

ALIXPARTNERS PE ESG SURVEY REPORT

# UNLOCKING VALUE:

The Imperative of ESG in  
Private Equity Investments  
and Operations

The private equity (PE) industry now routinely considers environmental, social, and governance (ESG) issues when evaluating prospective acquisitions and making deals.

The ESG label has become a political issue—particularly in North America—but industry leaders recognize that companies with strong governance, openness to the best talent, and environmentally efficient processes—whatever label you give those matters—are good prospects, and industry leaders have been acting accordingly.

Value creation is always the number one priority in PE. It's no surprise that industry executives examine environmental, social, and governance practices primarily to see if they can find value in them. Short answer: they do. Environmental policies reduce operating costs; social practices attract talent; governance processes reduce risk. The components of ESG make for better deals and better operations.

At the same time, however, there's plenty of opportunity to do better. The industry pays more attention to ESG in dealmaking than in operations. Alignment between PE firms and portfolio companies (portcos) is often lacking or incomplete, and portcos are generally less certain that ESG creates value than investors are. While PE firms and portcos have processes in place to discuss and manage ESG, most of them have not set specific ESG goals, incentives, or reporting standards. The value that industry leaders already see from ESG actions makes it possible to imagine that much more value could be created—for investors, companies, and society—if the PE industry challenged itself and supported those actions' efforts with data and accountability.



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Private equity firms see talent as a critical lever for value creation, and those firms that have social programs that demonstrate commitment to improving diversity, equity, inclusion, and belonging will be the most successful in attracting and retaining talent. In our survey, this is the number-one social activity for 36% of PE firms and 32% of portcos. PE leaders must take clear steps to implement programs that ensure their employees are treated with dignity and fairness and foster a work environment that promotes equal treatment for all."

— TED BILIUS

Partner, Managing Director, and Head of Transformative Leadership

## **KEY FINDING #1**

ESG is becoming ingrained in the due diligence and dealmaking processes.

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## **KEY FINDING #2**

Leaders in the industry see a clear relationship between ESG and value creation.

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## **KEY FINDING #3**

Portcos and PE firms are only partly aligned about ESG, with portcos generally more skeptical of ESG's value.

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## **KEY FINDING #4**

Good intentions are not matched by good reporting and operational practices.

A large, abstract graphic at the bottom of the page consists of a dense, flowing pattern of small, semi-transparent colored dots. The dots are primarily a light teal or cyan color, with some darker teal and blue dots interspersed. They create a sense of motion and depth, resembling a stylized ocean or a microscopic view of a material. The pattern is wider on the right side and tapers towards the left, partially overlapping the text area.

## KEY FINDING #1

ESG is becoming ingrained in the due diligence and dealmaking processes.

The PE industry now routinely takes stock of ESG issues when it is evaluating acquisitions and making deals. Eighty-one percent of PE leaders say ESG is always part of the due diligence process. Another 17% say it sometimes is, depending on the asset. Just 2% ignore it.

The attention to ESG in the diligence process appears to be more than a check-the-box exercise. More than four out of five—82%—PE respondents say their firm has an established policy to include ESG in the firm's investment plans. More than half of the PE executives we spoke to said they always or often place a value on ESG as they consider what to buy or how to position an asset for sale.

It is not clear from the data whether executives are considering the whole suite of ESG practices in most deals. The extent and depth of the investigation almost certainly depend on the asset being considered. Some aspects of governance—such as decision rights or areas of risk—are so routine that they might be considered table stakes. However, nearly a quarter of PE firm executives say environmental considerations significantly affect investment decisions and the expectations they have of their portcos; an additional 43% say environmental considerations have a moderate impact. And nearly half say they have walked away from a deal due to ESG considerations in the past year.

### INVESTING

**58% OF PE**

respondents report considering ESG when acquiring or selling an asset (always or often)

**81% OF PE**

respondents report including ESG in their due diligence, while only 2% do not



**82% OF PE**

respondents report having an established ESG investment policy

**47% OF PE**

respondents report having declined or refused investments due to ESG concerns over the past 12 months



**“** Executing deals has become increasingly difficult in today's environment of constant disruption. Whether it's geopolitics, supply chain, capital markets or economic uncertainty, finding the right deal and closing and delivering value has become trickier than ever. It's encouraging to see in our survey that the PE industry now routinely considers ESG issues when evaluating acquisitions and making deals. However, our experience suggests those efforts are focused mostly on legal, compliance, and cybersecurity. Stronger, better-integrated operational diligence that considers the unanticipated risks associated with a business' operations, technology, governance, and controls can uncover risks and improvement opportunities across the board.”

**— JOANNE TAYLOR**

Partner & Managing Director, Private Equity

## KEY FINDING #2

Leaders in the industry see a clear relationship between ESG and value creation.

Why pursue ESG goals? The reasons differ between portcos and PE firms—and vary depending on the goal.

But the firms and companies that pursue an ESG agenda do so primarily because they see value in it. That's not to say the industry is focusing on business value to the exclusion of anything else. PE firms say investors press them to improve the environmental records of their portcos; portcos, in turn, feel pressure from their investors, which are the PE firms; and both say they are reducing energy use and pollution because it's the right thing to do. Similarly, the social goals of diversity, equity, inclusion, and belonging help attract talent; but both PE firms and portcos say those social goals serve ethical and moral purposes as well as business goals.



### ENVIRONMENTAL VALUE: EFFICIENCY AND COST

**Q: If you've made a commitment to reducing your organization's (portcos') environmental impact, why are you doing it?**

#### PE

Pressure from investors

1

It's the right thing to do

2

Improve performance

3

#### PORTCO

Pressure from investors

It's the right thing to do

Company image and reputation

Pressure from customers and suppliers

Helps sell company after holding period





## ENVIRONMENTAL

Both **PE** and **PORTCO** respondents are prioritizing reducing energy as the primary area of focus for environmental initiatives

### PE

- 1** Reducing energy use and cost
- 2** Becoming carbon neutral or buying carbon offsets

Reducing waste

### PORTCO

- Reducing energy use and cost**
- Becoming carbon neutral or buying carbon offsets**
- Reducing waste**
- Reducing travel**
- Working with supply chain and vendors to reduce their environmental impact**

The industry's environmental actions focus chiefly on saving money. Reducing energy use and expense is cited as the top purpose by 29% of PE firms and portcos alike; reducing waste comes second, listed as a top goal by 19% of PE firms and 15% of portcos.

Fifteen percent of portcos say working with suppliers and vendors is their primary environmental focus. In all likelihood that focus results from customers that have set carbon-neutrality goals for their supply chains, because 12% of portcos report that suppliers and customers have put pressure on them.

The benefit of PE's social efforts is overwhelmingly about competing for talent—not just because the labor market is tight but also because, as many studies have shown, Generation Z and other younger workers have a strong preference for workplaces that are diverse, inclusive, and supportive.

The activities the PE firms and portcos undertake aim primarily to improve diversity, equity, inclusion, and belonging: those activities represent the number one social activities among 36% of PE firms and 32% of portcos. The two focus about equally on employees' mental health and safety: 17% and 18%, respectively. Privacy, by contrast, is much more important to portcos—cited as the top social issue by 20% of portcos—than to PE firms, at 12%.

## SOCIAL VALUE: THE WAR FOR TALENT

**Q: If you've made a commitment to improving your organization's (portcos') social programs, why are you doing it?**

### PE

It's the right thing to do

1

To attract and retain employees

2

Improve company performance

3

### PORTCO

To attract and retain employees

It's the right thing to do

Image and reputation



## SOCIAL

Both **PE** and **PORTCO** respondents agree that DEI&B is the top social issue facing portfolio companies



The majority of  
**PE (63%)**  
and  
**PORTCO (64%)**

respondents report DEI&B programs being very or extremely important to attracting, developing and retaining employees



**14% OF PE**  
and  
**36% OF PORTCO**

respondents report their social impact programs are minimal or non-existent



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Current and prospective employees are watching closely with rightfully high standards for employers to hold true to authentic diversity and inclusion commitments. Those values matter to building a culture of belonging, which is vital to attracting and retaining talent.”

**—ELTON NDOMA-OGAR**

Partner, Managing Director, and Head of Diversity and Inclusion

**Governance:** Industry leaders see a clear connection between superior governance and superior financial performance: better performance is cited as the goal of governance almost twice as often as it is cited as the goal of environmental and social initiatives.

In pursuing performance through governance, PE firms concentrate on leadership, whereas portcos focus on risk. Why the different emphasis? In part it reflects an appropriate division of labor: PE firms focus on getting the right people into the right seats at the front of the bus, leaving it to portcos to operate the business. But portcos' relatively low level of attention to leadership is also likely to reflect the fact that the PE industry as a whole has underinvested in leadership, talent strategy, and succession planning.

## GOVERNANCE VALUE: FINANCIAL PERFORMANCE

**Q: If you've made a commitment to improving your organization's (portcos') governance, why are you doing it?**

### PE

To improve company performance

1

It's the right thing to do

2

Helps in selling the company at the end of the holding period

3

Company image and reputation

### PORTCO

To improve company performance

Company image and reputation

It's the right thing to do  
Regulatory / legal pressure



## GOVERNANCE

Top areas of concern with the **PORTCO** organization's governance



### PE

-  Quality of the executive team and composition
-  Cybersecurity risk
-  Quality of the board leadership and composition
-  Enterprise risk management
-  Quality of systems for compliance

### PORTCO

-  Cybersecurity risk
-  Enterprise risk management
-  Quality of the executive team and composition
-  Quality of systems for compliance
-  Quality of the board leadership and composition



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Cybersecurity isn't only about protecting and empowering business mission and objectives, it's also about ensuring and protecting the trust of its stakeholders."

— BETH MUSUMECI

Partners & Managing Director, Global Leader of Cyber

## KEY FINDING #3

Portcos and PE firms are only partly aligned about ESG, with portcos generally more skeptical of ESG's value.

The vast majority of PE firms and portcos say their ESG efforts and priorities are at least somewhat aligned. Indeed, only 1% of PE firms and 9% of portcos say they are not at all aligned. But the alignment is imperfect at best. Nearly half of the portcos we surveyed—45%—said their ESG efforts are extremely well aligned with the ideas of their investor owners. The PE firms beg to disagree: just 24% of them report strong alignment with their portcos.

The likely reason for misalignment is that across the board, portcos are less sure that ESG creates value than the owners are.



### PORTCOS ARE MORE DUBIOUS ABOUT THE VALUE OF ESG THAN PE FIRMS

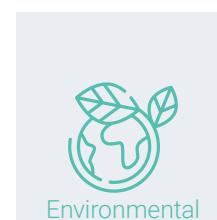
**Q: Have your portcos'/organizations' ESG initiatives driven financial performance or generated value?**

**PE**

**46%** Yes   **35%** Not sure   **19%** No

**39%** Yes   **41%** Not sure   **20%** No

**45%** Yes   **38%** Not sure   **17%** No



**PORTCO**

**38%** Yes   **28%** Not sure   **34%** No

**31%** Yes   **31%** Not sure   **37%** No

**24%** Yes   **31%** Not sure   **45%** No

Portcos are readier to see the value of environmental action—probably because they see its impact on reduced waste and energy spending. When it comes to governance, the two parties are almost flipped, with PE firms much more confident of the value of environmental action than portcos. That flip might be because investors realize more the ultimate benefits of good governance insofar as a well-led company commands a higher price on exit than one with spotty management and risk management.

Misalignment and partial alignment are potential sources of conflict—and of procrastination. Owners and managers have only so many resources and only so much time, and both PE firms and portcos say the biggest obstacle to progress is finding the time and the money.

The majority of PE and portco respondents report having too many priorities and limited time and resources as the biggest challenges to rapidly advancing ESG improvements

**Q: What are the biggest challenges to rapidly advance ESG improvements in your organization/PortCos?**



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Given the aggressive regulatory environment that we are currently in, it isn't surprising that both private equity firms and their portfolio companies ranked enterprise risk management and quality of systems for compliance among their top four areas of concern related to governance. Those results are consistent with the risk-related enforcement activity we are seeing in and around PE, and PE firms and their portcos should continue to strengthen their overall risk and compliance programs to make sure they are prepared."

**— TOM ANTISDEL**

Partner & Managing Director, Risk Advisory

## KEY FINDING #4

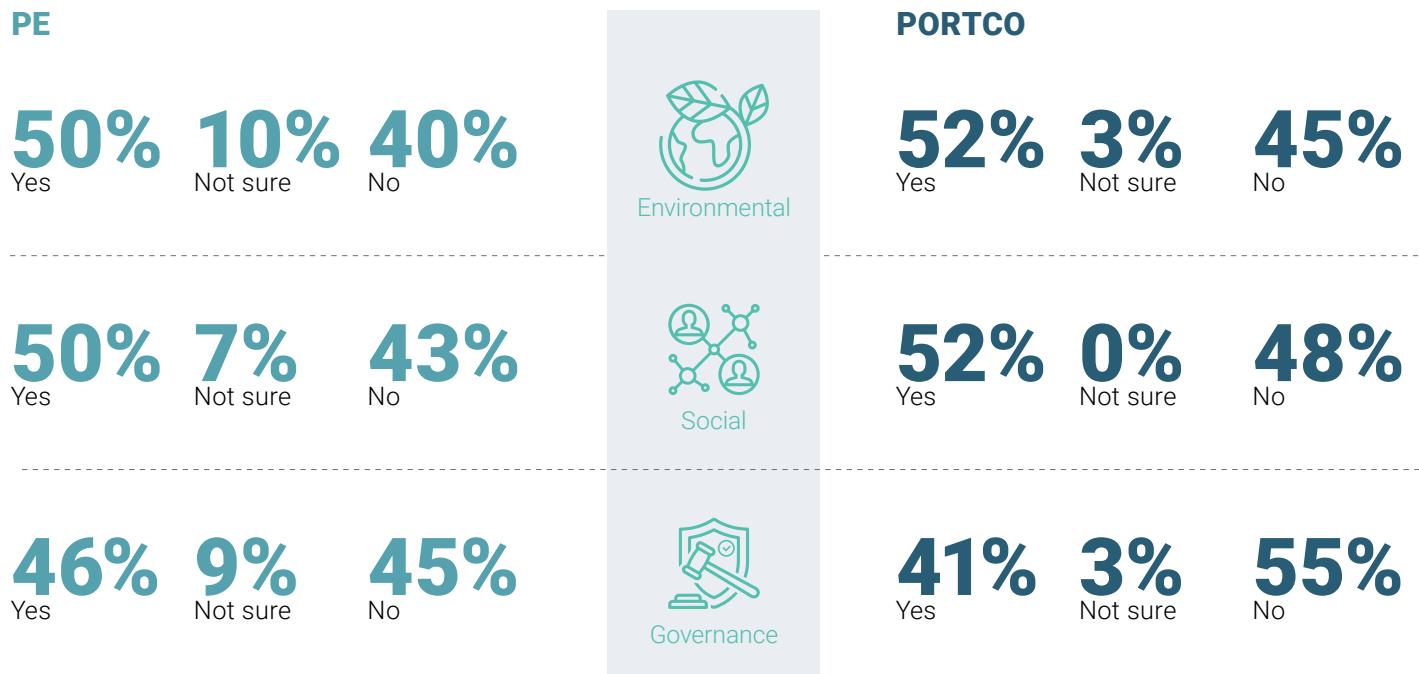
Good intentions are not matched by good reporting and operational practices.

In an industry noted for rigorous measurement and accountability, ESG is an exception, with metrics and incentives notably scarce. Though industry leaders broadly support ESG activities, the industry has done only a rudimentary job of deploying goals, offering incentives, and conducting measurements in the bolstering of its thesis that ESG creates value for investors, employees, and society.

Directors are paying attention to ESG, and there are managers whose job is to monitor and improve it. A strong majority of executives—65%—say the topic is discussed at board meetings at least quarterly; and 20% discuss ESG at a board meeting once a year. And there are folks in charge at the managerial level. A tad more than half of respondents say their organization has internal practitioners dedicated to environmental and social issues; a slightly smaller number have an executive in charge of governance.

### **ABOUT HALF OF PE FIRMS AND PORTCOS HAVE DEDICATED ESG PRACTITIONERS**

**Q: Do you have dedicated internal ESG practitioners in your portcos/organization?**





But if half have dedicated practitioners, then half do not—or don't know if they do, which itself is revealing. Slightly more than half of the portcos we surveyed—52%—report having no established ESG training, which would mean, for example, no antidiscrimination or sexual harassment training.

And while

**85%**

of portcos'

boards discuss ESG at least once a year, most of those discussions are not grounded in data: on average, about 70% of respondents report that ESG metrics are neither required by nor reported to the PE firm. Even more often—74% of cases—portco executives have no financial incentive geared to ESG goals.



## FLYING BLIND: FEW PE FIRMS AND PORTCOS MEASURE ESG



Environmental



Social



Governance

**Q: Do you require your portcos to report ESG metrics to you?**

**31% 31% 30%**

PE RESPONDENTS SAID YES

**Q: Does your organization have to report ESG metrics to your PE investors?**

**30% 27% 29%**

PORTCO RESPONDENTS SAID YES

## SHOW ME THE MONEY

Only

**26%**

of respondents say

**ESG PROGRESS IS PART OF EXECUTIVES' COMPENSATION PLANS**

As the saying goes, what's measured gets managed, and without measurement it is difficult to say—and impossible to prove—that ESG is fully integrated into the operational practice in the PE industry, however much it may be ingrained in acquisition and due diligence.

# CONCLUSION AND ACTION ITEMS

At a time when companies are facing major external challenges both for and against ESG, it's crucial that the industry take clear steps to move the conversation to high and defensible ground: to document the business value of being good environmental stewards, of treating employees with dignity and fairness, and of ensuring that they are good stewards of their investors' money. Some of those benefits are intangible—brand, employer brand, and the reputation of being so-called good corporate citizens. But many are tangible indeed, showing up in the efficiency of operations, in the ability to find and keep great people, and in strong cybersecurity and risk management. In a market where deals are scarce and capital is costly, PE firms that hone their ability to identify, acquire, strengthen, and sell top-notch enterprises have a competitive advantage.

Our study of ESG in private equity suggests four actions that PE firms and portcos should take:



## 1. STRENGTHEN ESG IN DUE DILIGENCE.

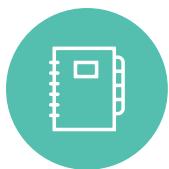
The most striking finding of this study is that the vast majority of PE firms incorporate ESG into their diligence processes. However, the data and our experience suggest that those efforts focus mostly on legal and compliance issues as well as certain risk areas such as cybersecurity. Stronger, [better-integrated operational diligence](#) can uncover risks and improvement opportunities across the board.



## 2. ESTABLISH GOALS, METRICS, AND INCENTIVES FOR ESG ISSUES.

Lack of goals is the second most-striking finding of this study. PE firms and portcos should challenge themselves to create specific targets that have clear links to enterprise value. Examples might be reductions in energy costs, elimination of waste and its associated costs; employee turnover rate costs; hiring, absenteeism, and healthcare costs; and succession-planning metrics. A number of organizations, including the [Global Reporting Initiative](#), the [Sustainability Accounting Standards Board](#), and the [United Nations Sustainable Development Goals](#) have developed sets of internationally recognized goals from which a company can choose what is most meaningful for its industry, most relevant to its deal thesis, and most material for its value creation levers.

With the development of goals comes the opportunity to establish metrics and incentives to (a) help better align PE firms and portcos and (b) help investors and executives decide what priorities to pursue—thus addressing two of the biggest problems the survey uncovered.



### **3. LEVERAGE PE FIRM RESOURCES TO DEVELOP ESG PLAYBOOKS, COMMUNITIES OF PRACTICE, AND CENTERS OF EXCELLENCE TO HELP PORTCOS.**

PE firms can bring financial and intellectual economies of scale to many areas of ESG by contracting with experts in, for example, the areas of diversity, cloud computing, or energy audits and efficiency; PE firms can also foster learning and best practice sharing among portco managers who oversee ESG issues, as many advanced PE firms do this already for hard issues in technology, procurement, and so on. As more and more PE firms hire human capital partners, these leaders should work with portcos to develop talent practices and a leadership bench that fully benefits from finding and developing people with many and varied backgrounds.



### **4. PROMOTE THE VALUE OF ESG WINS TO THE MARKET.**

Who wouldn't prefer to buy a well managed, secure, and efficient company with an engaged and loyal workforce, as opposed to one that's run haphazardly? Improving the management of ESG issues and increasing both the frequency of ESG reporting and its specificity will make assets more valuable. Documenting that value with industry-relevant, value-oriented goals and metrics will make assets easier to sell, will demonstrate the excellence of portco management, and, other things being equal, will increase multiples.

## METHODOLOGY

AlixPartners' PE ESG survey was administered online from June through August 2023. Respondents consisted of 141 PE firm managing directors, operating partners, or founders, and 42 portfolio company (portco) directors, the majority of whom are CEOs or CFOs. Sixty-two percent of the PE firm respondents are with companies based in North America, as are 64% of the portco respondents. The largest share of portco respondents (33%) were with companies registering annual revenues of \$100 million to \$500 million, with another 26% coming from companies with annual revenues of less than \$100 million. Forty-seven percent of PE firm respondents reported their firms' assets under management as less than \$5 billion; another 24% have assets under management (AUM) over \$50 billion.

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