential to mitigate CO2e emissions.

Firstly, because they believe the various environmental and societal threats stemming from climate change are so pressing that the effort to reduce CO2e emissions should be prioritized by the general public and the investors' community. Secondly, this KPI is clear to understand and possible to measure. Having said that, CO2e emissions isn't the only important KPI and not all sustainability projects they look at are centered around that. Warsaw Equity Group are now working on fine-tuning their impact KPI methodology based on their experience to date, the state of the impact investing market, and best practices / lessons learned from European impact funds that Warsaw Equity Group partner with.

- **Tangent Line Ventures'** (a venture capital fund with focus on deep-tech and impact projects across Europe) model is co-investment with financial institutions and corporate VCs, they believe that VCs do not require a rigid set of rules for measuring and tracking impact, but rather a few sound concepts. These principles, concepts or methodology have evolved through time and together with their investment policies, investment vehicles (early stage or a growth fund) and market dynamics.

- **Admir Berbiu, junior partner at Tangent Line Ventures (TLV)** gave an example: "Tangent Line's team previous funds have invested in pre-seed and very early-stage companies. Some of these companies were in a lab stage or still developing their technologies, which means their products were not yet in the market. Impact measuring in such cases consisted of measuring the companies' future potential impact based on their financial projections, business model and market data. One of those investments was related to an energy savings software platform for industrial applications which had 18 months go to market plan. If the company expectations were to have a yearly increase of x% of customers, which could use the platform after their product would be market ready, then we could relate the impact of the company to factors like the total energy savings, the lesser amount of raw material to produce this energy (considering the fact that coal is the main source of energy in Poland) and to the decrease of CO2 emissions to the atmosphere thanks to these savings. The tagline of our methodology at that time was to make an impact, rather than trying to create a set of rules to measure it."

  There are other entities with impact affiliations where impact investing is a favorable possibility but not a must, or where impact investing is still a developing area of their activity:

- **Stanislaw Kastory from Firlej Kastory** said about their methodology: "We don't measure impact, however we do a negative impact screening to ensure the company will not be a setback in the impact field. We later plan on incorporating an increased amount of screening as well as KPIs, however considering the early stage of our structure and small number of people, it is currently difficult for us to do it as seriously as we would like."

- **Bartek Knichnicki, managing partner at SATUS Starter** commented about measurements: „At the moment we treat impact investments similarly as others. In the end we are a VC and we have to look at the future profits and return for our investors. However, in case of impact investments we are a little bit less strict with our requirements in this area."

- **Mikolaj Kowalczyk, President of the Board at TISE:** "The KPIs are set in the financing or investment agreement, and they tend to be easily measurable like number of jobs created or maintained, number of kids accepted in a new school, number of meals provided on a weekly basis for a restaurant etc. The criteria do not change that much, what changes is their greater impact on financing conditions."

- **Wojciech Mróz from Ashoka** explained: "Due to the fact that we are starting out our impact angels' network and our angel investors have not yet made their first investments we have given ourselves time to create a consistent approach to impact measurement. At this point we want to do a theory of change analysis with each project, from which specific KPIs will be derived.

The participants of the survey as I mentioned before, are not exclusively active on the VC investor side, but also actors of the ecosystem helping the matchmaking between the investors and the project companies.

- **FASE** provides matching funding and facilitates impact-focused investments. During their process, they also help the companies develop a more coherent impact story, for example developing outcome KPIs to complement the simpler output figures. As Zsolt Pethe, FASE's CEE Regional Coordinator explained, they help the companies develop an impact chain/log frame as well as impact thesis.

The idea of standardization divided the survey's collaborators: many of them would support and welcome some sort of standardizes system, others were more skeptical:

- **Admir Berbiu:** "Having a standardized measurement system, a definite set of norms among VCs for measuring and tracking impact, may limit VCs' ability to differentiate themselves or cause them to innovate less in terms of how they may give positive outcomes to people and the world. On the other hand, a standardized methodology would aid in the prevention of impact washing, poor business investments, and the use of impact investing as a marketing tool by commercial investors. In general, a set of concepts or rules would aid investors in staying focused and ensuring that impact investing continues to have a positive influence. "

- **Silke Horáková:** "Further defining of generally accepted standards for impact definition and measurement covering a wide range of impact themes and practical guidance for their implementation will be not only useful, but essential for the development of the impact investing industry at scale. Moreover, I think it will be the role of the impact investing industry to develop tools and metrics for a general new approach to creating value in business and investments (including accounting, taxation, and regulation strategies), taking into consideration a stakeholder approach – the interests of employees, customers, communities and even the planet – rather than a pure shareholder approach.

- **Arvin Khanchandani:** "I would consider it very useful to have a standardized measurement system for impact investments, because it would lead to a higher degree of transparency and trust among the investing community and the general public.
  There's a clear problem of distrust related to measuring the impact of impact investments. This is often linked to the concept of "ESG" Investing which sometimes unfortunately leads to greenwashing.

- **Elemér Eszter:** „Every company, every solution is unique - in a more "standardized" measurement system a lot of information on the deep impact of the company may be lost for the sake of oversimplified comparability. We prefer to analyze every project individually. During this analysis process we have several discussions together with the company about how we can define & measure their impact as precisely as possible with a tailored approach. In our opinion, measuring the impact of social and environmental impact projects is also a different case. In case of "green innovation" companies for example a more standardized impact measurement system can be used as the final impact can usually be summarized in CO2 emission reduction, plastic (or any other raw material harmful for the environment) prevention, water reduction etc. These can be precisely calculated with the help of an LCA assessment. In terms of agricultural projects, where the product can have an impact not only on the environment but also socially (e.g. famine reduction or food seurity), the case is more complicated. Besides, if there are many actors involved in the supply chain, information can be lost easily at the level of each actor. In case of social projects, the impact is usually measured by the number of beneficiaries impacted. To conclude, there are some industries, where impact measurement can be more "standardized", and there are some, where it's not possible.

- **Václav Gregor, Partner & CEO, Soulmates Ventures:** "Of course it would be much more useful to have one central system which will everybody know and use. That will help to make the needed benchmarking and to really see how companies are performing in one unite scale. But we need to consider that there are companies from 5-team startup scale to corporations with thousands of employees, there should be set differences in the size of companies and the methodology they use. In terms of requirements but also in the monitoring of outcome data.

- **Hristo Valev, Partner Urban Impact Ventures (UIV):** „Standardization of the impact measurement approaches can be very beneficial for the industry and will streamline more capital towards sustainability-driven investments. In all fairness, however, we should not expect such standardization very soon as the industry of impact investing is still in its infancy and there is a lot of knowledge to be gathered yet, as well as concepts to be tested. Many impact investors try to align with the UN SDG framework which highlights the most pressing challenges of our time such as: climate change, irresponsible and unsustainable use of natural resources, risks to biodiversity and wildlife, social inequalities and protection of rights, justice, and inclusion. The framework includes measurable indicators per each of the SDGs but not all of them are applicable on micro or business level. Platforms, such as IRIS+ of the Global Impact Investing Network, try to bridge the deficiency in relevant indicators through thematic selections from other databases and science-based research. IRIS+ aligns its themes with the UN SDGs too."

B. Main sectors where impact investors were involved – "This is it factor"

Although impact investing itself is a specific sector within the VC/PE market I was curious if there were any distinct sector to focus on besides the obvious impact areas, and whether there is such thing which we could call as the ultimate impact investor magnet.

Most participants agreed on the fact that the persona and experiences of a founder were key in their decision whether to be part of a project or pass on it.

Besides the "obvious" impact sectors it was interesting to see which areas are most popular amongst the participants of the Region.

Impact Ventures consider their fund sector agnostic, meaning that they can invest in any impact industry where they already acquired deep industry knowledge. The three main impact areas they prefer to invest in 1) Education & Employment (We invest in companies in the areas of reskilling and upskilling in order to promote the social inclusion of people with different abilities); 2) Health and Well-being (We mainly invest in companies aiming to provide better care for all and/or address under-served needs through disruptive technologies); 3) Sustainability (We mainly invest in companies that promote sustainable production, re-use / recycling, and any type of green innovation). In our pipeline the distribution of social and environmental projects is nearly 50-50%. The special "this is it" factor usually comes in case of a company which has a unique, disruptive/ transformative solution, which is highly scalable, and it serves the needs of an underprivileged beneficiary group (or has an enormous positive impact on the environment.

SATUS Starter are looking for highly scalable projects with a big potential market and great team. Typical areas they are interested in are AI & Big Data, SaaS, Industry 4.0, cybersecurity, marketplaces.

Katalista Ventures accelerate and invest in startups having a positive impact on the Triple Top Line (TTL) – People, Planet and Profit. They use it as a business approach and ask their startups to think about those principles. The main idea is that the business should not just aim to minimize its negative impact on people and the planet, but to create a positive impact with every sale. It's about building a model that is sustainable no matter how much you scale it; as opposed to growing a company and then mitigating any harm it causes afterwards.

Similarly like Katalista Ventures **Tangent Line Ventures** breaks down the "this is it" factor into four: people and planet, profit and partnership, creating 4 basic questions to be answered: - Does the company positively affect people and our planet? - Does the company have the plan and possibility to scale up and grow? Could it generate high ROI for its investors? (Profit) - Can we as an investor help the company grow, do we have the right knowledge and network to support the company? Can we as investors provide value to the company, can we be "Partners"?

At FASE they don't have preferred areas, though FASE has had several successful deals in education, sustainability, and healthcare. They look for a genuine interest in the team in impact where impact is in the center and not simply as a tagline in the communication. As Zsolt Pethe added: "This 'feeling' could be validated within the first 20 minutes of conversation."

TILIA is investing in projects in four different areas with high impact potential:
- Social inclusion, civic empowerment and transparency in society
- Innovation in quality education
- Environmental protection with focus on circular economy, responsible production, sustainable agriculture and mobility
- Healthcare and wellbeing with focus on accessibility for disadvantaged groups, mental health and preventive care

Their selection process includes five main criteria. First of all, they look at the impact the project aims to create, its depth and scalability and how the business model and the impact creation are aligned. As in every startup, founders are key, their expertise, drive and motivation and the mix of competences necessary to execute the planned strategy. It is essential that the founders understand and focus on the key drivers of their business and the key financial metrics of their business plan. Further they look at the USP of the company (what is unique compared to their competitors), the business model and the market opportunity; the scalability of the impact and the business model should go hand in hand Finally, the stage of the project, the "fit" with their own expertise and additionality. Silke highlighted that "We normally invest at a "proof of concept" stage, i.e., we want

to see a ready MVP tested at a minimum in a pilot case, ideally with first customer traction (or strong indication of interest). We like to invest in projects, where we can add substantial value – both in terms of our strong expertise in the field of impact strategies and impact measurement as well as, more general, in shaping the business model and Go2Market strategy."

Simpact Ventures highlighted that "An impact fund is still a VC fund - except that it operates in a specific area and with a specific mission, but the approach in most aspects is identical. A company won't grow if it has a weak team, the market is small and the problem it solves - irrelevant. As in traditional projects - without the right time-to-market, even the best ideas can be lost. We don't focus on specific areas or activities - both product and service projects can be interesting, for natural reasons the area of edtech or medtech are closest to us, but our portfolio to date is a mix of different areas and this is how we want to invest further."

Soulmates Ventures have selected 8 streams they are interested in: water, air, energy, food & agriculture, circular economy, mobility, healthcare, and education. But they are also open to fintech and cybersecurity investments.

Warsaw Equity Group invests in two main areas: Automation (anything that can automate business or production processes, most often with the use of Industry 4.0 technologies such as IoT, Big Data, Additive Manufacturing, etc.) and Sustainability. They are not afraid of hardware projects despite them being generally trickier to execute well. As they say, "It's especially important when it comes to sustainability – we can't make the world more sustainable purely by software!"

C. How can we improve the impact investing sector in the Region; which are the trends we need to focus on

In an ideal world without wars, pandemics, climate, and energy crisis would be lovely to see how the impact investing sector evolve and which trends prevail without the disruptive circumstances. Unfortunately, we have to deal with our generation's problems day-by-day which determines the main trends that our contributors foresee.

Thankfully the projections were mostly positive, and all the responses included thoughtful suggestions how we can improve the impact investing sector not just locally but globally also.

Jacek Ostrowski (Simpact) foresees favorable tendencies: "Recent months have seen a number of positive signals from this area in our region. Funds and organizations operating in this area have established closer cooperation, we have joint investments, we meet and exchange experiences and also discuss projects. This cooperation will certainly work in favor of the market, and we are very happy about it. The second aspect - something we notice in Poland, among others - is the growing interest in impact. As Simpact VC, in 2017 we were the first fund with such a profile in Poland. Now we have not only more funds which either explicitly indicate that they are active in this area or define impact as one of their investment criteria (without monitoring it yet). Also appearing are accelerators or incubators for impact startups, competitions dedicated to impact startups, or the first initiatives for business angels wishing to operate in the impact area."

Stanislaw Kastory (Firlej Kastory) envisions that newer generations which are more likely to be aware of the importance of impact and environmentalism are likely to aid in ensuring that there are a larger number of regulations. This will cause companies to have a more sustainable approach.

Hristo Valev (UIV) expects more impact funds dedicated to the CEE region to emerge in a very foreseeable future. Sustainability-driven ecosystems are already popping up at various places across the region and there is a lot of entrepreneurial talent too. After all, sustainability is not a regional doctrine or fashionable design for certain geographies only. It is a concept that will be shaping our social and economic relationships for many years to come, and its applicability is universal no matter where you actually reside.

Almost every respondent mentioned the energy sector, and the growing interest in fighting climate change, **Václav Gregor from Soulmates Ventures,** also added that he thinks there will be a shift of the investment focus due to the war in Ukraine mostly in energy sector, cyber- and national security, food & agriculture, and he believes this situation will strengthen the impact investment sector in CEE.

Admir Berbiu (TLV) „Due to climate changes and the recent heat waves which are expected to be a long term occurrence, CEE will need to find solutions to solve the current water deficit for arable crops or drinkable water (especially Poland where e.g. Warsaw is the only European capital without a sewage treatment plant, and there are none in such other major cities as Lodz, Bialystock). Investing into water technologies and water treatment systems is a must for the region.
Plastics recycling continues to be a problem and paper is becoming more and more expensive. New materials, new polymers able to substitute plastic in packaging industry or petroleum based products will be a continuing trend. Such trend is boosted even more from the growth of ecommerce in the CEE. There a bigger self-awareness from consumers and customers and from other side there is bigger pressure from government on reducing co2 emissions. Companies such as Allegro, Amazon or Zalando will try to differentiate themselves by introducing to the market new ecological, recyclable product packaging or transportation solutions."

As **Arvin Khanchandani** from Warsaw Equity Group added: "Impact Investing is a megatrend everywhere and it's no different in the CEE. Start-ups able to find innovative ways to make the world more sustainable will command massive valuation premiums over the next decades. Investors are now slowly finding out that

impact investments can bring returns at or even above market rates. That's why I foresee a massive increase in impact investments in CEE in the next decade – the only way is up. According to EY, currently about 1 in every 6 Euros spent by Venture Capital funds in Europe is dedicated to fighting climate change. I can see this ratio increasing even more with multiple €100m+ funds emerging such as the World Fund, the Green European Tech Fund, Climentum Capital, or the Green Generation Fund to name a few. CEE is a bit behind this trend, but I believe it will soon catch up".

The responses from the **Zsolt Pethe** (FASE) and **Wojciech Mróz** (ASHOKA) aligned. Zsolt hopes that positive investment successes will bring new companies to the table by making the whole area more accessible and tangible. Also seeing that more and more investors like VCs are open towards impact investments. He thinks though that we still have a long way to go as the ecosystem is very small in the Region and more successes could be communicated more widely to get more companies and investors on board, furthermore accelerators and incubators are always necessary to develop new players in the market.

Wojciech assumes that an increasing number of investors will be created in the region in the near future, but there is uncertainty at the same time if same number of worthwhile projects would grow too. He believes there is an all-time big funding gap in Poland. There are currently quite a few impact accelerators, but very few specialized impact funds, and thus all the time few founders are creating impact startups. The solution could be more education to broad market, more guidelines what impact means and how it can be measured, and why it is important to invest in impact.

Elena Salamandîc-Alijošienė (Katalista Ventures) thinks that startups are in a unique position where they can work together with industry incumbents to develop the right solutions and help large companies adapt to the changing sustainability landscape. This is another trend they observe – the rise of technology enablers who support other companies to manage their impact. She gave an example regarding a startup in their portfolio: Earthbanc – a carbon and finance platform that helps financial institutions to meet their carbon management targets. As part of their first Rockit Impact Accelerator programme, Earthbanc worked together with Swedbank – a leading bank in the Nordic region – to pilot a carbon footprint management solution for Swedbank clients. She added "Carbon emissions are one of the most stringent and tangible (therefore measurable) climate issues, which opened up a lot of opportunities for startups to innovate. However, we also see startups focusing on broader climate issues, not only on carbon emissions reduction and removal. For example, in our accelerator programs we have startups that take climate action across a various range of sectors – insect farming, sustainable fashion, clean energy, sustainable urban infrastructure and mobility, and more."

Silke Horáková (TILIA) commented that the impact investing sector has still to come up with a unified approach and practice in impact measurement and management to be fully accountable for impact. Apart from this, large exits and impact unicorns are still to come to attract more capital globally, and last, but not least, we need clearer and more comprehensive industry statistics for impact investments.

Silke Horáková also shared the story of one of their portfolio investments: "Before we met, Petr Baca, founder of MIWA[3], had grown a successful company in packaging design. But he saw the dark side of the packaging industry and started to tackle the social problem. Petr decided to found MIWA and to go into the packaging-free industry – the circular economy in the plastics sector. The startup uses smart technology: a system of reusable dispensers circulating between producer and retailer and smart cups for consumers, allowing for customized, waste-free shopping at the highest technological level. We decided to provide pre-seed financing at a time when the circular economy was still at the very beginning and MIWA's business model a rather visionary business opportunity with a lot of business risks. MIWA was really one of the pioneers in the industry and one of the first to sign the New Plastic Economy Global Commitment to eliminate plastic waste and pollution at the source. Petr was awarded one of the SDG Awards in the Czech Republic in 2018 and was one of the three winners of the European Social Innovation Competition in 2019. They have been part of one of the working groups of the World Economic Forum and opened a showroom in Prague, to educate people about the problem of plastic waste. Recently, MIWA got approved by the European Innovation Council with a grant/equity contribution to their current series A fundraising round. The business has expanded in the Czech Republic and some Western European countries and is piloting its technology with brands like Nestle, Albert Heijn, Tesco and Google."

D. Impact washing

If we would like to improve our growing and forming impact investing ecosystem, I think we should be aware of the potential negative effect of the increasing focus on sustainability, social impact and environmentalism. As we sadly see how ESG brings along greenwashing, we should be prepared to detect and tackle impact washing.

Based on the responses the situation is promising: although most of the investors met some form of impact washing the detection system usually works well.

Hristo Valev (UIV) thinks impact washing is something we should be aware of and develop our skills to detect it early on. "If we think of it as a deliberate action, we cannot say we've come across any company that was trying to intentionally misrepresent or completely make up its impact. However, we often see investment

[3] https://www.miwa.eu/

proposals where founders are unrealistic about the impact side of their activity – imagining it is much bigger than it actually is or even 'seeing' it where it doesn't exist. In general, early-stage founders are not very knowledgeable on how to track and manage their impact, so there is definitely a role for the VC investor to guide and help them along the way."

Elemér Eszter (Impact Ventures): "From time to time we see intentions of impact washing during our pre-screening. It is an important topic to pay attention to, but if the investor has a robust impact measurement approach, these companies can be easily identified at the very beginning of the selection process".

But based on Impact Ventures' experience, fortunately, the opposite of impact washing also exists, when impact is found without pretention of the founders. Elemér Eszter shared that sometimes target companies don't realize or identify themselves as impact startups. He added: "When engaging in discussion about the impact potential of the company, we always enjoy the shared excitement and sense of purpose felt by Founders and Investors alike. In one case, our discussions led to an ideation session, from which a new employment model has sprung. The target company and us, have pooled our knowledge, and network to test the viability of the idea, which proved to be not only working and impactful, but demonstrating improvement over the original operational model, and became one of the core characteristics of the company from then on."

Arvin Khanchandani from Warsaw Equity Group came across with more cases of impact washing. As he mentioned: "Unfortunately there's a plethora of companies that practice "greenwashing" or "impact washing" and it's something we all need be acutely aware of. It's very easy and tempting for companies to mislead the public about their actions and impacts. Impact measurement and verification is not black and white and it's easy to get lost in the nuance. He listed some important questions he recommends that any prospective impact investors ask themselves prior to their investment: (i) Is the positive impact of the company I want to invest in or its products limited to just one aspect or more?; (ii) Is the positive impact of the company I want to invest in or its products measured in an appropriate way that doesn't raise concerns?, (iii) Are the claims regarding the company I want to invest in or its products backed up by appropriate data or verified by a trusted 3rd party? (iv)Are there any alternative companies / products that may have a more positive impact? (v) Can the company I want to invest in produce its products in a sustainable way? (vi) Can the waste streams of the company I want to invest in be managed in a sustainable way? (vii)Would my children want to work for or use products of the company I want to invest in?.

Admir Berbiu (TLV) shared some very interesting thoughts regarding to impact washing`s NET Impact: "We had talks with startups developing certain technologies with the aim to make an impact to people or the environment, After deeply analyzing them, it resulted that their net impact was close to zero or even negative i.e startups introducing new technologies on water re-treatment system for the oil and gas extraction industry. They might help the industry become more efficient in terms of costs and less harmful to the environment due to water re-usage, but on the other hand they enhance the activity of oil extraction which brings to additional long term land pollution. Another example would be start-ups working on new polymers to substitute petroleum-based materials. Founders of such companies were forgetting that the resources they needed i.e energy, water, transportation, and logistics overcome those to the actual polymers and their effect on the ecosystem is way more negative.

Silke Horáková (TILIA) also highlighted an issue we should be more aware of: "What is new in the market and a bit more problematic, is the lack of accountability for impact on the side of some investors. There are VC funds which call themselves impact investors and provide capital (also) for impact ventures purely based on the good intention of the venture and its business potential (but without further focusing on impact analysis). Impact investors should be accountable for impact, which includes impact due diligence, setting of impact KPIs and strategies, impact measurement and management. However, I wouldn't call the lack of this approach "impact washing" since the term implies some intentionality in order to gain some advantage (e.g., access to financing or complying with regulation). There is a great potential for impact investors to co-invest with different kind of capital providers and to take the lead on the impact management side. But in general, it opens the door to potential "impact washing" when no impact analysis is in place, and with more public money coming in to stimulate sustainable and impact projects, we will probably see more of it."

E. Overall conclusions

First and foremost, I would like to share my enthusiasm about the overall experience during the preparation of this study. All the participants were true professionals with real eagerness towards their work, achieving impact as a natural necessity and their vision and mindset makes me very optimistic about the future of this sector in the CEE region.

I also felt the positive reaction regarding the idea of cooperating which I think will be key for the improvement of impact investing in our Region.

As you can see from the responses presented above there are lot of similarity and few differences but overall, we all aim to make our planet a better place to live in which I think we need more than ever.

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I'm truly grateful to everybody who graciously accepted my invite and invested their time in responding to the survey:

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Post Milton Friedman economy:

IMPACT INVESTING IN PROGRESS

Elemér Eszter
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On the 16th of June 2014, Pope Francis made the following assertion during the conference organised by the *Pontifical Council for Justice and Peace (Pontificum Consilium de Iustitia et Pace):* 'The logic underlying these innovative forms of intervention [i.e. investments] is one which "acknowledges the ultimate connection between profit and solidarity, the virtuous circle existing between profit and gift… Christians are called to rediscover, experience and proclaim to all this precious and primordial unity between profit and solidarity".' (Pope Francis 2014)

This claim is consonant with a frequently quoted definition by Bill Drayton, the founder of *Ashoka:* 'The citizen sector needs a structure similar to the venture capital market, which is capable of acknowledging innovative social enterprises and providing them with financial means through their various stages of the business life cycle.' (London 2012)

The spreading and consolidation of the vision of socially and/or environmentally responsible investors contribute to a great extent to creating a sustainable and liveable world, which can be passed on to future generations. *Social impact investing* (SII) can help our planet sustain ecosystems and secure circumstances that are more suitable for living for the human race, which is continuously growing in numbers. According to data gathered by the WHO, more than 1.5 billion people on the planet have presently no access whatsoever to healthy drinking water. SII pursues the very ambitious goal of helping to solve problems of this kind and similar ones. It is no coincidence that the Vatican already organised several large conferences to promote the dissemination of SII methodology.

1. WHAT IS SOCIAL IMPACT INVESTING (SII)?

Social impact investing (or socially responsible investing, SRI) is a variant of venture capital investments where the investor – a venture capital fund which invests in companies in the start-up or maturity stage – seeks to generate social and/or environmental value in addition to profit. In other words, for this form of investment, the positive impacts exerted by businesses on the natural environment and/or the human race are not ´merely' positive externalities but constitute essential parts of their operation.

In Milton Friedman's approach, the impact of an economic actor on people and the environment is, in fact, an ancillary consequence – i. e., an 'externality'. For (social) impact investing, human and environmental impacts of businesses are essential, inherent and 'in-built' parts of their operation and, thus, salient elements of planning and investor decision-making.

The results yielded by social impact investing (SII) are more manifold compared to the achievements of classical venture capital investments. The goal of SII funds is the generation of measurable societal or environmental outcomes, in addition to profit, by companies receiving financial means from them. However, SII is not merely ethical investing. In ethical investing, the investor requires the company (the target company or portfolio company) to avoid harming society or the natural environment while securing financial returns. Similarly, one must distinguish SII from aid or support provided through **corporate social responsibility** (CSR). SII is not charity either. The company selected by the investor receives the capital under the condition that the investor will sell, after a certain period, the shares or units acquired through investment or equity raising to recover its investment. A company which uses a percentage of its profits to augment its CSR activities or for charitable purposes cannot be viewed as a social enterprise solely on this basis, even if the amount of money allocated to furthering societal goals is rather significant.

Let us consider a breast cancer diagnostics company as an example. This enterprise sells these breast cancer detection and diagnosis services to hospitals and insurance companies. Thus far, its functioning does not differ from the operation of for-profit businesses. Social responsibility/consciousness or societal utility comes into play when this company performs primary diagnosis by employing blind persons who use a tactile method for tumour detection. In this manner, the firm uses an unusual skill developed by disabled people in response to their disability – i. e., their sophisticated tactile sense – as part of its core business activity. Blindness and highly developed tactile sensing generate profits and, concomitantly, provide access to the world of labour for people to whom this would be rather difficult or even impossible. This kind of enterprise could attract a social impact investment fund.

Nonetheless, let me offer some examples that forcefully guided my personal journey from entrepreneurship, through venture capitalism, to establishing a **social impact investment fund.**

Embrace Global launched 2008 the project described below. Securing incubators for premature babies is a great challenge in many underdeveloped countries. Nevertheless, these infants desperately need to maintain their body temperature constant without being compelled to use up the energies necessary for the normal development of their organs. In severely underdeveloped areas, even when incubators are available in certain hospitals or doctor's offices, there is no medical staff capable of operating them, while power outages are frequent. **Embrace Global,** benefitting from the professional assistance of **Stanford University,** experimented with an infant warmer similar to a tiny sleeping bag, which can emulate the warmth of the womb and help premature babies survive their early stage of development without the risk of permanent disabilities. Production costs of portable incubators (or sleeping bags for premature babies) amount to 15 to 25 US dollars, whereas incubators are priced between 15,000 and 25,000 US dollars, depending on their condition. Once the newborn has survived this critical stage of life, the tiny sleeping bag can secure the right temperature for another infant. The difference between this portable and a regular incubator is that 'the sleeping bag for premature babies' requires only thorough disinfection before being used by another newborn compared to usual incubators, which require both maintenance and meticulous disinfection. The project is financially self-sustaining, while thousands of children owe their health to the device developed by **Embrace Global.** A small, cheap and unsophisticated object can produce a significant, positive societal impact.

The **BioLite HomeStove** is a 'mini turbo stove' which can produce significantly more heat than an open fire using far less fuel. The company developed this practical device for campers, but it turned out that **HomeStoves** can solve some of the problems faced by African households. For many families in developing countries, the kitchen is merely a cauldron or a pot resting on three stones and a fire burning underneath to provide the heat needed for cooking. It is a less efficient, unhealthy and polluting way of cooking. **BioLite** sells its product on the European and North American markets as a camping accessory that is both trendy and expensive. However, in Third World countries, the company provides tens of thousands of families with a healthier cooking tool, which is both environmentally friendly and more suitable for living and asks for only a small sum in return. Charly Kleissner, a leading personality in European social impact investing, invested precisely in this company. The investment was financially successful and continues to generate significant dividends for the investors.

Interestingly, the story of **Ízlelő Restaurant (Taster Restaurant)** in Szekszárd illustrates well the relationship between societal impact and the strong position on the market, which go hand in hand. The **Kék Madár Alapítvány (Blue Bird Foundation,** 2020) accumulated a decade of experience already in integrating persons with physical and mental disabilities. The Foundation's management decided, in 2001, to try and apply practically the principles they have been representing before as 'consultants'. In 2007, with the help of the **New England Sector Support Team's** (NESsT's) investment and EU funding, the organisation set up the **Ízlelő Restaurant (Taster Restaurant)** in Szekszárd. The restaurant is a highly positioned, elegant venue, which fits as a business enterprise into the city's gastronomic palette and exploits a niche in terms of market expectations. The restaurant's staff are mainly physically or mentally disabled. Marika, a woman in a wheelchair who is paraplegic from the waist downwards, is a waitress there. Many people in Szekszárd knew her even before she started working at the restaurant; residents of Szekszárd used to call her 'Marika in the wheelchair'. Nowadays, after two years of employment at the restaurant, if people ask about her in town, they speak of 'Marika from the **Taster'**. One might wonder whether 'this is impacting a single person's life,' but the statement is only partly true. Average citizens of Szekszárd perceive that the distinguishing trait of a community member has changed from her disability to her occupation. One can add that the defining feature of **Ízlelő Restaurant** is the generation of societal value. From a marketing point of view, this is important because it enabled the restaurant to attract business from far beyond the boundaries of its natural customer base defined by its local character. Presently, **Ízlelő Restaurant** is the caterer for several events in Budapest. The reason is simple: the organisers of these events think that 'if the participants spend money to enjoy tasty meals, they should have the opportunity to help other people.'

Ízlelő (Taster) already opened its second restaurant in Budapest, on the ground floor of the building, which is the seat of **Hegyvidék (Budapest 2nd District) Local Government.** The model is a success because it proved that when people have a choice between two restaurants of the same quality and price level, they tend to choose the one where they can 'help' society by spending their money. The template is also suitable for opening additional restaurants as franchises in Budapest and across the country.

2. THE SOCIAL IMPACT ENTERPRISE

The added value of SIIs is precisely the multiplication of the positive impact experienced by a local or narrower target group through investing capital in the company, which produced the impact.

Munich-based **Ananda Ventures,** a well-known social impact investment fund manager, has invested in a company called **Auticon. Auticon** trains and places in software development jobs adults with autism, who experience difficulties in integrating into society. The entrepreneur recognised that the monotony of certain development tasks is tolerated incomparably better by people with autism than by their non-autistic counterparts. **Auticon'**s unique expertise is the combination of two methodologies. The first is used for training people with autism to be able to take on unfamiliar and daunting development jobs, while the second helps to sensitise other developers in the team, making them capable to cooperate with people with disabilities, who otherwise experience integration difficulties. **Auticon** is not a recruitment agency. The company itself hires people with autism and places them as own consultants by other companies. **Auticon** operates successfully; large companies like **Siemens, Allianz** and **Postbank** use its services. Thanks to **Ananda's** investment, **Auticon** operates now in France and the UK, too. Achieving such growth would not have been possible without capital.

Only companies created with the twofold goal of generating **societal impact** and profit can be considered social impact enterprises (SIEs). The desired societal impact must be part of the business as a component underpinning financial success. When **Ananda** and the founders will sell the **Auticon** network to a large professional investor, it will be essential to find a buyer, who will refrain from eliminating the societal impact to increase profits. If socetial impact plays an essential role in generating financial return, instead of being just a secondary element, such a goal becomes realistic, but only in this case.

Over the past decades, several international organisations and institutions (the **European Investment Fund** [EIF], the **European Venture Philanthropy Association** [EVPA] and the **Global Impact Investing Network** [GIIN]) have sought to define the concept of social enterprises and which investors qualify as social impact investors. The identical element in their positions is the requirement to achieve (direct and indirect) measurable societal impact (or benefit). However, the SIE concept is equivocal for most economic actors. Since SIEs can be described now in rather general terms: ranging from the determined, well-intentioned initiatives to the financially successful large companies mentioned above.

The state's attitude is still uncertain, too. First, the state recognises and exploits the advantages of the SII structure. In several Scandinavian countries, 'social impact bonds' are used to finance prison or hospital construction. Politicians are aware that SIEs and SIIs are assuming tasks which have been performed previously by the state and happily join this trend. In Germany, **Ananda** measures separately how much money the German state saves taking advantage of their activity since the state does not have to pay unemployment benefits to people with autism who obtain a job at the organisation. Second, from a state perspective, this solution is difficult to interpret. 'The scope of the problem addressed by the given SIE is not wide enough.' 'The solution does not provide access to a sufficiently large number of persons and cannot always be replicated to groups situated above the state's threshold stimulus.' This situation is precisely the consequence of the tendency of social impact enterprises to address usually problems which can be dealt with locally. Nevertheless, the previous examples show that, with the growth of SIEs, country-wide operation can replace their local or sub-cultural character through SII.

One of the first questions is who will say exactly what and how much impact the investor expects. A crucial difference between the measurability of the impact of SIEs and classic for-profit companies is that data showing the societal or environmental impact does not feature in the companies' balance sheets. The adoption of the **Environmental, Social and Governance** (ESG) **Criteria** mirroring the effects of a large company's operation on society, the environment and its employees represents a significant breakthrough. These measurements are applied in most cases to publicly traded companies, but this unitary measurement mechanism does not apply to small and medium-sized enterprises. It will take very much time until similar indicators will be introduced for SMEs uniformly across the world. Even though the literature on impact measurement mechanisms is vast and variegated, introducing a conventional system like the balance sheets and the profit and loss accounts is still a task for the future. Nevertheless, measurement is necessary, as it is a condition of success for the investor (the fund manager). Furthermore, in many cases it is also a condition for receiving a success fee. Impact measurement requires not more than 5 to 10 indicators defined by the company in its business plan and used for presenting the societal or environmental impact to the investor. Certain effects may also be harmful; thus, the SII should consider the cumulative value of these impacts.

What is more salient: profit or societal and environmental impact? Numerous specialists argue the superiority or inferiority of financial performance as a criterion in its relation to societal or environmental impact. In my opinion, one should consider both measurements concomitantly and on equal footing.

It is important to stress that SIIs are investments, not merely donations. However, I do not imply a qualitative difference regarding impact between SIIs and their target companies, on the one hand; and foundations combined with their grantees

or organisations operating as foundations, on the other hand. In many cases, SIEs start from donations and will need SIIs sooner or later as the business develops and functioning becomes institutionalised. In this manner, funding by foundations and SIIs do not compete, but complement each other. Consequently, an SII fund might adopt a sensible strategy. This would imply waiting until a company established with foundation funding and grown with venture capital-type funding from an SII reaches a point in its business life cycle when its stable functioning and development allow it to replace the venture capitalist with bank funding.

Many of the major players in the SIE ecosystem recognised this complexity and have expressly designed a financing and institutional structure capable of providing SIEs with the types of resources described above in a planned manner and according to a predefined schedule. The **Omidyar Network,** for example, has developed a funding and strategy system suitable for accompanying a social (impact) enterprise and providing it with adequate financial resources through the funding cycles described above.

As stated earlier, the purpose of an SII fund is twofold: 1) to recover the investment and generate financial returns, and 2) to achieve societal and/or environmental impact. Analysts worldwide are cautious when commenting on the efficiency of SII funds. Very often, as the societal and environmental impact increases, the risk of the respective fund decreases. This is, of course, far from the desirable outcome experienced by Erwin Stahl, head of the German social impact venture capital fund **BonVenture.** Indeed, the average return of German SII funds over a 10-year horizon is not worse than the return of classic venture capital funds created for profit maximisation (Degeler 2018).

SIIs can also be considered a new method within charity culture, but they operate under a much stricter set of rules compared to the usual fund transfer methodology of foundations and associations. In this case, the transferred resource is onerous and the user has to operate in a financially productive way to be able to repay the investment to the investor. The widening gap between the rich and the poor is a serious problem. 'Giving something back' to society is important to an increasing number of the wealthy. The method of social impact investing is a controlled, transparent and onerous form of 'giving back to society'. A well-known phenomenon of generational change occurring among wealthy people worldwide is that in the process of family wealth transfer, the new generation formulates the expectation towards the trustee to generate societal impact besides securing the return on their money.

3. THE SITUATION IN HUNGARY

Businesspeople in Hungary possess plenty of intellectual capacity and will to recognise the potential of SIEs and choose this path as a vocation. The SIE ecosystem is developing; nevertheless, as Hungarian playwright Imre Madách wrote in his famous play **The Tragedy of Man,** 'there are more Eskimos than seals' for the moment. In this context, the quote means that members in the system who wish to provide services to SIEs for their development and operation are more organised and numerous than the actors who are investment-ready social impact enterprises by definition. The situation was no different when the startup ecosystem emerged. It is reassuring that nearly ten incubators, accelerators, investors and advisors have decided to jointly embark on a coordinated two-year programme to strengthen the number and quality of SIEs in Hungary.

SIIs encourage by their mere presence the emergence of social enterprises. For investors, the time interval necessary for deploying the available resources of the fund within the framework of the investment policy is always a salient question. From another perspective, the crucial question is whether there will be enough SIEs to make meaningful use of the money to be invested, if the SII approach proliferates at the usual pace in Hungary. Again, taking the German example as a starting point, one can identify two possible development paths. On the one hand, many teams are 'merely' well-intentioned initiatives today. They might define their direction of development to allow the attainment of the societal or environmental goal they pursue through a sustainable and financially efficient operating model, which will render them suitable for receiving resources needed for growth from an SII. On the other hand, it is also likely that 'ordinary' for-profit businesses operating today and generating – regardless of their primary intention – measurable societal or environmental value or benefit will use SII capital for their growth.

Hungary is ahead of her neighbours in terms of development of the SIE ecosystem. Hungary is the first Central European country, which set up social impact investment funds (social impact venture capital fund managers) in institutional form. **Impact Ventures** has been functioning since 2018. That one of the investors in the **Impact Ventures** funds is the **European Investment Fund,** Europe's largest institutional investor fund of funds, is a significant success, per se, for Hungary. **Impact Ventures** is raising the 3rd fund to continue leading impact investment in the CEE. **Impact Ventures team's** social & environmental vertical specific expertise and market knowledge attracts and scales the most promising pruposeful "impact businesses".

Similarly, the **Blue Planet Venture Capital Fund for Climate Protection** aims to achieve positive environmental impacts. This fund will provide financing to micro, small and medium-sized enterprises (MSMEs) applying innovative environment and climate protection solutions to support them in strengthening their market performance and position.

It is also encouraging that domestic social impact investors were the first in the region to establish their own organisation for interest representation, the **Social Impact Investors' Association (Társadalmi Hasznosságú Befektetők Egyesülete).** Thus, Hungary can join at the right time this international trend, which aims to multiply societal and environmental values in a market-based and sustainable manner.

4. WILL THERE BE LIFE BEYOND PROFIT?

Is the SII methodology, which amounts to 5–10% of the total investment 'pie', likely to have a real impact globally? One question regards the ability of the historical churches to adopt the system of instruments that makes environmental and societal considerations, instead of profit maximisation, an essential part of business decision-making. The other question is whether there will be an appropriate critical mass of venture capital and private equity funds to choose socially or environmentally responsible investing or whether SII will remain marginal.

Hungary joined an international trend, and she possesses significant human capital, which can be mobilised for this purpose. Thus, she can become the leading country in the region. The opportunity is open for Hungarian economic actors to join this process ahead of others. If they decide to join, they can contribute to the country's economic development and building a more sustainable world.

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