Private Equity International

Responsible Investment 2021

February 2021 • privateequityinternational.com

KEYNOTE INTERVIEW

Private equity's opportunity to lead global change

As the drivers of an industry-wide focus on impact investing and ESG pick up pace, KPMG's Tania Carnegie argues the opportunity for private equity is significant, particularly when players collaborate

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Q Given the events of 2020, how do you see the private equity industry's focus on ESG changing in 2021, and what do you think the new drivers will be?

The past year demonstrated the increasing relevance of ESG, and how, when managed effectively, it contributes to value creation and risk mitigation. As a result, we are seeing private equity firms incorporate ESG throughout the investment lifecycle in a more rigorous way.

Recent events have exacerbated existing societal and environmental concerns. The global pandemic, the Black Lives Matter movement, wildfires and other natural disasters have all impacted the economy, and the ability of companies to carry on business as usual. Companies with an effective ESG strategy are better equipped to deal with such crises and may not suffer the effects as deeply.

There are a number of factors influencing the view of ESG as a strategic imperative, including LP expectations and the increased interest of regulators. Changing expectations of public companies around stakeholder capitalism also provide opportunities to create value at portfolio companies, especially ones on track for an IPO.

Talent attraction and management is also a key driver. Increasingly, people expect to work for organisations that align with their values, and a firm's commitment to ESG is one of the ways it conveys what it stands for. If this energy is harnessed correctly it can have a tremendous impact on culture, which has positive implications for private equity firms as employers, and for the companies they invest in.

"The opportunities for private equity firms associated with supporting the transition to a low carbon economy extend beyond environmental implications"

Q Do you see a new impetus towards impact investing? How different are the drivers for ESG?

The pandemic amplified the severity of key societal and economic issues such as inequality, and added to the urgency for commercial solutions at scale – which is the domain of impact investors. Additionally, the pandemic dramatically increased the pace of change as we saw with the rapid transition to digital as many scrambled to work, learn or access healthcare from home. This also makes clear the need for a fundamentally different way of doing things, as well as a new sense of what is possible.

As a result, there was a flurry of activity in 2020 from a transaction perspective as well as new fund development and expansion of existing platforms. This further demonstrated the range of opportunities impact investing represents across different industries, geographies, areas of impact-focus and stages of maturity of investee companies. The disruption combined with the momentum in the market is attracting more investors.

Fundamentally, the drivers for ESG and impact investing are similar. ESG

Q What challenges remain for GPs looking to invest more responsibly? And what hurdles face the industry around ESG and impact investing?

One of the things that is evolving is the concept of what it means to be a responsible investor. For example, people are realising it is not a black and white issue whether a company is responsible or not. It is about how a GP assesses the opportunities and risks associated with an investment decision along the dimensions of E, S and G, and how they can move the needle to help achieve sustainable growth.

Similarly, a lot of progress has been made to shift the mindset about impact investing, especially for traditional investors with focused investment mandates. There is still work to be done, particularly around demonstrating authenticity and accountability, and proof of concept to investors who remain on the fence. These areas will continue to be a big focus.

There has been a lot of focus on what to measure in the absence of standards and ease of access to relevant data. Frameworks including the Sustainability Accounting Standards Board and Taskforce on Climate-Related Financial Disclosures are being widely adopted, which is helping to establish common practices.

Towards the end of last year, we saw a number of initiatives and collaborations to help streamline different frameworks and approaches. There is tremendous desire for greater alignment, which will attract more private equity firms and investors.

relates to factors relevant to the governance and operations of the company, while impact investors focus on how the products or services offered create positive impact. The two approaches complement one another and create value in different ways by looking at social and environmental issues through different perspectives.

Q What opportunities does private equity have to position itself at the heart of a green recovery as nations look to build back better?

The pandemic provided a serious wake-up call that the social and economic shocks associated with climate change will far eclipse those of covid-19.

Many large corporations and governments have made net zero commitments reflecting the increased priority of climate. Many private equity firms are already working with their portfolio companies to improve energy efficiency, with an increasing number now focusing on ways to enhance climate resilience. Significant progress is needed in short order to meet pledges made (beyond the use of offsets and initial reduction efforts) to realise the benefits of those strategies.

Private equity provides the capital to bring these solutions to scale, plus the focus and dedication needed to be successful. A number of firms are already investing in renewable energy and pursuing strategic opportunities in areas including sustainable infrastructure, packaging and agriculture. To be transformational, we need innovation to drive permanent changes in the energy efficiency of day-to-day life. This creates a breadth of new investment opportunities across different industries and sectors around the world.

The opportunities for private equity firms associated with supporting the transition to a low carbon economy extend beyond environmental implications. It is more holistic as it also includes supporting economic equality through job creation and more stability in marginalised communities. As the effects of climate change are far-reaching, so too is the positive impact of investment in the green recovery.

"Although the leadership demonstrated by individual firms is critical to continue raising the bar, it is through collaboration that the entire industry advances"

Q What about the rest of the private equity community, beyond GPs? What is KPMG doing to drive industry collaboration on ESG and impact matters?

Last year we launched KPMG IMPACT, an initiative to bring together our global professionals and subject matter experts to help our clients deliver growth with purpose, and I lead the effort to support our private equity and asset management clients. We are working on creative ways we can contribute, in particular as convenor, to help move the industry forward in a collaborative way.

The ESG and impact investing ecosystems are dynamic and growing. Although the leadership demonstrated by individual firms is critical to continue raising the bar, it is through collaboration that the entire industry advances. This is where things get exciting… over the past year we have hosted a series of roundtables with our private equity and asset management clients to explore what can be accomplished to advance ESG and impact by working together.

As a firm we have been working with the other big-four firms on a project to define common metrics for sustainable value creation championed by the World Economic Forum's International Business Council. We have also been working with the International Finance Corporation and other assurance providers to refine the independent verification guidelines associated with the Operating Principles for Impact Management.

KPMG contributes to many initiatives of the industry organisations we are members of, including FCLTGlobal, a not-for-profit that encourages long-term investment and business decision-making. We recently participated in a meeting convened by FCLTGlobal of private equity CEOs to develop an action plan to increase diversity in the boardrooms of portfolio companies.

Q How do you see the risk-return discussion evolving around ESG and impact?

The perception that ESG or impact investing requires investors to accept a lower financial return is diminishing with proven examples of how these approaches contribute to value creation. An effective approach to ESG helps private equity investors better anticipate risks, be more resilient and maximise operational efficiency.

Some still question whether impact is consistent with an investment mandate to maximise risk-adjusted returns. Investments made over the past few years have demonstrated that tremendous value can be created by companies with market-based solutions to the biggest problems facing society. Rather than being incompatible, it is a key driver of financial performance. ■

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