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Research Paper

Private Markets – Impact Investing

A Key Approach to Mission-Aligned Investing

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- *Impact investing is a rapidly growing field that has the potential to increase mainstream adoption across institutions and deepen the influence of long-term and strategic investments.*
- *According to the 2020 Sustainable Investment Survey conducted by Pitchbook, 95 percent of limited partner respondents are already evaluating or increasing their attention to Environmental, Social and Corporate Governance-Focused Investing (ESG). This is consistent with 69 percent of general partner respondents noting increasing interest from clients.*
- *Impact investing is arguably the most targeted route in implementing a Mission-Aligned Investing portfolio as it relates to a specific value-set or cause.*
- *In the proceeding paper, we discuss why private market investing is so conducive to structures for investors seeking real influence, key considerations for impact investors and how it is implemented in investor portfolios.*

Impact Investing is a Natural Extension within Private Markets

As detailed within our four-part research paper series, Mission-Aligned Investing is a style of investing that aims to align an investor's values to its portfolio. These values may range from Environmental, Social and Governance issues to specific religious beliefs and more. Impact investing, or the targeted investment in companies or funds with the intention to generate social or environmental impact alongside investment return, is a key approach that may be used in implementing a Mission-Aligned Investing portfolio.

While much of the implementation around Mission-Aligned Investing started in public markets, there has been growing adoption within private markets. Impact investing is a natural extension within private markets as the general partner often has majority control of a business allowing for greater alignment with, and influence over, the organizations' priorities and growth plans. Impact investing is often targeting specific outcomes – a greener environment, more diverse workforce, access to education, veteran support – and funds can be dedicated to one or more impact initiatives.

There are numerous reasons as to why private markets are most conducive to investors seeking real change, including:

- The focus on impact is made perfectly clear from the outset and companies are purchased with a particular goal in mind.
- Impact investors can act as patient and long-term providers of capital, supporting businesses as they scale over time. They can have direct influence, working alongside management teams as well as contributing their own operational expertise.
- There is also greater transparency into how a specific outcome will be achieved through a general partner's value-add playbook and historical deal experience.
- Ultimately, there is intentionality to bring about positive change and foresight into how that will be accomplished.

Key Considerations for Impact Investors

The profile of target impact managers is akin to that of any private markets recommended manager. They are experienced investors, but more importantly, they are experienced partners. They seek to invest in people whose values are similarly aligned. These are people who share the belief that purpose can drive profits. Often, they intentionally construct a concentrated portfolio of investments that allows the manager to meaningfully engage with every business as they scale. They create value by tapping into operational resources to support earnings growth alongside impact.

In addition, the investment team or advisors work directly with the executive team on strategic initiatives and they are involved at the board level. They are long-term investors and know that real change can only occur over time. With all decisions and actions, they not only look at what is best for the investors and the business but also how to have the most profound impact.

As with any investment, rigorous analysis is key when evaluating impact opportunities. While most traditional diligence paradigms for private markets investing apply to impact investing, there are two additional considerations in implementing an impact investing portfolio:

1. **Measurement and Management of Impact** – Impact is oftentimes difficult to calculate or analyze quantitatively. It is important to have a standard with which to measure an investment manager over time. This is challenging because each investor and client has his or her own definition of impact. Identifying specific ways in which to measure a manager's impact prior to investing is key to fulfilling long-term and objective performance evaluations.

2. **History of Impact Expertise** – As it relates to impact investing, avoiding the bad actors, also known as exclusion investing, is not enough. Moreover, rarely are the financial expert and the impact expert the same individual. Just as we prioritize firms with operational expertise, we expect firms within the impact space to have dedicated professionals with a background and track-record of success within the specific area of impact. These individuals are key to sourcing new opportunities and navigating niche areas of the market, especially in times of stress.

Implementing Impact Investing

As values can range drastically from one investor to another, a bespoke pipeline of impact investing opportunities is advantageous in developing an impact investing private markets program.

If the investor is interested in advocating for a greener environment, for example, sourcing efforts should be focused on managers who have a history of investing in renewable energy resources such as hydropower, solar, geothermal and wind. Likewise, if an investor seeks to facilitate a positive workforce effect in low to moderate (LMI) communities, managers who assess job quality standards and improvements in certain geographies should be considered.

Impact investors may also wish to consider executing an explicit side letter, or an agreement entered into by the general partner and a specific limited partner. The goal of this letter is to clarify or supplement the terms of the limited partners agreement as it relates to one specific limited partner. This allows the investor to have more control over socially responsible investing priorities. While some side letters may be non-binding, there is intentionality and greater transparency in the agreement.

Building an impact-oriented private markets portfolio is an interactive process. The interpretation of an investor's mission may change over time as new investment strategies and measurement data become available. This information may lead to greater understanding of the mission and the necessary modification of that mission over time. A pacing model acts as a blueprint for impact investors and will incorporate evolving goals as well as aid in the implementation.

Optimistic about the Future of Impact Investing

Impact Investing within private markets may be newer or less familiar to investors, but Fiducient Advisors, provides a range of resources to assist with sourcing and vetting impact investing funds. We are optimistic about the future of impact investing as greater responsibility for environmental and social initiatives can help firms create financial returns while also having a positive impact on the world. We have a commitment to purpose and profit, and we will help you devise and execute a Mission-Aligned Investing strategy that best accomplishes your specific goals.

For more information, please contact any of the professionals at Fiducient Advisors.

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Angelique is a Senior Research Analyst in the firm's Global Private Markets Group. Within this group, Angelique is responsible for sourcing and performing due diligence on investment opportunities across private equity, private credit and private real assets. Angelique is a member of the firm's Global Private Markets Group and Global Hedge Fund Strategies Group. Prior to joining the firm in 2018, Angelique was a Senior Investment Analyst at Granite Associates and an Investment Research Associate at Utah Retirement Systems. Angelique graduated summa cum laude with a BA in Finance from Westminster College in Salt Lake City. She is a CFA® charterholder and a member of the CFA Society of Chicago, the CFA Institute and 100 Women in Finance. Angelique is also pursuing her MBA from the Kellogg School of Management at Northwestern University. She enjoys world-travel, cooking, reading and being active in her free time.