



The importance of this link in the flow of capital cannot be underestimated at this early stage of the sector's development. Impact fund managers bridge the gaps in knowledge (both financial and social), create investment scale and amplify reach that are necessary to allow institutional investors to participate in the sector with confidence. And yet at this stage, they are struggling with their economics and need to scale their assets under management.

### Emerging successes

All is not lost, however. Some of the more established and credible niche fund managers are beginning to raise funds for their second private equity-style investment funds and there is increasing and genuine interest in the sector from mainstream investors.

At least three impact fund managers are in the market for second funds at present: Bamboo Finance, Developing World Markets and Leapfrog Investments.

While the investment approaches may differ, the managers have developed credible products, metrics and expertise and can now claim exits at reasonable rates of return. So the ingredients for successful fundraising are in place.

If they can successfully raise second funds, some of the pressure on their operating economics will ease (but will not be eliminated) and the likelihood of a viable core group of impact fund managers emerging will increase. In and of itself, this ought to be a potent accelerant for unlocking institutional capital. Without this, institutional capital is unlikely to enter the sector at scale.

### Mainstream interest

Are these pioneers the only hopes for the sector to grow its capacity to fund interesting impact investments? No. There is an increasing level of awareness, interest and enquiry from an unexpected quarter: mainstream private equity fund managers. Recent returns to PE firms, and particularly the shareholders of PE firms have been underwhelming. The main listed U.S. PE firms appear to be moving along a path to being asset gatherers in order to reduce their dependence on the performance of a single fund vehicle. The economics of adding uncorrelated portfolios and teams of fund managers are generally attractive as they typically enjoy positive operating leverage at a firm level and can benefit from offering a wider array of products to their clients. In addition, in some of the more mature corners of the PE world, a trend towards direct investing by limited partners is disintermediating traditional PE managers.

Visit **INSEAD Knowledge**  
<http://knowledge.insead.edu>

For today's niche impact managers, there may be cultural issues (to say the least) but a combination with mainstream PE could have material platform benefits. The operating leverage works both ways and in reality, the core strategic objective of both impact and mainstream managers is quite similar: To facilitate the efficient investment of risk capital. Further, the association with a known PE brand would give cachet to open institutional doors. Some may see this as an uncomfortable alliance, but it is not one to be ruled out.

So where does that mean the impact investing world is headed? Near term, we are entering a period that may well mark the end of the beginning. The industry is moving to focus on practical scale and execution issues. Second funds, established track records, exits with market returns, dialogue with institutional investors to understand their constraints, and the evolution of social metrics all give comfort that the sector is growing up. Looking ahead, an awkward adolescence can be expected: a period characterised by growth spurts, sensitivity and setbacks before moving into a more mature, settled state. On the other hand, it is not yet too late to dismiss the possibility that we will still be debating definitions in five years while stuck in a modest niche. The opportunity cost of doing so would be incalculable and the result, disappointing.



**Ian Potter** is an INSEAD Distinguished Fellow with **INSEAD's Global Private Equity Initiative (GPEI)**. Based in Singapore, Ian focuses on Impact Investing, Commodities and Private Equity. He is also a Senior Advisor to Morgan Stanley, sits on several Boards of Directors and is the Managing Partner of Lion City Capital.

Follow us on twitter [@INSEADKnowledge](https://twitter.com/INSEADKnowledge) or Facebook  
<https://www.facebook.com/Knowledge.insead>.

Find article at  
<https://knowledge.insead.edu/responsibility/impact-investing-unleashing-institutional-capital-2889>

Download the Knowledge app for free

