

Decarbonization Strategies in Private Markets

Climate Primer Series Pt. 1 — September 2024

The Pivotal Role of Private Market Investors

Private equity, with its long-term investment horizon and significant influence over portfolio companies, is uniquely positioned to lead the global decarbonization effort. As regulatory frameworks tighten and market pressures intensify, private market investors are [increasingly expected](#) to play a proactive role in mitigating carbon-related risks while advancing the objectives of the [Paris Agreement](#) and driving the transition toward a low-carbon economy.

However, achieving these objectives requires navigating [a range of complexities](#). The implementation of decarbonization strategies often entails substantial upfront investments in technology, infrastructure, and operational processes. While these investments are essential for aligning with climate science and securing long-term sustainability, they can exert pressure on financial resources and impact short-term profitability. Additionally, the transition may challenge established business models, requiring careful management of operational risks and revenue impacts.

Moreover, decarbonization strategies may be subject to [significant public scrutiny](#), stressing the importance of auditable carbon data management and transparent disclosure of value creation initiatives. Private market investors must approach these challenges strategically, balancing the pursuit of sustainability with the need to protect and enhance portfolio value.

Actionable Strategies for Decarbonizing Portfolios

Investors face the choice between divesting from high-emitting assets or transforming them. While divestment can provide quick wins by reducing carbon exposure, it merely transfers ownership of the problem. Transformation, though challenging and costly, involves reimagining and retrofitting assets to align with a low-carbon future. While selective divesting remains a potential step for many investors, true decarbonization requires [investing in the transformation](#) of key assets, even if this means tolerating temporary spikes in portfolio emissions.

- **Enhancing Asset-Level Data Transparency**

A cornerstone of effective portfolio decarbonization is accurate and auditable data. Notably, measuring the emissions profile of an asset lays the foundations for any decarbonization initiatives that may take shape in the future (see Part 2 of Malk's Climate Primer Series for an overview of emissions tracking). By calculating emissions profiles, investors are able to establish clear, measurable goals for emissions reductions and communicate these plans proactively to mitigate reputational risks. Regular updates and transparent reporting help build trust with stakeholders and demonstrate commitment to long-term sustainability. Further, adopting science-based targets, such as those outlined by the [Science-Based Targets initiative](#) (SBTi), ensures that decarbonization roadmaps are aligned with climate science (see Part 3 of Malk's Climate Primer Series for a deeper look into SBTi). These targets provide a clear framework for reducing emissions in line with the Paris Agreement and can be a powerful tool for driving accountability and measuring impact.

- **Educating Investment Professionals**

Successful decarbonization strategies require deal teams equipped with the expertise to identify and execute transformation opportunities. Investing in capacity-building initiatives, such as climate trainings and decarbonization "playbooks" empowers teams to integrate decarbonization efforts into the investment process effectively.

- **Tailoring Value Creation Initiatives for Portfolio Companies**

Decarbonization efforts must be customized to fit the specific market conditions and operational needs of each portfolio company. Tailored value creation initiatives can involve optimizing manufacturing processes, upgrading equipment, or redesigning logistics networks to reduce carbon footprints. These initiatives should align with the unique business strategies of portfolio companies, ensuring that sustainability efforts enhance operational efficiency and contribute to long-term value creation.

- **Documenting Decarbonization Strategies**

Transforming high-emitting assets is often a long-term endeavor that may extend beyond traditional investment horizons. Certain investment strategies (e.g., infrastructure) are designed to accommodate longer hold periods, making them better suited for long-term decarbonization plans. However, many traditional PE investors with 3-5 year hold periods are unlikely to see the full outcome of an asset's decarbonization plan. This makes transparent data-driven disclosures of decarbonization efforts even more important. Documenting climate policies and initiatives in annual reports and sell-side materials (at time of exit) enables future sponsors to pick up where predecessors have left off.

Strategic Considerations

Decarbonizing portfolios is a complex endeavor that requires careful strategic planning and execution. Investors must address challenges such as the collection and management of emissions data, which often demands significant resources and technological integration. Setting science-based targets aligned with the Paris Agreement is critical but requires deep expertise to ensure these goals are both ambitious and achievable. Operational disruptions and costs are inevitable as companies reengineer processes and upgrade infrastructure, necessitating phased implementation and strategic investments. Additionally, the evolving regulatory landscape and market dynamics require investors to remain agile, regularly adjusting strategies to mitigate risks. Balancing short-term financial pressures with long-term sustainability objectives is essential for ensuring resilience and value creation in the transition to a low-carbon economy. **Malk Partners can support investors through every stage of this transition across the investment lifecycle, from portfolio-wide emissions data management and target-setting to asset-level decarbonization initiatives and best-in-class disclosures.** For more information, please visit www.malk.com or reach out to Brian Fox, our Head of Climate & Carbon Solutions, at bfox@malk.com.

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About Malk

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