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INTEGRATING ESG

Driving sustainable value

When it comes to driving returns at portfolio companies through ESG initiatives, risk mitigation and value creation are not necessarily separate, says Permira's head of environmental, social and governance Adinah Shackleton

***Shackleton:** a collaborative approach is vital*

In 2010 global private equity house Permira developed an ESG framework to further formalise its approach to ESG and sustainability issues. The firm also formed an ESG group, headed up by Jörg Rockenhäuser (a member of the investment committee and executive committee and head of the Frankfurt office), with members from investor relations, compliance and risk and deal team functions.

Adinah Shackleton joined the firm in 2015 as its first full-time resource dedicated to ESG. First sitting within the investor relations team, Shackleton is now part of the Portfolio Group, which works with portfolio companies on value creation initiatives. She sat down with *Private Equity International* to discuss how the firm integrates ESG considerations into the investment process.

Q As the first dedicated ESG resource, have you had an educational role within Permira?

Because Permira had this more formalised approach since 2010, and won the BVCA Responsible Investment Award in 2012 for its commitment to ESG engagement, the level of awareness within the business is quite high. But I have been working on a one-on-one basis with deal teams on individual deals to help them think about the risks and opportunities that are relevant to that transaction, and how they can factor these into the due diligence process.

We also ran a series of value creation workshops at a recent internal conference, one of which related to ESG. We used the interactive session to share some of the initiatives portfolio companies have been working on so that our investment professionals can really learn from what other companies are doing in this space.

Q How do you integrate ESG into the acquisition process?

In the initial screening stages we look for red flag issues in relation to the deal or key concerns from an environmental, social or governance perspective.

Then, when we get into the due diligence phase, we look at ESG issues in more depth to really understand whether there are material risks or opportunities, for example relating to regulatory compliance, liabilities, cost savings, new revenue streams or potential reputational issues. I work with deal teams to help them think through how best to cover these points during due diligence. Do we need to get external advisors on board to help us do site visits? Or are there particular questions that we can feed into our own due diligence processes or other work streams to get comfortable around some of the topics?

Q Could these red flags shut down a deal?

There have been cases where ESG issues have played a part in the Permira fund's decision to walk away from a deal, but in most cases it's about understanding the level of risk and how portfolio company management teams can mitigate this once the funds are invested in the company. Are there things to address immediately as part of the 100-day plan? Or are there longer-term issues which can be addressed throughout the course of the investment?

Q How do you work with management teams?

Post-investment we undertake an engagement process with management teams to understand in more detail how they manage environmental, social and governance issues, and what the main opportunities are for them to improve, building on our

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understanding from the due diligence process. For some companies, we also undertake site visits during the investment to see how ESG issues are managed on the ground.

Q Are management teams receptive to discussions on ESG?

Generally, management teams are receptive to this. As well as benefits to the environment, workforce or communities, for example, we also present this in terms of, 'What's the business case for looking at these issues?' There are usually regulatory drivers or financial benefits of improving performance on ESG topics.

Energy is a really good example. If you can look at energy efficiency programmes, then for most businesses that's likely to have a direct cost saving. Or if you can improve lost time from health and safety incidents, again that's likely to have a direct cost benefit. Our approach is to work in collaboration with management teams to identify ESG initiatives they believe are good for their business. »

CASE STUDY: DR. MARTENS

Permira V acquired iconic British footwear brand Dr. Martens in 2014 in a €380m transaction. Since its investment, Shackleton has been working with the deal partners and the company's management team as it further develops the sustainability strategy, focusing on material topics including supply chain

Shortly after Permira V invested in Dr. Martens Permira engaged with the management team on ESG matters. While recognising that the company had for some years been actively committed to enhancing sustainability and upholding ethical working practices at both its own UK production facility and its offshore, third party suppliers, we identified a number of ESG opportunities intended to both formalise and extend the programme.

Since that review, the management team has been further developing its sustainability strategy. One of the key focus areas continues to be how the company works with suppliers and looks at issues such as labour and working conditions and ethical trade.

It's really important for the company to have a supplier code of conduct and the right processes in place to understand how the footwear is being made.

The company has developed long-term relationships with a small number of key suppliers to so it can build trust and transparency with them. This also helps the management team to understand any issues faced by suppliers.

Dr. Martens also work with a third party called Impactt on supply chain audits, and it has a supply chain team which frequently visits supplier sites. For example, in 2016, 20,500 first tier supplier employees were covered by Dr Martens Supplier Code of Conduct and 70 percent of Tier I footwear suppliers were audited in 2015-16. Dr. Martens is a member of the Leather Working Group, which works to assess the environmental compliance and performance of leather manufacturers, promoting sustainable business practices within the leather industry. In 2015, Dr. Martens sourced 96 percent of its leather from LWG medal certified tanneries.

The company has been looking at transparency around what it's doing in this space, providing more information for customers on its approach to the supply chain, where it's getting the leather from and other ESG considerations for its manufacturing processes and product.

Under the Permira fund's ownership, Dr. Martens has also formed a sustainability committee internally to report up to the board on progress. One of the key things we encourage with portfolio companies is getting good quality board-level dialogue on material ESG matters. Setting up a committee reporting up to the board on a regular basis can really help drive the strategy forward. ■

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» Some of these initiatives will be long term, some of them will be shorter term, and you'll see the value creation benefits during the course of the Permira fund's investment. Ideally companies will work on these initiatives and then when the Permira funds reach exit we'd like to present what the company has been working on and the benefit that's brought to the company in terms of performance and value.

When looking at sustainability, this longer-term view and a focus on management systems at the portfolio company level is important. It can take time to see the year-on-year benefits from ESG initiatives. Portfolio companies also need to have a longer-term view on ESG, beyond the Permira fund's investment, so that once the Permira funds have exited these ESG management systems are self-supporting.

Q How do you collect information from your portfolio companies and present it to your investors?

We have a data management system that we use to collect information from portfolio companies. This includes financial information and other information we use to monitor company performance. We've included environmental, health and safety, social and governance indicators in this system and we collect these on a regular basis. As well as these core metrics, we are also identifying tailored metrics for certain companies because we understand that those core metrics won't necessarily reflect the material ESG issues for all companies.

We have seen an increase from some investors in terms of the information they want to see about portfolio companies. In some cases, they're actually looking for company-by-company reporting. We've developed a reporting format which highlights the key areas that companies are working on and their key focus for the coming year. It also talks about company approaches to managing ESG topics and what certifications and international standards they have in place.

We produced an ESG report for the first time last year, and this year we're sending it out to a wider set of investors.

A few years ago the focus from investors was more on understanding whether private equity funds had a policy and if they had an approach around integrating ESG in the investment process. Now they want to see more around performance

Q How do you field requests for information?

As part of the fundraising process for Permira VI we produced a document on our approach to responsible investing throughout the investment lifecycle. It also included some case studies of how we'd worked with portfolio companies on ESG matters.

The PRI LP Due Diligence Questionnaire is starting to help streamline some of the questionnaires we receive from our investors. We're seeing a number of investors now using it and we are using it to structure the Permira funds' own reporting.

Whilst greater consistency in requests from investors is helpful, a potential challenge with having one template or approach for GPs to follow is different firms may have different approaches. I think it's important to continue to allow for firms to reflect that.

Q How important is ESG to your investors?

It varies depending on the investor. If I look at our investor base, there are some that are more attuned to ESG issues than others.

If I think about how dialogue with investors has evolved, a few years ago the focus was more on understanding whether private equity funds had a policy and if they had an approach around integrating ESG in the investment process. Now they want to see more around performance. They want to understand how these policies are implemented and get assurances that performance is improving at a portfolio company level. ■