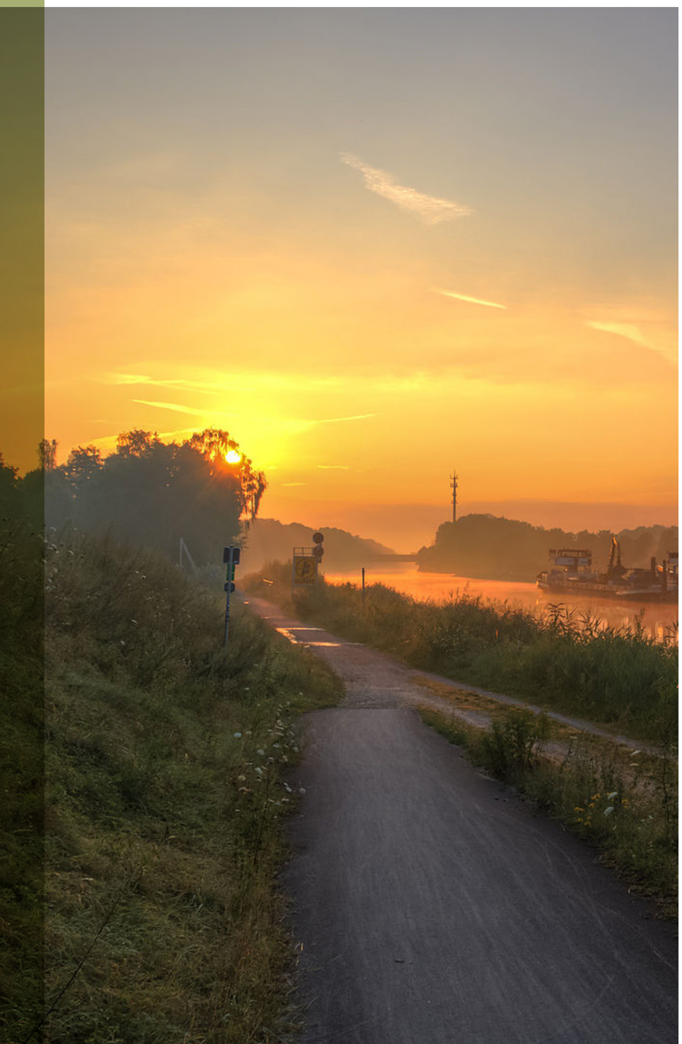
ESG in Private Equity℠ *: Issue Focus* - 2014

Large Enterprise Customer Sustainability Requirements Emerge as Drivers of ESG Management

A Study by Malk Sustainability Partners

Malk Sustainability Partners



About MSP

MSP is a specialty management consultancy that guides private equity investors to leverage ESG management to maximize returns and thrive in an era of increasing stakeholder interest in responsible investment. MSP's expertise lies in developing customized programs to protect and create value through ESG management. We drive all steps of the ESG program development process from articulating a policy and strategy through implementing initiatives to reporting, and do so in a manner that aligns to our clients' standard practices and prioritizes their portfolio company relationships.

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Introduction

At heart, private equity returns come from owning businesses that have happy customers. So it shouldn't be a surprise that the customer relationship is driving a nascent trend in general partner (GP) and portfolio company ESG management: large enterprise customer sustainability requirements. That's the focus of this report, the first in a series of deep dives on ESG management issues.

As you've read in this series and other well-documented research, the value private equity investors place on ESG management continues to increase. Since we published our *ESG in Private Equity* SM reports in 2012 and 2013, Pitchbook released its *2013 ESG Survey Report*, and the Principles for Responsible Investment (UN PRI) published *Integrating ESG in Private Equity – A Guide for General Partners*. Both reports provided evidence of the growing awareness and action GPs are taking to drive value creation through ESG management. In addition to these authoritative sources of information being available, we believe that trends show insufficient movement on a year over year basis to warrant a comprehensive annual update on ESG management. That's why we've decided to publish a complete "state of the market" update every other year and in the interceding years we will investigate a specific ESG management issue as part of our *ESG in Private Equity* SM series, entitled *ESG in Private Equity* SM *: Issue Focus*.

This year we look at the ripple effect of large brands' increasing focus on ESG issues in their supply chain. Growing consumer scrutiny and the increased transparency possible through digital and social media have made it clear that the supply chain presents a brand and business continuity risk to the world's largest companies. As an example, one factory incident can tarnish multiple buyers' brand reputation thousands of miles away. As a result, large enterprise customers are setting environmental and social performance targets for both their own operations and supply chains. This has resulted in supplier sustainability requirements, external audits, remediation programs, and, in some instances, termination of purchasing contracts. Simply put, the world has changed to make brands responsible for their supply chain.

Our survey of GPs found private equity-owned middle-market companies that are suppliers to these enterprise customers are seeing an increase in customer sustainability questionnaires, and, as a result, GPs are recognizing the benefit of portfolio companies proactively addressing this issue with customers. A few GPs have adopted a firm-wide systematic approach to managing this growing issue, and others are considering following suit. In certain industries where sustainability performance is key, GPs are grappling with integrating that approach into diligence.

While the customer-imposed sustainability driver is in its infancy and still relatively small, it is expanding. One only needs to look at the trajectory of limited partner ESG inquiries to take this trend seriously. Five or six years ago, just a few LPs were asking limited ESG questions, and now firms going out to market with funds are finding LP engagement on these issues is material. According to our surveys, between 2013 and 2012 alone, 58 percent of LP participants increased their commitment to ESG management. We project similar potential for customer sustainability requirements to drive ESG management.

This study discusses the background of this driver, the current state of sustainability inquiries, the likely sectors and issues in which GPs will see the majority of inquiries, and the benefit to proactively managing customer sustainability requirements. We are grateful to the many GP institutions that shared their perspective to make this report possible.

Andrew Malk
Managing Partner
Malk Sustainability Partners

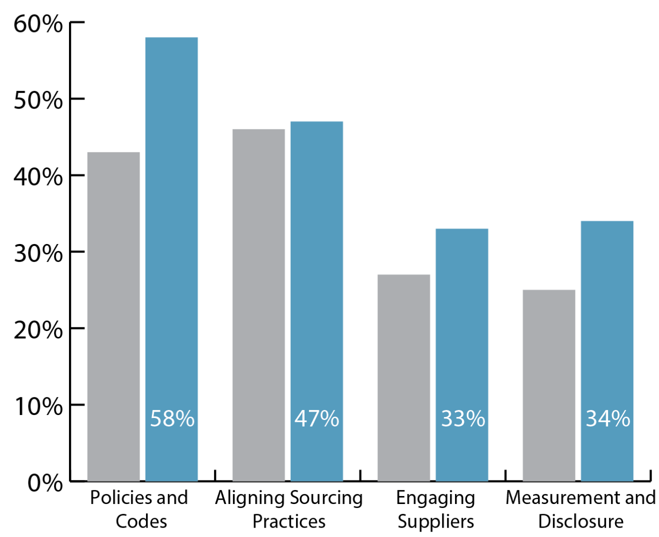
Background

Over the past few decades, media coverage, consumer pressure, and NGO scrutiny have increased global attention to environmental and social performance throughout companies' supply chains, significantly increasing companies' exposure to risk from poor sustainability performance. MSP's 2013 study, *Sustainable Supply Chain Management in Information Technology*, described a series of events that led to a dramatic increase in focus on sustainability in the supply chain. It found that high-profile incidents for recognizable brands such as Chiquita, Nike, and Apple drove similarly branded companies to implement sustainable supply chain (SSC) policies. Of the 34 surveyed respondents, all in the IT sector, 89 percent had implemented an SSC policy by 2012 compared to a mere 30 percent that had a policy in 2005.

Since the publication of that study, all signs indicate increasing awareness and scrutiny of social and environmental performance throughout companies' supply chains. The April 24, 2013 collapse of Rana Plaza, an eight-story apparel manufacturing facility in Bangladesh, demonstrated not only the severe risk to workers operating in a poorly audited factory, but also the speed with which the media could identify brands associated with production at the factory, including Walmart, Primark, and the Children's Place, among many others.[i] One year later, leaked cell phone video showed workers at an OSI food-processing factory in China picking up meat from the floor and putting it back into the processing machinery.[ii] Subsequent audits found expired and discarded meat was put into production on several occasions. OSI had been McDonald's largest protein supplier in Asia. However, Chinese authorities suspended business at the facilities, disrupting McDonald's operations and requiring it to make fundamental changes (such as offering fish and tofu nuggets) to address declining same store sales at affected retail locations.[iii]

Reinforcing these examples, Ceres, a non-profit organization advocating for sustainability leadership, assessed supply chain performance for 613 of the United States' largest public corporations in the 2014 version of its *Roadmap for Sustainability*.[iv] In the supply chain category, Ceres evaluated policies and procedures, alignment of procurement practices, supplier engagement, and measurement and disclosure. Compared to 2012, it found increases in each of the four areas evaluating how the companies handle supply chain sustainability. During those two years, an additional 15 percent of the companies implemented a formal policy or code for their suppliers, another 6 percent began a program to engage suppliers, and 9 percent began monitoring supplier performance. However, companies made little progress in aligning procurement and sourcing practices, demonstrating that companies are producing policies and codes first and will look to focus on sourcing in the future.

FIGURE 1: Ceres 2012-2014 Performance Change



Ceres scores companies on a 1-4 scale, with 4 being the lowest. Values based on percentages of companies receiving minimum score of 3.

Companies are paying closer attention to their supply chains to more robustly manage operational and reputational risk, avoid costly remediation, and meet their own sustainability commitments. In doing so, companies are establishing supplier codes of conduct, monitoring sustainability performance of suppliers, pursuing audits to ensure code requirements are being met, and, increasingly, specifying non-compliance consequences. Because this issue set is driven by customers rather than regulation, it affects private and public companies equally. Given this combination of factors, private equity owned companies are seeing increased customer sustainability inquiries as a potential ESG management driver.

Executive Summary

Our Findings

- Every interviewed GP holds at least one portfolio company that has received customer sustainability inquiries, though these inquiries vary significantly by sector and operation and are most common in the consumer goods, food and beverage, and technology sectors.
- There are significant business and public relations benefits to portfolio companies working proactively with their key customers on sustainability issues. While this is an emerging issue, portfolio companies can seize a leadership position if they support attainment of supply chain goals.
- The majority of GPs that take the initiative to ask whether companies have received customer sustainability inquiries do so in the due diligence process.
- Though most GPs do not yet have a systematic approach to working with portfolio companies to manage customer sustainability inquiries, most recognize that such a system would be a valuable addition to their ESG management efforts.

Our Approach

The results in this study arise from a combination of interviews with general partners and secondary research on customer sustainability inquiries. Deliberately, there is no attempt to quantify the results of the primary research. Customer supply chain focus is just beginning to emerge as what MSP expects to be a strong driver of ESG management in the future. As such, the definition of the issue set and responses are yet to be standardized. In future iterations of this study series, MSP will investigate whether there are ways to quantify the growth in customer sustainability inquiries and their management, and the value in doing so. For now, the value of this study is derived from being the first attempt to profile an emerging driver, not from creating a baseline.

1. Customer Sustainability Inquiries

GP Visibility into Customer Inquiries

Actual Incidence Likely to be Greater than Reported

As a first step to promote environmental and social performance in their supply chains, large enterprise customers are sending sustainability inquiries to their largest suppliers that require a response and, in many cases, additional management of issues like conflict mineral compliance, factory labor conditions, and, increasingly, greenhouse gas (GHG) reduction. Through this year's survey, MSP learned that all participants were aware of at least one of their portfolio companies receiving sustainability questionnaires from their largest customers. While 100 percent of participants had experienced a customer inquiry, the frequency and nature of questionnaires, at this time, depend greatly on each company's sector and key distribution channels.

For now, GPs, even those with dedicated ESG staff, do not routinely seek information about portfolio companies' customer sustainability inquiries. Typically, GP attention turns to companies' customer sustainability inquiries on an anecdotal basis, either because they have a portfolio company–reporting system that broadly addresses customer relationship management or because portfolio companies request their assistance in responding. This finding highlights the danger in assuming that customer inquiries don't exist just because GPs are unaware of them. "They aren't asking us for insights on how to answer those questions because they already have the local knowledge of how to do that," said Barrett Karr, Principal of Government Affairs for The Carlyle Group. "They do look to us sometimes for the supply chain insights, but if it's something localized, like employee insights, that doesn't come up to us. Even in communications with customers, we generally aren't involved in that level of detail." For these reasons, many of the examples in this survey are anecdotal; however, they do provide insight into the trend's general direction and some focal areas already seeing GP involvement.

Types of Inquiries

Specific, General, and Open-Ended Information Requests

Customers typically submit annual sustainability questionnaires to communicate requirements and collect information about companies' performance. The customer sustainability questionnaire takes a variety of forms. Walmart, for instance, is now known for requiring suppliers to fill out a Carbon Disclosure Project questionnaire, among other inquiries. That questionnaire includes inquiries on greenhouse gas emissions, energy use, management information, business strategy regarding climate change, emissions

Anonymous Industrial Manufacturer

Before a February 2014 exit, an anonymous GP owned and actively managed an industrial manufacturer. While under GP ownership, the company began receiving customer questions about its handling of conflict minerals. "Its first answer was 'Don't worry about it, we are a privately held company, we don't have to report on conflict minerals.' Its customers didn't like this response," said a GP principal. After the customers increased scrutiny, the company took strides to ensure a conflict mineral-free supply chain and ended up entering into long-term contracts with those suppliers. These contracts generated cost savings, providing material value for the company above and beyond working to satisfy key customers.

reduction initiatives, and climate change risks. These inquiries are part of Walmart's corporate effort to reduce its carbon footprint, which includes a commitment to remove 20 million MTCO2e from its supply chain.

While in the case of Walmart, multiple suppliers and vendors see the same questionnaire, many customer sustainability questionnaires are designed to ask questions specific to an individual supplier or vendor's operations. As an example of customization, one survey participant is operationally active with a portfolio company that produces upscale footwear and apparel sold at major retailers in the U.S. and Europe, whose customers' questionnaires tend to focus on the materials usage and social conditions in the manufacturing process.

In addition to questionnaires that look for specific quantitative metrics or other detail from suppliers, GPs also reported seeing a different type of questionnaire: an open response form. This style of questionnaire effectively asks: "What are you doing around sustainability?" with an implicit end goal of providing customers with "sustainability stories" for their websites or sustainability reports. A customer will typically only feature two or three of these supplier "sustainability stories" in its publications, leading to a strong customer relations benefit for those suppliers impressive enough in their sustainability performance to make it into the publication.

Regardless of the type of inquiry portfolio companies receive, GPs largely agree that customer pressure on sustainability has been increasing over the last several years and will continue to do so in the near future.

Sectors Drawing the Most Attention

A Focus on Consumer Products

All respondents had an idea of which sectors were most likely to receive customer inquiries. The general consensus is that the closer a portfolio company is to the end consumer, such as a consumer products

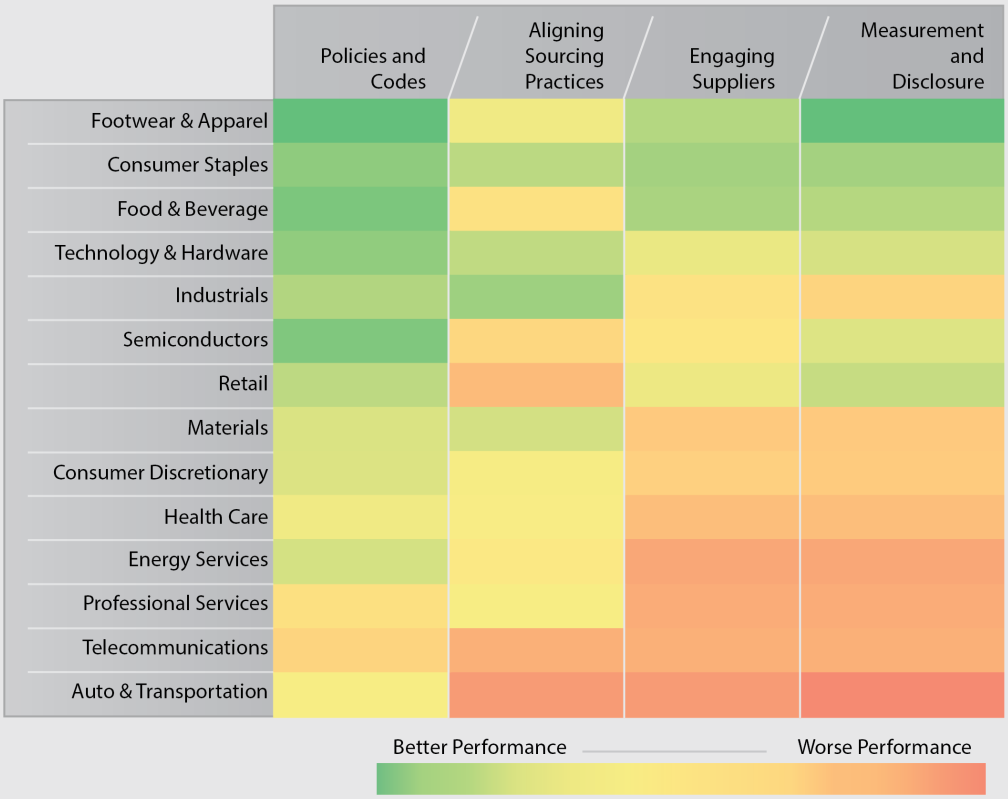
Customer Sustainability Requirements in the IT Sector

Selected findings from 2013 MSP survey of IT customer requirements. Participants included Apple, AT&T, Best Buy, Motorola, Samsung, Sprint, Verizon, and Walmart.

- Customers expect suppliers to track wastewater, solid waste, and greenhouse gas emissions and commit to reduction targets at an enterprise level by the end of 2015. Furthermore, an increasing number of customers will incorporate GHG management (baselines, reduction targets, and reporting) into supplier-spend criteria over the next one to two years.
    - Example: Sprint requires suppliers to commit to a GHG emissions reduction target and publicly report on progress by July 2015.
- Customers align their supplier management practices to the Electronic Industry Citizenship Coalition Code of Conduct (EICC CoC).
    - Example: customers often leverage the EICC CoC and auditing tools to drive effective and efficient sustainability management across the value chain.
- Customers require their suppliers to adopt social and environmental management systems.
    - Example: Apple requires suppliers to utilize management systems to ensure that they (1) conform to applicable laws and its supplier code of conduct and (2) mitigate operational risks.
- Customers hold suppliers handling and recycling e-waste to a defined set of industry standards.
    - Example: Samsung requires electronics recyclers to obtain e-Stewards certification.

brand or retailer, the more likely it is to receive sustainability requests from customers. This finding is supported by MSP's previous supply chain study, which identified several examples where consumer pressure played a decisive role in driving information technology companies to monitor suppliers' environmental and social performance. Other currently affected sectors mentioned by GPs include food and beverage, technology, telecom, and health and wellness.

FIGURE 2: Ceres Industry Performance: Supply Chain



Graphic based on MSP's analyis of Ceres' company scorecard data on supply chain performance for 613 of the United States' largest public corporations.

Data from Ceres' *Roadmap for Sustainability* corroborates what GPs report in terms of sector-specific focus. The footwear and apparel sector has the strictest requirements, with 100 percent of companies in Ceres' sample featuring both a formal supply chain sustainability policy or code and some evidence of monitoring supplier activities. Furthermore, footwear and apparel companies were also most likely to meet Ceres' most stringent scoring criteria, namely publishing a company policy or code with most or all of the human rights issues specified in the International Labor Organization (ILO) conventions (a series of legal instruments drawn up by ILO member governments, employers, and workers), requiring suppliers to adhere to environmental standards set by the company, and committing to working with suppliers on an ongoing basis to achieve compliance.

Echoing the GP participants' responses, footwear and apparel, consumer staples, and food and beverage had the best supply chain performance in MSP's analysis of the Ceres' *Roadmap for Sustainability* data. These top three sectors, which include companies such as Clorox, Coca-Cola, Gap, Kellogg, Kimberly-Clark, and Under Armour, were found to perform better than the remaining sectors.

Issues Addressed in Inquiries

Historical Focus on Social Performance

Retailers' supplier sustainability inquiries arose as a result of high profile supply chain social incidents such as Nike's use of underpaid workers and Apple's reported unsafe working conditions at the Foxconn Technology factories. For this reason, GPs reported that customers' inquiries have historically focused more on suppliers' social than environmental performance.

"From what I've seen, it's more on the social side," said Oak Hill Capital's ESG Officer Lee Coker. "Especially with responsible sourcing. Are there human rights violations from the suppliers' standpoint? Do they have a code of conduct or ethical policy?" Other GPs echoed that sentiment, noting that supply chain sustainability grew largely out of social issues damaging reputation and brand value.

Inquiries Highly Dependent on Sector and Company Operations

While there's a general consensus among GPs on which sectors predominantly require sustainability performance from their suppliers, there remains variability about which issues are typically addressed. Specific issue areas are typically driven by what is material to specific sectors. So while there's diversity among the universe of private equity-held companies, this consistency within a sector allows for general partners, particularly those with sector-focused operations teams, to anticipate and prepare for the inquiries a specific portfolio company will receive. This, in turn, aids in proactively managing customer inquiries. For example, one participant noted that for its companies in the logistics sector, inquiries often focus on packaging waste and energy efficiency. By contrast, another participant, with investments in the telecom sector, responded that the majority of inquiries to date pertained to health and safety because company operations include construction projects.

Increasing Concern for Environmental Performance

Certain GPs have seen an increased focus in the last few years on environmental issues as well as the traditional social and product-material issues. Customers are trying to meet their own environmental targets and looking to their supply chain for positive environmental action. Walmart is the quintessential example of this trend with its 2015 target, but is certainly not the only one. Efforts by other global brands to reduce their suppliers'

Conflict Minerals and Dodd-Frank Section 1502

GPs have seen an increase in questionnaires focused on materials and conflict minerals, given the large increase in consumer concern surrounding the origins of precious metals, culminating in the Dodd-Frank Section 1502 rule, which went into effect last year. The rule imposes assessment and reporting requirements for companies with products containing tin, tantalum, tungsten, and gold. Under the rule, a company registered with the U.S. Securities and Exchange Commission (SEC) must submit the Form SD, indicating whether any of its tin, tantalum, tungsten, or gold was sourced from the Democratic Republic of Congo or adjoining countries and disclosing the due diligence framework used in the determination.[v] Therefore, companies whose final product relies on these minerals frequently submit a conflict minerals questionnaire to key suppliers. Because of the products involved, the questionnaire is more common in the manufacturing and technology sectors. Concerns from customers in these questionnaires have led many suppliers, public and private, to commit to sourcing conflict-free minerals and to build the capacity to do so into a sustainability program.

Photo: A Wolframite (common tungsten ore) mine in the Democratic Republic of Congo environmental impacts include Unilever and Kimberly Clark addressing sustainable paper and board; Reckitt Benckiser expanding management of water, waste, and energy; and Home Depot inquiring about supplier greenhouse gas emissions.

As key suppliers to these brands, middle-market private equity owned companies are being required to help customers achieve these targets. Adam Black, Principal and Head of Sustainability for Doughty Hanson & Co., has seen the issue of environmental impact playing a greater role in sustainability inquiries in the consumer goods sector. "One aspect where we have noticed greater emphasis recently has been on climate change related issues and in particular more tangible evidence of reducing suppliers' carbon footprint and environmental impact. That's because some companies' customers, in certain sectors, have made public statements about achieving particular reduction targets throughout their supply chain and are making sure their suppliers are on board with this," he said.

"One aspect where we have noticed greater emphasis recently has been on climate change related issues and in particular more tangible evidence of reducing suppliers' carbon footprint and environmental impact. That's because some companies' customers, in certain sectors, have made public statements about achieving particular reduction targets throughout their supply chain and are making sure their suppliers are on board with this."

- Adam Black, Doughty Hanson

2. Private Equity Response to Customer Sustainability Requirements

Impact to Portfolio Companies

Enterprise Customers Announcing Consequences but True Impact Unknown

While several large, recognizable enterprise customers have specified consequences for not complying with their sustainability requirements, GPs have had little visibility into how seriously customers take remediation of violations or how they weight sustainability questionnaire responses in purchasing decisions. However, GPs did note instances where companies improved their relationships with customers by addressing customers' sustainability requirements in earnest. Despite the mixed perception of customer commitment to sustainability, GPs generally report that proactively managing customer sustainability inquiries is positive for managing relationships with key customers.

Incorporating Customer Relationship Management into Sustainability Reports

Every year, an increasing number of private equity-owned middle-market companies are publishing sustainability reports to communicate to key stakeholders their efforts on social and environmental performance. For companies that do positively interact with customers, a sustainability report has become the de-facto publication for showcasing these accomplishments. It's an opportunity to exhibit how customer reqiurements are driving sustainability programs from hazardous chemical avoidance to energy management systems. In addition, it provides an outlet to demonstrate the positive effects on business from managing customer sustainability requirements.

Target is a customer of many private equity-owned companies and is increasing its requirements for suppliers and specifying new, direct consequences for non-compliance. In 2013, it adopted what it called "clear labor and human rights" policies for its 3,300 "white-label" factory vendors. In an audit of its high-risk factories, it identified significant non-compliant vendors and "severe violations" of its standards. As a result, it terminated business relationships with each of the noncompliant factories and in 2014 is planning to audit factories before production begins, with the goal of avoiding non-compliance and getting a head start on factories requiring significant improvement.[vi]

A participant acknowledged one of his portfolio companies having to go through a process similar to what Target described. "In order to fulfill their end of the contract, they have sustainability obligations that they must meet and subject themselves to audit by the client. They get put in the penalty box if they don't reach a certain level of compliance. If they don't remediate, the client pulls the contract," he said, mentioning that sometimes these standards are gating criteria for being selected. For certain customers, testing or auditing is built into the service contract. Though Target's requirements and process are only now one year old, this development points to the growing interest customers have in limiting risk to brand reputation by identifying sustainability issues before contracting.

However, most GPs don't have visibility into this process of consequences for non-compliance and termination of contracts. This has resulted in the overall sentiment that the impact of customers' sustainability requirements in purchasing decisions is far from clear at this point.

"They get put in the penalty box if they don't reach a certain level of compliance. If they don't remediate, the client pulls the contract."

Strong Benefits to Working with Customers

Most GPs acknowledge that proactively managing sustainability questionnaires benefits customer relations management because suppliers demonstrate their alignment with customers' key goals. "Very often it depends how much weight supply chain impact is given by the portfolio company's customer, but, as a GP owner, I see my role as encouraging the portfolio to engage with their customers on supply chain ESG, especially with those that have publicly stated interest in this. We ask the portfolio to look at the customers' strategies before developing their own in order to check for alignment and identify commercial opportunity," said Adam Black. This was a common approach GPs noted for working with customers generally – identifying the customers' core strategy and working to help them achieve their key goals improves the relationship.

Zobele

In 2006, London based general partner Doughty Hanson & Co. acquired a majority share of Zobele Group, an air freshener and insecticide products manufacturer, and has since seen an increase in customer sustainability requirements. Specifically, Zobele has seen more pressure recently from customers on the issue of energy and greenhouse gas emissions due to customers trying to meet their own targets, according to Adam Black, Principal and Head of Sustainability at Doughty Hanson. Zobele interfaces with customers and proactively manages sustainability issues, which has benefited the company's customer relations. For Black, it's a further example of the value creation potential of positive environmental and social performance.

One particpant looks at sustainability as a core concept in creating value for a portfolio company, part of which is working with portfolio company customers on these key issues. One of this participant's main ESG programs is using lifecycle assessment data, reported through the GRI framework, to accurately portray product impact for the purpose of sales and marketing. The participant explained that, "We've been actively working with a subset of our companies on GRI reporting, because we think it's important from the stakeholder perspective. We try to get all of our companies report-ready because we believe it's an expectation if you're a public company that you would have published responsibility reports. Key stakeholders, including customers, are very interested in this."

Also endorsing the concept of proactively managing responsiveness to customer sustainability expectations, Jackie Roberts, Chief Sustainability Officer at The Carlyle Group, cited the example of Axalta, its car paint coatings company that filed for an initial public offering in August 2014. Axalta held conversations with customers outside of the typical sustainability questionnaire process, and after discerning its customers' key goals, began innovation on sustainable water-borne paints and coatings. Partly for that reason, it was able to win new business.

GP Involvement in Managing Customer Inquiries

Diligence: A Common Starting Point

GPs that are more involved with portfolio companies' customer inquiry management typically begin analyzing the issue during due diligence. As one participant said, "With [our firm] these questions are asking in due diligence. Depending on the sector and also on the nature of the investment, they are more or less relevant."

Another participant described a similar approach to looking at inquiries in diligence. "When we do due diligence, we have data on percentage of revenue by customer, and we talk to those customers and learn about their requirements. When working with management, we'd then tell them the potential to gain more business if they are good at meeting the requirements. But it is one-off, not a thematic question we always ask in due diligence. If it was uncovered we would build it into the value-creation plan for management," he said.

No Systematic Approach in Place

GPs are beginning to recognize the benefit of taking a systematized approach to assisting portfolio companies in preparing for and answering customer sustainability questionnaires. When necessary, GPs are also assisting portfolio companies in making strategic changes in response to customer requirements. However, given that these requirements are still imposed only on some companies in some industries and many portfolio companies have been handling them on their own, most survey participants acknowledge that they're not taking a standard and portfolio-wide approach.

> "But if we were to see that some company was not enacting similar sustainability measures or programs as others in the same sector, it would indicate that they may need help."
>
> - Jackie Roberts, The Carlyle Group

One reason is that, with already well-developed ESG programs, several larger GPs feel that their own sustainability requirements of portfolio companies are more stringent and/or broader than what a customer might ask at this time. "I think it comes down to their overall sustainability program. We are building more into due diligence – not just trying to identify opportunities for resource efficiency, but trying to understand what the sustainability program looks like, and what it's done so far, which gives us a clue of how prepared the company is. But if we were to see that some company was not enacting similar sustainability measures or programs as others in the same sector, it would indicate that they may need help," said Jackie Roberts.

Even without a systematic approach to managing customer sustainability inquiries, GPs involved in ESG programs recognize that it's beneficial for customers to communicate requirements on sustainability, because, as one participant said, it makes his job easier if the sustainability issues he looks to address are already embedded in the minds of portfolio company executives.

Ultimately, the portfolio company response to the customer hinges on communication of performance. That's an area where one participant sees possibility for improvement. This participant's ESG program hinges on minimizing portfolio company fatigue. "Our reporting is designed so that portfolio companies don't have to reinvent the wheel with each requested disclosure – their report to us will also serve as a report to other constituents," she said. In this, the participant sees the benefit of necessitating that portfolio companies include in GP ESG reporting their responses on customer sustainability inquires. "So wrapping what they might report back to customers into what they report to us could have some benefit," she added. Managing customer sustainability inquiries in this way as a GP would create insight into the information portfolio companies provide to customers without fatiguing company management.

Outlook

The sustainability inquiries of the largest and most significant enterprise customers have sparked a trend that is already affecting private equity-owned companies. GPs expect that this trend will increase and already, many consider questionnaire responses as an opportunity for their portfolio companies to enhance key customer relationships by aligning strategies.

As exposure to supply chain risk grows, customers are likely to increase consequences for non-compliance. Companies that do not actively manage sustainability issues important to their key customers' goals will be exposed to potential sales disruptions. Based on discussion with GPs and Ceres' research of 613 companies, MSP recommends that GPs with investment concentrations in the consumer products, technology, and food and beverage sectors – and particularly those with operationally active ownership strategies – prioritize the issue of customer sustainability requirements in their ESG management programs.

MSP will keep a keen eye on the development of this driver and look to measure its effect in future releases of the *ESG in Private Equity* SM series.

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Endnotes

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