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The Impact of ESG on Private Equity

Understanding the Transformation

November 14, 2024

Thought Leadership analysis by RSM Business Intelligence Services

Our observations

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The private equity industry is experiencing a fundamental transformation as Environmental, Social, and Governance (ESG) considerations become increasingly important to investment strategies and portfolio management. This shift is driven by a combination of regulatory pressures, particularly from the EU Green Deal, and growing market demand for sustainable investment practices. The evolution represents more than a temporary trend; it signifies a structural change in how private equity firms create, preserve, and realize value in their portfolios.

The European Union's regulatory framework has emerged as a primary catalyst for change in Europe, introducing comprehensive measures that directly impact private equity operations. The Corporate Sustainability Reporting Directive (CSRD), Alternative Investment Fund Managers Directive (AIFMD), EU Taxonomy Regulation (EUTR), and Sustainable Finance Disclosure Regulation (SFDR) amongst others collectively require PE firms to fundamentally reassess their approach to portfolio management. These regulations demand enhanced due diligence processes, sophisticated ESG data collection systems, and comprehensive reporting frameworks. Portfolio companies must now demonstrate compliance across various sustainability metrics, affecting everything from supply chain management to product development.

The relationship between ESG performance and financial returns is becoming clearer over time. Companies with strong ESG ratings consistently demonstrate lower costs of capital, reflecting reduced exposure to systematic risks over the long term. This advantage manifests in both more favorable debt terms and higher equity valuations. Market research reveals that high ESG-rated companies tend to outperform their peers, showing greater stability during market fluctuations and stronger long-term financial performance. These findings suggest that ESG integration is not merely a compliance exercise but a fundamental driver of value creation.

However, significant challenges exist in implementing comprehensive ESG strategies. The most pressing concern remains the limited availability of high-quality, independently verified ESG data. Many companies struggle to provide standardized, audited sustainability information, making it difficult for PE firms to accurately assess and compare ESG performance across potential investments. Additionally, the complexity of evolving regulations requires substantial investment in expertise and compliance infrastructure, creating challenges for smaller firms with limited resources.

Our observations

The impact of ESG integration extends across the entire private equity lifecycle, from initial due diligence to exit planning. PE firms must now evaluate potential investments through an ESG lens, considering both current performance and the potential for improvement. During the holding period, firms are increasingly focused on implementing sustainable practices and monitoring ESG metrics alongside traditional financial indicators. At exit, strong ESG credentials have begun to influence valuations and attract a broader pool of potential buyers, particularly those with sustainability mandates.

The sector's unique position as an active owner enables firms to drive meaningful change in portfolio companies' ESG practices. This advantage allows PE firms to implement comprehensive sustainability initiatives, improve operational efficiency, and create lasting value through ESG improvements. The industry's traditionally long-term investment horizon aligns well with the time required to realize benefits from sustainable business practices.

Looking forward, the importance of ESG in private equity is expected to grow further. As global challenges such as climate change and resource scarcity intensify, the ability to navigate sustainability issues will become even more critical for business success. PE firms that effectively integrate ESG considerations into their core strategies are likely to gain competitive advantages in fundraising, deal sourcing, and value creation. Those that lag in adopting sustainable practices may find themselves increasingly disadvantaged in an evolving market that places premium value on ESG performance.

The evidence strongly suggests that limited partners and investors should actively promote sustainable investments in private equity portfolio management. As the industry continues to evolve, ESG integration is becoming a key differentiator between market leaders and laggards. Success in this new paradigm requires not only technical expertise and resources but also a fundamental shift in how private equity firms approach value creation and risk management in their portfolios.

The message is clear: Private equity firms must embrace ESG integration or risk running behind. Those who adapt will not only meet regulatory and investor demands but should capture greater value in tomorrow's market.

Overview

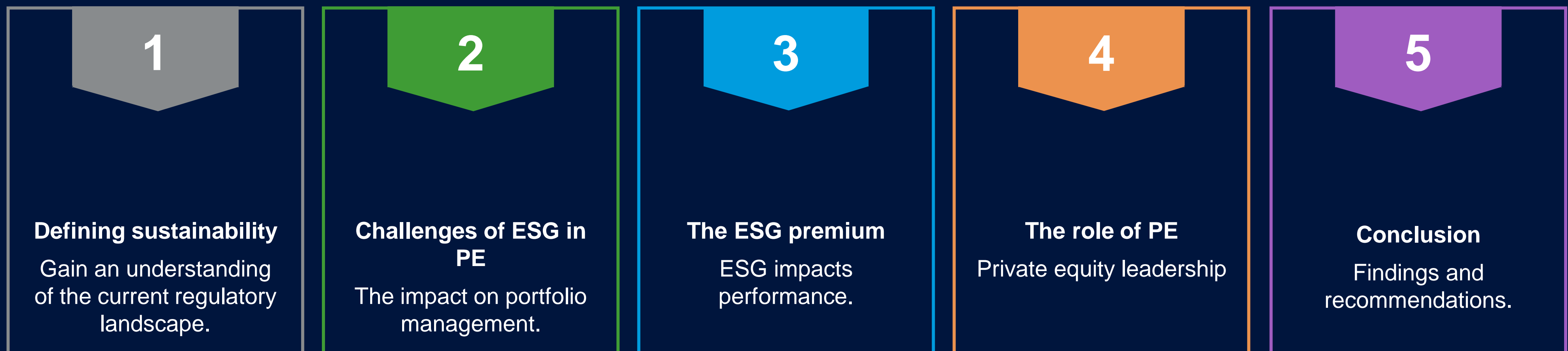
Overview

This report explores the intersection of sustainability and private equity portfolio management, focusing on whether limited partners and investors should support sustainable investments. As ESG considerations become central to investment decisions, the PE industry faces opportunities and challenges in adapting.

The analysis addresses four key questions:

1. How is sustainability defined in private equity, and what are the major regulatory frameworks involved (such as the EU Green Deal, CSRD, EUTR, AIFMD, and SFDR)?
2. What challenges do private equity firms face when integrating sustainability metrics, particularly regarding data quality and regulatory compliance?
3. How does ESG implementation relate to long-term private equity performance, including factors like cost of capital, market performance, and risk management?
4. What role does private equity play in advancing ESG practices across the investment industry?

The report shows that sustainability is a fundamental shift in value creation in PE investments, suggesting that firms integrating ESG may achieve better risk-adjusted returns and contribute to sustainable development goals. This research is timely as the industry faces regulatory pressures, evolving investor expectations, and global challenges like climate change, providing insights to help stakeholders navigate sustainable investing.



Private Equity and ESG explained

Private Equity can be simplified into three main components: the firm, managed by the general partner; the (portfolio) investments, represented in funds or portfolios; and the investors, known as limited partners. ESG metrics are important both due to investor demands and considerations during portfolio setup. Consequently, ESG can influence various aspects of the PE lifecycle. However, ESG will become a fundamental pillar of the lifecycle.

Limited Partners

E
Environmental

S
Social

G
Governance

Private Equity firm

General Partner

E
Environmental

S
Social

G
Governance

Portfolios

Defining Sustainability in the PE Context

Private Equity (PE) firms play a crucial role in shaping the business landscape through their investment strategies and portfolio management. As global regulatory environments evolve, particularly in response to climate change and sustainability concerns, PE firms find themselves at the intersection of financial performance and environmental responsibility. The European Union's Green Deal, a comprehensive set of policy initiatives aimed at making Europe climate neutral by 2050, exemplifies how regulations can profoundly influence PE operations, portfolio compositions, and long-term investment strategies. This regulatory shift not only affects PE firms directly but also cascades through their portfolio companies, creating a ripple effect that touches various sectors of the economy. Understanding the interplay between PE, its portfolio, regulations like the EU Green Deal, and their collective impact is essential for navigating the changing investment landscape.

The EU Green Deal and its associated regulations significantly impact private equity firms by necessitating a realignment of investment strategies. As the EU aims for climate neutrality and sustainability, PE firms must reassess their sector focus, particularly in carbon-intensive industries, while actively seeking opportunities in green technologies and sustainable business models. This strategic shift not only enhances compliance but also positions firms to gain a competitive advantage in fundraising and deal sourcing.

Enhanced due diligence is now essential for private equity firms, requiring thorough assessments of potential investments for alignment with the Green Deal's objectives. This includes evaluating climate risks, sustainability reporting capabilities, and compliance with stringent transparency regulations under the Alternative Investment Fund Managers Directive (AIFMD). Ongoing monitoring and improvement of ESG performance across portfolios are crucial, necessitating investments in technology and expertise to manage these new reporting requirements effectively.

** This overview highlights only a few of the major regulations; the EU Green Deal encompasses more initiatives beyond these.*

Regulatory impact on PE Portfolio's

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The Green Deal also opens new avenues for value creation within portfolio companies through investments in energy efficiency and sustainable product development. Strong ESG performance can become a key value driver during exits, making it imperative for PE firms to demonstrate tangible improvements in sustainability metrics. Additionally, aligning with EU regulations may enhance fundraising efforts, particularly from institutional investors focused on sustainability. By proactively addressing these regulatory impacts, private equity firms can mitigate risks while capitalizing on the significant opportunities presented by the transition to a low-carbon economy. In more detail, this means the following:

Impact on PE portfolio management

SFDR
Sustainable Finance Disclosure Regulation

Fund Classification: Classify funds according to SFDR categories, impacting fundraising and investor relations.

ESG Data Collection: Implement rigorous ESG data collection and reporting processes to meet SFDR requirements.

Investment Strategy Alignment: Adjust investment strategies to align with SFDR classification, influencing deal sourcing and portfolio construction.

Performance Metrics: Develop new KPIs and performance metrics for sustainability reporting.

Investor Communications: Enhance investor communications with detailed ESG disclosures, requiring new reporting tools and processes.

EUTR
EU Taxonomy Regulation

Classification of Sustainable Activities: Provides a framework for identifying environmentally sustainable economic activities, guiding investments towards greener projects.

Disclosure Requirements: Private equity firms must disclose the proportion of their investments that are taxonomy-eligible and aligned, impacting reporting practices.

Investment Reorientation: Encourages reallocation of capital towards sustainable activities, influencing portfolio composition and investment strategies.

Risk Management: Ensures that investments do not significantly harm other environmental objectives, requiring thorough risk assessments.

AIFMD
Alternative Investment Fund Managers Directive

Transparency and Reporting: Imposes stringent transparency and reporting requirements on private equity funds, enhancing investor protection and market stability.

Remuneration Policies: Mandates the implementation of remuneration policies that align with the long-term interests of investors and the sustainability of the fund.

Depositary Requirements: Introduces the need for a depositary to oversee fund assets, ensuring safekeeping and compliance with regulations.

Asset Stripping Restrictions: Limits the ability of private equity firms to extract value from portfolio companies through distributions, capital reductions, or share buybacks for two years post-acquisition.

CSRD
Corporate Sustainability Reporting Directive

Enhanced Due Diligence: PE firms must conduct thorough ESG due diligence to assess a target company's CSRD compliance.

Data Infrastructure Investment: Significant investments in ESG data systems may be needed for CSRD compliance.

Valuation Considerations: CSRD compliance can impact valuations, with well-prepared companies potentially commanding a premium.

Exit Strategy: Strong CSRD compliance can be a selling point for ESG-focused buyers.

Resource Allocation: Additional resources may be needed to support portfolio companies in meeting CSRD requirements, affecting fund economics.

Challenges of ESG in PE

The challenges of integrating ESG

Data availability and quality
One of the primary hurdles in integrating ESG into Private Equity is the lack of consistent, high-quality ESG data, exacerbated by the scarcity of independently audited information. Many companies lack standardized reporting practices, making it difficult for PE firms to accurately assess and compare ESG performance. This challenge is compounded by the current struggle to find ESG data verified by third parties, significantly impacting the reliability and comparability of ESG information and hindering informed decision-making.

Unlike financial statements, which are typically vetted by independent auditors, ESG reports often lack this level of scrutiny. Recent research indicates that only a fraction of companies are prepared for independent ESG data assurance despite looming regulatory deadlines. This assurance gap means many ESG reports may not meet the rigorous standards required for reliable investment analysis, potentially leading to greenwashing where companies overstate their ESG performance.

The absence of independently audited ESG data not only undermines investor confidence but also hampers the broader goal of promoting sustainable and responsible investment practices. This creates a significant barrier in the investment decision-making process and the overall integration of ESG factors into Private Equity strategies, as investors fear relying on potentially inaccurate data.

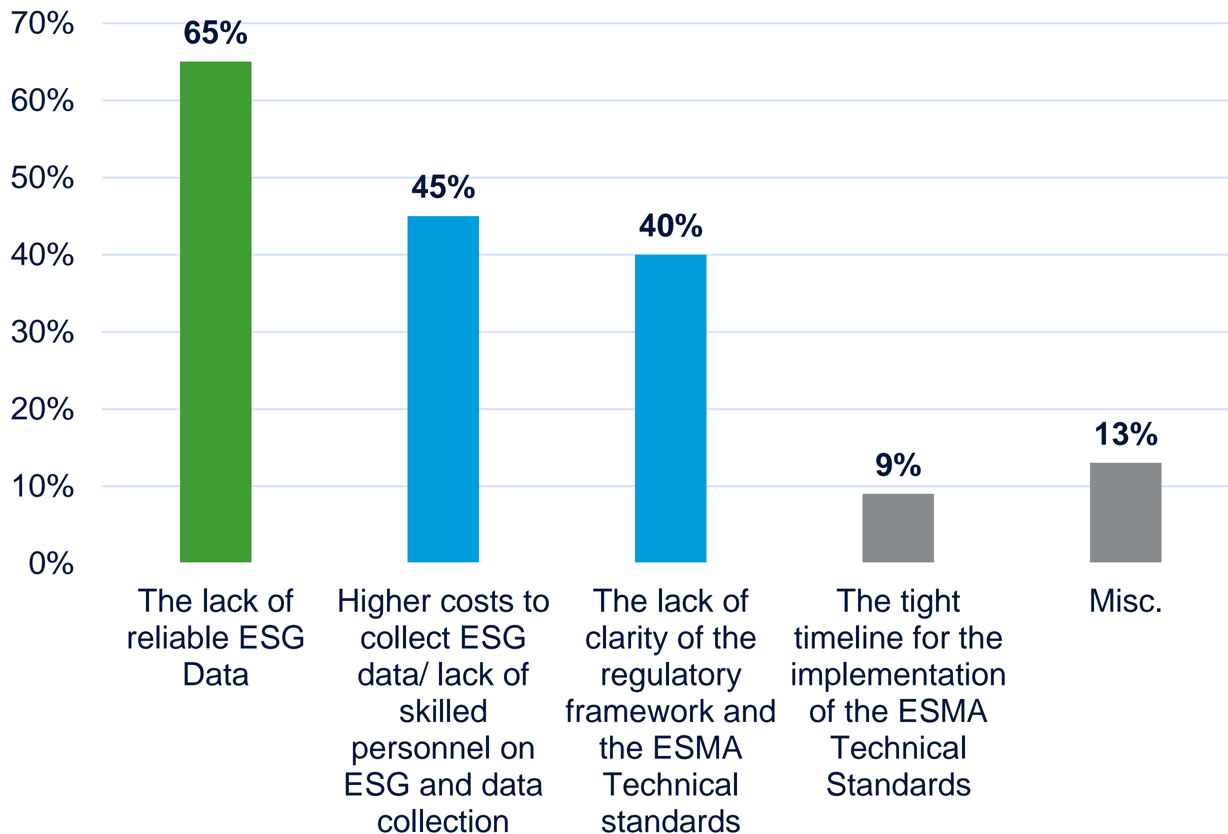
Lack of ESG regulatory knowledge
The integration of ESG factors into investment strategies is further complicated by a lack of comprehensive regulatory knowledge. This gap in understanding can lead to significant challenges for asset managers, who must navigate a complex and evolving landscape of ESG regulations. The lack of clarity in the regulatory framework, including the European Securities and Markets Authority (ESMA) technical standards, adds to this complexity. Staying abreast of these regulations requires continuous education and training, which can be both time-consuming and costly.

Moreover, the financial burden associated with ESG data collection is substantial. Gathering high-quality, reliable ESG data necessitates significant investment in technology and resources. Asset managers must implement robust data collection systems and ensure that the data is accurate and up-to-date. This process often involves hiring specialized personnel or training existing staff to develop the necessary expertise in ESG reporting and compliance.

The costs do not end with data collection. Asset managers also need to invest in ongoing training programs to keep their teams informed about the latest ESG standards and best practices. This continuous learning process is essential for building and maintaining a high level of ESG expertise within the organization. However, these expenses can be a significant burden, particularly for smaller firms with limited resources. The combination of high costs, the need for specialized knowledge, and the unclear regulatory framework makes the integration of ESG factors a challenging endeavor for many asset managers.

ESG Challenges for PE from the portfolio perspective

As highlighted in the previous page, new regulations and perspectives present challenges for existing PE firms. According to a 2024 research by CFA Institute, asset managers have identified the lack of reliable ESG data, and the additional resources needed for data collection as the primary hurdles they face.



Source: CFA Institute. "ESG Regulatory Framework in the EU." 2024. CFA Institute.

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Wholesale Prices Are Expected to Remain Expensive

Key Insights:

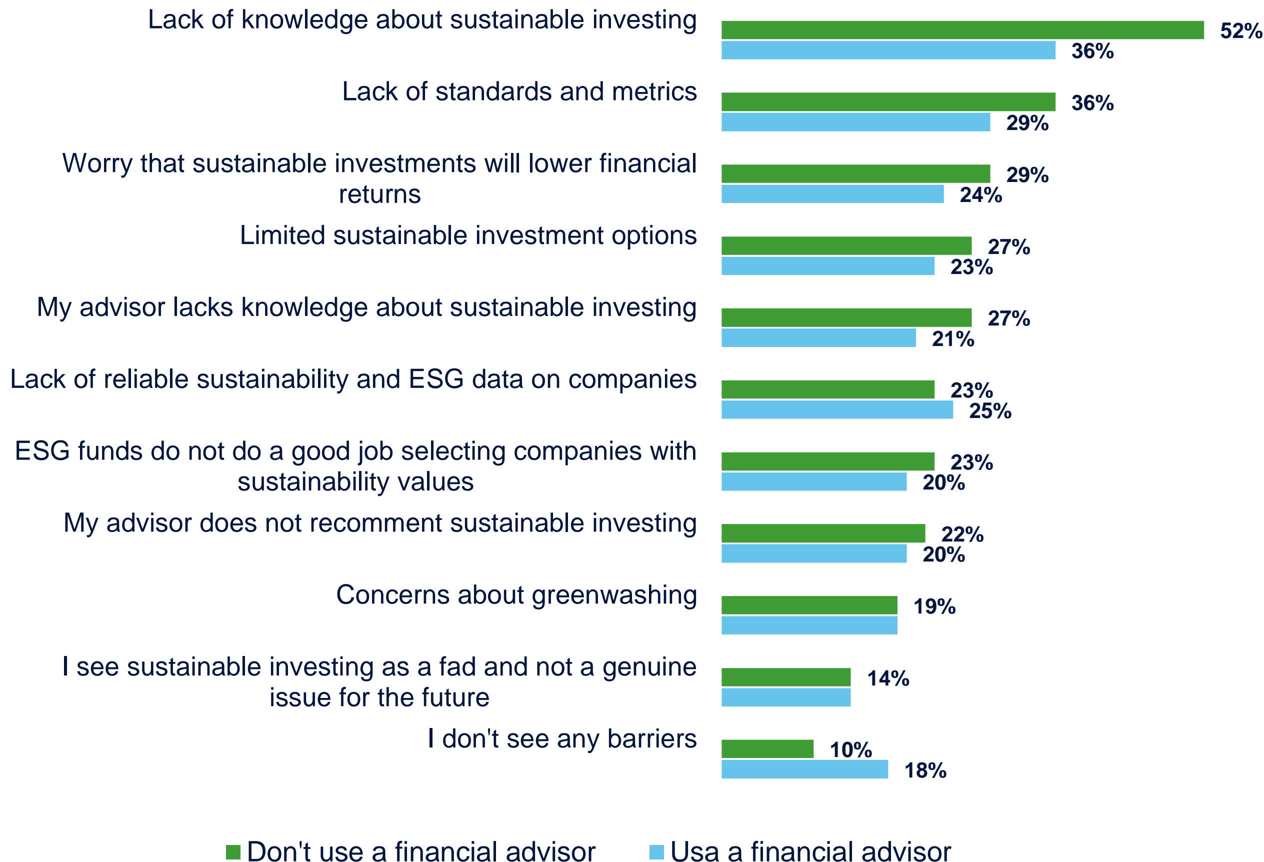
- **65% of respondents** identify the lack of reliable ESG data as a significant challenge. This issue stems from the nascent state of the ESG software landscape and is compounded by the lack of data assurance.
- **45% of respondents** cite the high costs of ESG data integration and the shortage of skilled personnel as major obstacles. These challenges, similar to the ambiguities in ESMA technical standards, hinder asset managers' ability to gather the necessary data for due diligence processes.

Need for ESG investment:

As the data shows, ESG must become a bigger staple within the IT structure and the development of staff.

ESG Challenges for PE from the investor perspective

Investors are increasingly interested in sustainable investments for their long-term value, but the lack of reliable ESG data and the resources needed for data collection slow down their investment rate. This knowledge gap and the complexity of integrating sustainability criteria pose significant challenges.



Sources: London Stock Exchange Group. "The Future of Wealth: Understanding the Sustainable Investment Knowledge Gap."2024. LSEG.

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The evolving ESG landscape creates uncertainties for investors.

Key Insights:

- **Knowledge Gap:** The primary obstacle for investors, whether they use a financial advisor or not, is the lack of understanding about sustainable investing.
- **Standardization Issues:** Similar to asset managers, the absence of consistent standards and metrics is a significant barrier to sustainable investing.
- **Skepticism on Returns:** Investors remain doubtful about the long-term financial returns of ESG investments.

Overcoming Barriers to Sustainable Investing:

Despite growing interest in sustainable investing, significant barriers persist. The primary challenges include a widespread lack of knowledge among investors, insufficient standardization and metrics, and skepticism about the long-term financial returns of ESG investments. Addressing these issues through education, the development of consistent standards, and demonstrating the financial viability of ESG investments could help overcome these barriers and promote more widespread adoption of sustainable investing practices.

The ESG premium

The ESG premium in PE portfolios

ESG Metrics and Cost of Capital
One of the primary benefits of incorporating ESG metrics into investment strategies is the potential reduction in the cost of capital. Companies with high ESG ratings often exhibit lower exposure to systematic risks, which translates into a lower cost of capital. This reduction is crucial as it can lead to higher valuations within a discounted cash flow model. The lower cost of capital is not merely a theoretical advantage; it has practical implications for the financial stability and valuation of companies. Firms with robust ESG practices are generally more resilient to sustainability-related risks, which can positively impact their financing costs and overall financial health. This resilience is particularly valuable in the context of private equity, where long-term stability and risk management are paramount.

Financial Performance and Market Outperformance
Empirical evidence supports the notion that companies with high ESG ratings tend to outperform their lower-rated counterparts in the market in the long term. This is observed across various indices and is consistent across different sectors and regions. The improved financial performance of high ESG-rated companies can be attributed to better corporate-earnings fundamentals. These companies often demonstrate stronger financial health, which is reflected in their market performance. The link between ESG performance and financial returns indicate that ESG metrics are not just a tool for risk management but also a driver of financial success.

Research highlights that companies with higher ESG ratings generally benefit from a lower cost of capital due to their reduced exposure to systematic risks. This lower risk profile means investors demand lower returns, decreasing the cost of equity. Additionally, these companies often enjoy lower debt costs because good governance practices reduce default risk, making them more attractive to lenders. Consequently, in a discounted cash flow model, the lower cost of capital increases the present value of future cash flows, leading to higher valuations for companies with strong ESG ratings.

Long-Term Stability and Risk Management
The implementation of ESG metrics also contributes to less volatile long-term performance. Aggregated ESG scores have shown stronger and more stable outperformance compared to individual environmental, social, and governance pillar scores. This stability is particularly beneficial for private equity investors who seek long-term returns. The less volatile nature of high ESG-rated companies makes them attractive investments, as they are better equipped to navigate market fluctuations and economic downturns. This stability is a critical factor in achieving a performance premium over the long term.

Long term ESG performance

Long-term ESG investments have demonstrated a premium by delivering enhanced financial performance and resilience. Integrating environmental, social, and governance factors into investment strategies not only mitigates risks but also supports sustainable growth, making ESG a valuable component of long-term investment planning.

Cumulative performance of highest- vs. lowest-rated ESG quintiles

Cumulative performance of highest- vs. lowest-rated ESG quintiles in sub-regions

Sources: MSCI. "MSCI ESG Ratings in Global Equity Markets: A Long-Term Performance Review."2024. MSCI.

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On the long term, ESG shows a premium:

Key Insights:

- **Investment Premium:** Over the past decade, higher ESG scores have consistently outperformed lower scores, indicating a clear investment premium.
- **ESG Component Impact:** The Environmental and Social components tend to have a greater impact on performance than Governance, though all three positively correlate with market performance.
- **Regional Leadership:** The Pacific and European regions are at the forefront of ESG investing, but the positive premium of ESG is evident globally, regardless of geographic location.

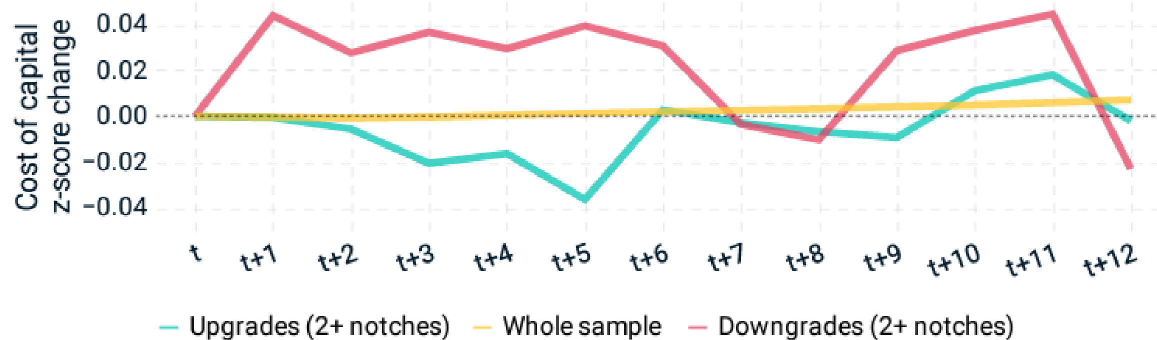
ESG Integration Enhances Financial Returns

Over the past decade, portfolios with higher ESG scores have consistently demonstrated a market performance premium. This trend is evident globally, with the Pacific and European regions leading the way. The Environmental and Social components of ESG tend to have a greater impact on performance than Governance, but all three positively correlate with market returns. This indicates that integrating ESG factors into investment strategies can enhance financial performance across diverse geographic locations.

The ESG Cost of Capital gain

In addition to performance gains, MSCI found that higher ESG incorporation rates lead to a more favorable cost of capital. Companies with strong ESG performance typically enjoy lower costs of equity and debt due to their reduced exposure to systematic risks. This financial advantage underscores the importance of integrating ESG factors into investment strategies.

Cost of capital after a substantial MSCI Rating change



Cost of capital correlation with the E, S and G pillar and overall scores

	IAS	E	S	G
Communication services	-0.24	-0.25	-0.21	-0.17
Consumer discretionary	0.02	-0.04	0.01	0.05
Consumer staples	-0.31	-0.15	-0.22	-0.16
Energy	-0.06	-0.14	-0.10	0.10
Financials	-0.08	0.04	-0.09	0.06
Health care	-0.25	-0.19	-0.07	-0.23
Industrials	-0.15	-0.13	-0.05	-0.03
Information technology	-0.25	-0.17	-0.05	-0.09
Materials	-0.21	-0.28	-0.17	-0.06
Real estate	-0.05	-0.05	0.02	-0.13
Utilities	-0.07	0.06	0.04	-0.15

Correlation coefficient: 0.2 / 0.0 / -0.2

Sources: MSCI. "MSCI ESG Ratings and Cost of Capital."2024. MSCI.

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ESG reduces investment risk:

Key Insights:

- **Impact on Cost of Capital:** Changes in MSCI ESG ratings significantly affect the cost of capital.
- **Lower Financing Costs:** Demonstrating ESG compliance leads to lower financing costs compared to not including ESG factors.
- **Positive Industry Correlation:** Strong ESG pillars, particularly Environmental and Social, correlate with positive outcomes across most industries, while the Governance pillar is less convincing..

ESG positively affects the bottom line:

Strong ESG metrics are crucial for reducing risk and financing costs. Higher ESG ratings significantly lower the cost of capital, as ESG compliance signals lower risk to investors and lenders. The positive correlation between robust Environmental and Social pillars and industry performance highlights the value of strong ESG practices. While the Governance pillar is less impactful, the overall benefits of strong ESG metrics are clear, making them essential for effective risk management and cost reduction strategies.

The future outlook of ESG

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Is the ESG surge slowing down?
ESG investing has slowed in early 2024 due to macroeconomic and geopolitical factors like inflation and rising interest rates, which have increased market volatility and impacted ESG fund performance. The significant exposure of ESG portfolios to sectors like technology and renewable energy, which have faced recent challenges, has also contributed to this slowdown. Additionally, the complexity and costs of regulatory compliance have weighed on ESG investments, prompting investors to reassess their strategies.

However, recent data shows a renewed interest in ESG funds, with capital flows increasing again in 2024. This renewed interest is driven by the long-term benefits of sustainable investing and the alignment of ESG strategies with financial performance. Notably, GIIN reports that investors have shown a positive CAGR of 21% in impact investments, highlighting the potential for strong financial returns alongside positive social and environmental outcomes*.

Forward-looking signal
ESG ratings provide a forward-looking signal that helps investors identify companies likely to perform well financially due to strong ESG practices. This predictive capability is invaluable for private equity investors making long-term investment decisions. Integrating ESG metrics into investment strategies offers insights into future company performance, enabling more strategic and informed decisions.

In conclusion, integrating ESG metrics into investment portfolios, especially within private equity, is likely to result in a long-term performance premium. The lower cost of capital associated with high ESG ratings, coupled with enhanced risk management and superior financial performance, contributes to better financial stability and higher valuations. The consistent market outperformance of high ESG-rated companies across various sectors and regions supports the case for ESG integration. Additionally, the less volatile nature of these companies and the forward-looking insights provided by ESG ratings make them attractive for long-term success. Therefore, implementing ESG metrics in portfolios is not only a prudent risk management strategy but also a driver of long-term financial performance and stability.

ESG is dead. Long live ESG
We must urgently address the tension between profitability and sustainability

Japan offers lifeline to ESG investing amid backlash overseas

Is ESG Investing in Decline?
Investors have retreated from ESG investing amid rising interest rates and heightened scrutiny. But if interest rates fall, could ESG see a resurgence in 2024?

Green bond issuance surges as investors hunt for yield

China's Green Financing Surges to $4.1 Trillion in 2023, Boosting ESG Investments

Surge in ESG investment amid management challenges

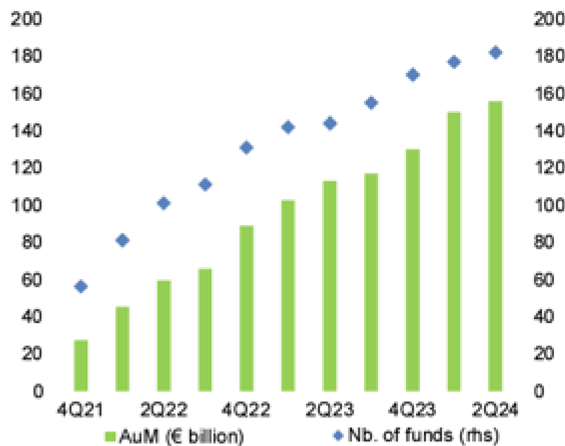
ESG investing and sustainable growth: moving forward

* Source: Hand, D., Ulanow, M., Pan, H., Xiao, K. (2024). Sizing the Impact Investing Market 2024. The Global Impact Investing Network (GIIN). New York.

The ESG Cost of Capital gain

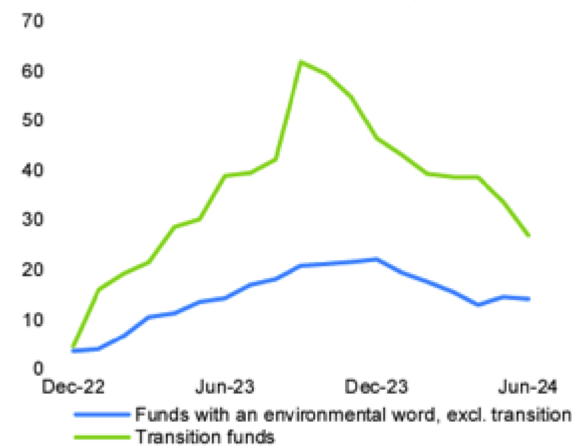
The market has shown a contraction in early 2024; however, there is a continuous increase in climate benchmark funds, showing continued interest and thus trust in ESG-related investments. This trend is highlighted by the substantial rise in assets under management (AUM) for these funds, driven by growing investor awareness and regulatory support for sustainable finance. Additionally, transition funds, which aid companies in adopting more sustainable practices, have been particularly successful in attracting higher flows, reflecting a robust commitment among investors to integrate ESG considerations into their investment strategies.

Funds tracking EU climate benchmarks
Continuous increase in fund assets



Note: Assets under Management (EUR billion) and number of EU equity and bond funds tracking EU climate benchmarks

Funds cumulative average net flows
Transition funds attract higher flows



Note: Average cumulative net flows of transition funds and funds with an environmental reference in their name, excluding transition funds, in EUR million

Sources: ESMA. "TRV Report on Trends, Risks and Vulnerabilities No. 2, 2024."2024. ESMA.

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ESG investment funds are gaining popularity:

Key Insights:

- **Increased Interest in Sustainable Investments:** There has been a strong and growing interest in sustainable investments, indicating a positive shift towards financing the green transition.
- **Rising Assets Under Management (AUM):** The assets under management for ESG-related funds have seen a significant increase, driven by investor awareness and regulatory support.
- **Popularity of Transition Funds:** Transition funds, which support companies in adopting sustainable practices, have been particularly successful in attracting higher investment flows.

ESG investing growth amid risks:

Research highlights a growing commitment to ESG investing, with increasing assets under management for ESG-related funds and the rising popularity of transition funds. This trend reflects sustained investor interest and trust in sustainable finance, even amid market contractions in early 2024. However, it also raises questions about potential risks, particularly concerning the sustainability of corporate debt in lower quality segments, indicating that while the outlook for ESG investing is positive, careful monitoring and management of associated risks remain crucial.

Our observations

The role of PE in ESG

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Having examined the integration of sustainability across PE we can now appreciate the pivotal role that private equity firms play in driving sustainable growth. This closing section synthesizes the insights from previous chapters to underscore PE's unique position as a steward of sustainable business practices.

The private equity industry stands at a critical juncture in its evolution, with sustainability and ESG considerations rapidly becoming central to investment strategies, value creation, and exit outcomes. This report has explored the multifaceted nature of sustainability in PE, from its integration across the investment lifecycle to its impact on exits and the potential costs of neglecting these crucial factors. Key takeaways from this analysis include:

1. **Holistic Integration:** Sustainability is no longer a niche concern but a fundamental aspect of private equity operations. Successful firms are integrating ESG considerations across all stages of the PE lifecycle, from initial due diligence to exit strategies.
2. **Value Creation Driver:** Rather than being a compliance burden, sustainability has emerged as a powerful driver of value creation. PE firms that effectively leverage ESG initiatives are seeing enhanced operational efficiencies, innovation opportunities, and improved stakeholder relationships in their portfolio companies.
3. **Exit Advantages:** Strong ESG performance is increasingly translating into tangible benefits at exit, including higher valuations, broader buyer pools, and smoother sale processes. This trend underscores the growing market recognition of sustainability as a key indicator of long-term business resilience and profitability.
4. **Risk Mitigation:** The costs associated with unsustainable portfolios are substantial and multifaceted, encompassing financial, operational, and reputational risks. PE firms that proactively address these issues are better positioned to protect and enhance the value of their investments.
5. **Regulatory Landscape:** The evolving regulatory environment, particularly in regions like the EU, is accelerating the adoption of sustainable practices in PE. Firms that stay ahead of these regulatory trends can turn compliance into a competitive advantage.
6. **Stakeholder Expectations:** Limited partners, employees, consumers, and other stakeholders are increasingly factoring sustainability into their decision-making. PE firms that align with these expectations are likely to strengthen relationships and access to capital and talent.

Stewardship as a boundary object for sustainability

Source diagram: Enqvist, Johan Peçanha, Simon West, and Vanessa A. Mast. “Stewardship as a Boundary Object for Sustainability Research: Linking Care, Knowledge, and Agency.” Landscape and Urban Planning, vol. 179, 2018, ScienceDirect.

Findings and recommendations

Looking ahead, the importance of sustainability in private equity is set to grow. As global challenges such as climate change, resource scarcity, and social inequality intensify, the ability to navigate these issues will become even more critical for business success. PE firms are uniquely positioned to drive this transformation, given their active ownership model and focus on operational improvements.

To thrive in this new paradigm, PE firms should consider the following actions:

- **Develop robust ESG integration frameworks** that span the entire investment lifecycle
- **Invest in ESG expertise and data capabilities** to enhance decision-making and reporting
- **Engage proactively with portfolio companies** to implement sustainable practices and drive value creation
- **Cultivate relationships with LPs and other stakeholders** around shared sustainability goals
- **Stay ahead of regulatory trends** and position portfolios for long-term resilience

In conclusion, sustainability is not just a trend but a fundamental shift in how value is created, preserved, and realized in private equity. Firms that embrace this shift and effectively integrate sustainability into their core strategies will be best positioned to navigate the challenges and capitalize on the opportunities of the coming decades. As the industry continues to evolve, sustainability will increasingly become a key differentiator between market leaders and laggards in the private equity space.

1 ESG Strategy

2 Fund raising

3 Origination and investment

4 Onboarding & 100-day plan

5 Ownership

6 Exit

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Mario van den Broek
Partner RSM Consulting

Mourad Seghir
Strategy consultant

Iman Zalinyan
Strategy consultant

Hans van Loenen
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RSM Netherlands Business Consulting Services B.V.

Mercuriusplein 9
2132 HA Hoofddorp
Nederland
+31 23 5300 400
www.rsmnl.com

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