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JULIEN JÉRÔME MIDOUX

COMPARED PRIVATE EQUITY IMPACT INVESTMENTS

SÃO PAULO
2017

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Thesis presented to Escola de Administração de Empresas de São Paulo of Fundação Getulio Vargas, as a requirement to obtain the title of Master in International Management (MPGI).

Knowledge Field: Gestão e Competitividade Em Empresas Globais

Advisor: Prof. Dr. Servio Tulio Prado Junior

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ABSTRACT

This research aims to study private equity impact investments based on a comparative analysis of different private equity funds practices. In particular, it examines how the requirements of impact investing are encompassed in private equity investment processes. First, a literature review was conducted to better define impact investing and assess the complementarity of private equity with impact investing. Secondly, a qualitative study was pursued based on a panel of interviews. Interviewees are investment professionals working for private equity firms with interests in impact investing. The analysis of the interviews indicates a certain commonality of the investment methods between the funds paneled whether they are pure player private equity impact investors or traditional private equity firms investing for impact. Beyond the proximity between investment strategies, the research also shows a strong focus on in-house impact targeting and measurement, with little resort to external tools. Such flexibility negatively affects the readability of impact performance from a market perspective. The research concludes impact investing still has to go through a standardization process to gain global recognition as a private equity segment.

Key words : Private Equity, Investment Process, Impact Investing, Responsible Investing, Impact Measurement

RESUMO

Esta pesquisa tem como objetivo de estudar os investimentos de impacto de private equity com a base de uma análise comparativa de diferentes práticas de fundos de private equity. Em particular, examina como os requisitos de investimento de impacto estão abrangidos nos processos de investimento em private equity. Em primeiro lugar, uma revisão da literatura foi feita para melhor definir o investimento de impacto e avaliar a complementaridade do private equity com os investimentos de impacto. Em segundo lugar, um estudo qualitativo foi realizado com base de um painel de entrevistas. Os entrevistados são profissionais de investimento que trabalham para empresas de private equity com interesses em investimentos de impacto. A análise das entrevistas indica uma certa semelhança dos métodos de investimento entre os fundos estudados que eles sejam unicamente investidos em impacto o que sejam fundos de private equity que fazem investimentos de impacto além de investimentos tradicionais. Além da proximidade entre as estratégias de investimento, a pesquisa também mostra um forte foco em processos de segmentação e de medida do impacto internos, com pouco recurso para ferramentas externas. Essa flexibilidade afeta negativamente a legibilidade da realização do impacto por parte do mercado. A pesquisa conclui que os investimentos em impacto ainda precisam passar por um processo de padronização para obter reconhecimento global como um segmento de private equity.

Palavras-chave: Private Equity, Processo de investimento, Investimento de impacto, Investimento Responsável, Medida do Impacto

LIST OF ACRONYMS

AUM:	Assets Under Management
BP:	Business Plan
CSR:	Corporate Social Responsibility
ESG:	Environmental, Social, and Governance
GIIN:	Global Impact Investing Network
GP:	General Partner
HNWI:	High Net-Worth Individual
ILPA:	Institutional Limited Partner Association
IPO:	Initial Public Offering
IRR:	Internal Rate of Return
KPI:	Key Performance Indicator
LP:	Limited Partner
PPM:	Private Placement Memorandum
PRI:	Principles for Responsible Investment
SDG:	Sustainable Development Goals
SME:	Small and Medium-sized Enterprise
SRI:	Socially Responsible Investment
UN:	United Nations

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1. Introduction

a. Presentation of the theme

Intergenerational transfers of wealth from the baby boomers to their children, the millennials, are expected to reach a total of \$30 trillion in the next 3 decades, in North America only (Accenture, 2016). More than half of these transfers (\$16.4 trillion) are made of investable assets, changing hands in less time that was needed to constitute them. According to the now yearly Deloitte Millennial Survey, 87% of them believe that *“the success of a business should be measures in terms of more than just its financial performance”* (Deloitte, 2016).

In April 2006 the former Secretary-General of the United Nations (UN) unveiled the list of 6 “United Nations Principles for Responsible Investment” at the New York Stock Exchange. As of August 2017, 1805 signatories from the financial services industry were registered worldwide. This trend is reflected in the growth of financial products that fit ethical values. In 2016 Socially responsible investing represented c. \$23 trillion, a 25% surge from 2014 (Global Sustainable Investment Alliance, 2016). But despite the size of the numbers, social responsible investing doesn’t change fundamentally the nature of businesses, it just affects them on the margins, by limiting their most harmful activities for the environment or society.

Actually creating a positive non-financial impact involved going beyond the mere negative screening of socially responsible investment. The challenge was to use private capitals, looking for financial profits, to solve social and environmental issues that public services could not cope with on their own. This association gave birth to a new investment strategy, the impact investing. According to the Global Impact Investing Network, a group that was created in 2007 by the Rockefeller Foundation in partnership with a few investors, we can define impact investing as *“investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return”*.

Although the total size of impact investing funds is difficult to establish the GIIN estimates that impact assets exceeded \$114 billion at the end of 2016. Private equity impact assets represent 27% of this total, second only to private debt with 41% (Despite not being the largest in terms of size, Private Equity remains both the most vivid asset class, with investors expecting to invest 87% more capital into impact investing in 2017 compared to 2016, and the youngest, with 74% of private equity impact investors entering the market in the last 10 years (GIIN, 2017). This trend reflects the suitability of private equity as an impact investing vehicle. Private equity investors commit capital for long term periods, with the intention of having a decisive influence on the corporate strategy of the investee, hence offering the possibility for an impact project to be developed or elaborated.

Recent initiatives in the impact investing field from major private equity funds such as TPG or Bain Capital sparked interest on the subject. Although the \$2 billion invested in the “Rise” fund (TPG) in 2016 and the \$390m invested in Bain Capital Double Impact fund in 2015 constitute landmarks in the development of impact investing by their size, they are far from being first movers in the industry. Since 2002, Bridges Fund Management, created in London under the patronage of Sir Ronald Cohen, is building impact investment strategies with a private equity focus. In this thriving market environment, the following research thesis is the occasion to further explore the complementarity between impact investing and private equity by comparing the practices of different funds.

b. Definition of the research problem

While there is wide literature available on the challenging equilibrium between financial return and impact targets (Rangan, 2011; Gray, 2015; Gregory, 2016), or on the development of impact measurement tools (Puttlick, 2012; Reeder, 2013; So, 2015), there is no complementarity study of impact investment principles with the operational requirements of funds investment processes. The private equity sector is the most suitable for this type of analysis, due to its strong complementarity with impact investing, and the overall standardization of the industry in term of methods.

The objective of this thesis is to assess how private equity investment processes encompass the principles of impact investing, based on a selection of private equity firms

To develop the analysis, this research is based on primary data collection through interviews of private equity impact investors. The funds were selected to reflect the diversity of the private equity initiatives developed in the impact investing field: part of the interviewees work for specially dedicated private equity impact funds, and part work for traditional private equity firms with interests in impact investing.

The framework used for private equity investment processes study is built on the private equity investment cycle:

- Fundraising
- Sourcing
- Screening and investment strategy
- Holding period
- Divestment strategy and exit

The data collection methodology follows the aforementioned private equity cycle framework. An interview guide was constructed to question respondents accordingly. Finally, the results of the interviews were refined to fit the private equity investment processes framework. The study leads to a series of insights on impact investing principles implementation in the private equity investment processes.

c. Structure of the Thesis

The thesis is structured in two main chapters:

A review of the academic literature and of the working papers:

- Defining impact investing and identifying its key drivers of its development
- Exploring impact measurement tools and their implementation
- Evaluating the apparent antagonism between impact and financial return
- Assessing the complementarity of impact investing with private equity

A series of 7 interviews conducted with actors of the private equity industry

- 3 interviewees work in private equity firms specialized in impact investing, the “**pure players**”
- 2 interviewees work in impact investing funds launched by traditional private equity firms, the “**Corporate impact investors**”
- 2 interviewees work in traditional private equity funds and bring their vision on impact investing, the “**Corporate investors**”

2. Literature review

a. Fundamentals of Impact Investing

In Ghana, a local farmer now has access to adapted insurance offerings covering life and health risks, directly through his mobile phone, protecting his family from the uncertainty of a personal accident. BIMA, the company behind it, owes its rapid development to the funds brought by its investors, among which Leapfrog, a growth equity impact investment fund.

In Chicago the pre-kindergarten education of 2,620 children in the public school system is financed through a social impact bond launched by Goldman Sachs in 2014. The bank will only get its money back if the initiative appears to have a positive impact on the children academic success.

In London, to face the ongoing housing crisis, hundreds of living units are being constructed on the site of a demolished building in Croydon. The new complex will offer 500 apartments, of which 30% will be rented as affordable housing. The project is led by Bridges Fund Management, the investment company founded by impact investing pioneer Sir Ronald Cohen.

These three investment cases demonstrate the diversity of impact investing, crossing several asset classes in different markets.

i. *Defining Impact Investing*

In 2014 the UN Conference on Trade and Development published the “World Investment Report”. The research concluded that \$2.5 trillion were missing to achieve the Sustainable Development Goals before 2030. One of the main outcomes of the study was that private sector, although being essential to bridge the gap, remains an almost untapped contributor. The challenge of mobilizing private resources to achieve social objectives is a lasting one, often conflicting with the apparent contradiction between social goals and financial goals.

The term of impact investing first appears after a series of meetings conducted in 2007 at the Rockefeller Foundation Bellagio Center in Italy, blending representatives of financial companies with leading actors of philanthropic organizations. The Rockefeller Foundation initiative led to the creation of the Global Impact Investing Network (GIIN). In September 2009 the GIIN was officially announced as an independent organization by former US President Bill Clinton. At the time, impact investing was defined as: **“Using profit-seeking investment to generate social and environmental good”** (Freireich and al, 2009).

The definition was further developed in a report published by J.P. Morgan, in a research partnership with the Rockefeller Center and the GIIN:

“Investments intended to create positive social impact beyond financial return”

J.P. Morgan, Rockefeller Center, GIIN (2010)

The key refinement of this last definition is the notion of “intention”, differentiating proper impact investing from traditional investments that may generate positive social or environmental consequences in a much more unpredictable way.

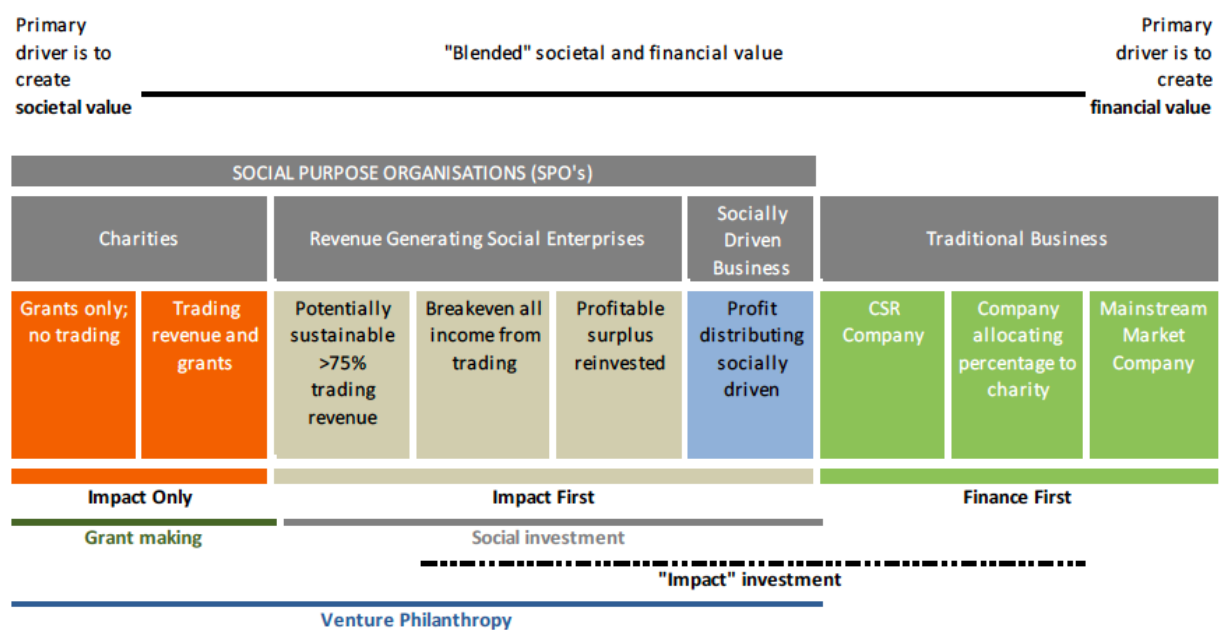
In a research paper published in 2011, Grabenwarter and Liechtenstein associate five main features with the impact definition given by J.P. Morgan:

1. **Profit orientation:** Impact investing must be sustainable on a financial perspective, by not depending on any exterior funding sources. Like other financial products, impact investments have to be considered under a risk / return perspective.
2. **Correlation between impact and financial return:** greater is the impact, greater should be the financial performance. Impact investing implies that financial return should not be encumbered by impact performance. It results that having a positive impact is not a liability for the investee, but a mere consequence of the execution of its business model.
3. **Social impact must be intentional:** impact making should be a core component of the business model of the invested company, not an accidental by-product of its activity. Investing for impact implies a deliberate willingness to increase this impact over the course of the investment.
4. **Social impact must be measurable:** impact measurement is necessary to prove the causality with financial return (2) as well as the intention (3). Further in this research the methods used to measure impact will be explained, and the notion of impact will be defined with more refinement.
5. **Positive effect on society:** the impact, defined as a positive improvement on previous social and environmental conditions, is part of a set of outcomes produced by the activity of the invested company. It is essential that the impact created may not be overtaken by other negative outcomes of the activity, so that the ending impact balance remains positive.

Although these elements of definition are agreed upon by a growing number of impact investing actors and are promoted by the GIIN, some other organizations, traditionally in base of pyramids programs, tend to confuse impact investing with investing in undeserved areas (Rockefeller Foundation paper, 2012). Such an equivalence should not be accepted, as it embodies investment that do not carry the intention to have an impact.

Beyond establishing a clear definition of what is impact investing, it is important to locate it in the galaxy of socially positive financial products. Drawing a panel will help distinguishing impact investing from other socially oriented investments.

The investment spectrum built by the European Venture Philanthropy Association (EVPA) is particularly relevant to draw the boundaries of the social investment universe. It clearly highlights that impact investing is at a crossover between purely social investments and traditional business, without having to do a tradeoff.

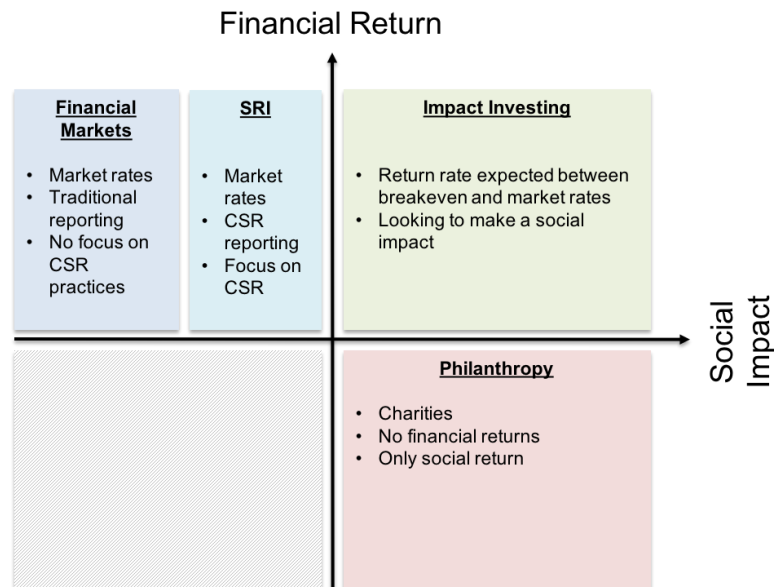


The Investment Spectrum - EVPA code of conduct (2017)

On the left side of the spectrum are **charities**, fully impact oriented with no financial purpose. Then come **social enterprises**, generating a revenue by conducting sustainable business. Finally, the right side represents **traditional businesses** with less inclination towards social goals. Impact Investing appears as a diverse category of investment, from social enterprises with a bare financial breakeven to more traditional companies.

Another way to present the universe of social oriented investments is the matrix developed by the French impact investing fund "Le Comptoir de l'Innovation". It clearly shows that impact investing disrupts standard financial markets by introducing a social impact metric on top of the financial return metric. Beyond the traditional "risk

/ profit” approach, impact investing has to be analyzed under a “risk / profit / impact” perspective.



Financial and Social matrix - Le Comptoir de l'Innovation

In the spectrum of socially positive investment vehicles, impact investing has to be differentiated from Philanthropy and from Socially Responsible Investments (SRI).

Socially Responsible Investments

SRI are made in companies whose Corporate and Social Responsibility (CSR) performance is considered above average. The investment philosophy of SRI is based on the idea that an expansive CSR strategy can be a driver of performance for investments while making a positive social impact (Hill & al, 2007). **SRI investments focus on negative screening**, by excluding companies with little CSR initiatives or whose industry is potentially harmful socially and environmentally (cigarette, alcohol, military...). According to De Colle and York (2009), negative screening is not an efficient tool to identify impact drivers, as it tends to exclude categories as a whole instead of companies in particular.

Instead, impact investing focuses on positive screening, intended to create additional social and environmental good, that would not have existed without the investment.

Philanthropy

Philanthropy does not intend to have a positive financial return while creating social and environmental impact. Even in such an event they would reinvest the money earned in the philanthropic activity.

ii. Segments of impact investments

Although Impact investing is defined by the idea that there is no choice to be made between financial performance and social and environmental value creation, we can identify diverse motivations among investors. According to Freireich and Fulton in the report they wrote for the Monitor Institute (2009), impact investors can be divided in two specific types:

Financial First investors

They are looking for financial returns matching market rates by pursuing investment activities that maximize profit while encompassing a social impact philosophy.

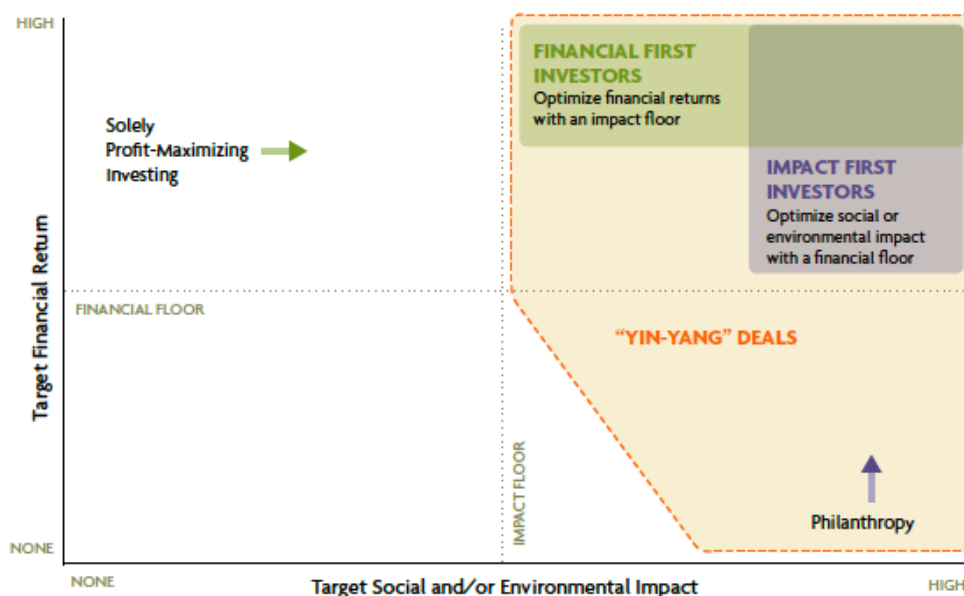
In particular, most of the liability-constrained actors (pension funds, insurance companies...) cannot accept returns lower than market rates due to their fiduciary responsibilities. The same is true for most of the investment funds, regardless of the asset class they invest in. Financial first targeting appears to be the most common approach to impact investing.

Impact First investors

They are looking for maximizing the impact while staying in a for profit structure. Their financial returns usually go from covering the capital to matching market rates.

Usually, private foundations such as *the Bill & Melinda Gates foundation* are considered as “impact first investors” The study published jointly by the World Economic Forum and Deloitte in 2013 mentions that private American Foundations can commit capital to impact investing in the frame of “Programme-related investments”, that are counted towards their 5% mandatory annual disbursement threshold. According to the authors of the research, such a possibility is often misunderstood by foundations representatives, leading to only 7% of US based foundations holding Programme-related investments”. This misconception can be linked to the limited levels of impact first commitments.

This split between investors should however not be considered as a theoretical rupture in the impact investing ecosphere, but as an opportunity for actors to leverage on their respective strengths to create innovative investment products. The 2009 Monitor report explores the **possibility of finance first investors and impact first investors to work together on the creation of “yin-yang deals” targeting high impact performance with market rate financial returns.**



Segments of impact investors and yin-yang deals - Monitor institute: Investing for Social & Environmental Impact (2009)

The authors of the study give the example of a microfinance impact project targeting farmers in a developing country. To be profitable for a banking institution the project needs to have a maximum percentage level of default on the borrowings. A public institution then provides a default guarantee on the loans, allowing for interest rates to go down, and making the project interesting for all the counterparts.

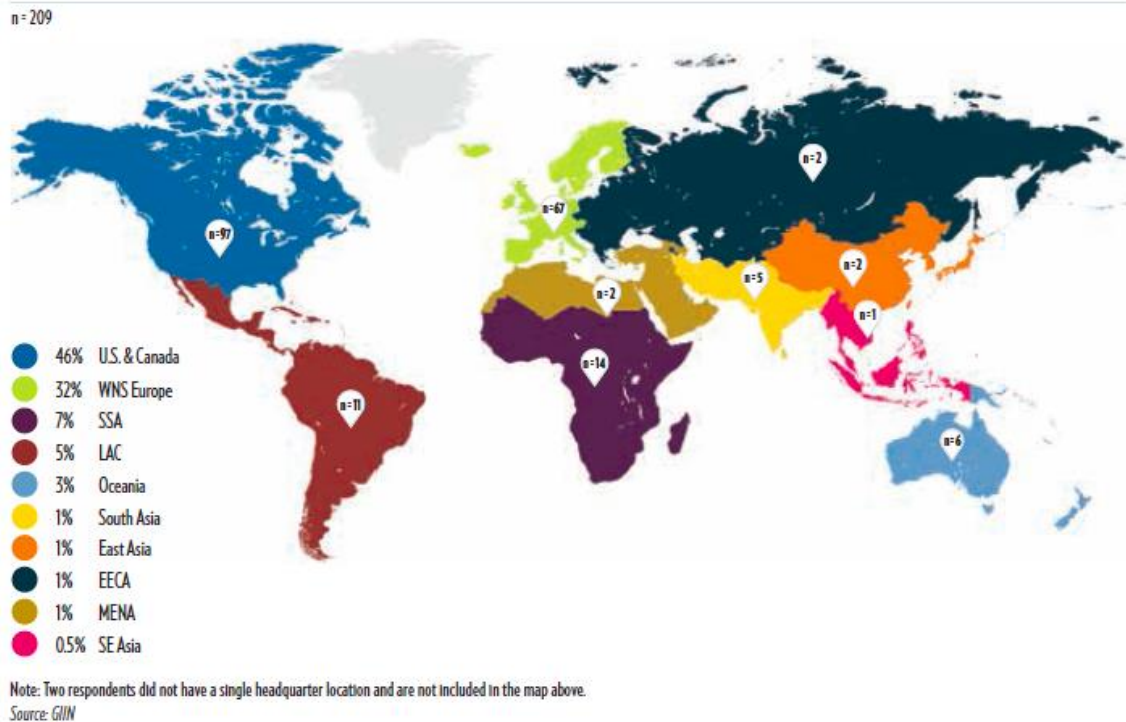
iii. Impact Investing market mapping

The impact investing market is diverse and its boundaries have not been strictly defined yet. At this stage of development, a sizing of the market would not be relevant. The objective of this part is to assess the relative importance of different actors, financial products, geographies, sectors and impact targets.

The most up to date data on the subject is to be found in the GIIN annual survey of the impact investing market. In its last Annual Impact Investor Survey, it covers investment activities in 2016, as well as growth perspectives for 2017. The survey is based on a sample of 209 respondents who have committed at least \$10m to impact investing since their inception, or have made at least 5 impact investments. **In total, respondents manage \$114bn in impact investing assets. For year 2016, respondents invested \$22.1bn in 8,000 impact investments, and expect to invest 17% more during year 2017.**

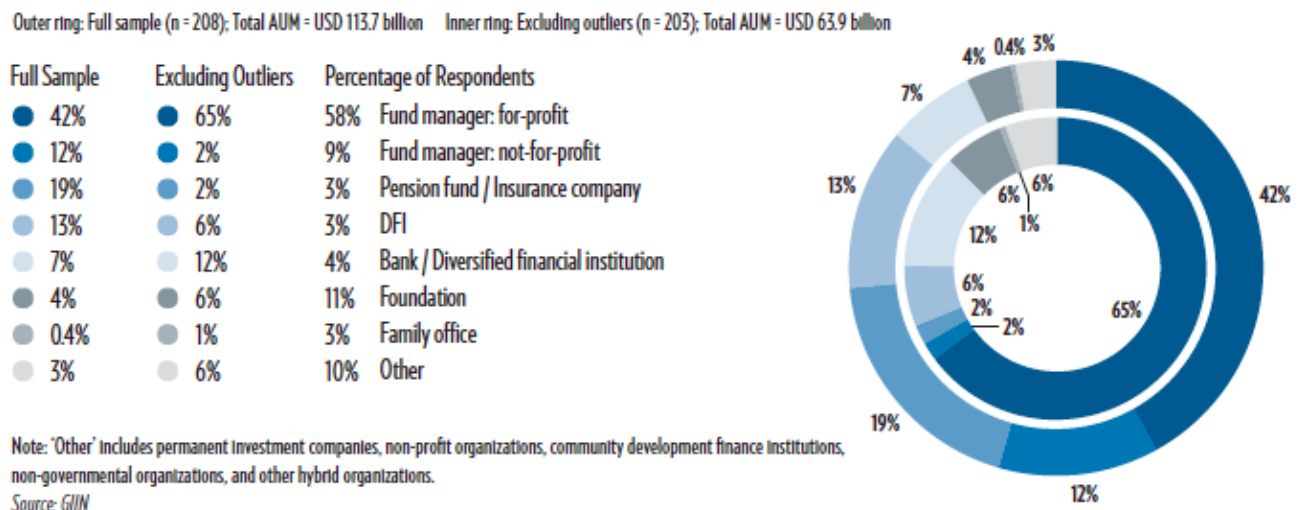
1. Investors

The survey first shows that most of the respondents have headquarters based in developed country (87% of them), with a strong **concentration in Northern America**. Despite the strong commitment of impact investing towards development goals in emerging countries this map shows that capital usually comes from wealthier parts of the globe.



Location of sample headquarters by number of respondents and percentage of total sample - GIIN Annual Impact Investor Survey (2017)

The following documents shows the list of investor categories classified by total impact investment AUM and by the amount of capital invested for impact in 2016.



AUM by Organization type - GIIN Annual Impact Investor Survey (2017)

Excludes two outliers and two respondents due to data-quality issues. Figures in USD millions.

		Capital invested			Number of investments		
	n	Median 2016	Total 2016	Total Planned 2017	Median 2016	Total 2016	Total Planned 2017
Fund manager: for-profit	119	13	11,307	15,286	6	4,824	5,835
Fund manager: not-for-profit	19	10	1,345	1,392	13	739	1,047
DFI	7	76	4,432	3,016	20	438	437
Bank / Diversified financial institution	7	242	2,089	2,528	60	846	1,108
Pension fund / Insurance company	6	190	1,459	1,905	7	33	36
Foundation	23	11	550	730	5	112	133
Family office	5	8	116	113	4.5	33	40
Other	19	8	844	936	19	926	921
Total	205	12	22,142	25,905	7	7,951	9,557

Note: 'Other' includes permanent investment companies, nonprofit organizations, community development finance institutions, non-governmental organizations, and other hybrid organizations. Figures in USD millions.

Investment activity by organization type - GIIN Annual Impact Investor Survey (2017)

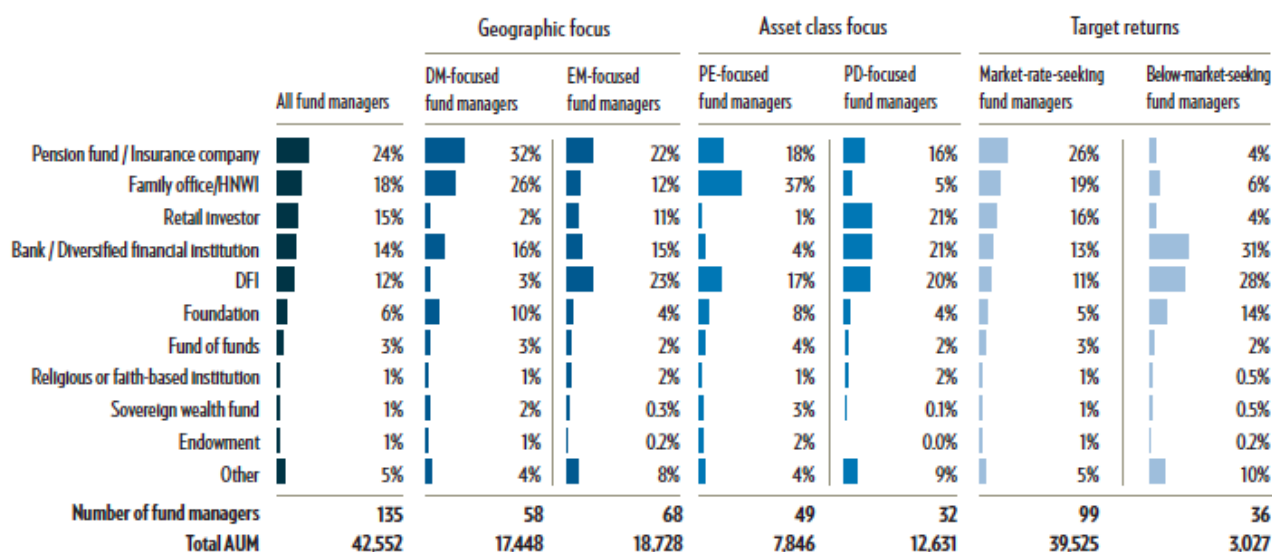
Fund Managers

They constitute the largest share of the aggregate, with 67% of all respondents and 65% of total adjusted AUM (without outlier respondents). These funds can have varied investment strategies, with private equity being one of them. For 2017 these investors project a 67% increase in capital commitments to impact investing compared to 2016.

In the GIIN survey, the fund manager respondents gathered capital from various sources. Out of the total impact investing AUM, 24% was invested by pension funds and insurance companies, 18% from family offices and HNWI, 15% by Retail Investors, 14% by banks, and the rest by Development Financial Institutions, Foundations, and others.

These contributions tend to vary depending on the size of the fund manager, with smaller ones attracting a larger share of family offices and larger ones attracting more bank and financial institutions capital.

Contributions also depend on asset class and geographical focus. Typically, private equity focused fund managers tend to raise more capital from family offices and HNWI when private debt focused managers are more active with retail investors, banks, and development financial institutions. Naturally, pension funds will be more active in developed markets and development financial institutions in emerging markets.



Note: Figures exclude two large outlier respondents.

Source: GIIN

Fund managers' sources of capital, overall and by geographical focus, and asset class focus, and target focus (AUM weighted) - GIIN Annual Impact Investor Survey (2017)

Development Financial Institutions

This group encompasses governmental development institutions as well as international organizations promoting economic development. These actors answer to an economical and political agenda, as such, they cannot be considered as charities, even if they are not necessarily pursuing for-profit operations.

While DFI only represent 3% of the respondents in the sample, they constitute 6% of the total adjusted AUM studied here. This discrepancy can be explained by the concentration of capital in the hands of few important DFIs.

An important number of DFI gather capitals in developed markets and invest in impact projects in emerging countries, but that is not the only scenario. In the US, the Department of Treasury created "Community Development Financial Institutions" (CDFIs), mostly targeting the housing sector through private debt products.

Pension Funds and Insurance Companies

Pension funds and insurance companies represent 3% of respondents and 19% of the sampled AUM, but that number falls to 2% once adjusted for outliers. Liability-constrained companies are typical "financial first" investors, as described in the 2009 Monitor Institute Report and are not likely to take any additional risk to invest in Impact Investing (all of the respondents in the sample target market-rate investments).

Although most of impact investing projects these companies are currently interested in focus on microfinance or local insurance products, there is a dynamic towards more mainstream impact investing. For example, Zurich, an insurance group from Switzerland, announced that it would allocate up to 10% of its private equity investments to impact private equity funds. In 2017 the sampled investors expect to commit 31% more capital than in 2016.

Bank and financial institutions

With 4% of respondents and 12% of adjusted AUM, banks and financial institutions represent a substantial part of the sample. These actors are not first comers on the impact investing market: according to 61% of surveyed fund managers, most of the banks are starting to consider impact investments or just started to develop an impact investing strategy.

This group keeps a “financial-first” investment perspective, with 63% of them looking for market-rate opportunities, but the survey shows a strong interest in the matter with a 21% forecasted increase in capital invested by 2017.

Foundations

Foundations are very present in this sample, of which they constitute 11% of total respondents, but they have a minor adjusted AUM, with 6% of the total. This low scale can be explained by the struggles met by foundations to raise capital, as they are “impact investors” for most of them.

As mentioned previously, US private foundations are submitted to a mandatory annual disbursement of 5% and “programme-related investments” can be counted towards this total. The newly impact investment opportunities can explain the 32% capital commitment increase by foundations expected for year 2017.

Family offices and HNWI

Family offices and personal fortunes represent only 3% of the sample, and 1% of total AUM invested in impact investing. Despite the small size, this capital is more likely to be motivated by personal goals, oriented towards making an impact through investing.

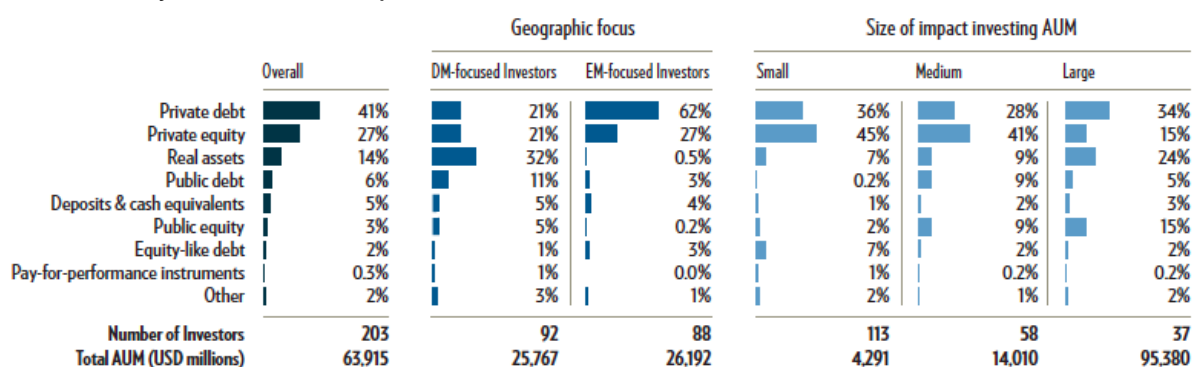
Other

The remaining 10% of respondents correspond to nonprofit organizations, non governmental organizations, and hybrid organizations, accounting for 6% of the total AUM. According to the study, 69% of them are “below-market investors” and can be considered having an “impact-first” positioning.

At the level of the sample, the study forecasts an increase of capital committed to impact investing of 17% from 2016 to 2017. This add-up is expected to come principally from for-profit fund managers, pension funds, insurance companies, and banks. Overall, the growth of the impact investing market seems to be driven by “financial first” investors rather than “impact first” investors, confirming the interest of private capitals for the matter.

2. Financial products

Among the respondents of the GIIN 2017 investor survey, the most invested financial products (excluding outliers) are Private Debt, accounting for 41% of total, Private Equity, accounting for 27% of total, and Real Assets, accounting for 14% of the total. Overall, private equity is most invested in by small and medium organizations, when large investors tend to have more substantial participations in real assets and public equities. In terms of diffusion, private equity is the most common financial product, used by 159 of the 209 respondents, followed by private debt, used by 113 of the respondents.



Note: For the overall sample and by geographic focus, figures exclude five large outlier respondents. By size of impact investing AUM, figures include outliers.

Source: GIIN

Instrument allocations by various segments - GIIN Annual Impact Investor Survey (2017)

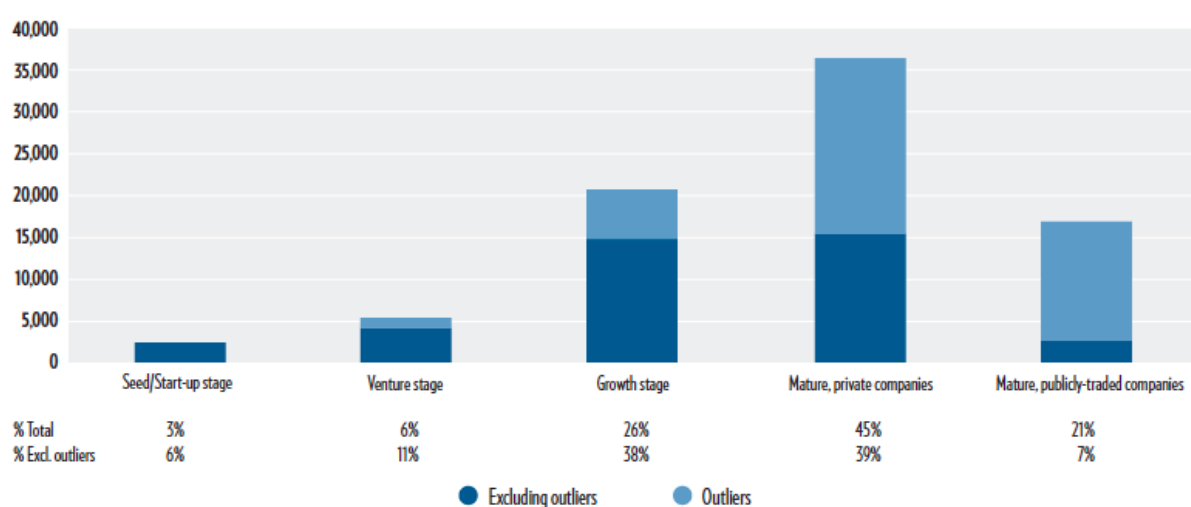
In the wide diversity of financial products used in impact investing, public equity and public debt seem slightly abandoned, representing respectively only 3% and 6% of the total AUM of the sample. Only 16% of the respondents in the survey do investments in public equities, with a slightly higher interest for respondents targeting market rates of returns. The most frequent reason mentioned for not investing in public equities is that “[The investor doesn’t think] it’s possible to create impact through public equities investments unless one has a sizeable enough share to influence management”.

In June 2013, Prime Minister James Cameron launched the Social Stock Exchange, featuring a list of publicly-listed companies with strong CSR commitments.

The launch of such an exchange dedicated to impactful companies would be a strong incentive to develop the impact investing market through public financial products. **For now, the allocation gap underlines the adequacy between the private market and impact investing compared to the public market opportunities.**

The asset allocation can also vary widely depending on the stage of business development of the investee. **39% of total AUM (excluding outliers) is invested in mature companies, closely followed by growth stage companies**, which account for 38% of AUM weighted investments. Venture stage is a significant category, which represents 11% of adjusted AUM, whereas seed funding stays behind.

Full sample: n = 163; AUM = USD 81.7 billion
Excluding outliers: n = 159; AUM = USD 39.6 billion



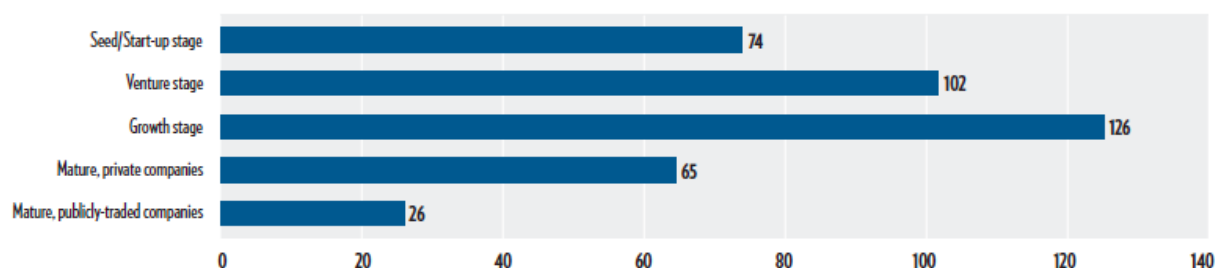
Note: Excludes respondents that allocate exclusively to 'N/A' or did not answer the question.

Source: GIIN

Allocations by stage of business - GIIN Annual Impact Investor Survey (2017)

The spectrum is quite different when we look at the diffusion among investors: growth stage keeps its leading position, with 77% of respondents allocating in the segment, whereas mature companies are part of only 40% of the portfolios. Seed funding, which accounted for only 6% of total AUM, is part of 45% of the portfolios, proving the interest of investors for the matter.

n = 164; excludes respondents that allocate exclusively to 'N/A' or did not answer this question.



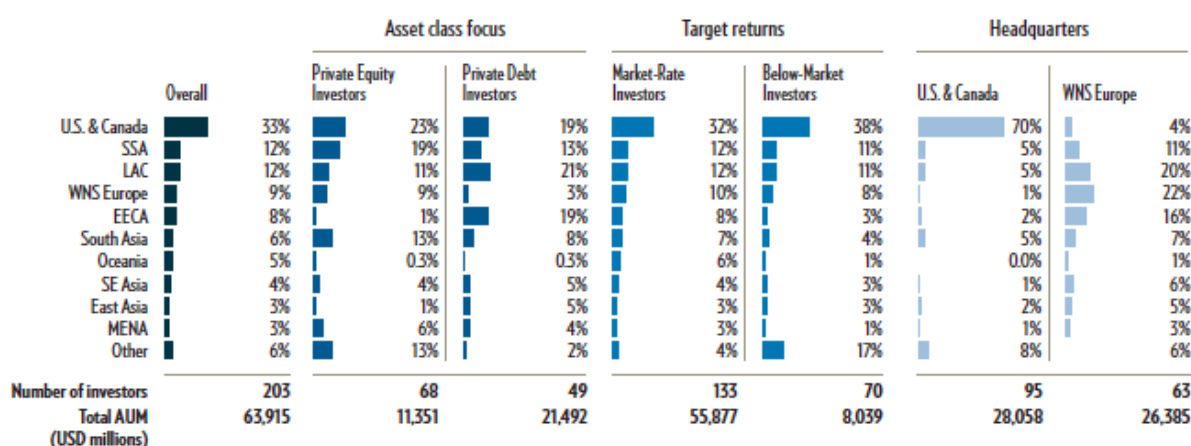
Source: GIIN

Number of respondents with allocations to a stage of business - GIIN Annual Impact Investor Survey (2017)

The impact investing market is clearly driven by private investment instrument, mostly private debt and private equity. Public investment instruments lag behind and don't seem to offer the same opportunities for impact looking investors in the current stage of the market. **Companies at all kinds of development stage attract investors, with growth stage enterprises being the most looked after.** Early stage investments, either in seed or in venture stage, are getting traction even if they cannot match mature companies in term of AUM committed.

3. Geography

Total assets allocated (excluding outliers) is equally divided between developed and emerging countries. Northern America takes a leading position with 33% of total AUM and Western Europe follows with a 9% stake. Emerging countries are not far behind, with Sub-Saharan Africa representing 12% of the AUM, equaled by Latin America and the Caribbean. Eastern Europe, Russia and Central Asia are close, with 8% of total AUM.



Note: Figures exclude five large outlier respondents.
Source: GIIN

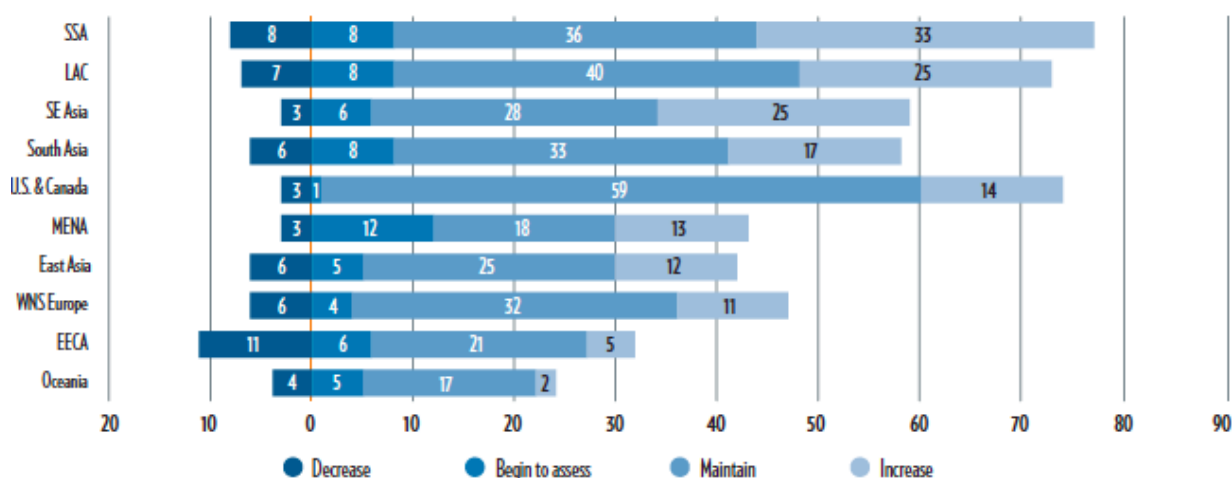
Geographic allocations varied by respondent segments - GIIN Annual Impact Investor Survey (2017)

In term of segmentation by financial instrument, private equity investors tend to be more active in Sub-Saharan Africa and South Asia while private debt investors have a stronger position in Latin America & the Caribbean as well as in Eastern Europe, Russia, and Central Asia.

Investors headquartered in the US or Canada allocate a vast majority of their AUM (70%) in the same region, while those headquartered in Europe tend to have a more diverse geographic footprint with a large positioning in emerging markets. If we compare this graph with the mapping of respondents headquarters it appears that

capital invested in emerging countries mostly comes from developed countries, with little local fundraising.

For the year 2017 most of the investors plan to maintain their geographic allocations. Meanwhile, the strong growth pattern in emerging continues with 33 respondents planning to allocate more capitals to Sub-Saharan Africa, 25 to Latin America and the Caribbean, and 25 to South-East Asia. Only Eastern Europe, Russia, and Central Asia is the region will be substantially disinvested by the respondents.



Planned proportional allocation changes by geography in 2017 - GIIN Annual Impact Investor Survey (2017)

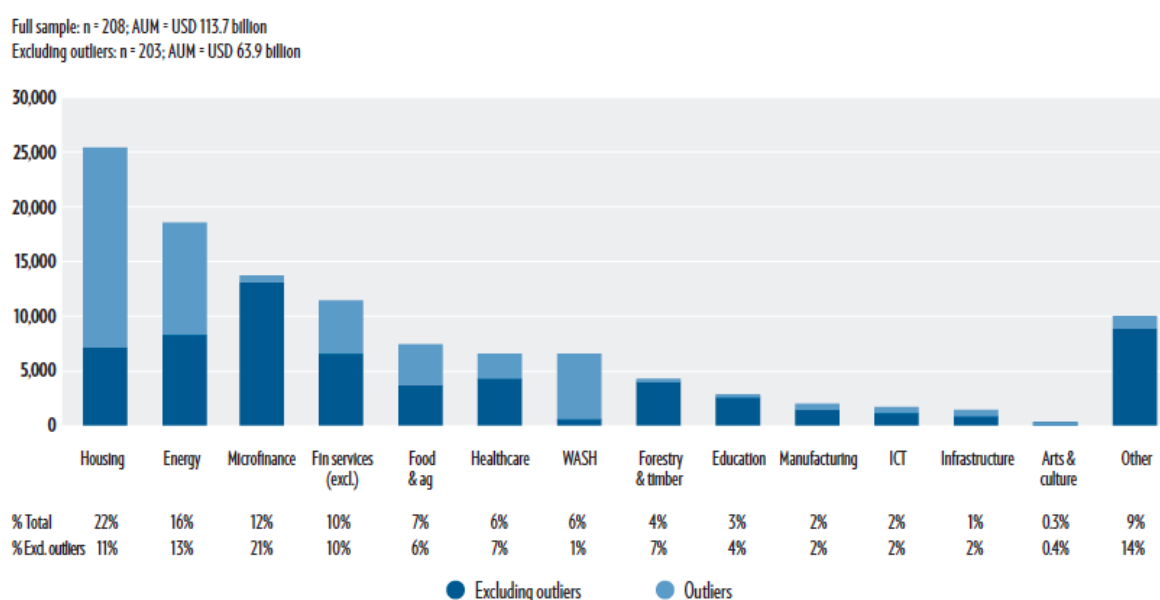
Geographic repartition of investments is equally distributed between developed countries and emerging countries. Developed countries attract investments due to a larger number of opportunities existing across asset classes. Emerging countries offer clear need for social and environmental impact attracting “base of the pyramid” investments looking to reach millions of people in underserved areas (Arosio, 2011).

According to McKinsey in its report “Impact investing finds its place in India” (Pandit and Tamhane, 2017), the impact investments in the subcontinent alone could increase from \$1.1bn today to up to \$8bn in 2025. The authors of the study identified fundraising to be a major challenge that would have to be taken in order to achieve such objectives. **As of now most of the capital is fundraised in developed country, and then partially channeled to fund impact investments in emerging countries. The next step will be to encourage the development of local impact investors based in emerging countries.** In India, the creation of the “Impact Investors Council” is a first step in that direction, but there is still much to be done to create a strong local investment network.

4. Sectors

As explored previously, impact investing can be made by a diversity of actors, through a wide set of financial instruments, in developed or emerging countries. **The sectorial focus of impact investing, however, seems to be concentrated in a few industries.** According to the GIIN, microfinance makes up for 21% of total impact investment AUM (without outliers), followed by energy with 13% and housing with 11%.

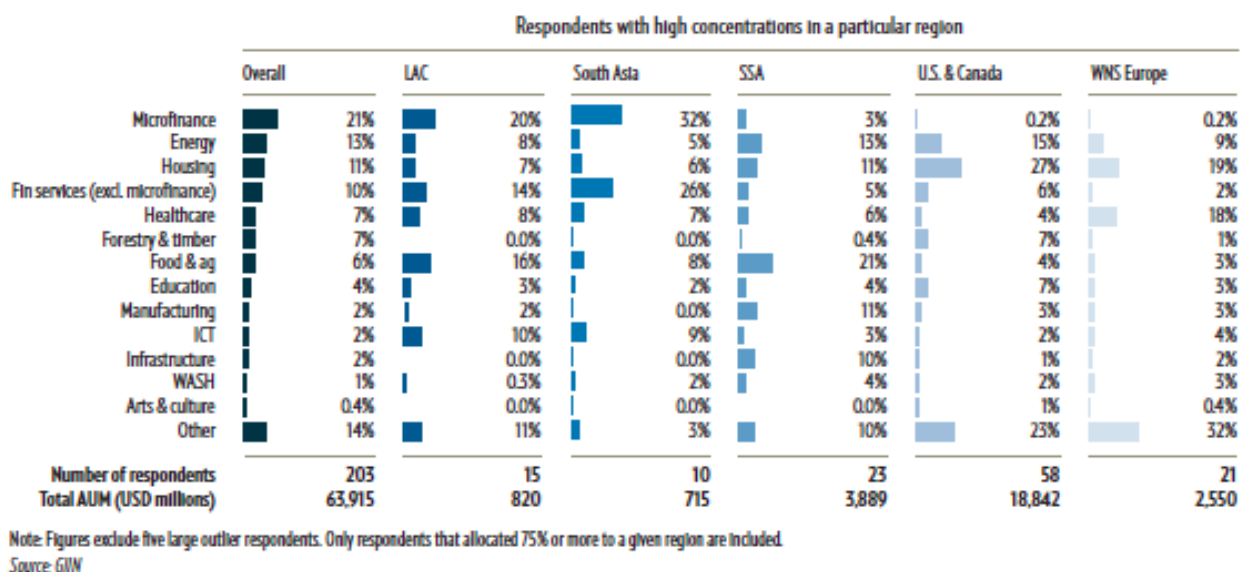
The first four sector invested make up for 55% of total AUM invested. However, other sectors relative to basic needs such as Food or Healthcare, despite their low weight in the AUM, are the most invested in term of number of respondents (respectively 112 and 100 out of 205)



AUM by sector - GIIN Annual Impact Investor Survey (2017)

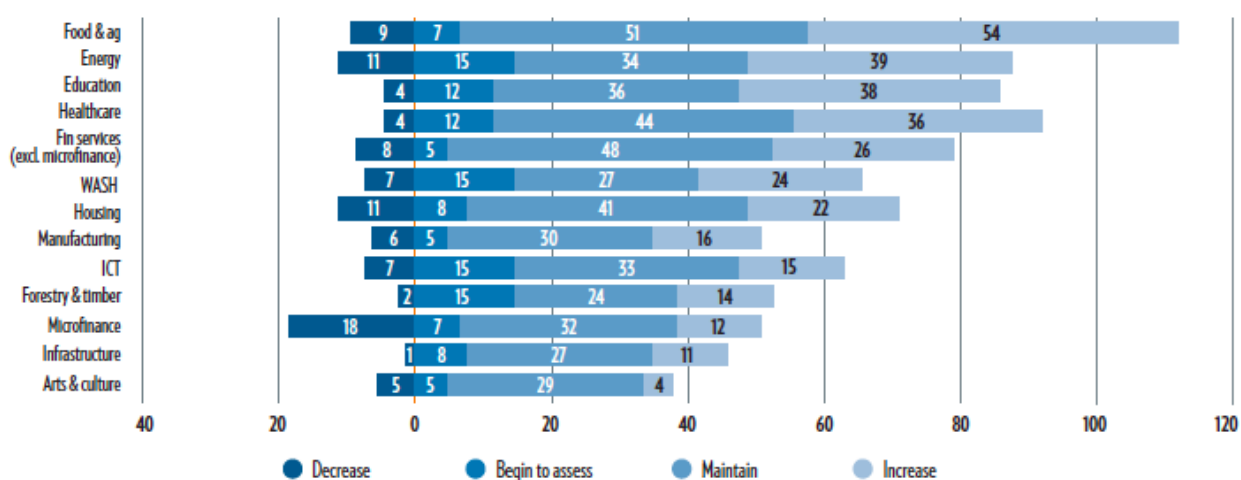
Sector diversification also takes different approaches according to the sub-groups of respondents. Private equity investors have a more diverse exposure to sectors than private debt investors, who commit 42% of their AUM to microfinance.

Then, the geographic distribution of investments is also to be taken into account. The importance of a sector in term of AUM depends on the local needs: emerging countries in South Asia and Latin America drive microfinance investments with respectively 32% and 20% of regional investments targeted to this sector. On the other hand, developed countries of Northern America will have a much stronger weigh into Energy and Housing, which are more adapted to the social and environmental issues of these areas.



Sector allocations among geographically concentrated respondents - GIIN Annual Impact Investor Survey (2017)

For the year 2017 there is a trend towards growing asset allocation in the food sector, as well as in energy, education and healthcare sectors. On the reverse, microfinance is expected to suffer a slight decrease.

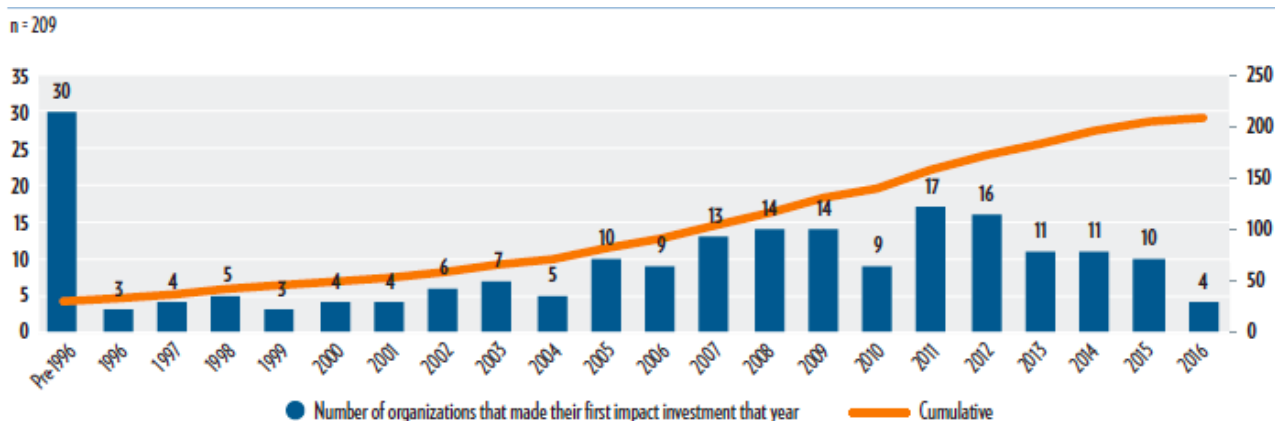


Planned proportional allocation changes by sector in 2017 - GIIN Annual Impact Investor Survey (2017)

iv. Development perspectives

1. A fertile context

If the birth of impact investing cannot be dated with certainty, it makes no doubt that it experiences an exponential development since 2005-2006, with an increasing number of organizations entering the market. There is a set of reasons that explains why the last 10 years could be fertile enough to drive up impact investments.



Year of first impact investment - GIIN Annual Impact Investor Survey (2017)

Major economic and financial crisis

The financial crisis of 2007, and the European debt crisis starting in 2009 shook the traditional beliefs of equilibrium between risks and financial returns.

According to the *Accelerating Impact* report (Rockefeller Foundation, 2012), the situation of disarray created on the market pushed investors to broaden their vision of risk by including non-financial items such as environmental, social and governance (ESG) factors in investment decisions. In the 10 years following the 2007 financial crisis the AUM by signatories of UN PRI jumped from \$10 trillion to about \$70 trillion.

Since 2007, these efforts were accompanied by the GIIN initiatives, which led to the building of a theoretical basis for impact investing.

Urging social and environmental needs

The subprime crisis eventually led to massive social damage such as increased rates of unemployment, spoiled savings and booming wealth inequalities. On the environmental side global warming and industrial pollution are threatening the lives of hundreds of millions. In 2015 the UN launched the SDG, constituted of 17 global goals for social and environmental development including “no poverty”, “reduced inequality” and “climate action”.

At the same time, austerity measures cut the public spending for social projects while official development stagnates according to the OECD. With philanthropy having a limited ability to raise capitals due to its non for profit approach the need for a form of investing blending financial return and impact performance felt blatant.

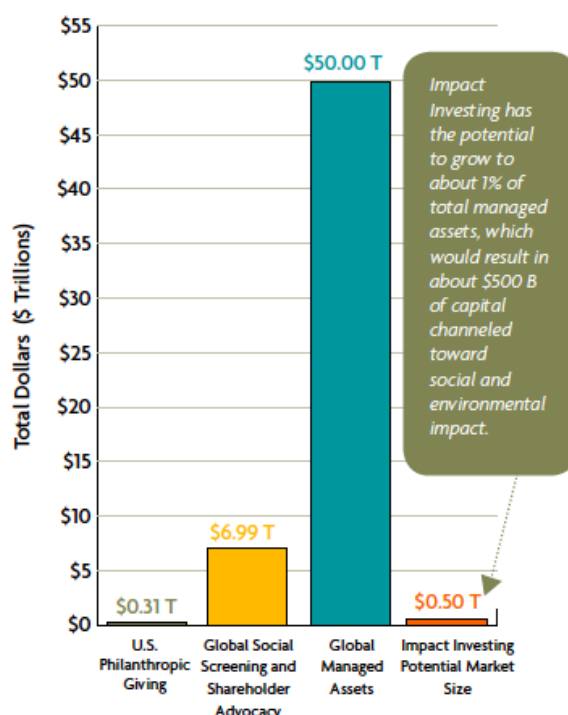
Great wealth transfer

In the next 30 years millennials are going to inherit \$30 trillion from their forefathers, the baby boomers (Accenture, 2012). With 87% of them believing that “the success of a business should be measures in terms of more than just its financial performance” (Deloitte Millennial Survey 2016) the reallocation of assets

towards more socially and environmentally conscious placements is to be expected. Impact investing growth is partially driven by the new ambitions of these younger capital-holders

2. A growing market

As it continues conquering new financial instruments and entering unexplored geographies, there still seem to be much room for impact investing to develop. In 2009 the Monitor Institute issued a report evaluating the potential market size of impact investing at 1% of global managed assets. According to the BCG, global Asset Management represented \$71.4 trillion in 2015 (BCG, 2016), which would represent a \$700 billion potential for impact investing. As a reminder, GIIN 2017 survey respondents managed a total of \$114 billion.



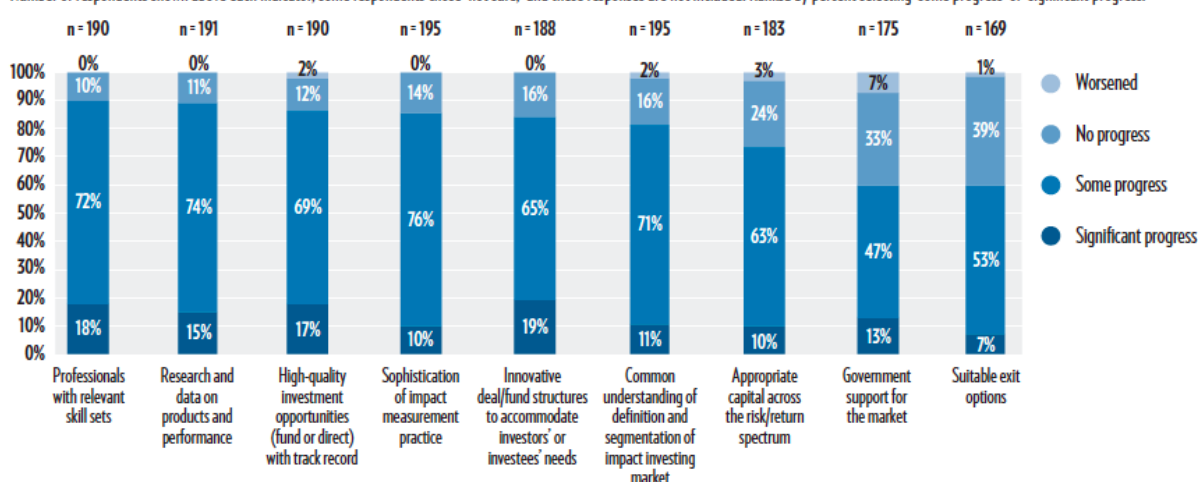
Comparative market sizing – Investing for Social & Environmental Impact, The Monitor Institute (2009)

The 2017 GIIN investor survey observes a **steady growth trend from year 2016 to year 2017 with capital invested increasing by 17% and number of investments by 20%. Most of the respondents plan to increase their capital by at least 5%.**

Beyond the pure financial metrics most investors note substantial ameliorations in indicators of market growth. 89% of investors believe that at least some progress was made in “research and data on products and performance”. Variation among asset classes remain vivid with 25% of private debt investors thinking that significant

progress was accomplished in “high-quality investment opportunities with track record” when private equity investors were only 13% to support the idea.

Number of respondents shown above each indicator; some respondents chose ‘not sure,’ and these responses are not included. Ranked by percent selecting ‘some progress’ or ‘significant progress.’



Progress on indicators of market growth - GIIN Annual Impact Investor Survey (2017)

According to the GIIN investor survey the capital invested for impact will grow more rapidly than the number of deals between 2016 and 2017, resulting in larger deals. This change in the market attracts bigger investors, only looking for deals above a certain threshold.

Recently, big private equity players such as TPG, Bain Capital, or Palatine Capital opened dedicated impact funds. Meanwhile, large insurers such as Zurich or AXA decided to commit a certain percentage of their private equity allocation to impact funds.

3. Limits and constraints

In the GIIN 2017 investors survey, four main factors were identified as limits to the development of impact investing:

Appropriate capital across the risk/return spectrum

The key issue behind lack of appropriate capital is the the fear that investors have of not finding market rate financial returns in impact investing. Also, many of the investors entering the market either focus on seed capital or on large private operations. In the middle are growth equity funds which often find it challenging to raise capital.

It is to be noted that this challenge is strongly linked to the asset class: while private debt investors were 24% to consider lack of appropriate capital as a “very significant challenge”, it was only the case of 14% of private equity investors. This discrepancy can be explained by different fundraising modalities and investment sizes.

Suitable exit options

The question of exit options is linked to the consequences of impact missions on enterprise value. The difficulty for an impact investment fund is to convince non-impact actors that corporate impact strategy can increase financial value on the long term. Finding suitable exit options is a boiling question on which 40% of impact investors have not noticed any progress.

High-quality investment opportunities with track record

Most of impact investment funds were created in the last 10 years and have a limited track record of transactions, with many funds not having exited an investment yet. The readability of the market is low for institutional investors, who find it hard to invest without milestones set. This issue should be solved with the time, and most of investors have already noticed some progress over the past few years.

Common understanding of definition & segmentation of impact investing

The first stone of the impact investing building, often forgotten, is to give a standard definition of the industry, enforced by dedicated organizations. The GIIN scrutinizes the market but does not control the use of the “impact investing” term.

Coming up with a common framework for impact investing will reinforce its credibility in front of traditional investors. To do so, transparency is decisive: impact objectives and impact measurement tools must be accessible for investors to properly assess the impact dimension of a project.

		Severity of challenge		Degree of progress	
		Very significant challenge	Significant challenge	Significant progress	Some progress
		n = 184–201		n = 175–195	
1	Appropriate capital across the risk/return spectrum	17%	35%	10%	63%
2	Suitable exit options	13%	34%	7%	53%
3	High-quality investment opportunities (fund or direct) with track record	11%	31%	17%	69%
4	Common understanding of definition and segmentation of impact investing market	11%	36%	11%	71%
5	Sophistication of impact measurement practice	10%	28%	10%	76%
6	Research and data on products and performance	9%	31%	15%	74%
7	Government support for the market	7%	29%	13%	47%
8	Professionals with relevant skill sets	6%	23%	18%	72%
9	Innovative deal/fund structures to accommodate investors' or investees' needs	6%	27%	19%	65%

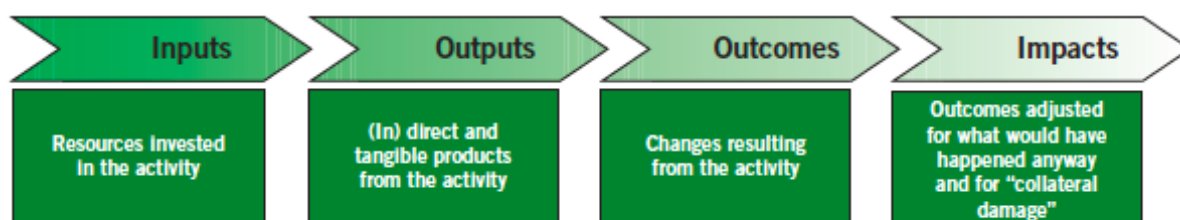
Challenges and progress in the growth of the impact investing industry - GIIN Annual Impact Investor Survey (2017)

b. Measuring the impact

Defining the impact and establishing impact measurement tools is determinant for impact investing as it increases the credibility of the industry towards investors. For funds to combine financial and impact objectives, they have to evaluate both targets according to the same high-level standards. Financial measurement methods are already much developed, but impact measurement methods are still unknown from many investors.

i. Defining impact

Grabenwarter and Lichtenstein (2011) identified four components of the impact investing value chain. According to the authors, investors often confuse impact with outputs or outcomes. Outputs are the direct products or services created by an investment (the “inputs”), and they can have a positive or negative effect on society or environment. This effect is materialized in specific “outcomes”, which are actual changes induced by the creation of outputs. Finally, impacts design the marginal positive outcomes created by the investment, on top of what would have happened if the investment would not have been made. Impacts also have to take into account “collateral damage” of the investment: maybe the activity created had negative outcomes for other social and environmental aspects.



Source: Authors, inspired by SROI Primer, Foundation of SROI, 2004.

Impact investing value chain - In Search of Gamma, An Unconventional Perspective on Impact Investing, IESE Business School (2011)

The International Association for Impact Assessment (IAIA) confirms this definition: **“the impact is the difference between what would happen with the action and what would happen without it”** (IAIA, 2009). According to Vanclay (2003), the impact can be conceptualized as a change of:

- **People’s way of life** – life, work, play, interactions
- **Culture** – shared beliefs, customs, language...
- **Community** – stability, cohesion, services
- **Political systems** – popular participation to collective decision making process, democratization

- **Environment** – quality of air and water, availability and quality of food, sanitation, physical safety, control of natural resources
- **Health and wellbeing** – diseases prevalence, mental, social and spiritual wellbeing
- **Personal and property rights** – economic disadvantages, civil liberties
- **Fears and aspirations** – fears and hope about the future of the community

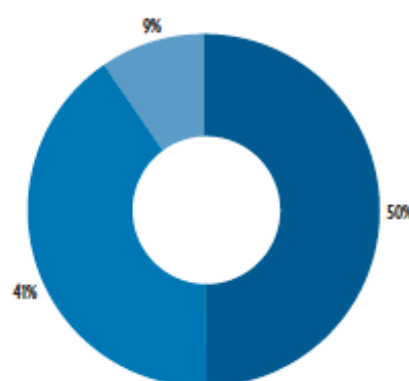
ii. Impact strategies

According to the GIIN report, the impact potential of fund managers is considered a very important feature by 71% of investors. Measuring and targeting the impact is not a contextual accomplishment, but rather a key part of an impact investing strategy. The two largest categories of impact are social and environmental objectives. Half of all respondents target both categories, while 41% target exclusively social objectives.

n = 209

- 50% Both
- 41% Social
- 9% Environmental

Source: GIIN



Primary impact objectives - GIIN Annual Impact Investor Survey (2017)

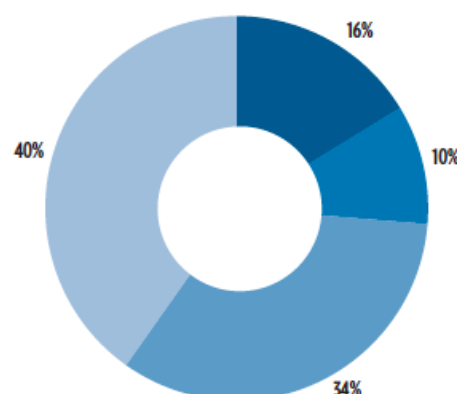
The impact target also depends on the strategic positioning of the investor. Below market rate investors are 61% to focus mostly on social impact, when it is the case for only 30% of market rate investors. On the other side, environmental impact is a priority for 19% of developed market investors but only by 1% of emerging market investors.

At the same time, a growing number of respondents is measuring their performance towards the Sustainable Development Goals (SDGs), adopted by the UN in 2015. Among respondents, 26% were keeping track of SDGs performance for at least a part of their investments, and 34% planned to implement such tracking measures in the future. This dynamic is more important in the sub-group of emerging market focused investors, of which 75% already had such instruments in place or in development.

n = 209

- 16% Yes, for all of our investments
- 10% Yes, for some of our investments
- 34% No, though we plan to do so in the near future
- 40% No, and we don't have any foreseeable plans to do so

Source: GIIN



Types of evidence sought through impact measurement - GIIN Annual Impact Investor Survey (2017)

iii. Measurement tools

Measuring the impact is essential to answer the demands of the different counterparts of an impact investment. Investor may want to quantify the impact created by capital committed, and Fund managers can be interested in comparing their impact performance to others, or compare it in the time. The impact measurement techniques used are integral part of the investment strategies deployed by investors.

Impact investing organizations defined their own sets of criteria for impact evaluation:

- **Impact Reporting and Investment Strategy (IRIS) – GIIN:**

It is a catalogue of performance metrics used by impact investors to evaluate social and environmental successes. Funds using IRIS can select a set of metrics adapted to their business. The use of IRIS principles is free of charge, although IRIS use is not a guarantee of impact.

- **B impact assessment (BIA) and Global Impact Investing Rating System (GIIRS) – B Analytics:**

The B impact assessment is an online tool that can be used to assess the impact of a business on all its stakeholders. The service is free to use and made available by the B Lab organization. The BIA employs IRIS metrics with additional measurement criteria. A company or a fund who undertook the BIA can use the GIIRS to rate the quality of its impact.

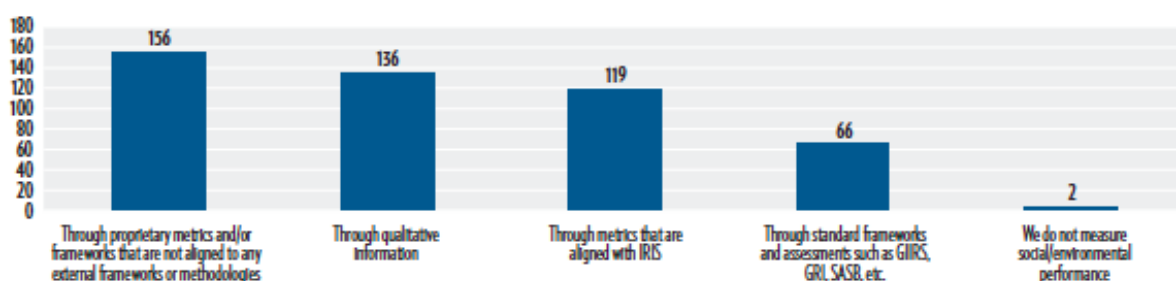
- **Social Return on Investment (SROI) – Social Value UK:**

The SROI uses a mix of qualitative, quantitative and financial information about a fund or a company to create an indicator of impact. Different from the

first two methods, the SROI monetizes the impact created. The idea is to value financially elements that cannot traditionally be accounted for in monetary terms.

According to the GIIN survey, 75% of respondents use “proprietary metrics or frameworks” in the measurement of social and environmental performance of their investments. At the same time, 57% of respondents used “metrics that are aligned with IRIS”, showing interest of the investors for pre-defined impact performance metrics. Finally, 32% of the sample used standard frameworks such as GIIRS. Overall, **it is common for investors to mix proprietary measurement methods with exterior techniques and standards, in order to fit their specific investment goals.**

n = 209; respondents could select multiple options. Number of respondents selecting each option shown above each bar.



Note: Respondents that said they do not measure their social/environmental performance noted that they invest in companies whose impact is embedded in their products and services.

How social/environmental performance is measured - GIIN Annual Impact Investor Survey (2017)

In a 2015 study, So and Staskevicius identified 4 main objectives of impact measurement:

- 1 - **Estimating impact** (pre investment due diligence)
- 2 - **Planning impact** (using live data collection methods to conduct impact strategies)
- 3 - **Monitoring impact** (measuring impact compared to objectives)
- 4 - **Evaluating impact** (assessing post-investment impact creation)

This “continuous cycle of measurement objectives” is completed by 4 categories of impact measurement methods:

- **Expected return:** comparing the social benefits of an impact strategy against the cost of not having them. SROI is a typical expected return measurement tool.
- **Theory of change and logic model:** creating a roadmap from initial investment to final impact along the holding period.

- **Mission alignment methods:** comparing the impact results of a strategy with the initial impact targets fixed at the moment of the investment.
- **Experimental & Quasi experimental methods:** after-the-fact evaluations to assess the impact of the investment versus status quo.



Map of measurement methodologies to measurement objectives - Measuring the “impact” in impact investing”, Harvard Business School Thesis (2015)

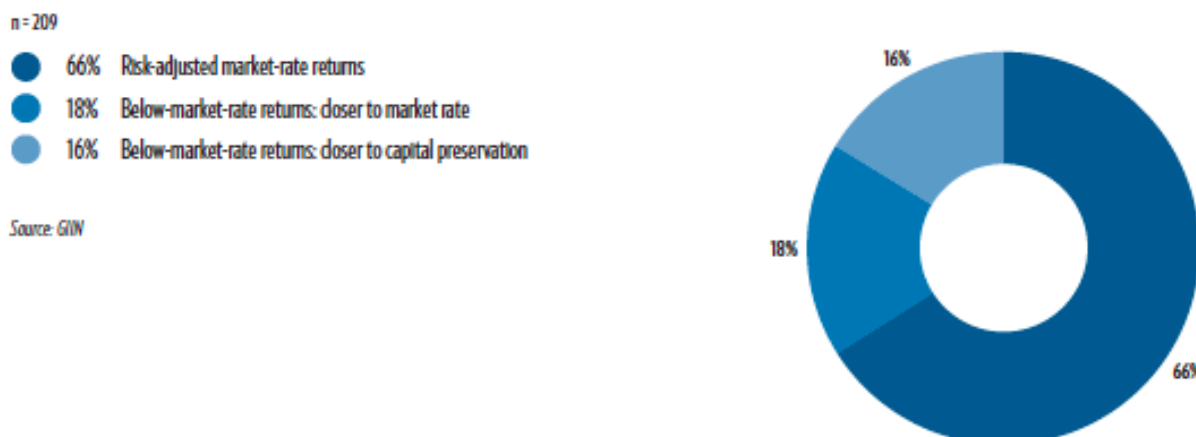
Impact measurement remains confronted to several challenges. Most importantly, the **measurement methods are highly fragmented and lack standardization**. Current catalogues of metrics such as IRIS or BIA would need to be reinforced in order to be used by a larger number of investors. **This responsibility is to be shared by investment funds, which lack measurement capacity**. Impact assessment is often conducted by investment teams, and ends up being reduced to an initial impact due diligence process, with little follow-up.

c. Profitability and risk profile of Impact investments

A number of investors stay out of the impact investing industry because they think having an impact implies sacrificing financial returns. Despite the little historical data available on the subject, **the few impact investment exits that were studied show no trade-off between impact and financial performance**.

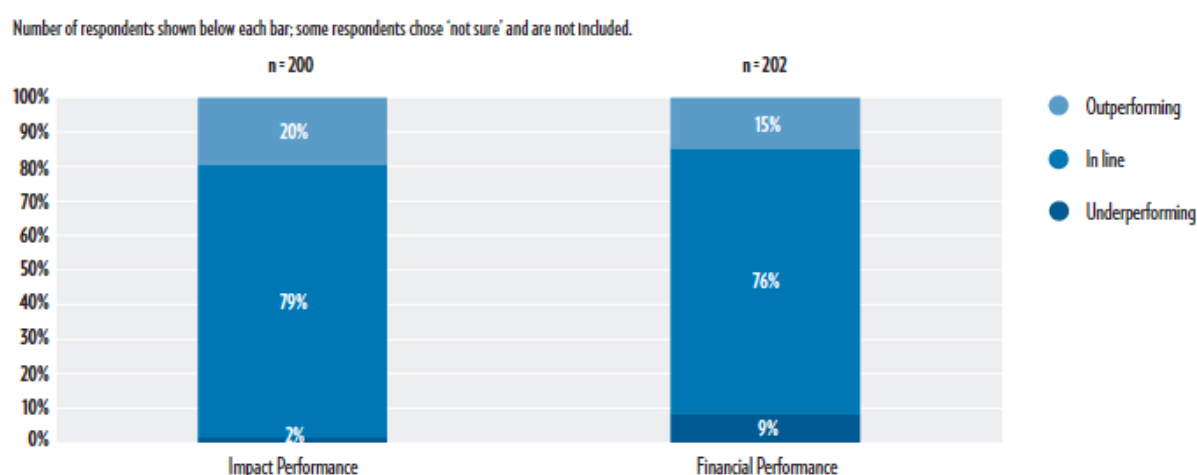
i. Financial returns of impact investments

The distinction made by fi can be refined by accounting for the financial target. In the GIIN 2017 survey, 66% of the panel declare looking for risk-adjusted market-rate returns, while only 16% target returns close to capital preservation. This diversity of financial targets is the consequence of different investment philosophies, and does not support the existence of a trade-off between impact and profit.



Target financial returns principally sought by percentage of respondents - GIIN Annual Impact Investor Survey (2017)

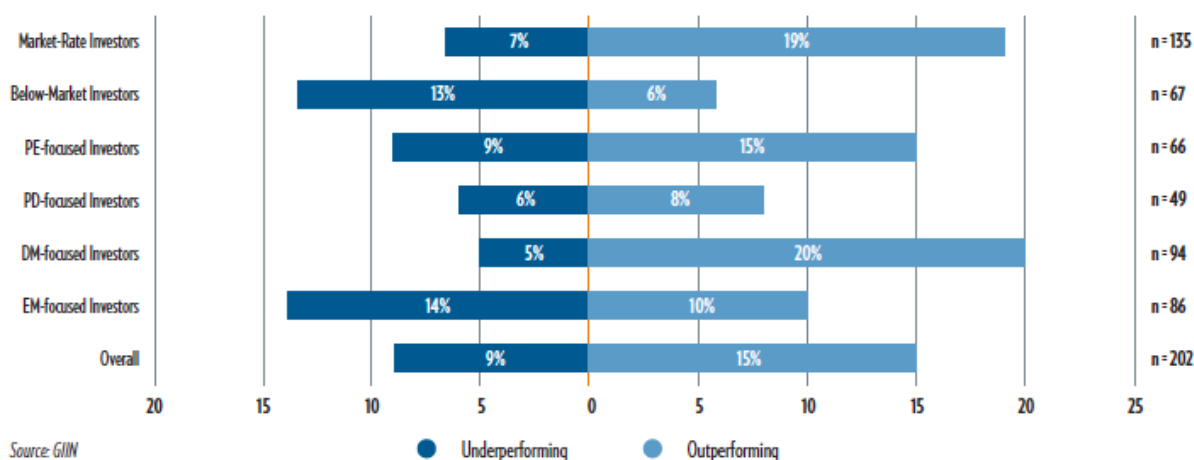
Of all respondents, 91% have either met their financial performance targets or exceeded them. With 66% of the sampled funds looking for risk-adjusted market-rate returns, the study challenges the idea of an arbitrage between impact performance and financial performance.



Performance relative to expectations - GIIN Annual Impact Investor Survey (2017)

The survey outlines some variations between different sub-segments of the sample in regard to financial results. In particular, market-rate investors were more likely to outperform their financial targets, as 19% of them did, compared to only 6% of below-market rate investors. The same disparity is noticeable for underperforming

funds, with 7% of market-rate investors missing their targets compared to 13% of below market-rate investors.

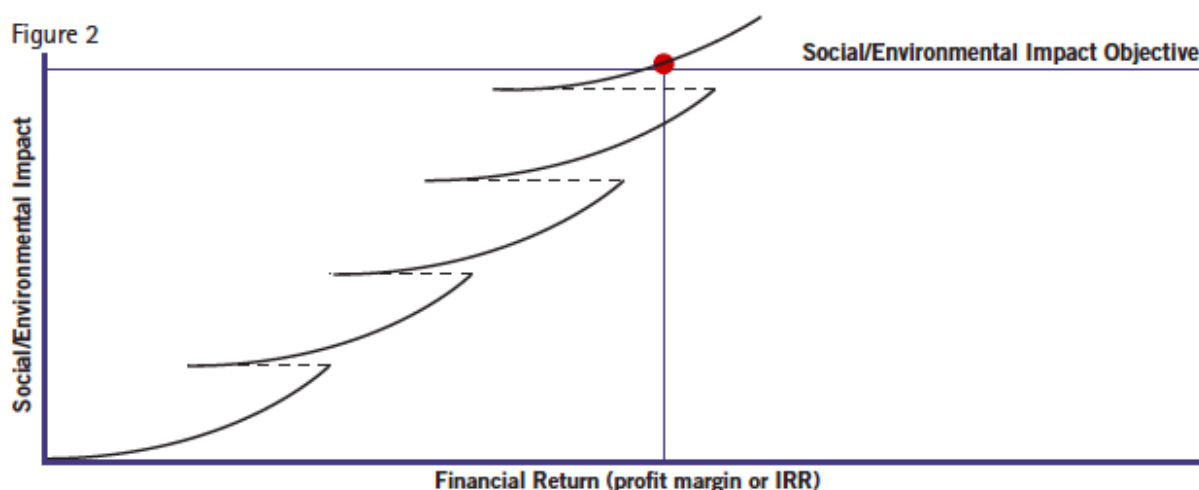


Financial performance relative to expectations by target returns sought, asset class focus, and geography of investment - GIIN Annual Impact Investor Survey (2017)

At this point, there is no evidence that seeking a positive social or environmental translates into a loss of financial return.

ii. Correlation between social impact and financial return

According to Grabenwarter and Liechtenstein (2011), a positive correlation can be identified between impact and financial return. In this model, there is an equilibrium to be found between a certain level of social and environmental impact and a certain level of financial performance. The authors drew a graph accounting for the fixed costs jumps needed to achieve impact objectives, reflecting a similar shape than the traditional graph between profitability and industrial production.



Positive correlation between financial return and social and environmental impact - In Search of Gamma, An Unconventional Perspective on Impact Investing, IESE Business School (2011)

The existence of such a positive correlation invalidates the theory of a trade-off between impact and financial return, as it proves the possibility of a balanced equilibrium. As stated by Neil Gregory in his research “De-risking Impact investing” (2016):

“Impact investments are neither necessarily worse or better bets than other investments; rather, the impact investing approach involves selecting assets and structuring investments differently to realize their potential to deliver both financial and social returns”

d. Private equity and impact investing

The impact investing market is driven by a spectacular diversity of objectives, in a wide array of geographies, through a great number of financial products. In the meantime, according to the GIIN, **more than 90% of impact investments are funded with private capitals.**

Among all financial actors, private equity takes the second rank of impact investing vehicles in value, behind private debt, but it is the most common financial product used among investment funds. In the GIIN 2017 Investors survey, 159 of the 209 responded declared investing in private equity products. Because of the special characteristics of private equity investing, it tends to be considered as the most suited product to promote impact investing.

i. What is private equity

1. Definition

Private equity is an asset class regrouping equity investments in private companies. Contrary to public equity, private equity participations cannot be traded on the financial markets, but are owned by specialized private equity investors. These investors, most often **private equity firms**, launch **private equity funds** to raise equity.

A private equity fund is usually defined as a partnership between two players: a private equity firm (**general partner**, GP), which manages the investment process, and a private equity investor (**limited partner**, LP), which invests the equity into the fund. LPs are most often institutional investors such as banks, pension funds,

insurance companies, or even foundations. These players are looking to diversify their positions with a potentially riskier, but also more profitable, placement.

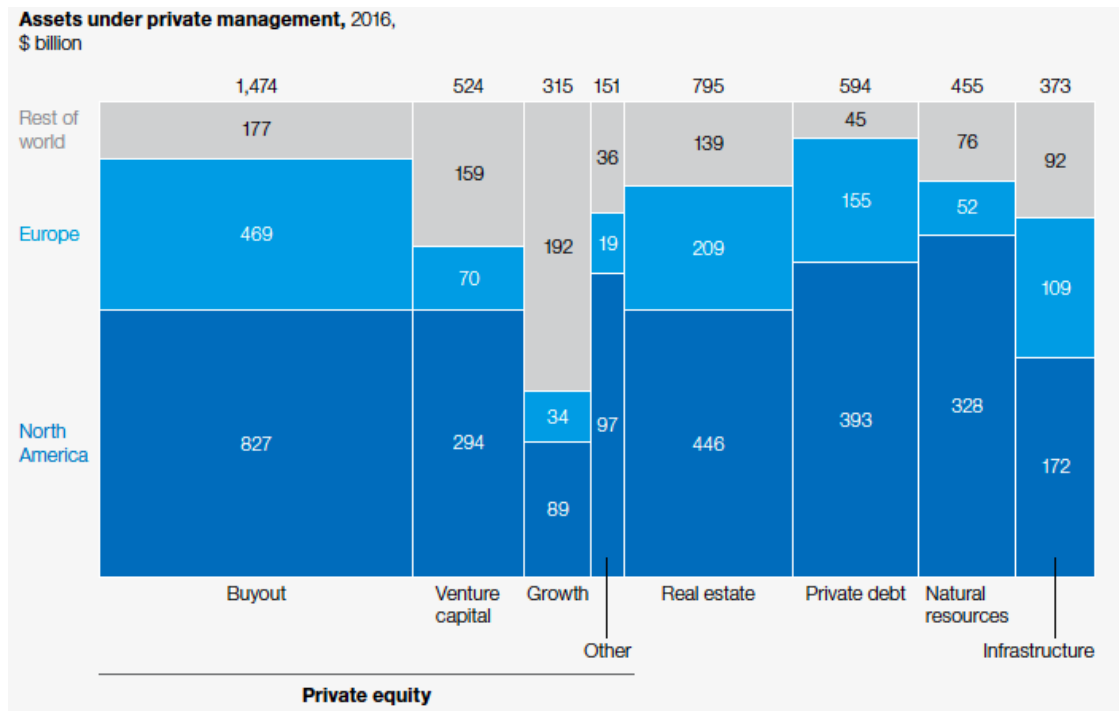
According to Kaplan and Strömberg (2009), a fund traditionally has a lifespan of 10 years. In the first 5 years, the equity has to be invested in companies; in the following 5 years (up to 8 in case the fund is extended), the equity has to be returned to LPs. When the investment cycle is completed, companies are sold to other investors, financial or industrial, or offered on the public markets through an initial public offering (IPO).

After the exit, the most common tool to measure the profitability of a private equity investment fund is the internal rate of return (IRR), which is the annualized return rate compounded from the ratio of exit equity over invested equity. If this IRR is superior to a certain level fixed in the partnership (the hurdle rate), the GPs receive a part of the profit (the carried interest).

Private equity apparition in its current form can be dated to the 1970s in the US, with the notable development of leverage buyout funds like KKR. **According to the specialized financial data publisher Preqin, the private equity industry represented \$2.49 trillion in June 2016, up from \$1.16 trillion in 2006.** This growth is expected to continue into 2017 as there is more capital available for private equity investments.

2. Private equity segments

The different forms of private equity correspond to different phases of a company development. The most common forms of private equity investments are **venture capital**, for investments in start-ups, **growth capital**, for minority investments in profitable companies, and **buyouts**, for majority investments in more mature companies requiring larger amounts of capital.



Assets under management in private markets now total \$4.7 trillion – A routinely exceptional year, McKinsey & Company (2017)

Venture Capital

Investments in young and innovative companies, mostly in the tech, information, or environmental sectors, often non-profitable at the beginning. The investors take the bet with the expectation that the investee will grow exponentially by disrupting the industry it operates in. Usually, various investors will be present at a fundraising round.

Growth capital

Growth capital is a newly developed segment of private equity. In comparison to venture capital it targets small or medium sized companies with stable cash flows that are profitable. Usually, growth capital involves minority investments, as the company owners wish to remain in control of the development strategy. Growth equity can be used by a company as a tool to decrease its financial leverage.

Leverage buyouts

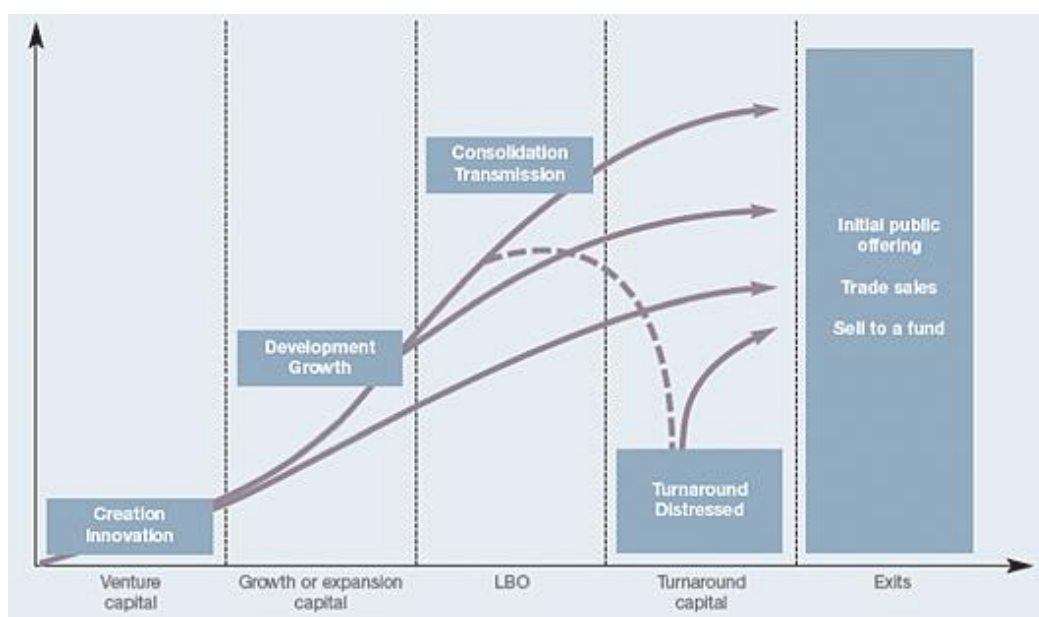
Buyout funds invest in larger companies in any sector of the economy. The investees are traditionally profitable companies with financial needs to expand their market presence. The investments are made using financial leverage to boost profit returns. Typically, a buyout fund would take the control of the company.

In a leverage buyout, the investment firm uses debt to leverage its investments. The private equity fund, also called “sponsor”, brings a proportionally limited amount of capital compared to the amount of the transaction, and finances the rest of the acquisition with borrowed money.

Once the acquisition realized, the private equity fund uses the company’s free cash flows to repay the debt payments. During its period of ownership, it uses its influence on the corporate strategy to increase the enterprise value, by making add-on acquisitions or by increasing cash flows.

After a few years, usually 3 to 8 for traditional private equity funds, the invested company is sold to an acquirer, which can be another private equity fund or an industrial acquirer. In certain cases, the company can be made public through an IPO.

Ideally, most of the debt used for the acquisition would have been paid back over the course of the investment and the earnings of the acquisition can be collected by the private equity fund. In successful scenarios, a private equity fund can expect to triple or quadruple the equity invested in a matter of years, offering strong returns to its LPs.



Private Equity and the life cycle of a business – Société Générale Private Banking

ii. Private equity investment cycle

The life of an investment fund is divided in four main phases. First, the general partners (fund managers) have to raise the capital from limited partners (investors). Then, they explore the market and target possible investees. After the investment,

the invested companies have to be managed to increase enterprise value. Finally, once the investment roadmap is completed, or when the GPs are satisfied with the performance of an investee, they sell it. If the investment is successful, the profits are shared between GPs and LPs.

1. Fundraising

In 2013, Anderson, a CFA at the consultancy firm Beekman Wealth Advisory described the fundraising process for a private equity firm.

Producing Marketing documents

First, GPs produce a “**Private Placement Memorandum**” (PPM), which sums up the investment strategy of the fund, the track record of the GPs, and the legal terms of the fund. The PPM is the main marketing tool of a private equity firm, and it should present its best performances to arouse the interest of investors.

Soliciting Capital Commitments

Then, with these documents prepared, GPs will solicit capital commitments from prospective investors. It can take months for the GPs to find LPs for a fund, especially when it is the first fund launched by the private equity firm. Usually, the GPs announces a fundraising target under which it would not launch the fund.

Closing of the fund

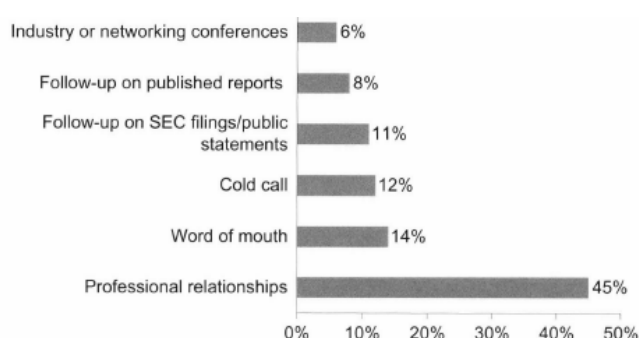
The legal establishment of the private equity fund happens at the moment of the closing. There can be several closings, typically the GPs would close a first fund once the fundraising target is reached, and another one in case more investors are interested. At the closing, LPs sign the “Subscription Agreement”, a legal commitment to make available up to a certain amount for GPs to invest. They also sign the “Limited Partnership Agreement”, which establishes the global terms of the private equity fund.

2. Investment period

The first cycle of a private equity fund after its closing are referred to as “the investment period” and can last up to 5 years. If any investment is made and exited before the end of this period, the proceeds are commonly reinvested into the fund instead of returned to the LPs.

Pipeline

The GPs usually screen a large number of companies before finding one company that they are willing to invest in. According to Teten and Farmer (2010), on average, out of 80 opportunities reviewed, one will lead to an investment. The length and efficiency of this process largely depends on the ability of the firm to build a strong pipeline. According to the Deal & Merrill DataSite, professional relationships constitute the most used channel to identify investment opportunities. Market vigilance is a close follower, if we include cold calling and following up on public statements and published reports.



What is the most important process your company's internal (deal-sourcing) group uses to locate possible deals? – The Deal & Merrill DataSite (2010)

Beyond the size of the investment pipeline, it matters to know more about its nature. In Mergers & Acquisitions August 2012 edition, Trivest partner Jamie Elias was quoted claiming that “firm-wide, we have a saying: go find a deal before it finds you”. It is much more interesting for GPs to source proprietary deals, through close relationships with industry participants, than to participate in selling auctions organized by investment banks. If multiple funds are competing on an acquisition opportunity, it will drive the prices up and bridle eventual profits.

Due diligence

When the pipeline is sized-down to a few investment opportunities, and after meetings were conducted with the management of every one of them, the last step before investing equity in the company is to launch a due diligence process. The objective is to assess the relevance of the investment compared to the fund investment thesis. Due diligence explores various aspects of the potential investee: commercial, operational, financial and legal characteristics of the target are analyzed. Recently, under the influence of SRI, more environmental due diligences are conducted, principally to identify risks of industrial contamination.

A proper due diligence process is crucial to determine the investment potential of a company. Cumming and Zumbelli work (2017) show a clear-cut link between time

and resources allocated to due diligence and future performance of investees. Their paper outlines that due diligence has a more pronounced impact on performance when it is conducted internally (by the private equity investment teams), rather than by external consultants. Now that an increasing number of investments are made in emerging countries, with uncertain norms and codes of conduct, due diligence gained an accrued importance in the private equity industry.

Capital calls

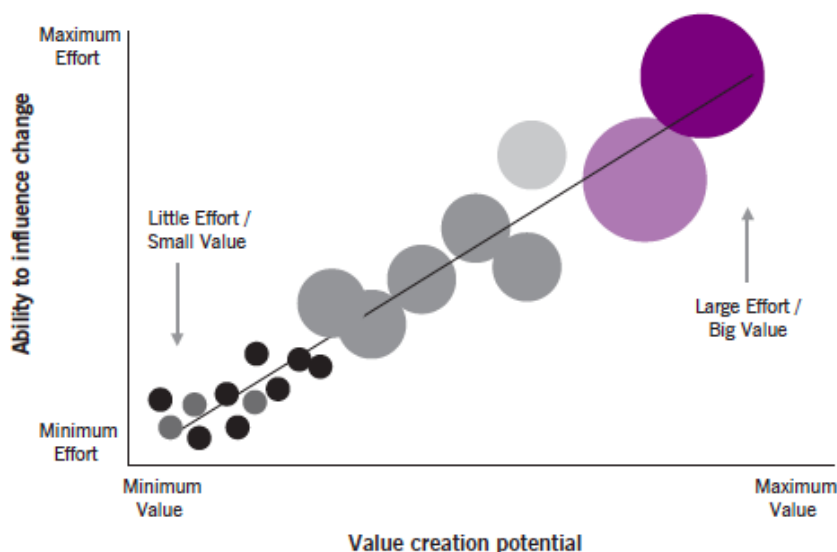
Once GPs have decided to invest in a company they can release “capital calls”, asking for LPs to make available a portion of the committed capital. Usually, these calls are made one week or more before the money is needed, so the LPs can proceed the orders to their banks and the GPs can better secure the financing of a deal. The specifics of a capital call, also named “drawdown”, are detailed in the Limited Partnership Agreement signed at the moment of the closing.

3. Holding period

Once an investment is realized the fund enters in the “holding period”, usually lasting 3 to 8 years, during which it intends to increase company’s value in order to maximize the return at the moment of the exit.

Operational improvement

Increasing enterprise value comes down to maximizing free cash flows. Standard financial engineering usually leads to increasing sales, maximizing EBITDA and reducing financing costs. Beyond that, and at the difference of other investments, private equity investors can have a strong influence on the management of the company, linked to their board membership. According to Matthews, Bye, and Howland (2009), operational improvement is the key driver of value creation in a private equity investment. For them, the ability of GPs to influence change in the company’s corporate strategy is determinant.



Potential value creation against ability to influence change – *Operational improvement: the key to value creation in private equity, Journal of Applied Corporate Finance • Volume 21 Number 3, Morgan Stanley, 2009*)

The difficulty behind operational improvement is to identify which initiatives have the best enterprise value creation potential compared to the amount of involvement requirement from the GPs to implement them. According to Matthews, the best strategic option is to combine large-scale projects, adding substantial value, with smaller ones that will not be as profitable but will help building on the relationship between GPs and top management. If successful, such integrated operational improvement strategies can constitute a decisive edge for private equity investments over other financial instruments.

Activity spectrum and buildups

In order to optimize the investee structure, GPs can decide to keep only core activities and sell parts of the business that are considered non strategic. If the business is more focused its readability will increase and so will its valuation.

Another way to create value during the holding period is to develop the investee through external growth operations. The investee itself finances these operations, and acquired companies are merged with its own activities. This building process helps reaching a critical size in a market and creating synergies by splitting redundant costs. Build up can also weight on the valuation multiples of the investee, if they are operating in a slightly different industry.

4. Harvesting period

Once GPs complete their investment objectives or reach a satisfying financial performance they can decide to enter an exiting process.

Exit

Because a successful exit has a critical impact on the return of the fund, exit possibilities are considered even before the deal is made. During the holding phase, GPs are always on the watch for potential buyers, and try to evaluate the most relevant scenarios. Exit opportunities differ according to the size of the company, its sector or its geographic footprint, but we can identify three main types of exit options.

Trade sale: the investee is sold to a corporate player having interests or operating in the same industry. This method leads to significant returns as industrial buyers are willing to pay a premium for the synergies created by the acquisition.

Secondary buyout: the company is sold to another private equity fund. This option is adequate for companies that present significant guarantees for private equity investors (strong and stable cash flows, assets that can be used as collateral). It is also the preferred route for early exit scenarios, in which case another private equity would refinance the buyout. Secondary buyout does not optimize the exit value but is to be considered as a quick and practical option.

IPO: For mature companies with enough scale to attract public investors, IPO can be an option. When market conditions are favorable, floating a company can be the most profitable exit strategy for a private equity investment fund. But IPO remains eligible for few investment cases, and represent a lengthy and risky process for the funds.

Distribution waterfall

Finally, once the PE fund exits an investment, the capital gains are distributed between GPs and LPs. The model is usually built to incentivize GPs to maximize the IRR. The LPs get their capital back, plus the hurdle rate, a guaranteed return that was decided upon in the limited partnership. If the hurdle rate is exceeded by the IRR, the capital gains are distributed between LPs and GPs. GPs would retain a certain percentage of the gains, the carried interest (commonly, 20%), while the LPs would keep the rest.

iii. The complementarity of impact investing and private equity

The financial crisis of 2007 was also a moral one. Confronted to raising economic and social issues, some investors started questioning the relevance of the historical equilibrium between risk and financial returns. **The integration of socially responsible principles of investments soon started gaining traction in the investment community.**

Already in 2007 data retrieved by Cumming and Johan showed increased appeal of institutional investors for responsible private equity investments. In February 2009, the United States Private Equity Council first adopted guidelines for responsible investment, based on the UN PRI. The at the time president of the council, Douglas Lowenstein, was quoted saying that ***“Private equity is all about investing for growth and maximizing returns to our investors. To accomplish that today requires considering a range of environmental, governance, human capital, and social issues”***.

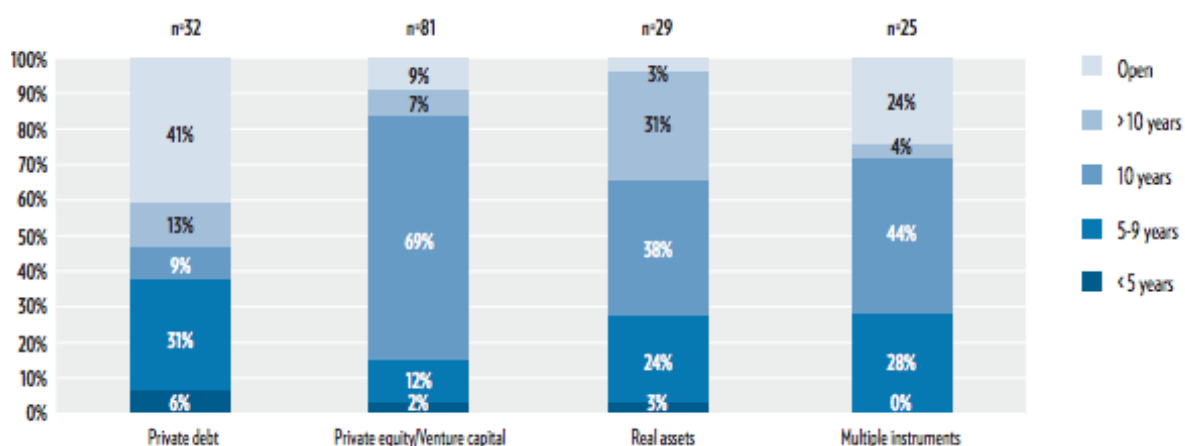
Private equity has been a motor of the development of socially responsible investments, proving that it is well suited to carry extra financial objectives. **Today, a list of features of private equity investment shows its strong affinity with impact investing.**

Long term investment perspectives

In 2016 Bill Gates launched the Breakthrough Energy Ventures fund, with the support and financial commitment of other founders of tech companies. The impact fund has the objective of funding innovative projects in the energy sector to lower energy prices and fight global warming. The fund is announced to have a lifespan of 15 to 20 years, making it a “patient capital” investment fund. This project shows that impact investing requires a long timeframe to be ideally effective.

Such a long term vision is not common with many financial products, in public equities for example, an investor can sell his shares in the instant. Traditional Private equity investors usually commit capital for more than 5 years, and sometimes more than 10 years.

The GIIN compared the impact investment fund term by the asset class they invest in. Of the private equity respondents investing in impact investing, 69% have a lifespan of 10 years, and 7% have a lifespan superior to 10 years. Only 14% declared raising funds for less than 10 years, with the last 9% not having any defined term. In this matter, private equity investments are only outreached by real assets, most of them being infrastructure development projects. As a comparison, only 22% of private debt respondents have durations equal or superior to 10 years, and 41% of them don't have a defined lifespan.



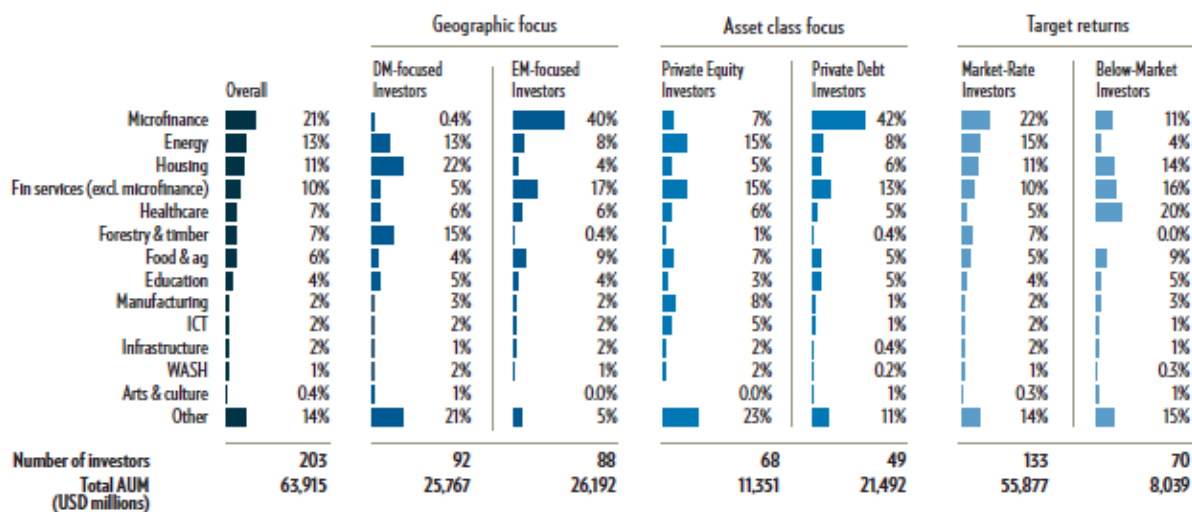
Fund Term by Asset Class - GIIN Annual Impact Investor Survey (2016)

Impact objectives can only be defined on the long term, giving the time to adapt corporate development strategies to dedicated social and environmental practices. Among asset classes, private equity can be considered as a most adequate product to honor this long term commitment.

Diversity of the investment spectrum

The American impact fund Leapfrog Invest principally targets microfinance initiatives in emerging countries. Meanwhile, Goldman Sachs Urban Investment Group focuses on real estate projects in underserved American communities. Finally, the Ecosystem Integrity Fund invests capital in firms contributing to environmental sustainability. All these funds, and many more, are part of the spectrum of private equity impact investors.

Because impact is a broad definition, impact investing comes across very different sectors. As a polyvalent investment vehicle, private equity offers the flexibility that impact investing requires to invest in a wide array of industries. In its 2017 investors survey, the GIIN highlighted this very special feature of private equity.



Sector allocations by various segments - GIIN Annual Impact Investor Survey (2017)

For private equity respondents, the most invested categories were “Energy” and “Financial services (excluding microfinance)”, topping at 15% of investments. Among the other 12 categories, 7 received 5% or more of investments. In comparison, private debt investors committed a whopping 41% in Microfinance, followed with a 13% commitment to financial services. **Between asset classes, private equity investors were more likely to invest in diverse industries than private debt investors.**

Direct influence on the operations of the companies invested

Whether they take a minority or a majority stake in companies, private equity funds can leverage on their close relationship with management. At the difference of private debt investors, they invest in a company with a vision for its development. As shareholders of the investee, they use their board membership to weight on the corporate strategy.

Reaching Impact objectives requires a solid capability to implement new measures in the company business. Such influence is hardly reach for non-equity holders. According to Crifo and Forget (2013) private equity firms have a stronger impact than public investors on the implementation of socially responsible practices in companies, given their stronger level of advocacy. Public shareholders can influence managers by selling their shares, while private equity shareholders can get involved directly in the management of the investee.

Private equity investors, given their position, are more likely to be able to encourage the development of impact creating activities in the invested company.

Private Equity best practices favor impact investors

Following the 2007 financial crisis, the Institutional Limited Partner Association (ILPA) introduced the ILPA principles, listing best practices in the relationship between the limited partners and the private equity funds. **These principles established new standards in funds governance and information-sharing conditions, and offered advantageous backup to investors in their negotiations with private equity fund managers.**

According to the report published by Clifford Chance in partnership with the GIIN, “Impact Investing Private Equity Fund Industry, legal considerations” (2015), there is currently a trend of impact investors forming coalitions to set standards for investment funds. This trend is expected to attract more impact investors towards private equity sponsors.

Strong growth potential of private equity impact investing

According to Preqin, the private equity database, private equity AUM is at an all-time high of \$2.49 trillion in June 2016. In fact, the market is booming since 2014, with low interest debt making leverage buyouts more interesting. The industry is expected to pursue its growth in 2017 as capital distributions are still well above capital calls: in the first half of 2016, \$257 billion was distributed by investors, with only \$129 billion of capital calls from private equity funds.

As the private equity industry grows, we can expect that it will have a stronger presence in impact investing commitments. According to the GIIN 2017 study, private equity funds expect to increase capital invested for impact by 89% in the coming year. The presence of private equity investors in the impact sector is still young, and has much space to develop. In the survey, 74% of private equity respondents had entered the impact investing market in the last 10 years, when private debt investors were 63% to have entered the market more than 10 years ago.

Because it is a long term investment instrument, giving investors direct influence on the operations of the investees, and offering strong guarantees to capital owners, private equity seems like a most suited vehicle for impact investing.

iv. Private Equity impact investing dynamics

On ImpactBase, an online database for impact investing funds and investors, **out of the 432 listed funds, 279 were developing private equity investment strategies.** Already, in the GIIN 2017 investor survey, 76% of respondents used private equity

instruments. **While it is not the first impact investing financial product in value, private equity is the most widespread investment strategy in the industry.**

1. Funds strategic positioning

Equilibrium between impact and financial return

In a study published in 2012, Insight at PCV identified a trend in the US towards the expansion of “double bottom-line” private equity funds. These funds dedicate equal priority to the achievement of financial and social goals and occupy the middle-ground between “impact first” and “financial first” investors. Already in 2012, double-bottom line represented 38% of the \$4 billion US private equity impact investing industry in term of AUM.

Early stage focus

There is a strong appetite of private equity impact investors for early stage and growth equity opportunities compared to buyout or angel investments. In 2015, the Wharton Social Impact Initiative published a survey of 53 impact investing private equity funds. Of the total capital committed by the respondents, 65% was attributed to venture capital and growth equity while mezzanine and buyout represented only 13% of it. We can expect more investments in buyouts as bigger private equity are entering the market with more capital to invest.

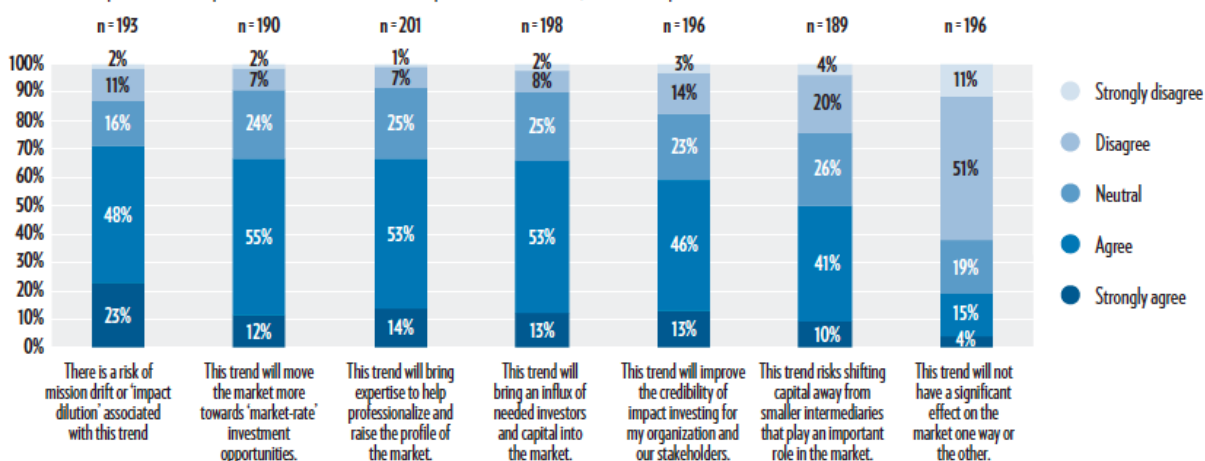
Larger firms entering the market

The first private equity actors to enter the impact investing market were specialized investors, such as Bridges Ventures launched in 2002 in the UK, or LeapFrog Investments, launched in 2007 in the US. These first initiatives were often backed by preeminent figures: Bridges Ventures was created by Sir Ronald Cohen, the founder of private equity firm Apax, while LeapFrog was officially endorsed by President Bill Clinton and his Clinton Global Initiative Foundation.

Now impact investing is not a niche market for private equity investors anymore. The interest of big asset managers for impact investing drives the demand up: In 2015, Zurich announced that it plans to invest up to 10% of its private equity allocation in impact products, representing \$100 million. Large private equity firms are answering the call for impact dedicated funds, as Bain Capital who launched a double-impact fund in 2015 which eventually closed at \$390 million. More recently, private equity giant TPG announced a record \$2 billion closing for its impact fund, backed by large pension funds and institutional investors.

The entrance of such large-scale players in the impact investing market was analyzed by the GIIN in the 2017 investor survey. While a majority of respondents think that such an evolution will help bringing more capital to the impact investing market, 71% expect that it might also dilute the impact commitment of investments and add further confusion with ESG and SRI strategies.

Number that responded for each option shown above each bar. Some respondents chose 'not sure,' and these responses are not included.



Respondents' views on the effects of the entry of large-scale financial firms in impact investing - GIIN Annual Impact Investor Survey (2017)

2. Investment process

Rigorous decision-making processes

Private equity brings to impact investing the rigor of its decision-making processes. Investment philosophies differ substantially between private equity investments for impact and traditional private equity, but the exigencies of the investors remain mostly the same. In the GIIN 2016 Investor survey, most of the impact investing respondents used the same decision-making process than traditional investors, conducting a due-diligence under the vigilance of an investment committee. Certain impact investors used an additional "impact screen only" to the usual due diligence, making the decision-making even more thorough.

n=16

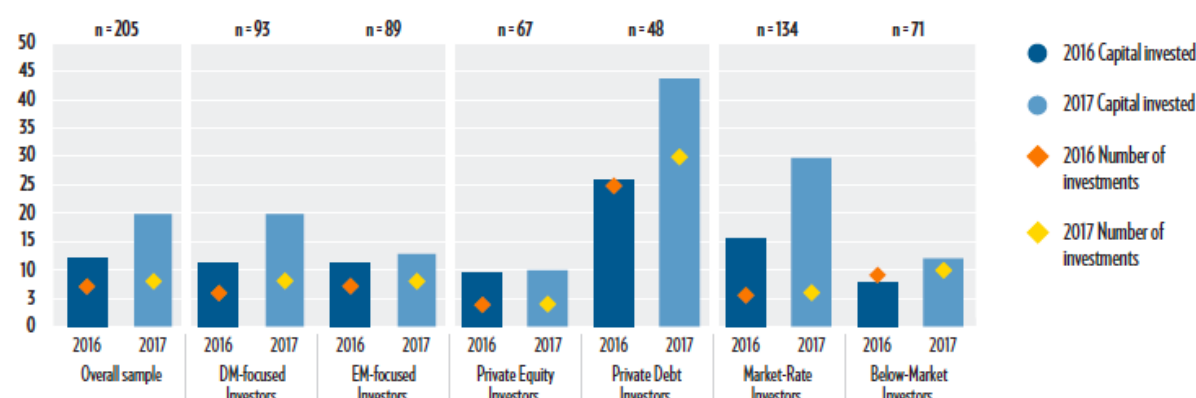
		Due Diligence Process			
		Different due diligence	Additional impact screen only	Same due diligence	Total
Investment Committee	Different committee	2	1	-	3
	Overlapping committees	2	2	-	4
	Same committee	-	2	7	9
	Total	4	5	7	

Impact investment decision-making process compared to conventional investment processes - GIIN Annual Impact Investor Survey (2016)

Increasing private equity ticket size

In the sample studied by the GIIN, the median private equity impact investor is quite small, with a total of \$9 million of investments in 4 deals. Overall, private equity impact investment deal size averaged at \$2.4 million, compared to \$50 million for traditional private equity (McKinsey, 2017). A strong growth in the size of private equity investments is expected in 2017, as respondents plan to commit 89% more capital while doing only 14% more deals.

Number of respondents shown above each bar; excludes two outliers and two respondents due to data-quality issues. Capital invested in USD millions.



Median capital invested and number of investments among various respondent segments - GIIN Annual Impact Investor Survey (2017)

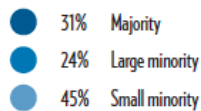
Most of minority investments, majority operations on the growth

Among all exited private equity investments in the sample, a vast majority were minority stakes, 45% small minority and 24% large minority. This is consequential to the limited amount of capital invested by private equity players in impact investing,

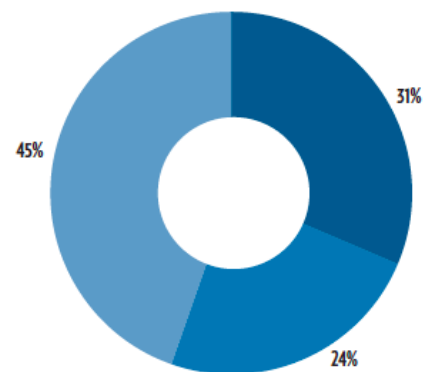
which is often not sufficient to take majority ownership of companies. In certain scenarios, the company founders or top management may also want to keep the majority at the board and only open the capital to minority investors.

As the average deal size is increasing, we can expect to see more majority investments in the coming years. In 2017, 31% of majority investments were counted by the GIIN, an increase from the 27% counted in 2016;

n = 121; 37 exits with unknown stake not shown



Source: GIIN



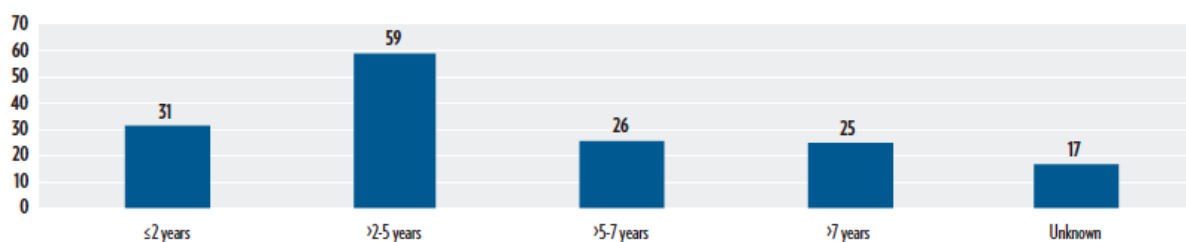
Initial ownership stake of sample exits 2010-2016 - *GIIN Annual Impact Investor Survey (2017)*

3. Exit options

Short holding periods

In its 2017 investor survey, the GIIN studied the history of private equity impact investing exits. On average, private equity impact investments are kept for 4 years and a half. Private equity investors looking for market rates of return have shorter holding periods than those targeting below market rates of return (53 months vs. 67 months on average), as they tend to sell when a profitable exit opportunity arises. The holding period is also influenced by the geographic area and the induced market size: in North America private equity impact investments are held for 40 months on average, compared to 80 months in Latin America and the Caribbean.

n = 158 exits



Holding period of sample exit 2010-2016 - *GIIN Annual Impact Investor Survey (2017)*

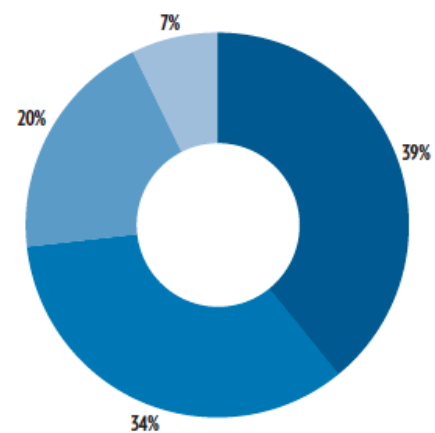
Private sales are favored, few IPOs

The large majority of companies remain private and are sold to other funds (39% of them), or to buyers interested in the industry (34% of them). There is a notable trend towards management buyback, a scenario in which the management buys the private equity fund out of the company and become its own owner. Management buyback are more frequent when top managers are highly committed to the development of their company. In many impact investing cases, the founders are still managing the company and may want to regain control over the business at the end of the investment cycle. In 72% of investment cases, the fund sold its entire participation at the moment of the exit.

n = 138; Some exits were via unknown mechanisms, and they are not shown.



Source: GIIN



Exit mechanisms 2010-2016 - GIIN Annual Impact Investor Survey (2017)

Preserved impact mission

The choice of an exit mechanism is related to the pursuit of the impact post-investment. It is questionable whether or not a new investor will be willing to continue the impact development strategy that was in place. In the sample, 53% of private equity respondents say they have a responsibility on this matter for all the investments they exit.

According to Gray (2015), private equity fund managers are confident in the pursuit of the impact strategy post exit. In his study, 95% of respondents claimed that impact mission would persist after a successful exit. Gray distinguished two categories of mission preserving exits: aligned exits and deeply aligned exits. In the second category, a mission preservation statement was included in the realization agreement. This option offers the strongest guarantees regarding impact preservation, but is restricting for the new investor, as such, it was not the most prevalent in the study.

4. Financial Performance and profit distribution

Competitive rates of return

In the GIIN 2017 investor survey, 82% of respondents declared looking for market-rate returns in their private equity impact investments. Further research by Gray (2015) under the vigilance of the Wharton Social Impact Initiative showed that such investors could achieve returns similar to market indices.

The WSII study referenced 51 market-rate-seeking exits. A brief comparison of gross IRR between market-rate seeking exits excluding write-offs (all non-aligned sampled exits) and aligned exits (in which GPs specifically looked for impact mission continuity) shows very little difference. The takeaway is that the pursuit of impact does not have a significant negative weight on the investee at the time of the exit.

	<i>All Market- Rate-Seeking Exits</i>	<i>Market-Rate- Seeking Exits (Excluding Write-offs)</i>	<i>Aligned Exits*</i>	<i>Non-Aligned Exits</i>
Gross IRR	18.59%	35.01%	33.52%	Insufficient Sample
Cash Multiple	2.30x	4.12x	4.86x	"
n	51	32	16	3

**Note: Aligned Exit category includes seven Deeply Aligned Exits*

Market-rate-seeking exits, gross returns - Mission Preservation and Financial Performance in Impact Investing, Wharton Social Impact Initiative (2015)

Private equity carried interest leading GPs remuneration in impact investing

Carried interest obtained by private equity and venture capital impact investors is the strongest among all asset classes (GIIN 2016 survey). With an average of 17.4%, the GPs remuneration for investing in impact private equity is comparable to the 20% usually expected in traditional private equity funds. The importance of investment selection methods and knowledge remain crucial, but the GIIN study shows that private equity impact funds GPs can achieve a remuneration competitive with traditional funds.

	Private debt	Private equity/ Venture capital	Real assets	Multiple Instruments
Average carried interest	17%	17.4%	12.3%	7.9%
n	20	72	20	22

Average carried interest by asset class - GIIN Annual Impact Investor Survey (2016)

3. Analysis and presentation of findings

a. Methodology

The research developed in this thesis is based on the qualitative analysis of first-hand interviews conducted with seven professional private equity investors.

The interviewees based in Paris (France) were met in-person, while the interviewees based in New York (USA) and London (United Kingdom) were conducted over the phone.

The first interview was conducted with Chris Cozzone (Bain Capital Double Impact) in an unstructured format. The questions aroused during this interview helped the researcher building an interview guide.

The following interviews were conducted in a semi-structured format: the interview guide was used as a reference, from which the interviewees could tackle other topics, depending on the specificities of the funds and the experience of the interviewees. Apart from the first interviewee, all interviewees were given the interview guide in advance.

b. Presentation of findings

i. Description of the interviewees

The interviewees form a panel of 7 private equity investment professionals working in different funds.

- 3 interviewees work in private equity firms specialized in impact investing, the “**pure players**”
- 2 interviewees work in impact investing funds launched by traditional private equity firms, the “**Corporate impact investors**”
- 2 interviewees work in traditional private equity funds and bring their vision on impact investing, the “**Corporate investors**”

Name	Firm	Position	Country
Pure players			
Mohamed Abdesslam (MA)	Citizen Capital	Portfolio Director	France
Félix Mounier (FM)	Alter Equity	Investment Director	France
Julie Pantigny (JP)	Comptoir de l'innovation	Investment Officer	France

Corporate impact investors			
Chris Cozzone (CC)	Bain Double Impact	Vice-President	USA
Beth Houghton (BH)	Palatine Private Equity	Partner, Head of Impact Fund	UK

Corporate traditional investors			
Candice Brenet (CB)	Ardian	Managing Director, Head of CSR	France
Olivier Millet (OM)	AFIC – Eurazeo PME	Chairman at Eurazeo PME, President at AFIC	France

ii. Pure impact investing players

1. Participant 1: Mohamed Abdesslam (Citizen Capital)

a. Presentation of Citizen Capital

Citizen Capital is a leading specialized impact investor based in Paris, France, with €65 million under management. The firm was founded in 2008 and closed its first fund in 2010 raising €22 million. The second fund was closed in 2017, raising €43 million.

Today, Citizen Capital finances startups and mid-cap companies with revenues between €1 million and €50 million and invest tickets from €1 million and €4 million. It currently has 9 participations in its portfolio.

The investment strategy specifically targets 4 impact themes:

- Inclusive economy
- Responsible consumption
- Social mobility
- Social innovation

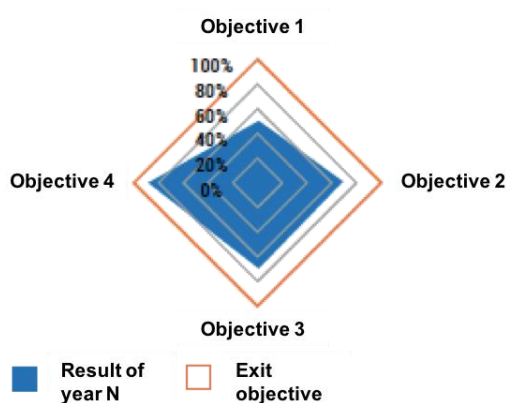
b. Interview highlights

Mohamed Abdesslam (MA) is a portfolio director at Citizen Capital and joined the team in 2009. Previously, he has been working in finance at BNP Paribas and Crédit Agricole.

Impact measurement and value creation

According to MA, impact measurement is an important tool for a GP to track the completion of the impact strategy compared to the impact objectives defined at the moment of the investment.

Citizen Capital was encouraged by its LPs to build a dedicated impact methodology. A cooperation with consulting firm Kimso led to the creation of a so-called “impact business plan”. At the moment of the due diligence, Citizen Capital identifies from 1 to 5 key impact metrics relative to the activity of the investee and determines the objectives that it wishes to achieve over the course of the investment. The impact BP is then validated by the investment committee of Citizen Capital, with the same exigency than the financial BP.



Impact business plan – Citizen Capital

For MA, the impact BP is correlated with the financial BP. During the interview, he took the example of OpenClassrooms, an online educational platform Citizen Capital invested in. The impact objectives retained in this case are the number of people trained, the number of unemployed people trained, and the number of people who graduated. Eventually, the accomplishment of these impact objectives leads to better economical performance as they are deeply rooted in the activity of the company.

The investment team is incentivized to achieve both financial and impact success, as impact performance (based on the impact BP) accounts for 50% of the GPs carried interest. In case impact objectives are not achieved, a part of the carried interest is vested towards a social initiative.

Citizen Capital is also involved in the promotion of impact principles through adhesion to global association and commitments. The firm is a signatory of the UN PRI since 2010 and obtained the “B Corp” certification in 2015. Finally, it works with the French engineering school “Mines Paris Tech” to develop academic research on impact investing.

Fundraising and financial objectives

Citizen Capital raised a total of €65 million from a diverse set of institutional investors. For MA, the LPs investing in Citizen Capital are looking for market-rate financial returns and impact performance, with no trade-off to be made between both. The use of measurement tools helps materializing the investment philosophy of Citizen Capital in concrete impact achievements, beyond pure financial success.

Sourcing

According to MA, the sourcing is very much the same than traditional private equity funds. Citizen Capital is in touch with M&A boutiques which are aware of its investment philosophy and keep the team aware of investment opportunities. The fund also communicates in the media about its objectives in order to have public presence and create a natural deal flow.

Another sourcing option for Citizen Capital is to reach out to companies spotted for their business model and commitment to certain impact objectives. The investment team defines industry verticals with potential social or environmental relevance: professional training, agrotech, edtech...

Investment process

Citizen Capital investment strategy is built around four main axes:

- **Understand:** look into the financial and social dimensions of the project; certify the alignment of the business model with the impact mission and check the use of responsible business practices (good working conditions, no discrimination, fair distribution of created value, positive governance)
- **Define an ambition:** conduct an impact due diligence and evaluate the CSR practices of the company; define objectives around indicators of impact (construction of the impact BP)
- **Accompany:** develop the impact strategy of the business geared towards predefined impact objectives
- **Evaluate:** produce the annual CSR reporting and follow up on impact objectives

Investment strategy

For MA, despite being a pure player of impact investing, Citizen Capital, competes with traditional private equity funds. As long as its BP of a company is attractive and its positioning is relevant, both impact and non-impact investors can be interested in the same opportunity.

With the raise of a bigger fund, Citizen Capital II, the amplitude of the invested tickets has been enlarged. According to MA, it is not the size of the investment opportunities that changed but rather the fundraising cycle of companies that fastened. Ventures now need financing earlier in their development while the time-lapse between roundtables shortens. Added to that, the spectrum of investment opportunities is large and the fund must be able to invest from €500 thousand up to €4 million in a company.

Citizen Capital is usually looking to be the lead minority investor on its investments, to have a prime influence on the corporate development. For this reason, it invests only in opportunities in which it will be able to carry its leading position in case the company is raising other rounds of capital. When asked with focusing on minority stakes, MA said that it is important for founders or top managers to keep the control of their company so they are more interested in its development.

Divestment strategies

Certain buyers can be more suitable than others for a specific company, and entrepreneurs can be challenged to take a better offer rather than a better investor. But according to MA, the risk of impact dilution after Citizen Capital exits from an investment is low, as the impact mission is linked to the activity of the company.

For this reason, a buyer that would drop the impact mission would greatly damage the enterprise value of the company. As economic activity and impact are imbricated, even an investor non-related to the impact story is encouraged to pursue it.

Citizen Capital partners with the engineering school “Les Mines Paris Tech” to develop impact investing research. One of the topics currently under investigation is the possibility of locking the impact mission in the company’s status.

Growth opportunities

LPs invest in Impact products to answer the growing demand of the business to mobilize private capitals to finance social and environmental challenges. According to MA, there may have been a time when impact investments were driven by communication purposes, but it is over now. LPs are asked by their own investors to

be present in the impact investing market, which is now fully considered as an asset class.

Asked about future developments of the private equity impact investing market, MA answered that they are currently more capitals to be invested in impact than impact funds raising capitals. According to MA growth is to be expected in the impact investing market at the condition that more companies with impact projects emerge. The challenge of impact investing relies on its ability to help entrepreneurs develop impactful ventures that will further evolve into private equity suitable companies.

2. Participant 2: Félix Mounier (Alter Equity)

a. Presentation of Alter Equity

Alter Equity 3P (People, Planet, Profit) is a French private equity impact investing firm with €41 million under management. It was founded in 2009 by Fanny Picard, a high-level French professional investor with previous experience at Wendel, a French private equity investment firm.

The firm first raised €18 million in 2013, before closing the fund in 2015 with €41 million raised from a diverse set of institutional investors.

Alter Equity targets minority investments in French medium size SMEs with revenues superior to €1 million and profitable growth potential. Its investment tickets can go from €0.5 million to €6 million. Today Alter Equity has participations in 8 companies operating in various industries, from energy efficiency to cosmetics.

b. Interview highlights

Félix Mounier (FM) is Investment Director at Alter Equity where he started working in 2012. Previously, he has been working for Ardian, the French private equity firm, and for EY, the audit and consulting services company.

Impact targets and measurement

The project of Alter Equity is born from the ambition of Fanny Picard to create an investment firm that would help solving key social or environmental challenges while developing beneficial business practices. Today's investment criteria of Alter Equity reflect this initial aspiration:

- The activity of the company has to **create positive impact** on the environment or on the people

- The company must develop constructive business practices and show positive CSR policies

During the interview, FM commented that growth equity is the ideal level of development to influence the management practices of a company. At this level the teams are usually small and the management is still pretty much considerate towards the employees; the intention of the fund is to carry on this benevolent nature.

To assess the implementation of the two criteria in prospective investments, Alter Equity developed an “extra-financial business plan”. This measurement tool is geared towards defined quantitative metrics pulled out of the 70 key targets listed by Fanny Picard. According to FM, a selection of 10 metrics is made at the moment of the investment to constitute the proper “extra-financial BP”. Depending on the specificities of the business invested, new metrics not present on the list can be drawn following talks with management.

The “extra-financial BP” is the only measurement tool used to follow the pursuit of impact targets. As of now, Alter Equity does not work with any external consulting firm on the topic of impact measurement.

When asked about incentives towards the accomplishment of social and environmental targets, FM added that top managers are interested in the success of the extra-financial BP through the management package. GPs are only interested by the financial objectives for now, but a future fund raised by Alter Equity would be very likely to variabilize the carried interest on impact targets, as LPs are asking for more guarantees on the non-financial achievements.

Fundraising and financial objectives

Alter Equity raised most of its fund from French and European institutional investors. One difficulty identified by FM during the fundraising process is that impact investing funds are still too small to arouse enough attention. Certain categories of investors such as pension funds or insurance companies do not want to invest less than a certain amount or possess more than a certain percentage of a fund.

According to FM when asked about the financial objectives of Alter Equity, the fund targets risk-adjusted market-rate returns, just as other private equity firms. For him, there seem to be no trade-off to be made between impact and financial return as long as the fund is invested in companies with sound business model and positioning. FM clearly associated the future success of Alter Equity to its ability to combine financially profitable investments with creating of great positive impact.

Sourcing and Due diligence

Interrogated on the sourcing practices of Alter Equity, FM referred to the standard methods of the private equity industry. Around 50% of the sourced opportunities are intermediated through M&A boutiques, and the other 50% are due to the public reputation of the fund, or to meetings with entrepreneurs during dedicated conferences. Only in a few cases Alter Equity investment professionals directly get in touch with a company they spotted.

When an investment is targeted and after meetings with the top management, an impact due diligence is conducted. According to FM, the idea is to imagine the “extra-financial BP” by listing the impact dimensions on which the company can make the biggest progress.

Investment strategy

As Alter Equity target profitable companies with sound business models it is competing against traditional private equity firms on many investment opportunities. According to FM, when several funds are on the shortlist to close an investment, the impact positioning of Alter Equity may give the firm more legitimacy as a knowledgeable investor, to which entrepreneurs can be sensitive.

Alter Equity invests tickets from €0.5 million to €6 million. The fund invests only in opportunities that it will be able to follow on the long term, if other roundtables are organized. When asked about the control of the company, FM explained that Alter Equity usually invests in minority stakes. The firm believes that growth capital private equity is very much about the top management, who needs to keep the control to be interested in the entrepreneurial success of the company.

Relationship with the managers

Just as a normal private equity firm, Alter Equity closely accompanies the top management of its investees. On top of monthly board meetings in which development issues and commercial performance are tackled, the firm often calls industrial experts to advise top managers on certain questions.

According to FM, the relationship is facilitated as managers and entrepreneurs of invested companies are well aware of the importance of impact performance, and their own interests

Divestment strategies

Questioned about the future divestments, FM said that he was certain the impact creation would persist post-exit. There is no risk that a future buyer would spoil

impact creation, as the impact strategy of an invested company is deeply rooted into its economic activity.

To support this argument, FM mentioned the investment Alter Equity made into OpenAirlines, a company producing a flight simulator to train professional commercial pilots. The software helps reducing carbon gas emissions, as it reduces the number of training-purposed flights. It is clear that the business model of OpenAirlines is strictly bounded with its impact strategy.

According to FM, large industrial groups don't have much credibility for impact creation and could well be interested buyers of Alter Equity portfolio companies.

Growth opportunities

For FM, impact investing does not replace other social investing initiatives such as social businesses and SRI. Impact Investing answers a specific demand from entrepreneurs to find an investor who understands the importance of impact creation and who will contribute to the development of their impact project.

Interviewed about the future developments of impact investing, FM identified the small size of companies with impact in France as a limiting factor for the launch of large impact funds like in the UK or in the US. As of now, growth equity seems to be the most suited investment segment in the French impact ecosystem.

3. Participant 3: Julia Pantigny (Comptoir de l'innovation)

a. Presentation of Comptoir de l'innovation

Le Comptoir de l'Innovation (CDI) is a French investment fund supporting companies with a positive social or environmental impact. CDI was created in 2010 as a spinoff of the French social organization "Groupe SOS".

CDI currently manages €105 million from a diverse set of institutional investors such as the asset manager Amundi, the insurance company AXA or the banking group BNP Paribas. Its three funds invest tickets of €0.1 million to €5 million for periods of 5 to 7 years.

It holds 39 minority participations in startups and SMEs based in France. Of all invested companies, 39% are social businesses, 41% are companies of the circular economy, and 20% are operating in digital collaborative industry.

b. Interview highlights

Julia Pantigny (JP) has been working at Comptoir de l'Innovation for 2 years. Previously she held positions in public and international organizations such as the OECD.

Impact and financial measurement tools

To measure the performance of its investments, CDI created the CDI rating system, a tool developed in-house that combine financial and extra-financial metrics. The firm identified diverse relevant areas divided in sectorial criteria. For example, a company can be tagged in the areas “housing” and “training and social insertion”.

- **Financial analysis:** the assessment of financial profitability is made based on a set of 300 weighted economic and financial criteria. This analysis encompasses a study of the market, and a detailed review of operations and financials. The model is adapted to the structure of the company (association, cooperative, social business...).
- **Extra-financial analysis:** the evaluation of impact performance uses a similar list of 300 weighted extra-financial criteria. The review encompasses sectorial social and environmental impact performance, as well as business practices such as employment and governance.

The CDI rating system allows for refined analysis of the companies financial and impact profile, through hand picked criteria weighted according to the standard practices of their respective sector. According to JP, the goal of a standardized measurement tool like the CDI rating system is to compare easily businesses that operate in different industries under specific conditions, while bridging the exigencies of financial profitability and social impact performance.

At the end of the review the company is given a grade on 4. If an investment is made in the company, this grade is used to develop a social impact BP, build around impact objectives specially selected. The completion of these objectives is regularly measured to assess the impact performance of the investee. As of now CDI only use internal measurement tools, and is not using any impact consulting firm.

Questioned about compensation packages for GPs, JP said that CDI didn't implement incentives for GPs based on impact performance yet (CDI does not distribute carried interest at all), although it is not reluctant to the idea.

Fundraising and financial objectives

CDI only invest in economically sound businesses, already profitable or with high potential to become profitable over the course of the investment. During the interview, JP insisted that no interview is made in structures that rely on subventions to pursue their activity.

The investors of CDI expect positive financial return, especially mutual investors who have fiduciary responsibilities. According to JP the target IRR of the funds is 7%, which accounts for managing fees (GPs remuneration); LPs perceive a net annualized return of 3% to 4%. This return is not as high as what could be expected from a traditional private equity fund, but satisfies institutional LPs looking to make a larger social impact. For JP there is a strong conviction among investors that social companies are more resilient to economic crisis than traditional companies, leading to lower risk profile of impact investments.

According to JP, CDI invests in diverse economic structures, from associations and cooperatives to social businesses. In many cases the funds are not invested in equity but rather in equity-related bonds emitted by companies. As explained by JP during the interview, these bonds are paid back to CDI at a rate which can be indexed on the financial or impact performance of the company. This rate is a useful tool for CDI to incentivize managers and entrepreneurs to the accomplishment of impact BP objectives.

Sourcing

Most of the deals are sourced from institutional partners such as startup incubators (e.g. “Alter’Incub Rhône Alpes”). Interrogated about the competition around the investments, JP explained that CDI operates in a rather cooperative environment. It is not common to compete against other investors to be present at roundtables. Every week on average 15 to 20 companies are screened, of which 2 or 3 eventually fit the investment scope of CDI.

Investment strategy and screening

CDI make minority investments of of €0.1 million to €5 million for periods of 5 to 7 years. The first criteria looked for in the screening process is the creation of social and environmental impact within positive business practices.

- **Sectorial screening:** CDI does not have a sectorial focus and invest in diverse industries: cleantech, foodtech, training and insertion, social tourism... Only compliance with the fund impact philosophy matters. During the interview, JP mentioned the recent investment in Cozynergy, an energy company offering to facilitate energy efficiency works. This company also

carries a social impact mission, as 40% of its clients live in energy precariousness. This combination of environmental and social impacts was determinant for CDI to take a stake of the company.

- **Development screening:** CDI is equally diverse about the development stage of screened companies; it can invest in seed, growth equity, but also in cooperatives. In non traditional companies such as social businesses, CDI can invest in equity-related bonds emitted by the investee.

Divestment strategies

Questioned about impact persistence, JP answered that CDI can use exit clauses to have a right of inspection at the moment of the divestment. If a potential buyer deliberately wants to spoil the impact strategy, CDI can veto the sale.

Growth opportunities

For JP, impact investing is evolving from a niche to a mainstream asset class. According to her, the development of impact investing relies on its capacity to combine impact creation and financial performance.

Questioned about the lack of investment opportunities, JP answered that the problem is not so much the existence of companies with impact projects (they are plenty), but the stereotypes around impact investing that may hinder lots of them from communicating on the topic, by fear of being associated with non for profit businesses.

iii. Corporate private equity firms impact funds

1. Participant 4: Chris Cozzone (Bain Double Impact)

a. Presentation of Bain Double Impact

Bain Double Impact (BDI) is an impact investing fund launched in 2015 by the American private equity giant Bain Capital. BDI uses Bain Capital experience and resources in the private equity industry to deliver competitive returns in the impact investing field.

Former governor of Massachusetts Deval Patrick was appointed Managing Director of the fund. Among the team, half of BDI investment professionals used to work for other Bain Capital funds, and half was recruited outside Bain Capital.

The fund raised \$390 million from pension funds, financial institutions, family offices, foundations and others, well-above the initial \$250 million target. BDI

investment professionals themselves committed more than 10% of the total of the fund. Among BDI LPs, many had never invested in impact funds before.

The fund targets middle-market buyout opportunities, and expects to close between 12 and 15 deals with investments between \$10 million and \$40 million. BDI is looking to take majority positions in invested companies, if not controlling stakes.

BDI investment philosophy revolves around three core investment themes:

- **Sustainability:** minimize environmental impact and ecologically beneficial practices (in water, energy, agriculture)
- **Health & Wellness:** improve access to healthcare and healthy lifestyles
- **Community building:** support economic growth and employment in underserved areas

BDI made its first 3 investments in 2017:

- **Impact fitness**, a fitness club franchisee operating out of localities with low-ranking health indicators
- **Living Earth**, the largest recycler of green material in Texas
- **SpringWorks Therapeutics**, a medicines company developing new treatments for underserved patient communities

b. Interview highlights

Chris Cozzone (CC) is an investment Vice-President at Bain Double Impact. He started working for Bain Capital in 2011 before being transferred to the Bain Double Impact team in 2016. Prior to joining Bain Capital, Chris Cozzone was a consultant at Bain & Company.

Inception of the fund

Questioned about the inception of BDI, CC explained that Bain Capital has always have been engaged in philanthropic actions. The firm started showing interest for impact investing after the acquisition of a 50% stake in Toms, a shoe-retailer, from its founder in 2014. Toms Shoes, despite being a for-profit business, develops a social mission: for each pair of shoes sold, a pair is given to an impoverished child. At the time, the founder of Toms Shoes decided to take half of the sale proceeds into a socially minded investment fund. On top of continuing the “one-for-one” shoe giving policy, Bain Capital decided to match the founder’s financial commitment to social investment.

Toms Shoes founder is not the only entrepreneur in this situation. According to CC, they are many company founders looking to preserve the impact mission promoted by their businesses, while trying to raise funds. On the other side, an increasing number of LPs wants to go beyond SRI and negative screening, and invest into impact creating products, under the condition that they offer market-rate returns with no tradeoffs.

When Bain Capital launched BDI in 2015, it made of the first big private equity players move into impact investing. For CC, the presence of Deval Patrick, former governor of Massachusetts and big impact investing advocate, was decisive in the success of BDI first raised fund.

Impact targets and measurement

According to CC, the first target of BDI is to companies with prime impact progression potential over the course of the investment, in the frame of strong ESG practices. What is important for the fund is not to create the most impact in absolute terms, but to have the greatest differential between impact created by a company at the moment of the investment and at the moment of the exit.

BDI works with the B Lab organization to measure impact generated by portfolio companies and its evolution over time. B Lab's Impact assessment tool uses standardized GIIRS ratings to allow comparison with other impact funds.

Questioned on this existence of an impact business plan, CC explained that a set of 2 to 5 customized metrics are created for each portfolio company to form an "impact blue-print. This "impact blue-print" is drafted in close relationship with the investee top management. By limiting the number of impact indicators evaluated, BDI avoids turning investees into reporting agencies, drowned under metrics.

According to CC, the "impact blue-print" is strictly linked to the business model of the company. For example, of the impact key performance indicators (KPIs) retained for the recent investment in "impact fitness" is the % of first subscribers to a fitness club. As the company will open more fitness units in underserved areas, this particular KPI metrics will improve.

BDI incentives towards impact improvement is limited to a certain level of variability in the cash bonuses of senior GPs, and does not include carried interest. As of now, the accomplishment of targets is only measured qualitatively.

Investment strategy and expected returns

BDI targets investment opportunities in mission-oriented for profit lower middle market companies in North America. The fund GPs expect to close between 12 and

15 deals with investments between \$10 million and \$40 million. BDI targets market-rate risk adjusted returns, just as any other investment fund managed by Bain Capital.

The fund invests only majority tickets in companies. For CC, it is essential to be in control of the company in order to implement the commercial and impact blueprints with more efficiency, and eventually create positive externalities.

Questioned on the competitive environment, CC explained that for the investment model to be scalable, BDI does not compete only with other impact PE firms, but with all PE firms that share its investment scope. When BDI partners with another impact investor, it does so with a fund that seek market rate returns, like it was the case on the “impact fitness” deal with Bridges Fund Management.

Exits

Interrogated on the risk of impact dilution after the exit, CC argued that all BDI investments are made in companies with aligned business model and impact model. Because both components are intrinsically connected, it is unlikely that the impact mission will be affected by an exit.

Growth opportunities

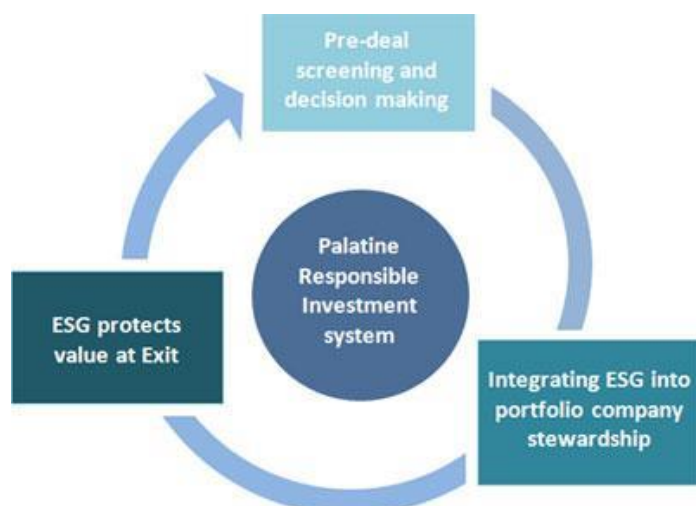
For CC, private equity impact investing will benefit from the global wealth transfer between baby boomers and millennials. The latter are more purpose driven than the former, and as large entrepreneurial families are transmitting billions of dollars to their children every year, we can expect them to weight on investment decisions in the near future.

2. Participant 5: Beth Houghton (Palatine Private Equity)

a. Presentation of Palatine Private Equity

Palatine is a private equity firm founded in 2005 in Manchester (UK), with offices in London and Birmingham. Since its inception, the firm raised 3 funds, with the latest one closing in 2015 at £220 million and which is currently being invested.

On top of being a UN PRI signatory, Palatine has a history of implementing strong ESG practices, built around the “Palatine Responsible Investment system”. The firm won multiple awards for considering ESG as a value-added factor in invested companies, rather than as a negative weight.



The strong track-record of Palatine as a responsible investor with above market financial returns encouraged the firm to go beyond ESG principles by raising a dedicated impact fund. Among impact sectors targeted by Palatine are renewable energies, circular economy, ethical finance, training, sustainable housing, or aging population.

In 2016 Palatine raised its first impact fund, which closed in 2017 at £100 million, from an initial target of £75 million. The fund will invest majority tickets of £2 million to £10 million in companies capable to deliver both market rate financial returns and strong impact performance. The fund made its first investment in 2017 in Trade Skills 4U, a company providing electrical training courses for individuals.

b. Interview highlights

Beth Houghton (BH) joined Palatine in 2007 and she is now head of the impact fund. Previously, she has been working as a managing consultant for 10 years. In 2016, Beth won the British Private Equity & Venture Capital Association first “Outstanding Individual Contribution” award for responsible investment.

Fund inception

Interrogated about the initial motivation of Palatine to launch an impact fund, BH explained that the firm has a strong history of implementing high ESG practices in its portfolio. Since the screening of potential investments, Palatine targets companies with high social and environmental standards and potential. Post-investment, the firm consistently works with companies to improve ESG measures during the holding period.

Asset managers like pension funds or banking corporations may be reluctant to invest for impact, as they believe it does not bring market returns. According to BH,

the strength of Palatine in this segment is its ability to combine strong track record of profitable responsible investments with access to institutional investors. This competitive positioning led to the raise of a dedicated impact fund in 2016.

Impact measurement

For BH, the particularity of an impact investment is to answer to specific environmental and social criterions, whereas ESG measures can be applied in any company. There can be ESG improvement in a company that does not follow impact investing requirements, however, an impact investment must go with a certain level of ESG integration. Impact cannot be created at the expense of responsible management practices.

To select companies to invest for impact, Palatine first determined a list of 10 impactful sectors that can also offer private equity returns. Among them are professional training, affordable and sustainable housing, renewable energies... During the interview, BH added that a potential investment must be inclusive, adaptable, and scalable. An impactful company with a focus too narrow to gain global market size would not be part of the investment scope of the fund.

Interrogated about the impact follow-up during the investment, BH explained that Palatine investment team identifies different impact KPIs specific to the company. For the fund first investment in Trade Skills 4U, the KPIs are geared towards training metrics such as “trained people that have been in the army”, “trained people of a certain age / background”.

Palatine is helped in the impact evaluation by management consulting firms, such as “The Berkeley Partnership” or sustainable business consultancy “fwa”. According to BH, Palatine is an investment firm, and developing in-house impact measuring methods would not be the most efficient manner to evaluate portfolio impact performance.

For BH impact and enterprise value are bounded, the more impact is created, the more enterprise value will increase. For this reason, Palatine Impact fund did not develop any financial incentive based on impact performance (carried interest or else).

Fundraising and financial objectives

Palatine achieved a £100 million closing for its first impact investment fund from an initial £75 million target, in a global context that could play against fundraisings (notably Brexit). Half of the LPs are historical Palatine investors, and half are new. The diverse investor base regroups public pension plans, endowments, funds of funds and UHNWI.

For BH, the ability of Palatine to raise an impact investing fund that size in under a year proves the appetite of investors for placements that deliver both market-rate financial return and impact performance.

Sourcing and Investment strategy

Palatine uses traditional methods for sourcing impact investment. The impact fund benefits from the in-house 4 people sourcing team, while the investment team is frequently in touch with regional M&A advisors to identify possible investment opportunities. On top of that, Palatine has developed contacts with different impact investing organization to gain public presence in the industry.

The first impact fund launched in 2016 targets investments up to £10 million in pre-defined themes like training, circular economy, wellbeing... Palatine impact fund mostly take majority stakes in companies in order to keep better control over their strategic development choices.

According to BH, because Palatine impact fund is looking for market rate financial returns, it is competing against any other private equity firm of the same investment scope. In that sense it is closer from some traditional private equity investors than from over impact investors with broader scopes. BH mentioned the example of Bridges Fund Management, which has broader impact definition and could consider investing in a poor neighborhood like impact investing just because of its location, disregarding the activity of the investee.

Finally, Palatine impact fund professionals develop the same relationships with the managers than traditional Palatine funds. Usually, GPs and managers would meet during board meetings and have frequent discussions together about the follow-up of impact KPIs or the development of ESG practices. In some occasions, Palatine may ask consultancies to advise investees on certain precise topics.

Divestment strategies

When questioned about impact persistence post exit, BH insisted on the value created by strong impact performance and developed ESG practices. For her, as long as impact is bounded with the activity of the investee, it creates enterprise value that makes the company more attractive for potential buyers. In that extent, a buyer has every interest to maintain the impact creation strategy.

Growth opportunities

For BH, the main deterrent of investors from entering the impact investing market is their fear that it will not be able to generate market rate private equity returns. For

her, the feeling that impact sacrifices return is a false accusation. Just as Palatine proved that strong ESG practices are beneficial without costing any money to companies, it intends to show that impact can be a valuable placement.

When interrogated about the growth drivers of impact investing, BH answered that current market trends contribute to the development of impactful mature companies. She mentioned the growing awareness of consumers for ethical products and services, or the aging population leading to the opening of new carehouses.

iv. Corporate investors

1. Participant 6: Candice Brenet (Ardian)

a. Presentation of Ardian

Ardian is a French investment firm with €65 billion under management, split between funds of funds (€39 billion), direct funds (€14 billion), Infrastructure (€9 billion), Private debt (€3 billion), and real estate. With 1400 funds invested and participations in 140 companies, Ardian is a leading international private equity player.

In January 2017, it was rumored that Ardian was about to launch a dedicated impact fund. Candice Brent denied the existence of such a project during the interview. Despite not having any impact investment activity, Ardian remains a large promoter of responsible investing, and contributed to the development of better CSR practices in the private equity industry.

b. Interview highlights

Candice Brenet (CB) is Managing Director of direct funds investments and Head of Corporate and Investment Responsibility at Ardian. She entered the firm in 2008 in the investor relations department, before taking charge of the CSR policy in 2009. CB has previous professional experience in the banking industry working for Société Générale.

CSR practices in private equity investing

Ardian is known for being a long-term investor with leading responsible investment practices. Since 2008, the firm develops a sharing initiative to distribute a portion of capital gains from an investment to the employees of the company invested, should certain conditions be completed. As of 2017, €21 million have been distributed to

9000 employees in 18 companies. According to CB, this initiative appealed to the development of a proper CSR policy.

In 2009, Ardian developed an in-house CSR charter and became a pioneer signatory of the UN PRI. Through the principles, the firm commits to incorporate ESG issues in its investment process and ownership policies. Ardian took further its attachment to responsible investment in 2015 by co-founding the “Initiative Carbone 2020” which intends to lower the carbon footprint of majority-owned portfolio companies by 2020. From the 5 initial founders, the initiative now regroups 18 investment firms.

To implement its CSR charter in its investment process, Ardian developed specific tools to evaluate and report ESG issues and performance. Notably, the firm developed extra-financial due diligences, which are now systematically conducted before investments. During the holding period, ESG reviews are regularly carried (from 5 in the first year, they went up to 46 in 2016). The objective of these reviews is to define improve ESG performance in portfolio companies by targeting specific extra-financial objectives.

According to CB, strong CSR practices are usually consistent with traditional private equity targets as they help better piloting long-term growth of participations and improve exit values. Ardian integrates ESG practices in the portfolio companies with a result-driven mindset which allows for offering extra-financial returns to investors without sacrificing financial profitability.

During the interview, CB added that large institutional LPs are showing increasing interest for responsible investment policies, as their impact on value creation is being proven. As such, a full-bodied CSR strategy can facilitate fundraising processes.

Views on impact investing

For CB, impact investing targets companies whose activity is entirely geared towards impact creation, whereas CSR practices can be implemented in any company. Another difference mentioned during the interview was the existence of ex-ante objectives in impact investing, when CSR strategies only give a certain orientation without defined objectives.

Questioned about the challenges of impact investing in the private equity industry, CB answered that it can be hard to clearly establish the investment universe of a dedicated impact investment fund, as it can not be defined in traditional terms of geographies or industries. Another limiting factor identified by CB is the size of the impact funds. Large institutional investors such as Ardian historical LPs want to commit at least €50 million to €100 million to a fund. As of now, they are very few impact investment funds raising tickets in that range.

At the beginning of 2017, rumors of Ardian launching an impact fund circulated in the specialized press. CB denied the existence of such a project. According to her, the impact investing market is not mature enough to attract the interest of Ardian. For now, Ardian plans on continuing the pursuit of active CSR strategies in its portfolio companies.

2. Participant 7: Olivier Millet (Eurazeo PME / AFIC)

a. Presentation of AFIC and Eurazeo PME

AFIC

The “Association Française des Investisseurs pour la Croissance” (AFIC) is an independent professional organization bringing together all the Private Equity structures in France: Venture Capital, Capital Development, Transmission Capital and Turnaround Capital. The AFIC represents 300 members investing in over 5000 companies.

Eurazeo PME

Eurazeo PME is a French private equity firm targeting majority investments in SMEs. As of 2016, the firm had 10 investments under management. Recently, it closed a third fund raising €658 million. Eurazeo PME does not have any impact investing strategy.

b. Interview highlights

Olivier Millet (OM) is the chairman of Eurazeo PME executive board since 2005, and the chairman of AFIC since 2016. Previously, OM have been working as a private equity investment professional at 3i and at Barclays Private Equity France.

He is a personal investor in Citizen Capital, the French impact investing firm.

Definition of impact investing

According to OM, it is fundamental to define precisely what “impact investing” is and what it is not, as misconceptions around the semantic terms will dilute the public awareness about the topic. For OM, impact investing is a specific branch of capital-investment targeting companies whose activities generate positive social or environmental externalities, with the intention of improving their impact.

Questioned about the specificity of impact funds compared to traditional investors, OM explained that both models are not opposed, but parallel. To be considered as an impact investor, a fund has to develop a dedicated mindset. A traditional fund that would happen to invest in an impactful company is not an impact investor. According to OM, specialized funds have a specific economic model that prioritize impact, despite certain financial return considerations. During the interview, however, OM specified that impact funds are very different from social companies or charities, as they invest in profitable businesses, and intend to offer a positive financial return to their LPs.

Further in the interview, OM distinguished Impact investing from CSR, a frequent source of confusion. Impact is bounded to the activity of a company, and represents a direct consequence of its development, whereas CSR can be applicable to any kind of company, with the intention of improving ESG practices. For OM, impact specialists need strong CSR policies to guarantee that their investment and management practices would not jeopardize impact creation. Meanwhile, as traditional investors become more aware of extra-financial issues, they tend to implement more consistent CSR measures.

Eurazeo PME, the private equity firm headed by OM, does not have funds dedicated to impact, however, it recognizes the extra-financial consequences of its investments by implementing in-house CSR strategies.

Initiatives of the AFIC towards promotion of impact investing

Impact investing regroups a widely diverse set of actors who chose to combine the research of financial profitability while pursuing extra-financial objectives. For OM, the impact market is now challenged to define industry standards in order to gain public traction. A first step would be to better report impact investing funds in order to quantify the amounts invested, the number of deals done, and the good practices.

In 2012, the AFIC created an “impact club” to give impact investing an organized representative body. This club now regroups 197 professionals working in 15 investment firms and managing €1260 million of impact investments. According to OM, this club gives exposure for impact funds, facilitating capital raises.

Development perspectives of impact investing

According to OM, as reputational risks became more consequential, it is no more possible to focus exclusively on financial returns. With large investors wanting to have a positive extra-financial influence, CSR policies are getting traction in mainstream investments. As a result, investors are not closed off anymore against impact investing opportunities.

During the interview, OM explained that contrary to public capital, private equity invests with a long-term perspective, and possesses strong leverage on the management of companies. As such, it is particularly suited to promote extra-financial value creation through inclusive corporate development strategies. The private equity industry currently represents between 3% and 5% of total assets under management, a share that is expected to increase.

For these reasons, OM believes that private capital will champion the growth of investments with extra-financial value in the next decade.

In particular, impact investing has important growth potential as it still represents a minimal part of the amounts invested towards private equity. An investor can commit 5% to 10% of its PE allocation to impact funds, and 90% to 95% in mainstream opportunities with strong CSR policies. Even if financial returns of impact investing are not as high as standard private equity investments, an appropriate mix between both is not unreasonable for large fund managers willing to create long-term extra-financial value. For investors, there is a balance to be found between impact investing and mainstream investing allocations.

For OM, capital development is an offer-market, not a demand-market. To have more companies with impactful business models, we need larger impact funds with bigger investment teams. As of now, Impact investing is not very well understood by investors, and finding resources to raise impact funds can be challenging. Institutional investors decide to allocate their capital in segments, and for them to invest in impact, impact investing has to be fully recognized as an investment segment.

c. Interpretation of findings

Private equity funds are recent actors of the impact investing field: according to the GIIN 74% of private equity impact investors entered the market in the last 10 years. This relative novelty explains the lack of research on private equity impact investments methods.

In this research, 7 private equity actors were interviewed. Among them, 5 are private equity professionals with direct impact investing activities, and 2 are high-level members of the private equity industry giving their vision on the impact topic. The results obtained through these interviews offer an insider vision of private equity impact investment processes and strategies.

i. Impact philosophy

1. Defining impact

There seem to be a consensus among interviewees on the definition of impact investing as the one given by J.P. Morgan and the Rockefeller Center in 2010: ***“Investments intended to create positive social impact beyond financial return”***.

The impact itself is most frequently restricted to social or environmental issues, which encompass the most numerous investment opportunities. In his impact cartography, Vaclay (2003) also identified cultural and political matters which were never mentioned by impact investors interviewed in the sample.

Both pure players and corporate impact funds seem to build their impact philosophy around a list of a few “impact themes”. For example, BDI explicitly focuses on three themes (“sustainability”, “Health & Wellness” and “Community Building”). while CC developed four main impact orientations (“inclusive economy”, “responsible consumption”, “social mobility” and “social innovation”). **The breadth of these themes intends to give investors more liberty in the interpretation of impact, broadening their investment spectrum as a consequence.**

To limit the dilution of impact objectives into broad orientations, **specialized impact investing funds may be tempted to define more precise criterions.** This is the case of Alter Equity, whose founder, Fanny Picard, built a list of 70 impact metrics representing the specific impact environment of the firm. On the same registry, Le Comptoir de l’Innovation uses a set of 300 extra-financial drivers.

Besides all the focus put on impact, a striking result of these interviews is that private equity impact investors give a lot of importance to positive CSR policies. **For all the interviewees, impact does not make sense per se, it has to be created by**

a company whose ESR practices favor sustainable activity and responsible governance. Impact and CSR are not consequential, but they go hand in hand when it comes to impact investing. As a result, CSR have to be taken into account in private equity impact investments. In that sense, the panel supports the idea developed by Hill & al (2007) that an expansive strategy CSR strategy can be financially accretive in the long term by improving social metrics.

2. Measuring for Impact

Defining impact is not enough, **investors expect impact funds to deliver on their extra-financial commitments.** In the panel, **all interviewees seemed aware of the urgency to be transparent on portfolio impact performance.** To prove that the capital invested is efficiently mobilized towards impact creation, measurement tools have to be implemented.

Full-bodied evaluation tools have been fully developed by impact investing organizations: the GIIN created the IRIS, and the B-lab came up with the GIIRS. **These methods could help building standards in the industry for impact assessment, but they were not commonly used among the sample of investors interviewed.** Only Chris Cozzone at BDI referred to the use of GIIRS through a collaboration with the B-Lab organization.

The results of the interviews conducted with the panel demonstrate great concordance with the GIIN survey, which showed that proprietary measurement methods were used way more commonly than standardized methods

Instead of using industry-wide methods, PE impact investment funds rather develop their own measurement systems. **The most frequent one is the “Impact Business Plan”, similar to a traditional business plan in its intentions, except it focuses on extra-financial performance.** Apart from Le Comptoir de l’Innovation which has an in-ouse rating system, all impact investors questioned use this tool. Customarily, **the investment team of the fund would meet with the top management of the investee to choose a few customized impact metrics (or KPIs).** An impact objective is then attached to each metric, to be completed either on a yearly basis or before the exit.

In their 2015 study, So and Staskevicius identified 4 objectives of impact measurement: estimating impact, planning impact, monitoring impact and evaluating impact. While the “Impact Business Plan” frequently encountered in the panel seem to be relevant to estimate and evaluate impact, it is not the most efficient tool to plan and monitor impact, as it does not offer precise measurement capacity.

To certificate that the different counterparts have aligned interest towards the accomplishment of pre-defined impact objectives, dedicated incentives can be implemented. For example, Citizen Capital indexes half of the carried interest on portfolio impact performance: if targets are not achieved, GPs will not receive full compensation. As of now, these incentives are scarce but they tend to expand as LPs ask for more guarantees of impact creation.

ii. Fundraising and financial objectives

When it comes to fundraising, the interviews showed that there is a lot of discrepancy between funds:

- **Pure players:** the funds are usually small (up to €43 million in the sample). LPs usually come from public investment institutions missioned to develop impact investing, or from large financial groups willing to dip a toe in the industry.
- **Corporate PE impact:** the funds tend to be much larger than pure players' (for their first impact funds, BDI and Palatine raised respectively \$390 million and £100 million). LPs are either historical investors in the PE firm traditional funds, or new institutional investors attracted by the buoyancy of a large PE firm.

As explained by Candice Brenet in her interview, **a limiting factor for impact investing fundraising is the size of the funds.** Large asset managers such as pension funds usually invest hundreds of millions of dollars in private equity funds. They are very few PE impact funds capable of handling an investment this size, and even in that case the investor would be reluctant to hold a too important stake himself. **The arrival of large PE firms on the impact investing market tends to clear up this issue** as they offer more extensive investment opportunities.

Beyond the sizing of the funds, investors wonder about the financial perspectives of impact investing. For Olivier Millet, the debate is still open to know whether impact investing is a segment of PE (no arbitrage between impact and financial returns) or a proper asset class (existence of arbitrage).

In the sample, **all the PE impact investing professionals affirmed targeting market-rate financial rates of return for their investments**, while engaging with different social impact objectives.

Rather than distinguishing between “financial-first” and “impact-first” investors, like Freireich and Fulton did in the Monitor report (2009) the panel supports the idea of a positive correlation between social impact and financial return, like envisioned by

Grabenwarter and Liechtenstein (2011). As such, they deny the existence of an arbitrage between impact and financial performance.

iii. Sourcing and investment strategy

When it comes to sourcing of companies suitable for impact funds, **the methods are the same than in traditional private equity industry**. Commonly, deals come from M&A advisors or media exposure. In other occasions, the PE impact fund would contact directly companies that it spotted, even though this possibility is less developed.

Companies invested by **PE impact investment firms operate in various industries**, from healthcare to training services. There is certainly a concentration of investments in specific sectors, but they are not targeted per se, just because they are more likely to carry an impact.

On the other side, **the geographic dispersion of PE impact investments seems to be more limited than traditional PE investments**. This is more a consequence of the size and capacity of PE impact funds than of a determined strategy. As the impact investment market grows, we can expect to see PE impact funds exploring new horizons.

The investors interviewed in this study are all based in advanced economies, investing in advanced markets. According to the GIIN annual impact investor survey, the funds exploring emerging economies are usually specially dedicated to this purpose. As such, these funds were not included in the panel.

There is a clear split between pure players and corporate PE impact funds on the topic of **ownership**.

- **Pure players:** In the sample, all pure players focused on minority investments, preferably in companies where the management is a large shareholder (as such, it is strongly incentivized to the success of the development strategy)
- **Corporate PE impact:** Corporate PE impact funds studied in this research target only majority investments. According to Chris Cozzone, having the full control of the invested company allows for better implementation of the commercial and impact business plans.

The discrepancy between pure players and corporate PE impact investors when it comes to ownership better explains why only 31% of impact investments surveyed in the GIIN 2017 study are majority stakes.

Various interviewees highlighted that as long as they invest in sound businesses, **PE impact funds are in competition between them, but also against traditional PE firms.** In such scenarios, **the focus on impact can play a decisive role to convince the seller that an impact fund could be more suited to pursue responsible corporate development** that protect the values and good practices of companies.

iv. Exits

For the same reason that PE impact funds find themselves in competition with traditional PE funds in buying processes, there is no guarantee that a company invested by an impact will be sold to another impact fund at the moment of the exit. **It is often questioned whether or not a sale to an industrial player or a non-impact investor would induce impact dilution.** As of now very few PE impact investments were exited, and data on the topic is non-existent.

In this series of interviews, most respondents claimed that **the risk of dilution is low as they choose to invest in companies in which impact creation is bounded to commercial activity.** For Félix Mounier from Alter Equity, the more a company will be successful commercially, the more impact it will create. As such, it is very unlikely that a buyer would spoil the impact project, as it is part of the DNA of a company, and contributes to create enterprise value. It can be more challenging to guarantee the pursuit of positive ESG practices after the exit, as CSR policies are tributary of the shareholders' vision for the company. But as the long-term beneficial effect of responsible practices on the value creation is recognized, buyers will be more inclined to preserve them.

In the framework built by Gray (2015), **deeply aligned exits** were distinguished from **aligned exits** by the existence of legal bindings guaranteeing impact preservation. This strong confidence in impact persistence may explain why **none of the interviewees spoke up about implementing mission preservation statements in realization agreements with buyers.**

Few impact investments were realized as of now, and it can be difficult to evaluate which exit methods are favored by PE impact investors. As many companies invested by PE firms of the interviewed sample are still early stages of development, **it is however likely that they will remain private once the investment realized.**

v. Growth opportunities

As a section of the impact investing industry, **PE impact investments growth is driven by global market trends such as increased awareness about extra-financial metrics** from institutional investors, or global wealth transfer towards younger generations.

Because of its long time commitment and its proximity to corporate development strategy, **private capital is by nature well suited to implement responsible practices in a company.** As such, Olivier Millet says that private equity will champion the growth of investments with extra-financial value in the next decade. **By extension, impact investing, which can be considered as an extra-financial investment strategy, is expected to benefit more from PE than from other asset classes.**

According to the investors interviewed in the panel, growth equity seems to be the driver of PE impact investments for now. **The entrance of corporate PE firms in the impact market is likely to change the balance as buyouts become a more common form of PE impact investment.**

The impact PE sector is in need of successful exits to prove wrong those who think that impact necessarily affect financial returns. To this extent, we can expect that the arrival of larger impact PE actors will offer attractive exit opportunities for pure players to realize their investments.

For now, PE impact investing is still in a maturing phase and more growth can be expected as it gains exposure. In its 2017 investor survey, the GIIN forecasted a 89% increase of private equity capital allocated to impact in the coming year.

The next challenge for the sector will be to scale up the size of funds raised in order to attract larger investors and PE firms. **As more capital become available, PE impact funds will gain competitive advantage against traditional PE funds, and get access to more investment opportunities.**

4. Conclusion

The objective of this research was to explore the implementation of impact investing principles into the canvas of private equity investments. Private equity has both advantages to offer a consistent investment methodology and to give enough flexibility to its counterparts to cover a wide array of investment situations.

The sample of respondents interviewed offered the occasion to compare impact investing strategies of pure player PE funds vs. those of corporate PE firms with dedicated impact funds. Beyond structural differences relative to the size of the funds or questions of ownership (minority or majority investments), investors of both categories seemed to share the same vision of impact.

At the scale of the sample, the different investment funds appeared to have adopted very common measures to account for impact requirements in their investment processes. At first, a list of impact themes is usually set up to guide the sourcing of investments. Once an investment confirmed, the investment fund and the management of the company would usually build an impact business plan to define precise impact objectives. Finally, the investment team follows the impact performance of the company during the holding period.

Private equity impact investing is currently undergoing a maturation process as it gains interest from the traditional private equity sphere. This research highlighted that very specific practices have already been implemented. As the sector grows, we can expect private equity firms investing in impact to refine their methodologies. In particular, impact measurement has to be more readable to allow for more transparency between the fund and the investors.

Now, it is the responsibility of the funds to sanctuarize impact investing and build it as a proper segment of private equity. A lengthy standardization process remains necessary for PE impact investors to gain global market recognition.

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6. Annex

a. Interview guide

Impact philosophy

Inception of the fund

- What were the main incentives to start the fund? (investors, public demand, market demand...)

Measures of impact

- What is your definition of impact?
- What criteria do you use to assess impact?
- Do you measure the impact in house or do you use an external consulting firm?

Alignment of interests on impact objectives

- How do you incentivize general partners to pursue the impact objectives? Is Carried Interest linked to impact performance?
- How do you incentivize the management to pursue the impact objectives?

Fundraising

Origin of the LPs

- Why are your investors interested in impact private equity?
- Do you think LPs expect market rate returns on the impact fund?

Size of the funds

- What is your feeling regarding your capacity to invest the entirety of the fund?

Investment strategies

Sourcing

- How do you source your investments?
- Apart from impact requirements, do you have any sectorial focus?
- Are you in competition with all the private equity funds or just with the private equity impact funds?

Due diligence

- Do you conduct an impact due diligence before committing capital?

Size of the tickets

- How do you determine the size of your investment tickets?
- Do you target mostly minority or majority investments?

Portfolio management

- Do you think that impact investing involves a stronger involvement in management?

Divestment strategies

- How do you maintain the impact strategy after the exit?
- Are you specifically looking to sell to another impact investor?

Further developments

- What are in your opinion the main drivers of private equity impact investing today?
- Do you believe that the development of private equity impact investing could be limited by: lack of capitals, lack of opportunities, complicated exits?