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ESG in Private Equity: A Fast-Evolving Standard



This report was published by INSEAD's Global Private Equity Initiative (GPEI). It was written by Bowen White, Research Associate at the GPEI, under the supervision of Claudia Zeisberger, Academic Director of the GPEI and Professor of Decision Sciences and Entrepreneurship and Family Enterprises at INSEAD, and Michael Prah, Executive Director of the GPEI.

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Overview

The ability of private equity firms to manage environmental, social and governance (ESG) investment considerations in their portfolio companies has received increased attention of late. Private equity firms on the fundraising trail are not the only GPs¹ cognizant of this trend; cost-savings potential, competitor activity and regulation all contribute to the rising awareness of ESG factors in investment committee decision-making.² The focus on ESG considerations has developed alongside investors' growing appreciation of the impact that nonfinancial factors can have on value creation, long-term company performance, and the health of society at large.

Over the past half-decade, this rising level of awareness has been spurred on by several organizations and industry bodies that have developed guidelines on best practice. The United Nations-supported Principles of Responsible Investment (UNPRI), drafted by an international network of investors, provides a framework for incorporating sustainability and ESG management best practices into investment decisions and ownership practices across asset classes.³ In coordination with the UNPRI, the Private Equity Growth Capital Council (PEGCC) developed Guidelines for Responsible Investment focusing on environmental, health, safety, labor, governance and social considerations specifically in the context of private equity investment.⁴ The UNPRI and PEGCC guidelines combined with internal responsible investment policies often provide the foundation for a GP's ESG framework.

After conversations with LPs and GPs on the subject, the time was right to share a collection of case studies and offer a bird's-eye view of the processes employed by a selection of leading private equity GPs. Detailed 3-page "snapshots" showcase the frameworks each has developed to address ESG across their organizations. These were compiled directly from interviews and conversations with the professionals responsible for ESG at each firm. While presented in a consistent framework, they are largely verbatim accounts.

As our first publication related to ESG, this report establishes a base for our ongoing work on ESG in the private equity industry. We trust that it will provide a practical guide and food for thought for private equity professionals – both GPs and LPs – looking to develop a robust understanding of the current approaches to managing ESG investment considerations in portfolio firms. This paper is published with the express desire to engage more GPs in discussions as they develop their capabilities related to ESG. We look forward to continued engagement with and input from the industry.

¹ A general partner (GP) is the investment advisor that raises and manages a specific PE fund.

² "ESG in Private Equity – 2013: Perspective and best practices for managing environmental, social and governance issues" – Malk Sustainability Partners, June 2013.

³ For further information, visit www.unpri.org.

⁴ For further information, visit www.pegcc.org.

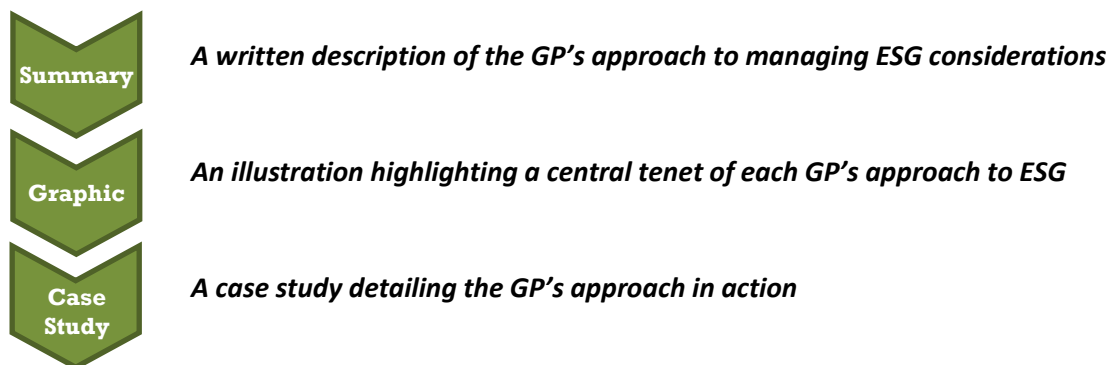
Approach and Findings

In 2005, the United Nations Environment Programme Finance Initiative published the Freshfields Report⁵, which linked managing ESG factors to investors' fiduciary duty, thereby thrusting ESG into the mainstream investment industry. Prior to that report, GPs had focused primarily on managing headline and reputational risk by ensuring that portfolio companies remained compliant with local legal and regulatory requirements. By mitigating this risk during the holding period, GPs could remove potential impediments to realizing the full value of a company's operations on exit.

INSEAD's Global Private Equity Initiative (GPEI) set out to highlight the evolving frameworks employed by private equity GPs for managing ESG investment considerations. To gain a more granular understanding of where the industry stands on these matters, we conducted a series of interviews with 11 prominent buyout and growth equity firms. We found that while certain themes underpinned all of our conversations, no two frameworks were completely alike. As such, we saw value in sharing a detailed account of each GP's approach with a wider audience, as well as inviting reactions and feedback.

The GP Snapshot

Our research started with conversations with 11 firms, all of whom had policies and procedures to manage ESG investment considerations. We summarized hours of interviews with each participating GP and condensed our findings into 3-page snapshots consisting of:



To make the 11 descriptions as objective and comparable as possible, we created a framework of headings highlighting the Background, Policy Development & Execution, Pre & Post-investment processes, Measurement & Valuation, and Lessons Learned related to each firm's ESG framework.

We begin by sharing several observations from our research, including the emerging ESG frameworks employed by the industry, the challenge of measuring and valuing ESG activity, and the role of ESG in emerging markets.

⁵ "A Legal Framework for the Integration of Environmental, Social and Governance Issues Into Institutional Investment" – Prepared by Freshfields Bruckhaus Deringer for the Asset Management Working Group of the United Nations Environment Programme Finance Initiative, October 2005.

I. Emerging Frameworks

Although managing environmental, social and governance factors in isolation is not a new concept in private equity investment, developing and applying a broad framework to manage ESG investment considerations very much is. Given the relatively early stage of development, the industry is still in search of definitive best practice. However, by examining the experiences of our research participants as a whole, we have identified three emerging frameworks currently employed for managing ESG considerations. These are not necessarily mutually exclusive, and a single GP may fall into more than one category. As global ESG themes and the ability to manage them continue to evolve, we expect the approaches taken and the frameworks applied to converge towards best practice.



Risk Focus

ESG risk factors are assessed mainly during the pre-investment process. A risk assessment primarily evaluates a target company's compliance with local laws and regulations with a view to mitigating reputational risk. A high ESG risk assessment often precludes investment. Proactive risk mitigation often entails only a minimum level of compliance.



Program Driven

GPs actively manage ESG investment considerations through targeted initiatives. Steps taken are often tangible, tailored programs focused on a specific company, an industry sector, or the portfolio as a whole. Firms implementing this framework typically hire an experienced ESG specialist to understand portfolio companies' needs, identify investment opportunities, execute initiatives, and validate performance.



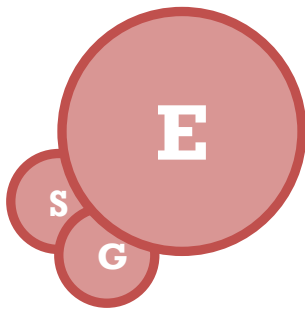
Integrated Approach

A broad framework defines ESG activity across all relevant GP functions including investment, portfolio operations, investor relations, and legal. Policies and procedures are typically integrated into existing systems and reviewed by ESG governing bodies. Such frameworks provide investment professionals and ESG-dedicated staff with a broad outline to managing ESG investment considerations over the life of a fund.

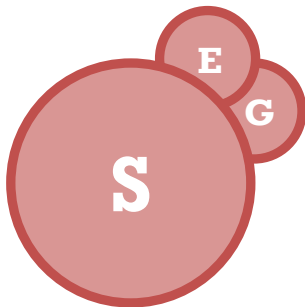
As GPs begin to develop a framework for managing ESG investment considerations, they must make specific decisions related to its structure, capabilities, and resources. Despite the diverse range of investment activity of our project participants, we found several common drivers for establishing an effective ESG framework, including securing a commitment to ESG from senior leadership and focusing on value creation (see Appendix A). The key drivers identified by our participating GPs are included in each three-page snapshot, while the 11 case studies provide additional insight into developing an effective approach to managing ESG considerations.

II. Where Does Your Firm Stand? Esg – eSg – esG – Topography

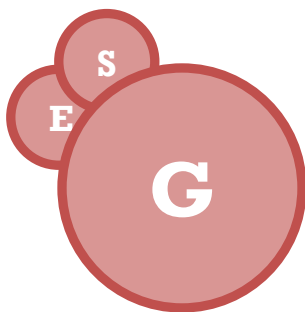
The ESG considerations material to investment decision-making vary from GP to GP. For some, environmental factors are at the fore; for others, social or governance issues may represent the ESG themes key to decision-making. Ultimately, they will be largely driven by a fund’s individual investments and a firm’s investment mandate as the relevance of ESG factors differ from one geography to another, and one industry to another. The following section provides insight into the three categories of ESG, highlighting the approach and initiatives that participating GPs employ.



GPs predominantly focus on value creation by improving eco-efficiency and developing environmentally sustainable products and services. US GPs are recognized leaders in driving eco-efficiency; KKR’s Green Portfolio Program and Carlyle’s EcoValuScreen are two initiatives that help portfolio companies identify opportunities to reduce costs and their environmental footprint. Terra Firma’s 2007 spin-out of Infinis from Waste Recycling Group – which created what would become the largest independent renewable energy generator in the UK – underscores the opportunity to create value when focusing on environmentally sustainable services in portfolio investment.



GPs manage developmental impact, labor, and health and safety factors affecting portfolio company stakeholders. Managing social considerations and impact in a portfolio company’s community is particularly relevant in emerging markets. Actis’ work with Umeme – a Ugandan power distribution company managing 99% Uganda’s electricity grid – highlights this point: infrastructure modernization led to a 94% drop in fatalities from fallen wires and other failures over a 5-year span. Similarly, Abraaj’s investment in Regimanuel Gray Limited provided leverage capacity for the company to continue to deliver affordable housing to low and middle-income families in Ghana and West Africa.



GPs ensure that portfolio companies have a robust governance structure which enables effective business review and control. Effective governance has long been an integral facet of private equity ownership; additional focus is paid to anti-bribery, anti-corruption, and environmental & social performance reviews in the context of ESG. In its investment in Netafim, Permira collaborated with the company’s founding Kibbutz organization to create a strong, independent board. For the Standard Chartered Bank Energy, Resources & Infrastructure team’s investment in Navigat Group Pte. Ltd., a formal protocol for reporting environmental and social matters to management and the board was established.

III. ESG Measurement & Valuation

Identifying a comprehensive way to measure the specific impact of a company's operations and ESG-related initiatives emerged as the key challenge facing the private equity industry today. Solid data and targeted analytics can be a critical driver for motivating and directing a company's efforts. Working with portfolio company management to identify the right metrics relevant to the business can help employees focus on KPIs that drive value and avoid wasted administrative effort. In all cases, routinely tracking performance improvement over time is a critical step and a clear differentiator in terms of sustained performance improvement. For example, to facilitate and streamline data capture, Apax has installed Credit360, a software solution used by multinational corporations, across its portfolio. The software allows portfolio companies to tailor their KPI set to their industry subsector and to track sustainability related performance over time.

Developing a model that directly links a company's active ESG management to monetary value is a crucial step for the future development and integration of ESG management capabilities across the private equity industry. Currently, environmental improvements are the most commonly valued, ranging from improved eco-efficiency to green products. Indirect value such as that created from improved reputational risk management, improved governance, or better labor standards is recognized but typically not explicitly measured. However, the impact of less-quantifiable improvements related to ESG has been identified as a lever to increase exit valuations, or at a minimum to reduce a company's cost of capital. For example, the ability of Navigat Group Pte. Ltd. – a portfolio investment of Standard Chartered Bank's Energy, Resources & Infrastructure team – to raise capital from international financial institutions with stringent standards related to ESG performance, highlights this point nicely.

One model that addresses the challenge of valuation is the Total Impact Measurement and Management (TIMM) framework developed by PricewaterhouseCoopers. PwC works closely with private equity firms on ESG management and has advised industry bodies on ESG measurement and valuation techniques. The framework guides decision-making by assessing a company's social, fiscal, environmental and economic impacts. TIMM applies monetary value to corporate environmental impacts by valuing the changes in human welfare associated with changes driven by corporate emissions or resource use. The framework values social impact by assessing how a company's activity affects social welfare and applying non-market valuation techniques to assign monetary value.

IV. ESG in Emerging Markets

ESG considerations play a special role in emerging markets as investments have the ability to impact local communities on a larger scale than in developed economies. While the focus in developed markets is often on environmental and governance factors, GPs active in emerging markets have a distinct opportunity to deliver impact by managing social factors in their investments. Reflecting this difference, they draw heavily on a wider array of sustainability and governance frameworks developed specifically for investment in emerging economies, notably the IFC Performance Standards on Environmental and Social Sustainability.

Private equity investors can generate social impact in emerging markets due to the scarcity of financial resources and industry best practice in these economies relative to developed markets. Targeted investment and improved management and operational techniques lead to lower prices for goods and services, reducing the injustice of the poorest paying the highest prices for everyday necessities. They often lead to better, safer products than hitherto available in the local market. For example, Carlyle's investment in Yashili during 2009 and 2010 and its subsequent improvements in raw milk powder sourcing and quality control differentiated the company from local competitors and provided a safe, high-quality product to Chinese consumers.

Increased portfolio company commercial activity typically also improves standards of living for employees and their families, through higher wages as well as investment by the company in better access to training, healthcare and schooling. Communities also stand to benefit from higher tax returns and improved infrastructure.

Several project participants active in emerging markets highlighted the importance of addressing health and safety considerations at portfolio companies and in supply chains in these markets. Following Permira's investment in Hugo Boss in 2007, the company established mandatory social and labor standards for its facilities and suppliers, validated by a global audit of its entire supply chain. By focusing on health and safety factors affecting not just employees but the community at large, Umeme, an electricity distribution Actis portfolio company, sharply reduced the number of fatal accidents from electrocution thanks to investment in distribution infrastructure and improved accident response timing.

Environmental considerations are no less important in emerging market investment. Implementing standardized operational best practice can have a major impact on resource efficiency, driving down waste and improving energy efficiency. Incorporating best practices in agriculture and fisheries can result in increased yields and improved sustainability.

As in developed markets, private equity firms active in emerging markets tend to focus on governance as the core of their business model. Yet better governance serves a purpose beyond the specific company by signaling that firms which embrace transparency and checks and balances can succeed. The focus is often on training existing management and expanding a management team's expertise through external hires, and on enhancing the transparency of boards by appointing external and truly independent directors. Measuring and sharing financial and non-financial KPIs provides additional governance levers to drive improved business performance and control in emerging markets.



The Abraaj Group

Background: Managing ESG considerations has been a key tenet of The Abraaj Group since its founding in 2002. The firm's initial approach to ESG focused on mitigating risks and drew heavily on many of its employees' experience working at the CDC Group. In 2006, Abraaj incorporated the IFC Performance Standards into its policy as guiding principles for managing social and environmental sustainability. Two years later, Abraaj launched a comprehensive overhaul of its approach to ESG and implemented procedures to more formally manage both ESG risks and opportunities throughout the investment process. The same year, the firm launched the Abraaj Sustainability Index, a comprehensive system to measure a partner company's development impact from a private sector perspective. A 2009 signatory to the UNPRI, Abraaj's current policy related to environmental and social factors draws on the 2012 IFC Performance Standards, and its governance policies draw on a stakeholder model defined in the King Code of Governance for South Africa.

Policy Development & Execution: Managing ESG considerations falls within the mandate of the Abraaj Performance Acceleration Group (APAG), a team whose primary role is to provide commercial, operational, strategic and ESG support to Abraaj's investments. The firm's ESG policy is referenced in its limited partnership agreements, explicitly linking ESG considerations to its fiduciary duty. Oversight of the firm's ESG policy is managed by its Management Executive Committee and the Abraaj Sustainability Council. Convened in 2013, the Sustainability Council meets at least twice a year and brings together thought leaders to provide guidance on how the Group can further increase in sustainability impact and to review and sign-off on the firm's ESG policy. Executing the firm's ESG policy falls to Abraaj deal teams, partner company management, and partner company board members at different stages of the investment process, with ongoing support from the APAG team.

Pre-Investment: Several processes guide deal teams through the assessment of ESG factors during the Abraaj pre-investment process. Deal teams first screen a potential investment by sector and industry, ensuring the target does not fall on Fund or general exclusion lists and assigning the target an inherent risk rating based on its Global Industry Classification Standard (GICS). Deal teams then employ a ten-point risk model to determine company-specific managed risk ratings for environmental, social, and health and safety factors. In addition, a target's governance processes are assessed via a governance risk matrix developed by the APAG team. The matrix also provides specific steps a target can take to improve its governance capability. The two risk ratings define a company's overall risk profile and guide deal teams when determining ESG due diligence requirements for a potential investment. In the event of a high risk assessment, external due diligence providers must be engaged, while the need for external due diligence for medium-risk targets is decided on an investment-by-investment basis. Following due diligence, deal teams prepare corrective action plans to address ESG risks and value creation plans to capitalize on ESG opportunities at the target company. Some corrective action plans contain conditions precedent to close which must be executed before Abraaj's investment can move forward.

Post-Investment: Following acquisition, partner company management is responsible for implementing any remaining corrective action and value creation plans. Partner company management teams have access to Abraaj's deal teams and regional and global APAG members from whom they can draw support. A residual risk assessment of environmental, social, health and safety, and governance factors is carried out following investment to assess the impact of implemented action plans and to



clearly define remaining ESG risks. In addition, the APAG team works proactively within the portfolio to identify ESG priorities and opportunities. Partner company ESG performance is reviewed by deal teams on a quarterly basis through the Portfolio Review Committees, and an in-depth annual review and report on ESG considerations in all investments is prepared for Fund investors.

Measurement & Valuation: The Abraaj Sustainability Index (ASI), a proprietary tool launched in 2008 and in the process of being updated, measures the sustainable development impact of Abraaj's investments. The Index aggregates 70+ quantitative and qualitative indicators related to themes of financial performance, environmental impact, human development and private sector development to produce a single company score. This score allows Abraaj to assess the evolution of partner company ESG performance over time and compare it to other constituents of its investment portfolio. The Index enables Abraaj to engage with partner companies beyond the financials and identify how partner company management and Abraaj's resources can be utilized to create sustainable development impact by focusing on the intangibles.

Lessons Learned: Abraaj identified two aspects of its ESG approach that help with the implementation of an effective framework:

- ❖ Execution of ESG management must be completely merged into the overall responsibility of deal teams. Abraaj initially managed ESG considerations via a dedicated team, but found given the depth and breadth of its portfolio, an integrated approach was needed. The ESG function was consequently integrated within the APAG team.
- ❖ ESG tools and processes must be consistently updated to ensure their relevance with emerging trends and best practice, and to provide efficient, functional solutions to deal teams.

Graphic 1: The Abraaj Sustainability Index provides a tool to measure the sustainable development impact of Abraaj's investments.



Abraaj Case Study:

The name Regimanuel Gray Limited (RGL) is synonymous with home construction in Ghana. Through acquisitions and organic growth, RGL has built a holding company that operates across the construction value chain, providing a diverse range of products and services both in Ghana and to the rapidly growing West African real estate sector. While the company has developed commercial property, RGL's target market remains low to middle-income homeowners.

In 2008 and 2009, The Abraaj Group invested in RGL, a company with which the deal team had a four-year working relationship as a partner company under a previous fund. Since Abraaj's 2008 investment, RGL has delivered more than 260 units and is currently constructing approximately 400 residential units made up of both houses and apartments. The company has a multidimensional development impact on West African communities, as the following examples portray.

Economic Linkages: RGL has been the leading supplier to an underserved housing market for almost two decades. Its expandable starter houses have been extremely successful, allowing potential homeowners to purchase two-bedroom units and add to them at their own pace. Since Abraaj's investment, RGL has paid US\$10.7 million in taxes and spent more than US\$54.1 million on local services and utilities.

Health, Safety & Environment: RGL strives to limit its impact on the environment before, during and after construction. In accordance with sector regulations, RGL prepares full Environmental Impact Assessments for all of its planned developments. In the design of its developments, RGL plans for water sprinkling and, where feasible, tarmacking roads to contain dust pollution from impacting surrounding environments. It also provides storm water drainage and sewage systems and ensures that construction and operational waste are recycled or disposed of properly.

Socio-Economic Impact: RGL is mindful of both internal and external stakeholders. Employee packages for its 608-strong staff include above-market wages, medical benefits, as well company contributions into a staff provident fund. The company also spent more than US\$10,000 in staff training costs in 2013.

Private Sector Development: RGL's role as a market leader in the supply of residential real estate is vital in addressing the severe housing deficit in West Africa. Among several developments currently under way, the company's experience in developing turnkey projects has led to a joint venture with the national pension fund to develop 2,000 units of low-to middle-income housing in the port city of Tema.

Management and Governance: Since its initial investment in 2004, Abraaj has been able to significantly improve the company's corporate governance structures, transforming RGL from a typical family-managed business to the institutionalized professional firm it is now. The company now has sub-committees to the board with appropriate charters, and Abraaj is represented on all such committees.

The RGL investment provided a compelling opportunity for The Abraaj Group to partake in the high growth of West African Real Estate-related sectors. The Group's investment provided much needed leverage capacity for the company to be able to continue to address this infrastructure gap in Ghana and the sub-region.



ACTIS



Background: Actis' commitment to managing ESG considerations derives from its belief that its investments bring benefit to investee companies, investors and broader society. The firm's approach is rooted in its history and draws in part from its founding as part of the CDC Group plc, from which it demerged in 2004. Actis' original ESG policy focused on risk mitigation, drawing upon national regulations in portfolio companies' home markets and IFC project finance performance standards and underlying guidelines. This narrow focus expanded over the years to include value creation initiatives focusing on both ESG risks and opportunities. Actis assesses ESG factors across five categories: environmental, climate change, health and safety, business integrity, and social. The firm is a 2009 signatory to the UNPRI and a member of its Private Equity Steering Committee.

Policy Development & Execution: Responsibility for managing ESG risks and opportunities in pre and post-investment periods lies with Actis investment managers and portfolio company management respectively. Top-down definition of the Actis ESG policy is governed by the firm's Responsible Investment Committee, which meets twice a year to examine ESG considerations across the portfolio and to set broad guidelines for the firm. Actis has had two director-level professionals solely dedicated to looking after the firm's ESG activity since its demerger from CDC. Their role is to help colleagues understand how to approach and manage ESG risks and opportunities in the context of Actis policies and procedures. The ESG team participates in all review stages of the investment process including deal screening, Investment Committee reviews, and exit reviews. The ESG team also provides tactical assistance to portfolio companies by mentoring managers, recruiting ESG professionals, and installing appropriate ESG review processes.

Pre-Investment: Investment managers are encouraged to actively communicate with the Actis ESG team to assess material ESG factors during deal origination. Screening at this stage ensures that portfolio company activity does not fall on Actis' prohibited investment lists, and that Actis and target company ESG policies generally align. Following the initial screening, deal teams assign risk ratings of low, medium or high across each ESG category and rate the company's policies and procedures to manage these risks. A separate assessment is conducted to measure the robustness of a target's governance capability. When significant ESG risks are identified at this stage, a preliminary action plan is prepared with detailed steps to be taken during due diligence and to mitigate risk post-investment. The degree of ESG due diligence is dictated by the degree of risk: the higher the risk, the higher the degree of involvement of the ESG team and external ESG diligence providers. When material ESG risks are uncovered during due diligence, deal teams liaise with investee company management to prepare a costed and timetabled ESG Action Plan, which is submitted to the Investment Committee during the final investment review. ESG opportunities, and metrics to track them, are also highlighted during final Investment Committee review.

Post-Investment: Following Actis investment, ESG Action Plans are initiated. Responsibility for ESG performance is held by portfolio companies during the holding period and monitored on Actis' behalf by its Non-Executive Director board representatives. For investments with high ESG risks, an ESG Subcommittee of the Board of Directors meets separately to consider specific ESG factors. Additional ESG monitoring takes place via the Actis investment review process, with dedicated reporting on at least a quarterly basis. An ESG risk tracker is employed during these reviews, providing a mechanism to



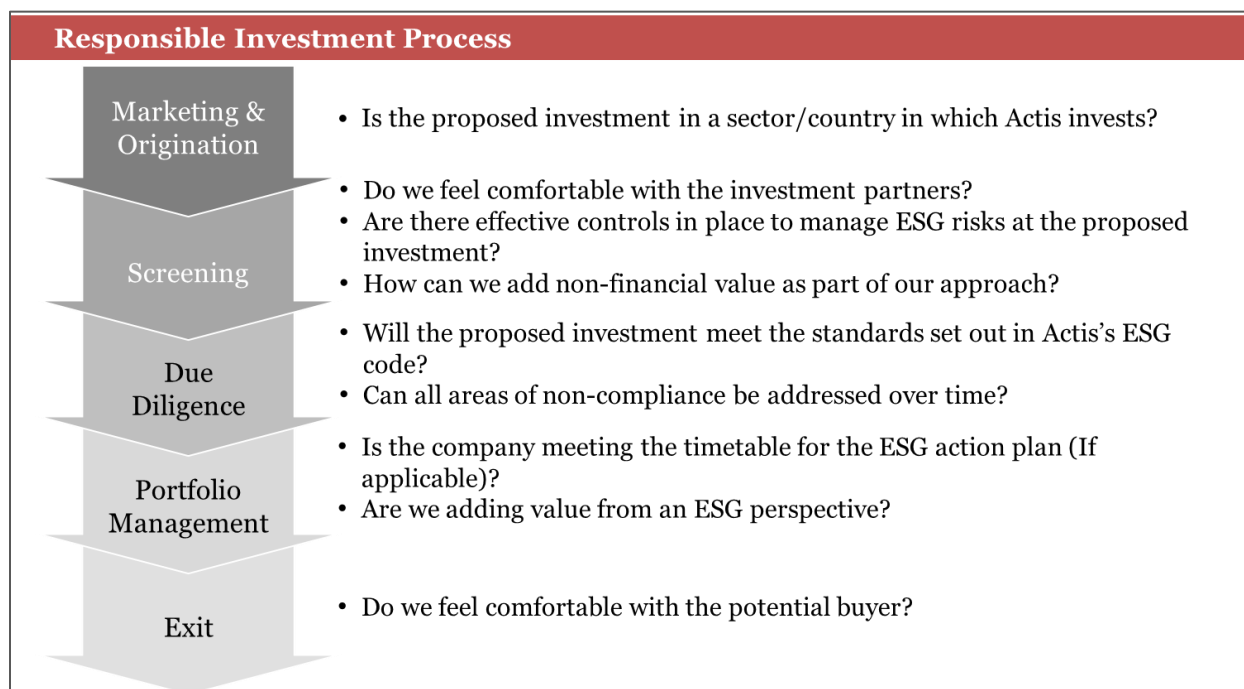
identify and flag escalating ESG issues. Consideration of ESG factors extends to the exit review process, in which a broad assessment of ESG performance is undertaken and the operational capability and reputation of potential purchasers are screened.

Measurement & Valuation: ESG performance is measured in different ways across the Actis portfolio. Actis' Energy Impact Model assesses the value drivers of Actis' energy investments, including non-financial drivers of market value related to ESG considerations. This model can be used to both track performance and plan for future value enhancement. Sector-specific, non-financial drivers assist ESG performance measurement across the financial services, consumer goods, health care and industrial portfolios. ESG and green building performance are measured in the real estate portfolio and compared to internationally recognized rating schemes, including LEED and Green Star.

Lessons Learned: Actis identified one aspect related to governance and one related to ESG performance that help with the implementation of an effective ESG framework:

- ❖ Establishing an ESG subcommittee ensures that sufficient time is dedicated to high risk ESG factors relevant to a company during the review process. A portfolio company's general manager is always a member of this subcommittee and meetings are often held in regions where an issue has occurred in the past, underscoring the topic's importance to company employees.
- ❖ The Actis Energy Impact Model facilitates discussions between Actis and portfolio company management to determine the measurable, long-term impact of its energy investments. This process focuses executive management on measuring the factors which are relevant to its business, rather than KPIs which are identified by external parties or frameworks.

Graphic 2 – ESG during the Investment Process: The chart below highlights the types of ESG-related questions addressed at different stages of the Actis investment process.



ACTIS Case Study

In March 2005, Actis acquired 100% of Uganda's national electricity distributor Umeme for a purchase price of US\$19 million. The same month, the company was awarded a 20-year concession to distribute electricity to Uganda's interconnected grid following a competitive bidding process. The concession formed a structural monopoly representing 99% of the country's electricity distribution network.

When Actis invested, Umeme's physical assets were in a state of disarray. Years of underinvestment had created a rotten network with failing conductors and wooden poles weakened by an unremitting invasion of termites, vegetation and humidity. The disruption of education during the turbulent years of 1980-1990 left many adults and children unaware of the dangers of fallen wires and conductors. The combination of deteriorated infrastructure and limited education had lethal consequences. Accidental deaths resulting from electrocution averaged more than 13 per year between 2005 and 2008.

To address this issue, Actis set up a main board, an audit committee, and an ESG sub-committee in 2007. Patrick Bitature, a highly respected Ugandan businessman and Chair of the Ugandan Investment Authority, was appointed as the independent Chairman of the company. Actis also introduced an experienced management team, made up of expatriate and Ugandan talent, including CEO Charles Chapman, an industry veteran from the Irish Electricity Supply Board, appointed in 2009.

In 2009, Umeme secured a US\$25 million IFC loan. This represented a 'coming of age', underscoring just how much Umeme's internal systems and processes had improved. Unusually, Umeme also secured a performance risk guarantee from the Multilateral Investment Guarantee Agency (MIGA), part of the World Bank. The involvement of these international organizations helped resolve a key constraint for the power sector in emerging markets – the shortage of long-term capital.

With a stable capital base in place, Actis recruited a dedicated safety team to address the danger posed by fallen wires and conductors. The safety team implemented strict protocols in regard to field team investigation of infrastructure failures and reported progress directly to the ESG sub-committee, which in turn fed information back to Actis. By 2010, field teams were operating to stringent timelines to make an area safe within 20 minutes of an accident's report, compared to a historical response time which often took hours. In addition, extensive multimedia campaigns were conducted to educate Ugandans – particularly children – about the dangers associated with fallen wires and conductors.

By 2012, Actis had invested over US\$134m in modernizing Umeme's distribution system. Fatal public accidents fell from a peak of 16 in 2006 to 1 in both 2011 and 2012. On 30 November 2012, Umeme successfully completed an IPO on the Uganda Securities Exchange, securing funds which would help finance its capital investment program. The company set a target to repair or replace three quarters of the dilapidated network infrastructure it had inherited by year-end 2013.



Apax Partners



Background: Apax Partners' approach to managing ESG considerations has evolved from an early focus on portfolio company compliance with local regulatory frameworks to a pro-active approach which today is embedded in its investment strategy and portfolio management. The firm adopted the PEGCC Guidelines in 2009 and became a signatory to the UNPRI in 2011. In mid-2012, it reinforced control of its approach by bringing ESG screening and due diligence responsibilities in-house. The same year, Apax began implementing Credit360, software used by multinational corporations to track KPIs related to sustainability, for new investments and across its existing portfolio. The firm's new approach is designed to increase accountability for ESG factors within the firm and to provide more granular detail of ESG performance.

Policy Development & Execution: The ESG policy at Apax is defined by the Apax Sustainability Committee, a cross-functional group of executives drawn from the investment team, investor relations, communications and the general partner, which meets once a month. The committee provides visibility and weight to ESG within the firm and is chaired by a senior equity partner. While there is no sustainability officer, one committee member reviews all ESG risks and opportunities during due diligence to ensure consistent presentation to the Investment Committee. Investment teams at Apax are responsible for individual deals from origination to exit, and thus execute pre-investment assessment and post-investment review of ESG considerations. The firm's Operational Excellence group assists on ESG considerations during the holding period on a tactical basis, but only when the ESG consideration in question overlaps with specific functional capabilities of the group.

Pre-Investment: Since adoption of the PEGCC Guidelines, sustainability has been embedded in Apax's investment process. Pre-investment activity focuses primarily on the identification of ESG risks, the company's ability to manage ESG considerations, and its performance related to ESG in the past. Investment teams are guided through the pre-investment due diligence process by a detailed ESG questionnaire, with one team member tasked with sourcing information for its completion. The questionnaire is typically filled out by the deal team with the assistance of the lawyers providing due diligence services on the investment and its content must be reviewed by the Investment Committee prior to Apax investment. The questionnaire is not prescriptive, allowing for the specific ESG factors which are material to a company to be addressed. ESG considerations which are identified by other teams involved in the due diligence process are also flagged to the deal team.

Post-Investment: Portfolio company-specific ESG considerations are managed on a day-to-day basis by the companies themselves. Apax investment team members are involved in ESG matters when they are tabled during board meetings for the companies for which they are responsible. In addition, Apax investment partners are required to sign an annual Statement of Representation which states that the portfolio company complies with local regulation and that they are not aware of any sustainability issues. Apax reports to its limited partners on a semi-annual basis in a detailed manner, and includes a section on the latest corporate social responsibility developments for each company.

Measurement & Valuation: The focus of the Apax sustainability effort in 2013 was the implementation of a structural solution to monitor, track and report on the ESG performance of Apax portfolio companies. A set of 80 KPIs related to ESG was developed to gather qualitative and quantitative data and binary Yes/No inputs from each portfolio company. In conjunction with this effort,

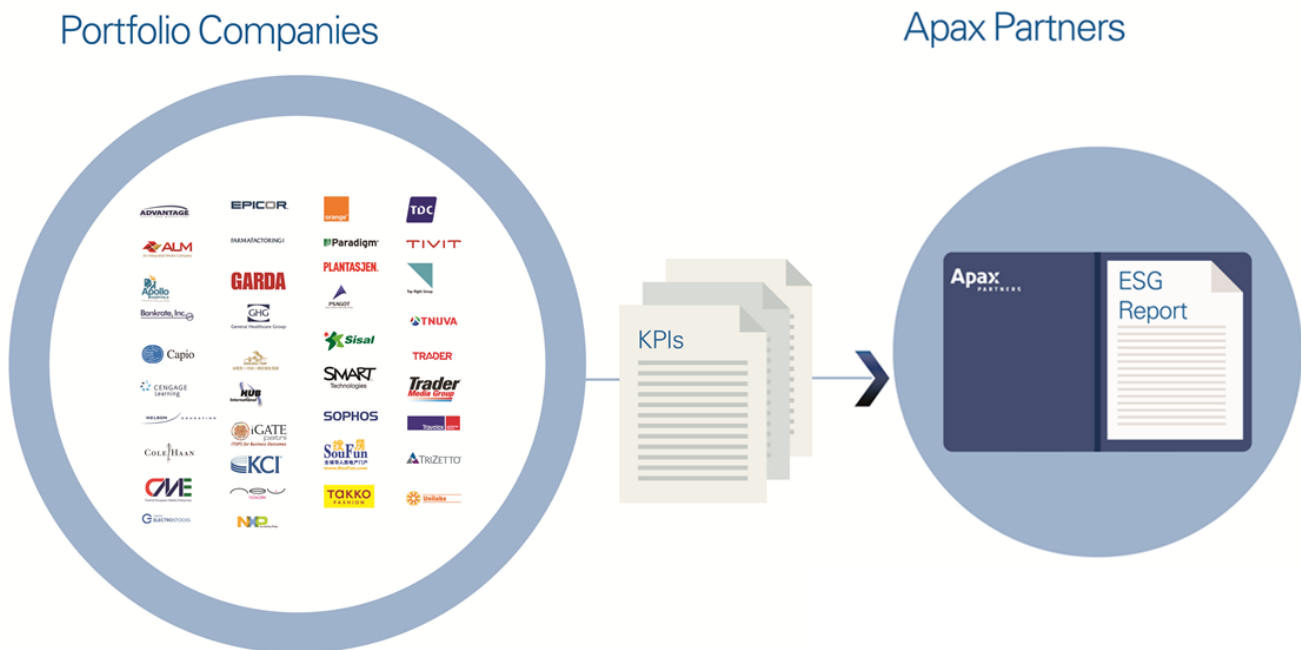


Apax identified a software solution, Credit360, to facilitate and streamline the data capture of the KPI information from across the portfolio and to function as a central repository for portfolio company ESG information and related supporting documentation. From 2013 onwards, each Apax portfolio company will provide this general KPI data to Apax on an annual basis. In addition, each company will implement a tailored Credit360 software system to track its KPI data over time and to serve as a data repository which can feed the general KPIs into the Apax system. This provides the benefit that each portfolio company will be able to maintain its own ESG data and track record, and tailor their KPI set to the specific industry sub-sector in which it operates.

Lessons Learned: Apax identified two aspects of its ESG approach that help with the implementation of an effective framework:

- ❖ Presenting the adoption of an ESG framework in the context of value creation and building better businesses, as opposed to a strict exercise in risk mitigation, can improve the degree of acceptance by portfolio company management.
- ❖ Developing ESG measurement capability, determining what can be measured, and generating a critical mass of data can help a GP focus its resources on ESG initiatives that can create a measureable impact.

Graphic 3: Through Credit360, Apax can collate a subset of key ESG KPIs from the Apax portfolio for external/internal reporting, and better identify ESG value creation opportunities.



Apax Case Study:

The Apax portfolio is focused on reducing its global environmental impacts – from the sourcing of raw materials, to the manufacture and distribution of products, to the use and disposal of products by consumers, patients, and providers. Apax has a number of initiatives in place across its portfolio that reduce complexity, waste and energy consumption. These range from: reducing electricity usage by replacing traditional light bulbs with LED bulbs, reducing paper usage by setting default double-sided printing in all company offices, and reducing water usage by investing in low-flow fixtures, auto shut-off faucets and other water-reducing features. Specific initiatives executed at the portfolio company level include the following:

Energy

Plantasjen: The company has improved its energy performance by increasing insulation in all newly built stores, and installing heat pumps in six stores in the last 12 months. The increased insulation has reduced the energy consumption of newly built stores by approximately one-third compared to older stores, while the newly installed heat pumps have reduced energy consumption by approximately 20%.

Capio: Throughout the Capio Group there are a number of initiatives in place to reduce energy use. These include investment in solar-panels and the use of low-energy bulbs, green cars and automatic light switches. In addition, energy efficiency is an important parameter when making investments in the construction of new buildings.

Water

GHG: The company continues to focus on maintaining staff awareness and communication regarding water use. GHG employed a specialist water-savings consultancy on a gain-share basis that audited all site bills, benchmarked water consumption, and undertook surveys of water consumption at all sites where benchmarking indicated excessive consumption. As a result, the company implemented remedial actions including reducing lavatory flushing, fixing failed valves and faulty equipment, and reviewing opportunities for capital investment.

Paper & Packaging

Tnuva: During the second half of 2012, Tnuva commenced a number of processes in order to reduce paper and packaging usage. Initiatives which are currently in process include: 1) replacing hard cheese packaging from PVC package to Pet; 2) introducing foam polystyrene sheets instead of normal polystyrene; 3) replacing one-time egg cartons with plastic washable packages; 4) reducing several bottles' plastic packaging weight; and 5) gradually replacing wood pallets with plastic pallets to reduce timber waste and increase production safety.

Waste Management

KCI: KCI offers a recycling program for facilities and patients that allows safe disposal of certain single-patient Negative Pressure Wound Therapy (NPWT) devices. KCI provides this recycling program free of charge to the customer. KCI has partnered with Sharps Compliance Inc. to convert customer-recycled KCI single-patient NPWT devices into PELLA-DRX, an industrial resource with a BTU content greater than or equal to that of coal. Therefore, none of the Sharps Compliance processed medical waste ends up in landfill; instead it is repurposed into an industrial resource capable of powering homes and businesses.



BC Partners

BC Partners

Background: At BC Partners, ESG considerations are integrated into the investment decision-making process as well as the management of portfolio companies. BC Partners formalized its existing commitment to these issues by becoming a signatory to the UNPRI in March 2009. In 2010, the decision to approve an ESG policy received unanimous support from the firm's Executive Committee. The policy sets out the significance of ESG considerations in relation to BC Partners' investors, portfolio companies, employees and other stakeholders. In addition, the firm maintains an internal ethical code of conduct. The methodologies for executing the firm's ESG policy are communicated to new associates as part of their introduction training.

Policy Development & Execution: BC Partners' ESG policy is defined at a high level and revisited at least once a year. Primary responsibility for implementing this policy in relation to the investment process lies with deal teams and is initially executed during the due diligence process. Ongoing monitoring at the portfolio company level is managed by the firm's operating partners, in conjunction with the deal teams. Operating Partner, Jan Kangelbach, was instrumental in designing and implementing the firm's ESG effort at the portfolio company level and serves as the first point of contact for ESG-related questions during the investment process. Communicating ESG-related activity to investors is managed by the BC Partners investor relations team.

Pre-Investment: A deal team's primary focus during the pre-investment period is the identification and avoidance of risks. An ESG checklist helps guide team members through a basic screening. Deal teams are encouraged to contact the operating partner team early in the origination process to help identify and assess key material risks and opportunities related to ESG. In the event that a material ESG risk is uncovered, a third-party advisor may be employed to execute formal diligence. Opportunities within ESG are developed alongside general business planning during the due diligence process. The findings of ESG diligence are documented in investment proposals submitted to the Executive Committee before a commitment of capital is made.

Post-Investment: BC Partners continues to engage an external consultant to conduct an assessment of ESG considerations at the company. This assessment is overseen by portfolio company management with assistance from the firm's operating partners and deal teams. The external consultant collects information through questionnaires, employee interviews and site visits. The resulting report highlights relevant ESG risks and opportunities, scores the portfolio company in each ESG category and provides a comparison to industry best practices. Full disclosure of all relevant information related to ESG is made available to potential buyers during the exit process.

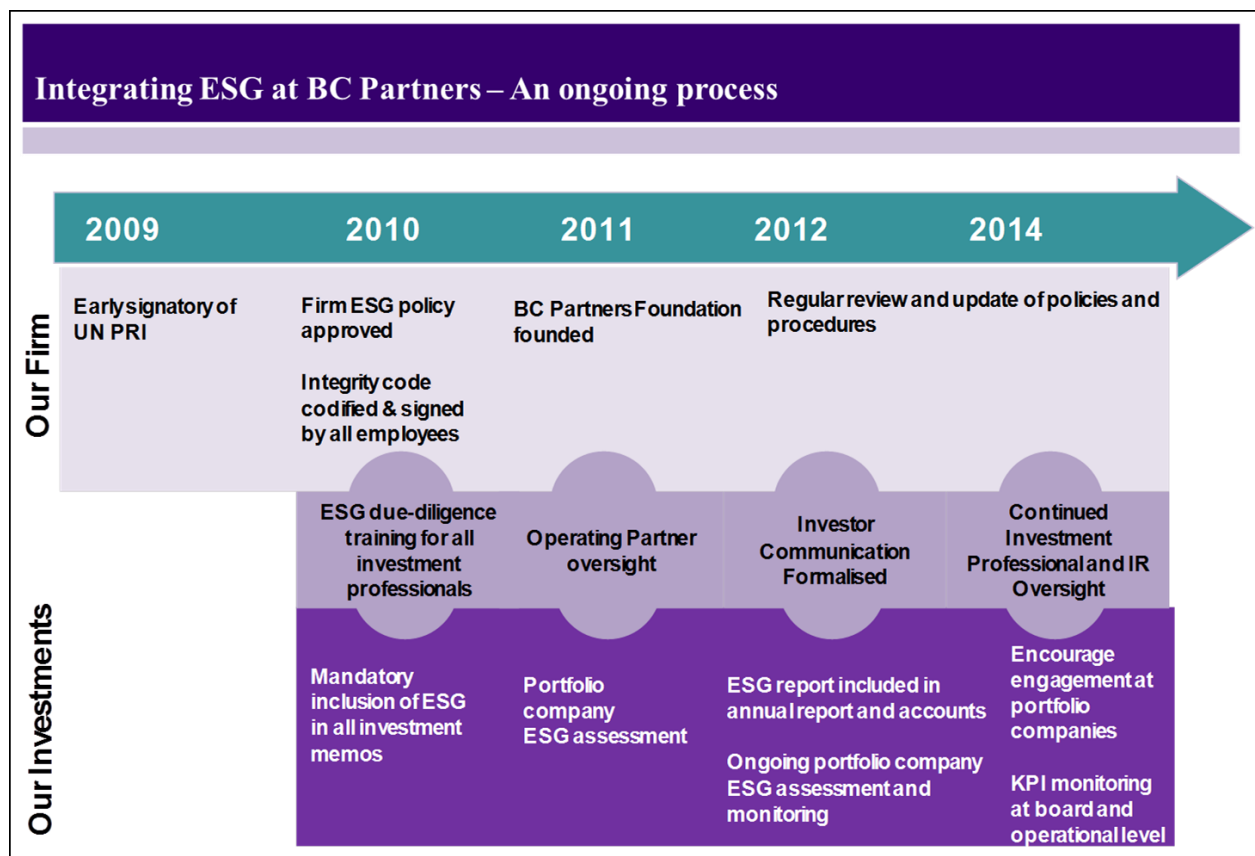
Measurement & Valuation: Since 2011, each company in the BC Partners portfolio has undergone an annual ESG assessment survey. Portfolio company management teams complete a questionnaire developed in collaboration with PwC's ESG Advisory Team, whom BC Partners retained, that assigns a score on an ESG maturity index. The index, developed exclusively for BC Partners, allows the firm to compare the portfolio company to its relevant public industry peers and to objectively track its progress on ESG related matters from year to year. In addition, BC Partners initiated on-site meetings between portfolio company management and PwC's ESG Advisory Team to review the issues identified in the ESG questionnaires and to identify potential areas for improvement. The results of these meetings are then discussed with the BC Partners deal team.



Lessons Learned: BC Partners identified three aspects of its ESG approach that help with the implementation of an effective framework:

- ❖ Establishing a firm policy foundation through internal and external best practice.
- ❖ Placing execution responsibility directly with deal and operating teams, and creating a sense of ownership with portfolio company management.
- ❖ Drawing on existing ESG management best practices from portfolio companies.

Graphic 4: The following chart depicts key milestones in the development of BC Partner’s approach to managing ESG considerations.



BC Partners Case Study:

Several BC Partners portfolio companies have implemented initiatives to manage ESG risks and opportunities. Notable progress was achieved in 2013 across the portfolio, as illustrated in the following examples.

Accudyne – Committed to increased leadership and evaluation of ESG considerations at production sites, and established new environmental health and safety targets.

Com Hem – Developed a company-wide CSR policy, enhanced IT security and introduced a new staff development program for managers.

Foxtons – Completed a bribery and corruption risk assessment in line with the UK's Bribery Act. In addition, the company continues to develop its health and safety capability, including frequent review of health and safety policy and risk assessments for all offices.

Intelsat – Evaluated the integration of renewable solar energy at certain sites, and continued promoting employee sustainability initiatives via a new intranet and weekly newsletters.

Migros – Implemented various waste management initiatives, such as sending organic waste to a biogas generator and introducing energy efficiency measures at all new stores. The company also received a Gold LEED rating at a local store.

Phones4u – Established a risk management and internal audit function which considers ESG factors. The company also introduced an employee survey, new sales and leadership programs, and measures to improve energy management and efficiency.

SGB-SMIT – Commissioned a carbon footprint analysis on four transformer products, achieved ISO certification for new sites, and implemented energy reduction initiatives. In addition, the company developed and implemented new internal group policies related to ESG.

Spotless Group – Continued to improve health and safety standards at its factories while implementing several energy saving initiatives. In parallel, the company rolled out multiple initiatives related to effective employee management and development.

Suddenlink – Created an internal award program to formally recognize and build awareness of its community engagement activities. The company partnered with Universal Electronics Incorporated to develop a remote-control recycling program, and is focused on enhancing product energy efficiency performance. Additionally, a pilot software solution that reduces vehicle fuel consumption is underway.



The Carlyle Group

THE CARLYLE GROUP

Background: In 2009, Carlyle began developing a top-down, systematic approach to managing ESG considerations in its private equity business. The following year, the firm established a set of responsible investment guidelines in collaboration with an ESG expert, drawing on internationally recognized standards such as the UNPRI and the UN Global Compact. While Carlyle’s historical approach to ESG had predominantly focused on mitigating risk, the guidelines provided a comprehensive framework to consider both ESG risks and opportunities throughout the investment process. In 2011, the firm took the additional step of encouraging its portfolio companies to review their operations in accordance with Carlyle’s ESG guidelines; more than 90% of the firm’s portfolio companies currently do so. These internal guidelines helped shape the PEGCC Guidelines, which Carlyle has in turn worked to incorporate into its investment decision-making process for controlled, corporate buy-outs. Carlyle’s ESG activity is mostly focused on the United States and Europe, where Carlyle investments command the most control.

Policy Development & Execution: Carlyle’s ESG policy is defined by the firm’s Global External Affairs Group (External Affairs), and specifically by the Head of U.S. External Affairs. The firm’s resources related to ESG are predominantly located in the U.S., and other geographies draw on U.S. capabilities. External Affairs is in constant contact with both Carlyle investment teams and limited partners, ensuring that both general and limited partners’ priorities are incorporated into ESG policy. Carlyle deal teams are ultimately responsible for executing the firm’s ESG policy pre-investment, and its portfolio company board members ensure that Carlyle’s ESG guidelines are followed during the holding period. External Affairs remains involved throughout the investment process, providing information and recommendations on how to best address specific ESG considerations.

Pre-Investment: Carlyle’s ESG guidelines set out a flexible framework through which deal teams assess ESG considerations during the pre-investment process. The firm’s framework is consciously process-lite and allows deal teams to determine the appropriate type and degree of ESG screening and due diligence on a deal-by-deal basis. Assessing ESG risk is the primary focus during the pre-investment process, and strategies to mitigate any material risk are identified at this stage. In the event of a material ESG risk, deal teams typically contact External Affairs to discuss Carlyle’s appetite for the specific risk and to identify external consultants to assist in due diligence. Deal teams must include a summary of a target company’s material ESG considerations in its Investment Committee memorandum. The Head of U.S. External Affairs and the firm’s Management Committee review all Investment Committee memoranda and have sign-off on all ESG considerations.

Post-Investment: Executing initiatives addressing specific ESG risks and opportunities is managed by portfolio company management during the holding period. Following investment, portfolio companies often undergo the firm’s EcoValuScreen, a tool developed in collaboration with the Environmental Defense Fund that identifies opportunities for operational enhancements that often lead to better environmental and financial performance. The EcoValuScreen is executed by one of a group of external consultants familiar with the priorities of the program and the firm’s responsible investment guidelines. Historically, material ESG risks and opportunities have been addressed by external consultants; however, Carlyle recently hired a Chief Sustainability Officer who brings specific knowledge and capability to execute ESG initiatives in-house. Progress of ESG programs are monitored at the portfolio company board level and via Carlyle’s annual reporting process.

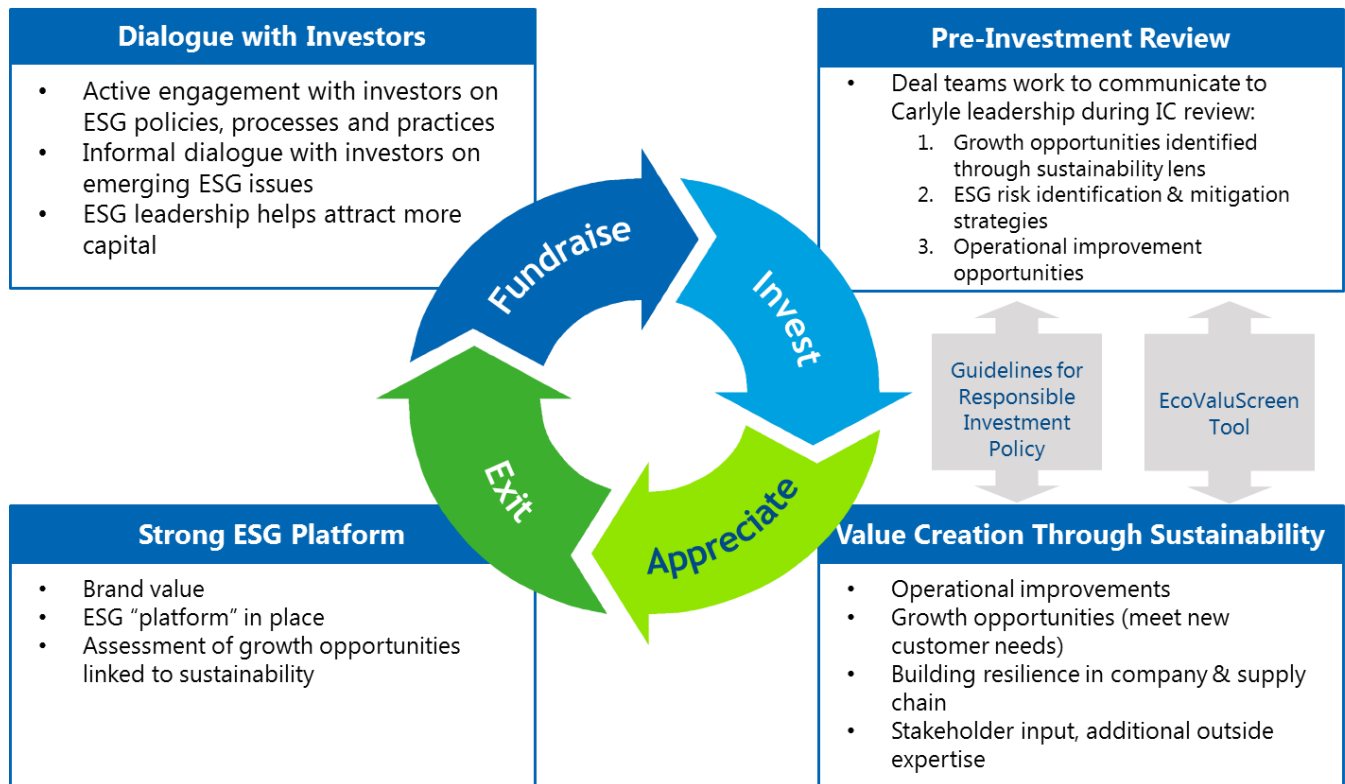


Measurement & Valuation: Carlyle measures the impact of ESG management where it produces quantifiable value to portfolio companies. Initiatives stemming from the firm’s EcoValuScreen often yield measureable energy efficiency and environmental performance improvements; initiatives currently implemented in the Carlyle portfolio produce estimated annual cost savings of US\$3.5 million. The firm also recognizes reputational value as a key outcome of its ESG management, particularly its ability to deliver the ESG capability expected by its fund investors.

Lessons Learned: Carlyle identified two aspects of its ESG approach that help with the implementation of an effective framework:

- ❖ Securing visible commitment from senior management and senior investment team members ensures that ESG factors are considered a firm-wide investment priority.
- ❖ Communicating the value creation capability of ESG management, as opposed to a cost borne by the firm and portfolio companies, incentivizes investment teams and portfolio company management to actively consider ESG factors.

Graphic 5 – Sustainability at The Carlyle Group: Managing Environmental, Social & Governance aspects of its business.



Carlyle Case Study:

Through two tranches of investment in September 2009 and July 2010, Carlyle acquired a 29.2% stake in Guangdong Yashili Group Co., Ltd. (Yashili), one of China's largest infant formula companies. Headquartered in Chaozhou, Guangdong Province, Yashili has more than 6,200 employees and distributes products over a nationwide sales network.



Like many infant formula companies in China, Yashili faced challenges following the nationwide melamine incident in 2008. With a strong determination to restore consumer confidence in the industry, Yashili's management worked closely with Carlyle to rebuild its brand image.

In Yashili, Carlyle saw addressing ESG considerations as a specific opportunity to create value in a firm suffering from an industry discount. To address the melamine issue directly, Yashili made a major strategic decision to procure 100% imported raw milk powder from high-quality overseas dairy sources and established product testing collaborations with top-tier international laboratories to strengthen product quality and safety control. The Carlyle-Yashili partnership set an example for the industry to rigorously transform itself and elevate its product quality to international standards.

With Carlyle's assistance, Yashili established the Food Quality and Safety Advisory Committee (FQSAC), the first of its kind in the Chinese dairy industry. The committee, chaired by former U.S. Food and Drug Administration director Dr. Robert E. Brackett, comprises individuals from major academic institutions and industry associations who have extensive experience working with authoritative regulatory bodies around the world. With FQSAC's strategic guidance on policies and procedures, Yashili further improved the safety and quality of its products, implemented product quality control protocols and introduced enhanced internal control systems. For example, Yashili's production baseline audit was conducted by certified auditors from an American auditing company, NSF International, in accordance with the Safe Quality Food Standard, and its product testing was also carried out by certified labs in the United States, New Zealand and Hong Kong.

Carlyle worked with Yashili to strengthen its management team and corporate governance. The company recruited experienced talent to strengthen key areas within the business. Carlyle helped recruit a Chief Quality Advisor to oversee implementation of product quality control protocols, a Chief R&D Officer to lead new product development, and a Chief Financial Officer to strengthen internal control and systemize financial reporting practices. Carlyle also helped formulate a management incentive plan to align compensation with long-term shareholder value. Yashili's successful IPO on the Hong Kong Stock Exchange in November 2010, which raised approximately HK\$2,705 million, further strengthened corporate governance.

Yashili is committed to product quality and corporate integrity for sustainable growth and to building its capabilities in quality control and R&D. The company has achieved industry-recognized quality standards, such as ISO9001 and HACCP, as well as certifications by various national authorities, including the China Food Safety Committee and China's General Administration of Quality Supervision, Inspection and Quarantine. In August 2013, Carlyle exited the investment through a sale to China Mengniu Dairy Company Limited, the No. 1 liquid milk manufacturer and the second largest dairy product manufacturer in China.



Doughty Hanson

DOUGHTY
HANSON

Background: Doughty Hanson’s approach to managing ESG risks and opportunities reflects its commitment to active portfolio company management. The firm’s focus on ESG coincided with the founding of its value enhancement team over a decade ago, and initially focused on identifying and mitigating ESG risk during target company due diligence. In 2008, the value enhancement team hired a qualified Head of Sustainability tasked with both managing risks and actively exploiting value creation opportunities related to ESG. The following year, Doughty Hanson developed and implemented a group-wide ESG policy. An early private equity signatory to the UNPRI and a member of its Private Equity Steering Committee in 2007, Doughty Hanson incorporates best practices related to ESG management and responsible investment from the UN Global Compact and both the British and the European Private Equity & Venture Capital Associations.

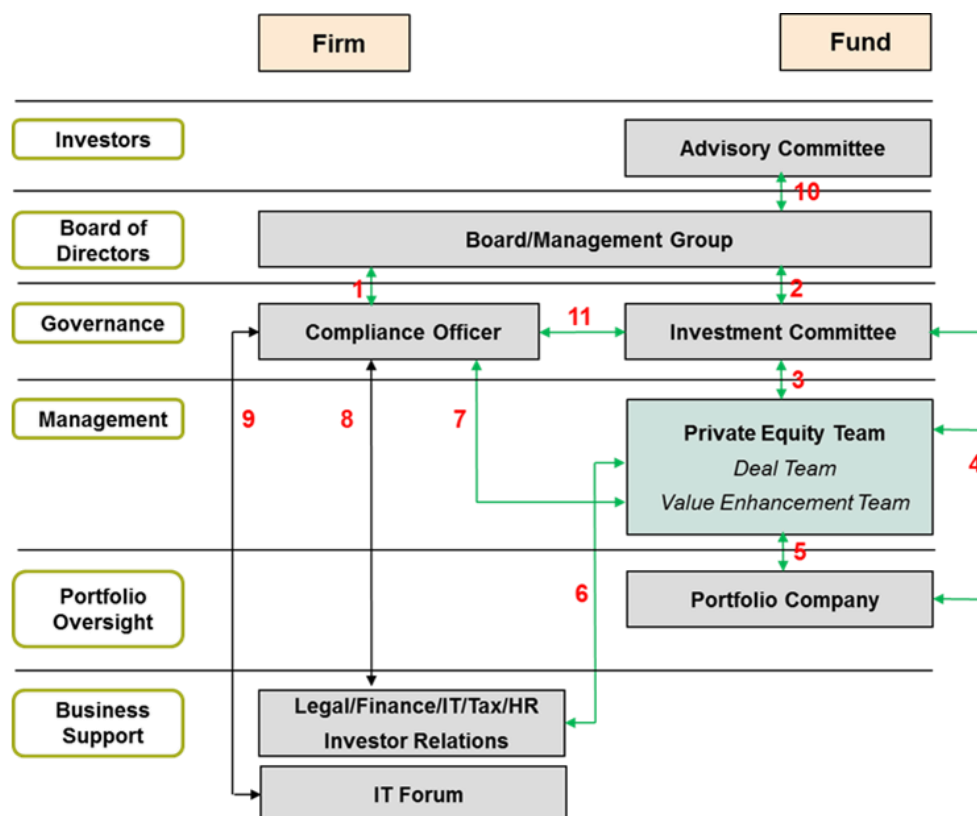
Policy Development & Execution: Doughty Hanson’s ESG policy is defined by the firm’s Head of Sustainability, who works closely with other members of the value enhancement team, as well as deal team, legal and investor relations colleagues to ensure that the policy is relevant and positioned to deliver maximum value to the firm. Responsibility for executing this policy during the pre-investment period rests with the Doughty team and shifts to a combined Doughty and portfolio company management team during the holding period. The Head of Sustainability is present throughout the investment process as both a full deal team member and a resource to management during the holding period. In addition, the Head of Sustainability is responsible for maintaining and continually developing a network of external consultants that can provide functional expertise related to specific ESG considerations.

Pre-Investment: Definition of and engagement on ESG considerations begins early in the deal origination process. Key ESG risks and opportunities are identified and discussed during weekly meetings reviewing the firm’s investment targets. This screening process typically begins with an assessment of risk and opportunity across the different ESG categories and a review of a target’s legal and regulatory compliance. The embedded nature of the ESG review allows deal teams to quickly focus on material risks and to tailor due diligence activity accordingly. When significant ESG due diligence is required, external consultants with specific capabilities and experience are typically employed. Doughty Hanson deal teams are also encouraged to engage target company management as early as possible to elevate the visibility of ESG principles and discuss steps to mitigate ESG risk.

Post-Investment: Following acquisition, value enhancement programs are implemented to manage specific ESG risks and opportunities. These programs are managed by steering teams led by a portfolio company CEO and senior Doughty investment professionals, and are supported by Doughty Hanson’s value enhancement team. The firm’s Head of Sustainability remains in constant contact with the portfolio to both identify new opportunities and assist in program implementation. ESG considerations are often addressed by re-tasking existing personnel; however, organizational development is a key Doughty tenet and the value enhancement team will assist in hiring external candidates to bolster ESG management capability where needed. In addition, the firm draws on experience and best practices from within its existing portfolio to assist in managing specific ESG considerations. Quick wins in energy and waste management are typically addressed across the portfolio, while tailored, adaptive programs address specific risks within each portfolio company.



Graphic 6 – Embedding ESG at Doughty Hanson: The chart below highlights how Doughty Hanson has integrated ESG into existing firm and fund structures.



Key lines of communication (embedded ESG highlighted in green):

- 1) Compliance Officer and Head of Sustainability reports key risks (including ESG) to the Board
- 2) Sign-off of investment decisions by Board independent of Investment Committee
- 3) Investment Committee process addresses all risk aspects of investments (including ESG)
- 4) Portfolio company reports risks to PE team, material risks escalate to Compliance Officer and Investment Committee
- 5) PE Team provides risk focussed support to portfolio companies (including ESG).
- 6) Business support functions provide input on relevant risks to deal teams (including bribery, corruption and CRC compliance)
- 7) Head of Sustainability reports on material Doughty Hanson sustainability issues to the Compliance Officer
- 8) Department heads report risks to Compliance Officer
- 9) Business continuity and IT risks managed and reported by IT forum to Compliance Officer
- 10) Advisory Committee consults the Board on risk matters
- 11) Compliance officer and Head of Sustainability involved with the Investment Committee process

Measurement & Valuation: Doughty Hanson actively measures various aspects of its management of ESG risks and opportunities. The firm requires portfolio companies to disclose specific financial and non-financial KPIs primarily related to environmental and social factors via an annual ESG reporting process. These KPIs are often those which public companies would typically report and therefore can help prepare portfolio companies for a possible listing. Additionally, tailored KPIs are reported on an annual basis to track specific ESG value enhancement programs undertaken by a company. Doughty Hanson focuses on reporting ESG performance as measurable costs savings and



revenue generation where possible, to focus ESG programs on tangible value creation. In addition, ESG programs help protect portfolio company value by managing the types of controllable risk which might damage the share price of a publicly-traded company.

Lessons Learned: Doughty Hanson identified several aspects of its ESG approach that help with the implementation of an effective framework:

- ❖ Securing visible support from top general partner management.
- ❖ Communicating to deal teams that pre-investment ESG activity is not designed to stop deals, but rather to assess relevant ESG risks and opportunities and help identify ways to manage them.
- ❖ Hiring a qualified in-house ESG professional to develop a deep understanding of portfolio company needs and to ensure credibility when executing ESG initiatives.
- ❖ Approaching ESG management as a core business and operations issue, not a PR exercise.
- ❖ Embedding ESG within existing management processes at the GP to avoid creating additional workload for deal teams.
- ❖ Managing ESG by “kicking the tires” through operational portfolio site visits.

Doughty Hanson Case Study:

Doughty Hanson’s approach to managing ESG opportunities extends beyond working with individual portfolio companies to engaging in initiatives spanning its entire portfolio. In 2009, the firm worked with Solar Century, one of the world’s leading solar energy companies, to review the solar energy potential across its portfolio. This led to a more detailed analysis of photovoltaic opportunities at four portfolio companies, with three of the four well-placed to take advantage of the initiative and ultimately adopting bespoke solar projects of their own: Impress, KP1 and Balta. Three other portfolio companies either confirmed a scheme was not viable or adopted small-scale local projects.

The initiative at Balta resulted in the installation of the largest solar energy project of its type (photovoltaic roofing) in the Benelux countries. To date, three factories in Belgium have been equipped with photovoltaic roofing, with a potential for further expansion to other sites. The total project comprises 49,000 solar panels over 271,000m² – the equivalent of 54 football pitches – with a total generating capacity of 11.5 MWp, or the power consumption of 3,300 families. The project produces annual savings of 4,750 metric tons of carbon dioxide emissions and generates income and cost savings of €1.7 million a year.



KKR

KKR

Background: In 2008, Kohlberg Kravis Roberts & Co. L.P. (together with its affiliates, “KKR”) established the Global Public Affairs team, whose mandate includes understanding public policy and stakeholder interests in the context of the firm’s investment activity. Among the team’s initial responsibilities was to develop a consistent, methodical approach to managing ESG considerations in the private equity investment process. Its goal is to provide tools for private equity investment professionals and portfolio companies to conduct real assessments of ESG risks and opportunities and to approach ESG-related value creation from an operational perspective. Three global, cross-portfolio ESG programs, rolled out between 2008 and 2012, typify this operational focus and highlight KKR’s priority of sharing resources and best practices across the breadth of its portfolio. The firm solidified its public pledge to being a responsible investor in 2009 by becoming a signatory to the UNPRI and participating in the development of the PEGCC Guidelines, and continues to expand its role as a member of various ESG-related organizations.

Policy Development & Execution: KKR’s Global Public Affairs team is responsible for defining the firm’s ESG policy and the structures to manage ESG risks and opportunities. Execution responsibility during the private equity pre-investment process falls to deal teams, and to portfolio company management teams during the holding period. A cross-functional internal ESG due diligence team assists in the evaluation of potential ESG risks and opportunities pre-investment. During the holding period, KKR may enlist the help of KKR Capstone, a consultant that helps drive cross-portfolio and company-specific ESG initiatives and is most often involved in initial program implementation. Global Public Affairs team expertise is available throughout the private equity investment process to facilitate assessment and management of ESG considerations.

Pre-Investment: Private equity deal teams are provided with a broad suite of resources and expertise to assess the ESG risks and opportunities of a company during deal origination and due diligence. After a private equity investment opportunity has been identified, deal teams collaborate with KKR’s internal ESG due diligence team and external consultants to determine the appropriate approach for assessing ESG considerations. KKR has developed guides that highlight relevant ESG factors to consider for 18 sectors and sub-sectors. Deal teams can also tap KKR’s relationships with NGOs for advice on additional theme and sector-related issues. Following initial identification of needs, the ESG due diligence team meets regularly to track the progress of potential private equity investments and their relevant ESG considerations. If relevant, an evaluation of the target company’s material ESG considerations is included in Regional Investment Committee reviews, and corrective actions for material ESG considerations may be included in the 100-day plan.

Post-Investment: Following investment, where relevant, portfolio companies will execute ESG initiatives spelled out in the 100-day plan, often in conjunction with KKR Capstone. The Global Public Affairs team and KKR Capstone offer private equity portfolio companies three global and two regional proactive programs focused on improving environmental performance, supply chain management, and business integrity through good governance globally; and workplace wellness program effectiveness and veterans hiring programs in North America. Each of these programs was developed in partnership with a leading NGO in its space. In addition to these programs, the firm has developed a series of handbooks that highlight best practices for common ESG-related opportunities from within and outside the KKR



portfolio. Where applicable, deal teams and Portfolio Management Committees work together to review performance on material ESG considerations during KKR’s quarterly reporting process for its private equity portfolio. Presentations and discussions on relevant ESG considerations are also integrated into annual meetings with portfolio company general counsel, chief procurement officers, and communications executives.

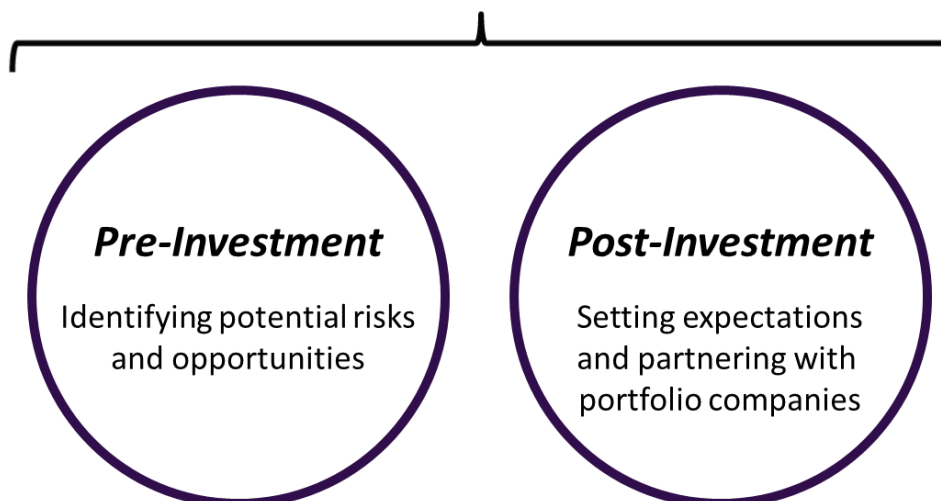
Measurement & Valuation: Performance on material ESG considerations at private equity portfolio companies is tracked via a small number of tailored KPIs through the KKR Portfolio Management Committee. In addition, KKR’s proactive ESG programs measure impact through a host of identified financial and non-financial metrics. While some of these programs are designed to mitigate risk and manage other less tangible aspects of a company, the Green Portfolio Program – an operational improvement program that examines critical business activities at portfolio companies through an “environmental lens” – identifies baseline levels of key environmental performance areas and develops action plans to improve performance.

Lessons Learned: KKR identified three aspects of its ESG approach that help with the implementation of an effective framework:

- ❖ Developing a flexible, integrated approach to ESG, with the ability to adapt to a specific due diligence situation or the unique needs of a portfolio company, is crucial.
- ❖ Innovation is a key ingredient to keeping up with ESG themes which are constantly evolving. Both portfolio company needs and industry trends can inform the development of new, portfolio-wide initiatives.
- ❖ Focusing on value creation and the ESG considerations that are most material to investment teams and portfolio companies is critical to securing participation and communicating the value of initiatives afterwards.

Graphic 7 – ESG at KKR

Material ESG Risks and Opportunities Assessed and Addressed

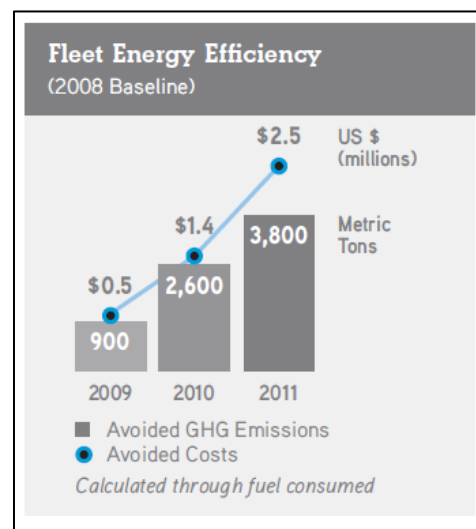


KKR Case Study:

In 2008, KKR partnered with the Environmental Defense Fund (EDF) – a leading nonprofit organization with more than 700,000 members worldwide and a long history of helping companies realize bottom-line benefits by better managing their environmental impacts – to develop KKR’s Green Portfolio Program (GPP). Managed globally by KKR Capstone and Public Affairs professionals, the GPP is an operational improvement program that uses an “environmental lens” to assess critical business activities of KKR’s participating private equity portfolio companies. Program participants identify key environmental performance areas (KEPAs), establish metrics and baselines to monitor them, develop goals and action plans to improve them, and measure and report program results. In many cases, participating companies already have environmental efforts underway, so the GPP provides additional resources, visibility and tailored support for each company. One GPP participant is Pets at Home.

Pets at Home is a leading U.K.-based specialty retailer of pet food and accessories and provider of pet-related services including grooming and veterinary care. The company’s commitment to minimizing the impacts of its business on the environment dates back to 2003. Recognizing the added resources and opportunities for best practice sharing that the GPP could bring, Pets at Home joined the GPP in 2010 and integrated GPP performance goals into its 100-day plan following KKR’s investment. Following an assessment of its KEPAs, the company decided to measure and manage the efficiency of its distribution fleet.

In absolute terms, greenhouse gas (GHG) emissions from the distribution fleet decreased approximately 21% compared to its 2008 baseline, and distribution efficiency improved by approximately 42% (measured by metric tons of GHGs per carton shipped). These improvements in efficiency helped Pets at Home to avoid approximately US \$4.4 million in costs and almost 7,300 metric tons of GHG emissions between 2008 and 2011. In 2012, Pets at Home achieved its fleet results by improving packing efficiency to maximize space utilization and by investing in four extra-long trailers that carry nearly 10% more pallets of stock to reduce the fleet’s total kilometers travelled. Future initiatives under consideration include bringing the delivery function in-house to enable tighter control and increasing the percentage of kilometers per liter of fuel by 2%.



These efforts are one part of the multi-faceted, multi-company Green Portfolio Program. At the end of 2013, 24 companies were publicly enrolled in the program, with 25 portfolio companies having participated since its inception in 2008. Nineteen companies reported results in 2013, the GPP’s fifth results announcement. Cumulatively, the participants have achieved US\$917 million in avoided costs and added revenues, while avoiding 1.8 million metric tons of GHGs, 19.5 million cubic meters of water use, and 4.7 million tons of waste.*

*Nineteen of the KKR portfolio companies participating in the Green Portfolio Program in 2013 reported results. The impact of initiatives of the Green Portfolio Program is based on KKR and KKR Capstone’s internal analysis and information provided by the applicable portfolio company. Impacts of such initiatives are estimates that have not been verified by a third party and are not based on any established standards or protocols. They may also reflect the influence of external factors, such as macroeconomic or industry trends, that are unrelated to the initiative presented. For information about the methodology, download the methodology document from the [Green Portfolio Program website](#).



Partners Group



Partners Group
Passion for Private Markets

Background: Partners Group's commitment to responsible investment is grounded in its Swiss heritage and founding principles. The firm assesses ESG considerations across its four asset classes: private equity, private real estate, private infrastructure and private debt. Insight and best practices from each asset class are shared across the firm. In 2006, the firm incorporated guiding principles in the areas of human rights, labor, the environment and anti-corruption from the UN's Global Compact into its investment activity and became a signatory to the UNPRI in 2008. The firm's Responsible Investment policy draws on these and other internationally accepted conventions and protocols including the Kyoto Protocol and the International Labor Organization's Convention Concerning Forced or Compulsory Labor. Resources dedicated to managing ESG considerations do so across its direct, primary, and secondary investments. The identification of material ESG trends and factors is facilitated by Partners Group's global network of offices and the familiarity with countries' legal, political and social roots this reach engenders.

Policy Development & Execution: Partners Group's Responsible Investment policy is reviewed and approved by its Executive Board. The Responsible Investment Manager, who works in the firm's Industry Value Creation team, is dedicated to enabling the robust application of this policy, and is also responsible for refining methodologies, raising awareness, sharing best practices, and ensuring ESG considerations are addressed throughout the firm's ownership period. In Partners Group's private equity activity, investment teams are responsible for executing ESG screening and due diligence, drawing on the internal and external resources available to them. Overall responsibility for ESG considerations lies with portfolio company management during the holding period.

Pre-Investment: Assessment of ESG considerations begins early in the Partners Group due diligence process. Investment teams are required to use formal ESG assessment templates to identify relevant ESG factors in each investment target. They undertake thorough due diligence on these factors and then make judgments on their significance. Investment teams are armed with a suite of internal and external resources, ranging from assistance from the Responsible Investment Manager to engaging third-party consultants, to execute required ESG due diligence. A review of ESG factors must be presented at Investment Committee and any ESG consideration deemed material must be addressed in deal teams' portfolio company business plan for the first 100 days following investment. Before a transaction is executed, the partner responsible for the investment must sign a statement confirming that the proposed investment meets the firm's ESG standards.

Post-Investment: During the holding period, the Responsible Investment Manager works with portfolio company management, Partners Group board members, and the Industry Value Creation team of over 20 colleagues to roll out ESG-related initiatives. While these initiatives are typically introduced through the board, the Responsible Investment Manager also interacts at the operating level to drive projects forward; a focus in this process is engaging portfolio company management to highlight how addressing ESG considerations fits into broader commercial and strategic objectives. Partners Group is moving towards a quarterly review of portfolio company ESG performance, although reporting on active initiatives is more frequent.

Measurement & Valuation: Partners Group measures ESG performance through KPIs defined at the portfolio company board level. While some metrics such as job creation are measured across the



portfolio, relevant KPIs are defined per the ESG priorities of each portfolio company. Partners Group assesses the potential impact of ESG risk on company value by evaluating how adverse ESG-related events affected comparable company's short and long-term value.

Lessons Learned: Partners Group identified three aspects of its ESG approach that help with the implementation of an effective framework:

- ❖ Genuine commitment to ESG considerations from top management to ensure its relevance across the firm.
- ❖ Integration of ESG responsibility and processes at a functional level throughout the investment process, the ownership period, and client reporting.
- ❖ Defining ESG goals and priorities in the language of good business practice.

Graphic 8: Partners Group applies the following key questions when integrating ESG considerations at each stage in its investment process.



Partners Group Case Study:

Partners Group particularly focuses on the relationship between ESG factors and investment returns and is very selective in choosing investment partners which have a well-established ESG practice. The successful equity investment in AHT Cooling Systems GmbH (AHT) illustrates this point. Partners Group made an equity joint-lead investment alongside Quadriga Capital in AHT in 2007.

Company: Founded in 1983, AHT is the global leader in the production of horizontal refrigeration and freezer cases for the commercial sector. Its products are used in three main applications: by supermarkets, for storing and displaying ice cream, and for storing drinks in bars and restaurants. AHT manufactures its products in two facilities, its Austrian headquarters and a production facility in China (that was established during the holding period), and distributes its products across Europe, Asia and the Americas.

ESG Opportunity: Partners Group and Quadriga Capital follow long-term environmental and social trends to help identify promising investment opportunities. Their Industry Value Creation teams are responsible for integrating these environmental and social trends into investment sourcing strategies that are then implemented by investment teams in each asset class. Recognizing the need for greater energy efficiency, Quadriga Capital and Partners Group identified an opportunity to drive value through ESG levers at AHT during the due diligence process. AHT pioneered a cooling technology, called “plug in cooling”, that is significantly more energy efficient than competing cooling technologies.

Holding Period Performance: During the six-year holding period, AHT’s sustained focus on product innovation, for example on refrigerants and compressors, doubled the energy efficiency of AHT cooling products. Over this period, AHT has mitigated over 400,000 metric tons of carbon dioxide by providing more energy efficient products than those available from competitors. Moreover, AHT became an industry role model in social and governance matters.

In addition to a positive environmental outcome, the focus on improved energy efficiency helped drive commercial benefits. AHT has gained a strong competitive advantage thanks to its energy efficient products. Lower energy consumption contributed to a cost of ownership for AHT customers of roughly half that of competing products.⁶ Along with other initiatives, the demand generated from improved efficiency helped drive a 50% increase in company revenue and an increase in staff employment from 650 at acquisition to 1,100 at exit. Sales growth was pronounced with discount food retailers, a particularly cost conscious customer segment.

Exit: Quadriga Capital and Partners Group exited the investment in AHT in 2013 to an institutional investor. It is estimated that about one-fifth of the value created during the holding period can be attributed to the faster sales growth that AHT achieved thanks in part to its more energy efficient products and its exemplary social and governance policy.

This investment illustrates key aspects of both private equity managers’ approach to the management of ESG factors: fully integrating the evaluation of ESG factors into the investment process, identifying investments which benefit from long-term environmental or social trends, and seeking opportunities to create value via ESG factors.

⁶ Source: AHT



Permira

Background: Permira developed its framework for managing ESG risks and opportunities by drawing on LP priorities, best practices from the private equity industry, and international standards of responsible investment. During this process, the firm's Executive Committee updated its guiding business principals to include commitments to add sustainable value to investee companies and to adhere to industry best practices related to ESG. The firm's ESG Toolkit provides a guide for assessing ESG factors for new investment opportunities and communicating material considerations to the Investment Committee; new employees are introduced to these practices during the firm's New Joiners Program. Following the adoption of this framework, Permira undertook reviews of its existing portfolio companies which assigned ESG risk ratings, identified ESG opportunities, and highlighted the key ESG considerations at each portfolio company. Permira is a signatory to the UNPRI and PEGCC Guidelines, and adheres to the EVCA guidelines for disclosure. It was awarded the BVCA Responsible Investment award in 2012 for its commitment to integrating reporting to both its investors and stakeholders on all aspects of its ESG engagement.

Policy Development & Execution: Permira's Executive Committee is responsible for defining the firm's ESG policy. A working group led by a member of both the Executive and Investment Committees, consisting of investment, risk, and investor relations personnel, is responsible for overseeing implementation of the policy and formulating improvements. The investment professional in the working group is also the firm's ESG project manager and coordinates ESG activity with Permira deal teams. Deal team members are responsible for assessing ESG risks and opportunities throughout the investment process, while portfolio company management is responsible for implementing solutions and initiatives to manage material ESG considerations during the holding period.

Pre-Investment: Screening of ESG risks begins during deal origination. The ESG Toolkit and an ESG template guides the process but is not prescriptive, allowing deal teams to focus on the relevant aspects of ESG for a given sector or target company. During this screening, deal teams assign two ESG risk ratings (red, yellow or green) according to the target's sector of activity and its internal ESG management capability. Permira deal teams discuss all risk ratings with the firm's ESG project manager to ensure that risk criteria are assessed consistently. If a target receives a positive preliminary investment recommendation, a due diligence team is formed which will formulate solutions to identified ESG risks and develop plans to capitalize on ESG opportunities. When deemed necessary, external consultants are typically employed to assist in ESG due diligence.

Post-Investment: Following investment, a 5-6 day review is undertaken by an external advisor for a more granular understanding of a company's ESG considerations. Information is gathered via interviews with portfolio company management, review of existing ESG documentation, and a review of the company's existing policies related to ESG. The advisor will use findings from this assessment to validate or challenge the risk rating assigned to the company and recommend specific initiatives to address ESG risks and opportunities. A portfolio company's risk rating helps prioritize the management of specific ESG issues early in the holding period. The external advisor also builds a detailed business case for identified ESG opportunities which highlights revenue upside and cost reduction potential, and proposes specific actions to be implemented. Deal teams reassess portfolio company risk ratings every six months as part of the monitoring process. They define, refine and monitor progress of action plans to manage ESG considerations when necessary. The ESG working group is available for support and guidance during



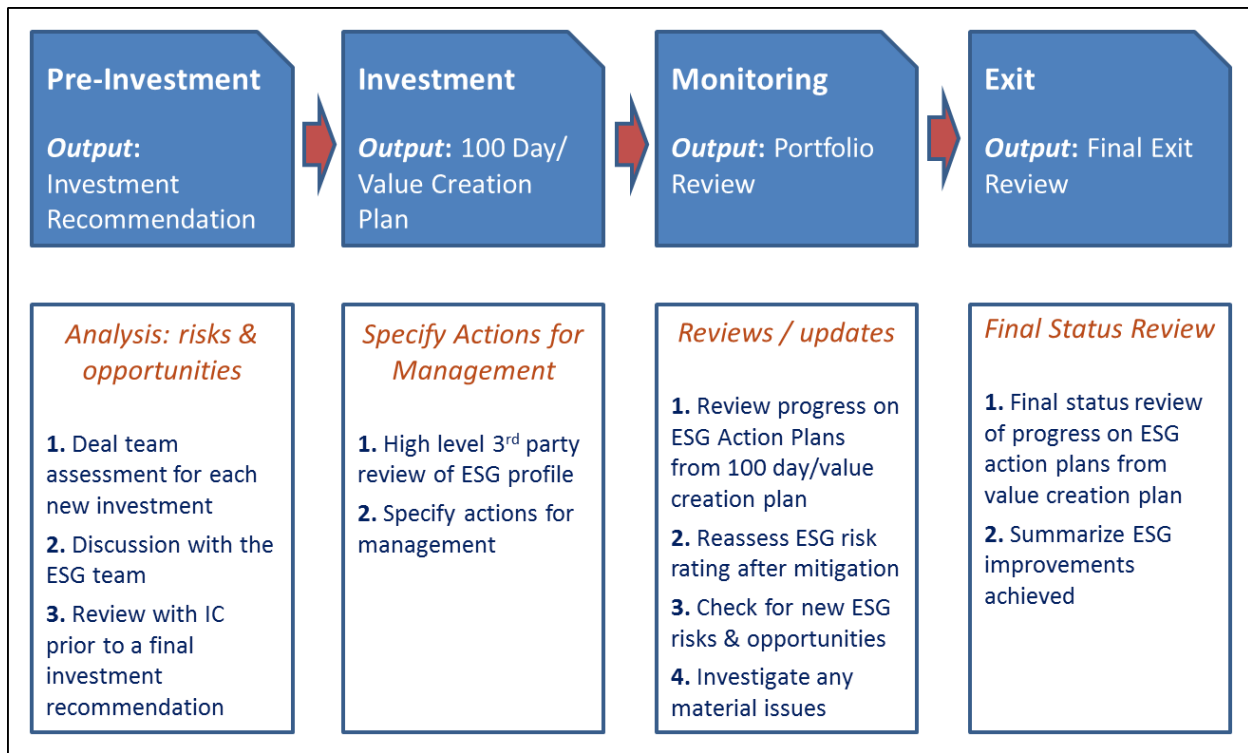
these biannual reviews and more broadly during the holding period. Deal teams must also report on how managing ESG considerations impacted the performance of a company and its valuation as part of the divestment process.

Measurement & Valuation: Permira measures the impact of managing both ESG risks and opportunities. The risk rating is one of the key ESG measurements undertaken at the firm. Improved ESG risk management capability and a reduced number of adverse events related to ESG have helped lower portfolio companies’ cost of capital in some instances. When programs addressing ESG opportunities generate material revenue or cost reductions, deal teams and company management monitor progress and relevant KPIs closely. Major energy and carbon dioxide reductions have been achieved in Permira portfolio companies such as Freescale and TDC.

Lessons Learned: Permira identified three aspects of its ESG approach that help with the implementation of an effective framework:

- ❖ Design ESG policy and procedures with a broad but relatively simple approach that is flexible to focus on the material considerations of each investment.
- ❖ Ensure that managing ESG considerations is integrated into the investment process and investment teams’ responsibilities, and not seen as a risk management or compliance function.
- ❖ Consider management’s ability to address ESG factors when determining the ESG profile of an investment opportunity. Robust capability can mitigate ESG risk in high-risk industries.

Graphic 9 – ESG during the Investment Process: The chart below reflects the steps related to managing ESG considerations at different stages of the Permira investment process.



Permira Case Study:

Permira manages ESG considerations through the consistent application of its responsible investment framework across all of its investment activity. Derived from international best practices and firm ideals, the framework allows investment professionals to develop non-standardized solutions to company-specific ESG risk and opportunities. The broad remit but flexible application of the firm's ESG policy is reflected in the variety of solutions applied to date in the firm's portfolio; the following three examples highlight the diverse range of initiatives.

Netafim: In Netafim, Permira investment professionals identified an opportunity to address the long-term trend of global water and food scarcity. Netafim's drip irrigation technology vastly improves the efficiency of farmer's water use, both increasing crop yields and allowing scarce water supplies to be used for other purposes by local communities. Following its 2011 investment, Permira partnered with the company's founding Kibbutz organization to create a strong, independent board and to expand global sales for the benefit of farmers worldwide. The company currently provides drip irrigation systems to farmers in over 100 countries, and has achieved up to a 40% reduction in irrigation water use and a 50% increase in agricultural yields. In some cases, switching to Netafim's system has also allowed farmers to reduce energy consumption, minimize weed growth and improve fertilizer efficiency.



Hugo Boss: The leading global high-end fashion retailer Hugo Boss manages a vast global production, sourcing and sales business. Since Permira's investment in 2007, the company has developed robust systems to ensure compliance with global labor and environmental best practices in its supply chain. Hugo Boss draws from internationally recognized labor and social standards in line with the conventions of the International Labour Organization and the Universal Declaration of Human Rights of the United Nations, and has established mandatory global standards for its facilities and its suppliers. Specific initiatives include a global audit program which audits all Hugo Boss suppliers, and an annual social compliance audit of all company-owned facilities and many of its suppliers' operations. Feedback from this process has improved worker conditions by upgrading social compliance systems, improving health and safety measures, and enhancing hazard documentation.

Just Retirement: Just Retirement provides elderly people with financial products to better manage their savings during retirement. Following Permira's 2009 investment, Permira investment executives and specialist advisors have supported the expansion of the company's offerings at a time when retirees were under increased pressure from the global financial downturn. Just Retirement has established a market leading position in enhanced annuity products in the UK, and the company's equity release mortgages have unlocked tax-free cash from the homes of nearly 20,000 elderly customers. Permira-appointed company directors draw on extensive financial expertise to support new product development to better address customer needs.



Standard Chartered Bank



Background: Standard Chartered Bank (SCB) focuses on sustainability in order to create long-term value for its shareholders and make a positive contribution to the communities in which it invests. The Energy, Resources & Infrastructure Principal Investment (ERI) team at SCB works to manage ESG considerations in pursuit of these goals through the investments they execute. All sectors in which the ERI team invests are covered by one of the Bank's Position Statements, which determine the environmental and social (E&S) standards for SCB's wholesale banking debt, equity and advisory services. The Position Statements draw heavily on IFC Performance Standards on Environmental and Social Sustainability, SCB's adherence to the Equator Principles, and industry best practices and guidelines to determine relevant standards for each sector. The Sustainable Finance team was established in 2006 to provide support to transactional teams on E&S related matters.

Policy Development & Execution: Overall responsibility for E&S matters at SCB rests with the Brand and Values Committee, a subcommittee of the main board. Per SCB's Position Statements, the ERI team is required to execute E&S due diligence in accordance with policies and procedures and to negotiate E&S requirements for the holding period with investee companies. Following investment, performance and compliance with these E&S requirements is the responsibility of portfolio company management. The Sustainable Finance team is available to the ERI team to support assessment of E&S considerations throughout the investment process, particularly where issues identified during due diligence require further investigation or escalation to the relevant Reputational Risk Committee.

Pre-Investment: Initial screening of E&S considerations is done by the ERI team during deal origination. Once ERI enters into formal due diligence on an investment target, they will contact the Sustainable Finance team and present the transaction. The Sustainable Finance team will help identify the key E&S considerations involved in the deal, assist in identifying appropriate third-party E&S due diligence providers and work with the deal team to execute the required E&S due diligence. In the event of a material E&S consideration, the Sustainable Finance team will work with the ERI team and any appointed external advisors to develop an E&S action plan to address the issue; the Sustainable Finance team may also recommend escalation to a relevant Reputational Risk Committee. A health and safety action plan is typically incorporated into a target company's overall business plan, which is submitted to the Investment Committee for consideration. Governance considerations are managed strictly by the ERI team.

Post-Investment: Following ERI investment, a C-level employee – typically the Chief Operating Officer – is tapped to oversee E&S considerations at the portfolio company. E&S performance is tied directly to compensation, and typically 10-20% of a portfolio company's annual bonus pool is tied to E&S performance relative to identified KPI targets. In the event that a portfolio company does not adhere to an E&S action plan, it would find itself in breach of its shareholders' agreement with SCB and subject to penalty clauses of the agreement. It is the ERI team's philosophy that each portfolio company board meeting should commence with a review of E&S performance, underscoring the importance of E&S to company management. E&S reviews are also typically included in portfolio companies' monthly reporting to ERI and in a section of each company's annual report. The Sustainable Finance team is minimally involved during the holding period, but provides advice and assists in the monitoring process on an ad hoc basis if requested by the ERI team or if ongoing engagement is warranted by the pre-investment risk assessment.

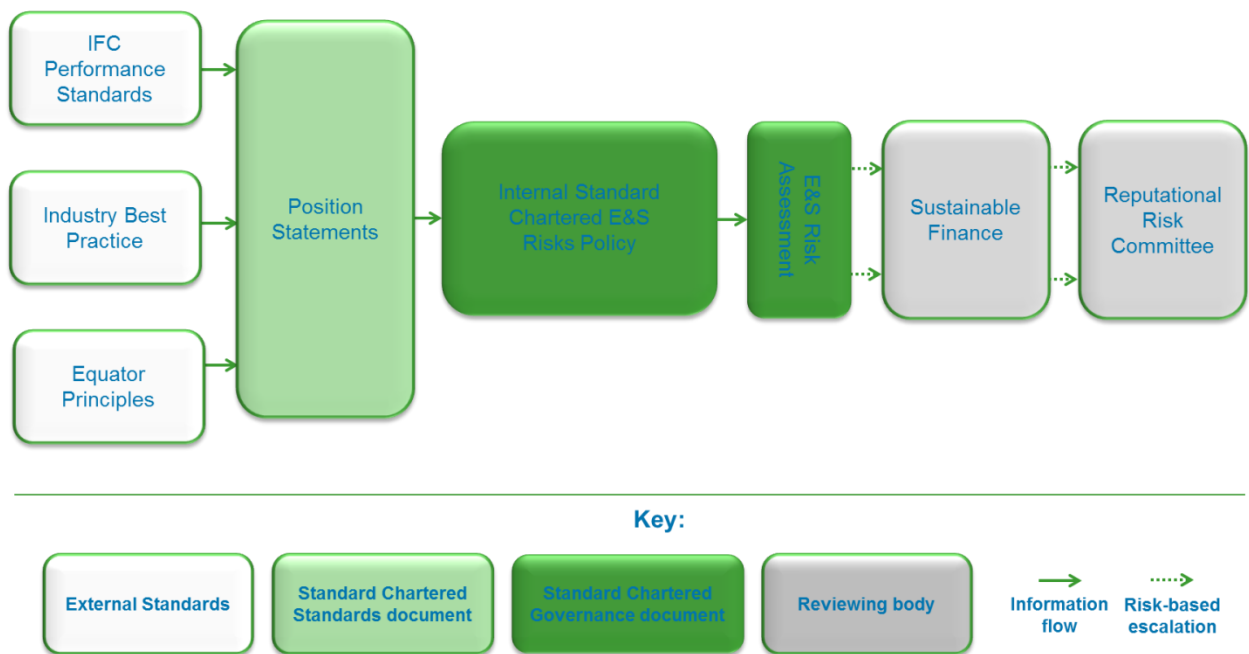


Measurement & Valuation: The ERI team tracks 3 to 4 relevant KPIs per portfolio company investment on an annual basis; one of them must be related to E&S. These KPIs are mutually determined by company management and the ERI team. The ERI team does not specifically measure the value created by its E&S initiatives; however, portfolio companies with improved E&S performance have accessed both debt and equity capital on improved terms in the past.

Lessons Learned: The ERI team identified three aspects of its approach to managing E&S considerations that help with the implementation of an effective framework:

- ❖ Highlighting how improved E&S standards can create value, by improving a company’s bottom-line performance and increasing its valuation at exit, encourages investee companies to adopt sustainability priorities in a timely fashion.
- ❖ Implementing a more structured approach to managing E&S considerations can often rationalize existing capability and improve overall E&S performance in emerging/growth markets.
- ❖ Communicating investee company resources and E&S priorities can allow sustainability personnel to tailor or amend action plan mandates, while remaining within their broad requirements, to help meet investee company needs.

Graphic 10: Standard Chartered Bank’s assessment and review of environmental & social risks is informed by external standards and applied in a systematic manner across the Bank’s financing and advisory activity.



Standard Chartered Bank Case Study:

In January 2012, ERI, through the Standard Chartered IL&FS Infrastructure Fund (“SCI Asia”), invested US\$58 million for a minority stake in Navigat Group Pte. Ltd. (Navigat), Indonesia’s leading distributed power plant developer, owner and operator. Navigat’s primary business under the MaxPower brand is as a gas-fired power plant developer, owner and operator with over 300MW of installed capacity in Indonesia and Myanmar. Navigat has grown rapidly since the initial investment by the ERI team, with both capacity and revenues projected to treble by year-end 2014.

During ERI’s due diligence prior to investment, an E&S consultant was commissioned to undertake an audit on the adequacy of Navigat’s E&S management system. The consultant was tasked with identifying gaps between Navigat’s E&S performance and the requirements set out in SCB’s Position Statements, and with proposing specific, timetabled operating and capital expenditures to address any discrepancies. As a result of the audit, ERI’s investment became contingent on Navigat agreeing to execute a plan related to specific E&S matters, including the following:

- Appointing an advisor to conduct a thorough assessment of the company’s E&S capabilities and identify areas for improvement.
- Beginning the ISO certification process for both environmental management systems and health and safety.
- Identifying one E&S KPI among the 3 to 4 major KPIs used to track the company’s overall performance and to help determine annual bonuses.

Following investment, the ERI team and the company agreed to an E&S action plan based on the consultant’s report and the three above requirements. Navigat established several procedures to assist with the implementation and review of these requirements, including: 1) preparing regular E&S reports; 2) establishing a formal protocol for reporting E&S matters to senior management and the board; and 3) beginning senior management and board meetings with a report on material E&S matters.

Navigat has made significant progress in improving its already solid E&S performance. Since ERI’s investment, all key E&S metrics at Navigat have improved, including lost time due to injury, the frequency of E&S audits, and E&S training. Over the past 24 months, 10 new staff members have been added to the health, safety and environment team, including a highly experienced senior manager who oversees all E&S matters and reports directly to the Chief Operating Officer. In addition, all company personnel have received training in fire-fighting and first aid, with fire drills and emergency response preparedness conducted at a number of sites.

Navigat’s improvements in its E&S systems have been recognized by external parties. Following audits conducted between November 2013 and January 2014, the SAI Global Certification Body awarded the company ISO 14001 certification for its environment management system and OHSAS 18001 certification for its health and safety management systems. Improvements in E&S have also positively impacted fund raising. Following strong financial and operational performance and its substantial improvement in health, safety and governance standards, in late 2013 and early 2014 Navigat successfully raised over US\$327 million in new debt and equity from international financial institutions that require their business partners to adhere to stringent health, safety and governance standards.



Terra Firma Capital Partners



Background: Terra Firma has always aimed to operate and invest responsibly. While creating economic value is its primary investment objective, the firm also aims to be at the forefront of GP transparency, alignment with stakeholder interests, and alignment of economic value with environmental benefits and positive social impact. The firm began to formalize its ESG policy in concert with its signing of the UNPRI in 2011. Prior to this, its approach to managing ESG considerations was informal and integrated into other policies and procedures. Since 2011, Terra Firma's ESG policy has evolved through collaboration with industry peers and investors, providing structure to existing practices.

Policy Development & Execution: Terra Firma's Sustainability Committee, established in 2013, defines the firm's ESG goals and initiatives, and drew up a Responsible Investment policy. The Committee is chaired by the firm's Chief Financial Officer and includes senior employees representing deal team, operating, legal, and investor relations functions; additional staff members participate on an ad hoc basis. This group is responsible for the application of the firm's ESG policy, with the portfolio monitoring staff tasked with sharing best practices across the firm, implementing and monitoring specific operational ESG initiatives, tracking ESG performance metrics at Terra Firma portfolio companies, and reporting on ESG. Responsibility for assessing ESG risks and devising corrective measures during the acquisition process lies with the deal and operational teams. At the day-to-day operational level, portfolio company management is responsible for ensuring ESG priorities are addressed, with support and monitoring from Terra Firma.

Pre-Investment: The assessment of ESG risks and opportunities is typically conducted within normal investment pre-acquisition research and valuation processes. The firm respects limited partners who wish to follow sector exclusion policies, and itself has a no-invest policy for companies with child and forced labor risks. When a potentially material ESG consideration is identified pre-investment, an external diligence provider may be employed to assess the issue and recommend a course of action. Terra Firma is in the process of establishing a more structured approach to ESG in the pre-investment period. New guidelines will provide sectoral and jurisdictional guidance, increase the breadth of topics considered, and allow deal teams to more effectively interact with external diligence providers early in the screening process.

Post-Investment: Significant ESG risks and opportunities identified during due diligence which were not addressed during investment structuring are typically attended to during the first 100 days of the holding period. In order to ensure high quality governance, Terra Firma typically adopts a standard corporate governance framework at the time of acquisition and thereafter an active approach to managing its portfolio businesses. Managing environmental risk and aligning economic and environmental benefits are a priority, given its significant holdings in the renewable energy infrastructure sector. The firm focuses heavily on health and safety issues, due in part to their relevance in the energy sector, and has deep functional expertise in the area. Recently, Terra Firma has employed external advisors to assess ESG risks and opportunities within specific portions of the portfolio, to compare ESG performance to publicly listed peers and to identify steps for improvement.

Terra Firma expects high standards of behavior from its investees. Annually, each portfolio company board is required to submit a signed statement relating to ESG performance including areas such as anti-



corruption, non-discrimination and assurances against trade with sanctioned countries. Material developments related to ESG are disclosed to a wide audience at Terra Firma in weekly and monthly portfolio company reporting. Under newly established ESG monitoring, companies prepare an annual report detailing performance on an agreed list of ESG metrics. Additionally, Terra Firma encourages its portfolio companies to increase public disclosure of ESG performance, using the example shown by its three renewable energy businesses.

Measurement & Valuation: Where relevant, Terra Firma measures and assigns value to ESG-related risks and opportunities throughout the investment process. As with other factors, the firm assesses how material ESG factors impact the value of the company at acquisition, such as through the cost of meeting industry standards and regulatory requirements. For ESG risks that are difficult to explicitly value, the firm relies on employees with executive-level experience to determine whether an investment’s return profile is commensurate with its level of risk.

Lessons Learned: Terra Firma identified three aspects of its ESG approach that help with the implementation of an effective framework:

- ❖ Ensure any new ESG approach has buy-in from the firm’s leadership. It is essential that a more active or formal ESG approach is in line with strategy, and that ESG values and awareness filter through to all levels.
- ❖ Adapt existing good practice at portfolio companies rather than approaching ESG as a new concept at an operational level. Many portfolio businesses already have significant experience and expertise in managing certain areas of ESG.
- ❖ Approach good ESG practice implementation as a gradual and continuous process with no defined end point.

Graphic 11: Terra Firma aims to be a good corporate citizen and a responsible counterparty, employer and investor. Managing ESG considerations is a key input into Terra Firma’s broader approach to responsible investing.



Terra Firma Case Study:

In 2007, Terra Firma created what would become the UK's largest independent renewable energy generator, Infinis, by demerging it from the Waste Recycling Group (WRG). The rationale behind the demerger was the opportunity Terra Firma saw to transform a non-core WRG division into an industry-leading business generating significant returns via a process with a positive environmental impact. More broadly, Terra Firma identified renewable energy as a profitable growth business underpinned by an increased focus on alternative energy sources and by government financial incentives designed to encourage investment.

After putting in place an experienced team of executives to manage the newly independent business, Terra Firma worked with Infinis to develop and refine a strategy to expand its portfolio into other forms of renewable energy. Various elements of ESG have played an important role in this development.

Environmental Emissions: Two key elements contribute to Infinis' beneficial environmental impact: energy production and greenhouse gas reduction. Infinis' main business at the time of the demerger focused on generating electricity through burning methane extracted from landfills. By producing energy in this manner, Infinis displaces production which would otherwise come from fossil fuel sources and prevents the discharge of significant amounts of carbon dioxide and methane from landfills. Netting off the small impact of Infinis' own operations, the business' activities prevent emissions equivalent to approximately 11 million metric tons of carbon dioxide annually.

Health & Safety: Infinis and its wider group had a strong health and safety record before the demerger, but Terra Firma identified a number of strategies for continuous improvement which bolstered its capability. To address perceived industry-wide underreporting of near-miss incidents, the company adopted a near-miss reporting incentive scheme; for each near-miss reported, Infinis contributes a small sum to a fund used to support good causes nominated by company employees. Through this scheme, causes important to employees are supported, the significance of near-miss reporting is emphasized and the business is able to tackle potential health and safety issues earlier. In 5 years, it has identified over 2,000 near-misses and generated over £50,000 for employee causes. The safety outcome has been equally impressive, with the rate of reportable incidents falling by 50% over the period.

Transparency: Terra Firma instilled in Infinis a belief in the benefits of transparent reporting and combined that with a focus on operational quality. Infinis published its first Corporate Social Responsibility (CSR) report during its first year of operation and has been an example of best practice within the Terra Firma portfolio ever since.

The progress Infinis has made has been recognized. Its safety programs have won numerous awards and Infinis has been listed as one of the Best Green Companies by the *Sunday Times*. Its focus on operational quality resulted in its Glenkerie wind farm becoming the first UK renewable energy project to win the Civil Engineering Environmental Quality Assessment and Award (CEEQUAL) for sustainability in engineering. Infinis completed an initial public offering on the London Stock Exchange in November 2013, where its track record of transparency and operational ESG improvements were beneficial. It serves as an example of the positive impact which ESG can have on both the business and the investment. Terra Firma has been able to share these lessons and experience with its other businesses.



Summary Comments

We hope that this report has provided an insight into the private equity industry's current approach to managing ESG risk factors and investment opportunities, and food for thought for both private equity GPs and LPs. We expect to revisit this report regularly to highlight progress and share observations with industry players.

Reflecting on this project and our conversations with participating GPs, the 11 snapshots underscore two themes we observed again and again: the unique aspects of each GP's ESG framework, and the impact managing ESG considerations can play in building better businesses. While a universally accepted approach to managing ESG considerations does not yet exist, the common threads in each of our snapshots hint at the emergence of best practice.

This project has provided a base from which the GPEI will explore other points related to managing ESG investment considerations. Additional research topics that emerged during the course of our project include ESG measurement & valuation and LPs' role in the ESG story. Please stay tuned to hear more about our expanding research coverage of ESG.

ESG is an important area of focus in our research agenda since we firmly believe that managing these considerations in private equity investee companies provides a lever to improve the lives of employees, community stakeholders, and society at large.



Appendix A

This appendix highlights the key characteristics of a GP's ESG approach that help with the implementation of an effective framework. Content is largely sourced and aggregated from the *Lessons Learned* sections in each GP's snapshot.

Committed Leadership: Secure the visible support of senior GP leadership and investment personnel to underscore ESG management as a firm-wide priority. Involving senior leadership also helps align the firm's ESG framework with its existing values and long-term strategy. In addition, strong leadership support provides ESG specialists with a mandate to operate across the firm's investment activity.

Flexibility: Create an ESG framework that can both incorporate emerging ESG trends and encompass the specific needs of a private equity firm's portfolio investments. Designing a simple framework with deep capability in the firm's industries and geographies – rather than a complex framework with specific requirements – empowers deal teams to exercise judgment and focus on the ESG investment considerations relevant to each stage of the investment process.

Integrated Responsibility: Develop an ESG framework that places execution responsibility with deal teams during deal screening and due diligence, and with portfolio company management during the holding period. Integrating responsibility with these key decision-makers helps ensure that ESG management is not marginalized as a “bolt-on” activity and can prioritize ESG considerations material to decision-making.

Value Creation: Focus on ESG factors as levers for value creation to align ESG management with the core function of private equity: building robust, profitable businesses. Shifting the focus of ESG from risk mitigation to value creation helps investment personnel think about ESG proactively, as opposed to a barrier to executing deals. Identifying and reporting the value created through managing ESG investment opportunities can improve adoption of ESG initiatives across the portfolio.

Portfolio Expertise: Draw on expertise within a firm's existing portfolio when developing initiatives to tackle specific ESG investment considerations, as many portfolio companies have a track record related to sustainability or corporate social responsibility (CSR) criteria. Allocating time for portfolio company management and functional personnel to discuss ESG during portfolio-wide events and conferences can help spread awareness and best practice throughout the portfolio.

External Consultants: Employ external consultants to execute specific due diligence and tailored ESG initiatives during the holding period. Developing relationships with a broad network of external consultants and non-governmental organizations can allow GPs to efficiently draw on validated, best-in-class expertise on a case-by-case basis, and keep in-house costs related to ESG to a minimum. External consultants can also jumpstart the development of a firm's ESG framework by incorporating the latest best practices.

Further Reading

- [IFC Performance Standards on Environmental and Social Sustainability](#) – International Finance Corporation, 2012.
- [King Report on Governance for South Africa 2009](#) – Institute of Directors Southern Africa, 2010.
- [The Equator Principles III – 2013](#) – Equator Principles, 2013.
- [Global Corporate Sustainability Report 2013](#) – United Nations Global Compact, 2013.
- [Fiduciary Responsibility: Legal and practical aspects of integrating environmental, social and governance issues into institutional investment](#) – Asset Management Working Group of the United Nations Environment Programme Finance Initiative, July 2009.
- [Private equity and responsible investment: an opportunity for value creation](#) – World Wildlife Fund & Doughty Hanson, 2011.
- [ESG in Private Equity: Perspectives and best practices for managing environmental, social, and governance issues](#) – Malk Sustainability Advisors & Environmental Defense Fund, 2013.
- [The Integration of Environmental, Social and Governance Issues in Mergers and Acquisitions Transactions: Trade Buyers Survey Results](#) – PricewaterhouseCoopers & UNPRI, 2013.
- [Putting a price on value](#) – PricewaterhouseCoopers, 2013.
- [Robeco Sustainable Private Equity Program: Responsible Entrepreneurship Report 2010](#) – Robeco, 2011.
- [Toolkit on ESG for fund managers: Adding Value through effective environmental, social and governance \(ESG\) management](#) – CDC Group, 2010.

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