Private Equity International

Getting to the 'real juice' of ESG value creation

The private equity industry has made progress on the pressing and fiddly issue of ESG data; it is now looking forward to 'a focus on outcomes'. Toby Mitchenall reports

The private equity industry has made great strides on one of its most pressing ESG challenges: data.

The desire for environmental, social and governance performance data that allows like-for-like comparison between portfolio companies and funds has been a talking point among sustainability professionals for almost as long as the ESG initialism has existed.

A question from the floor at *Private Equity International*'s Responsible Investment Forum: Europe in November was: "Are we really still talking about this?"

We are, and with good reason. Comparable data sets will allow analysts to track correlation between ESG performance and financial outcomes. They will take ESG from the anecdotal to the quantifiable, and move the conversation on once and for all from "Is this costing us money, or making it?" to "How do we do this well?"

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>
> **ABRIELLE ROSENTHAL**
> **Towerbrook**

There is progress to report on this front. When the Sixth Swedish National Pension Fund started to gather portfolio greenhouse gas emissions data in 2015, "very few GPs could share qualitative portfolio company data with us", said Anna Follér, head of sustainability at the pension.

"Since the launch of the EDCI, that has dramatically changed," she continued, referring to the ESG Data Convergence Initiative, which more than 375 LPs and GPs had signed up to by late 2023 in order to measure and report ESG data in an aligned way. "Around half of our GPs are EDCI members, so we could definitely see how that possibility to collect data went through the roof."

Follér was speaking on stage at the forum on one of a number of panels addressing data. She explained that when the pension requested emissions data in 2023 in line with the EDCI, the average response rate was three days, with "quite a few responding with the

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data in a perfect format within the day".

None of the GPs declined to send the data, she added, with only one sending just anonymised data ("completely useless for us, actually"). "I mean, that's a huge difference," Follér said.

A more cohesive approach

ESG data disclosure practice formerly comprised an incongruous hotchpotch of divergent reporting standards and guidelines, but it is starting to look more like a cohesive, complementary set of approaches.

Alongside Follér on stage was Abrielle Rosenthal, chief sustainability officer at Towerbrook, a GP and early supporter of EDCI and other frameworks. When asked about the ESG measurement and reporting framework released by industry body Invest Europe, Rosenthal said it was "very complementary" to the other frameworks Towerbrook is using, such as the EDCI.

"That's the point here," said Rosenthal. "These frameworks are not one or the other; they are complementary."

The goal, she added, is that when frameworks ask for a particular metric, they all ask for it in the same way. "As [frameworks] converge, GPs will be able to look – with a lens of materiality – and identify the frameworks that work best for their portfolio. We found Invest Europe a very good tool and easy to use, and [it] added value in our data collection process."

Tricia Winton, a partner and global head of ESG for Bain Capital, also welcomed new frameworks, referencing in particular the recently launched Private Markets Decarbonisation Roadmap (PMDR).

"We pressure test against these various frameworks… they bring new angles and new emphasis, and they are helpful to push forward our progress and approach, showing how we need to modify or build on it over time," Winton said.

Michael Marshall, head of sustainable ownership at pension fund Railpen, added that his organisation is particularly supportive of IFRS S1 and S2, a set of global disclosure frameworks launched in 2023. "We've been using the SASB standards [a predecessor to the IFRS frameworks] for many years when analysing a listed security where we are taking active risk, or a co-investment opportunity in our private markets book.

"We are very pleased when general partners use that sort of materiality framework for their own ESG analysis or consultants do it on their behalf."

While this is immediately relevant for listed securities, Marshall noted, he

'Maturity' is key to engagement

Understanding a portfolio company's ESG maturity is the best starting point when trying to collect data, according to panellists at the Responsible Investment Forum. *Charles Avery* reports

What is the secret to effectively engaging with portfolio companies to gather quality ESG data? The answer begins with a data maturity assessment, according to panellists at *PEI*'s Responsible Investment Forum: Europe in late 2023.

"We start looking at maturity; where is this company specifically?" Ellen de Kreij, lead adviser of Apax Partners' ESG practice, said on a panel on ESG engagement. "How mature is this business in its journey? Has it done anything on ESG before? Is it 'medium' – has it already got some policies, but it doesn't have targets… etc. And that will inform how we then engage with companies."

Apax is a stalwart of European private equity and invests in the tech, services, healthcare and internet sectors, according to its website. It launched its debut impact fund in 2021, for which it has tied a portion of the carried interest to impact KPIs.

"If you have a company that is not ESG mature, then by default probably the data that you're going to get if you ask for any information, it will just be rubbish," de Kreij said. "So then you'll be moving rubbish through the system that you can't really do any analysis on. What you need to ensure is that they also understand what things they need to develop in their journey."

As a result, though Apax's approach to ESG engagement is always "slightly different", it is always "very much focused on the maturity of the businesses".

John Laing sustainability head Sandrine Lalmant emphasised the importance of understanding maturity in a separate panel. Her firm has set one of the most ambitious portfolio ESG targets in the infrastructure space; it hopes to have aligned 70 percent of its assets under management with net zero by 2030, and 100 percent by 2050.

"One of the things that we've been doing is that we've implemented an ESG maturity assessment that's based on the key pillars of our ESG strategy," said Lalmant. "So when people fill in their data, the output of that data is not just a data set. The result is this maturity metric, and that's a lot easier to discuss [with portfolio companies]."

suspected it wouldn't have a significant short-term impact on privately held companies.

Next stop: audit

GPs have one eye on a future where ESG data is not just self-reported, but is audited by third parties. "We [take the] view that our ESG metrics are going to sit alongside financial metrics and be audited over time," said Winton. "We are building to that capability."

Towerbrook is working on a similar assumption, said Rosenthal: "We are also fully expecting that the market will move to one in which this data is assured over time similarly to financial metrics; so we are building with that in mind."

One should not assume, however, that the involvement of a third party will necessarily guarantee the quality and consistency of data. Railpen's Marshall relayed an anecdote whereby an LP peer had been trying to get a handle on its own operational carbon footprint. By using two separate consultancies working on the same underlying data, the pension came up with numbers ranging from 15,000 tons to 24,000 tons per year. "This is the state of play right now," said Marshall. "We and our general partners are not alone in hopefully improving over time."

While investors are now using a common language and toolbox to calculate certain common KPIs, others – such as avoided emissions, an important metric in tracking the impact of climate investments – are works in progress. As in other areas of sustainability there are voluntary, industry-led initiatives plotting a way forward.

In this case, it is Project Frame, which has more than 750 community members collaborating on how to calculate forward-looking emissions data, often referred to as Scope 4. "There's a lot more to do to really get those standards out there and consistent," said Matthew Harwood, chief strategy officer at VC firm Climate Investment, during a discussion on energy transition impact investing later in the day.

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TRICIA WINTON
Bain Capital

Scope 4 is an area in need of more standardisation work, because it "is still really tricky and incredibly time consuming if you want to get it right", said Shami Nissan, a partner and sustainability head at infrastructure firm Actis.

Beyond crunching the numbers, GPs seem to be looking forward to a time when their energy is focused less on the data itself and more on the outcomes.

"We have to move from a discussion of metrics to more of a focus on outcomes," said Bain Capital's Winton, adding that standardisation is hopefully accelerating this shift. "Instead of looking at how many companies are reporting on employee engagement, what's much more important is how an industry-leading NPS [net promoter score] is generating performance. The real juice is in focusing on the outcomes and linking that to value creation." ■