

## IMPACT INVESTING

# Making an impact

Impact investment is on the rise, with the increased involvement of more mainstream players in this part of the market. Partners Group's Kevin Lu discusses how their entry is changing the market

Responsible investment practices have come a long way in the last decade as investors increasingly seek ways of creating value and mitigating risk through an environmental, social and governance lens. Yet many are also looking for ways of making a positive impact through their investments across a variety of measures, from promoting gender equality and reducing poverty through to mitigating climate change and protecting human rights. For many, this has been made easier by the creation in 2015 of the United Nations' Sustainable Development Goals, an articulation of 17 goals for sustainable development, as they provide a framework around which investors can focus their impact investment efforts.

The growth of impact investing is clear. In its 2018 annual survey of impact investors, the Global Impact Investing Network says that the latest "best available 'floor'" for the size of the impact investing market is \$228 billion, a marked increase on the 2017 figure of \$114 billion, with respondents expecting to increase the amount of capital they invest by 8 percent over the coming year. Private equity, given its concentrated shareholder model and corporate governance features, is one of the main beneficiaries of this move and it's therefore no surprise that some of the industry's biggest players have now raised impact funds.

Earlier this year, Partners Group established a specific impact strategy, PG LIFE, which aims to achieve market-rate financial returns as well as positive social and environmental impact by investing in line with the UN's SDGs. We caught up with Partners Group's Kevin Lu, partner and chair of PG LIFE's impact committee, to explore the growth of impact investing and what effect the entry of mainstream investors will have on this part of the market.

## Q What's your view on the difference between ESG and impact investing?

I see this as a spectrum rather than binary, so you have a continuum of ESG, investing according to the SDGs and impact investing. This spectrum is simply a reflection of the genuinely different ways for investors to monitor the impact of their investments. You have to consider that there are different types of investors and fund managers – you have smaller, niche impact investors that focus on a very specific geographic or thematic area and then there are more mainstream investors that cast the net much more widely and invest much larger amounts of capital. Overall, I see responsible investment as the umbrella term that covers this spectrum and it's a space that has evolved – and continues to evolve – from, for example, the broad set of principles set out in the UN Principles for Responsible Investment through to more specific ways of achieving impact.

So, for example, we monitor ESG factors for all our investments, we involve our ESG and sustainability team and implement ESG initiatives in all our lead and joint-lead investments and we have our PG LIFE strategy that has a specific impact mandate and focuses on investments whose products and services directly support the SDGs.

## Q It can be a bit like alphabet soup for the uninitiated – to what extent do you think there's still confusion around some of these terms?

I don't think there's confusion about the outcome, whether that is simply improving ESG performance or achieving deep impact, but there is still definitely some confusion around what people are talking about and that's a function of the space still evolving. People label what they're doing



Lu: onus is on LPs to vet impact offerings

**Q How do you see the impact investment market developing in the future?**

I see an evolution of the niche, thematic players as they grow. These are highly targeted strategies and you have a lot of philanthropic capital directed at this space. At the other end of the scale, you'll see more large, commercial players emerge to meet investor demand for impact investment at scale. This makes sense from a capital deployment perspective – if you're a large LP and you have an impact objective

for part of your portfolio, you need larger vehicles in which to invest. You also need the comfort that you are investing with an institutional platform with well-defined processes, rather than with a few people with a lot of passion. And once these larger players develop a track record, I think you'll see more LPs allocate to impact investment programmes. I guess the question of how the market will evolve remains in the middle part of the market – it's difficult to know whether these players will gain any traction in the impact space.



differently and there is no standardised definition of each of these terms.

However, I'm not concerned about the lack of a standard definition because the bigger question is whether we are now reaching an inflexion point for ESG and impact investing. The fact that more mainstream players are developing products and offering investors a means of accessing impact investments has to be a positive development. The fact that people are generally more responsible investment-minded suggests that the direction of travel is good, it's just that different players are trying different ways of developing ESG and impact.

**Q What's driving more mainstream impact strategies?**

It's a natural evolution: 10 years ago, impact was a nice-to-have. It was niche. Yet over the

last few years, it has started to enter into the collective mindset of LPs and these days, if you don't think about impact, you are an outlier. For its part, the industry has been innovative in offering LPs impact products. For example, we've seen impact funds being raised by some of the largest private equity firms over the last two years and this has enabled LPs to access products that help them meet their impact as well as return objectives.

There's also an element of larger managers realising that they have made such investments in the past, just without the intentionality of making them "impact investments" per se. These products reflect increased deliberateness in how to evaluate, measure and own these same companies with impact goals in mind.

And then there are the generational »

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» differences – if you’re an LP, your constituencies are changing. There is far more focus on impact among younger generations and so LPs investing on behalf of these generations have to take this into account. These differences also affect investors from a staff perspective. When I’m hiring millennials, for example, it’s clear that they think very differently about their careers than junior employees did just 15 years ago. It’s no longer about how to maximise earning potential; it’s much more about what their career means to them.

**Q What would you say to those that suggest the entry of more mainstream players will dilute impact investing?**

There will always be those who equate an industry reaching new levels of scale with dilution, but, in the impact investing space, I think the reverse is true. The vision of most impact-minded investors is to see the concepts and values of impact investing reach scale. This cannot happen without leading investment managers carrying across these concepts and values to larger, more mainstream assets, and doing so with the governance rights to deliver meaningful impact.

And if you want to achieve impact at scale, there also have to be platforms that can be commercial and that achieve the financial returns that investors are looking for – you can’t ask them to sacrifice returns or they will look elsewhere. Mainstream investors have access to large amounts of

dealflow and that allows them to be highly selective. Our strategy, for example, is to invest through our impact programme only if a transaction has also met the criteria for our private equity, real estate or other programmes.

You have to consider that a big part of an impact methodology is to introduce forward-looking monitoring. You put in place KPIs for management based on what you want to achieve from an impact point of view, so if you’re building a solar park, for example, you have to think both about how it will reduce greenhouse gas emissions, but also how the business will responsibly dispose of batteries and protect local biodiversity, among other things. If you inject this type of forward-looking mindset into companies and you define impact objectives effectively, there is a multiplier effect. If you own the largest renewable platform in a country, its practices will affect other renewable platforms in that market and perhaps even beyond. This is the promise of impact at scale; the potential to have a systemic impact on the “mainstream” economy.

**Q To what extent can LPs assess and compare impact methodologies and measurement, given the lack of standardisation?**

If you’re looking at the financial aspect of whether the strategy makes money, that’s quantifiable and therefore easily compared. When it comes to measuring impact, there is no standard way of reporting, despite a number of initiatives. For example, the IFC’s Operating Principles for Impact Management, which are an attempt to prevent dilution of impact investment and offer some clarity on what it is, are still conceptual. That’s not a criticism, it’s a statement of fact – Partners Group was involved in the initiative. And I don’t think it’s a problem because moving towards standardisation

for the sake of standardisation can actually be counterproductive as it can give a false sense of objectivity. You have to make too many assumptions if you try and quantify impact in IRR or multiple terms.

However, this places the onus on LPs to understand what separates a robust impact methodology from a superficial one. This should start with simple questions: what is the manager’s definition of impact? How do they screen and evaluate investments for impact? Beyond monitoring and reporting outputs, what processes are in place to truly manage for impact?

Proper LP vetting will certainly help assess impact strategies, but I think many managers will be wary of entering the impact investing space without a robust methodology. The potential cost to brand and reputation is too great if they get it wrong.

**Q Private markets are in some ways a natural home for impact investment, but to what extent do you think there is scope for growth in the public markets space?**

Yes, private markets have a big advantage in impact investing because their models allow for much greater control of the transaction throughout its lifecycle – private equity firms can own and influence a portfolio company’s strategy. Public markets are, by their nature, much more indirect – the same goes for fixed income. I’d ask the question of whether there is a way of having a minority shareholding but still a big say in corporate governance. Public company governance tends to be more inefficient, so if there was a means of injecting the tighter, more direct governance seen in private markets, that would be a huge boost to the impact investment industry. The public and fixed income markets are so large that if this issue could be resolved, it could be transformative. ■