



Enlightened capital

**The role of trust in
impact investing**

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“An economic model based on wealth concentration and resource extraction leaves most of the world over reliant on philanthropy and government. Through impact investing, the private sector can incorporate a broader definition of value into capitalism, making it work much better for more people.”

Greg Shell,
Managing Director,
Bain Capital Double Impact

Introduction

Is private equity ready for the rise of impact investing?

The impact investing market size is now estimated to be \$502 billion with more than 1,340 organizations currently managing impact investing assets worldwide.¹ While this represents a small percentage of overall invested assets, there has been tremendous growth in capital invested in impact over the past 5 years and that trajectory is fully expected to continue. The International Finance Corporation (IFC) estimates investor appetite and market potential for impact investing is upwards of \$26 trillion, or 10 percent of financial assets held by institutions and households globally.

Spurred by shifting societal expectations about the role and responsibility of business in the larger world, impact investing is part of a larger movement that deepens the sense of purpose of the financial markets and raises the bar for responsible business and investment. Specifically, impact investing seeks to direct the flow of capital into enterprises and assets that contribute solutions to social and environmental problems, while also delivering financial returns.

Recently, there has been a notable increase in impact investing activity in the private equity industry, with a number of traditional private equity firms launching impact funds and injecting billions of new capital. This has also drawn in traditional institutional investors who have not previously been attracted to impact investing.

As a leading advisor to private equity funds and investors, KPMG has been closely tracking and supporting the growth of impact investing, as well as the broader transformation of the capital

markets. We have witnessed how the push for greater transparency and accountability across the global financial sector is influencing the investment landscape. Based on the trends and evidence we've seen to date, we believe impact investing is the future of investing, both within private equity and across all asset classes.

Impact investing continues to evolve. For growth to continue, there is still work to be done to overcome skepticism about its legitimacy as an investment approach, its financial and social return potential, and the intentions of market participants to differentiate impact funds from traditional funds.

continued on next page ►

¹ Sizing the Impact Investing Market (Global Impact Investing Network, April 1, 2019)

² Creating Impact: The Promise of Impact Investing (International Finance Corporation, April 8, 2019)

We think impact investing presents an immediate opportunity for private equity funds and investors, if done with authenticity, transparency, and the true integration of impact throughout the investment lifecycle. We know that for those interested in the space, questions abound: What value will we generate for our firm and society? Will there be a trade-off in financial performance? How will we meet investor expectations for impact performance, measurement, management and engagement? How will impact investing change our overall investment approach and our supporting processes and operations? How will we address investor skepticism and earn trust in our impact strategy?

This report delivers insights from senior private equity executives who are active in impact investing to help funds and investors prioritize where to focus for success. In our conversations, we sought to understand the key factors that drive impact investing activity and support the continued growth and success of the market. In exploring these topics with those at the forefront of the industry, we found consistent viewpoints on what motivates private equity impact investors, what it takes to succeed, and strategic steps for earning trust in impact investing, enabling it to reach its full potential. ●



Impact investments: By the numbers

74% of respondents said the financial attractiveness of impact investments relative to other opportunities were somewhat or very important in their decision to invest.

82% of respondents said their impact investments met impact expectations.

76% of respondents said their impact investments met financial expectations.

15% reported outperformance across both impact and financial expectations

76% of respondents set impact targets for some or all of their investments.

Top 3 respondents' challenges for the industry:

appropriate capital across the risk/return spectrum

common understanding of definition and segmentation of the impact investing market

– suitable exit options.

The data above was drawn from the 2018 Global Impact Investing Network (GIIN) Annual Impact Investor Survey, which reports on survey responses from 229 impact investing organizations that collectively manage more than \$228 billion in impact investing assets.

Definitions

Impact investing is an investment approach that seeks to deliver financial returns alongside intentional and measurable impact.

ESG refers to the consideration of environmental, social, and governance factors as part of investment decisions that are material to operations.

General partners are the private equity firm that manages the private equity fund.

Limited partners are investors in the private equity fund.

Methodology

This report examines the role of trust in the continued growth and success of private equity impact investing. It is informed by KPMG's deep experience as advisors to leading private equity clients as well as interviews with private equity executives. Interviewees represented general partners, limited partners, and heads of impact investing networks. The focus of this report is on market-rate impact funds and the limited partners who invest in them.

“CalPERS views impact investment as seeking to intentionally generate positive social and/or environmental impact on top of, not in a trade-off with, a financial return.”

Dana Hollinger, board member, California Public Employees Retirement System (CalPERS)

“I believe that the definition of impact investing should include businesses for whom unrealized impact is a real opportunity. In other words, you get companies to behave in key ways that help drive highly impactful behavior. The unrealized potential for impact has to have a credible thesis for an impact investor to go in and help a company run a playbook that allows them to do really impactful things.”

Greg Shell, Managing Director, Bain Capital Double Impact

Motivations for investing in impact

What is driving traditional private equity firms to launch impact funds, and the investment decisions of limited partners?

We sought to uncover the varied motivations behind the rise of impact investing in private equity. In this section we highlight the impetus for the increased activity in the words of those we interviewed.

We found that general partners' interest in impact investing is driven by: the need for solutions-focused capital; to address unmet needs; and demand from investors. Some consider impact investing to be a natural extension of their existing environmental, social and governance (ESG) strategies. While some limited partners identify impact investing as an approach based on their personal values, many of the limited partners we spoke with were pragmatic about the need for returns while also trying to fulfill a higher purpose.



General partners

Based on our discussions, we found several common reasons that motivated impact investing activity among general partners.

Respond to investor interest

General partners note demand for impact investing among a variety of client types. Increasingly, it's not only the 'obvious' prospects that are interested, such as foundations, health organizations or faith-based organizations which may have natural inclination to consider impact. More mainstream institutional investors, such as pension funds and corporations, want to invest their assets in a sustainable way, too.

"We heard numerous institutional investor clients asking for a separate account that invests in assets to benefit society," said Adam Heltzer, head of responsible investment at Partners Group, a global private markets investment manager. In 2018 Partners Group launched PG Life, an investment strategy aligned with the United Nations Sustainable Development Goals (SDGs).

Investor interest is often a driving force behind of the development of new impact funds. Key drivers, for investors, include long-termism and alignment of values.

"There is clearly a market opportunity for impact investing, and like any good business, general partners should be capitalizing on that," said Brendan Doherty, co-founder of Forbes Impact, a community of influential wealth holders committed to scaling impact investing through advocacy and collective investments.

"Impact investing exposes our investors to the most attractive parts of the economy. It populates the portfolio with companies that behave in ways that differentiate them from competitors, protect their long-term viability, and help them win in the marketplace." said Greg Shell, managing director at Bain Capital Double Impact, a private equity fund focused on the investment themes of sustainability, health and wellness, and community building.

“ There is clearly a market opportunity for impact investing, and like any good business, general partners should be capitalizing on that. ”

– Brendan Doherty, co-founder of Forbes Impact

Allocate capital toward solutions

Many general partners are driven by the need for investment capital to finance solutions to the big problems facing society. This presents unique investment opportunities for both impact and financial returns, while leveraging the scale of the capital markets to create the level of change needed. Many general partners are using the UN SDGs as their roadmap.

"To meet the capital requirements to fulfill the UN SDGs, commercial capital is needed. We felt that bringing a scaled institutional impact fund to the market was both possible now, and more importantly the right thing to do," said Maya Chorengel, senior partner at impact investment fund TPG Rise.

"Investing in companies with products and services that address a global challenge offers an opportunity to both do well financially (e.g., achieve private equity returns) and do good (e.g., solve a critical problem)," said Ken Mehlman, co-head of KKR Global Impact.

"We are trying to expose ourselves to faster growing and secular trends in more attractive parts of the economy. That's where the disruption is occurring and that's where the value creation is likely to be," said Shell of Bain Capital Double Impact.

"The impetus for starting an impact strategy is the need for humanity to change its ways, given the environmental and ecological damage of the last century," said Ewa Kozicz, co-head of Cowen Sustainable Investments, an investment platform that provides tailored financing solutions to companies accelerating the transition to a sustainable economy. "We have also reached a tipping point in terms of technological innovation and the economics behind new technologies being sustainable. As a result, we believe there is a really interesting opportunity for a financing strategy in this space. From our perspective, sustainability is the single largest source of innovation."

**SUSTAINABLE
DEVELOPMENT GOALS**

Learn about the UN SDGs on page 7

Motivations for investing in impact (continued)

Address unmet needs

Many general partners we interviewed were driven to move the needle on impact after observing a lack of available investment opportunities for large scale investors.

“Institutional investors have a growing interest in impact investing, but they need to write large checks. They need somewhere to put that money to work,” said Heltzer of Partners Group.

“One of the reasons The Rise Fund was created was to leverage TPG’s investing discipline and track record to draw in capital from investors who as fiduciaries cannot accept anything but a commercial, risk adjusted rate of return, but wanted access to an impact strategy.” said Chorengel of TPG Rise.

“On the supply side, there is currently very little dedicated capital in the space that is not venture capital or utility scale infrastructure,” said Kozicz of Cowen. “We believe a scalable, return-driven strategy for institutional investors that provides an environmental impact fills that void.”

“KKR created its global impact fund to capture lower middle market private equity impact opportunities around themes we knew well, that had real impact, but because of the growth in the size of our funds, were opportunities that were too small for the firm’s existing funds and strategies. As we mapped out potential impact investments, we found many promising companies in the

lower middle market, but we didn’t have the right capital to deploy. Our buyout funds were too large to make these investments. KKR Global Impact allows our investors to tap into these opportunities,” said KKR’s Mehlman.

Extend ESG strategies

The decision by general partners to invest for impact is often influenced by their experience integrating environmental, social and governance (ESG) factors into their investment approach. Across private equity, there is increasing recognition that successful impact investments must include depth around ESG as well as impact.

“We weren’t starting from scratch when launching an impact fund. We had several impact activities within our ESG program, and PG Life is our effort to scale those activities,” said Heltzer of Partners Group. “ESG and impact go hand in hand.”

KKR’s impact fund also intentionally pursues both impact and ESG objectives.

“Impact and ESG are both critical. In addition to delivering a product or service that measurably contributes to one of the UN SDGs, our companies also must optimize ESG practices, which may have a material impact on the performance of our impact investment in that company, including its ability to positively benefit society or the environment,” said Mehlman of KKR.

Limited partners

The limited partners we interviewed included those managing their own capital, such as high net worth individuals, family offices, and foundations, and those managing capital on behalf of others, including pension fund managers. This distinction influenced their motivation for investment decisions.

Align values

Limited partners managing their own capital are drawn to impact investing as a way to invest their capital in line with their personal beliefs or to advance a broader vision. The opportunity to pursue common societal goals above and beyond financial returns is one draw of the impact investing approach. Stakeholders across the investment value chain agree proper alignment of objectives is important to effective impact investing.

Some limited partners think asset owners should be wary of confusion around the very definition of impact investing when seeking investment opportunities that mesh with their goals.

“Some investors simply want to make sure what they own doesn’t contradict their personal values. Others seek to create a positive net impact with at least some of their capital, with a fundamental mission to contribute to solutions to the world’s big problems,” said Adam Bendell, CEO of Toniic, a global network of family offices, foundations and high net worth individuals who are active impact investors. “Investors need definitional clarity to take the right portfolio construction approach.”

The Ford Foundation—which is guided by a mission to reduce poverty and injustice—takes a holistic view of the impact all of the assets of the foundation can create, including its building (which is used as a social justice center), its grant making, its convening power, and its endowment.

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“Impact and ESG are both critical. In addition to delivering a product or service that measurably contributes to one of the UN SDGs, our companies also must optimize ESG practices, which may have a material impact on the performance of our impact investment in that company, including its ability to positively benefit society or the environment.”

– Ken Mehlman, Co-Head,
KKR Global Impact

UN SDGs: Global goals for a better world

The United Nations Sustainable Development Goals (UN SDGs) are a roadmap of 17 interdependent goals designed to end poverty, protect the planet and achieve world peace by 2030. They were established by the UN in collaboration with its member states as part of a universal call to action for economic, social and environmental investments that meet the future needs of future generations. The UN estimates that \$5-7 trillion annually of missing investment capital is needed to achieve the goals, and an increasing number of investors, asset managers, and corporations are aligning their activities to demonstrate how they are contributing to the goals.

Source: www.un.org



Motivations for investing in impact (continued)

“Private equity impact investing is an active investment tool, helping us use our capital to advance our mission of reducing inequality while targeting competitive, risk-adjusted returns,” said Christine Looney, deputy director of Mission Investments at Ford Foundation. “Our mission is focused on four very particular objectives—affordable housing, diverse fund managers, quality jobs and financial inclusion. We look for fund managers that invest in opportunities in those two these sectors.”

High net worth individuals and family offices are also motivated to make impact investments by a strong sense of values and purpose.

“Many family offices and principals want to transfer their values when they transfer their wealth, and feel impact investing is important to reach that goal,” said Abigail Noble, CEO of The ImPact, a member network that helps family enterprises make impact investments more effectively. “Wealth holders think actively about want to leave behind for future generations when they make impact investments.”

These values-driven limited partners often view impact strategies as an opportunity to have more direct control over the influence their money has the on the world at large.

“Many primary asset owners see their wealth as an extension of themselves,” said Bendell of Toniic. “With a default approach of passive index investments, they may inadvertently work against their values by what they own, whereas with intentional impact investments, they can move their capital to companies that actively contribute to solutions.”

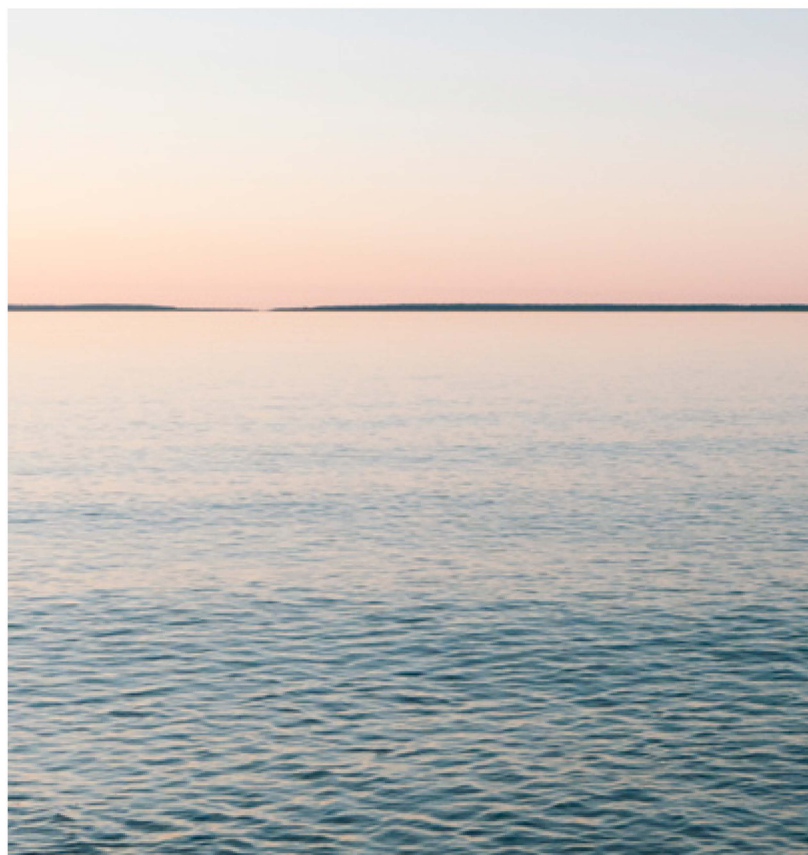
“My interest in impact investing is very pragmatic in the sense that I want to live on a planet that can continue to sustain life. If there’s a way to allocate my investment capital to that, then I will, and hopefully so will the rest of us,” said Ibrahim AlHusseini, founder and managing director of the Husseini Group.

Meet fiduciary duty

Limited partners that invest on behalf of others have a fiduciary duty to their stakeholders. Their focus is on achieving or exceeding target financial returns, and pursuit of impact is secondary. To consider an impact investing strategy, they must feel confident that impact and attractive risk-adjusted returns go hand in hand. Although they don’t identify as impact investors and their motivations are not values-driven like some asset owners managing their own capital, a number of pension funds have started exploring impact investing. Some are already investors in impact funds.

“So far, CalPERS has done little impact investing and is approaching the space cautiously given our focus on generating the returns needed to meet our obligations to our 1.9 million beneficiaries. Given our fiduciary duty, we cannot focus on impact alone,” said Dana Hollinger, board member at California Public Employees Retirement System (CalPers), a \$355 billion pension fund. “That said, in cases where we can generate attractive returns and have impact, investments become more interesting to us. In some cases, CalPERS has made investments in areas some may consider impact, such as our purchases of renewable energy power plants, but we made those investments because they were attractive assets for us to own as long-term investors given our liabilities.”

“Across the investment value chain, our members believe that long-term thinking and behaviors in capital markets create greater value over time,” said Alison Loat, managing director of FCLTGlobal, a not-for-profit organization that works to encourage a longer-term focus in investment and business decision making. “Impact-oriented investing is often aligned with long-term goals, from pension plans working to ensure secure retirements across generations to corporations working to improve the communities where they operate.”



Washington State Investment Board (WSIB), which manages investments for 17 public employee retirement plans in Washington State, does not have a mandate to build an allocation for impact investing. It decided to invest in an impact fund that focuses on sustainable financial returns as a necessary and mandatory precursor to achieving the impact thesis, and it views that investment as an opportunity to learn about the impact methodology and its potential application more broadly.

“Our core mission is to maximize returns at a prudent level of risk for the benefit of our retirement plan beneficiaries,” said Chris Phillips, WSIB’s director of Institutional Relations and Public Affairs. “If investment results don’t show up, all bets are off because the rest of the retirement system can get stressed. Impact can become part of the conversation but only if we can see a material connection to long-term financial benefits.” ●



Impact and financial performance: Is there a tradeoff?

The question of required trade-off in financial returns with the consideration of impact is a common one. Quite simply, financial performance is a priority for the general partners and limited partners we spoke with. Overwhelmingly they indicated the expectation to achieve traditional private equity returns through their impact fund investments, with some believing that an impact lens provides them with an advantage.

“We believe the best way to overcome investor skepticism is by delivering financial returns and showing clients there is no tradeoff,” said Kozicz of Cowen.

“One of the biggest questions we were asked when we started The Rise Fund was whether we would be able to find business models for which substantial, enduring impact and business success are collinear, where there isn’t necessarily tension between doing good and doing well financially or where there is a tradeoff between impact results and financial results. We found many of these opportunities: businesses that create positive impact for society and the environment that are also appropriate investment for us as fiduciaries of commercial capital,” said Chorenge of TPG Rise. It is important to note that impact investing is a broad investment approach that requires many different types of capital, ranging from concessionary, to catalytic, to commercial, to patient.

Priorities of impact investors

For deeper insight into the impact investment landscape, we wanted to understand: the priorities general partners set for themselves; the kinds of questions investors are asking during fundraising, due diligence and post-deal; and expectations for impact management and reporting. We found investor expectations seem to align to three dimensions: impact measurement and management, engagement, and trust.

“ To me, impact is not a feel good exercise. What makes me feel good are results. ”

Ibrahim AlHusseini,
Founder and Managing Director, Hussein Group

Impact measurement and management

Our discussions revealed that impact measurement and management are priorities of both general partners and limited partners. Those active in impact investing indicated that impact management informs better decisions at the time of investment and throughout ownership. By monitoring impact on a periodic basis, funds can make adjustments during ownership to drive the achievement of specific impact metrics, potentially enhancing value creation.

“Impact can’t be a sidebar; it’s got to be core to the business model of the portfolio company for us to invest,” said Mehlman of KKR. “We want to build strong companies that contribute to addressing the UN SDGs with proven solutions that can scale and grow.”

As impact investing is still evolving, there are no formal standards for measurement and management. Many general partners we spoke with acknowledged the importance of establishing a solid basis for measurement and for refining their approach to incorporate lessons learned along the way.

“Impact investing will need to evolve to include higher standards of impact measurement that more clearly show if value is really being created in portfolio companies,” said Shell of Bain Capital Double Impact.

“Fiduciary duty and target returns are very clear for financial investments. They’re not so clear for impact,” said Heltzer of Partners Group. “A firm might say it achieved one part of the impact thesis, but not another. It’s hard for limited partners to understand the total impact and know whether they should be pleased or disappointed.”

General partners also acknowledged the importance of aligning with and leveraging existing methodologies and tools for impact measurement, while still developing their own unique approaches aligned to their view of the market, culture, and investment approach. They are focused on establishing a meaningful framework to measuring, monitoring, and reporting impact that is in line with their approach to portfolio management and has sufficient rigor and depth to satisfy investor needs and enable effective decision making and reporting.

“Investors want us to demonstrate that we can invest with an authentic, rigorous, measurable and credible impact lens and do well financially,” said Mehlman of KKR. “They want to know what our metrics of impact are and how we are managing them.”

“Investors are skeptical when funds promote impact investing through marketing, rather than demonstrating how impact is integrated into the investment process,” said Phillips of WSIB.

Effective measurement of impact holds portfolio companies and funds accountable for delivering impact alongside financial returns. General partners seek impact measurement that is aligned with their investment approach and existing frameworks, and is also specific enough to yield useful information about progress toward impact goals. They are trying to balance this against the additional effort required by portfolio companies and the capacity of their own teams.

“There is a danger of funds that label themselves as impact-oriented but aren’t intentional for how they manage, measure and report impact,” said Noble of The ImPact.

Many general partners expressed the willingness to learn together, leveraging the experience of others and contributing to the broader impact ecosystem. Many are involved with or considering involvement with industry wide initiatives and are using or plan to these efforts to guide investment activity.

“To best serve investors, funds should focus on metrics that provide real insight into the value portfolio companies create and hold portfolio companies accountable to investors.”

– Fran Seegull, executive director of the U.S. Impact Investing Alliance

Setting standards for impact management

There are a number of initiatives striving to establish common practices for impact measurement and management.

The Impact Management Project (IMP) is an initiative to facilitate a network of leading standard-setting organizations to coordinate specific impact measurement and management efforts. Based on industry consultations, IMP has established a framework that consists of five dimensions of impact.

(Source: <https://impactmanagementproject.com/>)

The International Finance Corporation (IFC) established Operating Principles for Impact Management, which provide the essential features of managing investment funds with the intent to contribute to measurable positive impact alongside financial return. The principles encourage transparency of signatories' alignment with the principles, including public disclosure of their commitment and regular independent verification of their alignment.

(Source : <https://www.ifc.org/impactprinciples>)

The Global Impact Investing Network (GIIN) has developed Core Characteristics of Impact Investing to provide clear reference points and practical actions to establish baseline expectations for impact investing. The Core Characteristics are: intentionality; use evidence and impact data in investment design; manage impact performance; and contribute to the growth of the industry.

(Source: <https://thegiin.org/characteristics>)

Impact Capital Managers is a new network of general partners of market-rate venture capital and private equity funds in the U.S. and Canada to collaborate around key questions and common goals facing the industry, including best practices for the measurement and reporting of impact.

(Source: <https://www.impactcapitalmanagers.com/>)

Priorities of impact investors (continued)

Engagement

Investors in impact funds are a diverse group. They include institutional investors, sovereign wealth funds, family offices and high net worth investors, and they represent both first-time and experienced impact investors. Many of the general partners we spoke with noted their impact funds attracted investors they had not done business with before.

Our conversations revealed that understanding a general partner's approach to impact is a priority for most limited partners during fundraising and post-close, driven by their own interest and perspectives on impact, and the desire to understand the relationship between impact and financial performance. This is requiring general partners to rethink how they engage with investors.

During fundraising, investors are interested in understanding different things. They commonly ask general partners how they define and measure impact, and how impact and performance will be measured overall. Some investors have certain investment focus areas or approaches to measuring impact. They may also be assessing investment in multiple impact funds and are trying to understand what "good" looks like and best aligns with their needs.

Limited partners also ask about the pipeline of opportunities. How do target companies for an impact fund differ from companies a typical private equity fund would invest in? Are there enough investment opportunities that align with the fund's investment and impact thesis?

"When the funds are pitching, our members are interested in learning more about the fund's impact results, metrics, and how they intend to get to this outcome. They can be very demanding and rigorous with what they expect," said Noble of The ImPact.

"Our investors want assurance that our impact fund is institutional quality, instead of a product to which market rate returns are being imposed. They look at the exit price, the internal rate of return and the multiple of money, as well as metrics that show what social and environmental impact our companies are having," said Shell of Bain Capital Double Impact.

Post-close, investor engagement is also typically more robust for impact funds than non-impact. Some limited partners request special meetings or reports on impact that is being created at portfolio companies. Others want an in-depth look at the fund's impact approach in order to learn alongside them and evolve their own approach to impact measurement.

"For The Rise Fund, in addition to all of the regular channels of engagement with our limited partners, we have an extra level of communication around impact," said Chorenge of TPG Rise. "We create some special reports on the impact being generated through our investments. There is more exposure, more material, more information, and more knowledge sharing specifically on impact."

Because different limited partners have different needs—and some are more interested in impact than others—general partners are challenged to manage a wide variety of expectations in their approach to investor engagement.

"True impact is hard to measure and there are no set standards for impact reporting," said Fran Seegull, executive director of the U.S. Impact Investing Alliance, an industry group that is working to build the impact investing ecosystem. "As investors call for more information and engagement, including bespoke and custom reporting, funds may end up tracking numerous metrics that aren't actually useful for management decision making. To best serve investors, funds should focus on metrics that provide real insight into the value portfolio companies create and hold portfolio companies accountable to investors."

"Limited partners are rapidly evolving in how they think about impact. Some are hiring impact specialists to support their increased focus on impact. In that regard, I think that they will continue to evolve what they expect their asset managers to deliver," said Maryanne Hancock, CEO of Y Analytics, an organization established to equip capital allocators with the research basis to understand the impact of their investment decisions.

Additional benefits of impact

Attracting and retaining talent: Our interviews revealed that developing or investing with an impact lens can be a draw for investment professionals, increasing the personal satisfaction they derive from their work and creating positive energy around the firm. For current team members, impact investing presents an exciting opportunity to leverage their skillset for a higher purpose. Private equity firms have also expressed success in recruiting new talent to the firm by virtue of their impact focus.

Improving deal flow: Impact investing can also help general partners identify, pursue and capitalize on previously overlooked but high-potential investment opportunities. The competitive private equity environment can lead to overvaluation and diminish return potential. However, many general partners we interviewed said their impact focus helps them see and seize opportunities others have missed. Having an impact strategy can draw the attention of business leaders who had previously been skeptical of the private equity industry, desiring a relationship with a firm that understands and supports their company's greater purpose. Private equity firms that are active in impact find they are able to meet such needs and attract a new type of deal.

Priorities of impact investors (continued)

Trust

All investment relationships are based on trust. Based on our conversations, most general partners and limited partners believe that for impact funds, there is an enhanced expectation of trust beyond the typical fiduciary relationship.

Several factors contribute to the added dimension of trust required for impact investments.

For one, impact funds are delivering an additional outcome in addition to financial returns in the form of societal benefit. Traditional private equity firms have an established track record around delivering financial returns but do not have a track record regarding impact or delivering financial returns alongside impact.

In addition, impact investing is an emerging field. While there are a number of impact measurement approaches and frameworks that are commonly used, demonstrating the intended impact in a way that is comparable is challenging in the absence of generally accepted standards for impact measurement. Investors must trust that impact is grounded in a robust methodology.

Beyond measurement, investors are also interested in obtaining a deeper understanding of how impact is integrated into key decisions throughout ownership, and the impact that was created and can be attributed to ownership.

“Earning trust is a byproduct of demonstrating rigor and thoughtfulness,” said Heltzer of Partners Group. “What is your overall goal in impact? How are you going to report it? How will you continuously improve? Funds should have enough transparency to show the thinking behind their approach, even if it’s proprietary, and share what they’ve learned with the broader industry.”

Limited partners also want to understand the motivation and intent of general partners, in particular understanding their level of commitment to impact. Goals alignment is particularly important to limited partners that are motivated by their values, such as family offices and high net worth individuals. They want to understand how portfolio companies will handle decisions around impact management, and how financial and impact metrics align or conflict. For these types of investors, trust is held at a very personal level.

For all investors, trusting that general partners are doing what they promised is fundamental to a successful long-term relationship.

“All kinds of operational decisions down the road will test a company’s commitment to achieving impact,” said Bendell of Toniic. “If fund managers and the corporate leaders they invest in don’t share the goals of investors, there is a real chance of misalignment. This can be corrected by explicit impact goal setting when making a private investment, and with shareholder engagement with public investments.”

“The key question is ‘what are we doing to earn trust?’” said Mehlman of KKR. “We need to earn the trust not just of investors, but of, quite frankly, a skeptical public. We need to walk our talk in a very important way, and that’s something we take very seriously.”

Our discussions with private equity executives also emphasized the need to build on decades of work in the broader investment community to raise the standards for impact investing. The general partners we interviewed believe trust will be earned by building an ecosystem with shared goals, commitments and systems that work together to increase transparency and credibility. Fortunately, a community of impact investors—separate from private equity—have already started to pave the way, leading efforts to measure, manage and report on impact more robustly. Rather than start some scratch, private equity impact investors acknowledge the progress that has already been made and seek to participate in and contribute to that progress. ●

“ Impact investing is the largest investment opportunity of our time, allowing the financial world to conduct business in a way that generates both financial returns and social good.”

— Michael Whelchel, Co-Founder & Managing Partner, Big Path Capital

A photograph of a bamboo forest path. The path is made of gravel and is flanked by tall bamboo stalks. A person is walking away from the camera on the path. The bamboo stalks are green and have a distinct segmented pattern. The path is covered with fallen bamboo leaves. The lighting is soft and natural, suggesting a sunny day. The overall mood is peaceful and serene.

“ All kinds of operational decisions down the road will test a company’s commitment to achieving impact. If fund managers and the corporate leaders they invest in don’t share the goals of investors, there is a real chance of misalignment.”

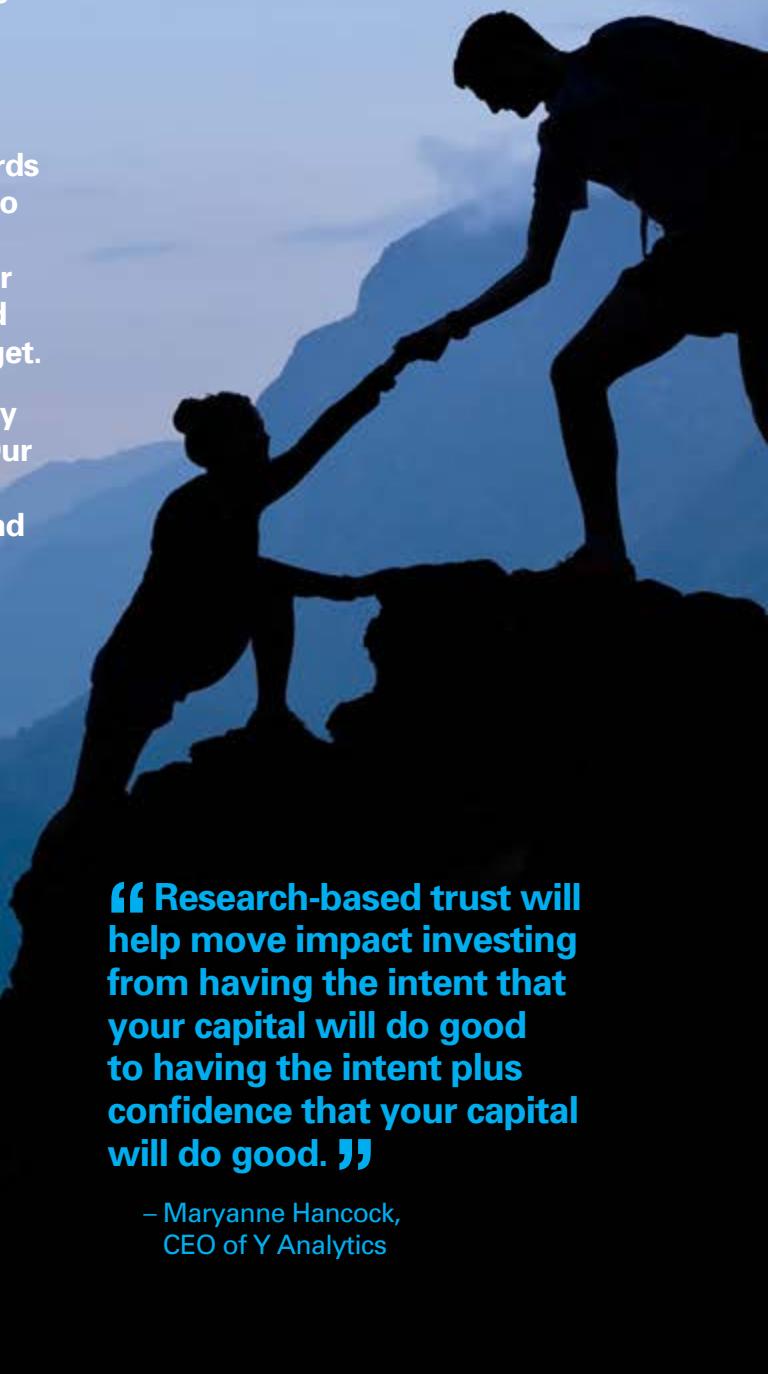
Adam Bendell, CEO, Toniic

Actions to earn trust in impact investing

Market-rate private equity impact funds have a unique opportunity to attract large pools of capital in order to drive impact at scale. Investor appetite for impact investing is high and the market holds great potential. But to achieve a larger reach, funds must first engage investors and in many cases the broader public in this nascent and evolving space.

The role of trust in the continued scaling of the impact investing market became clear during our interviews. In a new market that lacks the standards and transparency of public equity, funds seeking to put larger amounts of impact capital to work are increasingly being asked to demonstrate that their intentions are pure, their approach is credible, and their performance (financial and impact) is on target.

The scalability of impact investing in private equity will depend on the ability of funds to earn trust. Our discussions revealed key actions that help to earn trust: transparency and disclosure; authenticity and integrity; and integration of impact.



“ Research-based trust will help move impact investing from having the intent that your capital will do good to having the intent plus confidence that your capital will do good. ”

– Maryanne Hancock,
CEO of Y Analytics

Transparency and disclosure

Enhancing communication regarding the approach to impact management: In this report we've reflected the importance of engagement between general partners and limited partners to both parties. Given many limited partners' interest in obtaining a deep understanding of the general partners impact management approach, this is a particular area where limited partners' expectations will continue to grow. In particular, enhanced communications regarding the general partner's approach to impact management—demonstrating how it has been implemented and the results, using credible data and evidence—are essential to earning trust in impact investing.

Incorporating independent perspective: Many impact funds are also engaging consultants to assist them in developing and supporting delivery of their impact management framework to supplement their expertise and incorporate leading practice into their approach. A number are also proactively pursuing third party attestation of impact in the form of impact assurance to provide their limited partners with an independent perspective. One day, having an audited impact report alongside the fund's audited financial statements may become a requirement of all private equity impact funds.

“ One thing that limited partners are hungry for is independence of perspective. They rightly want to ensure that we will call a spade a spade, that we will be dispassionate about impact assessments, and that we'll bring real facts. ”

— Maryanne Hancock, CEO, Y Analytics

Authenticity and integrity

Communicating successes, failures and lessons learned: Even though it's early days for many impact funds and true impact generally takes a long time to materialize, investors are interested to understand the progress that is being made. This leads to some concern that if the results do not meet expectation, the skeptics will be proven right. But our conversations revealed acceptance of the fact that things aren't perfect the first time around. Rather, investors want to understand how funds are incorporating lessons learned and iterating their approach. In addition, shared learnings are the precursor to the development of formal industry standards, which will help build credibility in impact investing practices and allow the market to scale.

Demonstrating intent: It's not enough for general partners to explain their motivations and aspirations. They need to show it. In addition to understanding the general partner's impact management approach, investors want to understand how the general partner sees the potential for impact investing more broadly at their firm. Will they launch another impact fund? Will impact permeate the firm's overall investment approach in future? Will they adopt industry frameworks for impact management, measurement and disclosure? These are signs of the firm's commitment and ability to contribute measurable impact at scale alongside financial returns—not just their desire to do so.

“ We needed to trust enough in the fund manager's overall methodology that we knew investments would not be made for the wrong reasons. We had enough trust in the integrity of the fund manager's belief in their methodology, linking financial growth with social needs, that we made an investment. ”

— Chris Phillips, Director of Institutional Relations and Public Affairs, Washington State Investment Board (WSIB)

Actions to earn trust in impact investing (continued)

Integration of impact

Incorporating impact management and measurement in decision making: All investments must be managed to achieve the specific targets set forth for investors, and impact investments are no exception. By focusing on the core processes of impact management, information about impact performance can be leveraged throughout the investment chain to drive better operational decisions that help achieve impact where it's intended, as well as enhance or create new value. One way of incorporating impact management and measurement into decision making is setting impact targets alongside financial targets and reporting on progress to support all stakeholders in managing towards impact. Another is incorporating the voice of the end-user in the feedback loop—e.g., the people ultimately helped by the impact investments.

Assessing net impact: The focus of impact investing is to generate positive impact. However, in reality, there is a risk of unintended consequences that also needs to be considered. Assessing true impact requires consideration of both the positive and negative impacts associated with investments. This includes integrating best-in-class ESG practices alongside impact, already a priority for a number of funds we spoke with. This combined approach is poised to become even more relevant in the future as many investors also have increased expectations regarding the integration of ESG factors into investment decisions. ●

“At the Ford Foundation, we seek trusted partners who share our view of a problem, have a clear plan to address it, and are able to show us how they’re using our investment to work toward a solution. Most of the managers we support set out an impact objective they’re striving to achieve as well as a financial target so that we can understand progress over time.”

– Christine Looney, Deputy Director of Mission Investments, Ford Foundation

KPMG's Impact Ventures practice

How we serve private equity funds and investors

KPMG's Impact Ventures practice helps private equity funds and investors develop and execute strategies that integrate impact as a means to drive long-term value creation. As a trusted advisor, we help clients apply an impact lens to every aspect of the private equity cycle: from fundraising, to investments and deals, to portfolio management, to exit and realization.

The Impact Ventures practice embraces core values that have guided KPMG for more than a century and

are aligned directly to the spirit of the impact investing movement: serving clients with passion and purpose; earning public trust in the capital markets; and improving the communities where we live and work. With significant practical experience in both impact investing and private equity, spanning business sectors and global markets, we are deeply committed to sharing our collective knowledge to help private equity clients navigate the emerging impact investing space and create real value for both investors and society.

PHASE	FUND OBJECTIVES	HOW KPMG CAN HELP
Strategy	<ul style="list-style-type: none"> Identifying impact investing opportunities Understanding impact investor needs Evaluate potential deal pipeline 	<ul style="list-style-type: none"> Developing the vision and setting goals Analyzing the market and investors Reviewing the investment portfolio for existing impactful investments
Governance	<ul style="list-style-type: none"> Integrating impact into investment decisions and ownership Creating the right incentives for impact Minimizing unintended consequences 	<ul style="list-style-type: none"> Establish accountability framework Developing investment criteria Educate the investment committee
Framework	<ul style="list-style-type: none"> Establishing processes to manage and report on impact Aligning impact management with the investing approach Managing impact investing risk 	<ul style="list-style-type: none"> Developing, implementing and enhancing the impact framework Evaluating impact processes against industry leading practices
Execution	<ul style="list-style-type: none"> Attracting the best talent Enhancing skills and capabilities Helping investors and portfolio companies meet impact targets 	<ul style="list-style-type: none"> Conducting impact due diligence and monitoring Evaluating impact and financial data to unlock opportunities Advising portfolio companies on impact management
Operations	<ul style="list-style-type: none"> Operating the fund in a way that drives positive impact Building market credibility for the impact investing approach 	<ul style="list-style-type: none"> Analyzing fund operations against leading practice Evaluating consistency of operations with portfolio companies
Accountability	<ul style="list-style-type: none"> Communicating fund commitments Meeting reporting requirements Earning the trust of investors and the public 	<ul style="list-style-type: none"> Establishing the investor reporting framework Assessing assurance readiness Performing impact assurance Advising on public disclosure requirements
Community building	<ul style="list-style-type: none"> Learning from others Contributing new thinking Establishing a leadership position Developing the impact investing ecosystem 	<ul style="list-style-type: none"> Developing a platform to share impact investing insights Co-developing impact investing thought leadership

Contributors

Thank you to the private equity executives who shared their knowledge, experiences and insights for this report.

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Conclusion

Impact investing is the future. Private equity can help it scale.

Our conversations with private equity executives both validate and fuel KPMG's point of view that impact investing represents the future of investing.

Impact investing on the verge of a breakthrough. In a time when both society and the economy are experiencing uncertainty, it provides a new opportunity to leverage capital to drive solutions that will yield benefits for both. Aligned with broader calls to reform capitalism and integrate the pursuit of both purpose and profit in business, impact investing broadens our perspective on the highest utility of capital. Beyond the headlines, the data shows clear signs of the growth with substantial predictions for continued success. If it lives up to its aspirations, impact investing can be a powerful tool for institutional asset owners to use their capital to meet their responsibility to contribute a better world, while meeting their financial objectives, too.

Private equity investors—both general partners and limited partners—have a core role to play in supporting the growth of companies that operate in a way that has a positive impact on society and the environment. Impact investing is still relatively new for market-rate private equity firms. To contribute to its growth and success at the institutional level, private equity participants need to update their approach. Earning trust will be a critical priority, requiring new opportunities to engage with stakeholders, establishing new metrics and analysis to demonstrate performance, and perhaps most importantly, the integration of impact every step of the way.

And expectations of private equity impact investors only continue to increase as more funds are launched, the industry evolves, and larger pools of capital are invested in impact. This journey won't end in a day, and no one can't reach the finish line alone. Trust must be earned not only at the firm level, but across the impact investing ecosystem, requiring the collaboration of all stakeholders to develop better products, reach more investors, and support the development of standards and guidance that bring greater consistency and accountability to impact investing.

“The world changes when lots of different people come together to contribute to that change from their particular vantage point. That includes citizen activists, policymakers, inventors, technologists and can also include companies and industries built around that change. We can help create strong companies that will contribute to addressing the UN SDGs, providing solutions to societal problems that can scale and grow.”

– Ken Mehlman, Co-Head, KKR Global Impact

“There’s a different way to think about value creation. Our corner of that is to invest in companies that are helping to solve societal challenges. We find companies we think will win for the fact that their appeal and their behavior will make them a more valuable company. Our job is to help accelerate that process by which they become more valuable.”

– Greg Shell, Managing Director, Bain Capital Double Impact

“For The Rise Fund, in addition to all of the regular channels of engagement with our limited partners, we have an extra level of communication around impact. We create some special reports on the impact being generated through our investments. There is more exposure, more material, more information, and more knowledge sharing specifically on impact.”

– Maya Chorengel, Senior Partner, TPG Rise

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