Beyond financing: the rise of direct lenders as catalysts for impact

As we navigate an era defined by unprecedented environmental, technological, and geopolitical shifts, financial players play a pivotal role in shaping a more resilient and sustainable economy.

By *Aurore Gauffre*

Financing companies that contribute directly to the SDGs with their products or services remains critical, as is the ability to actively support traditional businesses in their transformation. In this context, direct lenders, by structuring flexible financing solutions and engaging deeply with portfolio companies, have the potential to drive meaningful impact.

Choosing an impact investment approach

Impact finance is an investment strategy aimed at generating measurable positive social or environmental outcomes while achieving financial returns. Since no standardised regulatory framework exists, its definition depends on market practices and the investor's chosen methodology. However, three core principles are commonly recognised:

- Intentionality: a clear commitment to achieving non-financial benefits.
- Measurement: a systematic approach to tracking progress.
- Additionality: the investor's direct contribution to creating the targeted impact.

Two complementary approaches exist within impact finance. The first is the 'aligned' approach, which focuses on investing in companies that already generate a significant portion of their revenues from sustainable products and services, helping them grow their activity and positive impact. The second is the 'transformational' approach, which involves supporting conventional businesses in their transition toward sustainable models.

The advantage for direct lenders

As investors in mid-sized companies, direct lenders often hold a significant share of a company's debt – sometimes the entire debt – through 'unitranche financing'. This gives them a unique position based on direct relationships with the company and an influential role in governance, such as holding an observant board position.

Direct lenders can leverage two aspects of their unique position to drive impact, especially transformational impact. The first is structuring tailored financing and documentation by embedding sustainability-linked mechanisms, aligning financial incentives with sustainability performance. The second is providing operational and strategic support by engaging in-depth with management teams and offering expertise in sustainability strategy and implementation.

Structuring tailored financing and documentation

Sustainability-linked debt is a loan or bond where financial conditions, particularly interest margins, are adjusted based on the borrower's achievement of specific Sustainability Performance Targets (SPTs). If the borrower meets these targets, they benefit from a reduction in the interest margin (usually around 10-15bps). Conversely, failure to meet them may lead to an increase in the margin. Common SPTs include reducing carbon emissions or improving diversity within governance bodies.

Initially, when sustainability-linked loans emerged in the private market in 2019, these adjustments were only downward. However, they are increasingly bidirectional, reinforcing alignment between the company and its ESG objectives. An impact lender structures the loan mechanism in line with its theory of change, ensuring the financial benefit of achieving sustainability targets offsets implementation costs. Additionally, lenders may negotiate specific contractual clauses committing the company to an ESG roadmap, knowing that non-compliance does not instantly trigger early repayment.

An impact lender can offer substantial margin reductions, up to 1%, with symmetrical increases. Their ability to provide such incentives is key to demonstrating intentionality and additionality in transformational impact approaches. Accepting such an interest rate structure reflects a company's commitment to an impact-driven business plan.

Providing operational and strategic support

Beyond pricing mechanisms, impact lenders can offer strategic and operational support to implement sustainability initiatives. This includes assisting portfolio companies in navigating regulatory frameworks, adapting business models to the green transition, fulfilling client requirements such as ESG reporting, and developing best-in-class responsible employer practices focused on talent attraction and retention.

Impact direct lenders can rely on internal operating partners dedicated to

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sustainability. These experts provide broad sustainability support and connections to external providers for specific sustainability actions – such as solar panel installations, Green PPA agreements and CSR manager recruitment. This centralised approach enhances efficiency, pricing, and oversight. Furthermore, in cases where private equity sponsors lack ESG maturity, the company’s management increasingly depends on the direct lender for sustainability guidance.

Leading to better risk management

Evidence increasingly shows that ESG improvements drive long-term value creation and better risk management. Benefits include new revenue streams from sustainability products and services, lower employee turnover, enhanced energy efficiency, and other cost savings improving EBITDA.

For example, Eurogerm, an agri-food group specialising in wheat-flour-bread, partnered with Artemid for an impact loan supporting its decarbonisation strategy aligned with the Paris Agreement. By implementing operational levers to reduce emissions, Eurogerm developed an innovative low-carbon brioche in 2024, achieving a 50% carbon reduction compared to standard products and a new revenue stream.

Additionally, ESG integration strengthens lender relationships with portfolio companies by engaging on sustainability topics with mid-level management, enabling access to information, early risk detection and reputational risk mitigation.

Documenting intentionality

The common practice for Impact and Article 9 fund managers is to demonstrate their intentionality by implementing enhanced governance mechanisms and alignment of interests within the fund documentation.

- Governance mechanisms: setting up a dedicated ad hoc committee comprising fund investors and external experts ensures proper monitoring and evaluation of impact or sustainability objectives. If objectives are not met, the committee may require corrective actions, such as engagement with company leadership, additional financing, or, as a last resort, initiating a divestment process.
- Alignment of interests: a portion of the fund’s carried interest or performance fees can be tied to achieving impact objectives, ensuring full mobilisation of the investment team towards both financial and extra-financial goals.

A unique role to deliver impact

Direct lenders are uniquely positioned to drive meaningful impact by integrating sustainability into their financing strategies and governance influence. By structuring tailored financial incentives, offering operational support, and aligning stakeholder interests, they can accelerate the transition to more sustainable business models. Their role goes beyond financing; it is about fostering long-term value creation and risk management. As impact finance continues to evolve, direct lenders have the opportunity to become key enablers of transformational change in the global economy. ■

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SUMMARY

Direct lenders can create meaningful impact by structuring flexible financing solutions and actively engaging with portfolio companies.

Linking financial incentives (positive and negative) to sustainability performance targets is a key way for lenders to enhance impact and financial returns.

Beyond pricing mechanisms, lenders can provide strategic support to implement sustainability initiatives – from supporting best-in-class responsible employer practices to R&D for sustainable innovation or negotiating green power purchase agreements.