Institutional investors seeking to make an impact

Wed, 12/06/2019 - 07:22

Tags : ESG & Responsible Investing Funds Private Equity

By Elizabeth Pfeuti - ***With great power comes great responsibility, and in 2019, institutional investors, who collectively oversee tens of trillions of dollars, are becoming alert to what their fiscal might can do.***

In May, Europe's second largest pension investor PGGM announced it had asked its private equity team to help meet its impact investment targets.

PFZW, the pension fund for Dutch healthcare workers and PGGM's main client, had set out four themes it wanted to use its financial strength to tackle: water scarcity, food security, climate change and healthcare.

The mantle had already been taken up by other asset class teams within PGGM, but it was something new for private equity.

Most of the investor's EUR12.5 billion allocation to private equity is held in generalist funds, which are almost all focused on buyouts.

Willem Jan Brinkman, director in the private equity team at PGGM, said it was difficult to select impact investments, so the team turned to finding targeted ones.

"We started a few months ago and have looked at a lot of managers," says Brinkman. "We want to allocate EUR500 million, so the ticket sizes can be smaller than we are used to."

This smaller allocation fits well with the size of most impact-focused private equity funds, which is usually around USD200 million, according to Alex Scott, head of Pantheon's ESG committee.

The size mismatch has often been a stumbling block for large investors.

"Often projects and assets needed in impact investing are so small and the allocations from institutional investments have to be big enough for it to be worth them deploying assets," says Scott.

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PGGM runs more than EUR217 billion in total, so smaller tickets mean each investment must work harder to be worth the time, effort and cost of awarding the mandate.

PFZW agreed to the extra effort of finding these funds, so Brinkman and the team set about analysing the market, looking at many managers they had never encountered before.

"In our view, private equity offers huge opportunities for institutional investors as there are so many companies, unlike the limited number of listed ones," says Scott. "And in private markets, companies can be created with a specific purpose and complementary attributes."

A private equity investor can also help develop the strategy and scalability of a company, according to Scott, making it a good fit for investors wanting to make an impact with their money.

"Private equity has been one of the largest areas of impact investment to date," says Amit Bouri, chief executive of the Global Impact Investing Network. "It is at the early, seed stage where most of it takes place. Most of these companies are not at buyout stage, but they are getting bigger, which is good for investors who are used to writing big tickets."

Since the launch of the GIIN a decade ago, Bouri has noted a growing interest and number of operators in the impact investment sector.

In 2013, just 350 people attended the GIIN global conference in London. By 2018, its event in Paris gathered more than 1,300. The network now comprises more than 280 member organisations based in more than 42 countries and include large financial institutions, corporations – including private equity firms – family offices and philanthropic donors.

Over the last few years, more local and international organisations have begun popping up too, offering guidance to investors wanting to make an impact.

"People are focused on improving the scale and effectiveness of these investments," says Bouri. "We have seen lots of boutique firms embracing impact investment, but larger ones are launching portfolios, too."

For Edward Collins, CEO at Earth Capital Partners, which manages USD1.5 billion in sustainable and impact investments, this shift means he is no longer on the margin.

"Initially, impact investing was a niche business and really something only for philanthropic gestures and family offices," says Collins. "Now it is a genuine asset class in its own right."

This evolution has resulted from the dogged collection and analysis of data to show that rather than sustainable investment dragging on performance, it can produce better returns than traditional asset allocation. Impact investment, the next step for some, has the potential to make both good returns and a positive change.

"More people are realising that a sustainable approach and financial return go hand in hand, and we are seeing a growing specialist funds proving that it is possible," says Brinkman.

According to the UN's Principles for Responsible Investment, some USD1.3 trillion has already been committed to impact investment. And where there is investor capital, people want to manage it.

“Smaller players used to control most of the industry, but some of the larger players are now building funds for the first time – this is enabling large pension funds to allocate capital there,” says Collins.

Brinkman says that PGGM is in discussions with some large players, but the team was engaged with smaller investors, too.

There is certainly competition for assets, but unlike other areas of private equity, the range of opportunity it so wide, there is room for more to join – but there is no free pass. Track record and experience are still key.

“Across the whole of the PGGM impact investment agenda, financial ambition comes first as we recognise it is possible to combine financial and societal returns,” says Brinkman.

To get a meeting with PGGM, managers need a track record not just a good story.

“The funds have to meet the same criteria as our other investments,” says Brinkman. “In our first screening, there were a lot of managers with returns that would not fit. But we are engaging with those that do.”

At Earth Capital, Collins sees investors allocating to impact investment as they believe it can make a positive return and are starting to see it would be detrimental to their portfolio to not do it.

“Everyone got so used to looking at Bloomberg screens – impact investment requires us to go back to basics,” says Collins. “If you can’t measure the impact of your investment, you can’t measure your investment.”