Private Equity International

The A-Z of Impact Investing

November 2019 • privateequityinternational.com


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70+
Years heritage
US$15bn
Capital raised since inception
16
Offices
215+
Investments
160+
Exits
120
Investment professionals
44
Countries invested in
US $5bn+
Committed to 34 energy investments
25GW
of power provided
4.7 million tonnes
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Private Equity International

The A-Z of Impact Investing

ISSN 1474-8800 • NOVEMBER 2019

Insight

Analysis

A-Z

Insight

Impact investing From agri-investing to zero waste, our A-Z shows how impact has entered the investing mainstream. Here are six trends shaping the sector

1

A united approach

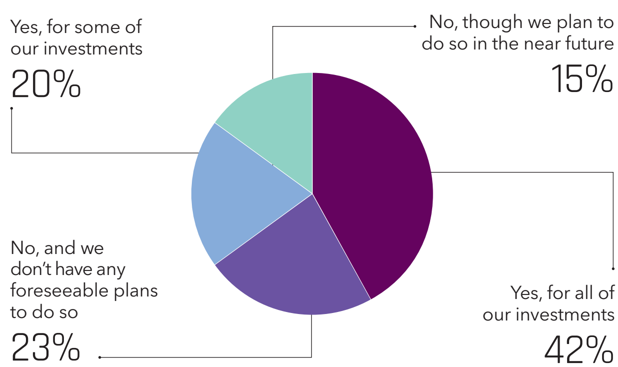
The term 'impact investment' was coined in 2007 by the Rockefellers, putting a name to investments made with the intention of generating both financial return and social or environmental good. Interest in impact investing escalated, meanwhile, in the aftermath of a financial crisis that undermined the credibility of the traditional capitalist system.

But it wasn't until the United Nations Sustainable Development Goals came into force in 2015 that this nascent industry was able to unite behind a collective set of ambitions. "The SDGs are incredibly important," says Tania Carnegie, leader of the Impact Venture practice at KPMG. "They help articulate the contribution being made towards solving the bigger picture challenges that society is facing."

The United Nations estimates that somewhere between $5 trillion and $7 trillion is required annually to help achieve its 17 goals, and 169 associated targets, by 2030, and so the SDGs are clearly a galvanising force. Almost two-thirds of impact investment managers are currently using this framework to track their performance, according to the Global Impact Investing Network's 2019 annual survey, up from just over half in the previous 12 months.

Institutional investors, in particular, are keen that managers position their strategies in the context of the Sustainable Development Goals. However, there is a danger that the SDGs can be more readily incorporated into marketing materials than investment practice.

Do you track performance to the UN SDGs?



Source: GIIN survey of impact investors

2/3
Of impact investors use the UN Sustainable Development Goals to track impact performance

$5trn
Minimum the UN believes is necessary every year to help achieve its 17 Sustainable Development Goals

90%
Of impact investors say their financial expectations have been met or exceeded

Beyond the environment

While climate change commands column inches and investment dollars, impact does not exist exclusively in the environmental domain. A plethora of sub-sectors has emerged addressing wider societal challenges. Affordable housing is a prevalent theme, "keeping rents down for existing tenants through energy retrofits, for example", says Rekha Unnithan, portfolio manager for impact investing at Nuveen. "The idea is to provide stability of housing for the working population."

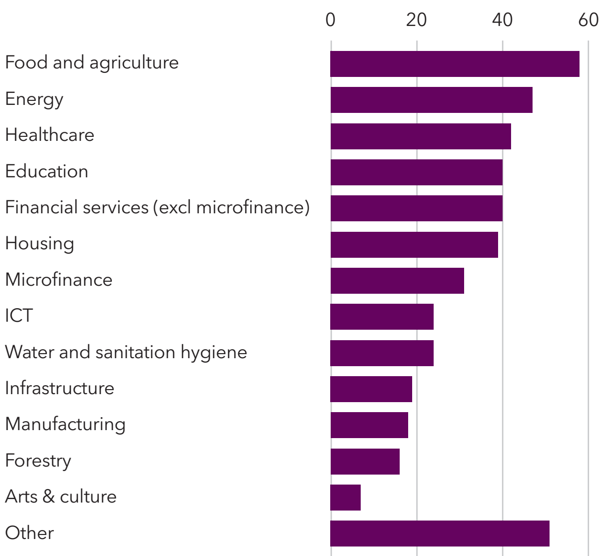
Inclusive financial services that provide credit, savings or insurance products, for instance, to low-income customers also helps eradicate poverty and promote individual and community autonomy.

"If people lack access to finance or face high costs of capital, it is very difficult to improve their lives or grow their businesses," says Taylor Jordan of Goldman Sachs Asset Management. "If you can provide appropriately structured financial services to underserved populations at the right price, you open up opportunities and develop local economies."

Health and wellbeing is another critical area for impact investors and correlates to number three of the UN's Sustainable Development Goals. Indeed, according to the GIIN's 2019 survey, healthcare is one of the top-three target areas, behind energy and food and agriculture.

Education, too, is an area of impact investment. According to the UNESCO Institute for Statistics, one in five children around the world are currently out of school, while just 0.5 percent of global spending on education goes to low-income nations.

Sector allocations of impact investors (%)

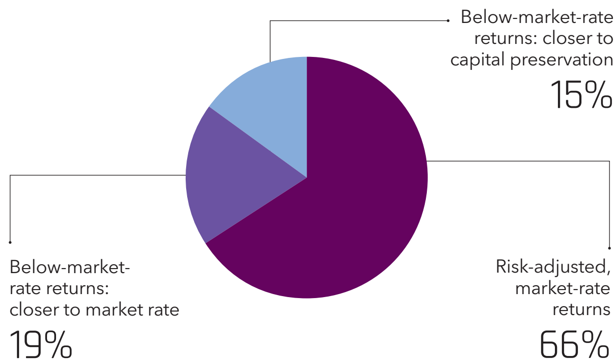


Source: GIIN survey of impact investors

Many happy returns

Of course, by definition, impact investments need to meet financial targets as well as drive environmental or social outcomes. This sector is no longer the preserve of philanthropists. While expectations vary, GIIN's latest survey suggests that around two-thirds of investors are now seeking market-rate returns.

Targeted financial returns



Source: GIIN survey of impact investors

Still more significantly, over 90 percent of respondents reported that their financial expectations had been met or exceeded, while 98 percent said the same was true of their impact goals.

Another study, produced by Moneyfacts, looked at the performance of ethical funds compared with their mainstream peers over four different time frames and in five different categories, and found that the former outperformed the latter in 13 out of 20 scenarios. Early indications are that impact investment can deliver on its dual objectives.

"Impact investment is completely commercially viable in our view," says Shami Nissan, head of responsible investment at Actis. "That view is based on a long track record that spans several decades and a guiding philosophy that value drives value. Some may see an inherent conflict or need to compromise either financial returns or impact, but our view is that the two are mutually supportive."

However, it is important to remember that the fledgling impact investment asset class has only really experienced a protracted bull run. It is unproven in a downturn, a challenge it may have to face sooner than it would like.

"The industry hasn't experienced a downcycle. It is a relatively recent phenomenon so it will be interesting to see how impact investments perform when the cycle turns," says Paul Hastings' counsel Vadim Avdeychik. "Our clients certainly seem to believe that impact investment should outperform, however, because it offers a truly new way of looking at the world."

4

Millennial momentum

The ability to measure impact may remain a work in progress, but there is a millennial momentum that is building behind the impact movement.

While successive generations enjoyed ever increasing standards of living throughout the 20th century, that pattern has now gone into reverse.

Millennials, on average, have household incomes that are 4 percent lower than members of Generation X, whereas the incomes of Generation X in their early thirties were 30 percent higher than the baby boomer generation that came before them.

Spurred on by role models from their own age group, meanwhile, who appear to have embraced capitalism without compromising their ideals, millennials are increasingly shunning traditional forms of financially-focused investment to use their money as a force for positive change.

"The generational shift we see with millennials, coupled with the increasing participation of high-net-worth individuals and women, is driving impact investment," says Nissan of Actis. "These groups really care about how their capital can be used for positive societal and environmental outcomes."

Young workforces are demanding higher standards from their employers. Young entrepreneurs are combining commercial acumen and tech savvy with a deep-rooted desire to address global issues. This generation has also rediscovered a passion for engaging directly with politicians, while the inexorable rise of social media is helping to spread their message far and wide.

Millennials are a relentless driving force behind the explosion we are witnessing in impact investing, as they seek to shift the focus of capitalism from self interest to the wider good. With the ongoing transfer of wealth from older generations expected to reach $24 trillion by 2020, the potential for impact could be huge.

5

A climate for change

Nowhere is the millennial voice louder than in the campaign to combat climate change. "The millennials and younger generations are leading the climate protests and they want to see that impact is fully integrated into investment decisions," says Jordan of GSAM. Jordan co-founded impact investing firm Imprint Capital which was acquired by GSAM in 2015.

And indeed, with the UN Intergovernmental Panel on Climate Change's dire warning last year that we only have 12 years left to contain global warming without putting millions of lives at risk, environmental concerns have come to dominate the impact agenda.

Impact investments tackling climate change can range from solar and wind energy projects or battery storage to energy efficiency plays, sustainable transport, sustainable materials and sustainable agriculture. And, of course, the positive impacts of such investment can be felt far beyond the physical environment itself.

"Climate change has already risen up the agenda, but we will see ever more focus on this because it's so intertwined with other impact objectives – you can't tackle hunger if the land you grow food on is flooded or too dry," says Clarissa De Franco, managing director of Africa Funds at CDC.

"Climate change is such a huge issue that impacts society and the environment on so many levels, from the economy, human health and the ability to feed people through to water availability and civil unrest," adds Nissan.

"It is the number one issue that we face as a society and a planet."

6

Measuring progress

To maintain standards, it is imperative that we are able to measure impact performance. Investors need to be able to assess and benchmark impact managers' track record of delivering on their laudable aims."There is a heightened expectation of trust associated with impact investing," says Carnegie. "So, being able to deliver on the promise in your investment thesis, being able to live up to that expectation of trust, is essential. Measuring outcomes is a part of that process."

The ability to measure performance has been hindered, to some extent, by the industry's relative immaturity. The majority of impact funds have long-term investment horizons and it won't be until those come of age that outcomes can accurately be assessed.

Nonetheless, an array of different frameworks have emerged, designed to assist the measurement process. These systems have been developed by individual managers, which have then opened them up in the collaborative spirit for which impact investment has become known, or else by myriad industry associations. But, in many ways, this proliferation has become part of the problem.

"There is a great deal of fragmentation, and that creates challenges around benchmarking and best practice," says Runjhun Kudaisya, counsel at law firm Paul Hastings. "The market is lacking a common language and there is definitely a need for more clarity."

"Investors will ultimately coalesce around one framework or another. That is the way that it always happens," adds Avdeychik of Paul Hastings. "That is what is needed for this industry to move forward." ■

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Private Equity International
Published 10 times a year by PEI Media. To find out more about PEI Media visit **thisisPEI.com**

Printed by Stephens & George Ltd
stephensandgeorge.co.uk

FSC www.fsc.org MIX Paper from responsible sources FSC® C013417

Editor's letter

So what exactly does impact investing stand for?

Graeme Kerr
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Impact investing is not without its critics. The holier-than-thou feeling that impact proponents evoke has a tendency to get under the skin of those among us – especially journalists – who are more used to asking tough questions rather than claiming to change the world. That scepticism reached a crescendo earlier this year with the news that William McGlashan, managing partner and founder of TPG's impact vehicle, the Rise Fund, was among the 33 parents charged for their alleged roles in a college admissions bribery and money laundering scam uncovered by the FBI.

Following on the heels of the collapse of the Abraaj Group, an emerging markets investor that had puffed up its impact credentials but collapsed after alleged financial misconduct, the irony was not lost on some of impact's naysayers. As *Time* magazine editor-at-large Anand Giridharadas tweeted at the time: "And I know the Bill McGlashans of this world. I reported on them. I argue with them now. They email me. They DM me. And they explain that I don't get it. I'm too negative. They are solving real problems. I'm just writing about things."

> **"Arguments raged about what the letters should stand for"**

The *PEI A-Z of Impact Investing* comes at the issue from a different angle. As editor of the annual *PEI Responsible Investing Special*, I have watched the emergence of the impact investing movement with interest. There are clear issues: notably, what exactly is the difference between responsible and impact investing, and how exactly can you measure impact?

But I really wanted just to drill down and ask the most basic question of all: What exactly is impact investing? The A-Z is an attempt to do just that. Where better to ask that question than at the Global Impact Investing Network Investing Forum in the company of artist Lee Playle. We quizzed delegates about what the letters should stand for and Lee produced 26 separate illustrations during the course of the two-day conference.

Arguments raged about what the letters should stand for but the resulting two-metre by three-metre wall became one of the talking points of the conference. Indeed, the response was so enthusiastic that we decided to turn the A-Z into this supplement.

Yes, there are some sceptical voices out there about whether impact can achieve all that its proponents claim, but if you're looking to survey exactly what it is trying to do, then our A-Z is as a great place to start. I hope you enjoy it as much as we enjoyed producing it.

Graeme Kerr

Graeme Kerr

The A-Z of Impact Investing

Just how far does the reach of impact investing extend?

That was the question we sought to answer when *PEI* teamed up with Brighton-based illustrator Lee Playle at the Global Impact Investing Network Investor Forum in Paris, *writes Graeme Kerr*. The idea was to create an illustrated A-Z based on the suggestions of the conference delegates of which each letter could represent.

The challenge was as much a creative endeavour as a journalistic enterprise. Could our artist succeed in producing 26 illustrations by the end of the two-day conference? Would the resulting two-metre by three-metre illustrated wall, which became one of the talking points of the forum, adequately encapsulate the breadth of vision of the impact movement?

The answer was a resounding yes. "It's awesome, just awesome," said impact investor Rebecca Buyers. "I think it does a really good job of pictorially displaying what impact investment is."

Similarly impressed was Preeti Sinha, chief executive of the Geneva-based Financing for Development Ventures. "I think it's a whole new interpretation of what our priorities are for impact," said Sinha, nominating that L should be for low-cost housing because basic living standards are core to the impact mission.

The big private equity players, such as Bain Capital, KKR and TPG, have all launched funds targeting impact investment in recent years, and they were well represented at the GIIN Forum. "One of my favourite letters is C for clean technology," said Emma Tuzinkiewicz, a manager at KKR. "I think it's really inspiring for the global world right now to think of the transition from fossil fuels to different types of clean technology."

Such was the popularity of the A-Z that we decided to turn it into this supplement. No one is claiming this is the definitive list – we could repeat the exercise all over again and get 26 entirely different suggestions – but then that is the compelling thing about impact: it's a mission that knows no bounds.

So whether it's B for Blockchain – and the tech opportunities offered by impact investing – or Y for Young Blood – and the Millennial Generation who are among the asset class's biggest advocates, we hope you, like us, marvel at the breadth of vision on display here.

Impact investing may have its critics but it is certainly placing a whole fresh spin on the world of ESG, as the A-Z amply demonstrates. ■

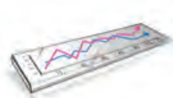





















Illustrations: **Lee Playle**

Agri-investing

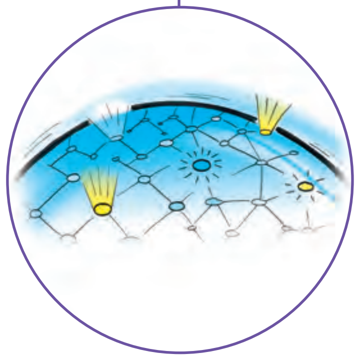
For investors looking to tackle global warming concerns, agri-investing is one of the sectors that can have the biggest impact on the environment.

Hot on the heels of the UN Intergovernmental Panel on Climate Change's worrying global land use report, *Climate Change and Land*, Jeremy Coller's Farm Animal Investment Risk & Return initiative published a separate study highlighting the same concerns: food production's impact on the environment.

Both reports featured equally daunting findings, with the IPCC estimating that if pre- and post-production is considered, agriculture, forestry and other land use accounts for 21-37 percent of all human-made carbon emissions, while the 2019 FAIRR Index found 43 of the 60 largest animal protein producers (globally processing 70 billion animals a year and accounting for 14 percent of all emissions) fail to accurately measure their greenhouse gas emissions.

But with so much work to be done to improve the sustainability of global food production processes, the impact investment opportunity is equally significant. The decades-long focus on fossil fuels has put coal firmly on the road to becoming a stranded asset – the Coller Capital chief investment officer has suggested something similar could happen with the food we eat.

"The Paris agreement is impossible to achieve without tackling factory farm emissions," Coller, a long-time vegan, said at the launch of the 2019 FAIRR Index. "Coal is a stranded asset, and cows are the new coal."



Blockchain

Could blockchain prove to be the missing link in the impact investment chain?

Best known as the decentralised or distributed ledger that underpins cryptocurrencies such as Bitcoin, blockchain technology is being used to create "impact tokens" that investors can use to fund projects.

At the forefront is Moeda Seeds Bank, a Brazilian micro-finance technology company, which won first place in a United Nations-sponsored hackathon. Lack of access to banking is a big barrier to small businesses in emerging markets. Moeda uses blockchain technology to connect impact projects directly to investors. The digital ledger also allows investors to keep track of the project's progress and provides accountability, helping provide investors with proof of impact.

In March 2019, Moeda partnered with private equity impact investor Bamboo Capital Partners and the government of Togo to launch the BLOC fund targeting €100 million to invest in blockchain projects that could benefit low and middle income populations in emerging markets.

Florian Kemmerich, managing partner of Bamboo Capital Partners, says blockchain is one of the biggest untapped impact investment opportunities and has the potential to transform millions of lives in some of the poorest regions of the world.

The Togo government agrees, believing the fund will "attract the most innovative international companies developing tech solutions which can improve the living conditions of people in Togo and across Africa," says Cina Lawson, Togo's minister of posts, digital economy and tech innovation. "It will also serve to support local tech entrepreneurs to grow their businesses providing them capital and tech expertise."

Clean technology

"Climate change is such a huge issue that impacts society and the environment on so many levels, from the economy, human health and the ability to feed people through to water availability and civil unrest," says Shami Nissan, head of responsible investment at Actis.

"It is the number one issue that we face as a society and a planet. As a result, you cannot overstate the impact of clean energy on sustainability."

Indeed, clean energy is one of the largest parts of the clean technology landscape, with the *World Energy Outlook 2018* report from the International Energy Agency estimating that investments in renewable energy supply will need to reach more than $2 trillion a year to 2040. And we are currently nowhere near this – in 2018, $289 billion was invested globally in renewable power and fuels, according to the *Renewables 2019 Global Status Report* – which suggests that, as the global economy moves towards decarbonisation, there is plenty of scope for investment in renewables.

That does not just mean investing in solar or wind projects. "One of the biggest developments we're seeing is in battery storage for renewable energy," says Adam Heltzer, head of ESG and sustainability at Partners Group.

"That is clearly critical for more widespread adoption of clean power sources. We've invested in a renewables platform in Australia, for example, and that has a highly scalable battery storage component to the business."

Yet there are many other strands to clean technology – from energy efficiency and sustainable transport to sustainable materials and efficient food production and agriculture. "Clean technology cuts across multiple industries," says Taylor Jordan, managing director at Goldman Sachs Asset Management.

"There are several themes that we believe benefit from macro tailwinds but investors need to be careful about capital intensity and adoption curves."

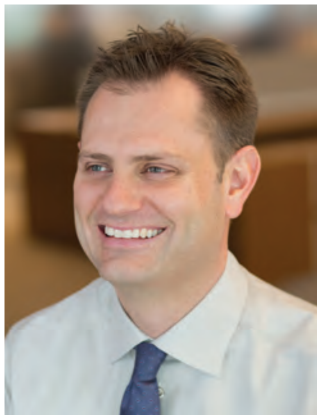
It's a view shared by Heltzer. "Climate change is the 2,000lb gorilla," he says. "You have governments, the private sector and civil society all working towards addressing what has become imperative. From an investment and business perspective, one of the most significant developments is the creation of the Task Force on Climate-related Financial Disclosures because it will force investment managers to think more critically and work tangibly to address the risks and opportunities. That clearly presents increased scope for growth in the clean technology sector."

While clean technology may have got off to a difficult start, with many early investments in clean energy in particular yielding poor returns for investors, significant reductions in the cost of solar and wind technologies over recent years has made this part of the sector much more competitive. There are also new types of clean technology emerging."We are increasingly seeing capital-light business models that promote greater resource efficiency," says Jordan.

"Energy efficiency is a key strand here," adds Heltzer. "One of our investments, Techem, for example, is now managing the transition of millions of residents across Europe to meters. Previously their energy and water bills were based on size of their apartment, but by billing them according to usage, consumption has reduced by 15 percent or more."

EXPERT COMMENTARY

The sharp fall in the cost of installing and generating renewable power is driving the shift to low carbon technologies, says Taylor Jordan of Goldman Sachs Asset Management



Cleaning up in energy

Environmental, social and governance, or ESG, has been rising on the agenda for institutional and individual investors. Our clients have become increasingly focused on finding investment solutions where their impact and financial goals are met and these outcomes are both aligned and measurable. To address this growing demand from clients and to treat ESG with the rigour and care it deserves, Goldman Sachs Asset Management (GSAM) acquired one of the largest dedicated ESG and impact investment advisors, Imprint Capital, in 2015.

The acquisition brought together the breadth of GSAM's institutional resources with the depth of Imprint's almost 10 years of experience and thematic expertise in ESG and impact investing. This powerful combination has enabled ESG to be fully integrated into GSAM's own core investment processes and into the strategies offered to clients.

The shift in power generation

Clean energy is one of our largest and most active investment themes. Across clean energy, we invest in enterprises helping to develop new clean energy technologies and assets or projects deploying clean energy technologies. Renewable energy infrastructure has become a large market given future expected shifts in new power generation globally.

$11trn

Amount expected to be invested in new power generation by 2050

More than an estimated $11 trillion is expected to be invested in new power generation capacity globally by 2050, of which nearly three-quarters is expected to new wind or solar farms. This translates to an average of over $250 billion of capital invested in renewable energy assets each year through 2050, according to Bloomberg New Energy Finance.

Wind and solar costs continue to decline, making renewables economically competitive with fossil fuels. Once installed, these technologies are not subject to the same price volatility that is associated with fossil fuel sources. In some regions with high electricity prices, clean energy is already cost-competitive with conventional sources. Although renewables are typically more expensive than fossil fuel plants on an upfront per-megawatt basis, a lack of input costs makes them the cheapest marginal producer of power once installed. Investors can participate at different points along the renewable energy infrastructure development lifecycle, from the earliest stage of asset development to assets under construction or fully operational generation units. Operating and construction-stage assets in the US and Europe are relatively stable, well understood and efficiently priced.

Revenues are largely fixed by 20-year energy offtake contracts and operating costs are low, offering bond-like yields. Such operating projects are thus most suitable for investors with an appetite for long-lived assets and current income.

To target attractive risk-adjusted returns, there are a number of strategies investors may consider including focusing on specific geographies, looking to enter the asset during earlier stages of development, or focusing on more niche market segments with higher risk counterparties such as community solar.

A community approach

Solar has ranked first or second in new electric capacity additions in each of the last six years, despite being a small part of the overall electricity mix today. During the first quarter of 2019, the US installed 2.7 gigawatts of new solar photovoltaics, representing 51 percent of total new electric capacity additions. The US now has 67GW of total installed PV capacity and this is expected to more than double over the next five years, according to the Solar Energy Industries Association.

Of the 10.6GW of solar PV installed in the US in 2018, 23 percent of new additions came from residential solar, compared with 20 percent from non-residential and 58 percent from utility scale projects.

Seventy-seven percent of US households are prevented from installing rooftop solar panels due to low credit scores, roof shading, or because they don't own their home, according to greentechmedia.com. Given these limitations, the adoption of residential solar has been highly unequal and skewed towards higher income homeowners.

Community solar helps broaden the population of beneficiaries of solar by allowing

The march of the millennials

Taylor Jordan was co-founder of impact investing firm Imprint Capital which Goldman Sachs acquired in 2015. Here he explains the allure of a responsible approach.

Q Impact investing is clearly on a growth trajectory. What is driving this in your view?

There are two main drivers. First, we now have a broad set of investors that want to leverage their assets to create tangible impact. That has expanded from foundations, which were among the earlier adopters, to family offices and now institutional investors. We'll continue to see growth in impact strategies as wealth transfers to younger generations that naturally embed their values into both their purchase and investment decisions.

Q So what's the second driver?

Impact themes are benefitting from a broad set of macro tailwinds. Take clean energy: early investors catalysed billions into the sector which enabled a significant drop in the cost of installing and generating power; positioning renewables to become the dominant form of new power installation going forward.

Q Before joining Goldman Sachs, you co-founded Imprint Capital. Why did you team up with Goldman Sachs?

I've been involved with impact investing for over 15 years, starting out at a nonprofit – RSF Social Finance, based in San Francisco. While there, I helped build an impact portfolio in the early 2000s before the term was coined and there was mainstream interest in the topic. I learned a lot from that experience that I felt could benefit other investors. So, together with my co-founder, John Goldstein, we established Imprint Capital, which started out creating tailored impact portfolios for foundations but broadened out to help financial institutions build ESG and impact portfolios for their clients. As the business developed, we felt the need to scale our work. Goldman Sachs acquired our business in 2015 and gave us resources and reach to work with more and larger clients.

Q Where are you currently finding environmental opportunities?

In clean energy, power generation has been largely played out at utility scale, but we see pockets of opportunities in commercial and industrial solar, battery storage and grid services. In sustainable transit, we see the continued evolution of connected vehicles, electric vehicles, and eventually autonomous vehicles and we're looking at opportunities beyond cars, such as buses and motorcycles. In food and agriculture, there are opportunities in agriculture technologies that improve efficiency and yield and take advantage of changing consumer preferences in areas such as alternative proteins. We are also seeing interesting businesses in waste and materials in areas such as bioplastics.

Our eight core impact themes

Clean energy
Pover generation
Grid services
Energy efficiency

Sustainable transport
Electric
Connected
Autonomous

Education
K-12 Education
Higher Education
Continuing/adult education

Health
Healthcare services
Devices and diagnostics
Life sciences

Financial inclusion
Financial technology
Lending

Food & agriculture
Agricultural production
Processing and distribution
Consumer goods

Waste & materials
Efficiency
Sustainable materials
Waste management

Ecosystem services
Forests
Habitat
Carbon

Source: AIMS Imprint

Democratising access to clean energy

Arcadia Power is a nationwide energy choice platform that integrates with utilities to make it easy for customers to sign up for clean energy.

Most customers continue to source energy from their local grid and Arcadia offsets their usage by purchasing an equivalent amount of renewable power from wind projects; other customers are subscribed to community solar gardens or enrolled in energy efficiency measures.

Arcadia also provides its customers with easy online billing options via a modern user interface, creating a higher quality digital experience than most utility offerings. By making national demand for renewables cheaper and easier, Arcadia is democratising access to clean alternatives and making the grid's overall energy mix cleaner.

In 2018, Arcadia's customer base of 266,905 connected accounts used 680,000 megawatts of clean energy, avoiding 530,060 metric tonnes of greenhouse gas emissions.

Solar at a discount

True Green Capital is a developer and owner of community solar projects in New York State.

Over 50 percent of US households are unable to host a solar system due to renting, insufficient roof space or shading.

Community solar is a local solar facility that is shared by multiple community subscribers who receive credit on their electricity bills for their share of the power produced. This enables homeowners, renters, and businesses equal access to the economic and environmental benefits of solar power generation, while also building a stronger, distributed, and more resilient grid.

True Green's distributed sun portfolio in New York generates clean, renewable energy into the local grid and provides its customers a discount to utilities electricity rates.

At the end of Q3 2019, the portfolio comprised four operating community solar projects that generated 11 megawatts of clean energy and had 10 projects in construction that equated to 109 megawatts. A single megawatt of solar powers 164 homes.

both homeowners and renters to access solar energy and savings without having to physically install solar panels on their rooftop. Instead, a cluster of solar panels are installed in a neighbourhood site, allowing dozens or even hundreds of community members to subscribe to the project. Clean energy generated from the site is then fed into the local power grid and the community project subscribers receive their share of solar credits through their utility, typically resulting in a reduced monthly utility bill. This also makes it easier for the local utility to manage the integration of the additional solar energy, reducing physical stress on the grid.

Community solar has grown rapidly since 2015, reaching 1.4GW of cumulative installed capacity by year-end 2018, according to the Solar Energy Industries Association. There are 43 states in the US with at least one community solar project online and 19 states have recognised the benefits of shared renewables by encouraging their growth through policy and programmes.

Community solar has enjoyed rapid adoption across the US and is poised for strong growth due to size of the addressable market. However, the development of community solar projects has lagged demand due to a lack of financing options. Lenders and investors have been hesitant to finance due to the relatively new and unfamiliar nature of the projects. Additionally, the small size of community solar projects makes them less attractive to big institutional investors and requires financiers and developers with regional expertise. Investors able to navigate these market dynamics will help democratise access to residential clean energy by providing an affordable clean energy option to the previously excluded 77 percent of US residents. ■

Diversity

Diversity has been in the spotlight in recent years with institutional investors, particularly large US pensions, keen to see their GPs addressing the issue within both their investment teams and portfolio companies.

The reason is simple: gender and ethnic/cultural diversity can lead to better investment decisions, ultimately resulting in higher returns for investors. According to research by McKinsey, companies placed in the top quartile for gender diversity at the executive level are 21 percent more likely to generate above-average profits than those in the bottom quartile. For ethnic and cultural diversity, top quartile businesses are 33 percent more likely to outperform on EBIT margin.

Yet, the private equity industry has a long way to go. Data compiled by Bloomberg found women account for just 8 percent of senior investment roles at the top 10 largest private equity firms. In the US, a study from the Knight Foundation this year found that minority-owned private equity firms accounted for just 3.8 percent of the 2,800-plus firms surveyed.

Not addressing diversity can have financial consequences. A deficit in workplace diversity contributed to Chicago Teachers' Pension fund passing on a $50 million infrastructure allocation to Blackstone and Brookfield Asset Management last year. Nevertheless, some firms are taking the lead, such as Carlyle Group, which hired a chief diversity officer last year.

"Diversity is inevitable in impact investing, both from the way that we do and practice impact investing, the diversity and range of tools we need to use, but also the range of people we need to reach, based on gender, ability, ethnic background, sexual orientation," says Faye Drouillard, founder of impact foundation The Giving Circle of Ireland. "It's part of our everyday existence."

Education

According to the UNESCO Institute for Statistics, around 263 million children and adolescents are out of school worldwide – equivalent to one in five.

At the same time, of all the money in the world spent on education, only 0.5 percent goes to low-income countries, even though they contain roughly the same number of children as rich countries.

"Education impact investing could mobilise new funding, enable private sector engagement in both public and private education service delivery, and introduce and scale approaches or tools to improve efficiency of service delivery, promote innovation in teaching and learning methods, and monitor outcomes and systemic effectiveness," noted D Capital Partners in its *Impact Investing in Education* paper.

Private capital has already been doing this, all along the value chain. CDC Group and New Enterprise Associates have invested directly in schools, such as Bridge International Academies, a Kenyan provider of affordable K-12 education. In 2015 Omidyar Network invested in South Africa's Siyavula, an educational technology provider. Distance learning providers and groups that help with the transition from education to employment are also potential targets of private capital.

Investing in the sector is not without challenges. Deal sizes are small relative to other impact sectors. Improvements in educational attainment are difficult to measure and often take many years to come to fruition. Patient capital is required to achieve returns and make an impact. It can also be difficult getting buy-in from the state, which sees education as falling within its own purview. By adopting a localised approach, investors are showing that these challenges are surmountable.

Financial return

Once the preserve of philanthropic efforts, deploying capital for impact has moved squarely into the realm of investors seeking financial returns, as well as positive social and environmental outcomes.

In fact, the definition of impact investing set out by the Global Impact Investing Network explicitly includes the objective of financial returns.

While impact investing covers a range of financial return targets, the proportion of impact investors seeking market-rate returns has been growing steadily and now stands at around two-thirds, GIIN research suggests. In addition, the vast majority of respondents to the organisation's annual survey (91 percent) report financial returns either in line with or exceeding their expectations (even more – 98 percent – said their impact expectations had been met or exceeded). Far from being uncomfortable bedfellows – as some sceptics might believe – these figures suggest that impact objectives and financial returns can easily go hand in hand.

"There is a place in impact investing for a broad spectrum of financial objectives, from concessionary to market rate and everything in between," says Adam Heltzer, head of ESG and sustainability at Partners Group. "However, if you are to mobilise significant capital and create catalytic change, investors need to generate a financial return."

There is scope for investors with different objectives to join forces to achieve greater impact as well as improve financial returns. "There is a lot to be gained from impact investors from all parts of the spectrum working together," adds Heltzer. "In the past there was some scepticism among the more concessionary investors targeting the parts of the world with the greatest need for capital about the motives of financial return investors. But we're now seeing a sharing of ideas that improves practice across the board – those focused exclusively on impact objectives are now more able to see how to create more sustainable businesses, and investors with financial and impact objectives have a greater understanding of what can genuinely create impact."

The GIIN's ambition is for social and environmental factors to be "integrated into investment decisions simply by default, as the 'normal' way of doing things". We may be a little way off this yet, but there are already some experienced hands that can demonstrate the commercial imperative of impact investing.

"If you manage social and environmental issues effectively," says Shami Nissan, head of responsible investment at Actis, "you are not only de-risking the business and ensuring business continuity, but you're also more able to identify positive actions you take. If you then layer community projects on top of that, you are earning a licence to operate in what can be sensitive environments. We may not take the shortest route from A to B, but by addressing these issues, we're creating significant value in the companies we back."

KEYNOTE INTERVIEW

No need to compromise on financial performance

Financial returns and positive social and environmental outcomes are mutually reinforcing if investors take a well-considered and targeted approach, says Shami Nissan, head of responsible investment at Actis

As this publication clearly demonstrates, impact investing has come a very long way in a short space of time – and possibly nowhere more so than in the conversation around whether impact investment can deliver strong financial returns. What was once considered a niche investment strategy that had more to do with philanthropy than generating returns is becoming an increasingly important part of institutions' portfolio construction considerations. In 2014, just over half of investors (54 percent) surveyed in The Global Impact Investing Network's study targeted market-rate returns; by 2019, that percentage had grown to 66 percent.

Even so, it's still a subject for debate among many investors, in particular as some aspects, such as ways of measuring and reporting on impact are still in their infancy and can be confusing. We caught up with Shami Nissan, head of responsible investment at Actis, to discuss how impactful investment strategies can align closely with financial return objectives and explore the difference between impact metrics and measurement.

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Q To what extent is impact investing commercially viable?

It's completely commercially viable, in our experience. This is based on a long track record that spans several decades and a guiding philosophy that values drive value. We've always had a 100 percent commercial objective and our investments have resulted in meaningful impact in the majority of the sectors and countries where we work.

Q What kind of compromises are involved?

Some may see an inherent conflict or a need to compromise either financial returns or impact. Of course there is a continuity but our view is that the two goals are mutually supportive. We invest in hard and soft critical infrastructure which supports the basic needs in the countries, cities and communities in which we operate – from energy to education and healthcare – and we approach this in a way that distributes value not just for immediate stakeholders, but also the wider community.

A thoughtful and intentional approach to creating impact helps ensure the business has a licence to operate and is valued highly by employees, the wider community and, ultimately, a buyer when it comes to exit.

Q Some sectors can be more obvious targets for impact investors. But is it possible to generate impact across the board?

Absolutely. Right now, impact funds tend to be focused very much on specific sectors with high intrinsic impact, such as healthcare, education and agriculture – that's one end of the spectrum. Yet the world's economies are comprised of myriad sectors and the challenge is how you achieve impact across all sectors. I'd say this is more of an incrementalistic approach. This approach requires an understanding of the top levers in the business for delivery of a measurable positive impact to people or the planet. You must then implement and measure.

Q So what is Food Lover's Market doing to generate impact?

Food Lover's Market, one of the largest retail groups in Africa, is a company that really demonstrates how a business can make significant, lasting differences. It underwent a root and branch review of everything it does to create a truly sustainable business for today and tomorrow.

Waste reduction is one area – it managed a 43 percent reduction in waste to landfill in just six months, saving it 250,000 rand ($16,491; €15,132) a year in the process. Reducing water consumption, high quality training, family budgeting courses, help with safe transport for employees, supporting smallholders in a way that takes into consideration climate change – these are all initiatives being put in place by the company that both build financial value and have important social and environmental impact that stretch far beyond the company's premises.

Q Given the link you outline between financial performance and impact outcomes, are there metrics that overlap?

Yes – many of the financial or commercial performance metrics we use can also track impact. If you look at education metrics, for example, there may be the number

"Some may see an inherent conflict or a need to compromise either financial returns or impact, but our view is that the two are mutually supportive"

How can impact and financial returns be mutually supportive?

Ostro is a great example of this. We created this Indian renewable energy business from scratch in 2014. This allowed us to shape the kind of company we wanted to build. In a country where 200 million people still lack access to electricity, there is clear impact in helping bring more people onto the grid and doing so with renewable energy sources. By 2018, the business had 1GW of contracted generating capacity.

However, we also recognised that there was much more we could do to create value and manage risk at the same time. Together with management, we implemented international best practice for labour accommodation standards and site safety – these standards are exceptional in a market where working conditions are often poor and accidents frequent. Safe drinking water was also an issue for local populations, leading to a number of health problems. Ostro therefore installed water ATMs, where the community could access clean, safe water for a small fee. It's these kinds of initiative that give Actis and our portfolio companies a licence to operate among vulnerable communities while at the same time building significant financial value.

This was demonstrated when we exited the business in 2018 through a sale to Goldman Sachs-backed ReNew Power. Following the deal, the buyer cited Ostro's strong ESG record as a factor that boosted its valuation. Indeed, there is now a story building in India about the kind of companies that we put into the market – there is a kind of halo effect for Actis-backed companies. Buyers know that they are clean, well run and socially responsible businesses, all of which add financial value when it comes to exit.

of enrolments, graduation rates, post-graduation employment levels and starting salaries, number of courses offered etc. These are financial and operational reporting tools, but they also provide a window on how much impact you are having on student outcomes. In healthcare, it's the same. Number of clinics opened, number of patients seen, improvements in clinical outcomes – these are all operational and financial metrics that blend with social outcomes.

There are clearly other impact metrics but broadly speaking you don't have to have a whole new reporting headache; you're often already gathering the information in any case. It's worth saying, though, that metrics are different from measurement.

> *"There has been a lot of work done on which units to look at for impact – we're almost drowning in the different sets of metrics we can use"*

Q In what way do you see metrics as distinct from measurement?

Metrics are clearly important and there has been a big focus by the industry on this. We're almost drowning in the different sets of impact metrics we can use.

Where we haven't made much progress as an industry is measurement systems. LPs need to be able to compare the impact performance across different managers and funds. GPs need to be able to measure impact at portfolio company levels, and compare across companies, even if they are different sectors. There needs to be a way of reading across all these – as Sir Ronald Cohen said last year: "If impact investing is our rocket ship to social change, impact measurement is our navigation system."

That's why we have worked to create an impact measurement framework that, from January 2019, we have applied to all our investments. That allows us to give an impact score to each investment we make so that our impact returns can be compared in the same way as financial returns can be. We have also made the framework open source so that it is available to everyone – the industry needs to move forward together. If we move towards a common measurement system, this could help unlock significant capital from LPs.

Q How do you determine which areas are material?

We have to prioritise because you can't measure and aggregate all impact, so you focus on areas that are the most material – those that are transformative and enduring. So we look at the five biggest impact levers for each investment. These could be CO2 avoidance, jobs created, educational improvements and healthcare outcomes, for example. For each individual impact, we score it on debt/number of beneficiaries/how underserved those beneficiaries and on contribution. This score addresses the question: Would this have happened anyway?

Q How do you see impact investing developing over the medium term?

It will continue to gain momentum. The creation of the UN's 17 Sustainable Development Goals has really helped people galvanise around a framework organised by themes and, while there is still some way to go before we have greater harmonisation around impact definitions and measurement, institutional investors are increasingly assessing how their capital can be deployed to generate both financial and societal returns.

Some of this is driven by the generational shift we see with millennials and with the increasing participation of high-net-worth individuals and women in investments – these groups really care about how their capital can be used for positive societal and environmental outcomes. The development finance institutions will play an important role here by sharing what they have learned to help mobilise capital and build a robust impact ecosystem. ■

Can you outline impact programmes that run across multiple portfolio companies?

We have implemented programmes that benefit both the local economy, local stakeholders and and our portfolio companies and we've done this on the theme of training, for example.

In Kenya, we partnered with ArcSkills to provide vocational construction-related training to local unemployed young people, an important initiative in a market where there are skills gaps and 80 percent unemployment rates among under-30s. Between June 2016 and July 2017, the programme trained nearly 300 people, 40 percent of whom were female, with the vast majority gaining certification in areas such as masonry, plumbing, plastering and formwork. This gives us a pipeline of skilled labourers that can deliver high-quality workmanship according to international health and safety standards. Yet it also provides enduring benefits for the young people and the wider economy as our trainees are more able to secure employment beyond our investment.

It's the kind of initiative that can be replicated across our markets and we've now run similar programmes in India to help train workers for Indian renewable platform Sprng and in Cameroon, where we're building the country's first shopping mall to international green building standards.

Global vision

Impact investing may have originated from small investments targeted at improving the lives of local communities, but the growth of the industry and the increased urgency of finding solutions to issues such as climate change have led to much greater ambitions.

Some say the creation of the UN's Sustainable Development Goals in 2015 has been a game-changer in this respect, in particular as all countries agreed to adopt them.

"We live in a very big, messy world," says Adam Heltzer, head of ESG and sustainability at Partners Group. "You need enormous will and resources to address the complex issues it faces – that requires a global vision.

"The SDGs have been a huge success story because of their wide adoption. They are the closest thing we have to a global strategy for improving peoples' lives and managing the environment and our resources sustainably. They create a framework through which all actors can focus their efforts and build coalitions and collaboration across countries, governments, businesses and people."

Healthcare

The third Sustainable Development Goal, good health and wellbeing, fits squarely within one of the key sectors for impact investors.

Indeed, in the Global Impact Investing Network's 2019 survey of impact investors, healthcare sits in the top three target areas, behind energy and food and agriculture.

Yet while healthcare may seem obvious as an impact sector, there can be significant risk, and investors need to look carefully at the type of sub-sector they support.

"In theory, all healthcare investments can have a positive impact," says Taylor Jordan, managing director at Goldman Sachs Asset Management.

"But the risk of unintended consequences can be high – look at the opioid crisis. We therefore focus on healthcare solutions that materially reduce cost and improve care in areas such as services and technology."

Inclusive finance

The sector aims to establish start-ups, help people out of poverty and assist them with gaining more control over their lives.

It can cover a range of issues, from providing financial services such as credit, pensions, insurance and savings products through to offering education on household budgets and business management.

"If people lack access to finance or face high cost of capital, it is very difficult to improve their lives or grow their businesses" says Taylor Jordan, managing director at Goldman Sachs Asset Management. "If you can provide appropriately structured financial services to underserved populations at the right price, you open up opportunities and develop local economies."

The financial services landscape in emerging markets has been transformed, but inclusive finance is also relevant in developed markets. "In the US, for example, you have millions of people living in poverty without a strong social safety net," adds Jordan. "Many rely on payday lenders to cover financial shortfalls which can lead to a vicious cycle of debt. We see a growing set of investments that leverage technology and market innovations to bring down costs and effectively serve underserved populations."

Job creation

Job creation has long been one of the metrics through which the private equity industry has sought to convince the wider world that it has a positive impact on the communities its investment touches.

Yet this does not make private equity automatically an impact investment – the job creation figures publicised by individual firms and industry associations are, by and large, incidental – and employment creation has historically been a by-product of investing to expand a business.

Yet for some investors, there is a clear intention of creating jobs as a means to develop economies and improve peoples' lives. CDC, the UK's development finance institution, is one example of this. "Job creation is our primary mission because we believe it leads to economic empowerment and there is a strong alignment with financial returns," says Clarisa De Franco, managing director, funds and capital partnerships at CDC.

Job creation is particularly powerful as an objective because it has the potential to help economies meet a number of the United Nations' Sustainable Development Goals, including no poverty, zero hunger, gender equality, decent work and economic growth and reducing inequality.

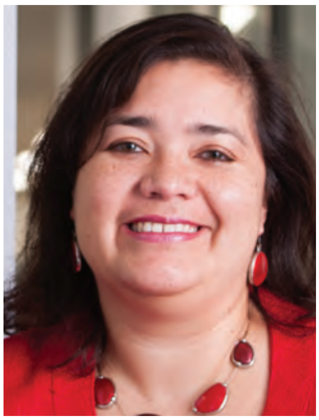
However, this is far from a simple addition game. "It's not enough just to look at the absolute numbers of added employees in a business or the wider community," says De Franco. "You really have to assess whether you are creating high-quality jobs. Better and higher-skilled jobs improve company prospects and do more to help lift people out of poverty. With higher wages, you're also boosting local economies more broadly."

Taylor Jordan, managing director at Goldman Sachs Asset Management, agrees. "One of our main focuses is on financial inclusion to create jobs in underserved communities," he explains. "But if private equity firms are intentionally targeting job creation as an impact goal, there needs to be a focus on job quality with income levels and benefits that genuinely make a difference in employees lives."

For CDC, there is also a multiplier effect, given that it focuses on investing in areas where capital is needed most. "Many of the firms we've backed over the years can now attract more capital from LPs," says De Franco. "That means they can now also target larger businesses. That has a trickle-down effect on employment quality as, with capital, these companies can invest in training. That allows better-paid employees to improve housing and spend on education and healthcare for their families."

KEYNOTE INTERVIEW

How creating jobs relieves poverty



As private sources of capital warm to the idea of impact investing, there is much they can learn from DFIs, say Clarisa De Franco and Yasemin Saltuk Lamy of the UK's CDC Group, which has been deploying capital for positive outcomes for over 70 years

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While most institutional investors are relative newcomers to the growing impact investing space, the concept of deploying capital to fulfil positive social and environmental objectives while generating a return is far from novel.

Development finance institutions (DFIs), which are usually majority owned by national governments, have been investing to support private sector development in emerging markets for many years with the aim of improving the lives or life prospects of people in challenging countries.

And, given their mission is often to attract further private capital to the markets in which they invest, DFIs have a wealth of experience and knowledge they can share with other investors to help them climb the learning curve quickly. We spoke to Clarisa De Franco, managing director Africa Funds, and Yasemin Saltuk Lamy, deputy CIO of Catalyst Strategies, at the UK's CDC Group, to find out how partnerships between DFIs and other investors generate significant impact, and achieve returns.

Q For those who don't know CDC well, can you tell us about what you do?

Clarisa De Franco: As a DFI and investor, wholly owned by the UK's Department for International Development, our primary purpose is to promote private sector development in Africa and South Asia by supporting the Sustainable Development Goals. We've been investing for economic development for more than 70 years, so we have a wealth of experience understanding these markets and deploying capital both directly into companies and through funds. We are impact-led with a commercial focus of generating returns that we reinvest in businesses in our markets. We believe that by building businesses, we can create jobs that will help lift people out of poverty.

Q How can DFIs such as CDC help other investors in their impact strategies?

CDF: In many ways, it depends on what the investor's strategy and objectives are. If they are looking to invest in the markets where we operate, we can share our experience with them. Or we can take a step further and co-invest together, as they leverage our track record and relationships. We understand the realities of our markets and we have valuable networks that other LPs can draw on. We can also provide input on the active managers in a specific region.

If an investor wants to look at renewable energy, they need knowledge of the regulatory framework and what the potential pitfalls are – we can help here as well as connect them with the active GPs in that industry. There's huge value in that. If you're investing in markets with no knowledge of the key players, having someone hold your hand, make introductions to active participants and provide sector and local market insight mitigates significant risk.

Yasemin Saltuk Lamy: And we can also learn from other investors, too. That's why partnership is important to us.

Q So how might you learn from such a partnership?

YSL: We have been in the market for a long time and so we've built individual and institutional knowledge that we can share with others, but we're always learning too.

When the MacArthur Foundation launched the Catalytic Capital Consortium in March with the Rockefeller Foundation and the Omidyar Network, we saw an opportunity to compare notes on how we use catalytic capital. We are open about this approach and have joined the public dialogue to raise its profile. This goes beyond investing together, it is learning together.

"Climate change is high on the agenda. We will see ever more focus on this because it's so intertwined with other impact objectives"

CLARISA DE FRANCO

Q Many LPs will see significant potential for positive impact in your markets but will also have concerns. What can you do to address these?

CDF: Their concerns tend to fall into three main categories – risk perception, returns and depth of market. On the point about risk, it's incumbent on DFIs such as us to explain clearly to other investors what the reality is on the ground. Much of the concern tends to be based more on preconception than reality. It's our responsibility to share our knowledge of the markets, how we conduct due diligence and make introductions to people we know and trust.

We also really have to get to the point where we can demonstrate commercial, sustainable returns before many investors can get comfortable. We've been working closely with our GPs and leading industry organisations to understand and unbundle returns to determine what the drivers are and that enables us to identify opportunities. The headline figures suggest that only single-digit returns can be generated

Q You mentioned Africa's nascent venture capital market. What are you doing to support its development?

CDF: We have been active here and have several strategies in play to help boost the development of VC in Africa. For example, we have a dedicated VC fund programme for both our regions (Africa and Asia). This provides a platform for us to be a key player in VC by helping to build the ecosystem for venture funds over time.

YSL: This is also part of our Catalyst Strategies programme, where we have a higher risk appetite for target markets where there is little precedent. Novastar Ventures is a primary example of CDC's ability to anchor funds and attract third party LP appetite. We were investors in the firm's first fund, which closed in 2013. Through our investment, we saw the value that VC can bring by supporting entrepreneurs to grow businesses, helping drive economic growth and creating jobs. Novastar has invested in a wide variety of start-up businesses, from a company that collects and converts organic waste into agricultural products, to one that provides off-grid solar systems, an ethical fashion brand and a technology business that connects smallholder farmers to markets.

Its first fund closed at $80 million, the firm is now targeting $120 million for a successor fund and has already reached a $72.5 million first close, with CDC a key investor again. It is also expanding beyond East Africa and into West Africa. It's an exciting demonstration of the investor appetite to support Africa's VC fund managers and the growth that's possible.

but this needs to be deconstructed to show the real picture. Understanding the difference between large funds and micro funds highlights how currency can affect returns. Emerging markets strategies are all based on growth, that's quite unlike developed markets where leverage plays a role – the numbers may not be directly comparable.

Finally, it's true that the cheque sizes many institutions are seeking to deploy are simply too large in some of the areas we invest, but by helping to develop private equity markets and the broader ecosystem, opportunities grow in size over time.

Q You invest in many markets that other investors perceive as being too difficult. What's your role here?

CDF: We invest our capital where capital is most needed, primarily to boost capacity and activity. We want to develop ecosystems that can eventually be self-sustaining. By anchoring new and emerging funds, we're helping build private equity industries that will attract capital from other investors in the future, acknowledging that those managers must deliver appropriate returns. We were early investors in what have now become pan-African funds, such as Helios and DPI, which are now able to attract significant capital from other LPs. We're also supporting the development of the nascent but increasingly vibrant venture capital scene in Africa. We have to take the long-term view, be patient and offer finance in a way that meets local market needs.

YSL: Our Catalyst Strategies are a clear example of this. Developed over five years, they take an innovative approach to addressing impact. Through these strategies we can support nascent markets or create innovative solutions to address persistent market failures. Individual investments are less likely to have much impact in these cases, so we have a set of strategic objectives and work back from there to determine how we can tackle the issues – that could be through supporting GPs, but it could also take the form of technical assistance and grants alongside investment.

Our Energy Access and Efficiency strategy is a good example of how we address a market-wide challenge. Through this strategy we're supporting investment into solar panels for households where energy access is an issue. If households are to buy the panels, they may need finance. So, we've been working to help develop consumer finance protection principles to help prevent the risk of over-indebtness. This type of initiative helps the households involved, the company providing solar panels and also the wider market.

> *"We're supporting investment into solar panels for households where energy access is an issue"*
>
> **YASEMIN SALTUK LAMY**

Q What do you look for in the GPs you back?

CDF: Much as in other markets, we're looking for teams that have the skills and networks to execute their strategy. And, we're looking for managers that really think about their firms as organisations that consider which teams are built, is it just deal-executors or are they looking to create an entity that will endure over time? Are they developing junior talent? And how are the economics shared across the broader team, ensuring alignment with investors? This is familiar territory for any private equity fund investor, but it's paramount in a nascent markets' because we must ensure the industry's development is sustainable. Well-managed GPs create impact and long-term commercial returns. We use our local networks and presence to identify fund managers and we're able to validate who we're working with.

Q How do you measure impact?

YSL: Our key metric is job creation, which has a clear alignment between financial and social objectives. If you're helping companies grow, you're usually creating new jobs as well as more valuable companies and having an impact in a variety of indirect ways. We use various tools to help monitor and measure both direct and indirect impact.

But we're also keen to ensure impact measurement develops on a much broader level as this will help bring more capital into impact. We've been supportive of the Impact Management Project that brings together 2,000 organisations to share best practice and coalesce around the 17 UN Sustainable Development Goals. It is a good framework to start standardising practice areas for the industry.

Q How do you see the future of impact investment?

CDF: Climate change is high on the agenda. We will see ever more focus on this because it's so intertwined with other impact objectives – you can't tackle hunger if the land you grow food on is flooded or too dry, for example. Indeed, in addition to building capital markets the other priorities for CDC's Catalyst Strategies is people and planet. Yet tackling environmental issues doesn't have to entail a specific strategy; we're looking very closely at how we can support managers investing in all types of business to identify areas where they can, for example, improve energy efficiency and reduce water usage. Additionally, we are working more closely with fund managers that are looking to develop renewable energy assets and resource efficiency.

YSL: We're reaching a stage where impact strategies are no longer a choice – it's becoming clear the world needs investment to promote sustainability and stakeholders are increasingly demanding that investors align their financial and impact objectives. It's a journey, investors need to step back and work out what they are seeking to achieve and how they will get there because no one institution can solve everything. A key development will be for investors to take a more proactive approach to what we know will happen in the future. We know African demographics will change, for example, so we need to be developing strategies according future needs. ■

Kids and the future generation

Helping children to adapt in our rapidly changing world begins at birth and continues through early childhood and education for impact strategies.

A good example of what can be achieved can be seen in the Open Society Foundations, a network of foundations, partners and projects in more than 120 countries created by philanthropist George Soros.

One of the foundation's main objectives is education for all – promoting child-centred high-quality schooling and teacher training, while seeking to strengthen good governance and accountability across educational institutions and systems. From providing a better future for Syrian refugee children to training early childhood educators in Islamabad and providing legal advice to Roma parents, the foundation takes a broad developmental approach in all its initiatives.

A noteworthy project is Sesame Workshop, an educational programme specifically created to address challenges and the needs of Syrian children now living in Jordan. The programme combines *Sesame Street*'s expertise in mass media and educational content with the International Rescue Committee's expertise in conflict and displacement. Now in its third year, Sesame Workshop is expanding to reach children and families through television, mobile phones and direct services in homes and preschools, giving them the skills to succeed in life. Its goal is to reach nine million children in Iraq, Syria, Lebanon and Jordan over the next five years.

Low-cost housing

In the UK, the lack of readily available affordable housing remains a problem as private rents continue to rise and sharp falls in affordability are causing homelessness.

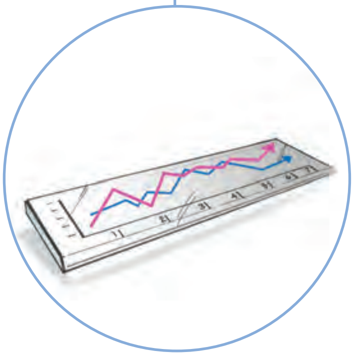
London and New York-based sustainable and impact investor Bridges Fund Management is one manager that aims to invest around the underserved parts of the UK. The firm's investments in housing fall under one of its four key investment themes: stronger communities.

Capital from its property funds, which have raised more than £500 million ($629 million; €570 million) as of September 2019, has been invested in developing close to 1,500 homes in Greater London, of which around 40 percent are classed as affordable housing. "What we have been able to do over time is work out ways to structure deals and work with local authorities and reduce costs on the build process so that we can increase the amount of affordable housing within the overall mix," says James Taylor, Bridges' head of communications.

One of the firm's recent investments is helping to regenerate the centre of Croydon, south London, with 251 lower-cost residential units, 262 affordable residential units and 13,000 sq ft of commercial ground floor space at Taberner House.

Bridges also puts environmental sustainability at the centre of its property investments. One of the residential buildings it has developed in Hayes, located in the outskirts of west London, was constructed using cross-laminated timber, which reduces build time and material wastage.

Through Bridges Evergreen Holdings, its long-term capital vehicle, Bridges has also created the Ethical Housing Company, with a goal to acquire a portfolio of between 80 and 100 lower-cost homes in Teesside to rent to people on lower incomes.



Metrics

The ability to measure impact is hugely important because it creates accountability, says Tania Carnegie, leader of KPMG's Impact Venture practice.

"Investors need to have confidence in a manager's ability to generate financial returns and its ability to create social and environmental benefit. Measuring both sets of outcomes is critical to achieving that."

"Effective measurement and assessment is vital to improving outcomes in impact investing," adds Maryanne Hancock of Y Analytics, a company that helps capital allocators understand, value and manage social and environmental impact.

"Solutions and methodologies need to stretch across products, industries and markets, account for magnitude of impact and ultimately increase confidence and better inform capital allocators and decision makers. Done correctly, effective assessment can help unlock the scaled capital needed to reach the sustainable development goals."

The impact investment community has certainly made substantial progress in building the frameworks required to measure outcomes over the past decade, including the social return on investment, or SROI, framework, as well as work carried out by the Global Impact Investing Network and Impact Management Project. Impact consultancy Bridgespan and investor TPG Rise, meanwhile, have developed and implemented what they call the Impact Multiple of Money.

"We are now at the point where viable and practical means of measuring impact are in the public domain," says Stephanie Krater of social impact consultancy Bridgespan. "The existence of tools should no longer be cited as a barrier to measuring impact."

Challenges undoubtedly remain, nonetheless. Despite a proliferation of frameworks for measuring impact, there is still no single common language. While tools now exist, arguably we have too many. "We haven't yet got to the point where we have a widely accepted framework such as GAAP in the accounting world," says Carnegie.

"Investors will eventually coalesce around one framework or another," adds Vadim Avdeychik of law firm Paul Hastings. "That is what always happens, and it is what is needed for the industry to move forward."

Meanwhile, some social impacts are simply harder to measure than others, for example, the impact of changing gender norms or the impact of driving civic engagement. And, of course, predictions of impact will always be estimates, just like predictions of financial performance.

"But while there are robust systems for measuring financial performance – standards and actual money to see along the way and at the end," explains Krater, "tracking outcomes for people and planet is complex and expensive. Causality is hard to know, and the benefits can take years to materialise."

The impact industry is still in its nascent stages. Long-term investment horizons mean both financial, and impact, track record is limited. Nonetheless, developing the ability to measure performance will prove critical to the growth of this burgeoning asset class. "Measuring impact is important for the same reason that measuring anything is important – it can prompt action," says Krater. "In this case, the actions we hope to prompt include allocating capital to higher impact uses and engaging with companies to strengthen the impact they have."

KEYNOTE INTERVIEW

Why metrics matter for impact investors

Tania Carnegie, leader of the Impact Venture practice at KPMG, on the power of positive impact measurement to drive opportunity

Q What does impact mean for KPMG and why is it important for you as a business?

As a firm, we have been focused on impact investing for almost a decade. We started to see our clients becoming interested in this investment approach in the wake of the financial crisis. They were looking for a deeper sense of accountability, a higher utility to the capital that was being deployed and a greater sense of purpose as to what companies actually stand for.

We saw a movement emerging and we wanted to be sure that, as a business, we were contributing our time, resource and expertise to helping that movement develop.

We also, of course, wanted to help our clients embrace impact with an approach that was appropriate for them.

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Q How much has this movement grown over the past 10 years and how much further do you believe it can grow?

I think the potential is enormous. The impact investment industry is estimated to be worth around $502 billion with more than 1,340 organisations participating around the world. That is clearly still a small proportion of overall invested assets, but – over the past five years in particular – we have seen a tremendous evolution. In fact, the IFC estimates the appetite and opportunity for impact investment to be around $26 trillion, which equates to 10 percent of financial assets globally. Over the past few years, we have seen mainstream finance players getting increasingly involved, from private equity firms launching impact funds to large global financial institutions, banks and wealth managers, specifically tailoring impact products and services for their clients. Now, of course, we are seeing a momentum build around the development of retail products as well. I really think we are just scratching the surface and clients certainly are starting to see this as far more than a niche opportunity. They view impact as transformational and as where the future of investing is heading. That makes this an incredibly exciting space.

Q What – or who – is driving this transformation?

Younger people certainly have a tremendous amount of interest and influence.

That is abundantly clear. But impact isn't exclusively for the younger generation. For example, we see a real interest among the boom generation, matriarchs and patriarchs within our family office clients. This is particularly true for entrepreneurial families who tend to welcome new ideas and opportunities.

From a fiduciary perspective, our institutional clients are keen to capture and enhance returns on their capital, beyond the purely financial. And a lot of experienced company executives are thinking hard about how they invest their money and create a broader sense of purpose within their businesses. The younger generation has a loud voice, but they are not the only ones embracing impact.

Q To what extent are we seeing an advisory ecosystem grow up around the impact investment community?

We are seeing a growing number of boutique impact advisory firms. And then, of course, there are multi-disciplinary firms like KPMG, which are supporting their audit, tax and advisory clients, while also providing an additional impact lens.

One of the things we have really focused on as a firm, is how we can provide our clients with the advice they need to have a rigorous, authentic and credible approach that stands up to the scepticism that is natural in any new and evolving space. We take a lot of pride in helping our clients build trust around their impact approach.

Q Where do the big impact opportunities lie? Is the major focus environmental or are social challenges equally well represented?

I definitely think it's both. I would add that we see an increasing recognition of the link between social and environmental issues. Environmental challenges often influence the social challenges that a community may face. In geographical terms, the spectrum of opportunities is also broad, taking in North America and Western Europe as much as developing markets.

Q Which asset classes are proving most effective for impact investment?

One of the most exciting things about impact investment is that it is an approach that is applicable across all asset classes. In

Private equity turns to impact investment

The ability to measure, monitor and communicate outcomes will prove key, says Tania Carnegie

There has been a significant increase in impact investment activity in the private equity industry in recent years. A number of traditional private equity firms have launched dedicated funds, injecting billions of new capital and drawing in institutional investors that haven't historically been attracted to this area.

According to KPMG's *Enlightened Capital* report, which is based on extensive interviews with both GPs and LPs, many private equity firms are pursuing impact strategies in response to investor interest. Furthermore, this interest is not only coming from obvious prospects such as foundations and health or faith-based organisations, with a natural inclination to consider impact. Mainstream institutional investors including pension funds and corporations are also demonstrating real appetite.

Private equity firms are attracted to impact investment because of an unmet demand for financing solutions to the big problems facing society as well. That presents unique opportunities for both impact and financial returns, and many GPs are using the UN SDGs as a road map.

But there are nonetheless challenges that remain for private equity investors interested in embracing the impact opportunity, not least countering scepticism regarding the legitimacy of the investment approach and concerns about a trade off with returns. Authenticity, transparency and the genuine integration of impact throughout the investment life cycle are critical, and the ability to measure, manage and communicate impact is therefore key.

GPs active in impact investment acknowledge the importance of leveraging existing methodologies for measurement, while still developing their own unique approach aligned to their view of the market, culture and investment expertise.

They are also focused on balancing the ability to measure impact with the additional burden on portfolio company management and internal resource. However, the *Enlightened Capital* report also shows that many are willing to learn together, leveraging the experiences of others to contribute towards a broader impact ecosystem.

addition to private equity, we are also seeing activity in real estate, infrastructure and in the public markets. I think that is very encouraging.

Q What are the big challenges associated with impact investing?

I think the first big challenge is to build an awareness and understanding about what impact investing actually is. As much as it has been growing in popularity as an investment approach, it is still a relatively new concept for the majority of investors.

Of course, that means it represents a tremendous opportunity, but it also means there is a lack of common understanding. People will often have preconceived ideas and I think that is a barrier that we need to address in order to channel as much capital as possible.

There are misconceptions, for example, about whether there is a trade off between impact and financial returns, or sometimes people think that impact investment is only an early-stage opportunity, or is restricted to certain asset classes. And then, of course, there is the challenge of measuring impact.

Q What stage have we reached in terms of the ability to measure impact?

There are a number of approaches that are beginning to be adopted around measurement and management and that is helping to form the basis of a common understanding. But we haven't yet got to the point where we have a widely accepted framework such as GAAP in the accounting world. It is really important, therefore, for fund managers to be clear about their investment thesis and transparent about what they are trying to accomplish and also for investors to be clear about what they are looking for in terms of returns and outcomes.

Q Why is the ability to measure impact so important?

In short, accountability. If you are an impact investor, you are not only interested in making money but also seeing that your invested dollars are helping to influence positive change. That means the ability to demonstrate returns in both financial and impact terms is critical. Certainly, the clients we work with take the view that they are equally important.

There is a heightened expectation of trust associated with impact investing. So, being able to deliver on the promise in your investment thesis, being able to live up to that expectation of trust, is essential. Measuring outcomes is a part of that process.

"I really think we are just scratching the surface and clients certainly are starting to see this as far more than a niche opportunity"

Q How important have the UN's SDGs proved in terms of metrics?

The SDGs are incredibly important. They are commonly featured as part of the impact frameworks that our clients are developing. Many are adopting them as a roadmap to help them understand where investment opportunities lie or how their current investment approach aligns. It helps them articulate what contribution they are making to solving the bigger picture challenges that society is facing. The SDGs are really proving unifying.

Q What are the obstacles to a greater ability to measure impact?

I think one of the key obstacles is a lack of expertise. Impact measurement is not new. The public sector and social sector have been measuring impact for many years and there's a great depth of expertise there. But this is still new for the financial community and bringing in some of that expertise is a priority. This is an area where KPMG's experience can really add value.

Q Given the ability to measure and benchmark that we have today, how is impact investment delivering in terms of both returns and impact outcomes?

It is still early days. A lot of the investment activity is taking place in the private markets and so there is not a lot of public disclosure of results. However, there is a great deal of interest from all parties in the ability to be transparent, to be collaborative and to really learn from one another. And while we are not quite there on the benchmarking of specific results, there are other ways to express the results being achieved.

One way impact investment is being assessed right now is through a number of different investor surveys. A key question being asked is whether impact investments are meeting expectations in terms of financial returns and impact.

Those surveys are generally indicating that the answer is yes, those expectations are being met. It is not clear what those expectations are to begin with, of course, but that is one way to get a sense of what is happening.

Q How do you think impact investment is likely to evolve going forward? Can it deliver the impact required fast enough given the urgency of the global challenges it is aiming to address?

I think we will continue to see more and more capital targeting impact investments. There will continue to be an evolution of next generation products looking to satisfy the weight of investor demand out there. With the urgency around climate change and social issues that are being articulated will come real opportunity for investors and for business leaders. It's that articulation of opportunity that will continue to drive the evolution and scale of impact investment. ■

Nutrition

Food insecurity is a critical issue, and not just in the developing world. In the US, there are supply-side investments aimed at bolstering the production of milk and proteins where there are shortages, as well as improving storage and preservation time for fresh foods.

There are also companies on the demand side, for example a business that helps Americans receiving SNAP (Supplemental Nutritional Assistance Programme) benefits access their balances immediately.

Start-ups, meanwhile, are busy focusing on developing new sources of nutrition. Private investor Fabrice d'Erm is working with a company that believes protein-rich algae is the answer. "If you don't have the right nutrition, you can't get the right education," says d'Erm.

"Hopefully, using algae, we can solve a lot of the problems we have with nutrition around the world, while also reducing the CO_2 emissions associated with other types of food production."

Oceans and clean water

The impact opportunity around oceans and clean water is extensive, ranging from sustainable fisheries and aquaculture, to water purification technologies, water-reducing production processes, and products and services that reduce the use of plastic, and therefore reduce the quantity of plastic ending up in the sea.

"One great example is Sky Ocean Ventures, set up by the Sky Group to invest in impact-driven organisations that have innovative solutions, new science and technologies that can create scalable solutions to address the global ocean plastic crisis," says Chris Parsons of specialist impact investment bank ClearlySo.

The key challenge, however, is that so many businesses have negative externalities that relate to clean water and clean oceans, and there has not always been a way to quantify or measure these, says Stephanie Krater of social impact consultancy the Bridgespan Group. However, there is now work being done by Trucost, for example, which estimates the cost of using or polluting water that is supporting activity in this area.

PPP

Development finance institutions show how public-private partnerships can generate impact and returns – through direct investment in commercial enterprises and investment via private funds.

"DFIs have a strong role to play in building capacity and helping mobilise commercial investor capital towards areas that need investment most and that have the potential to create significant impact," says Clarisa De Franco, managing director, funds and capital partnerships at CDC. "Many commercial investors may not feel comfortable yet with investing in the markets we target, but if we can address the challenges these economies face and create sustainable industries, other investors will come – it just takes time."

And, as with any partnership, there are benefits on both sides. "There is much that other investors can learn from the experience of DFIs, and we can also learn from commercial investors," says CDC deputy CIO of Catalyst Strategies, Yasemin Saltuk Lamy. She points to MedAccess, established to lower the cost and increase the availability of medical supplies in under-served markets, and Gridworks, a development and investment platform that targets transmission, distribution and off-grid electricity in Africa. Both have received around $200 million from CDC.

Quality outcomes

To be considered successful, an impact investment must reach both its financial and impact objectives.

"Impact investing is about generating measurable, social or environmental impact alongside financial returns," says Chris Parsons of specialist impact investment bank ClearlySo. "We have seen clients that started off raising seed capital, subsequently secure investments from larger, mainstream institutions at substantially higher valuations as their business and revenues grew, showing that they can deliver higher commercial value as well as measurable impact to investors."

Parsons cites the example of Bulb Energy, which raised early capital from institutions and individuals in 2017, before raising further capital at higher valuation multiples last year. "It is now seen as one of the potential unicorns of the impact investment market," he says.

The extent to which achieving these parallel financial and impact outcomes is the norm is unclear, however, primarily because the industry is still so young. "There have yet to be a lot of big exits in the impact investing space, and even fewer of these exits have been accompanied by rigorous, retrospective studies on their impact, so in some ways the jury is still out," says Stephanie Krater of impact consultancy the Bridgespan Group.

"That said, we have reason to be particularly optimistic when impact investment is directed to businesses in which profit and impact are inherently in lockstep. For example, off-grid solar companies will only be financially successful if they can reach new customers, and if they can reach new customers, they will very likely have positive impact." Indeed, early returns research produced by the Global Impact Investing Network has found that impact investments can perform just as well as their conventional counterparts, according to Sapna Shah, managing director of GIIN. "It really just comes down to manager selection, as it does for any investment," she says.

But with limited track record to draw on, there are a number of questions that investors should be asking of impact managers before committing their capital, chief among them, how impact is measured. Investors need to understand what frameworks are used and if results are independently verified by auditors. They also need to scrutinise how impact is resourced within a firm and whether managers are genuinely investing in order to further sustainable development goals or "greenwashing" their existing strategy with an SDG overlay, says Vadim Avdeychik of law firm Paul Hastings.

Avdeychik adds that investors should also bear in mind that the impact industry hasn't experienced a downturn and with the prospect of a change in the economic environment on the cards, it remains to be seen how impact will fare.

"It is a relatively recent phenomenon, so it will be interesting to see how impact investments perform when the cycle turns," he says. "Our clients certainly seem to believe that impact investment should outperform and, if it does, that will lead to even bigger inflows of capital as a result."

KEYNOTE INTERVIEW

Delivering on the promise

Paul Hastings' Vadim Avdeychik and Runjhun Kudaisya on the questions LPs should be asking to ensure quality impact outcomes

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Q What changes have you seen in terms of demand for impact investment opportunities and what is driving that?

Runjhun Kudaisya: Over the last decade, impact investment has evolved from a nascent and disruptive investment concept, to something that is becoming more complex, multi-faceted and mainstream. There is definitely increased demand for impact products and services from individual and institutional investors, and asset managers are keen to provide those opportunities.

We have worked with a wealth management firm that raised an impact investing entity predominantly from high-net-worth individuals looking for more of a social and environmental focus, for example. We are also in the process of launching another vehicle backed by a government body looking for financial viability at the same time as targeting the big social and environmental goals.

While demand is increasing, however, it is still a small proportion of the total private investment fund space. Of the numerous funds I worked on last year, just a handful focused on this strategy. So, the potential for future growth is also huge.

Q What questions should investors be asking as they seek to balance the appropriate financial risk and rewards with quality impact outcomes?

Vadim Avdeychik: I think it is important for investors to understand the metrics, and the frameworks, that a manager is using to make their investments. Are they simply using the SDGs as an overlay, and trying to fit their existing strategies into the UN SDG framework? Or are they actually making investments based on their ability to further enhance the SDGs? As investor interest in this space increases, there is a high probability that some managers are chasing AUM by greenwashing existing investments. It is important that LPs understand how their dollars will actually be used to create positive impact.

Investors should also explore whether a manager is using internal criteria to determine impact investment measurement or using standards provided by a third party, because that will reflect the nature of the reporting that those investors receive. They need to be able to analyse and understand the benefit that has been generated so that they can report back to their own investment committees. At the end of the fund term, it should be possible to gauge how that fund has performed against the agreed objectives and reporting framework, but that is only possible if those objectives and reporting framework are clearly communicated at the outset.

RK: I think it is important to remember that investors have very different financial return expectations. Some are largely philanthropic and are investing for their strategic objectives, while others are absolutely looking to pursue competitive market-rate returns and, indeed, consider doing so to be a fiduciary duty. There are also investors who are looking to deploy capital sustainably while achieving profitable exits in social enterprises.

There is a lot of discussion about whether fiduciary responsibility only applies to financial outcomes or whether it extends to other outcomes also, but certainly many investors have a keen focus on the financial performance of impact funds.

In terms of questions we get asked in the marketing process – LPs ask about impact definitions; the proportion of impact investment companies in a fund; what the thematic verticals will be; what criteria will be used for selection; and what indicators will be used for monitoring. Investors will want to know whether that monitoring is passive or active; whether it is audited by a third party or comes straight from the underlying portfolio company; and what the level of reporting will be. I can tell you that with most of the funds we have worked with, there is no standard approach to the measurement and communication of impact, but it is certainly a very hot topic with LPs.

> *"There is a great deal of fragmentation, and that creates challenges around benchmarking and best practice"*
>
> **RUNJHUN KUDAISYA**

Q What about the way in which managers resource impact? How significant is that for potential outcomes?

VA: Some of the larger managers tend to have a whole team of dedicated staff whose sole job it is to focus on impact investing. These teams spend time analysing the fundamentals of each specific investment using an impact lens. They make sure there is appropriate reporting and they also liaise with different third-party service providers to ensure that frameworks are being utilised properly when making investment decisions.

Smaller managers may not have quite as robust a team of individuals and may have fewer resources in place in order to provide dedicated staff. This is something investors need to bear in mind. If they are looking at a new entrant to the impact game, it is important that the manager is truly committed and has dedicated appropriate resources to ensure that impact is at the forefront of the investment strategy and not just being used as a marketing tool.

Q How are you seeing the impact investment ecosystem evolving? What range of opportunities are LPs faced with?

RK: The traditional concept of impact investing 11 years ago was very much aligned with creating purpose around companies. The parameters have since expanded and the breadth of opportunity has grown.

Historically, impact investment has focused primarily on low liquidity, innovative companies. But now it is also focused on more liquid and mature businesses that develop products or services that benefit society and the environment, ranging from energy efficiency, clean water and affordable housing to women-owned businesses and other SME development.

We have also noticed that investors are starting to think beyond equity investments. They are looking to embed impact into fixed income as well. We have come across structures like bond products to provide private capital to microfinance institutions and social enterprises in certain developing markets. We have also worked with an impact fund of funds. These are some examples of how the market is evolving and becoming more nuanced.

> *"It is important for investors to understand the metrics, and the frameworks, that a manager is using to make their investments"*
>
> **VADIM AVDEYCHIK**

Q What does this increased complexity mean for measuring impact outcomes?

RK: There is a great deal of fragmentation, and that creates challenges around benchmarking and best practice. The market is lacking a common language and there is definitely a need for more clarity. But the industry is still in its early stages. All the funds we have worked on, for example, are still in the late offering or early investment period, with five to eight-year investment horizons. It won't be until those funds start to mature and deliver results that it will become clear which management systems are most effective. I think increased standardisation is essential, and it will come, but it will take some time.

VA: Investors themselves will ultimately coalesce around one framework or another. That is the way that it always happens. And it is what is needed for the industry to move forward.

Q Have the UN SDGs not provided some form of helpful framework?

VA: I think the SDGs have been really important for managers trying to identify and allocate resources consistent with those goals. However, investors, including private equity investors have been crying out for more guidance on investments that satisfy SDG criteria. Just recently, the United Nations Development Programme proposed standards that investors and private equity managers can rely on when pursuing SDG investments. There are 31 standards that fall in three buckets. There are standards for strategic intent and goal setting, standards for impact measurement and standards for transparency and accountability. Those standards have been created at the request of the investment community, to help them make sure they are deploying capital in a way that specifically contributes to those SDGs. It comes back to Runjhun's point about the importance of a common language.

Q As we arguably approach another downturn, how is this unproven asset class likely to perform and what will that mean for its future?

VA: The industry hasn't experienced a downcycle. You are right. It is a relatively recent phenomenon, so it will be interesting to see how impact investments perform when the cycle turns. Our clients certainly seem to believe that impact investment should outperform because it offers a truly new way of looking at the world. We will have to wait and see, but if it plays out as managers believe it should, that will lead to even bigger inflows of capital as a result.

Remember, these are long-term investments. We will only truly know if the promised impact is delivered in 10 or 15 years. But given the scale of the global challenges these investments are seeking to address, I don't think the industry is going anywhere, anytime soon. I also believe that what we are now calling impact investment will simply become a natural part of all investment analysis. It will be what investors come to expect from any manager looking after their money. ■

Vadim Avdeychik is counsel in the Investment Management practice of Paul Hastings. He advises clients on the formation of impact funds and with respect to ESG policies and sustainable investing criteria. Previously, Avdeychik was counsel at PIMCO.

Runjhun Kudaisya is counsel in the Investment Management practice of Paul Hastings, advising on the formation, structuring and launch of private funds, including impact funds. She also counsels investment advisors in regulatory matters, including registration and compliance policies and procedures.

Where does fiduciary responsibility lie?

Paul Hastings' Vadim Avdeychik on the regulatory environment governing impact investment

"The regulatory environment surrounding impact investment is different depending on which jurisdiction a private equity manager is looking to serve. In the US, there is very little specific regulation whatsoever. However, the Department of Labor, which oversees ERISA pension plan assets, published a Field Assistance Bulletin in 2018, which fundamentally says that fiduciary responsibility should focus on financial return and not solely on ESG, responsible or impact investing. Those things can be considered, but they should not be the primary goal.

"Then, just this year, we saw an executive order from the White House which directed the then Department of Labor chair to re-evaluate the current rules as they apply to ERISA fiduciaries with respect to voting of proxies. Reading the tea leaves, I think the rationale behind that executive order was to reiterate that fiduciaries should focus on maximising shareholder returns rather than any ESG policy goals.

"We are, however, seeing an uptick in various groups urging regulators to take action on ESG reporting. For example, in October 2018 we saw a petition to the SEC for a rulemaking on ESG disclosure. The signatories to this petition included certain notable securities law professors, asset managers and investors. Finally, more recently, the Business Roundtable chaired by Jamie Dimon of JPMorgan put out a statement noting that business leaders should commit to balancing the needs of shareholders with customers, employees, suppliers and local communities. These types of initiatives may drive greater focus in the US on impact investing, especially if we see an administration change.

"In contrast, what we have seen in Europe is almost the complete opposite. We are definitely seeing more proposals coming out of Europe that, in their current form, would appear to mandate greater reporting with respect to impact investments on both the investor and the management side."

Renovation

Retrofitting – or renovation – is a core component of many real estate impact strategies. Nuveen, for example, is an investor in dynamic glass company View, which improves the energy footprint of buildings.

Glass needs to be replaced around every 30 years, and View's products are often retrofitted into existing spaces. In fact, Nuveen's own New York offices are currently being fitted with the automatically tinting glass.

Renovation and retrofits are also important components of Nuveen's residential strategy. One of the firm's three pillars of impact is affordable housing and the firm is continually acquiring multi-family housing stock, not only to improve its environmental sustainability, but also to keep rents affordable.

"It could be something as simple as changing all the lightbulbs in a property to LED," says Nuveen's portfolio manager, impact investing, Rekha Unnithan. "We also do audits of water and energy consumption and constantly strive to make housing as efficient as possible, even if it was built 20 years ago. There are always things you can do at the margin to improve real estate from an impact perspective. Frankly, those things also contribute to our bottom line."

Scale

The Global Impact Investing Network recently estimated that impact investment assets under management total $502 billion, up from $114 billion in 2016. The scale of global awareness is also rising rapidly.

GIIN has found that one in four dollars of professionally managed assets, equating to around $13 trillion, now considers sustainability principles. That means there is real potential for investors, who have already aligned their capital with their values, to more intentionally drive progress through impact investment.

"In addition to these quantitative measures, I think there are quite a few qualitative indicators of scale, including the emergence of an advisory ecosystem," says GIIN managing director Sapna Shah. "For example, we now have auditors verifying social and environmental performance and law firms working on structures, terms and covenants pertinent to impact.

"A lot of progress has been made in the past decade. That said, the $502 billion is nowhere near enough to meet the climate, social and health needs the world is facing. There is quite a bit further to go."

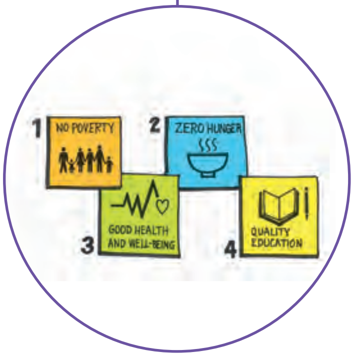
Ticking clock

Last year, the UN Intergovernmental Panel on Climate Change published a landmark report that claimed we only have 12 years left for global warming to be kept at a maximum of 1.5 degrees, beyond which even half a degree will significantly worsen risks of drought, floods, extreme heat and poverty for hundreds of millions of people.

The time we have to tackle a whole host of global challenges is running out.

Indeed, the most recent *Goalkeepers* report from the Gates Foundation indicates that while progress is being made towards the Sustainable Development Goals, it is not being made fast enough to meet all the goals by 2030.

"The good news," says Stephanie Krater, partner at social impact consultancy the Bridgespan Group, "is that there is still a tremendous amount of private capital – more than enough to get the job done – that could be shifted towards impact investment in the near future. Private capital can be mobilised faster than any other type of capital and our hope is that the impact industry can continue to advance fast enough to meet these goals."



UN SDGs

The United Nations estimates that some $5 trillion to $7 trillion is required annually to reach its 17 Sustainable Development Goals and 169 associated targets, by 2030.

That level of support can only be reached through the joint efforts of governments, regulators, academia, philanthropists and the corporate world. But it is becoming increasingly clear that private sector financing, and in particular the burgeoning impact industry, has a critical role to play.

Indeed, the UN SDGs have created a unifying force around impact, helping to provide a common motivation for the nascent impact community. “The SDGs have provided an important framework and focus for enterprises and investors in the impact investing world,” says Chris Parsons, head of investment banking at specialist impact investment bank ClearlySo. “They have highlighted the key social and environmental issues facing the world.”

“The SDGs are incredibly important,” adds Tania Carnegie, leader and chief catalyst of the Impact Ventures practice at KPMG. “They are commonly featured as part of the impact frameworks that our clients are developing. It helps them articulate what contribution they are making to solving the bigger picture challenges that society is facing.”

According to the Global Impact Investing Network’s 2018 *Annual Impact Investor Survey*, more than half of investors are currently tracking some, or all, of their impact performance against the UN goals. However, given the scale of capital required, the GIIN believes it is vital that more investors go beyond alignment and instead, raise and direct new capital towards progress against the SDGs.

According to Rekha Unnithan, portfolio manager, impact investing, at Nuveen, there is a risk the SDGs are being incorporated into marketing materials more readily than into investment strategies themselves. “Obviously the SDGs have really taken off. You can’t go into a European airport lounge these days without seeing the SDGs on someone’s laptop as part of their marketing deck,” Unnithan says. “That is great in terms of being able to articulate what we do in the context of larger global goals. But we are at an inflexion point with regards scaling with integrity and I think agreeing and maintaining standards is key.”

Vadim Avdeychik, a lawyer in the investment management practice at law firm Paul Hastings, adds that while the SDGs have been important in terms of helping managers identify and allocate resources consistent with those goals, the SDGs themselves have provided insufficient guidance for private investors. Avdeychik therefore welcomes the standards being unveiled alongside the SDGs around strategic intent, measurement, transparency and accountability. “Those standards have been created at the request of the investment community, to help them make sure they are deploying capital in a way that specifically contributes to those SDGs. It is all about creating a common language,” he says.

KEYNOTE INTERVIEW

As the popularity of impact investing grows exponentially, maintaining standards is key, says Nuveen's Rekha Unnithan

Scaling with integrity

Q What does impact investment mean for Nuveen and how does it fit within your broader investment strategy?

We define impact investment as the intentional investment practice of creating both risk-adjusted financial returns and measurable social and/or environmental outcomes. The focus of our impact investments in private markets is in private equity and real estate where there are significant capital gaps and where we believe we can actively invest in solutions to benefit people and the planet.

Q What investment themes are you focused on?

Our three thematic areas for impact investment are affordable housing, inclusive growth and resource efficiency. Affordable housing is a real estate strategy that's focused on preserving affordable housing stock in the US, keeping rents affordable for existing tenants and implementing energy retrofits, for example. The idea is to provide stability of housing for the working American.

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Inclusive growth is a private equity strategy. It is global in nature. We invest roughly half our capital in emerging markets and half in developed markets. The thesis is that low income customers are paying customers and that those customers are underserved. We look at areas like financial services – credit, savings, insurance, remittance – and find companies that are exclusively targeting that low-income demographic. The products need to be designed differently. The approach to customer acquisition needs to be tailored. But we believe these are profitable and sustainable business models that can have significant inclusive benefits.

Resource efficiency is a private equity investment practice, focused on bringing efficiency to value chains in multiple sectors from real estate and agriculture to manufacturing. It can either involve companies providing services to those value chains or disrupting the value chains themselves. It may be investing in companies improving energy efficiency in buildings, for example, or it may be about reducing waste.

Q How have the UN Sustainable Development Goals helped frame your investment approach?

We were investing for impact well before the SDGs were created, but many of the areas that the SDGs have identified as being important for investors and stakeholders to consider, are closely aligned with the investment areas we have chosen. Affordable housing fits nicely with the SDGs around sustainable cities and climate action. Inclusive growth fits nicely with reducing inequalities and eliminating poverty. Resource efficiency also fits with climate action because of the focus on waste reduction and CO_2 emissions reductions in the metrics. Resource efficiency is tied to the circular economy and responsible consumption as well.

We also make investments in healthcare and learning outcomes, which marry with the SDGs too. This has been our approach since before the SDGs existed, but investors increasingly want to see their impact quantified in the context of the broader SDGs and our strategy translates very well.

Q How has your underlying investor responded to your impact strategy and has this changed over time?

Our primary investor today is our parent company, TIAA, a provider of financial services for non-profit organisations, and we are in active discussions about our portfolio with other long-term potential investors. We have built the portfolio over eight years and invested a little over $1 billion, and TIAA's attitudes towards the portfolio have been positive. You have to remember that when we started to invest in this deliberate way, there was very little evidence that it would work. At that point, impact investment was just two years old. We were very much asking our investor to place their trust in us.

As a result, the investor was focused on process as much as on outcomes. They wanted to know what our approach to deal selection, risk mitigation and underwriting would be. To an extent, those conversations have now evolved because we have been able, not only to deploy capital successfully, but to quantify the investment returns, and more importantly the impact returns that have resulted. Those are all trending very favourably which means the underlying investor is bullish about the strategy and is deploying more and more capital each year.

Q So, what is your approach to investment decision-making and what are the challenges associated with assessing impact potential?

We have created an impact investment management system, internally, with the help of our ESG and sustainability colleagues. This gives us a roadmap to follow on an investment by investment basis, and also at a portfolio level. We have set portfolio level impact objectives, articulated our theory of change and considered what does, and doesn't, qualify in each thematic. It's very easy to say something is impactful based on gut feeling, but you need that management system to support consistent evaluation.

We try to quantify the depth, scale and risk of impact for every prospective investment. Each company will be different. A more mature company with an established product may have low risk and simply be looking for capital to scale impact. Another earlier-stage business may be entering a market that doesn't have evidence of impact delivery. There the impact risk will be higher, but the depth of potential impact will also be higher, because the opportunity is

"Impact is integral to the way we think about exit"

View with an impact

Nuveen invested in View, a company that produces and installs smart windows that automatically adjust to sunlight, in 2017.

Each blue-tinted windowpane has its own IP address and can be controlled from a smartphone app. "Architects love to use glass in buildings but developers don't always because standard glass can be energy inefficient," says Rekha Unnithan. "Now you can use glass that still provides all the health and wellbeing advantages of that connection to the outdoors, and also reduces your energy footprint by between 20 and 40 percent."

Since Nuveen's initial investment, View has increased the number of projects it has completed from around 200 to more than 500. It has also gone on to raise $1.1 billion from a large global investor. In addition to reducing energy consumption, the glass significantly increases the amount of useable space in a commercial property by reducing glare and heat from the sun. It also eliminates the needs for blinds altogether. Indeed, Nuveen has become one of View's customers. TIAA's New York office is currently undergoing a $200 million renovation, including the replacement of every window with View Dynamic Glass.

completely untapped. Articulating those dynamics is important for investment decision-making and we are in the process of translating that into a scoring system.

That all happens at the outset. If a deal is approved, we will then typically take a board seat where we will be highly vocal about impact metrics and ensuring they are material to the business. If we invest in a company with a view to reducing waste, we will want to know the number of tonnes that have been diverted from landfills, for example. We do not think these considerations should be in any way distinct, or separate, from core business metrics. The company should be measuring them anyway.

Q What role does impact play in your preparations for exit?

Impact is integral to the way we think about exit. Typically, we buy multi-family properties in order to keep affordability levels in place, for example. But how can we be sure affordability will be preserved when we sell? Sometimes you can just have a long-term deed restriction that prohibits anyone from raising rents above affordable levels. That means that you are looking for an aligned buyer that knows that the existing business strategy makes sense. In other situations, you may be able to get government subsidies that enforce long-term affordability as part of a trade-off for tax abatement, for example. This would ensure affordability post-exit and so is a failsafe method for preservation.

With private equity, the science is a little bit less exact. When we first entered this area, we were concerned that a big bank might come in and buy a low-income product portfolio and change the business model. But the reality is that doesn't happen. If a big bank is buying a financial inclusion lending company, it is because it wants access to that customer and so there is no incentive to mess with the product base. We also sometimes exit into the public markets, in which case there is a whole set of governance standards to monitor the company's sustainability over the long term.

> *"Investors increasingly want to see their impact quantified in the context of the broader SDGs and our strategy translates very well"*

Q How do you approach balancing financial and impact objectives?

We only do investments that meet both. We do not look at investments that have the potential to generate fantastic returns but that may, or may not, have a positive impact. That's not our remit. We will only invest in companies that have a clear impact thesis. But if that impact thesis does not translate into the financial returns that we need, we will walk away as well. We are extremely disciplined on both fronts.

Q To what extent have the SDGs helped to create a common language around impact, and to standardise impact measurement?

The SDGs have definitely given practitioners like us an additional ability to articulate what we have already been doing. But there is an argument that they may even have caught on too much from a marketing perspective. Everyone now has them integrated into their marketing deck.

In fact, I believe that the impact investment market is at an inflexion point regarding scaling with integrity. It is something that is really important to me personally, as well as to Nuveen. I am involved in an industry initiative to create a series of principles that define what is, and isn't, an impact investment process, for example.

It provides a framework to help investors evaluate impact managers around diligence, underwriting, ESG standards, measurement and exit. It also demands third-party verification that can in turn offer investors comfort as they look to deploy increasing sums of capital in this area. I think this type of standard is absolutely critical.

Q How do you expect impact to evolve as an industry?

We are now hearing about billions of dollars moving towards impact, which is great. But I do think we need to be humble and to recognise that lots of problems cannot be solved purely in this way. Governments, or public sector stakeholders, really need to address these issues. Climate change, in particular, is not going to be solved through investment alone.

I also think that impact investors should consult more with universities and other research organisations about how we can make these vital changes effectively, to ensure that investment decisions are based on evidence and that our investment activities actually do have an impact. You need to know what the problems are and then go back and measure if you are actually making a difference. Just pushing dollars is not, in itself, a mark of success. ■

Vulnerable communities

Improving people's livelihoods is a core impact initiative and that requires working with those on low incomes in the most vulnerable situations. Metrics for vulnerable communities include developing a lower-cost product or a superior product at a lower cost, and providing access to products and services to them.

For emerging markets investor LeapFrog Investments, the vulnerable include people living with HIV. Leapfrog's first-ever investment was in AllLife, a South African company that has built a profitable company by offering affordable life cover to those with HIV, who were automatically excluded from life insurance cover because the virus can lead to AIDS. AllLife also contacts their clients every month to ensure they are taking their medication and staying healthy.

The health improvements in clients are impressive – an average 15 percent improvement in their CD4 count (a measure of the strength of the immune system) within six months of being insured. Through AllLife, people with HIV can take out loan finance, build their lives and participate in the community.

Meanwhile, Atlantic Philanthropies' investment in Vital Healthcare Capital, a community development financial institution, helped it to sustainably finance healthcare providers that could help the vulnerable in the US access primary healthcare. V-Cap grew from a small organisation to one with $30 million in three years, and closed four investments in community health providers that serve low-income communities.

Women's empowerment

Women's empowerment can mean everything from investing in female-led businesses to improving their health, providing access to education and ensuring they are represented on company boards.

According to the Overseas Private Investment Corporation, women face a $320 billion shortfall in access to credit worldwide, and investing in women pays dividends because they spend 90 percent of their incomes on food, healthcare and education in their households.

Several agencies have women-specific programmes. In September, Aspen Network for Development Entrepreneurs, as part of a partnership with the US Agency for International Development and the Visa Foundation, set up a new Advancing Women's Empowerment Fund that will distribute more than $1 million over two years to organisations working to close the financing gap for women-led businesses.

One of OPIC's big initiatives is the 2X Women's Initiative, which expands investments in women-led businesses and funds around the world.

Last year OPIC committed a $12.5 million loan to WaterHealth India to help installation of nearly 900 decentralised plants to purify water onsite and sell it three or four times cheaper than bottled water alternatives. Apart from providing clean water, the project is expected to create more than 1,300 jobs for women under the company's Women Operated Water systems programme.

One of the most dangerous activities for women, according to the Global Impact Investing Network, is collecting fuel for cooking, particularly in refugee and conflict areas or remote rural locations. Impact certification organisation The Gold Standard Foundation has led a project to install 24,000 efficient cook stoves in Kenya that improved indoor air by nearly 98 percent and benefited more than 130,000 people.

X-ray vision

Complete transparency is imperative for the continued evolution of the impact investment industry. The impact investors themselves need X-ray vision to effectively create and manage positive impact with information-based decision making, says Sapna Shah of the Global Impact Investing Network.

"Transparency between investor and investee is also critical," Shah adds. "Impact reporting provides enormous food for thought. It opens up dialogue between asset managers and their investors, about goals and values and how those can better be achieved."

Maya Chorengel of private equity impact investor The Rise Fund, meanwhile, adds that impact investors need to both measure and report impact performance to their partners regularly and to share their assessment methodology more widely.

"This commitment to transparency, which is a core part of our belief system at Rise, allows people to understand why an investment delivers on impact and financial returns and can provide useful tools to others entering the market, ultimately helping expand the pool of capital dedicated to fostering change and actually achieving the positive outcomes we seek," she says.

Young blood

The younger generations are playing an essential role in driving the growth of impact investment. One of the key reasons that businesses started to pay attention to their impact on society in the first place was that a new generation of employees demanded it.

Meanwhile, young entrepreneurs are combining commercial experience and a strong understanding of technology with a passion and focus to address global social and environmental issues, says Chris Parsons of specialist impact investment bank ClearlySo.

"In terms of public awareness and politics, the younger generation are also raising the profile of these issues with policymakers, creating a move to fairer and more sustainable behaviour," Parsons says.

The widespread use of social media, meanwhile, is making it easier for young people to call out "bad actors", adds Sapna Shah of the Global Impact Investing Network.

Finally, the ongoing transfer of wealth from older generations to millennials, which is expected to reach $24 trillion by 2020, is likely to drive demand for more sustainable investment strategies and products.

Zero waste

From plastic in our oceans and toxic electrical goods sitting in landfill to food mountains and unworn fast fashion clothing items, waste of resources – and the pollution this causes – is a major issue on the planet.

As little as 9 percent of plastics are recycled globally and evidence is mounting that developed economies, unable to recycle the waste they are creating, are shipping plastics to emerging markets, where they are entering water systems or being burned, creating toxic fumes. Small wonder, then, that there is a growing movement towards creating a zero waste society.

While this is, according to Taylor Jordan, managing director at Goldman Sachs Asset Management, "an aspiration – we have a long way to go", there are a range of investment opportunities that can help tackle this through the creation of a circular economy.

As Ben Constable Maxwell, head of sustainable and impact investing at M&G Investments, explains: "Zero waste is an approach that focuses on redesigning industrial and production processes to cut waste – we need to reduce, reuse, repair, recycle. This has been thrown into relief by the plastic crisis and China's decision to stop accepting other countries' waste. We have to get to the problem before it is created – we can't just rely on recycling."

Impact points of view

"As investors, our diligence on the impact case needs to move from a situation where we trust intentions and focus on people's passions to documented diligence"

Tim Macready, CIO of Christian Super, an Australian pension fund, on the need for rigour

"If impact investing is our rocket ship to social change, impact measurement is our navigation system"

Sir Ronald Cohen, widely regarded as the 'father of impact investment', stresses the needs for accurate metrics

"Climate change is affecting our investments and this is something we need to manage. And that means we need GPs to manage it"

Anna Follér, sustainability manager at Swedish national pension fund AP6, on how the impact of global warming has become part of its fiduciary duty

"The impact investing brand is definitely appealing right now. And it is tempting for fund managers to do a pretty paint job on it"

Amit Bouri, the CEO of the Global Impact Investing Network, warns of the dangers of greenwashing impact strategies

"Investors need to work out what they care about. That's the starting point for understanding what metrics they should be using when evaluating a fund manager's impact"

Audrey Selian, director of the Artha Institute, an online impact investment platform, on how LPs need to lead the debate

"Permanent vehicles should have an even greater incentive to make the right decisions on ESG matters"

Stephen Moseley, head of private equity at Alaska Permanent Fund Corporation, on the emergence of permanent capital impact funds