



# Private Equity - Developing ESG Mindset For Value Creation

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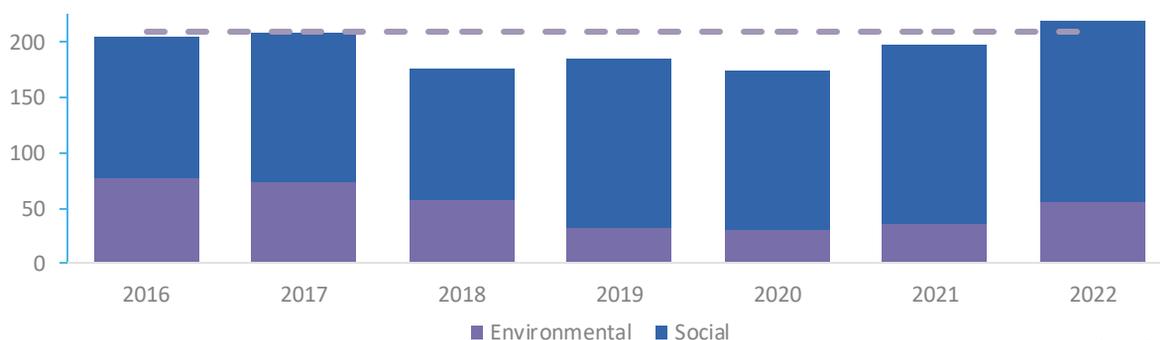
# Private Equity - Developing ESG Mindset For Value Creation

ESG jargons like 'Corporate Governance', 'Sustainable Investments', 'Social Investing', 'Green Investing' or 'Ethical Investing' have become more prominent in the last few years among Private Equity firms owing to their gradually shifting mindset. However, the idea still faces some scepticism in terms of considering it at par with critical investment parameters like 'due diligence'. The shift in mindset, on the other hand, is quite encouraging for ESG focused companies seeking new investments. Once considered barely a way to get constructive press or influencing socially conscious employees, the framework is now considered by Limited Partners (LPs) and General Partners (GPs) as a tool for value protection and creation. The curious experimentation being done by these stakeholders in this domain makes it an interesting space to watch.

## Studies support changing thought process

According to Sustainable Investments Institute, **support for environmental and social proposals at the shareholder meetings of US companies increased to 32% in 2021 in comparison to 27% in 2020 and 21% in 2017**. Based on the index provider MSCI's research, companies backed by a strong sense of purpose and embedding sustainability tend to perform well and score higher ESG ratings associated with higher profitability and lower tail risk.

**No. of US shareholder resolutions related to environmental and social issues appearing on proxies of Russell 3000 companies exceeds 2017 levels**



Source: Bloomberg Intelligence

Structurally, the approach of social impact-minded investors has transformed from subdued participation to aggressively looking out for opportunities resulting in significant inflows to SRI and ESG-oriented strategies funds. 'Green' business activities such as a sustainable supply chain or recycling of materials have gathered significant interest recently.

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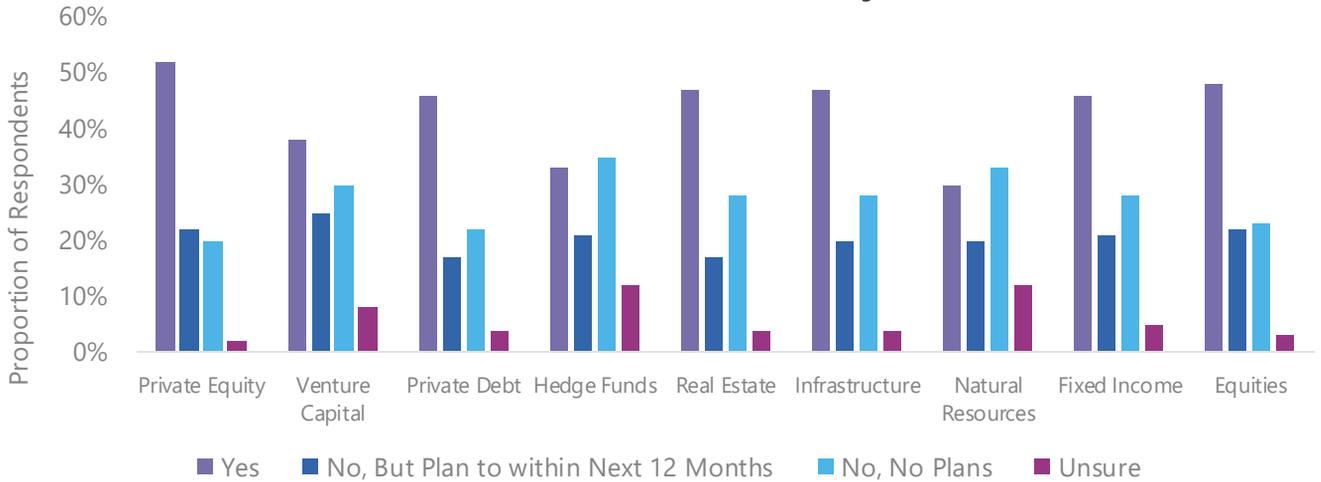
**Big players leading the way to standardize ESG reporting and tracking KPIs**



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As per a Preqin report, ESG investments now account for 36% of private capital under management with an estimated \$3.10 trillion committed. The private equity asset class, leads the sector by assets with \$1.82 trillion invested in ESG funds. The trend continues with ESG managers raising \$403 billion in the first nine months of 2021, compared to \$506 billion in all of 2020.

## Investors with ESG Investment Policies in Place by Asset Class

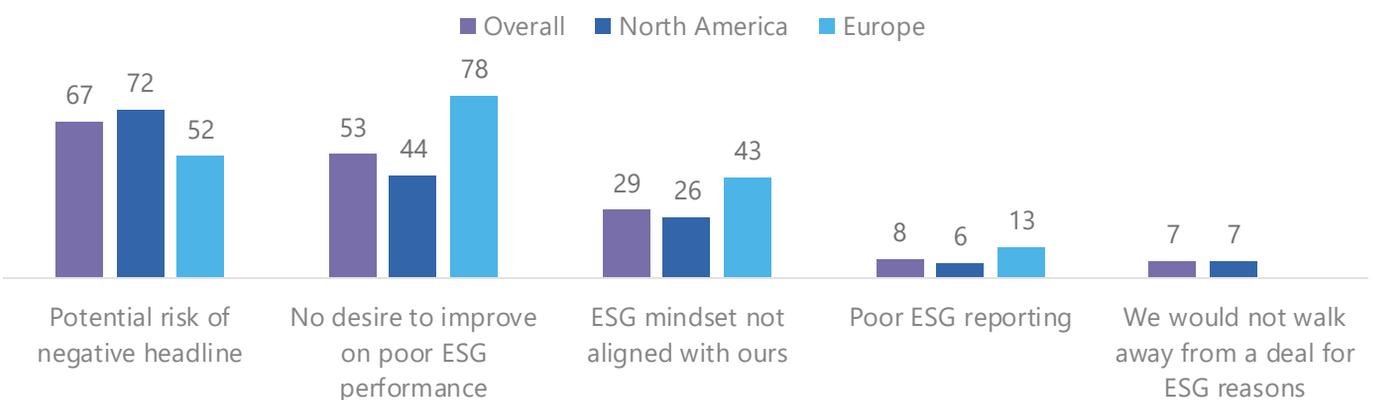


Source: Preqin pro. Data as of September 2021

A recent Bain survey showed that an increasing percentage of LPs now factor ESG issues into investment decisions and consider how they will affect private equity (PE) investments. The trend is more prominent in Europe than North America owing to a series of regulatory measures taken by the former. 44% of North American LPs considered a lack of desire to improve on poor ESG performance to be a deal-breaker, compared with 78% of European LPs. Over the next few years, most LPs will focus their efforts on ESG reporting, internal capacity building, and DEI (diversity, equity, and inclusion). This survey also emphasise that ESG-related risks and a lack of ESG performance improvement are the most dominant reasons LPs walk away from investments.

## ESG reasons causing LPs to walk away from a potential investment

Share of respondent (%)



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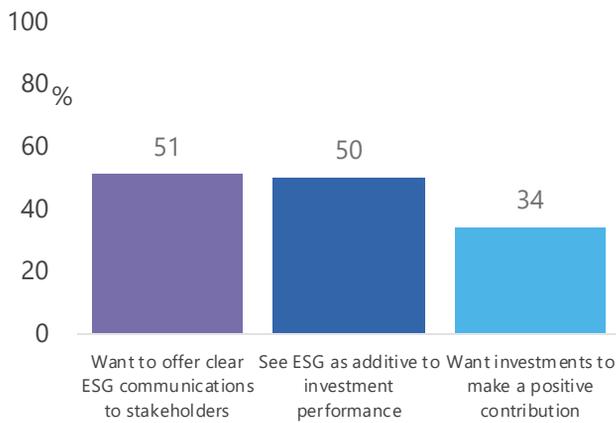
## Will ESG actually drive value for PE? The belief is real....!!

By virtue of private equity firms' main consideration of a profitable exit, embracing an ESG strategy would by default draw significant attention to metrics. Extensive scrutiny of potential ESG-friendly funds requisites transparency and supporting data. It is shaping the resilience of private equity firms' due diligence and judgement of management's approach toward ESG and willingness to improve their company's ESG credentials, in turn adding value to their investment.

### Risk mitigation versus value creation - ESG commitments influence valuation premiums

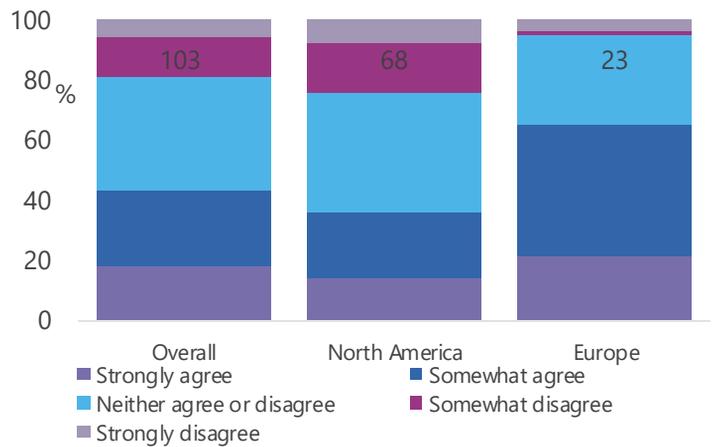
#### Top three reasons why LPs incorporate ESG

Share of respondents (%)



#### LPs' views on whether ESG drives valuation premiums

Share of respondents (%)



### GPs view ESG as a way to create and protect value

% of respondents who ranked each answer One Of their top three drivers Of ESG activity



Source: PWC Private Equity Responsible Investment Survey, 2021

CAPITAL MONITOR



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## ESG Driving Elevated Returns

There have been a few tangible factors that are driving the returns higher for PE firms post ESG integration in their strategy. Enhancing profitability is the ultimate aim once a private equity firm comes onboard. Embracing ESG is helping that cause in multiple ways including:



### **Lower Financing Cost**

On LBO Transactions, which are quite prominent



### **Revenue Growth**

Through inclination towards green products for the millennials who are willing to pay more for sustainable products



### **Cost Optimization**

Through efficient use of resources including energy usage, recycling and intelligent sustainable products designing



### **Employee Satisfaction**

ESG oriented businesses will attract the best talent in future as the generation becomes more aware and action driven



### **Regulatory Framework**

Businesses with strong ESG-related policies might find it easier to sail through stringent upcoming regulations and instead focus more on growth



### **Fund Inflow**

Significant portion of New Money flowing to ESG funds from current generation of investors who have inherited a lot of money

## How Evalueserve Can Help

With the fast-evolving PE landscape and the sheer amount of opportunities in the market, every firm would like to move quicker and identify the best ESG focused investments. Evalueserve currently partners with private equity firms to speed up their opportunity identification time and help them on every step of the deal value chain. Key support areas are highlighted below.



**Opportunity Identification**



**ESG Scores & Benchmarking**



**Research & Deal Evaluation**



**Thematic Screening and ESG insights**



**Financial and Commercial Due Diligence**



**Tracking green finances for portfolio companies**



**PortCo Support**



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## About Evalueserve:

Evalueserve is a leading analytics partner powered by mind+machine™, that helps clients get the most out of their core processes. Our global team of 4,000+ experts is dedicated to helping our clients and partners meet their goals. We've successfully applied our mind+machine™ approach to the management and transformation of business processes across all functions.

We work with 500+ clients across a wide range of industries and business functions, helping them to make better decisions faster; reach new levels of efficiency and effectiveness; and see a tangible impact on their top and bottom line.

## About the Authors:



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**Thank You**  

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