

KEYNOTE INTERVIEW

Building better businesses



ESG opportunities outweigh the challenges as sustainability initiatives boost top lines and cut costs, say [Winna Brown](#) and [Elisa Pirani](#) at EY

Q What are the key opportunities and challenges in integrating ESG principles into private equity investment?

Elisa Pirani: First and foremost, companies now have the opportunity to differentiate themselves in new markets, with new customer segments and in new geographies, thereby increasing their top line. There are also opportunities in terms of cost savings. Sustainability has historically been associated with an increase in cost as companies experimented with various initiatives, but we are now seeing both economies of scale and economies of learning being applied.

As long as sustainability is linked to value creation, the opportunities should

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therefore certainly outweigh the challenges, not least because it means that funding will be more easily available from both public and private sources.

Of course, integrating ESG is not only about identifying opportunities, it is also about identifying a new set of risks, most notably climate risk, which can impact the operational fulfilment of production, the transportation of stock and the availability of raw materials. Companies need to have a plan B for their entire operational footprint and, to a great extent, for their supplier base as well. Taking this approach creates stronger and more resilient businesses.

Where we do see companies facing challenges, meanwhile, is in keeping pace with a constantly evolving regulatory landscape. While companies may have been making decisions based on the guiding principles of double materiality in Europe six months ago, for example, they may soon need to adjust course based on a new set of more detailed guidelines that has recently been issued and is now under approval.

It always pays to be ahead of the game, rather than playing catch up, but that can make it necessary to revisit steps that have already been taken. This can lead to a sense of frustration, particularly among stakeholders that are not as close to the world of sustainability and the regulatory expectations it entails.

Q How have the ESG debates impacted ESG integration and how should firms be responding?

Winna Brown: There is no denying that political debates are a reality, but the primary objective of private equity firms is to build better businesses and deliver strong returns for investors, while navigating an evolving political and regulatory environment. EY's *Global Private Equity Survey* found that LPs in Asia-Pacific, Europe, the Middle East, India and Africa are paying a great deal more attention to all areas of ESG today. Even in the Americas, LPs are placing increased scrutiny on environmental, social and governance considerations. Between these investor demands and the global regulatory environment in which private equity firms operate, there can be no doubt that ESG – and emissions transparency and reduction in particular – has become an important business issue, quite aside from any polarity in political opinion.

As a result, we believe there are five key practices that firms should be thinking about when integrating ESG into their portfolio companies. First, focus on substance over form. Prioritise genuine improvements that align with your corporate strategy so that any investment really moves the needle. Second, focus on long-term value creation. ESG is not necessarily a quick fix. It can, however, lead to greater resilience, improved competitiveness and sustainable value creation, resulting in stronger multiples and facilitating better exits.

Third, ensure data transparency and accountability. You need to be able to accurately measure and report on the progress of the initiatives that you invest in, if you want to be able to take the credit. Next, act in synergy with your broader ecosystem. Don't operate in a vacuum. Involve suppliers, customers and competitors in sector-led initiatives. Keeping an eye on what is happening outside your own immediate

Q What opportunities do you see in the world of renewables and how is that space evolving?

EP: While the broader buyout market retreated in 2023, energy transition deals rebounded strongly. There are five key elements to the energy transition: traditional renewables; energy efficiency; lower carbon mobility fuels; industrial decarbonisation and chemicals; and resource decarbonisation. Traditional wind, solar and energy storage continue to dominate the investment landscape, commanding around 50 percent of private equity capital deployed in the energy sector. However, last year, investors also started looking at a wider range of opportunities.

Within renewables, private equity's focus has moved from development and ownership to service models, as return expectations have shifted. We are also seeing a move into software, reflecting a need for higher efficiency in managing complex energy systems.

Private equity investors have been less active in emerging renewables segments such as geothermal, nuclear and hydrogen, due to a lack of consensus on the way forward. Where we are seeing opportunities, however, is in the retrofitting and upgrade of existing renewables assets. Something that was shiny and new only a couple of years ago may now need refurbishing to make it fit for purpose for the future.



environment allows you to proactively expand, while reducing or sharing costs and taking advantage of economies of scale.

Finally, engage with all stakeholders, including LPs, regulators and consumers. Engaging across the ecosystem will give you a better understanding of the world your portfolio companies are operating in, allowing you to stay ahead of changing expectations and to build better businesses.

Q How can sustainability measures be used to positively impact portfolio company value?

WB: It varies from company to company and sector to sector, of course, but generally speaking we see two main sustainability levers. There are initiatives that create a direct impact on profit, either by growing the top line or reducing costs – for example, growing revenue through new sustainable

product lines that appeal to a new customer base or allow you to charge a premium, or reducing costs, through procurement or operational efficiencies including energy savings and reductions in water usage and waste.

Then there are initiatives that have indirect impacts and are enabling in nature. For example, government incentive schemes and green financing programmes can make the ROI on expensive sustainability initiatives more attractive. Another indirect component to consider is risk management – enabling a business to avoid carbon taxes or make its supply chain more resilient so that when there is disruption, it is not adversely affected. This type of risk management should form part of a holistic approach to sustainability.

Finally, I would point to talent as an indirect enabler. Having a stable, engaged and skilled workforce is a critical differentiator and a top strategic priority for private equity firms. All these indirect sustainability measures influence the direct sustainability measures that in turn impact profit, growth trajectories, resilience and ultimately the ability to generate strong returns.

Q How are firms approaching the creation of new products tailored for emerging markets and modern consumers in order to boost return on investment?

WB: I don't think firms are doing anything different to what they have always done. They have always been laser-focused on strategic planning and staying ahead of the competition when it comes to market expansion opportunities.

What is key here is to understand that sustainability strategy and corporate strategy are not two different things. They are inextricably entwined. To that end, firms should be assessing new potential markets, and understanding changing consumer preferences and purchasing power, just as they have always done. They should be

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considering their products and adapting them to meet the needs of the consumer base they are looking to attract in addition to leveraging technology to design products and services that fulfil those demands.

Any successful growth company is going to focus on new products and markets through these three lenses, together with evolving regulation and consumer sentiment. Sustainability is just another, albeit important, consideration to be evaluated and incorporated into the decision making. The key is not to over or underestimate the trends we are seeing, but to incorporate them into the assessments that companies have always been making in order to stay ahead of the competition.

Q To what extent is sustainability improving fundraising fortunes, particularly in this difficult fundraising environment?

EP: Despite a general decline in

fundraising in 2023, sustainability remained a significant focal point for investors, driven by a global emphasis on decarbonisation and the energy transition, and a growing recognition that ESG considerations positively influence financial outcomes. Indeed, some investors are now earmarking significant buckets of capital specifically for sustainability-related investment.

Furthermore, ESG remains a critical component of manager selection. Research carried out by the World Bank and Singapore Management University in 2023 revealed that the higher the frequency of social or environmental issues experienced by a manager, the lower the likelihood of allocators committing capital. In fact, 40 percent of firms experiencing an above average number of environmental incidents were unable to raise a successor fund.

The emphasis that investors are placing on sustainability can also be seen in the number of sustainability-related mega-funds that closed last year. Copenhagen Infrastructure Partners announced a first close on €5.6 billion for its latest greenfield renewables vehicle, for example. Meanwhile, KKR closed its second global impact fund on \$2.8 billion, Qualitas Energy raised €2.4 billion for its latest flagship renewables fund, and TPG raised \$2.7 billion for its third Rise fund.

While regulation such as the Sustainable Finance Disclosure Regulation in Europe is clearly propelling investor interest and thereby creating incentives around sustainability transparency, it is notable that there is also strong appetite for sustainability funds coming from investors in geographies without these robust regulatory frameworks. These investors simply see sustainability as an attractive investment opportunity. ■

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