PODCAST
ESG AND INVESTMENT COMMITTEE BOARDS

ESG is becoming increasingly important for private equity firms and their investors. In a recent *Real Deals* podcast hosted in association with JTC, a panel of experts discussed the reasons for ESG's growing influence and what this means for private equity investment committee boards.

ON THE PANE:

Marie Fitzpatrick, *senior director of fund services, JTC*

Alison Hampton, *founder, Alma Verde Advisors*

By Nicholas Neveling

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Environmental, social and governance (ESG) factors have taken a central role in business decisions during the last decade. ESG's influence now extends to where investors are directing capital, how businesses interact with counterparties and how consumers behave and spend.

What, then, are the implications of ESG for investment committee boards? How should organisations report on ESG and what does that mean for how investment firms operate and make decisions?

JTC's Marie Fitzpatrick and Alison Hampton from Alma Verde Advisers sat down with *Real Deals* for a podcast where they shared their thoughts on how ESG has evolved and interfaces with the decisions private equity professionals are making day-to-day. *Here are some of the highlights from the discussion:*

Picking the right battles

Fitzpatrick said that in the funds industry ESG first started to come onto the radar as a serious topic around a decade ago. The focus on ESG has come a long way since.

In 2013, Fitzpatrick noted, only 8 per cent of the private equity market had adopted an ESG strategy. Today, the absence of an ESG strategy would almost certainly see a manager missing out on potential capital commitments. The adoption of an ESG plan was therefore still a relatively new process for managers, and best practice was evolving all the time.

Fitzpatrick said that ESG was a broad subject and could be measured against innumerable standards and guidelines. Instead of trying to cover off every single ESG theme, however, managers would be better served by focusing on what was most important to their firms. This was the most effective way to build an ESG framework into a private equity house's day-to-day workings.

Fitzpatrick said that managers should approach ESG from three angles. Firstly, managers should "own their ESG plan" by identifying what was important to their team and adapting processes to reflect these values. The second factor to consider was to be clear on how to measure and report on ESG at fund level and include this in the Limited Partner Agreement (LPA). Finally, managers should be attentive to the ESG objectives of potential investors and reflect these requirements as much as possible, as this could determine whether an LP committed to a fund or not.

"For fund managers, it's a balance of not only their company values, but also the broader, long-term considerations of their stakeholders," Fitzpatrick said.

How to make ESG happen:

Hampton said GPs who had come to grips with ESG all displayed similar characteristics.

The "tone from the top" was essential. This started with setting up processes that enabled GPs to identify material issues and outline the business case for making change early on. Buy-in from deal teams was crucial.

"It's feeding it right the way in upfront… almost into the point of origination. It should inform how a GP looks at what they can do for a business. Private equity acquires businesses that have room for improvement. ESG is one of the key areas they can come in and make improvements," Hampton said, adding that ESG should also flow into the post-deal value creation plan too, and that effective GPs signal their ESG plans to management teams and portfolio companies early on.

Measurement of ESG was also central to effective ESG implementation. Fitzpatrick said that the private equity industry as a whole was yet to settle on a single framework. And, work by the UN and G20 put broad principles in place, but it was up to managers to interpret and apply these themes to their specific situations.

"ESG reporting is bespoke to the manager. It has to be set to where the manager has actually decided what it wants to report on and include. It could cover reduction in emissions and water use or job creation at portfolio company level," Fitzpatrick said, adding that there had been significant improvements in the collection of data and analysis to facilitate ESG reporting.

Where does the investment committee fit in?

Fitzpatrick said the investment committee's role was one of leadership and decision-making, and ensuring that investments under consideration met the criteria laid out in the PPM and LPA.

"The people on the investment committee have to be committed to the ESG policy of the firm. The committee's role is to ensure that every deal meets all the investment criteria, including ESG," Fitzpatrick said, adding that ESG was no longer a "side thought" for investment committees.

For Hampton, the effective implementation of ESG by the investment committee and firm leadership required a combination of putting in place governance structures and policies in place for people to follow, as well as integration of those policies into culture and day-to-day business. This involved going right the way down into how the performance of individuals at a firm was measured and assessed.

"There is no point in putting a policy in place if it doesn't actually embed itself into the DNA of a firm, and starts to become business as usual," Hampton said. "There is no point in saying ESG is important if individuals are only measured on how many deals they do… It has to be fed into that performance assessment metric and viewed as a key competency for a deal professional."

● **The podcast is live on realdeals.eu.com & other media players.**