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Impact Investing

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Why impact's long-term fundraising outlook remains bright

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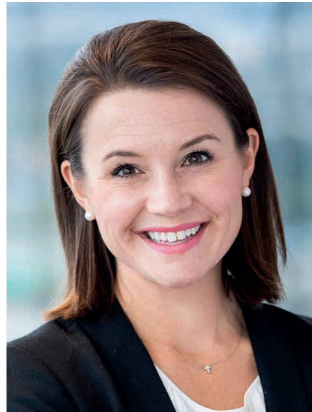
KEYNOTE INTERVIEW

Backlash has little effect on ESG and impact priorities



Private equity firms remain focused on issues that could pose risks or value-creation opportunities for their portfolio companies, says Elizabeth Ming of KPMG

Q How has the ESG backlash affected GPs' ESG and impact priorities?

The backlash is affecting the way that ESG and impact are being discussed in terms of terminology, but it is not changing the way in which GPs are doing business with respect to these topics.

It has always been the case that GPs prioritise financial returns, so to the extent that these considerations are integral to any risk management or value-creation focus, they are being addressed in the same way that they always have been. For example, addressing issues related to workforce retention, access to water or a rising sea level can be business issues – relevant to the financial sustainability of certain companies.

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Q What do you say to the sceptics – why is now a better time than ever to invest in nature and the energy transition?

The 'Why now?' is different for every business, but there is no question that there are issues that pose significant risk to companies, and solutions are needed to address those risks.

While not imminently impacting every company to the same degree, it is important that investors understand the impact and time horizon of climate change and the energy transition on portfolio companies. Obvious physical risk examples include flooding and forest fires, but perhaps less obvious considerations are things like how rising temperatures are impacting the workforce, causing issues that affect operational efficiency.

Beyond that, regulatory demands are impacting the need to report on

Q From your perspective, has the private equity industry bought into the impact investing priorities of the UN Sustainable Development Goals?

Absolutely, without question.

Tackling these issues is good business, not just because of the risks they pose to the financial sustainability of a business, but also because there are market opportunities related to the solutions that will yield returns for investors.

The ESG-related challenges a GP endeavours to resolve will vary significantly depending on the market sector and the level of control that the investor has, but the private equity industry is keenly aware that making progress towards the UN Sustainable Development Goals is imperative for a financially sustainable economy.

certain ESG factors, which is creating a significant need for infrastructure to enable companies to meet those requirements. Aside from investing in these solutions, it is also important to understand these reporting expectations and factor in the related costs to comply at underwriting.

Consumer sentiment and the demand for more sustainable products continue to increase. Further, as we deplete natural resources, companies will face increased costs and business disruption related to access to supplies. Restoring natural resources will have to occur over a longer time horizon and therefore time is of the essence.

Impact investors have a critical role to play not just in the solutions, but also in seeding the innovation to get businesses to a scale where large private equity firms can come in and scale the intended impact.

“It is important that investors understand the impact and time horizon of climate change and the energy transition on portfolio companies”

Q How has the measurement and reporting landscape for ESG and impact evolved over the last year?

There is continued demand for information, which is in some ways sector agnostic or SDG agnostic, especially in areas such as emissions reporting and diversity, equity and inclusion. That demand for information is driving behaviours.

Whether or not the topic is mission critical for a business, companies are having to disclose information on

topics that they may not be actively managing or monitoring. The required transparency has pushed companies to understand the implications more deeply for the business, and assess the comfort level with the degree of action (or inaction) that a topic, such as climate, receives from management.

Regulation has continued to expand in terms of both jurisdictions and scope. Perhaps the biggest and most far-reaching example is the EU Corporate Sustainability Reporting Directive (CSRD). It covers all topics, not just climate, and incorporates a concept of double materiality. At the other end of the spectrum is the US Securities and Exchange Commission's Climate Rule, which focuses only on climate and only on financial materiality. Companies are wrestling with the cost to comply, and technology solutions are rapidly being brought to market to enable compliance.

An increase in net-zero and sustainable finance commitments has further changed the reporting dynamic because it is not enough just to make the commitment – stakeholders expect action, and measurement and reporting to support the claims about action. The scope of this reporting is expanding beyond just the metrics and includes significant detail about the process implemented to fulfil the commitment.

Finally, the demand in the corporate world for assurance around this data is getting close to table stakes, particularly for public companies. There is coalescence on the idea that if you are making strategic decisions based on this data then it should be robust, transparent and there should be accountability to delivering it to this level of rigor.

We have been on a journey to get good data for several years; now we are going to start to see significant effort around the accountability of producing reliable and transparent information. I expect that, as more corporates obtain assurance on non-financial information, access to reliable information will increase and we will see asset managers delivering assured, non-financial information to their stakeholders.

"We are going to start to see significant effort around the accountability of producing reliable and transparent information"

Q What about the case for data? Why is it worth the cost?

This is where we need to be a little bit more focused because it is a journey, and it takes time. There is no question that we need data to make informed decisions and anecdotal stories are not helpful when trying to plot the return on investment in an investment thesis. However, you do not necessarily need all the data, so understanding what data is relevant to make good decisions is key.

In IPOs we are seeing a lot of companies coming to us for support in identifying the metrics that best tell their stories and then looking to bring some accountability around those. In addition to reliable storytelling, it is about understanding the cost of transition, both from a risk mitigation perspective and an opportunistic perspective. If we are talking about some sort of carbon reduction process in the investment thesis, for example, you cannot really understand the financial impact of tackling that without reliable data.

"Tackling these issues is good business, not just because of the risks they pose to the financial sustainability of a business, but also because there are market opportunities related to the solutions that will yield returns for investors"

Lastly, there is an important case for data as it relates to benchmarking on the impact side. The more comparable data we can produce, the more we are able to begin to create some benchmarking for the industry to help inform impact investors – both LPs and GPs – around what good looks like. Some of the changes that we are aiming for here are long-term changes that are not going to happen overnight, so in a three-to-five-year hold period we need to be clearer on what is a success from an impact perspective and what we can hope to achieve. ■

Elizabeth Ming is an ESG audit partner in KPMG's private equity practice