



PE's ESG agenda advances in US, but barriers remain

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The U.S. private equity industry is increasingly embracing environmental, social and governance strategies in the wake of the COVID-19 crisis, but challenges related to reporting and the lack of standards persist, according to Hameer Vaid and Hunt Holsomback of Alvarez & Marsal Holdings LLC's private equity performance improvement service.

Although the U.S. trails Europe in advancing ESG strategies, it is slowly catching up due to the increasing emphasis among key investment firms to address these issues. Many of the newer funds now have "ESG provisions and covenants baked in," and large banks and financial institutions are mandating ESG as a component in their lending criteria, Vaid and Holsomback said in an interview with S&P Global Market Intelligence.

The duo, however, warned about certain obstacles to ESG implementation, including the lack of comparative data, evolving global standards on requirements, variability in reporting impact across alternative investment asset classes and implementation cost and time. A survey of investors released Oct. 13 by EisnerAmper LLP likewise cited the lack of standardized reporting and data sets as the biggest hindrance to the adoption of ESG investment, followed by sourcing quality investment opportunities and eliminating the notion of poor returns.

Activity is underway to address some of these challenges. For example, a group of general partners and limited partners representing more than \$4 trillion in assets under management, led by The Carlyle Group Inc. and the California Public Employees' Retirement System, unveiled a collaboration to standardize ESG reporting at the end of September. Blackstone Inc., Bridgepoint Group PLC, CVC Capital Partners Ltd., EQT AB (publ), Permira Advisers Ltd. and TowerBrook Capital Partners LP are among the general partners in the group.

The initiative is a move in the right direction, but it could also face adoption risk, said Vaid, who noted that quantitative reporting is still in the nascent stages and benchmarking from a cash flow perspective is still in the works. A reporting standard could still be a year or more away, Holsomback added.

When it comes to ESG integration in the private equity sector, "perfect is going to be the enemy of the good," Institutional Ltd. Partners Association CEO Steve Nelson said at the recent EisnerAmper 2021 Annual Alternative Investment virtual summit.

There is some evidence that private equity involvement has a positive impact on the ESG profile of portfolio companies. S&P Global Trucost data, which assigns ESG scores to publicly listed companies, shows that between 2017 and 2020 the highest-scoring companies largely improved their ratings after private equity investment.

Ecolab Inc. and Republic Services Inc. grabbed the first and second spots in terms of ESG scores in 2020 at 77 and 65, respectively, beating the average of 21 in their respective specialty chemical and commercial service industries. Both companies are backed by Cascade Investment LLC, an investment firm founded by Bill Gates. Also on the list are two companies backed by KKR & Co. Inc. and TPG Capital LP, both of which have impact strategies. Ingersoll Rand Inc. has a score of 61 and Cushman & Wakefield PLC's score is 34, both above the average score of 17 in their respective machinery and real estate industries, Trucost data shows.

ESG scores of US companies with PE firms among top stakeholders

Ranked by 2020 ESG score

Company	2020 ESG score	Potential score contribution ¹	Required public disclosure (%) ²	Additional disclosure (%) ²	2020 ESG score industry average	ESG score industry ³	Top PE stakeholder	Stake (%) ⁴	Entry year
● Ecolab Inc.	77	98	94	99	21	Chemicals	Cascade Investment LLC	10.7	2011
● Republic Services Inc.	65	91	81	96	21	Commercial services and supplies	Cascade Investment LLC	34.2	2004
● Kraft Heinz Co.	62	93	91	95	19	Food products	3G Capital Inc.	17.6	2015
● Ingersoll Rand Inc.	61	89	92	88	17	Machinery and electrical equipment	KKR & Co. Inc.	7.1	2017
● Royal Caribbean Cruises Ltd.	58	91	89	93	23	Hotels, resorts and cruise lines	A. Wilhelmsen Capital AS	6.9	2005
● Devon Energy Corp.	45	66	75	62	29	Oil and gas (upstream and integrated)	EnCap Investments LP	6.0	2016
● Nasdaq Inc.	44	78	80	77	19	Diversified financial services and capital markets	Investor AB (publ)	11.6	2010
● Cushman & Wakefield PLC	34	69	79	65	17	Real estate	TPG Capital LP	19.8	2018
● Moderna Inc.	28	53	54	52	12	Biotechnology	Flagship Pioneering	5.1	2018
● Lumen Technologies Inc.	24	40	51	35	30	Telecommunication services	Temasek Holdings (Pte.) Ltd.	8.8	2017

● Company's 2020 ESG score is better than the average score of the industry it is classified under CSA assessment methodology

● Company's 2020 ESG score is worse than the average score of the industry it is classified under CSA assessment methodology

Data compiled Oct. 4, 2021.

ESG score is calculated using the disclosure analysis methodology from the corporate sustainability assessment, or CSA, framework. The methodology utilizes information disclosed in the public domain with supplements of additional disclosure made by the company. The ESG score is a 100-point scale and is calculated based on the company's scores from CSA questions on two metrics: required public disclosure and additional disclosure.

¹ Maximum score a company could have achieved if all disclosed information met the requirements of the CSA methodology, resulting in a score of 100 for each of the questions for which information was found.

² Based on the company's disclosure level, which is defined as the weighted percentage of applicable questions requiring publicly available information for which at least some information was available and relevant for scoring.

³ Company's ESG score industry classification under the CSA framework as derived from the Global Industry Classification Standard and other industry classifications of the CSA assessment methodology.

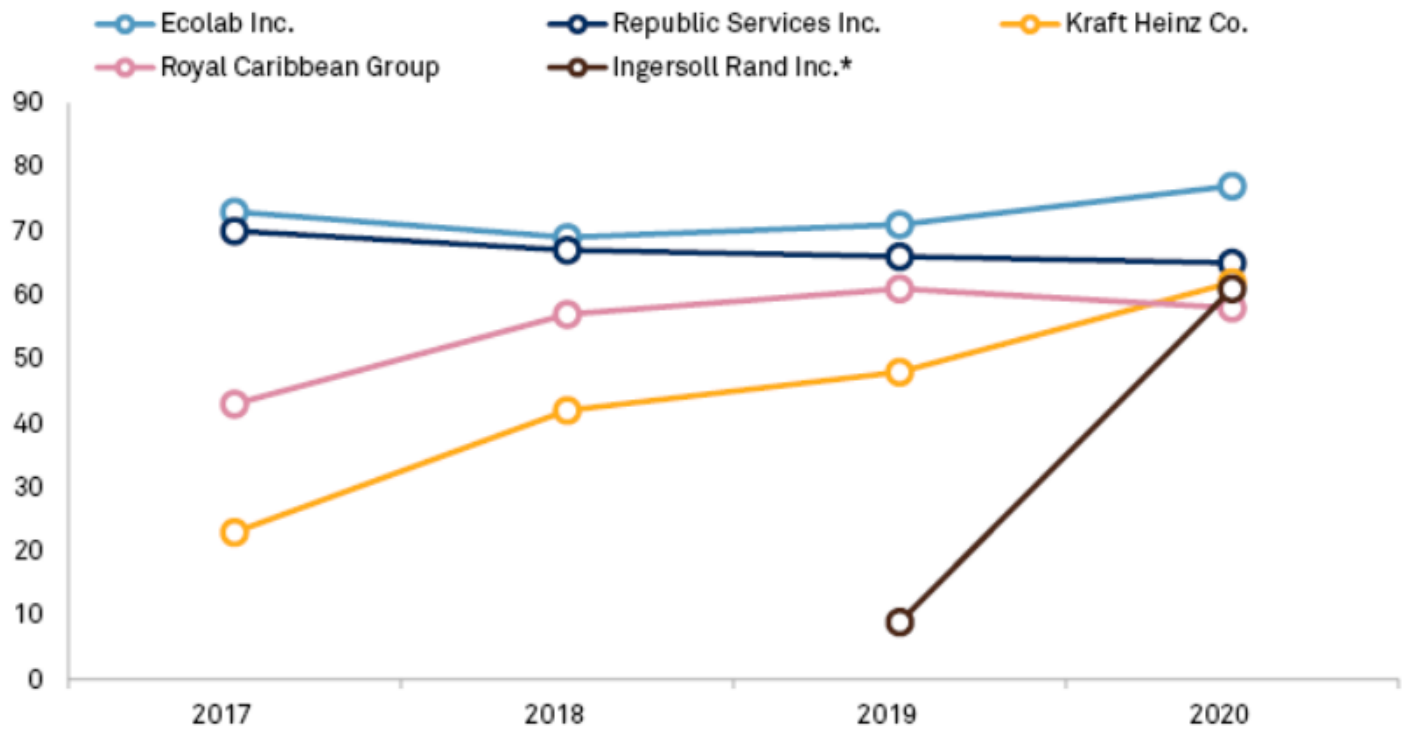
⁴ Stake of the top private equity stakeholder as of Oct. 4, 2021.

Analysis includes companies located in the U.S. with private equity/venture capital ownership of at least 5% of voting shares.

Analysis is limited to top 10 companies with 2020 ESG scores available.

Source: S&P Global Trucost

Historical ESG scores of top US companies with PE firms among top stakeholders



Data compiled Oct. 4, 2021.

* ESG score was only available from 2019 onward.

Analysis includes companies located in the U.S. with private equity/venture capital ownership of at least 5% of voting shares.

Analysis is limited to top five companies with 2020 ESG scores available.

Source: S&P Global Trucost

Perfect is the 'enemy of the good'

External pressure for widespread ESG adoption has created some lofty goals for private equity, and the risk is that expectations may be far from what can be achieved in a practical sense.

The push for deeper ESG dialogue and creative solutions from limited and general partners and the community as a whole could give the private equity industry tools for progress in relatively short order. However, "perfect is going to be the enemy of the good here," said Institutional Ltd. Partners Association CEO Steve Nelson during a panel session at the recent EisnerAmper 2021 Annual Alternative Investment virtual summit.

"Industry-led ESG solutions are going to be the best possible outcome for us, as opposed to a rigid regulatory mandate," Nelson said. "The hope is that we don't end up at the end of this with 15 competing frameworks and a whole range of definitions and solutions that don't track across markets or across strategies. That sort of tangle will be a major impediment for all involved."

Trucost is part of S&P Global Market Intelligence.

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