ESG Insights Report

2024

Foreword

17Capital is a private credit manager, specialising in NAV finance for the private equity industry. It provides non-dilutive capital to high-quality private equity management companies, funds, and institutional investors as part of their toolkit for value creation and portfolio management.

As a global leader in our field, we are continually evolving our ESG approach to ensure that it remains a top priority for 17Capital, our investors, and our clients. As such, we are delighted to share our inaugural ESG Insights Report. This report is based on a detailed survey of our network of private equity GPs, with 30 respondents spanning Europe, North America and the Middle East, representing a range of AUM and firm size.

Insights from the research paint a vivid picture of the ESG landscape in private equity. Prominent themes identified include:

- **ESG has matured into a dedicated function.** GPs are making a firm commitment to ESG through dedicated resources and maturing functions. However, key challenges surfaced in the survey, such as harnessing non-financial data and unleashing the potential of AI, coupled with the demands of meeting expanding and evolving regulation.
- **ESG is an important driver of value creation.** ESG is increasingly being incorporated into the ownership and exit phases of the investment cycle. 76% of GPs surveyed consistently integrate ESG during ownership and 41% at exit, which signals ESG is not just a tool for risk management but also a driver of value creation. Companies with strong ESG credentials that align with a core business strategy may be perceived as lower risk and command a premium valuation.
- **Biodiversity is rising up the environmental agenda.** With 75% of GPs having a climate strategy in place, many are making progress on climate action, both at the management company and by engaging with portfolio companies to affect change in the real economy. GPs are now also turning to address the emergence of nature-related risk, with 69% of GPs surveyed integrating biodiversity into their investment processes.
- **DE&I is strategically important, but approaches vary.** Diversity Equity & Inclusion is an area of strategic importance for GPs and their portfolio companies. GPs generally acknowledge DE&I is important to help meet investor expectations, enhance decision making and attract and retain top talent. The survey revealed mixed approaches to target setting, compensation-related incentives, and training, suggesting the approach to DE&I is not standardized across GPs.
- **ESG opportunities persist and practices will evolve.** There has been some debate in recent months about the future of ESG as a term, and a movement. Yet amidst this backdrop there is evidence that ESG momentum will continue and practices will evolve. Opportunities on the horizon include innovation in ESG-linked financing, the potential of AI to transform ESG activity and adding financial incentives to tie the delivery of profit with purpose.

We continue to believe companies that manage ESG topics while driving financial returns will be better positioned for future longevity and success. Although today's environment presents regulatory, data and political challenges, we are encouraged to see GPs are sticking the course on ESG.

We are extremely grateful to our clients for their contributions.

Claire Hedley
Head of ESG, 17Capital

Chapter 1

ESG: a maturing and growing focus area

Chapter 1

ESG: A maturing and growing focus area

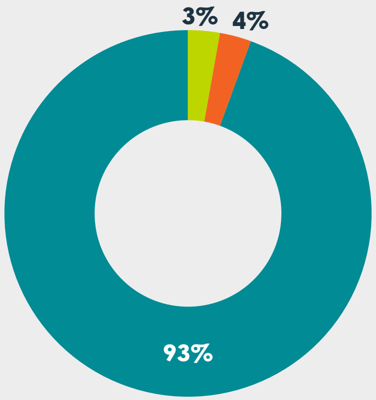
ESG, once considered an emerging theme within private equity, is now an established practice area. It is widespread across GPs to have dedicated ESG teams in place and in many instances there is a senior 'Head of ESG' leading the efforts. There is a trend towards adding more specialist ESG resources such as legal and operational specialists, which signals the increased regulatory focus and drive for operational value creation in ESG.

ESG factors are becoming increasingly important in due diligence processes, portfolio management, and exit strategies. Those with robust ESG strategies are often better positioned to mitigate risks and capture new growth opportunities in an increasingly sustainability-conscious market. For GPs, ESG integration is no longer just about risk management but also an opportunity to identify value drivers that align with investment goals and fiduciary duty.

There is investor pressure too. LPs are increasingly demanding that GPs demonstrate commitment to sustainability and social responsibility through transparent reporting and communication. It is commonplace for GPs to produce a firm level ESG report and some are now also producing fund level ESG reports with further detail for investors.

Spearheading ESG

Figure 1: Dedicated ESG personnel within GPs

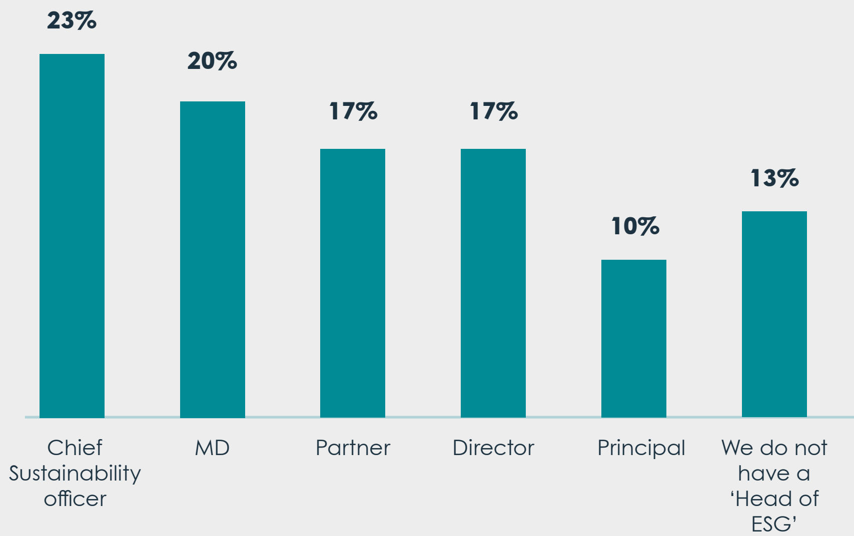


93% of GPs have one or more full time employee dedicated to ESG

- One or more full time employee
- No dedicated resources
- Other

Q. Which of the following best describes your ESG team / resources?

Figure 2: Presence of a "Head of ESG"



Q. Do you have a 'Head of ESG' within your organisation, if so at what seniority?

In a context where regulatory requirements are gaining in complexity and where sustainable investments are growing in LPs asset allocation, it is a necessity for GPs to increase their ESG resources. By resources, in our case we mostly intend budget for tools, training and consulting services, as the team is now already complete (4 dedicated FTEs). This will bring greater means to reinforce our actions with Portfolio Companies and achieve defined ESG objectives.

Joanna Tirbakh, ESG Director, Naxicap

Senior figureheads are commonly spearheading ESG activity. 23% have a Chief Sustainability Officer (CSO) and collectively 77% of responding GPs have either a CSO, Managing Director, Director or Partner as their recognised "Head of ESG". Just a small fraction (13%) do not have a recognised "Head of ESG".

Growing investment into ESG resources

Figure 3: Future expectations of ESG resourcing

Q. When thinking about your internal ESG resources, which of the following functions do you currently have in place?

There are established and growing ESG structures and resources. 83% of firms have an ESG committee and GPs are deploying dedicated operating partners (48%) and legal resources (36%) to ESG.

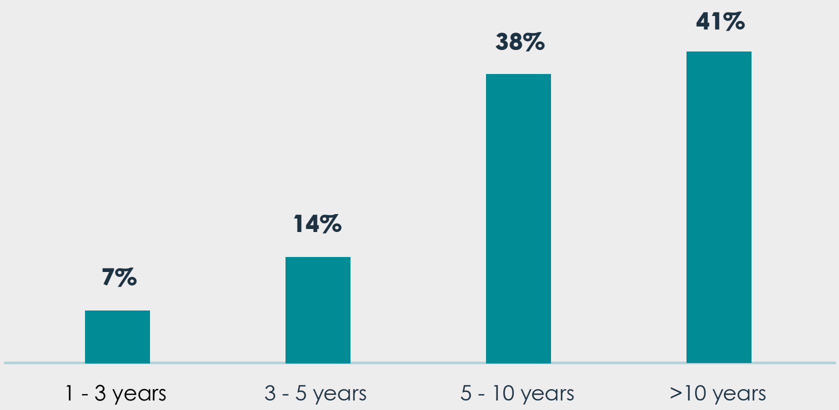
Furthermore, almost one in five GPs (18%) indicate that developing dedicated ESG legal resource is a consideration for the future. This growth reflects the evolving and expanding regulatory landscape, in addition to ESG value creation being an increasingly important lever for private equity.

> ***The reporting landscape has increased dramatically in recent years, in part due to European regulation but also due to the increased focus by LPs. Whilst we welcome the focus on ESG, we will need to consider how to match this demand. We have recently set a science-based target and so we need to ensure that reporting obligations do not undermine our portfolio engagement efforts or hinder our Net Zero aspirations. The only way to manage these competing demands will be to increase resource in the team to ensure that ESG continues to be embedded across the Firm's investment activities.***
>
> *ESG Director, Leading mid-market private equity manager*

[1] Q. Over the course of the next 1-2 years do you expect ESG resources in your organisation to… (45% of GPs expect their resources to remain the same over the next 1-2 years. 0% of GPs indicated they expected investment into ESG resources to decrease).

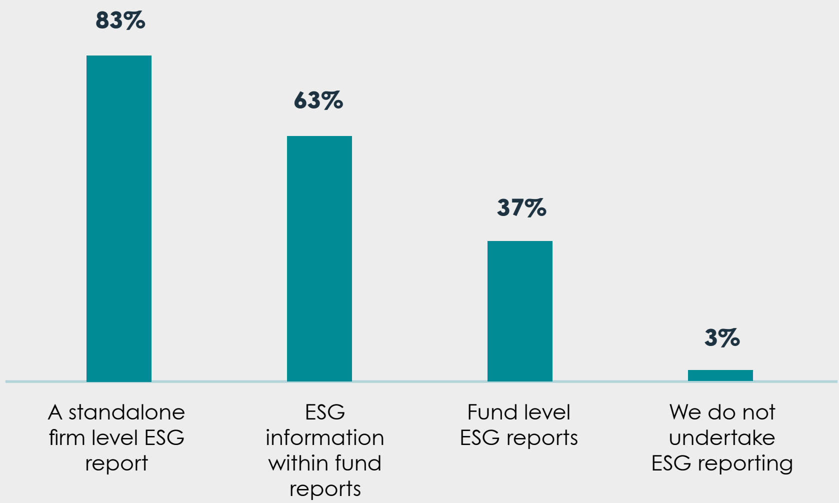
ESG policies and reporting

Figure 4: GPs with an ESG policy



Q. *How long, if at all, have you had an ESG policy in place?*

Figure 5: ESG reporting



Q. *Which of the following forms of ESG reporting does your firm provide?*

Note: *Multi-select question, therefore results sum greater than 100%.*

All GPs surveyed reported that they have an ESG policy in place. 79% say they have had an ESG policy in place for 5 years or more, demonstrating ESG is a maturing focus area.

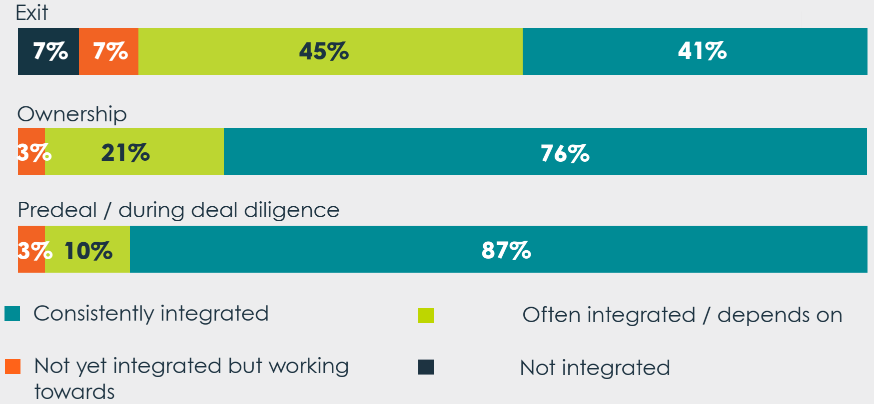
83% of GPs produce a standalone ESG report, while 63% include ESG information in fund reports. Over a third (37%) produce fund level ESG reports. Despite this, less than a quarter (24%) of GPs use the terms "ESG", "Sustainable", "Green transition", "Impact" or similar in any of their fund names.[2]

With tighter regulations on sustainable investment activity, using sustainability-based terms will likely remain the same, if not decrease. This is specifically so in the UK with naming and marketing rules of the Sustainable Disclosure Requirements (SDR). These restrict certain use of sustainability-related terms such as 'ESG', 'green' or 'sustainable' in the naming and marketing of funds, which can only be applied if certain criteria are met.

[2] Q. Do any of your fund's use "ESG", "Sustainable", "Green transition", "Impact" or similar terms in the fund name?

ESG integration

Figure 6: Integration of ESG through the investment cycle

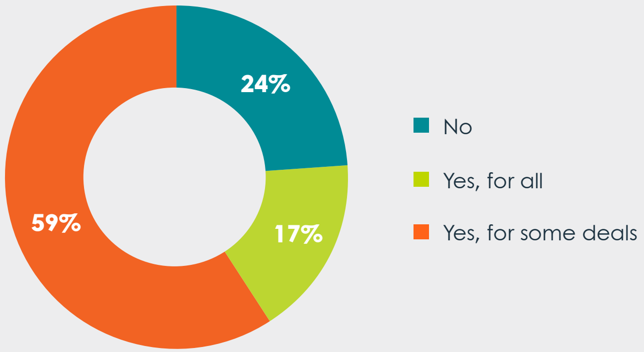


Q. *Throughout each stage of the investment cycle, how do you systematically integrate ESG?*

87% of GPs consistently integrate ESG into pre-deal due diligence. It is now an essential part of risk management for GPs. The risk of not doing so is the acquisition of an asset that faces legal or reputational challenges, which in turn will impact investment returns.

While ESG during pre-deal diligence is most widespread amongst GPs, many now go beyond the initial risk management of an asset and integrate ESG into active ownership (76%) and exit strategies (41%). ESG considerations can impact the valuation of a company and widen or improve potential exit opportunities. Fewer GPs are consistently integrating ESG into exit strategies, but we expect this to increase over time as ESG continues to mature.

Figure 7: Vendor due diligence on exit

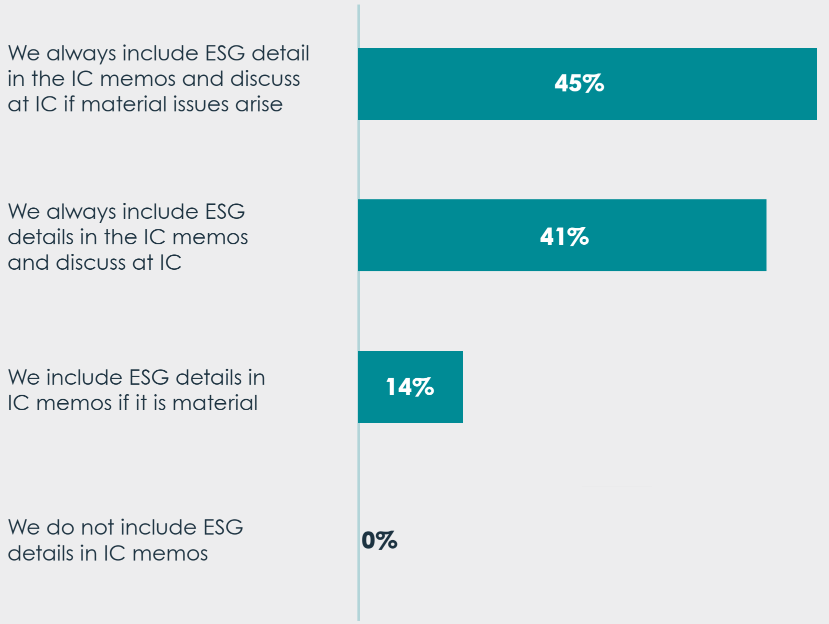


Q. *Does your organisation complete vendor due diligence upon exit?*

Currently 17% of GPs are using vendor due diligence for all deals and 59% are using them for some deals. Vendor due diligence reports can demonstrate to a buyer the ESG credentials of a company for example, impact angle, positioning on net zero, human or worker rights or regulatory preparedness.

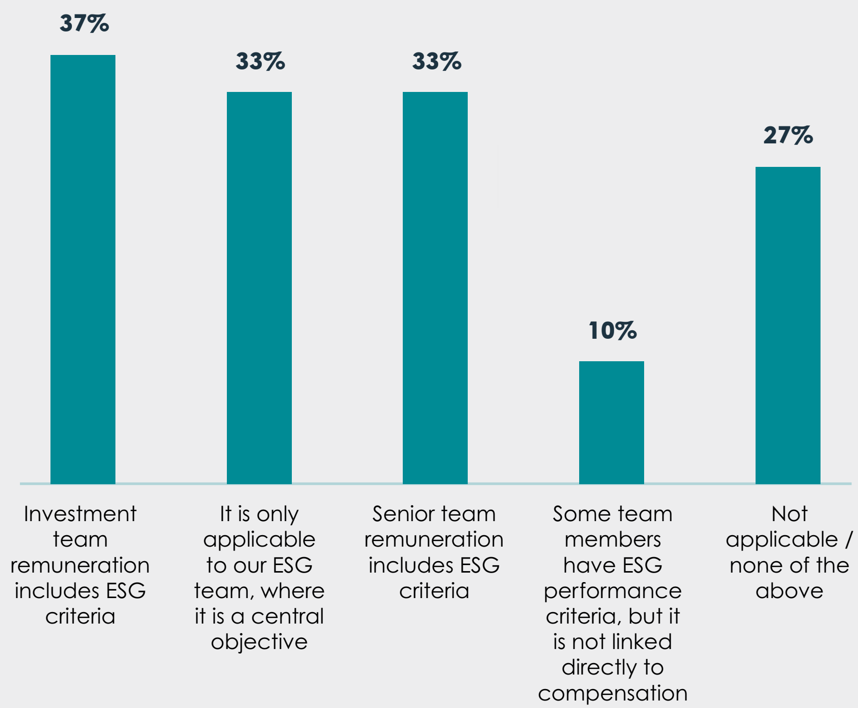
ESG integration

Figure 8: ESG at investment committee



Q. *When thinking about ESG at your Investment Committee, which best describes your organisation?*

Figure 9: The ESG remuneration carrot



Q. *Which of the following statements describes your approach to ESG remuneration within your company?*

Note: *Multi-select question, therefore results sum greater than 100%.*

Including ESG alongside other more traditional investment factors at investment committee signifies the importance of ESG to the firm's investment philosophy. 86% of GPs always include ESG detail in investment committee memos. 45% indicate details are only discussed if material issues arise.

37% of GPs report that their investment teams' remuneration includes ESG criteria and 33% state their senior team remuneration includes ESG criteria. For 33% of GPs ESG remuneration is only applicable to their dedicated ESG team, where it is a central objective.

Chapter 2

Mounting pressures: Harnessing complex data and meeting regulatory requirements

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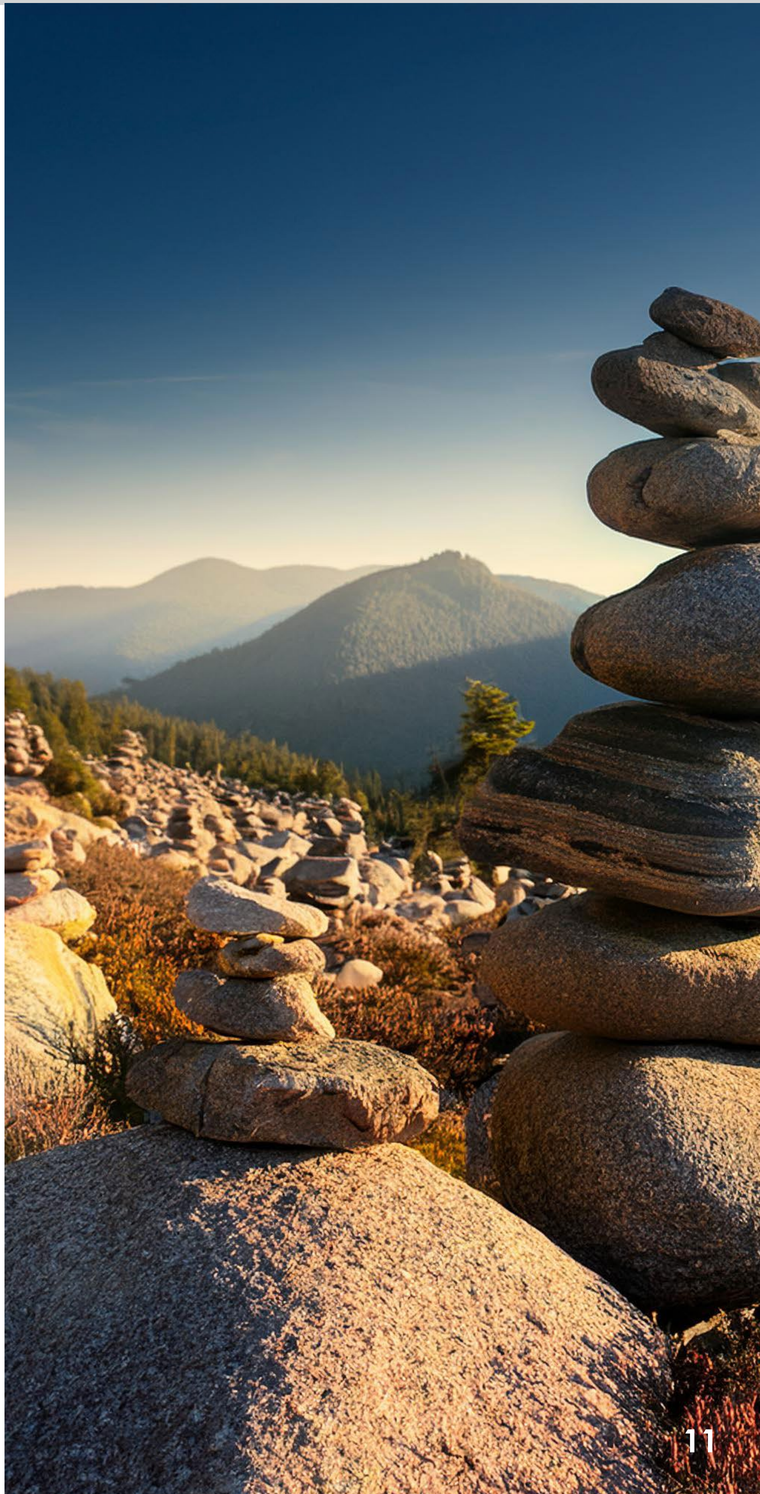
ESG data collection and analysis is critical for firms striving to meet growing investor and regulatory demands. It is well established that reliable ESG data helps GPs identify areas for operational improvement, enhance long-term value and meet regulatory obligations. However, GPs in our survey put a spotlight on the time and resource intensity of their ESG efforts. A core challenge is the lack of standardised metrics, making data collection and comparability difficult.

We find that many GPs are on a journey, investing in technology and partnering with specialised suppliers. Many have not arrived at a final integrated solution, and instead straddle more than one means to collect, store and access ESG data.

Emerging ESG regulations are reshaping the private equity landscape, pushing firms to adopt more transparent and robust sustainability practices. Regulation and data are interlinked. In order to be transparent, GPs will need to collect and evidence data. GPs within our research indicate that they are most unprepared for increased supply chain audits, a regulatory shift which firms feel will have significant impact in the next year.



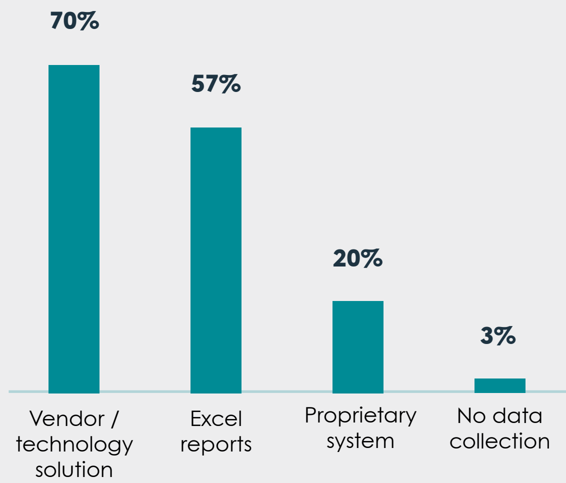
Harnessing ESG data

Figure 10: ESG time and resource pressures

Q. Please indicate how resource intensive your firm finds the following areas of ESG...

39% of GPs find ESG data collection and analysis "extremely" time and resource intensive. A further 39% find it "very" time and resource intensive. In addition, 32% of GPs find LP ESG requests "extremely" time and resource intensive, 61% find LP ESG requests "very" time and resource intensive.

Figure 11: Collecting, storing and accessing ESG data



Q. How do you collect, store and access ESG data?

Note: Multi-select question, therefore results sum greater than 100%.

Over two thirds (70%) of GPs use a vendor or technology solution for ESG data collection, storage and access. 57% still use Excel spreadsheets and 20% have developed proprietary systems. Of those who use a vendor or technology solutions most have adopted these within the last 3 years (55%), part of a wider upward trend seen in innovation, automation, and AI adoption.[3]

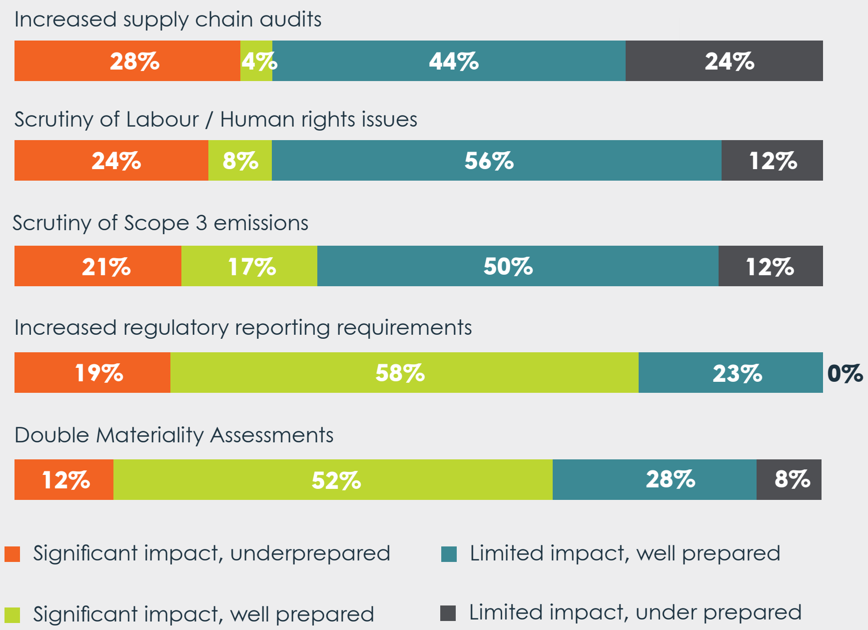
Across our total sample, more than a third (37%) of GPs use more than one approach to collect, store and access their ESG data, demonstrating a widespread 'patchwork' approach.

> ***While ESG reporting tools are improving, they still do not fully provide the insights and capabilities that we require as an investor to provide tailored feedback and input into company ESG strategies. Therefore, we continue to rely on a hybrid approach that blends external tools with our own maturity matrices, customised dashboards and benchmarks.***
>
> *Julia Zlotkowska, ESG Manager, Montagu*

[3] Q. When did you onboard this system? (Asked to those using a vendor / tech solution)

Meeting ESG regulatory requirements

Figure 12: Emerging pressures

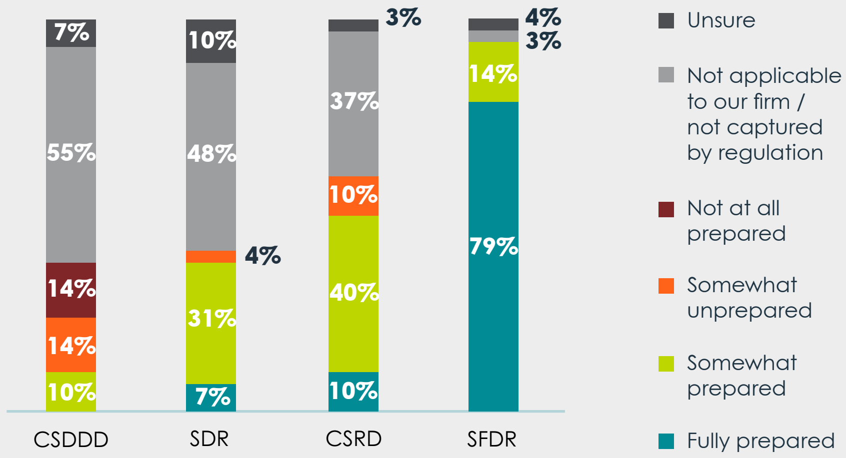


***Q.** When thinking about your overall ESG activity, how significant an impact do you think each of the following will be on your organisation over the next 12 months and how prepared do you feel?*

77% of GPs feel that increased regulatory reporting requirements will have a significant impact over the next 12 months. 58% feel prepared for upcoming reporting requirements, but 19% feel underprepared.

Increased supply chain audits are the area that GPs are most likely to say there will be a significant impact over the next year, for which they are underprepared (28%) followed by scrutiny of labour / human rights issues (24%).

Figure 13: The regulatory landscape



***Q.** Please indicate on the following scale, how prepared your organisation is to comply with the following regulations?*

Across the sample of GPs within our research, the majority identify as being captured by and prepared for the Sustainable Finance Disclosure Regulation (SFDR).

Most firms identify as not being captured by the Corporate Sustainability Due Diligence Directive (CSDDD), but of the proportion captured, GPs are either not at all prepared (14%) or only somewhat prepared (14%).

CSDDD, which entered force July 2024, mandates companies in scope to implement human rights and environmental due diligence across their operations and supply chains. Compared to the Corporate Sustainability Reporting Directive (CSRD) which is primarily a reporting directive, CSDDD has higher thresholds for applicability.

Chapter 3

Action on climate and the environment

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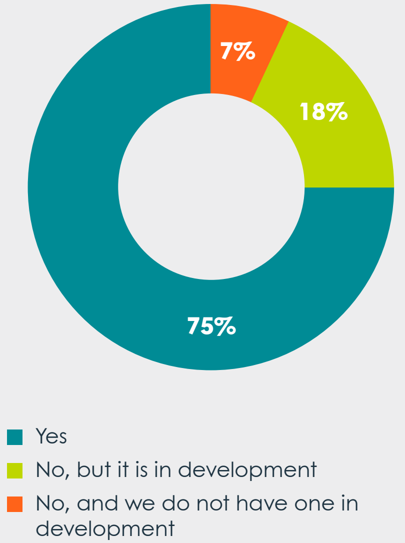
Action on climate and the environment

A climate strategy not only mitigates risks but also unlocks opportunities in sectors such as renewable energy, clean technology, sustainable agriculture and manufacturing. Many GPs are adopting the Task Force on Climate-related Financial Disclosures (TCFD) framework[4] to enhance transparency and provide investors with insights into climate-related risk. We also find widespread public commitment among GPs to the Paris Climate Agreement goals.

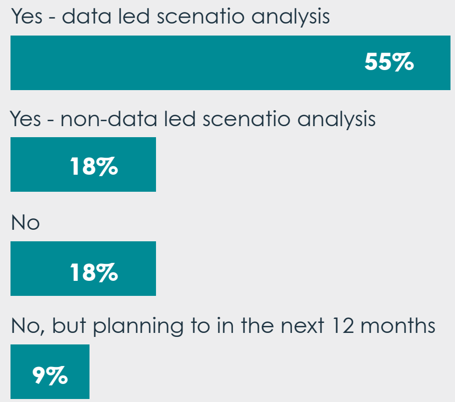
While the work of developing climate strategies and executing on goals appears in full swing, a nascent area within climate and environment is nature-based risk. There is growing pressure for greater accountability, especially in sectors like agriculture, energy, and natural resources, where biodiversity loss can significantly affect long-term sustainability. Global initiatives like the Taskforce on Nature-related Financial Disclosures (TNFD) have taken shape as a result and we find GPs taking steps to consider biodiversity factors investment decisions.

Figure 14: Presence of a formal climate strategy



Q. *Has your organisation developed a formal climate strategy?*

Figure 15: Scenario analysis within climate strategy



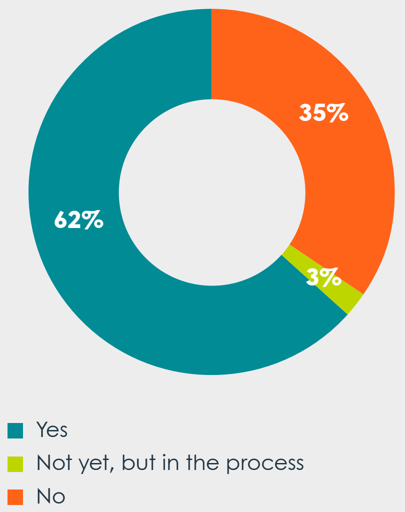
Q. *Does your firm's climate strategy include scenario analysis?*

75% of GPs report having a formal climate strategy, a further 18% have a formal climate strategy in development. Among GPs who have a formal climate strategy, more than half (55%) include data-led scenario analysis.

[4] 52% of our sample when asked "Are you a signatory to the following industry initiatives / standards?"

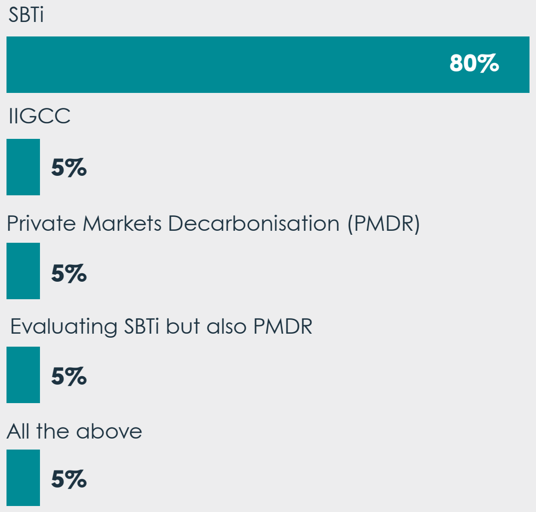
Climate commitments

Figure 16: Commitment to Paris Agreement goals



Q. Has your organisation made a public commitment to align with the Paris Agreement goals on climate change?

Figure 17: Frameworks and standards adopted



Q. Which framework / standard do you use predominantly?

Among respondents to our survey, there is widespread commitment to Paris Climate Agreement goals. 62% of GPs have vowed publicly to align with the goals. In pursuit of meeting Paris goals, most have adopted the Science Based Targets Initiative (SBTi) (80%).

Frameworks and standards

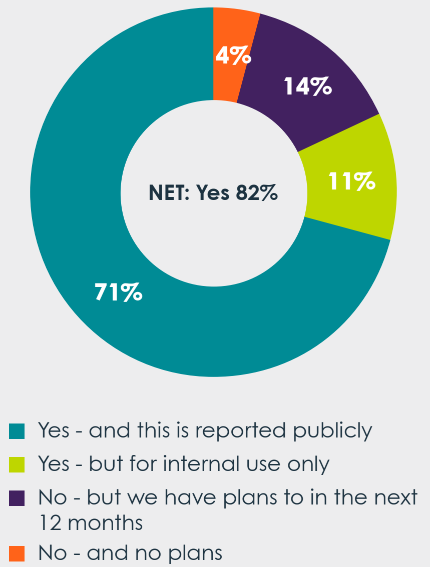
Science Based Targets Initiative (SBTi) develops standards, tools and guidance which allow companies to set greenhouse gas (GHG) emissions reductions targets to reach net-zero by 2050 at latest.

Private Markets Decarbonisation Roadmap (PMDR) provides firms with a common language to communicate their portfolio's decarbonisation status.

Institutional Investors Group on Climate Change (IIGCC) is a group which helps investors set strategies in line with achieving net zero global emissions, build resilient investment portfolios, and understand and manage physical climate risk.

Emissions measurement

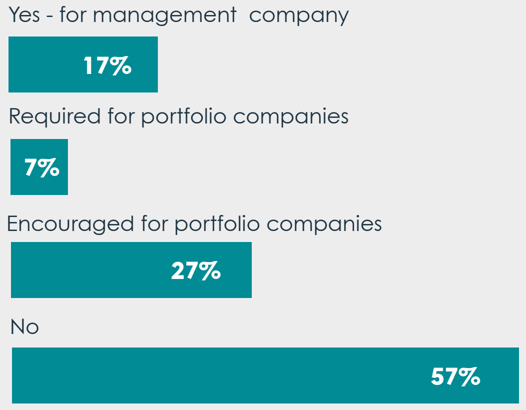
Figure 18: Measuring emissions for the management company



***Q.** Do you measure emissions for the management company?*

82% of GPs measure emissions for the management company, with most reporting the information publicly. However, 11% measure the information, but only for internal use.

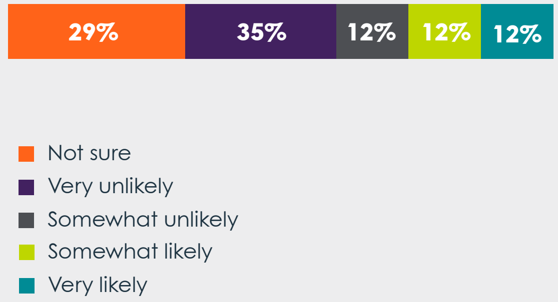
Figure 19: Limited assurance on emissions data



***Q.** Do you currently get limited assurance on emissions data?*

***Note:** Multi-select question, therefore results sum greater than 100%.*

Figure 20: Future expectations of external assurance on ESG data

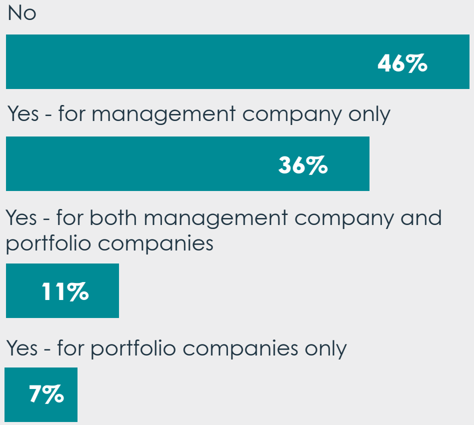


***Q.** How likely are you to start implementing some external assurance on ESG data over the next 12 months?*

Most firms surveyed (57%) do not get limited assurance on emissions data. 24% are likely to start implementing some external assurance over the next 12 months, this is likely to be linked to the requirements of limited assurance in CSRD disclosures.

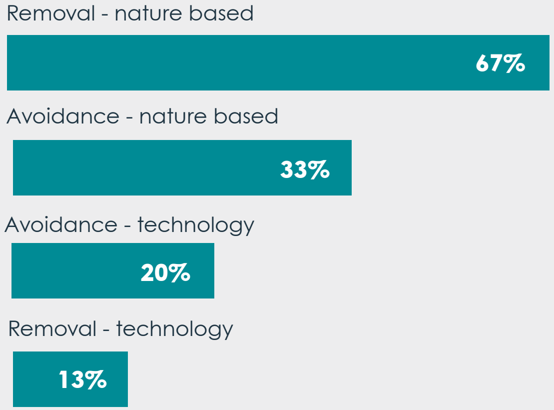
Voluntary carbon markets

Figure 21: The voluntary carbon market



***Q.** Do you purchase carbon credits in the voluntary carbon markets?*

Figure 22: Types of carbon credits purchased



***Q.** Of the following, what type of carbon credits do you buy?*

Note: *Multi-select question, therefore results sum greater than 100%. Results filtered to those who purchase carbon credits in voluntary markets.*

15% of GPs expect demand for carbon credits to significantly increase and 41% expect demand to somewhat increase in the next 5 years[5]

Voluntary carbon markets can be used to purchase carbon credits to "offset" residual emissions. While these markets are nascent and developing, organisations may view carbon offsets as part of their climate solution and a mechanism to drive private capital towards conservation.

36% of GPs are using carbon credits for the management company. Around one in ten (11%) purchase carbon credits for both management and portfolio companies, while 7% purchase carbon credits for portfolio companies only. The most common type of carbon credits bought by GPs are nature based, both removal and avoidance. Use of carbon credits is expected to increase in the future.

Definitions

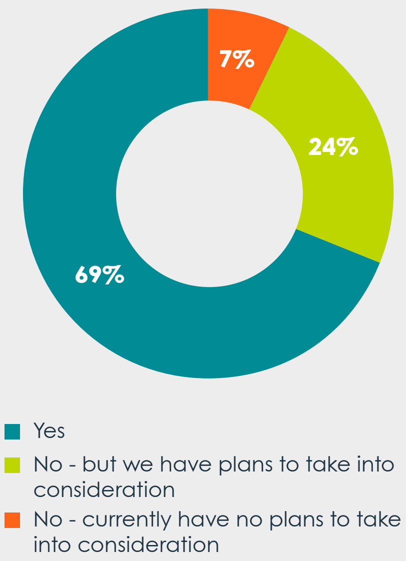
Carbon removal: focuses on removing emissions that are already present in the atmosphere via nature based (e.g.,reforestation, afforestation, soil carbon) or technology solutions (e.g.,direct air capture).

Carbon avoidance: aims to curb emissions from human activities such as destroying forests and burning fossil fuels by targeting these activities and capturing the emissions they create, or preventing the activities altogether. Nature based solutions include improved forestry management (IFM) and REDD+, while technology solutions include projects such as improved cookstoves or energy efficiency.

[5] Q. How do you expect your demand for carbon credits to change over the next 5 years?

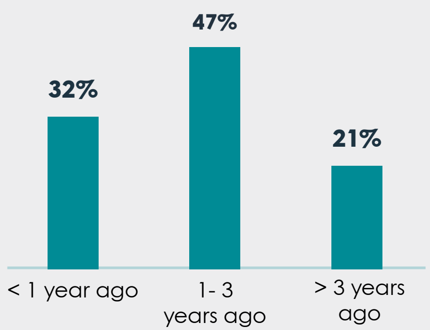
The rise of nature-related risk

Figure 23: Biodiversity factors within the investment process



Q. *Does your investment process take into consideration biodiversity factors?*

Figure 24: Implementation of biodiversity factors in the investment process



Q. *When did you start implementing this?*

Biodiversity is a new and expanding focus area within private equity. 69% of GPs say their investment process takes into consideration biodiversity factors. A further 24% of GPs plan to take it into consideration in the future.

Of those who include biodiversity factors within their investment process, 79% have implemented this in within the last 3 years, demonstrating its recent emergence. Looking to the future, 18% of GPs are considering becoming signatories of the Taskforce on Nature-related Financial Disclosures (TNFD).[6]

> ***Biodiversity is one of the potential environmental considerations of our investments, we measure it by the metric 'Biodiversity Preserved', in hectares. The metric is calculated based on the number of hectares which the company covers and follows specific biodiversity guidelines. We have a portfolio company that positively impacts this metric through their business activity which boosts biodiversity. At current, we are conducting a pilot project to better and more accurately quantify the company's biodiversity impact using advanced technical hardware.***
>
> *Francesco Anichini, ESG Associate, Ambienta*

[6] Q. Are you a signatory to the following industry initiatives / standards?

Chapter 4

Spotlight on Diversity, Equity & Inclusion

Chapter 4

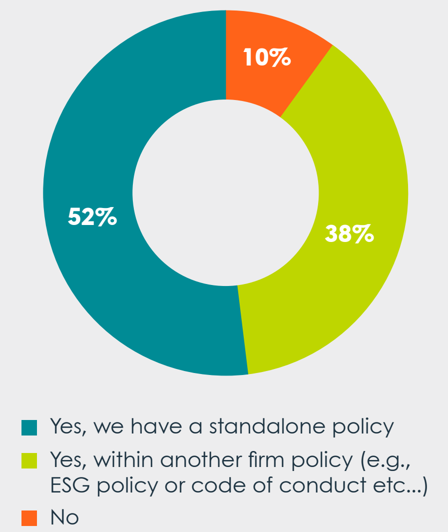
Spotlight on DE&I

Our survey finds prevalent recognition across the market of the strategic importance of Diversity, Equity & Inclusion (DE&I).

LPs are also demanding that GPs demonstrate diverse representation both within their teams and across portfolio companies.[7] GPs are responding by making resource commitments to DE&I and there is a willingness to integrate and track across the management company.

Robust DE&I practices are not only vital for meeting investor expectations and enhancing decision-making but also for attracting top talent and delivering long-term value in an increasingly competitive and socially conscious landscape.

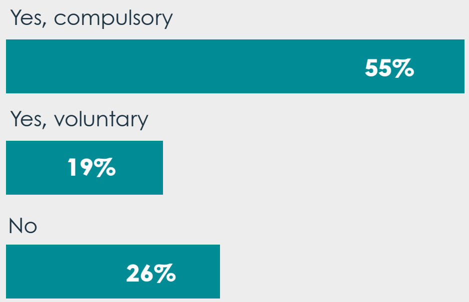
Figure 25: Presence of DE&I policy



Q. Does your firm maintain a Diversity, Equity and Inclusion policy?

90% of GPs have a documented commitment to DE&I. Over half (52%) have a standalone DE&I policy. A further 38% have DE&I captured within another firm policy such as their ESG policy.

Figure 26: DE&I training



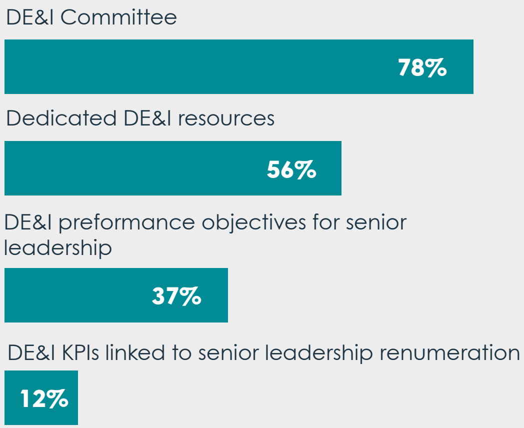
Q. Does your firm provide DE&I training?

74% of GPs provide DE&I training. Over half (55%) have compulsory training, one in five (19%) offer DE&I training on a voluntary basis.

[7] Demonstrated by the Diversity in Action Initiative led by the Institutional Limited Partners Association (ILPA). As of April 2024, more than 300 signatories have joined the ILPA Initiative.

DE&I integration and target setting

Figure 27: DE&I integration and resource commitments

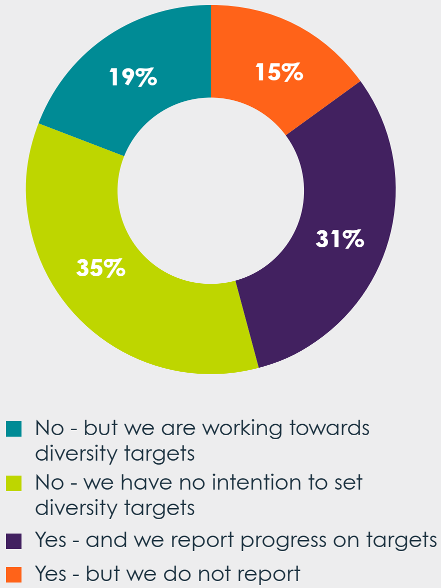


Q. *Does your firm have the following...?*

Note: *Multi-select question, therefore results sum greater than 100%.*

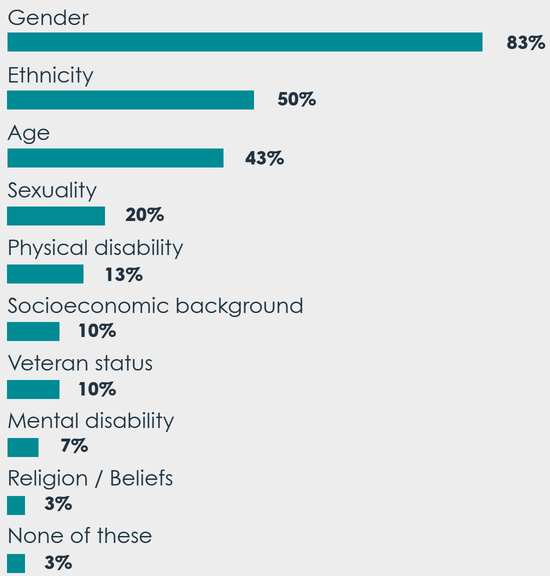
78% of GPs have a DE&I committee and over half have dedicated DE&I resources (56%). Onus is being placed on leadership, 37% of GPs set DE&I performance objectives for senior leadership teams. At current, just a minority of GPs (12%) have senior leadership renumeration linked to DE&I targets.

Figure 28: Setting diversity targets



Q. *Does your firm set diversity targets?*

Figure 29: DE&I metrics tracked



Q. *What DE&I metrics do you track within the management company?*

Note: *Multi-select question, therefore results sum greater than 100%.*

Collectively, 46% of GPs have diversity targets, 31% report on those targets. When tracking DE&I metrics, Gender (83%) is most likely to be measured, followed by Ethnicity (50%) and Age (43%).

Chapter 5

GP support for portfolio companies

Chapter 5

GP support for portfolio companies

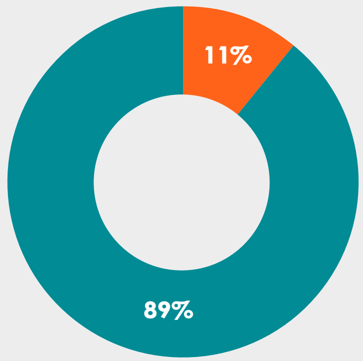
GPs are increasingly recognising that effective management of ESG issues extends beyond the initial asset screening process, as it can protect and enhance the profitability and attractiveness of investments during the hold period.

This is reflected in the actionable support provided to portfolio companies across governance, climate and environmental initiatives, and DE&I efforts. The level of engagement from GPs varies, ranging from general support and guidance to specific and targeted actions.

There is notable emphasis on environmental factors, with GPs actively assisting portfolio companies in setting targets, measuring emissions, and improving disclosure practices. This focus aligns with growing global pressures to establish emissions reduction targets, compelling firms to adopt more sustainable practices.

By helping companies track their environmental impact, GPs not only contribute to a more sustainable future but also position their investments for long-term success.

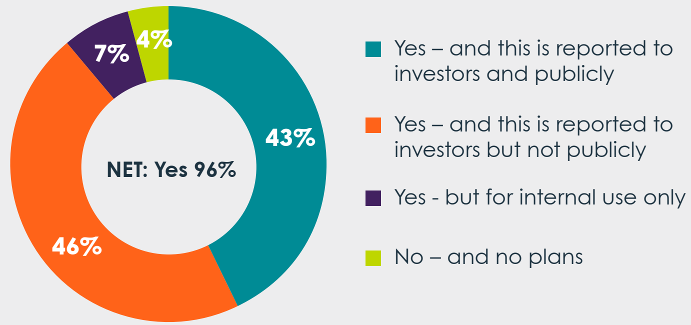
Figure 30: Supporting portfolio companies with Paris aligned targets



Q. Do you support your portfolio companies to set Paris aligned targets?

Nine in ten (89%) GPs support portfolio companies towards setting Paris aligned targets.

Figure 31: Firms that measure emissions for portfolio companies



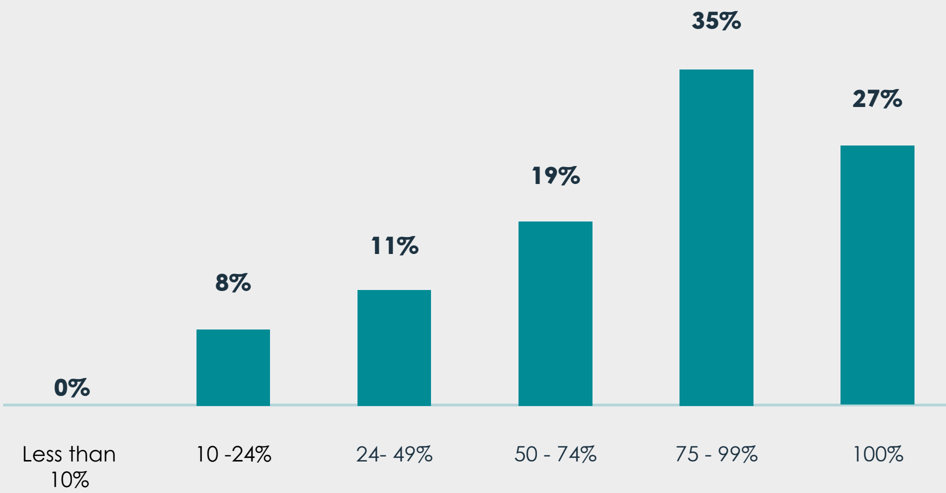
Q. Do you measure emissions for portfolio companies?

Emissions measurement is prevalent for portfolio companies but is less likely to be fully disclosed. 96% of firms measure emissions for portfolio companies, but only 43% report the information publicly.

Capturing emissions internally and not disclosing to the public can be accounted for preparing for regulatory requirements and/or responding to LP requests.

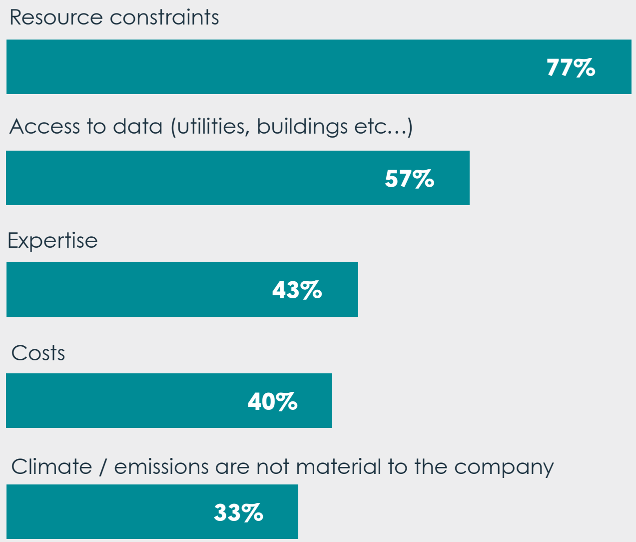
GP support for emissions measurement

Figure 32: Percentage of portfolio companies measuring emissions



***Q.** What percentage of portfolio companies currently measure and report emissions data?*

Figure 33: Constraints to measuring and reporting emissions



***Q.** What are the barriers to companies not measuring and reporting emissions data?*

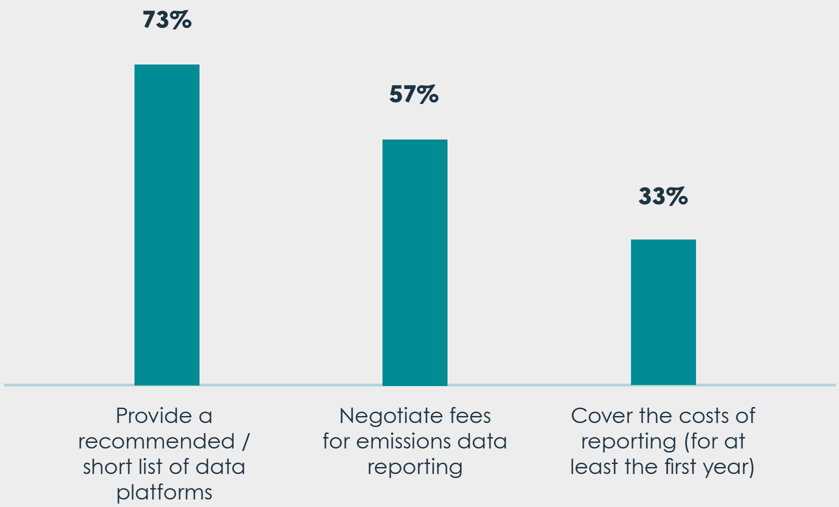
***Note:** Multi-select question, therefore results sum greater than 100%.*

81% of firms surveyed currently measure and report emissions data for over half of their portfolio companies. However, just 27% of firms surveyed measure and reporting emissions for all portfolio companies.

Resource constraints are the biggest barrier, with climate / emissions being immaterial ranked lowest.

Climate support for portfolio companies

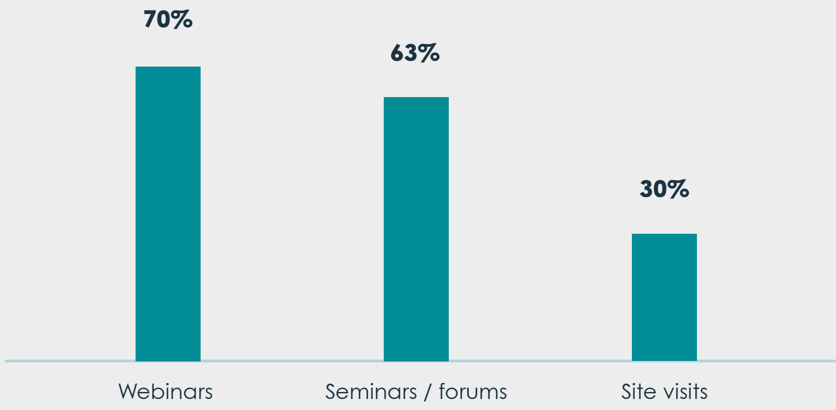
Figure 34: Climate support for portfolio companies



Q. *As a GP, do you provide/support portfolio companies with any of the following with regards to emissions management and reporting? (% saying yes)*

Note: *Multi-select question, therefore results sum greater than 100%.*

Figure 35: Engagement with portfolio companies on climate



Q. *How do you engage with (portfolio) companies on climate topics /*

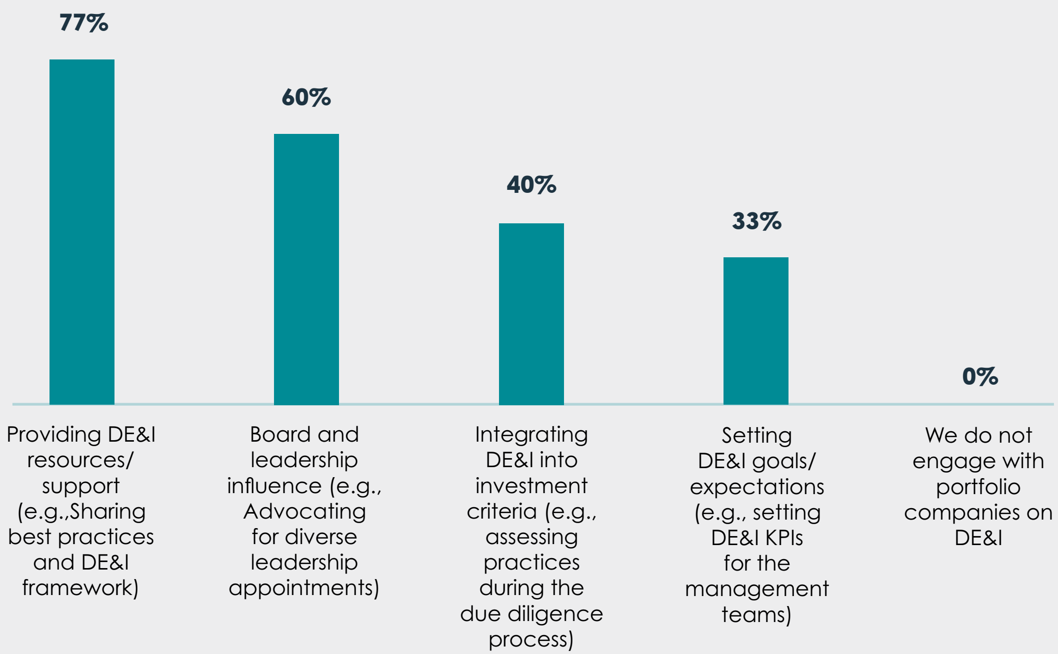
Note: *Multi-select question, therefore results sum greater than 100%.*

Firms offer a range of support to portfolio companies to help emissions management and reporting, often focusing on high-level support, such as providing lists of recommended data platforms. Notably 33% of GPs cover the cost of reporting for portfolio companies (for at least the first year).

GP engagement with portfolio companies is more likely to be through webinars (70%) and seminars (63%) than site visits (30%).

DE&I support provided by GPs

Figure 36: DE&I support for portfolio companies



Q. *In which of the following ways, if at all, does your firm engage with portfolio companies on DE&I?*

Note: *Multi-select question, therefore results sum greater than 100%.*

There are a plethora of ways GPs are supporting portfolio companies on DE&I. Three quarters (77%) of surveyed firms support portfolio companies by providing resources and support (such as best practices). Just a minority (33%) have set DE&I goals for portfolio company management teams.

> ***At Hg, DE&I is embedded throughout our investment process—from the due diligence stage, where key metrics and policies are screened, to the holding period, during which we support our portfolio companies along their DE&I journey. We provide resources such as toolkits and policy templates to foster inclusive cultures and diverse leadership.***
>
> *Phoebe Snow, ESG Analyst, Hg*

Chapter 6

Outlook and emerging industry issues

Chapter 6

Outlook and emerging industry issues

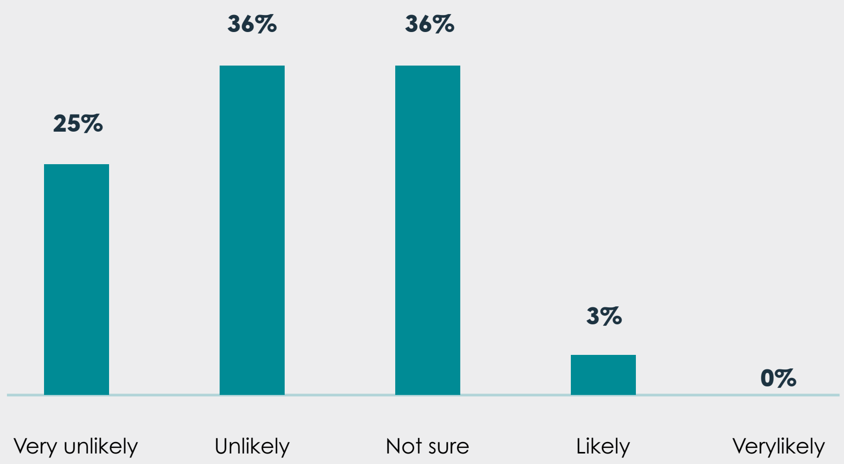
Private equity continues to evolve and adapt its approach to ESG, with a minority of GPs adopting impact-linked carry which ties certain incentives to a fund's performance in terms of meeting impact (or ESG targets). Though not currently commonplace, the practice ties together neatly the notion of delivering profit with purpose (over a shorter time horizon).

Financial innovation will also be required to advance ESG. Here there is likely to be a vibrant future for ESG-linked financing. Many GPs are already using ESG-linked financing for portfolio companies and there is strong consideration for use in fund finance.

There is also opportunity on the horizon. AI and other innovative tech solutions have the potential to transform ESG activities within private equity. Benefits could be reaped across data collection, analysis, and reporting.

GPs who grasp the opportunity will be better placed to identify ESG risks, streamline due diligence, and monitor portfolio companies' sustainability performance. AI can also surface insights from unstructured data, driving better decision-making and value creation. However, we find many GPs are not yet ready to harness AI's power. This is likely down to a range of challenges, such as inconsistent data and challenges in integrating AI systems into existing workflows.

Figure 37: Advent of ESG / Impact-linked carry

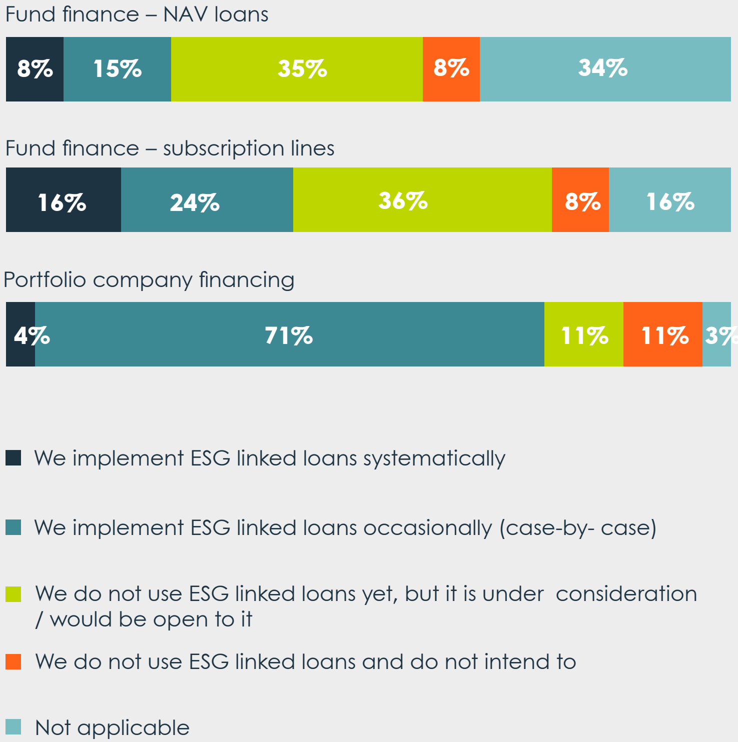


Q. *How likely is your firm to implement ESG or impact-linked carry over the next 3 years?*

61% of GPs say that it unlikely or very unlikely they will implement ESG or impact-linked carry over the next 3 years.

Outlook and emerging industry issues

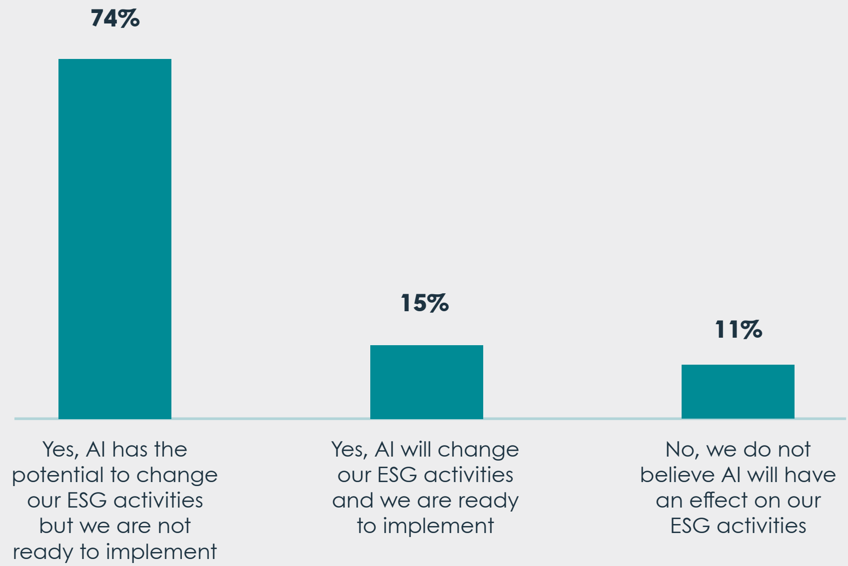
Figure 38: The future of ESG-linked financing



Q. *Across each of the following scenarios, which statement best describes your approach to ESG financing?*

GPs are most likely to use ESG linked loans for portfolio company financing. Over a third (35%) have ESG linked loans in NAV finance under consideration or would be open to it for the future.

Figure 39: Seizing the opportunities of AI for ESG



Q. *When thinking about the potential of AI, do you anticipate it having a transformative role in supporting your ESG activities?*

Most GPs view AI as a great opportunity, but far fewer feel ready to seize that opportunity. 89% of GPs think AI will change or disrupt ESG activities, but 74% are not ready to implement the technology to harness the benefits.

Methodology

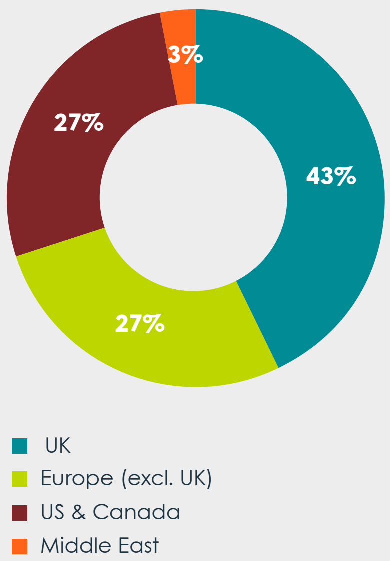
Methodology and respondent profile

Methodology

Methodology and respondent profile

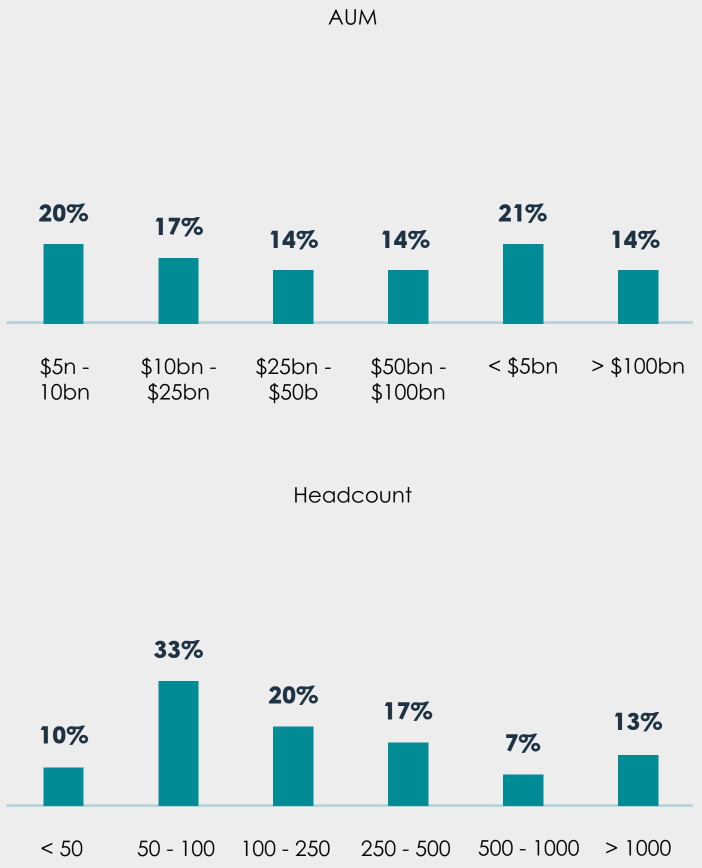
We sent our survey to our network of GPs and received 30 responses. Our sample includes a cross section of firms by geography and size (headcount and AUM). Fieldwork was conducted 18th July – 5th September 2024 via an online survey.

Respondent breakdown: HQ



The sample is skewed towards the UK (43%) but also has strong coverage of GPs in the rest of Europe & the United States.

Respondent breakdown: AUM and headcount



Methodology

Glossary

Acronym	Description
• **CSDDD** - Corporate Sustainability Due Diligence Directive	• Introduces the obligation for companies to conduct appropriate human rights and environmental due diligence with respect to their operations, operations of their subsidiaries, and operations of their business partners in companies' chains of activities.
• **CSRD** - Corporate Sustainability Reporting Directive	• Requires companies to report on the impact of corporate activities on the environment and society and requires the audit (assurance) of reported information.
• **IIGCC** - Institutional Investors Group on Climate Change	• A group which aims to enable investors to set strategies in line with achieving net zero global emissions, build resilient investment portfolios, and understand and manage physical climate risk within their investments.
• **PMDR** - Private Markets Decarbonisation Roadmap	• PMDR provides private markets firms with a common language to communicate their portfolio's decarbonisation status.

Methodology

Glossary

Acronym	Description
• **SBTi** - Science Based Targets Initiative	• Develops standards, tools and guidance which allow companies to set greenhouse gas (GHG) emissions reductions targets in line with what is needed to keep global heating below catastrophic levels and reach net-zero by 2050 at latest.
• **SDR** - Sustainable Disclosure Requirements	• The UK SDR introduces a set of sustainability-related product labels, product- and entity-level disclosures, an anti-greenwashing rule and additional rules regarding sustainable investing for the UK.
• **SFDR** - Sustainable Finance Disclosure Regulation	• Requires asset managers to disclose their ESG risks, policies and results. Its purpose is to make European clients aware of the impact of investments and to make it easier to compare financial products in terms of sustainability.

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We hope you have found this report interesting. If you would like to discuss any of the points raised, or would like to find out more please do not hesitate to contact us.

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