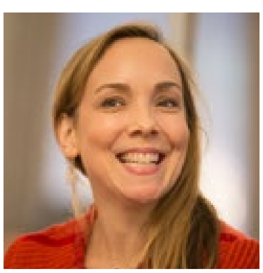
Managing Portfolio Companies' ESG Efforts

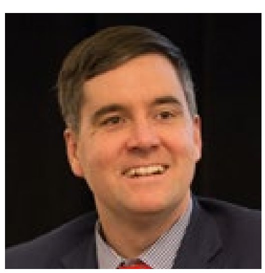
Four experts discuss how their firms instill ESG values into private equity investments

Alan Kao
Principal and Global Service Line Leader for Compliance, Strategy and Transaction Services, Ramboll Environ

Jackie Roberts
Chief Sustainability Officer, The Carlyle Group



Elizabeth Seeger
Director, Public Affairs, KKR



Lee Coker
ESG Officer, Oak Hill Capital Partners

Alan Kao, Ramboll Environ: What sectors have you found to have the best opportunities for ESG impact, and in what sectors has ESG been more of a challenge?

Jackie Roberts, The Carlyle Group: There are certain sectors, like oil and gas and industrials, in geographies like developing countries, where investment professionals are very sensitized to these issues, and they generally get a hard look in due diligence—whether it's looking at contingent environmental liabilities or labor issues in developing countries or operational risks. When I think about sectors where we can have an impact, we usually think about questions that start with "Where is what I call 'private governance' truly playing a role here?"

In a five-year hold period, we can look at where customer and competitor dynamics are changing the lay of the land. We look at this in terms of both the risks of falling behind new types of risks for that sector, and also where there are opportunities for developing new products or services. We see that a lot, for example, in the consumer sector. When you have a large retailer, like Walmart, scoring on sustainability, [ESG efforts] are all driven by different supplier relationships and buyers driving changes. I think that HR workforce strength issues are an area where our sector can play a major difference. For instance, our sector could have a big impact on gender diversity, racial diversity, health, and safety.

Kao: How do you get your arms around a large portfolio? How do you prioritize?

Lee Coker, Oak Hill Capital Partners: When I was at EDF [Environmental Defense Fund], we partnered with Oak Hill Capital's portfolio to answer that question for the firm and for the private equity sector more broadly. We narrowed it down to

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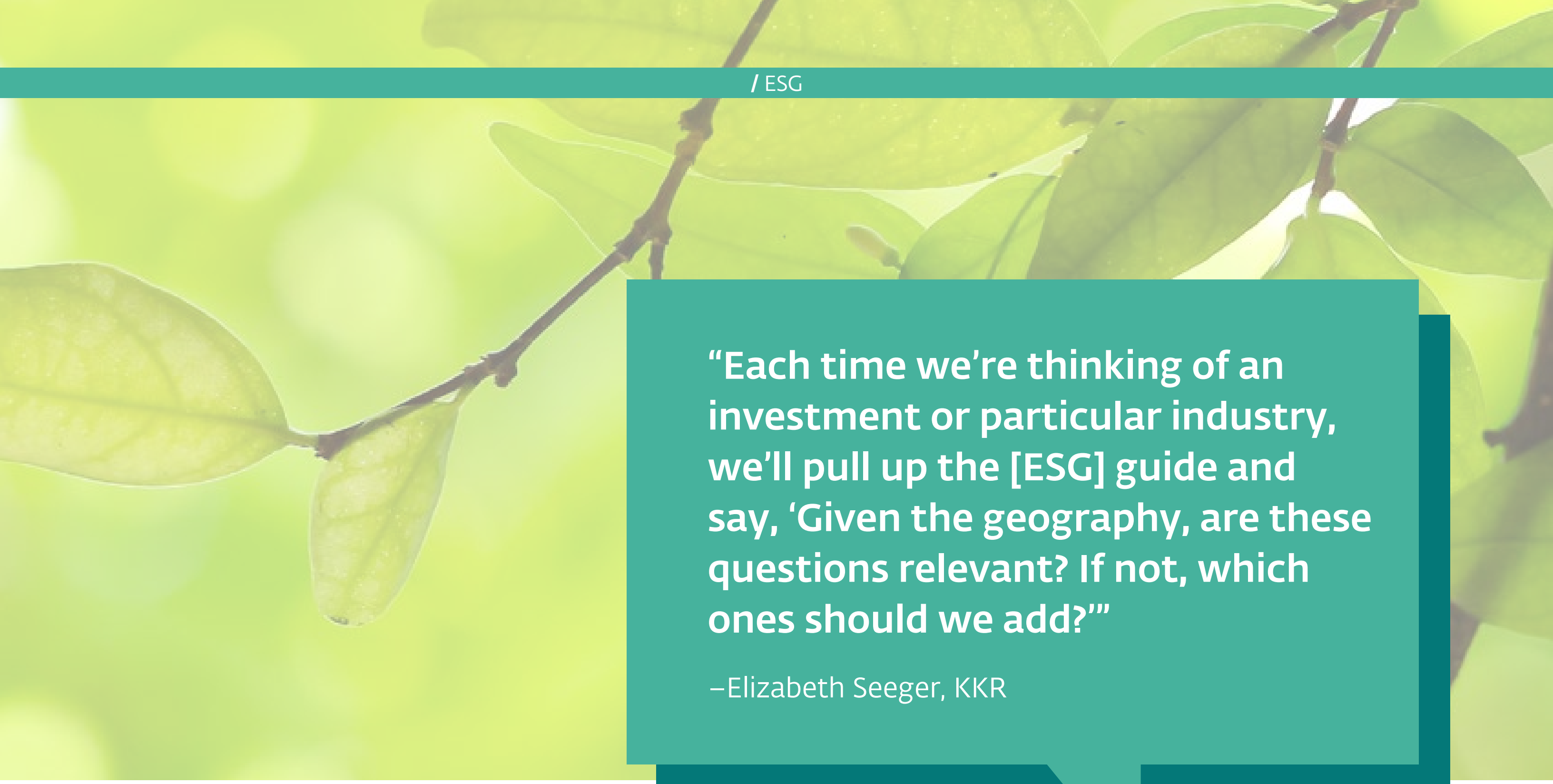

“Each time we’re thinking of an investment or particular industry, we’ll pull up the [ESG] guide and say, ‘Given the geography, are these questions relevant? If not, which ones should we add?’”

–Elizabeth Seeger, KKR

three things. The first was considering the current state of the business. What stage of investment is the company in? What are the business’s top priorities, and how could we tie in ESG initiatives into those activities? Another was where the opportunity is, from an environmental or social impact perspective. The next was a check to ensure that improving the ESG profile would also create significant financial value.

Elizabeth Seeger, KKR: At KKR we, early on in the process, developed a series of guidelines. Each time we’re thinking of an investment or particular industry, we’ll pull up the guide and say, “Given the geography, are these questions relevant? If not, which ones should we add?”

Roberts: I think the role of LPs in asking the hard questions about every company is certainly helpful in making sure [that], over time, this is disseminated throughout. The deal professionals have to continue developing this capacity and be trained to learn about [ESG] and see the value in being well-versed in the subject.

Kao: What are some specific examples of ESG strategies that you’ve successfully deployed?

Seeger: Two years ago, KKR Capstone hired a full-time energy engineer who works solely with KKR private equity portfolio companies and real estate portfolio companies to help them think through what is the business case for resource efficiency improvements, what vendors they can use, what are some of the best practices that others are applying. And so, by providing this resource and guidance, we’re really able to drive more progress.

The other is the Responsible Sourcing Initiative, which we’ve been running with BSR as our partner since 2010. And in that case, we’ve been going to large numbers of portfolio companies, almost 30 companies, to help them assess what are their policies and procedures related to low-cost country sourcing.

Kao: Do any of your firms tie ESG factors to compensation or other incentives for the deal teams? And if not, do you think that that’s something that will be coming in the future?

Coker: Identification of ESG factors is integrated into the due diligence process and is included in investment committee memos. Deal teams are focused on these factors from the beginning of an investment to understand how these issues may impact the risk/return profile of the investment.

Seeger: In our case, compensation isn’t tied to any one particular KPI of any sort—ESG or not. It’s really evaluated on three criteria: commercial impact, living the firm values, and leading and managing people.

Kao: Have any of you been witness to losing a deal because you pressed a potential investment on ESG factors?

Roberts: No, but I think the reverse has been true, which is that we’ve had some deals come along, with a very strong ESG component, that have been highly sought after and we lost because it got bid up to a level that our deal teams felt like we couldn’t match it. ■