

Responsible *Investment* Hot Air or a New Way Forward?

Environmental, social and governance (ESG) issues are on the agendas of an ever increasing number of limited partners, CEOs and their boards, a feature of investment indices and common parlance in Government as they set regulation. In recognition of this, private equity firms are taking an increasingly active approach to corporate responsibility. Initiatives like the Equator Principles, the Walker Guidelines and the UN Principles of Responsible Investment (UN PRI) seek, in part, to embed these concepts into the investment sector

In association with



But what does it all mean and how does it affect you?

Myth 1 "It's All Too Technical for Me"

The concept of Responsible Investment (RI) can be surrounded by jargon and is not always easy to get a handle on. We want to demystify the issue on behalf of our members and support them in finding a route to RI which is appropriate to LPs, GPs and their investments.

There are many buzz words around RI, including: "ethical investment", "sustainability", "environmental protection and compliance", "social and environmental accountability", "corporate social responsibility", "environmental and social governance" or "ESG". But what do they mean and how do they fit together as concepts?

Essentially:



In relation to LPs and GPs, this covers two basic questions:

- What do I choose to invest in?
- How can I make the business perform better?

These questions and their answers apply to a whole spectrum of business issues, but are also integral to environmental and social considerations and would typically cover topics such as:

• Understanding and managing environmental and social impacts of the business	• Influencing impacts up and down the supply chain (i.e. ones over which there is not direct control)	• Verifying progress against these objectives and targets
• Protection of employees via compliance with health and safety law	• Developing procedures and practices to deliver control and improvement	• Communicating performance to stakeholder group beyond your investor base
• Managing and mitigating any detrimental impacts to the local community	• Establishing objectives and targets to improve performance	

Myth 2: "But I'm a private equity house with only 10 people. This doesn't affect me"

The vast and diverse portfolio of businesses in which private equity firms invest create indirect exposure to environmental and social issues. As a significant stakeholder in these businesses, it is in investors' interests to understand interactions and to ensure that the relevant management team is well-placed to address them.

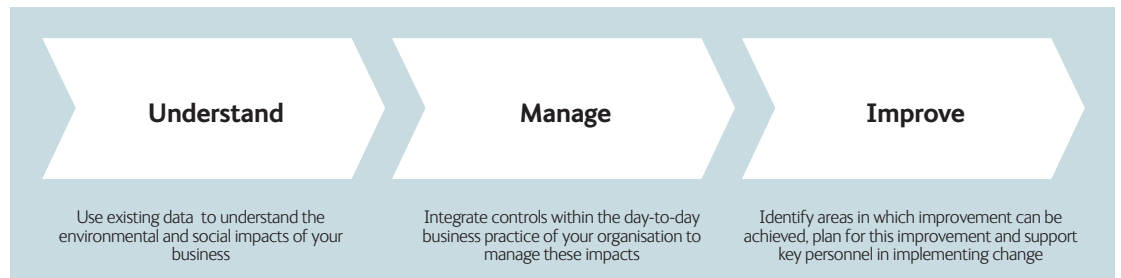
A number of underlying reasons form the sound business case for RI.

1. **Direct cost savings** – managing your portfolio's energy consumption can be a substantial saving on the bottom line
2. **Reputational risk management** – brands can be both built and destroyed on the basis of reputation, and clearly environmental and social issues are beginning to prey on consumers' minds

3. **Compliance management** – environmental, health and safety legislation increases almost by the day, and fines for non-compliance can reach £50,000 per item (excluding legal fees). Where new legislation impacts a business, it is important to plan for its impacts and allocate capital to ensure compliance within the business plan
4. **“Future Proofing” Investments** – there are hard truths about the way the world is going that will have significant strategic implications for business. These truths can be boiled down to two facts and one statement of the obvious: Over the next 40 years population numbers will grow by 50%, energy demand will double and current levels of consumption and waste management are literally unsustainable. Understanding and managing the risks and opportunities presented by these issues will be critical in ensuring the long-term viability of your assets
5. **Market Creation** – the need for low carbon technologies has stimulated an entirely new market, including wind farms, energy from waste and solar power, which can offer attractive investment returns for its investors.

Myth 3 “It’s too difficult to apply to my business”

RI must be seen a process that delivers tangible business benefits, and not an end in itself. Critical to securing tangible benefits is the implementation of the process to the business model. Each business is different in its interaction with society and the environment, so it is true that there is no “one size fits all” solution but there are some fundamental concepts which are always relevant:



In many circumstances small changes to existing systems and strategies can generate substantial ESG benefits and bottom line improvements. This could include:

- Getting more out of due diligence – environmental due diligence commissioned to support investment should be appropriate in scope, and include evaluation of traditionally non-core items such as carbon output, health and safety performance, supply chain management and community involvement. Most importantly, due diligence reports must be put to good effect as a baseline from which ESG can be established and improved
- Improving dialogue – delivering social and environmental change requires personal engagement with these issues. Much of the move towards RI requires better engagement, whether it is directly with the management teams, or with the wider employee forum
- Embedding controls – ESG is not an “add-on” requirement to the core of business. By working with the existing business model and incorporating key controls as an integral part of the working day, facilitating change can become easier
- Capturing the true benefits of cost control – where cost savings are made, these normally have a direct impact on resource consumption, energy usage and waste generation. Often these secondary impacts are not accounted for within management progress reporting.

In conclusion

The crux of the matter is that incorporating social, ethical and environmental considerations, via RI, is not about changing the business model of the investment community ... it is simply about making it better. Getting the balance of these considerations right can mean tangible business benefits – something we all endeavour to achieve

The BVCA understands that this is not necessarily an area in which all of our members feel most confident, and as such we are developing a directory of external consultants who are well-positioned to provide the necessary advice and support moving forward....

Case Study: Alliance Boots

KKR is committed to placing excellence in ESG principles at the centre of what it does and how it communicates, and this has been cascaded into the Alliance Boots business, resulting in reputational improvements and significant cost savings.

Scorecard

Progress towards the Group's ESG goals are monitored and tracked through a scorecard, which is driven by annual targets in four areas: community, environment, marketplace, and workplace. Key objectives and priorities are embedded into the daily activities of employees. The scorecard means that ESG is not seen as an additional activity, but instead integrated into daily routines – and thus is regarded as part of delivering value by either reducing costs or generating new commercial opportunities.

Beneficial outcomes:

- Strong international reputation, including a Gold Award in the Sunday Times 'Business in the Community Companies that Count' survey
- Improved understanding of stakeholder requirements, via consultation with key parties such as: government, academics, the media, suppliers, customers, employers, shareholders and NGOs
- Improved store design and transport purchase, which deliver both cost savings (including £1.6M in fuel costs) and reduced carbon impact.

Case Study: M&S - Plan A

In January 2007, M&S committed to spending £200 million on capital investment over 5 years on implementing their eco strategy designed to green their operations, products and services, known as Plan A –. By June 2009, the company reported that the resulting cost-savings had already made it cash positive. Key elements of these cost savings include:

- Reduction of carrier bags by 83% as a result of charging for use, which has also generated £1.2 million in charity donations
- Decreased total carbon dioxide emissions (despite increasing store space) as a result of energy efficiency measures
- Support down the supply chain in the development of four "green factories" which use circa 40% less water and power than a traditional garment factory.

In addition it has helped differentiate their brand in an increasingly green market place while playing to their strengths as a quality, responsible operator.

Case Study: Little Tasty Drinks

Innocent was founded in 1998 with just £500. It has built its market share and brand image on some key environmental and social concepts (and also some rather tasty drinks):

- 100% natural products
- Responsible ingredients from farms operating to environmental and ethical standards
- Sustainable packaging, including bottles made from 100% recycled plastic
- Resource efficiency, in particular carbon and water
- Profit sharing via the donation of 10% profits to charity

This approach found high favour with an increasingly discerning market leading to rapid growth. In April 2009, a 20% share in the company was sold to Coca Cola for £30 million. Anticipating the inevitable backlash in media coverage, the company published a clear statement on the underlying reasons for the buy-in on its website.