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Market for Social Impact Investing by Private Equity Funds Stands at $4 Billion in the United States

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AUTHORS:
Tom Woelfel / Project Manager / TWoelfel@pcvmail.org
Ben Thornley / Director / BThornley@pcvmail.org
Beth Sirull / Executive Director / BSirull@pcvmail.org

Private equity impact investing for social benefit represents a significant practice, but less than 0.5 percent of the $1 trillion-plus private equity industry in the U.S.

There has been significant growth since 2000 in “double bottom line” funds explicitly seeking market-rate financial returns and social impact concurrently

OVERVIEW

In one of the first efforts to characterize the landscape of social impact investing through private equity in the United States, PCV InSight values total assets managed by U.S. private equity managers with the goal of achieving both financial returns and intentional social benefits at approximately $4 billion.

The most concrete measure of the sector's growth is the doubling in the number of explicitly "double bottom line" funds

The market includes 69 General Partners (GPs) that meet stringent qualifications for inclusion in this landscaping[1]:

1) Each GP explicitly seeks intentional social impact in addition to financial returns; and

2) Each GP tracks and reports on that social impact to Limited Partners (LPs) or publicly.

While the practice of private equity investing always has and remains primarily about achieving attractive financial returns, the intentional effort to generate social outcomes is increasingly prevalent. Categories of social outcomes include, but are not limited to:

- Job creation in targeted geographies;
- Job quality, including living wages, benefits and training opportunities;
- Management and employee diversity;
- Economic development in underserved areas more broadly;
- Community engagement, including volunteerism;
- Supply chain impacts and responsible contracting;
- Employee wealth creation through shared ownership; and
- The delivery of products and services with intentional social or community benefit, for example in the health care or education sectors.

According to research from J.P. Morgan and the Global Impact Investing Network (GIIN), impact investing is poised for significant growth in 2012, with $4 billion in planned new investment.[2] The market for social impact investing in private equity is likely to follow a similar trajectory as more GPs embrace both financial return and social outcomes in order to access this new influx of capital, although the practice remains a small niche in the overall US private equity industry, which has total assets of over $1 trillion[3].

The most concrete measure of the sector's growth is the doubling in the number of explicitly "double bottom line" funds seeking market-rate financial return and social impact concurrently since 2000. Specifically, 17 new GPs have been created since 2000 with the explicit intent to invest for a dual purpose. This outpaces the growth of "financial first" funds (14 new GPs since 2000) and "impact first" funds (nine new GPs since 2000).

[1] The study does not include funds seeking solely environmental impacts but does include funds seeking social and environmental impacts.

[2] Insight into the Impact Investment Market, December 2011, Yasemin Saltuk, Amit Bouri, Giselle Leung, JP Morgan Social Finance and the Global Impact Investing Network (GIIN). http://www.thegiin.org/cgi-bin/iowa/resources/research/334.html

[3] http://www.valuewalk.com/2011/12/the-pitchbook-private-equity-decade-reports/

Newer double bottom line funds are also larger than those created before 2000, suggesting that this approach is maturing and becoming more widely accepted by investors.

PCV InSight reviewed privately and publicly held data for over 300 GPs. Newly created impact investing distribution and information platforms, including GIIN's ImpactBase, ImpactAssets, and the Global Impact Investing Ratings System, significantly aided in the research.

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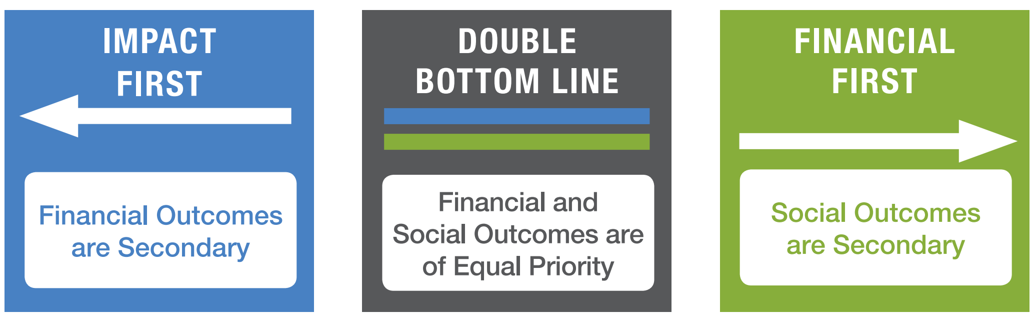
EXAMINING THE ACTORS: U.S. SOCIAL IMPACT INVESTORS IN PRIVATE EQUITY

GPs make impact investments for deliberate profits and social benefits based upon varying preferences for both. They have been segmented in this research into three distinct groups, drawing on the Monitor Institute's categorization of impact investors as "financial first" or "impact first".[4] While not ideal (we believe investors fall along a continuum of "willingness to pay" for social impact), this approach is useful because the "financial first" and "impact first" categorization can be more readily inferred through public information. We have added a third category in this research: "double bottom line".



Financial first GPs

Traditional private equity managers may make impact investments as a result of double bottom line mandates. Economically targeted investment programs created by public pension funds and other institutional investors have been used historically to support economic development priorities such as job creation. Some minority owned funds supported through the emerging manager programs of large institutional investors have also been considered financial first investors for the purpose of this research, where the firm explicitly targets social impact as an ancillary benefit alongside financial return.

Impact first GPs

Impact first private equity managers can include community equity funds that seek social outcomes and often accept a concessionary rate of return on their investments. Purpose-driven funds also fit within this category as they seek social outcomes aligned with the

[4] Investing for Social and Environmental Impact: A Design for Catalyzing an Emerging Industry, January 2009, Jessica Freireich and Katherine Fulton, Monitor Institute. http://www.monitorinstitute.com/impactinvesting/documents/InvestingforSocialandEnvImpact_FullReport_004.pdf

purpose or mission of their organization (e.g. faith based organizations or philanthropic foundations). A number of venture philanthropy funds are also organized as GPs and place higher priority on social outcomes by providing concessionary capital in hopes of achieving mission- or program-aligned social outcomes.

Double bottom line GPs

Funds that explicitly describe financial return and the achievement of social outcomes as being equal in priority include a maturing group of community equity funds. These funds have concluded that sacrificing financial performance in order to achieve social outcomes is an unsustainable model given the unwillingness of the largest investors to concede market rates of return. Funds that look traditional may be better described as double bottom line if they invest with the explicit intent to achieve measurable social outcomes and evaluate and report on these impacts regularly. The dedication of resources to ongoing measurement by these funds reflects the importance they place on achieving social objectives. Double bottom line GPs also include many new and largely unproven funds coming to market with dual priorities for achieving social outcomes and financial return.

Distinguishing Characteristics

Each GP has key distinguishing characteristics, many of which were used to classify the funds for this research, including:

- **Financial return –** market rate or concessionary
- **Investment strategy –** early stage, growth equity, mezzanine, buy-out
- **Deal terms –** e.g. equity set-asides in the event of a successful investment exit or other forms of additional compensation for employees at companies receiving investment
- **GP experience –** years of management experience
- **Impact reporting –** level of priority given to rigorous tracking of social impacts
- **Intent –** focus on financial returns or social outcomes in published marketing materials or investment strategies
- **Legal structure –** for profit, non-profit
- **LP/investor composition –** foundation investors, public pension funds, high net worth individuals etc.
- **Size –** assets under management
- **Investments –** investments in target markets , in target sectors, or both
- **Track record –** documented history of successful exits

The following table makes general observations about three of these characteristics, illustrating differences among financial first, impact first, and double bottom line GPs.

	Financial return	LP/Investor composition	Investments
Financial first	Market rate	Institutional fiduciaries Other market-rate investors and intermediaries	Tend to be in traditional companies in target places
Impact first	Concessionary	Government Foundations (Program Related Investments) Individuals	Tend to be in companies doing socially-beneficial work in target places
Double bottom line	Seeking market rate	Foundations (Mission Related Investments) Banks motivated by the Community Reinvestment Act Individuals Institutional fiduciaries	Tend to be in companies doing socially-beneficial work and/or in target places

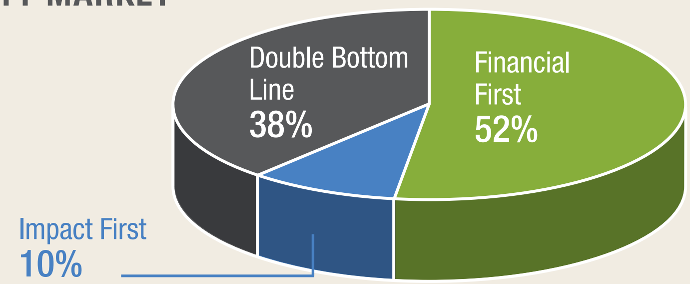
MARKET COMPOSITION AND LANDSCAPING

Financial first GPs have an estimated **$2.1 billion** in social impact investing, or over 52% of the total $4 billion in assets. These managers account for the remainder of $70 billion in total GP assets under management not directed to social impact investments.

Impact first GPs hold **$400 million** in assets under management, or 10% of total assets dedicated to social impact investing. All of the assets of impact first GPs are classified as social impact investments.

Double bottom line private equity managers hold **$1.5 billion** in assets under management, or 38% of total assets dedicated to social impact investing. All of the assets of double bottom line GPs are classified as social impact investments.

$4 BILLION U.S. SOCIAL IMPACT INVESTING PRIVATE EQUITY MARKET



Size and experience

InSight has categorized the GPs into six groups based upon a fund's focus (financial first, impact first, or double bottom line) and the year of GP inception. For year of GP inception, the year 2000 was selected as a cut-off point, with funds designated as either pre-2000 or post-2000 (including those formed in 2000) as a proxy for classifying GPs as more or less experienced. The matrix below lists the number of U.S. GPs that fit in each category, and the range of total GP assets under management (AUM) for GPs within this grouping (including assets directed to social impact and assets not directed to social impact in the case of financial first GPs).

		FUND FOCUS		
Year of General Partner Inception		**Financial First** N=30	**Social First** N=14	**Double Bottom Line** N=25
Pre-2000	N=29	16 GPs AUM: >$100 mil	5 GPs AUM: $25 mil- $100 mil	8 GPs AUM: $20 mil- $150 mil
Post-2000	N=40	14 GPs AUM: >$75 mil	9 GPs AUM: $5 mil- $50 mil	17 GPs AUM: $25 mil- $345 mil

The three groups with the most GPs are double bottom line funds post-2000 (17), financial first funds pre-2000 (16), and financial first funds post-2000 (14). While financial first funds are the most prevalent (30) within U.S. social impact investing, the rapid growth in double bottom line GPs is especially notable.

Financial first GPs have the largest pools of assets under management, with the smallest GP investing $75 million. These assets encompass all of a GP's investments including, in the case of financial first funds, those assets that are invested with no intent to generate social impact.

Newer double bottom line funds are larger than those created before 2000, suggesting a maturing of the market and growing support from investors for explicitly double bottom line strategies.

Impact first funds created post-2000 are more numerous, but smaller than impact first funds launched before 2000, suggesting the practice is less scalable than double bottom line investing.

		FUND FOCUS		
Investment Strategy		**Financial First** N=30*	**Social First** N=14	**Double Bottom Line** N=25
Early Stage	N=31	11 GPs	10 GPs	10 GPs
Growth Equity	N=29	16 GPs	2 GPs	11 GPs
Mezzanine	N=8	2 GPs	2 GPs	4 GPs

*Note: One Financial First GP is not included in this matrix as it utilizes a buy-out investment strategy

Investment strategy

In addition to separating funds by year of GP inception, GPs have also been classified based on investment strategy. Three categories were created based upon GP investment strategy, including early stage, growth equity, and mezzanine. There is just one buy-out fund among the 69 GPs in the landscaping.

Eighty-six percent of GPs making social impact investments focus on early stage and growth equity investments. Similar percentages of financial first (90%), impact first (86%), and double bottom line (84%) funds invest using early stage and growth equity strategies, demonstrating the dominance of these approaches in social impact investing markets.

Impact first funds heavily utilize early stage investment strategies given their smaller pools of capital, whereas a majority (53%) of financial first firms rely on growth equity strategies. Double bottom line funds incorporate early stage (40%) and growth equity (44%) strategies almost equally. Only a handful of funds fall within the mezzanine category, with the highest representation among double bottom line GPs.

SUMMARY FINDINGS

- 58 percent of GPs making social impact investments were created after the year 2000, indicating growing interest in the practice.
- The 58 percent of GPs created after the year 2000 represent 53 percent of assets under management. These newer funds are smaller than their more established counterparts – except in the double bottom line category, where newer funds have more assets.
- Twice as many GPs classified as double bottom line were formed post-2000 than pre-2000, demonstrating the growing conviction among GPs and their investors that financial return and intentional social outcomes can be achieved concurrently.
- 53 percent of financial first firms were created pre-2000, indicating a longer history of practice in this area, driven primarily by public pension fund economically targeted investment programs with the dual objectives of generating attractive financial returns and local economic development.
- An overwhelming majority (86 percent) of funds employ investment strategies focusing on early stage investments (44 percent) and growth equity investments (42 percent).

FUTURE DIRECTIONS: A FOCUS ON DOUBLE BOTTOM LINE INVESTING

As the most numerous group of GPs post-2000, double bottom line funds will see continued growth and are ripe for further investigation. InSight's new collaboration with CASE at Duke and ImpactAssets – "The Impact Investor: People and Practices Delivering Exceptional Financial and Social Returns"[5] – is an important step forward and will provide a more deeply informed, actionable, and "practitioner-powered" picture of impact investing strategies than ever before.

Whereas financial first funds bolt social impact on to a relatively conventional and known approach to investment, and impact first funds have a longer history of somewhat mixed performance in community development, double bottom line funds present a new and unique proposition: that social impact can be generated alongside uncompromised financial return.

5 http://www.pacificcommunityventures.org/research/policy-research/#c3

Impact first funds are likely to remain small and will continue to invest in early stage companies for more targeted social benefit. Some financial first GPs will create new double bottom line funds as the market matures and more dollars are available for these investments.

Additional Information on Social Impact Investing in Private Equity

INFORMATION PLATFORMS

ImpactAssets – www.impactassets.org
ImpactBase – www.impactbase.org
Global Impact Investing Rating System – www.giirs.org
Consultant Databases and Institutional Disclosures
Cambridge Associates - www.cambridgeassociates.com/
CalPERS - www.calpers.ca.gov

TRADE GROUPS

Global Impact Investing Network (GIIN) – www.thegiin.org
Mission Investors Exchange – www.missioninvestors.org
Community Development Venture Capital Alliance – www.cdvca.org
National Association of Investment Companies – www.naicvc.com
National Association of Seed and Venture Capital Funds – www.nasvf.org

About PCV InSight

PCV InSight is the thought leadership and non-financial performance evaluation practice at Pacific Community Ventures, a Community Development Financial Institution and 501(c)(3) committed to increasing the availability of capital and economic opportunities in underserved communities.

PCV InSight has provided consulting services to the California Public Employees Retirement System (CalPERS) since 2005, evaluating and reporting on the social and economic benefits of all $17 billion of CalPERS investments in California across asset classes.

PCV InSight also documents the non-financial impacts of the targeted equity investments of fund-of-fund managers Hamilton Lane and Macquarie Funds Management and the mission-related investments of Annie E. Casey Foundation and the Northwest Area Foundation. In addition, through support from The Rockefeller Foundation, Omidyar Network, Annie E Casey Foundation and others, PCV InSight provides policy research and market analysis in impact investing.

More information is available at www.pacificcommunityventures.org/research.