KEYNOTE INTERVIEW

The search for outcome-orientated ESG data

GPs and LPs are stepping up their global ESG efforts to collect decision-useful data, say Anne Matusewicz and Jérémy Rasori at Reporting 21

Q How has ESG evolved for private markets investors in recent years, particularly when compared to the public markets?

Anne Matusewicz: We have seen significant changes in terms of the attention given to ESG, and that has manifested both through staffing, with more dedicated hires at senior levels, as well as through investment and the attention paid to ESG data and value-creation strategies. We have gone from collecting no data to collecting significant amounts of data, and the next step is integrating that data and making it decision-useful to drive returns.

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All public companies now have sustainability reports and there are various data providers scraping the web. However, in private markets in the US there is no obligation to create reports or disclose publicly, making it much more important for investors themselves to be asking for that information in a structured way that promotes comparability.

Jérémy Rasori: Up until five years ago, in Europe there were only a few pioneers in the private markets that had formalised ESG policies and were engaging with stakeholders on sustainability.

The Sustainable Finance Disclosure Regulation changed the course of ESG in Europe and forced a lot of players to start formalising policies and collecting extra-financial data.

Sustainability has become an essential part of risk management procedures and is now integrated into every stage of the investment process. The use of reporting tools has become more widespread, and more structured approaches are being built around this.

Q How have the attitudes of large private markets investors towards ESG changed compared with five years ago, and how do approaches vary between the US and Europe?

JR: Large private markets investors feel they can no longer ignore ESG. There was still an opt-out five years ago, but now it has become essential for fundraising, with lots of questions being asked about how ESG is integrated into the investment life cycle. There is an ESG section in every fundraising deck.

Attitudes have also changed because of the stronger regulatory requirements, mostly at the European level, which means doing nothing is no longer an option. ESG is starting to become an employer brand issue, where a firm needs to talk about sustainability to attract younger talent. In addition, target companies are starting to choose their GPs based on sustainability considerations.

AM: Portfolio companies are looking for partners that show dedication to ESG, and who can demonstrate knowledge and leadership relevant to that company and how addressing these issues will add value to the business.

In the US, we lack the regulatory backdrop of Europe, so that is not the key driver, but other stakeholders are driving the conversation. LPs are asking questions about ESG strategy, what teams look like and how governance structures work, and they are demanding more data. Because it is not mandatory in the US, you have larger players that operate on both sides of the Atlantic that are leading the way, and smaller players following behind. There is also a growing number of smaller firms that are baking ESG into their mission, and those players, despite their smaller size, are leaders as well. Overall, there is a broad range of ESG maturity across private markets investors in the US.

Q Is there a difference in the level of engagement between GPs and LPs?

AM: It depends on whether sustainability is a part of the mission at either the GP or LP level. We see a wide spectrum of LP engagement, with some asking for a lot of data and information to drive forward their commitments and others addressing it as more of a checking-the-box exercise. That is also the case for GPs, where some are much more sophisticated in collecting and analysing ESG and impact data than others.

JR: There are varying levels of engagement among both GPs and LPs in Europe. That said, many of our GP clients in Europe started to look more thoughtfully at ESG because they had at least one LP that asked them about ESG data and policies, so there is still a sense that LPs are driving the market with their requests. Still, not all LPs are equally committed and structured when it comes to ESG, and there are some large private markets investors in Europe that are lagging on these topics, while others are ahead of the curve.

Q Are portfolio companies open to responding to ESG surveys? What is the feedback from them on the issues that arise?

JR: Overall, portfolio companies are open to responding to ESG surveys. From the different clients we have, I would say the response rate to ESG surveys ranges from 70 to 100 percent of portfolio companies, and that depends on whether the firm has a minority or majority investment, and on the asset class. In venture capital, for example, it is harder to collect data because the companies are smaller and they lack dedicated resources to respond.

In the past year or two, some portfolio companies have become more reluctant as the number of questionnaires grows. Today, there may be three or four surveys from their investors, as well as others coming from suppliers and clients, so those are starting to take up a lot of time. Some portfolio companies are deciding to only answer to the lead investors, for example, and are suggesting they distribute the data to other co-investors.

AM: There are certain questions that the companies are already answering to different stakeholders, so consolidating that data in one place to respond more efficiently can benefit portfolio companies themselves by creating a single source of truth on all ESG data.

The issue is that this becomes unwieldy if the same question is being asked in 10 different ways by 10 different people. The objective should always be for there to be a more limited set of outcome-orientated data that is going to be decision-useful, rather than just asking lots of questions to get more data points from the portfolio companies that may be hard for them to answer. We have seen some consolidation of frameworks in terms of different initiatives aimed at being more succinct with what is being requested, and hopefully that focus on what is really needed will continue.

Q Where are LPs still looking for guidance when it comes to tracking ESG across their private markets portfolios?

JR: There are three main areas where LPs still need to improve or focus their efforts. The first would be to get more of the data they are already asking for. Some LPs are not only asking GPs for data but also asking for portfolio company data. Even though they have invested in a fund, they don't just want consolidated data, they want to get into the granular detail from the bottom up. There is a real hunger for data in the private markets, unlike the public markets, where we now arguably have too much data. We will see how that evolves.

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>
> **ANNE MATUSEWICZ**

The second part would be to improve data quality. For the investors that started collecting data in the past couple of years the focus has been to increase response rates, but they don't all have the resources or the staff to start checking that data and looking into the reliability of it. There is often a need for someone to go back and forth with the GP to improve that data quality, and that is going to be a big point on the agenda for LPs going forward. A number of our clients leverage our data validation capabilities because they simply aren't staffed to do this in house.

The third thing LPs are looking for is to compare themselves with their peers. There is a lack of benchmarks in the private markets, so investors are looking to assess both their ESG performance and understand how that compares with the rest of the market. This can be challenging because the definitions of indicators are different from one firm to another. There is a clear need for a more harmonised set of KPIs to allow for that comparability.

AM: Investors are also looking for guidance on what strong ESG performance looks like, both at the company level and GP level. That depends on each firm's view of what the most relevant issues are to their investment strategy and to their view of sustainability, so it is difficult to rank systems and make sense of where people stand today. We have developed a benchmarking capability for our clients – both LPs and GPs – to look at where the market is right now on specific indicators.

Q Where do you expect to see PE firms focusing their ESG efforts in 2023 and beyond?

JR: The private equity market seems to be prioritising climate and decarbonisation. Every firm is starting to think about the carbon footprint of their portfolio, how they can assess and calculate it, and what their strategy should be to align themselves with the Paris Agreement. In terms of emerging topics, biodiversity is gaining attention, along with the relevant methodologies to address this issue.

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> **JÉRÉMY RASORI**

More broadly, SFDR compliance remains front of mind in Europe. Funds classification and the reporting associated with SFDR, particularly principal adverse impact indicators, are areas of focus.

AM: The ability to attribute your ESG efforts to performance upon exit is something everyone wants to figure out, which means it is critical to effectively communicate the value derived from your strategy and your work around ESG issues.

We also see more focus on the role of the GP in ESG, and how that goes beyond just requesting data to providing much more support to portfolio companies. They need to be adding value, whether through the operating partner or the investment team, with sustainability toolkits, training, education and events that can deliver real insights and support to drive strategy. That is increasingly what management teams are calling for. ■

Anne Matusewicz is the co-head of ESG and impact strategy and Jérémy Rasori is a senior sustainability consultant at ESG software platform and advisory firm Reporting 21