KEYNOTE INTERVIEW

LP appetite for impact continues to surge



Investors see more impact opportunities and want more rigour behind those strategies, say Matt Autrey, Ana Maria Harrison and Yohan Hill at Adams Street Partners

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Q How would you describe current LP appetite for impact investing, and how has that changed over time?

Ana Maria Harrison: LP appetite for impact has increased substantially, and this year in particular has seen a big uptick in interest among our investor base for both dedicated strategies and the incorporation of impact factors in general. Among the accounts we manage, there has been growing demand to invest in impact through separately managed accounts. We have seen a rise in the number of large requests for proposals for pure impact mandates, as LPs move from integrating impact into their portfolios towards putting aside a pool of capital with that sole focus.

Matt Autrey: There is surging interest in impact from both institutional and retail investors, and a large proportion of that is being driven by investors' desire to have investments aligned with their priorities and values. Regulation is also a factor, as there are several net-zero initiatives gathering momentum globally that incentivise impact investments.

We are seeing clients want solutions tailored towards their specific areas of focus and have been structuring portfolios to specifically address those needs – whether that is climate, health and wellbeing, or otherwise.

Q Where are LPs focusing their attention with regard to the integration of impact considerations into investment programmes?

AMH: LPs are more focused on putting money to work in impact and seeing the data behind that. That has been a huge shift on the investor relations side – it is now about actions

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> **ANA MARIA HARRISON**

rather than intentions and there is a lot more attention paid to due diligence and to defining what LPs are looking for. Many LPs want to participate in framing and seeking involvement in the formulation of the strategy and the mandate. There is more attention paid to reporting, and how managers provide information to satisfy investors' goals.

Over time, it seems there has been a tipping point in that investors now have begun to expect the same returns in impact as in other strategies. They used to expect to sacrifice some element of returns, but because they have seen some strong returns from impact, that has driven a lot more interest in the strategy. Investors that have impact sleeves or mandates now are targeting the same level of returns as in the rest of their private markets portfolio.

MA: ESG and impact considerations are being woven into investment programmes in different ways. Some investors view it as a risk management tool, avoiding investments that may have negative social or environmental consequences. We have also seen a large rise in investors viewing impact through an environmental lens, seeking to both target climate-related investments and to measure the climate impact of their investments. We have clients who ask us to seek to address that need in their portfolios.

There has also been broader interest in social impact themes such as health and wellness, economic development, and education and training, where we believe there are compelling opportunities to generate attractive financial returns while having a meaningful and measurable impact.

Yohan Hill: We are seeing a greater level of sophistication and rigour from investors targeting this space. That is partly driven by developments such as the EU's Sustainable Finance Disclosure Regulation and other regulatory changes, which are providing more clarity on certain requirements for those looking to raise funds for these strategies.

More broadly, there is greater adoption and understanding of best practice as it relates to impact. We see more consultants and asset owners referring to emerging standards, and they are becoming more sophisticated in how they evaluate managers' ESG credentials.

Q What is the scale of the market opportunity? And what types of deals and projects are you focusing on?

MA: Our investment teams believe the opportunity set has never been larger and more attractive for impact investing than it is today. We are meeting as many as five new managers every month generating potential robust direct dealflow and investment opportunities. We are tracking around 700 impact funds raising capital globally, and these funds have more than $70 billion of dry powder to collectively invest.

The market is maturing, with the average impact fund now raising $500 million. They may be new managers, but they often have deep investing history and are bringing experience and networks to focus on this segment of the market.

One of the largest growth areas we have seen has been managers targeting sustainability and climate, which is driven by a favourable regulatory environment and an influx of traditional large managers that now have impact funds. That typically creates additional exit options for newer managers in the

Q Where are the challenges and opportunities in relation to healthcare?

MA: Healthcare and wellness is emerging as a major impact theme. It has always been a resilient segment of the economy, and has drawn interest because of that, but the disruption taking place from a technology standpoint has now also created an impact opportunity set.

An increased focus on mental and physical health is creating investment opportunities for companies providing those services, while driving access to healthcare-related products and services is another huge opportunity, given the rising costs and the need to take costs out of the system. We are finding some compelling business models that provide services to underserved communities and demographics.

The challenge is how to separate what is truly healthcare-related impact versus your average healthcare investment. As a firm, we tend to fall back on industry-accepted impact frameworks such as the Impact Management Project's Five Dimensions of Impact, Operating Principles for Impact Management, and UN Sustainable Development Goals to try to assess who is benefiting, what is the impact and whether you can measure that over time in a meaningful way.

space and means the opportunity set has scaled.

Within climate, we are seeing a lot of attractive investment opportunities from venture to buyouts in energy transition and decarbonisation, renewables, sustainable agriculture and green transportation. More broadly, there are many opportunities in products and services that are increasing access to underserved communities by leveraging technology in areas like healthcare, education and training.

The common thread for all of these is marrying a financial value proposition – something that is more efficient or cost effective – with the goal of creating a measurable social or environmental impact. There is a real synergy emerging in the market today where those two combine.

YH: Alongside that growing opportunity set has come greater appetite for ESG data, because an asset must be both thematically credible and measurable. Investors are not only being asked to report on positive impact but also on wider impacts, some of which could potentially be adverse.

Q How are funds looking to make an impact in relation to climate?

MA: There are several segments within climate that we have seen funds focus on. First is net-zero climate objectives, which is a global issue attracting investment across regions. We have seen managers focus on companies that are driving reduced emissions in several different ways, including green transportation, alternative forms of energy, or efficient batteries.

We also see interest in companies that measure the carbon footprints of businesses and identify ways to reduce those. There is heightened focus on how products are made and delivered, with consumers wanting to know their purchases are being produced in a sustainable way.

Climate opportunities attract a lot of interest because the underlying impact can be quantified and measured very readily. You can track your carbon footprint across a portfolio over time and can have goals and targets around that, which makes it easier to mitigate the risk of greenwashing accusations.

Q What are the latest developments around data and reporting on impact?

YH: In the last 24 months, we have seen the introduction of SFDR in Europe, which has set out clear requirements at an entity and fund level on what it means to market ESG or impact-focused funds in terms of reporting. That has created significant impetus in the market to start generating the data to meet those requirements, and it looks like the UK will soon adopt similar rules.

In the US, the Securities and Exchange Commission has signalled its intent to introduce its own requirements, all of which should help incentivise private equity firms to focus on capturing basic information on the social and environmental impacts of their underlying portfolio companies.

A second theme is the adoption of voluntary reporting standards. We have seen several initiatives to standardise ESG reporting, with a particular focus on private markets following developments in public markets. One example is the ESG Data Convergence Initiative, which aims to capture and harmonise environmental, social and governance metrics, and to which Adams Street Partners was an early signatory.

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> **YOHAN HILL**

As we look to engage more in impact investment opportunities, it is important for us to be able to monitor and track impact over time. If we can have a standardised set of metrics that we all agree on, that makes it a lot easier.

MA: On the GP side, one interesting development we have seen is a rise in the number of companies and managers tying their economic incentives to measurable milestones, perhaps tying a portion of carried interest or the management fee to the achievement of certain ESG goals. We like that alignment, which further reinforces the separation we see growing between real impact-focused managers and 'tourists' that are opportunistically getting into this space. ■

Matt Autrey is a primary investments partner, Ana Maria Harrison is an investor relations partner, and Yohan Hill is a principal and director of ESG and responsible investing at Adams Street Partners