Private Equity International

Impact Investing

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A sense of purpose
Can money make a difference?

KEYNOTE INTERVIEW

How private equity is part of the solution

The pandemic has intensified the focus on solving the problems facing society, providing an opportunity for bold new thinking, says the leader and chief catalyst of KPMG's impact venture practice Tania Carnegie

Q How has the coronavirus pandemic affected the momentum that has been building behind the impact investment movement?

We are living in a scenario that few of us could have imagined a year ago. Our way of life has been disrupted. Industries have been turned upside down, and the economic impact has been significant. And, of course, the effect on families and on communities has been enormous.

As a result of this upheaval, covid-19 has accelerated the need for solutions to the big challenges facing society.

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Many of those challenges were already well known – income inequality, access to healthcare, access to education and climate change, for example – the pandemic exacerbated the level of need. The result has been an increased imperative for commercial opportunities to address these problems at scale, with corresponding interest from investors to support them. This has been a positive by-product of what has undoubtedly been an awful situation.

Q Are these solutions-based companies purely the domain of impact specialists, or are we moving towards a less siloed approach?

I believe we are heralding an era of bold new thinking. Private equity firms have always been interested in companies that address gaps in the market, whereas impact specialists have been focused on companies that create positive social and environmental outcomes through their business model. We are seeing a convergence of the two as many of the gaps in the market are related to societal issues and climate change, with associated economic consequences. Managers are leveraging the experience gained over the past few years to start making the impact investment philosophy ubiquitous.

Q Is it realistic to think we could reach a stage where impact investment becomes an outmoded term?

I do believe that will happen. We are already starting to see some of the major private equity players focusing, not just on launching impact funds, but on ways they can consider impact across all their investment activities. This is similar to how firms are incorporating ESG as part of investment decisions and asset management – it becomes part of the way things are done.

Q Are there sufficient solutions-focused companies out there to meet the growing investment demand?

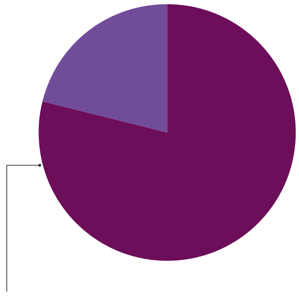
We are seeing more and more companies firmly focused on addressing deeply entrenched social and environmental issues that we know also have a very significant economic impact. They span different industries and different geographies, so the opportunity set is pretty widespread. I think those businesses will really fuel impact's transition from the exception, to the norm.

If you look at KPMG's recent 2020 CEO Outlook report, for example, it is clear that this idea of purpose is something that companies are doubling down on. At the beginning of the year, 77 percent of CEOs said that their primary objective was purpose driven. Today, however, 79 percent of CEOs say that they have a stronger emotional connection to their company's purpose than they did before the crisis began. As that sense of purpose permeates the corporate sector more broadly, it is going to create a very fertile pipeline for private equity firms across the board, not only those looking purely through an impact lens.

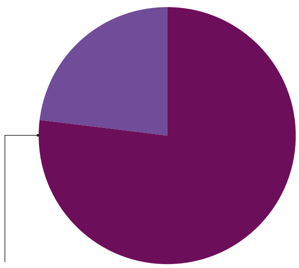
So, yes, I do think we will reach a point when we talk about investment, we are naturally talking about financial risk and return, and the contribution the company is making to address society's challenges and the value that creates for shareholders. I think covid-19 could help accelerate that transition, just as it has accelerated so many other developments, from remote working to digitisation, that might otherwise have taken years to come into effect.

Working with purpose

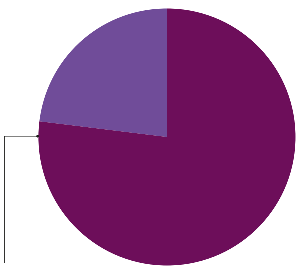
In light of the pandemic, CEOs believe that purpose is more powerful and relevant than ever



79%
Say they feel a stronger emotional connection to their purpose since the crisis began



77%
Say their purpose has helped them understand what they need to do to meet the needs of stakeholders: employees, communities, customers, partners and investors



77%
Say their purpose provides a clear framework for making quick and effective covid-19 related decisions

Source: 2020 KPMG CEO Survey Report

Q As mainstream firms increasingly embrace a solutions-led approach to investment, where does ESG best practice end and impact begin?

ESG and impact are complementary, as they relate both the way a company operates and the products and services offered, and effective impact strategies require best-in-class approaches to ESG.

We are seeing an increased focus on ESG in the private equity space, and in particular around the 'S' pillar. Private equity firms are acutely aware of the importance of human capital and talent management practice and the value that people bring to a business has definitely been highlighted by covid-19. The way that companies recruit, support and retain their teams has been put under the spotlight. Indeed, our CEO survey revealed that talent risk is deemed the number one threat to long term growth.

In that sense, looking after your people is good ESG practice as it relates to the operations of an organisation. But it is also very much related to that organisation's impact. You need visionary leadership to embrace and execute on an impact strategy, whether that strategy is intrinsically part of the company's DNA or whether it is an area that is being brought into renewed focus.

The other area of ESG that has become significantly more pronounced over the past year is diversity, equity and inclusion. That has been emphasised by recent events, in particular in the US. But it has also reinforced the importance of having diverse teams and cultivating a diverse talent pipeline to maximise value for a business. After all, a private equity firm's primary purpose is to create value through ownership. Whether you are a dedicated impact investor or not, these positive steps can have a direct influence on a company's ability to grow, to create value and to have impact.

Q Has the institutional investor community now fully bought into the idea that it is possible to have dual priorities without forgoing financial reward?

We see continued momentum around impact in the institutional investment community, however the preconceived notions about trade-offs associated with impact investing are challenging. It's critical for investors to understand the GP's approach to incorporating impact as part of the investment process in order to assess the relationship between impact and returns.

Many of the institutional investors we deal with have narrow investment mandates focused on delivering returns. Although they don't have an impact mandate, they are cognisant that companies offering impact solutions bring a unique proposition to market and commercial returns. A number of funds are specifically targeting these investors and delivering commercial rates of return – rather than view impact as a limitation, they believe impact contributes to value creation.

As these types of opportunities and examples increase, recognition is also increasing that it is possible to deliver on both returns and impact expectations. Hopefully this will dispel the myth that there has to be some kind of trade off.

Q How are LPs' approach to impact due diligence evolving?

LPs continue to be focused on understanding the impact thesis of the fund and how it will be incorporated in the investment and ownership approach. Investors may prioritise impact differently, although of common interest is understanding how the impact approach will create value.

Q Is there still further work to be done to create robust measurement tools to help support LPs in their decision making?

What we are hearing loud and clear from members of the private equity community is that there are a number of good frameworks and tools to choose from. We are seeing firms leverage what is already in existence and bringing that into their own investment style, as opposed to going out there and developing a net new approach. You can see an example of that in the number of firms that are becoming signatories to the Operating Principles for Impact Management or leveraging the Impact Management Project.

Q Does the combination of a flourishing impact philosophy and the covid-19 crisis present an opportunity for private equity to really lead the recovery and to showcase the benefits it is able to bring to society?

I absolutely think so. We often use private equity as an example for other parts of the financial services community considering how to incorporate impact investment as part of their product suite. They ask themselves how they can learn or adapt from what it is that private equity is already doing successfully. Private equity has always been on the cusp of investing in the latest technologies and innovations that influence and evolve industries and daily life. This is an opportunity for the PE industry to take that directive to a positive extreme and innovate around the very notion of investing. ■

> *"Private equity has always been on the cusp of investing in the latest technologies and innovations that influence and evolve industries and daily life"*

Q How do you anticipate the impact movement will evolve over the next few years and what obstacles do you think could get in the way?

One of the potential speed bumps is the concept of impact washing. Accountability, authenticity and integrity are all absolutely vital. If LPs start to feel that the pursuit of impact isn't quite as significant as they had been led to believe in due diligence, that could undermine future efforts. By the same token, I think it will be important to see how tough decisions are made during ownership and how impact considerations are folded in as part of broader decision-making processes. For example, if a decision is made that results in less impact, but more profit, it's important that the context is fully communicated and understood so that the integrity of the approach stands up.