ESG in Private Equity[SM] - 2012

Perspectives and best practices for managing environmental, social, and governance issues

A Study by Malk Sustainability Partners in Collaboration with the Environmental Defense Fund

MALK Sustainability Partners

EDF ENVIRONMENTAL DEFENSE FUND™

About Malk Sustainability Partners

Malk Sustainability Partners (MSP) is a specialty management consultancy that guides investors and businesses in developing profitable corporate sustainability strategies. We specialize in enhancing the resource efficiency and environmental management of our clients to maximize earnings and build winning brands in an era of increasing stakeholder interest in sustainability.

Our expertise in responsible investing and business practices helps funds to manage exposure to ESG risks and enhance fund performance. Furthermore, MSP's depth of knowledge, extensive experience, and broad technical network positions us as a trusted advisor to private equity general partners, providing them with the tools to reach success.

For more information about MSP, please visit us online at www.MalkSP.com.

About Environmental Defense Fund

Environmental Defense Fund is a leading national nonprofit organization representing more than 700,000 members. Guided by science, business and policy expertise, EDF designs and transforms markets to create solutions to the most serious environmental problems. Since 2008, EDF has been working with leaders in the private equity industry to develop approaches for firms to measure and improve business and environmental performance across their portfolios.

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Glossary

Eco-efficiency:	The practice of leveraging of environmental management to increase resource use efficiency, cut waste, and generate cost savings
EDF:	Environmental Defense Fund
EHS:	Environment, Health and Safety
ESG:	Environmental, social, and governance
GRI:	Global Reporting Initiative
GP:	General Partner, referring to a private equity fund manager
IFC:	International Finance Corporation
LP:	Limited Partner, referring to an institutional investor which allocates funds to private equity fund managers
MSP:	Malk Sustainability Partners
US PEGCC:	US Private Equity and Growth Capital Council
UN PRI:	United Nations Principles for Responsible Investment

MSP Introduction

At Malk Sustainability Partners, we are finding that attention to responsible investment is broadening throughout the finance sector. Not only do sustainability stakeholders view the flow of capital as a critical element of the long-term transition to a more sustainable world, but investors across asset classes are recognizing that management of environmental, social, and governance (ESG) issues is material to long-term value creation.

Private equity funds are in a strong position to capitalize on this transition. They often own a controlling interest in their portfolio companies and take an active role in driving operational and strategic improvements. As a result, they are well positioned to accelerate the adoption of more socially and environmentally sustainable ways of doing business.

It was from our direct experience observing these trends that our firm partnered with Environmental Defense Fund (EDF) in this effort to capture a comprehensive perspective on how fund managers across the private equity sector view ESG issues and their relationship to value creation. From the survey results, we are gratified that the consideration and management of ESG issues goes well beyond the funds with which MSP and EDF have worked.

We are extremely appreciative of the time our respondents so graciously gave us and are proud to share this informative report with the investment community in the interest of accelerating its focus on sustainability.

Andrew Malk
Managing Partner
Malk Sustainability Partners

EDF Introduction

At EDF, we believe that environmental management can play a vital role in long term value creation. In our work with leading companies, we seek big opportunities to catalyze change, stimulate markets and raise the bar for environmental performance. We have been working since 2008 with leading private equity firms to develop and spread best practices that unlock business benefits for the firms, their investors and their portfolio companies, by saving energy, cutting emissions and reducing the need for other natural resources.

Increasingly, we are hearing and seeing from our partners in this effort that awareness and action related to ESG issues and their potential to create value are on the rise. Firms are no longer asking why they should focus on ESG, but how to do it. From hiring in-house ESG professionals to developing strong governance and investment models, leading firms are working hard to develop systematic and strategic approaches to turning ESG management into a source of competitive advantage and value.

The trends highlighted in this study point to these emerging best practices and provide context around the challenges and opportunities facing both private equity firms and their limited partners. We hope this report will serve both as a useful reference and a guide for firms and investors thinking about their own ESG efforts. We look forward to continuing the conversation and collaboration with firms seeking to raise the bar for their industry.

Tom Murray
Managing Director
Environmental Defense Fund

This study engaged senior team members of 13 private equity general partners and 6 limited partners, with the majority of respondents located in the United States. It focused on current and anticipated future management of environmental, social, and governance issues.

The findings include:

» **69% of fund managers** have observed increasing concern about ESG issues from their investors during the past 3 to 5 years

» **92% of fund managers** expect to increase their attention to ESG management in the future

» **54% of participating funds** have or are developing an ESG management program focused on value creation.

This document also provides recommendations on best management practices in private equity for environmental, social, and governance issues.

The Background on ESG: A Rapidly Growing Force

ESG (environmental, social, and governance) is a broad term used across the investment community to describe a range of non-financial investment considerations related to sustainable development, environmental stewardship, social equity, and corporate governance. Familiar elements of ESG management include greenhouse gas emissions management, employee compensation equity, board composition, and accounting practices.

In recent years there has been an expanding effort and growing imperative to relate ESG management to the financial performance of companies and investors. Key stakeholders to private equity funds such as LPs, many of whom have become signatories to the United Nations Principles for Responsible Investment (UN PRI), are placing higher expectations for triple bottom line management on fund managers.

Creating Value with Sustainability Measures

Structural changes in the private equity sector have made ESG an attractive area for value creation. Funds must now contribute more equity to acquisitions than was previously the case, and competition has increased the purchase price of attractive acquisitions. The result has been more focus on creating value beyond financing structure through active ownership and operational capacities. An example is the now almost ubiquitous 100 day plan, which is a strategic approach to prioritizing changes to be implemented immediately upon acquisition of a company.

Many private equity funds are now amassing a range of operational tools from pooling health benefits to optimizing telecom expenses. One particularly exciting option involves leveraging the sustainability trend by capitalizing on eco-efficiency opportunities as a component of enhanced ESG management across the investment cycle. Quite simply, GPs are starting to focus on energy efficiency and waste reduction as meaningful ways to reduce costs and boost cash flow.

There is still divergence in how eco-efficiency and other aspects of ESG management are approached. This study seeks to clarify the state of the market with regard to ESG in private equity, and to highlight how fund managers are leveraging non-financial issues and metrics to drive performance in their organizations.

Executive Summary

Our Approach: A Broad Sampling

The MSP team engaged 18 organizations across the private equity sector during the second quarter of 2012, including both fund managers and their LPs. These interviews focused on views and approaches to ESG issues within these organizations, and the relationship between these issues and value creation.[1]

The organizations were represented by a mix of investment partners, ESG professionals, operations experts, and investor relations personnel. The content of the conversations revolved around three primary topics:

- Awareness of ESG initiatives across the private equity sector and their relative importance;
- Current and anticipated future ESG management capabilities within the participant organizations; and
- Potential drivers of an increasing focus on ESG within participant organizations and across the private equity sector.

The results of these interviews were augmented by secondary research as well as MSP and EDF's direct private equity engagement experiences.

Our Findings

Our survey resulted in numerous observations on the state of the market with regard to ESG issues while also highlighting a range of best practices in ESG management amongst private equity fund managers.

State of the Market Observations

- **VALUE CREATION:** Fifty-four percent of participating funds have developed, or are currently developing, an ESG management program to create value, often emphasizing cost savings from eco-efficiency and meeting the expectations of LPs. These platforms are in addition to the basic environmental health and safety compliance tools which nearly all funds have in place.
- **INVESTOR CONCERN FOR SUSTAINABILITY ISSUES:** Sixty-nine percent of fund managers have observed increased concern about ESG issues from their investors during the past three to five years. European LPs have led the way, but recently growing attention from North American institutions has been observed.

54% of participating funds have or are developing an ESG management program focused on financial value creation.

- **TREND DRIVERS:** Over 60 percent of respondents cite the increasing expectations of LPs, as well as the benefits of cost savings as the biggest drivers of increasing ESG focus.
- **UNCLEAR METRICS:** The absence of clear, standardized metrics to effectively measure and monitor ESG issues and their relationship to value creation remains a challenge. However, emerging resources ranging from the broad UN PRI to specific tools such as the Actis Energy Impact Assessment Model are beginning to address this challenge.
- **ESG AS A DIFFERENTIATING FACTOR:** LPs are beginning to consider ESG capabilities of GPs in the allocation of private equity capital. In addition, ESG performance is becoming material to terms of investment agreements.
- **SHARED VISION OF THE FUTURE:** A resounding 92 percent of fund managers expect to increase their attention to ESG management in the coming three to five years.

Best Management Practices

Our interviews revealed a diverse set of ESG practices that are at varying levels of implementation. The most consistently cited were:

- **LEADERSHIP** - *Adoption of a specific policy for managing ESG issues throughout the investment cycle*
  Practices range from signing the UN PRI to development of fund-specific responsible investing and ESG related policies.
- **PEOPLE** - *Recruitment of experts to plan and execute ESG related initiatives*
  Firms are engaging external consultants, recruiting in-house ESG experts, involving their investment professionals and committees, and forging partnerships with appropriate ESG partners such as non-government organizations (NGOs).
- **DILIGENCE** - *Enhanced integration of ESG considerations into the due diligence process*
  ESG diligence is expanding from legal compliance and remediation reviews (such as groundwater or land contamination) to more comprehensive risk and opportunity assessments. Innovative funds are beginning to leverage ESG due diligence as a means to identify value creation opportunities.

- **OPERATIONS** - *Collaboration with portfolio companies to enhance ESG performance at the operational level*
  From individual engagements to the development of shared best management practices, funds are working with their portfolio companies to enhance operating efficiency while reducing environmental footprint. Some firms are collaborating with portfolio companies on environmental, health and wellness, and governance issues.

- **METRICS** – *Use of metrics and reporting to manage ESG efforts and measure improvements*
  Where appropriate from a value creation perspective, fund managers are working with portfolio companies to set performance baselines and targets for resource use and environmental impacts. Some managers are also developing fund-level metrics for issues such as carbon intensity and aggregate cost savings.

- **COMMUNICATION** - *Development of communications tools highlighting ESG accomplishments*
  Industry forums, case studies, and citizenship reports are among the tools used to highlight ESG efforts and achievements to limited partners, acquisition targets, and the public. Such communication supports investor relations objectives and boosts public image.

Interview respondents consistently related their ESG practices to core strategic objectives, primarily the reduction of operating costs, meeting the expectations of LPs, and driving value creation by enhancing the reputation of portfolio companies or helping them access new markets. This finding refutes the common, if increasingly outmoded, view that ESG efforts are citizenship initiatives which are unrelated or even at odds with value creation.

In a market environment where private equity fund managers must increasingly innovate and compete to create value and drive returns, many of our GP respondents now view ESG management as a tool to aid in doing so. The data derived in this study suggests that the growth rate of initiatives in this area will only accelerate.

State of the Market

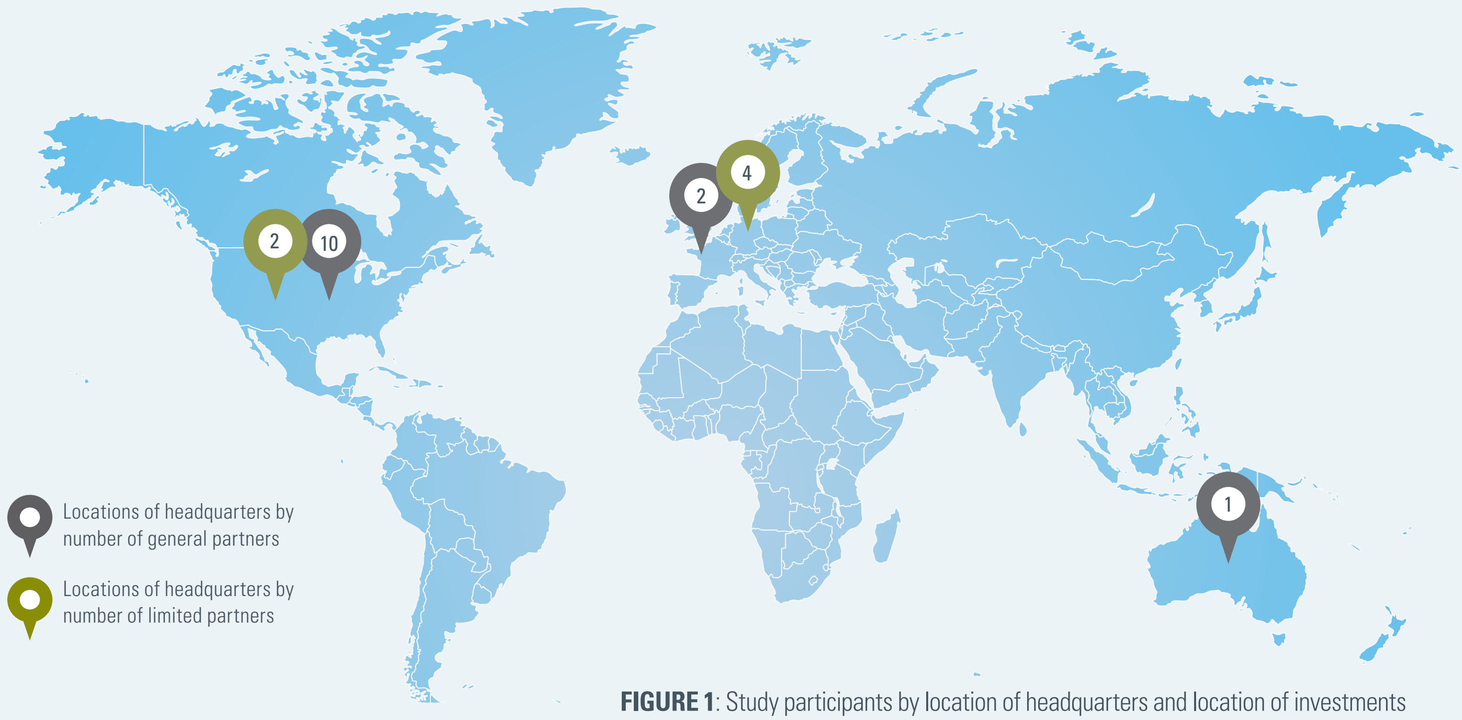


FIGURE 1: Study participants by location of headquarters and location of investments

Study Participants

Thirteen private equity fund managers, or GPs, and 6 LPs with capital committed to private equity funds participated in this study.[2] Per Figure 1 above, the large majority of participating GPs are headquartered in the United States while most of the participating LPs are based in Europe.

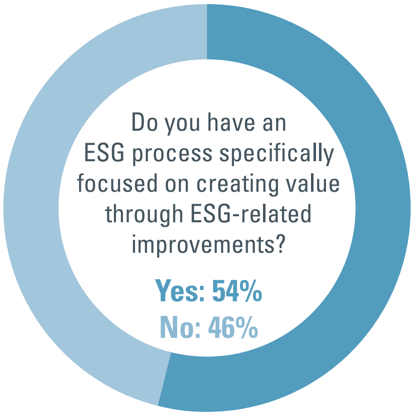
The GPs ranged in size from funds with $500 million of capital under management to organizations with $60 billion investment records. While they varied widely in their approaches to ESG management, many have prioritized ESG management as a value creation lever.

One distinguishing factor of this study is the inclusion of LPs. As the clients of GPs, LP interest in ESG management is a leading driver of GP attention to and adoption of ESG management programs. Therefore, their involvement is an important calibrating mechanism.

A full list of respondents can be found in **Appendix A.** The interviewees range from investment professionals and operations experts to investor relations personnel and ESG managers.

Insights from GP Respondents

Survey participants answered several questions focused on their views and management of ESG issues, as well as how they may expect their perspective to evolve.



An ESG Process Centered on Creating Value

The majority of our respondents view ESG issues from a value creation perspective that builds on more traditional environmental health and safety (EHS) matters. Nearly all funds have implemented a basic process to review legal compliance with EHS regulations during the due diligence process, particularly for companies in high impact fields such as manufacturing. These processes are also leveraged to identify major risks. Many funds are now moving beyond basic EHS platforms to explore how management of ESG issues can drive value creation.

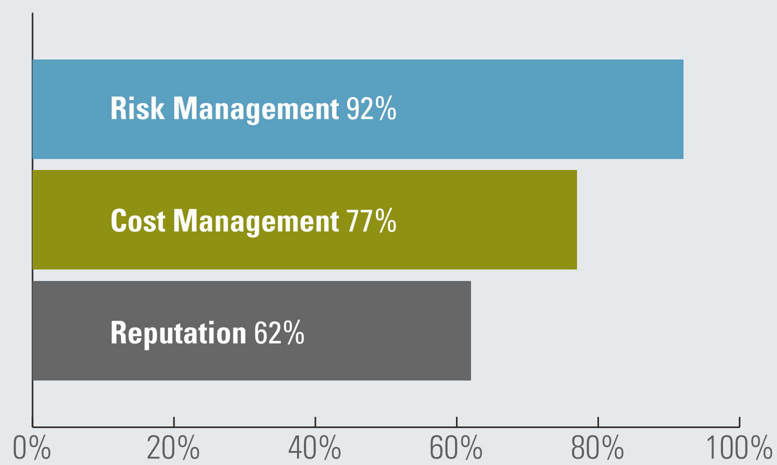
Fifty-four percent of respondents described a form of program which goes beyond traditional legal compliance review to create value.

Impact of ESG in Risk and Cost Management

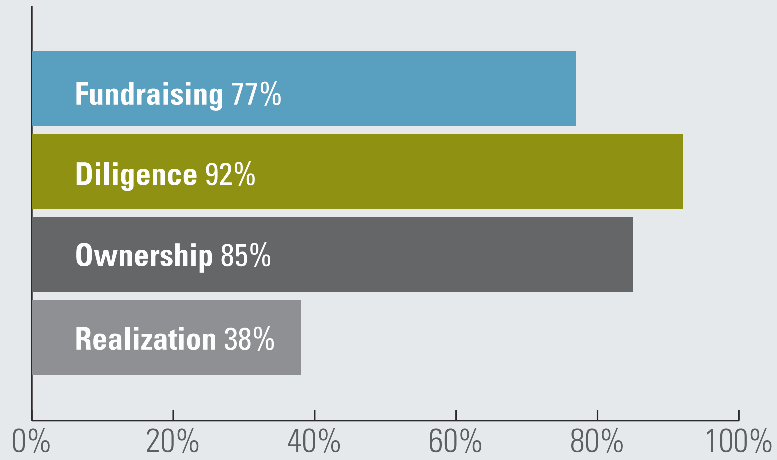
Risk and cost management were cited as the two most material areas where ESG considerations impact portfolio companies. A nearly unanimous 92 percent of responding GPs described risk management with regard to ESG issues as relevant to their corporate mission, while 77 percent of respondents saw cost management with regard to ESG issues as relevant. In both cases, respondents describing ESG as material to risk and cost management included some participants that currently have or are developing ESG management platforms, as well as others that do not.

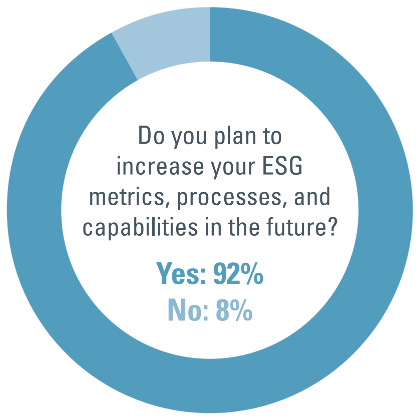
Additionally, 62 percent of respondents noted ESG as material to a fund's reputation.

In what ways do you view ESG as material to your investments?



At what stages of the investment cycle do you consider ESG?





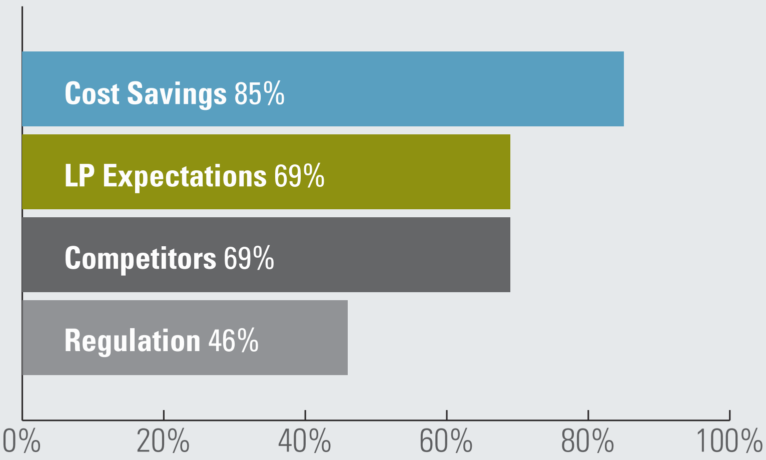
ESG in the Due Diligence and Ownership Stages of the Investment Cycle

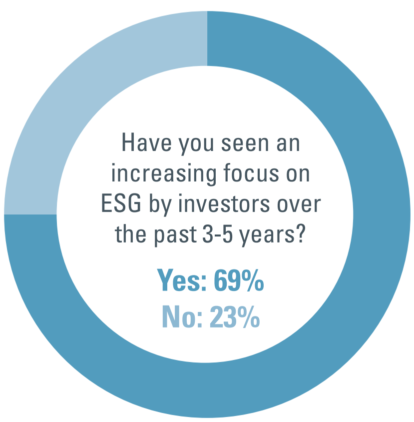
Respondents indicated that ESG criteria are most commonly considered during the due diligence and ownership phases of the investment cycle in the form of risk management; 92 percent of respondents cited the relevance of ESG during diligence and 85 percent during ownership. Seventy-seven percent of respondents reported considering ESG factors in fundraising, primarily in the form of questions from LPs, while only 38 percent see ESG considered during investment realization.

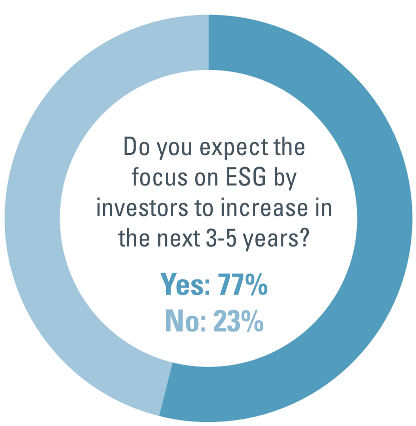
Increasing ESG Metrics and Capabilities

Almost all of the respondents expect to see a greater focus on these issues going forward as funds move beyond compliance-oriented ESG due diligence to seek value creation opportunities. Ninety-two percent , or nearly all respondents, expect their organization to expand its use of ESG metrics and processes in the future.

What factors will drive an increasing focus on ESG by your fund?







Driving Future ESG Focus

Building on the earlier finding that cost saving potential currently drives ESG focus at many funds, savings were also cited as a major driver of additional future focus on ESG management. Eighty-five percent of respondents noted that the rising cost of resources and the opportunity to grow earnings by cutting energy and other input costs is a major factor in their focus on ESG issues.

The increasing ESG-related expectations of LPs are another prominent driver of GPs' increasing focus. Nearly 70 percent of respondents noted a growing focus on ESG amongst their investors during the past three to five years, while 77 percent expect this focus to intensify during the coming three to five years.

This finding tracks with that of an earlier study by PwC which found that 88 percent of funds expect additional LP attention to ESG issues in the next five years.[3] Additionally, the UN PRI noted that between 2010 and 2011, the percentage of signatories (including many LPs) that integrated ESG considerations into management of private equity assets rose from 69 percent to 84 percent, reflecting increasing investor interest on ESG management in this sector.[4]

Finally, nearly 70 percent of respondents also cited competitor activities as a driver of their increasing ESG efforts. As LP expectations rise and as funds must demonstrate additional value-add to acquisitions targets, keeping up with industry trends in ESG management is a relevant competitive factor.

"As long term investors, management of environmental, social, and governance issues is important to PGGM for both financial and social reasons. Our clients and their beneficiaries ask us about these issues and we want to be at the leading edge of responsible investing."

Tim van der Weide
PGGM

The View from LPs

To calibrate the views expressed by our GP respondents, our team spoke with six major LPs with holdings in private equity. Four of these LPs are headquartered in Europe and two are headquartered in the United States. While the sample set is relatively small, these conversations did provide a window into how private equity LPs view evolving ESG issues.

Growing Interest in ESG Issues

Our LP respondents consistently expressed interest in ESG management from a risk management perspective, though the degree of scrutiny dedicated to ESG issues varied between organizations. In general, European LPs have placed more attention on ESG issues than their American counterparts. However, American LPs are also beginning to focus on ESG management, with particular interest paid to the direct relationship between ESG management and private equity returns.

Although approaches vary in maturity, respondents at LPs agree that the ESG issue set is here to stay and that emphasis will increase over time.

Many LPs, including organizations such as the Universities Superannuation Scheme (USS) in the United Kingdom and Dutch pension administrator PGGM, have developed sophisticated approaches to addressing ESG issues in response to concerns from their pensioners and public sector interests. These approaches often grow out of investors' own fiduciary responsibility to represent the interests of their pensioners; as these stakeholders become more interested in ESG issues, their asset managers must act accordingly.

When USS began investing in private equity in 2007, for instance, the organization was able to leverage a legacy of ESG management dating back to an initial policy developed in 1999. This experience helped the USS team to integrate ESG considerations into due diligence of private equity GPs in a simple and streamlined manner. Head of Responsible Investment, David Russell, shared four questions which the USS team consistently asks when evaluating a GP:

- How do you, as a GP, look at ESG issues in your own due diligence?
- How do you look at these issues when managing an asset?
- How do you communicate to LPs and other stakeholders?
- What are your views on ESG-related protocols including the UN PRI and the US Private Equity [and Growth Capital] Council Guidelines for Responsible Investment?

These overarching questions, in conjunction with sets of sector and asset specific questions on ESG issues, enable USS to effectively engage its private equity GPs on the ESG performance of assets in some of the ways described below.

"My general impression is that ESG issues have risen quite rapidly on the priorities list of private equity general partners. The last four years have seen a significant increase in awareness in the sector at a rate much faster than I would have expected."

David Russell
USS

Investor ESG Expectations Drive Action

Respondents consistently noted that ESG management has influenced selection of fund managers. LPs which inquire about these issues generally see them as a way to more comprehensively qualify the value creation and risk management capabilities of fund managers. For example, one LP cited a case where due diligence revealed that a GP seeking funding had an extremely limited ESG policy; this led to further investigation of the GP and the discovery of undesirable conduct and litigation risk. In this instance, reviewing a GP's ESG policy helped the LP to make a more informed investment decision.

In addition to influencing fund manager selection, ESG performance is becoming material to investment agreements and even a condition in meeting capital calls. One European LP respondent noted that his organization's annual performance review of every fund manager includes ESG obligations. If a GP fails to report to the expected level, or fails to meet an agreed-upon ESG objective, the LP reserves the right to suspend capital calls.

While still primarily the practice of only the most engaged LPs, there is a detectable and growing trend among institutional investors to include ESG capability as a criterion for fund selection and ESG performance as a standard for continued capital contributions. As explored above, a growing group of GPs are noting and acting on this trend.

"ESG and sustainability are macro themes which will influence value creation going forward. We are interested in how to participate in this theme through investment vehicles, as well as how to integrate management tools for ESG-related risks."

Scott Chan
SCERS

American LPs: Increasingly Interested in ESG Performance

GP respondents often cited a perceived difference in the level of ESG concern or interest between European and American LPs. This perception has merit; of the 251 asset owners which have become signatories to the UN PRI, 20 organizations are based in the United States compared to 141 European entities.[5]

The sample set of U.S. LPs is limited, but both participating American LPs acknowledged that ESG issues have become more prominent during recent years and that this trend is likely to continue.

One respondent in particular is working diligently to integrate ESG across its operations. The California Public Employees Retirement System (CalPERS) has invested in a green fund, developed an ESG code, and hosted a workshop entitled 'Sustainable Investing: Integration of Environmental, Social and Governance (ESG) Factors' which highlighted opportunities for the pension administrator to integrate ESG considerations across varying asset classes.

"We are continuing to explore the relationship between sustainability issues, stronger brands, and improved profitability. If ESG efforts implemented by our private equity managers lead to greater efficiency, cost reduction, better risk management or some other improvement that positively impacts the financial return to CalPERS, then our organization is fully supportive."

Wesley Bradle
CalPERS

During 2011, CalPERS also collaborated with consultancy Mercer on a number of ESG related reports, including a major effort cataloging evolving ESG criteria across a comprehensive range of asset classes, including private equity.[6]

Raising capital from European LPs already requires a systematized approach to managing ESG issues. While American organizations are often seen as somewhat behind on this issue, they are beginning to direct more attention to ESG management in private equity and other asset types and this evolution bears monitoring.

Consistent Methodologies Will Accelerate ESG Action

LPs in both the United States and Europe remarked that the lack of clear methodologies and metrics for measuring ESG issues presents a challenge in effective monitoring. While some issues, such as energy or water use, are comparatively easy to measure and relate to value creation, others are not. For instance, one LP respondent cited child labor as a social issue that is important yet difficult to monitor due to a lack of metrics. The scarcity of clear metrics and reporting standards has complicated evaluation of performance by LPs and made monitoring and managing of issues by GPs more difficult.

Guidance on monitoring ESG issues is emerging with a range of organizations, including funds, consultancies, and public institutions working to develop metrics and guidelines to clarify these often murky issues. PGGM's Tim Van Der Weide, for instance, cited a 2011 study exploring the implications of climate change for LPs.[7] As another example, the International Finance Corporation in the United States and CDC in the United Kingdom have produced tools and guidelines for ESG management which GPs, such as Actis, reference in making investment decisions.

While a lack of broadly accepted metrics for responsible investing remains a challenge, progress has been made to remove what some of this study's respondents see as a hurdle to adopt more sophisticated approaches to ESG management.

Our Perspective

Across the private equity sector, viewpoints on responsible investing and ESG management are evolving. Some investors see a pressing mandate to focus on ESG issues, while others see compliance requirements increasing slowly over time. On either end of this range, GPs are creating value by monitoring and acting on ESG issues, particularly opportunities to improve efficiency, cut operating costs, and reduce environmental impacts.

Going forward, we expect these trends to continue. LPs will ask more of their fund managers and the criteria established by protocols, such as the UN PRI, will become more stringent. At the same time, a greater proportion of GPs will take notice of the value created from ESG management and take action to capture it.

The second half of this report explores the best practices in ESG management adopted by funds to manage ESG related risks and opportunities to create value.

Best Management Practices

In addition to securing clear data on the state of the market with regard to ESG, we engaged the study's GP respondents to discuss ESG practices at their respective organizations in the interest of uncovering current best management practices and their impact on returns.

We found a wide spectrum of ESG practices employed across the sector. This diversity is due in large part to the lack of a formal standard for ESG best management practices in private equity and variance in needs based on fund size as well as geographic and sector specific focus. We have catalogued the practices described into three levels of commitment and investment:

1. **EMERGING:** This baseline category includes compliance activities and efforts which go slightly beyond compliance.
2. **DEVELOPING:** This category is comprised of activities and commitments which go beyond legal compliance to demonstrate a fund's growing focus on ESG management as a driver of value creation.
3. **LEADING:** The most mature category includes the policies and practices of a minority of GPs who have been concerned about ESG management for several years and are leveraging ESG management to create value for their companies and investors.

These best management practices are briefly summarized in the figure 2 below.

FIGURE 2: Summary of practices described by respondents

SEE FULL SIZE CHART ON THE FOLLOWING PAGE

In each of the sections below, our team has also provided perspective on what may be expected as ESG management in private equity continues to evolve in the coming years.

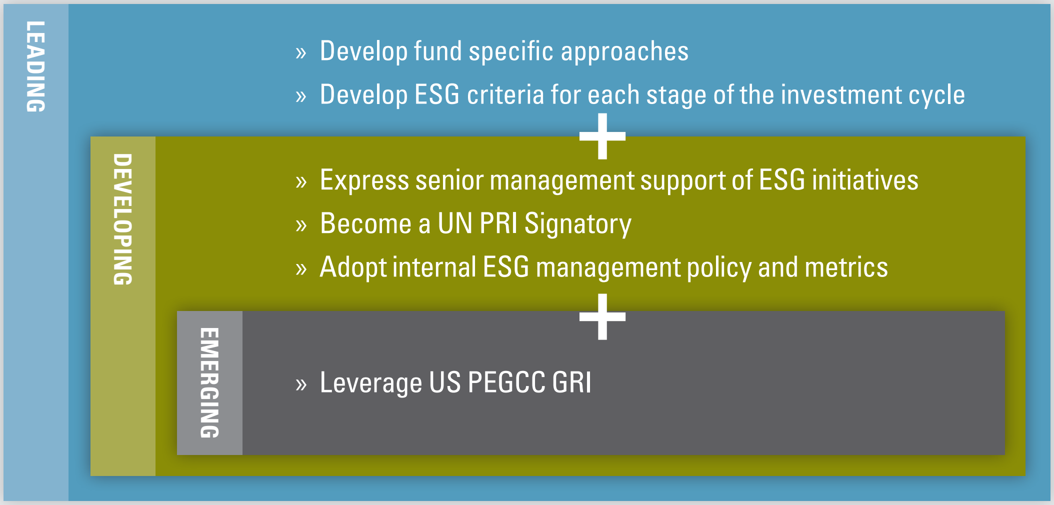
	Leadership	People	Diligence	Operations	Metrics	Communication
LEADING	» Develop fund specific approaches » Develop ESG criteria for each stage of the investment cycle	» Involve investment professionals and investment committee » Empower ESG team to partner with portfolio companies » Engage stakeholders and NGOs	» Create geography and sector specific ESG policies » Integrate ESG opportunities into 100 day plans » Create investment committee ESG guidelines	» Create an ESG community and platform to share best practices and resources among portfolio companies	» Leverage industry forums and case studies to showcase accomplishments » Measure impact of social and governance initiatives on investments	» Participate in collaborative research and tool development
DEVELOPING	» Express senior management support of ESG initiatives » Become a UN PRI Signatory » Adopt internal ESG management policy and metrics	» Engage consultants/ advisors to develop fund level ESG management platform » Hire in-house ESG professionals	» Standardize procedure for integrating ESG into due diligence » Involve ESG team in due diligence	» Measure results and share lessons learned across the portfolio	» Establish value-oriented ESG goals » Benchmark ESG metrics across portfolio	» Integrate ESG program and accomplishments into fundraising materials » Develop corporate citizenship reports
EMERGING	» Leverage US PEGCC GRI	» Engage consultants/ advisors for specific ESG related projects	» Adopt sector specific ESG due diligence criteria » Conduct legal compliance and contamination diligence	» Partner with individual companies to identify opportunities for operational improvements	» Adopt standards and processes for measuring ESG metrics » Identify relevant ESG metrics	» Develop ESG case studies » Participate in industry forums

FIGURE 2: Summary of practices described by respondents

1. Leadership: Commitment & Policies

Building an effective ESG management platform begins by securing the commitment of a GP's management and creating a policy to systematically manage ESG issues.

Leadership: ESG Leadership Practices



Commitment Starts at the Top

As is true of any corporate initiative, the successful adoption of an ESG management platform requires the commitment of top management as well as effective communication throughout the organization and across its portfolio. Amongst our respondents who have focused on developing such platforms, several drivers were cited as drawing top management's attention and commitment to these issues.

In some cases, the personal interests of a founding partner drove the initial development of a platform. For instance, at one Europe-based GP respondent a founder's interest in social responsibility led him to consider how an enhanced focus on social and environmental issues could create value for his organization. This consideration led to a broader commitment across the fund to relate ESG to value creation and eventually to the appointment of a dedicated ESG professional.

More often, an external driver focuses top management on ESG issues. These drivers can include public or NGO driven interest, an inquiry from an LP, or a desire to capture opportunities such as realizing cost savings through a focus on eco- efficiency. For example, in March of 2012, Carlyle Group Managing Director, David Rubenstein, spoke about ESG and sustainability issues with the *Wall Street Journal*, noting that "Sustainability equals more cash flow. And if you are willing to put in the time to improve the sustainability principles of a company, you can in fact make more money".[8]

The UN Principles for Responsible Investment as a Launch Pad

"The UN PRI is important both as a framework for responsible investing and ESG processes, but also a way to interact with other members of the financial services community focused on these issues."

Adam Black
Doughty Hanson

As noted above, the UN PRI now includes nearly 1,100 signatories, up from the initial 38 just six years ago.[9] The UN PRI provides useful initial guidance on how funds and other financial services providers can invest responsibly. Signatories commit to actions such as incorporating ESG issues into investment analysis and seeking appropriate ESG disclosure from entities in which they invest. The principles provide suggested initiatives as well as resources to assist signatories in enacting these commitments.

Becoming a signatory to the UN PRI is a common step in the development of an ESG management platform, particularly for LPs. Thirty-one percent of our GP and 83 percent of LP respondents are signatories to the UN PRI. Overall, the percentage of private equity GPs which have signed the principles is small but growing quickly; from five percent in 2009 to eight percent representing over $200 billion in 2010 - a 60 percent increase in one year.[10]

An alternative to the UN PRI, adopted by some respondents either alongside or in lieu, are the US Private Equity Growth Capital Council's (US PEGCC) Guidelines for Responsible Investment. These nine guidelines focus on ESG legal compliance and are not signed, like the UN PRI, but rather applied as deemed relevant by fund managers. Referencing the US PEGCC guidelines is a potential first commitment for GPs developing a responsible investing policy for their own fund.

Fund-Specific Approaches

Beyond adopting broad principles for responsible investment, some respondents have developed fund specific commitments and policies to support their investment team in reaching responsible investing goals. Actis, for example, has published an ESG Code connecting ESG issues to the fund's investment thesis and establishing policies for managing them throughout the investment cycle. Similarly, TPG has published commitments to integrate sustainability practices into the operations of its companies, sustainability considerations into due diligence and investment decisions, and greater transparency across its portfolio.[11] The fund directly relates these issues to better investment decisions and enhanced results in the form of cost savings, reflecting the need of GPs to translate ESG management into improved investment performance.

On the LP side, PGGM published a fund-specific responsible investment policy which relates ESG themes to the fund's vision and specific stages of the investment process. CDC, the U.K. Development Finance Institute, has gone even further to publish a toolkit on ESG management for its private equity fund managers outlining how they can comply with the organization's ESG requirements.[12]

Industry Example: A Need to Leverage ESG Strategies

With $5 billion under management and a focus on investing in emerging markets, private equity GP Actis has a particularly strong need to leverage ESG strategies and commitments to navigate risk. The fund has publicly committed to promoting world class standards in health, safety, environmental management, climate change, social engagement, business integrity, corporate governance, and transparent accounting. This commitment is manifested through a range of initiatives from the adoption of World Bank and IFC global standards to the integration of ESG into its due diligence process and across the investment cycle.[13]

Our Perspective

As explored in the *State of the Market* section of this document, most fund managers expect to increase their commitments to ESG management in the coming years. Our expectation is that more funds will develop formal ESG codes related to their specific investment theses, providing investment teams with specific guidance on integrating ESG issues into investment screens and due diligence checklists. These codes will be useful tools to communicate top level commitment to ESG management, and will become expected by LPs. GPs will also begin to make sections, and in some cases the entire documents, publicly available.

2. People: Building Teams to Lead ESG Efforts

Appropriate human resources are crucial to effectively executing on commitments. GPs are accomplishing ESG objectives by leveraging consultants, internal staff, and portfolio company management.

People: ESG Leadership Practices

LEADING

» Involve investment professionals and investment committee
» Empower ESG team to partner with portfolio companies
» Engage stakeholders and NGOs

+

DEVELOPING

» Engage consultants/advisors to develop fund level ESG management platform
» Hire in-house ESG professionals

+

EMERGING

» Engage consultants/advisors for specific ESG related projects

> *"I led a series of consulting projects for Blackstone leveraging my background in energy before joining the firm as Chief Sustainability Officer. My operational background has been critical in identifying cost savings across our portfolio."*
>
> *Don Anderson*
> *Blackstone*

Staffing Up

Having set commitments, the next step is to allocate the human resources to fulfill them. Funds with an emergent and compliance-oriented focus on ESG issues most commonly assign management to their general counsel, who often relies on third party consultants to study specific ESG-related risks during transactional due diligence. Such study is generally related to complying with environmental regulation.

Due to their lean management teams, smaller funds often continue to rely on outside advisors. Conversely, the next step for larger funds is to bring on team members trained in ESG management. While in some cases these professionals are housed in the investor relations department, it is more common to hire operations experts who can help portfolio companies to navigate environmental, health, and safety (EHS) issues while realizing eco-efficiency savings from streamlining resource use.

Finally, the continued involvement of investment professionals is important. GPs with a more advanced focus on ESG management noted that the ESG team is regularly included in group meetings with portfolio companies and coordinates with senior investment managers to report on ESG opportunities and risks.

"Within the portfolio companies, we conduct assessments within each function of the business that compares natural resource use efficiency (i.e., Lean methods) and growth drivers to best practice leaders across industries. This enables us to scope, size and realize significant operational savings typically in the 2 year time horizon from improved performance in platforms like logistics, packaging, energy use or waste. In some companies we also identify growth drivers impacting the top line."

Pat Tiernan
TPG

Leveraging ESG Staff Across a Portfolio

ESG focused teams are small, even amongst respondents which have placed a high priority on realizing eco-efficiency benefits. As a result, the teams must be creative in deploying time and resources. Our respondents pointed out a number of approaches for doing so.

Some GPs have formed sustainability leadership councils, which bring together multiple portfolio companies to share best practices on efficiency and ESG-related risk management. These councils take a variety of approaches such as focusing on an 'issue of the year', where the ESG team develops expertise in a particular subject like enhancing fuel efficiency in logistics management. The council then works to roll out this expertise across the fund's portfolio. Other respondents described seminars and workshops bringing together multiple portfolio companies and focusing on a range of subjects, from energy management practices to integrated reporting. These seminars were seen as an effective method of 'cross-pollinating' thinking about ESG issues.

Finally, respondents noted that they bring in third party help to gain additional leverage in rolling out ESG and eco-efficiency initiatives. This includes partnering with consultancies and NGOs.

Industry Example: The Art of Matchmaking

One respondent makes a practice of bringing together operating professionals across their portfolio of companies to discuss EHS and ESG issues. This enables team members with similar functional responsibilities to discuss actions, incidents, and best management practices. Where relevant, companies can also share customer expectations related to this issue set. Coordinating such conversations is beneficial to the companies involved and requires less human and financial resources than a sustainability leadership council, though it is more difficult to integrate best practices across the fund's entire portfolio.

Our Perspective

Staff dedicated to ESG management will vary depending on the size of a GP's team and level of active management. We expect operations teams to become increasingly responsible for conceiving and executing cost saving eco-efficiency initiatives in partnership with portfolio companies, while investment teams will receive training in environmental and social issues. Larger funds will build ESG teams to coordinate ESG related activities across the fund. These efforts will often be initiated with guidance from consultants and be housed within operations departments. Smaller funds will train their teams on ESG management, but will be more likely to rely on consultancies to oversee their ESG activities.

3. Diligence: Enhanced ESG Risk Management

Enhanced ESG diligence builds on familiar EHS reviews to examine non-conventional risks and identify opportunities where initiatives such as eco-efficiency can contribute to value creation.

Diligence: ESG Leadership Practices

LEADING

- » Create geography and sector specific ESG policies
- » Integrate ESG opportunities into 100 day plans
- » Create investment committee ESG guidelines

+

DEVELOPING

- » Standardize procedure for integrating ESG into due diligence
- » Involve ESG team in due diligence

+

EMERGING

- » Adopt sector specific ESG due diligence criteria
- » Conduct legal compliance and contamination diligence

Going Beyond Basics

Nearly all funds now have a process to review EHS compliance during due diligence of companies in industries where such issues are highly material. GPs who focus on emerging markets may also review corporate and national governance during their due diligence process.

An increasing number of GPs are now moving beyond traditional EHS review to develop more comprehensive and even opportunistic approaches to ESG-related risks. Some firms surveyed discussed the rising importance of investigating "non-conventional" risks, such as deep supply chain risks or exposure to commodity inflation, while others seek to identify opportunities to increase operating efficiencies.

Increasing the scope of diligence to cover these non-conventional risks can help GPs to accurately price an investment, negotiate a better deal, manage or reduce exposure to risks after the investment is made, or possibly turn down an opportunity with excessive ESG risks.

Materiality

In developing a more robust approach to ESG management in due diligence, the first step is to integrate industry specific ESG issues. For example, water management is a material issue for food and beverage firms or utilities but is less relevant for cosmetics providers or airlines.

A range of resources are available to guide fund managers in deciding what issues to examine during due diligence. Our respondents most commonly cited tools from the IFC as well as the CDC's *Toolkit on ESG for Fund Managers* as useful reference guides.

"ESG review is a standardized part of our process and is always included in a risk matrix with other issues including personnel and regulatory matters. This initial assessment then informs a risk management document which we update throughout the investment cycle."

David Grayce
Pacific Equity Partners

Integration into the Investment Process

To adequately review ESG risks, funds must involve ESG professionals in the due diligence process. While funds at an earlier stage in the development of their ESG management platforms commonly rely on external experts to lead EHS reviews, GPs with more mature efforts employ ESG staff – supported by consultants – to investigate ESG-specific issues.

As an example of such integration, Actis's Mark Goldsmith noted that the fund's ESG team is involved in studying five distinct ESG related areas: EHS, climate change, social issues, business integrity, and corporate governance. The fund's ESG code provides guidance on managing these issues throughout the investment cycle, including during due diligence.

As another example, the Carlyle Group developed the EcoValuScreen, a tool to help investment managers target cost saving or other value creation opportunities during the due diligence process. Once identified, funds can integrate the realization of such opportunities into management plans and metrics.

Whether from a risk management or value creation perspective, integrating ESG considerations into the due diligence process improves decision making and enables better returns through a more comprehensive review of investment parameters.

Industry Example: An Integrated, Structured Process

One industry leader uses a structured process that integrates ESG into due diligence from deal sourcing to investment documents. This firm developed an extended ESG risk evaluation tool that was then integrated into their existing evaluation process. It uncovers risks such as exposure to carbon regulation, water availability, and energy volatility as well as opportunities for cost saving or even revenue generation. The ESG team works with the investment committee by integrating additional guidance into the investment deck and meeting weekly to discuss the deal pipeline. When investment managers reach the next stage of diligence, the ESG team provides additional questions that investment managers discuss when meeting with company management. Finally, the data gathered during diligence is included in investment documents with ESG expectations and goals for the acquired company's executives.

Our Perspective

We expect a broader range of ESG issues to be considered during due diligence in the coming years. Beyond EHS compliance, funds will consider aspects such as resource and supply chain management as both areas of risk and of opportunity. More consistent guidance on reviewing ESG issues specific to industries and geographies will aid them in doing so. Third parties will commonly be leveraged during ESG-related due diligence, both for subject matter expertise and to provide additional perspective to fund managers.

4. Operations: Partnering with Portfolio Companies

Private equity firms are well positioned to identify and capture opportunities to improve environmental, social and financial performance across their portfolios of companies. Furthermore, the opportunity to share successes and resources and scale best practices presents tremendous value creation potential.

Operations: ESG Leadership Practices

LEADING
- » Create an ESG community and platform to share best practices and resources among portfolio companies

+

DEVELOPING
- » Measure results and share lessons learned across the portfolio

+

EMERGING
- » Partner with individual companies to identify opportunities for operational improvements

Capturing Operational Improvements at Scale

Respondents pointed out a broad range of examples where ESG and investment professionals partnered with portfolio companies to achieve substantial value creation. Below are examples of such successful partnerships between private equity GPs and their portfolio companies:

- TPG collaborated with portfolio company Caesars Entertainment on energy and waste management initiatives. Between 2003 and 2010, Caesars invested $50 million in 110 eco-efficiency projects, resulting in $17 million of annual run-rate savings and a 33 percent reduction in waste at 2 properties; and [14]

- KKR worked with portfolio company U.S. Foods as part of its Green Portfolio Program to achieve $30.6 million in avoided energy and fuel costs between 2008-2010 from eco-efficiency initiatives in the company's fleet and distribution centers.[15]

Partnering with portfolio companies to realize benefits from ESG initiatives is not solely the domain of larger funds such as TPG, KKR, Carlyle, and Blackstone. Smaller funds have also begun to focus on such initiatives, though fewer case studies are publicly available at present.

Fund managers and their ESG teams most commonly begin by focusing on low to no cost opportunities to reduce operating expenditures through eco-efficiency, and then begin to consider larger capital improvements to realize additional cost savings.

"Environmental management has become an important part of our value creation toolbox. Energy and waste management drive cost savings while, in some cases, focusing on the environment has led to profitable new product lines."

Pat Tiernan
TPG

"My team conducts a data-driven diagnostic for portfolio companies with significant environmental footprints. This approach highlights the potential for efficiency initiatives which may not have been considered."

Don Anderson
Blackstone

Platforms that Accelerate Learning and Share Resources

Private equity firms are unique in that they often have the opportunity to take advantage of operational improvements across similar companies in their portfolios. Many funds invest in particular sectors where companies share opportunities to improve operating efficiency with respect to energy, waste or water. GPs are also well positioned to identify shared services to address health and wellness opportunities across a range of portfolio companies.

A handful of leading GPs are developing platforms to share operational improvements as well as the resources needed to implement projects effectively. Building a platform to share practices and resources across companies has the potential to accelerate value creation and bring down barriers for implementation at both current and future acquisitions.

Industry Example: Systematically Driving Efficiency

TPG described an advanced and formalized process for reviewing companies and prioritizing initiatives. The fund leverages a set of tools to assess facility energy use, the architecture of information technology systems, and waste management practices, among other areas of resource use and environmental impact. The fund's operating team analyzes the data and then partners with the company to realize cost savings. Companies above a certain revenue threshold are advised to develop a specific environmental policy and targets.

Our Perspective

Partnering with portfolio companies to identify, capture and scale operational improvement presents firms with a clear, efficient pathway to create ESG-driven value. However, the approach and implementation strategy at GPs can vary widely given the diverse nature of funds' operating structures. We expect to see an increasing number of firms adding capacity and employing robust metrics to support the effort to work across portfolio companies strategically. Given the relatively short payback period for many operational improvements, we also expect that working with portfolio companies can help to increase their confidence in ESG initiatives and promote investment in other aspects of ESG management.

5. Metrics: Measuring Value Enhancement

Choosing appropriate metrics for ESG performance enables funds to understand the impact of these issues on investments and to structure programs to create additional value.

Metrics: ESG Leadership Practices

LEADING

- » Leverage industry forums and case studies to showcase accomplishments
- » Measure impact of social and governance initiatives on investments

+

DEVELOPING

- » Establish value-oriented ESG goals
- » Benchmark ESG metrics across portfolio

+

EMERGING

- » Adopt standards and processes for measuring ESG metrics
- » Identify relevant ESG metrics

Measuring to Manage

Jack Welch's famous adage that you can't manage what you don't measure is as true with ESG issues as anywhere else. To justify growing investment in ESG management, funds must be able to quantify financial value, as well as social and environmental benefit.

Measuring ESG issues can be challenging and has often been an impediment to accelerating focus on them. In striving to measure ESG issues, our respondents noted that they first examine portfolio companies' integration of management standards such as ISO 14001 (environmental management systems) or ISO 50001 (energy management systems). Some respondents have asked portfolio companies to begin reporting on aspects of their environmental footprints such as energy consumption or carbon emissions. One ESG manager even noted tracking carbon intensity at the fund level due to interest from Scandinavian and Australian LPs.

Measuring social or governance impacts can be more challenging. At present, our U.S. respondents are less focused on these metrics as it is difficult to directly relate social and governance initiatives to investment returns. European GPs are slightly more attuned to monitoring these issues, though they too noted the challenge. Fortunately, tools such as the SA8000 (social accountability) standard and IFC guidance are emerging. Available evidence suggests a positive correlation between such ESG efforts and financial returns.

Return Thresholds

As explored above, cost savings from eco-efficiency initiatives were consistently cited by our GP respondents as a driver of their ESG focus. These efforts consist of process improvements

"Eco-efficiency initiatives are generally easier to measure than many other ESG-oriented activities. To date for example, we have saved around £18 million on establishing efficiency measures such as more efficient fuel monitoring, reducing waste and conserving energy.

Gaining additional revenue takes a bit longer owing to the additional R&D and validation effort, but last year we saw revenues of £2 million at one company and of £1.5 million at another, and all arising from developing products with greener credentials at each company."

Adam Black
Doughty Hanson

such as facility energy management, manufacturing, and logistics. Setting quantitative objectives for improvements in these areas becomes possible once funds and companies gather data on their resource usage.

Our respondents consistently noted that eco-efficiency initiatives are expected to generate attractive returns on investment comparable with other process improvements that might be considered by GP's for portfolio companies. One program manager noted that expecting environmental initiatives to generate competitive rather than concessionary returns is highly important as it moves ESG management from an altruistic effort to sound business strategy. Return expectations on investing in efficiency varied somewhat between respondents. However, achieving a three year payback was a common answer.

In addition to achieving an attractive rate of return, scale was mentioned as a consideration. To dedicate time and attention to eco-efficiency initiatives, respondents noted that it makes the most sense to focus on companies where the most savings can be achieved. These include, among other areas, companies with manufacturing operations, significant retail activity, or a company with a major data and IT backbone.

Industry Example: Getting Metrics Right

Early in developing its metrics and reporting requirements for companies, Actis found a strong relationship between governance, health, and safety performance and returns. The fund began tracking worker safety and realized material cost savings by setting safety improvement goals. For integrity metrics, it looked to outside resources, specifically Transparency International's Corruption Perceptions Index, to ensure performance improvements in emerging markets investments. After realizing that absolute emissions were a poor metric for their energy investments, the fund created carbon intensity targets for the portfolio as well as a specific energy industry impact investment tool. The metric even helped Actis improve the performance of investments in coal plants by targeting emissions reduction and providing better benchmarks for performance of power plants.

Our Perspective

Converging on standardized metrics will help to quantify the extent to which ESG management drives value creation. As GPs and LPs agree on how environmental impact, social accountability, and corporate governance should be measured across industries, these elements can be quantified and tracked against investment returns. As this occurs, we expect clearer evidence to emerge on the correlation between strong management of ESG issues and superior business performance; consistent with strong evidence already available from public companies. In the near term, we believe that GPs will begin by monitoring environmental metrics as they are more easily quantified and related to value creation; for instance, understanding energy and waste expenditures enables action to cut these costs.

6. Communication: Fund and Company Reporting

Communicating on ESG efforts and accomplishments is increasingly expected by the LP community. Doing so can support fundraising and investor relations while contributing to the development of better ESG management tools.

Communication: ESG Leadership Practices

LEADING

» Participate in collaborative research and tool development

+

DEVELOPING

» Integrate ESG program and accomplishments into fundraising materials

» Develop corporate citizenship reports

+

EMERGING

» Develop ESG case studies

» Participate in industry forums

Stakeholders in Sustainability

Beyond the direct value of the cost savings realized through ESG management practices, respondents noted the importance of communicating with peers and other stakeholders on these issues. Communications activities described by respondents include participation in ESG-oriented forums, the development of citizenship reports or case studies, and integration of ESG commitments and accomplishments into investor communications.

ESG forums include the UN PRI, United Nations Environmental Program Finance Initiative (UNEP FI), and Coalition for Environmentally Responsible Economies (CERES). Respondents noted that participation in these forums is a productive opportunity to share best practices with peers or investors. For example, a number of LPs such as CalPERS and the Florida State Board of Administration (FSBA) are active members of CERES and the coalition is working to form a private equity working group.

UN PRI surveys its signatories each year on their evolving approaches to ESG management. Respondents to this survey, which include both GPs and LPs, can choose to have their answers made publicly available or simply aggregated in the PRI's annual report on progress. Even GPs which are not signatories of the PRI can be affected by this annual disclosure requirement, as LP signatories will seek to gather information from the funds in which they invest.

Case Studies & Citizenship Reports Showcase Results

Citizenship reports and case studies which highlight ESG actions are another means to showcase accomplishments to investors, the public, the NGO community, the media, regulators and other stakeholders. Case studies leveraging metrics described in the section above are useful in highlighting the value created through a specific ESG engagement effort, while citizenship reports examine commitments and activities across a fund's portfolio as well as integration of ESG considerations into the investment process. Funds which have published citizenship materials include KKR, the Carlyle Group, and Actis (see industry example below).

Documents showcasing value created through ESG efforts are also useful as investor relations tools, particularly during the fundraising process. In addition to satisfying the interests of LPs, citizenship materials provide additional transparency for publicly traded funds, which have a broad stakeholder set.

Research Partnerships

Beyond publishing materials on their own activities, some GPs collaborate with stakeholders to publish knowledge resources, such as a 2011 report by Doughty Hanson and the World Wildlife Fund.[17] Others contribute their perspectives to third party efforts such as this report to advance improved ESG management in private equity. This kind of collaboration is an excellent opportunity to learn about new perspectives or value-add opportunities while promoting best practices across the sector.

Industry Example: Spreading the Word

Below is a non-comprehensive sample set of funds which have published citizenship reports or other ESG oriented materials:

General Partners

Actis

Doughty Hanson & Co

Apax Partners

Goldman Sachs

The Carlyle Group

KKR

Oak Hill Capital Partners

TPG

Limited Partners

apg All Pensions Group

CalPERS

TIAA CREF

Our Perspective

GPs will receive an increasing number of inquiries about ESG commitments in the coming years from LPs and other stakeholders. To address these inquiries, investor relations teams will prepare reports highlighting their organizations' efforts and accomplishments. These communications tools will follow structured guidelines provided by the UN PRI or an industry sector supplement from the Global Reporting Initiative (GRI). Such communications tools will not be exclusively developed by large funds; smaller funds will also receive ESG related inquiries from their investors and will need to communicate about the issue set in a systematic way.

Conclusion

Now more than ever, private equity general partners must focus on actively creating value across their portfolios through fine-tuning management, refining strategy, and making operational improvements. A 2012 study by McGladrey found that 70 percent of firms now implement a 100 day plan, a strategic approach to prioritizing changes to be executed immediately upon acquisition of a company.[18] At the same time, increasing investor concern and interest in margin enhancement through waste minimization are among many factors making management of ESG issues a business imperative.

Based on our experience and the insights shared by this study's respondents, our team foresees the following trends in the coming years:

- Increasing numbers of funds will develop ESG codes related to their organizations' investment theses. These documents will be shared with LPs and some segments may be made publicly available;
- More funds will develop ESG teams, often housed in their operations departments, while training investment professionals on ESG issues. Consultants will continue to play an important role in executing on ESG commitments;
- Broader ESG considerations, such as supply chain risks or eco-efficiency opportunities, will be integrated into GPs' due diligence processes;
- GPs will systematically partner with portfolio companies to implement resource efficiency initiatives;
- Funds will increasingly monitor resource use amongst portfolio companies. In the longer term, a broader set of environmental and social metrics will be incorporated into portfolio management; and
- Reporting on environmental, social, and governance management will be expected by more LPs in the near-term and will ultimately become standard practice.

These predictions are supported by our finding that 92 percent of the private equity funds which participated in this study intend to increase their focus on managing ESG issues across their portfolios.

Next Steps

As your organization begins to consider how to capitalize on ESG management, we recommend the following initial steps:

LEADERSHIP	Establish a responsible investment policy. The UN PRI can provide useful guidance and resources for your fund and nearly 1,100 organizations have signed on to-date. Adopting a responsible policy creates a solid foundation for building environmental, social and governance programs.
PEOPLE	Invest in the capacity needed to manage ESG risks and opportunities. Bringing on additional staff, hiring experts and consultants, and engaging with stakeholders are available options for increasing capacity and learning at your firm.
DILIGENCE	Integrate ESG management into the due diligence process and management plans and metrics for portfolio companies.
OPERATIONS	Identify and capture cost saving opportunities. The cost savings realized from eco-efficiency initiatives are a major driver of ESG programs at leading funds. Investigate the potential to improve efficiency, eliminate waste and reduce operating costs at your companies and share successes across the portfolio.
METRICS	Link ESG and financial metrics. Performance data and credible metrics enable true economic value capture and communication with internal and external stakeholders.
COMMUNICATION	Engage your stakeholders and LPs by communicating publicly about your firm's ESG efforts, results, and goals for the future. Ask your investors how they view ESG issues and what they expect from their GPs with regard to ESG management.

While there are challenges to adopting better management practices, such as linking ESG data to financial returns or navigating differences in the expectations of LPs, many funds are leveraging tools and experts to navigate these challenges and to unlock value through sustainability. We are excited to have uncovered strong evidence pointing to the acceleration of this trend and look forward to reporting on it in the coming years.

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GRAPHIC DESIGN *by Bop Design*

Appendix A: Study Participants

General Partners

ANONYMOUS GENERAL PARTNER	Europe
ANONYMOUS GENERAL PARTNER	United States
ANONYMOUS GENERAL PARTNER	United States
ACTIS	United Kingdom
ARLINGTON CAPITAL PARTNERS	United States
BLACKSTONE GROUP	United States
CLAYTON DUBILIER & RICE, LLC.	United States
CLEARLAKE CAPITAL GROUP	United States
DOUGHTY HANSON & CO.	United Kingdom
KKR *(Kohlberg Kravis Roberts & Co. L.P.)*	United States
OAK HILL CAPITAL PARTNERS	United States
PACIFIC EQUITY PARTNERS	Australia
TPG Capital	United States

Limited Partners

ANONYMOUS LIMITED PARTNER	Europe
APG	Netherlands
PGGM	Netherlands
UNIVERSITIES SUPERANNUATION SCHEME	United Kingdom
CalPERS *(California Public Employees Retirement System)*	United States
SCERS *(Sacramento County Employees Retirement System)*	United States

Footnotes

1 *Each interview was conducted on a non-attributable basis, unless specifically agreed otherwise.*

2 *One respondent participated as both a GP and an LP in the survey as it functions as either type of investor depending on circumstances.*

3 *Responsible investment: creating value from environmental, social and governance issues, PwC, March 2012.*

4 *UN PRI Report on Progress 2011*

5 *Signatory figures as of May 17, 2012*

6 *'Responsible Investment's second decade: Summary report of the state of ESG integration, policy and reporting', Mercer, August 2011*

7 *'Climate Change Scenarios - Implications for Strategic Asset Allocation', Mercer, February 2011*

8 *The Private Equity/ Sustainability Link: David M. Rubenstein of Carlyle Group on why the two can go together'. The Wall Street Journal. March 26, 2012.*

9 *Signatory figures as of August 17, 2012*

10 *UN PRI 2011 Report on Progress*

11 *www.tpg.com/sustainability*

12 *Toolkit on ESG for Fund Managers, CDC, 2010*

13 *http://www.act.is/content/EnvironmentalSocialAndGovernance*

14 *More details at www.tpg.com/value-creation*

15 *More details at green.kkr.com/results/usfoods*

16 *Doughty, Hanson, and Co. 'Private Equity and Responsible Investment: An Opportunity for Value Creation'. November, 2011*

17 *As a component of the fund's annual report*

18 *Private Equity Survey: Creating value; spurring growth'. McGladrey. 2012.*