
Finding Value in the Environment



By [Bowen White](#) , Research Associate, INSEAD Global Private Equity Initiative

Private equity firms are building the capability to manage environmental, social and governance factors throughout their investment process.

Private equity fund managers are well-known for their ability to generate value through active ownership of their portfolio company investments. From capital structure and strategy optimisation to streamlining operations and costs, their mission has long been identified with maximising returns for their investors (limited partners or LPs). In doing so, private equity fund managers (general partners or GPs) today are paying increased attention to environmental, social and governance (ESG) factors.

Led by the changing goals of their predominantly institutional investor-base – which includes pension funds, endowments, and insurance companies – GPs’ approach to ESG is becoming more and more sophisticated. Increasingly, GPs are both managing ESG risks and capitalising on ESG opportunities to create value in their portfolio investments.

The [INSEAD Global Private Equity Initiative](#) has documented the evolution of the industry’s approach to managing ESG investment considerations in our recent report, [ESG in Private Equity: A Fast-](#)

Evolving Standard. While the industry is still in search of definitive best practice, the experience of many GPs showcases how these factors are not just good for marketing or PR, but can contribute to building stronger businesses and create tangible, monetary value. For many GPs, managing environmental considerations can provide an entry point into managing ESG considerations more broadly.

How KKR is doing it

In 2008, Kohlberg Kravis Roberts (KKR) partnered with the Environmental Defense Fund (EDF), a non-profit organisation that helps companies realise bottom-line benefits by better managing their environmental impact, to develop KKR's Green Portfolio Program (GPP). The GPP uses an "operational lens" to assess critical business activities of KKR's portfolio companies, identify baseline levels of key environmental performance areas, and develop action plans to improve them.

One KKR portfolio company that has implemented the GPP is Pets at Home, a leading UK-based specialty retailer of pet food and accessories and provider of pet-related services. The company joined KKR's GPP in 2010 and integrated its performance goals into its planning following KKR's investment.

Several of Pets at Home's GPP initiatives are bearing fruit. By improving packing efficiency, maximising space utilisation, and investing in extra-long trailers that can carry nearly 10 percent more stock, the company has been able to reduce total kilometres travelled and achieve better overall fleet results. These and other measures have had a direct impact on Pets at Home's environmental impact, as greenhouse gas emissions from the company's distribution fleet decreased approximately 21 percent compared to its 2008 baseline and distribution efficiency improved by around 42 percent (measured in greenhouse gas emissions per carton shipped). These improvements have helped Pets at Home avoid US\$4.4 million in costs and 7,300 metric tons of greenhouse gas emissions between 2008 and 2011.

Pets at Home is one of 24 companies publicly enrolled in KKR's GPP as of December 31, 2013. The 19 participants that reported results in 2013 achieved cumulative avoided costs and added revenues of US\$917 million, while avoiding approximately 1.8 million metric tons of greenhouse gas emissions and 4.7 million tons of waste.^[1]

KKR's ESG capabilities

KKR's commitment to ESG was formalised in 2008, with the creation of the Global Public Affairs team, whose mandate includes understanding public policy and stakeholder interests and aligning them with the firm's investment activity. The team provides tools for private equity deal staff and portfolio companies to conduct assessments of ESG risks and opportunities. In addition to defining the firm's ESG policy and structures to manage risks and opportunities, the Global Public Affairs team is available throughout the private equity investment process to facilitate assessment and management of ESG considerations.

During the investment process, KKR deal teams and portfolio companies are responsible for evaluating and managing ESG considerations in partnership with the Global Public Affairs team and KKR Capstone, a team of operational experts dedicated to creating value by driving improvements at KKR portfolio companies. In addition to collaborating with KKR's core ESG team, deal teams can tap the firm's relationships with leading external consultants and global NGOs to determine the most effective ESG management measures. During the holding period, companies in the KKR portfolio have access to three global and two regional proactive programs - one of which is the GPP - focused on driving performance via ESG levers. Each of these programs was developed in partnership with a leading NGO.

How is it measured?

Performance on material ESG considerations at private equity portfolio companies is tracked via tailored KPIs and progress is shared with the KKR Portfolio Management Committee where relevant. In addition, KKR's proactive ESG programmes measure impact through a host of identified financial and non-financial metrics. While some of these programmes are designed to mitigate risk and manage other less tangible aspects of a company, the GPP explicitly focuses on creating measurable value through concrete operational improvements.

Many other private equity firms are unlocking value through ESG management. Carlyle's turnaround of Yashili, one of China's biggest infant formula companies, will be the subject of my next post.

Bowen White is a Research Associate at the [INSEAD Global Private Equity Initiative](#)

[1] Nineteen of the KKR portfolio companies participating in the Green Portfolio Program in 2013 reported results. The impact of initiatives of the Green Portfolio Program is based on KKR and KKR Capstone's internal analysis and information provided by the applicable portfolio company. Impacts of such initiatives are estimates that have not been verified by a third party and are not based on any established standards or protocols. They may also reflect the influence of external factors, such as macroeconomic or industry trends, that are unrelated to the initiative presented.

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About the author(s)

Bowen White Bowen White is the Associate Director of INSEAD's Global Private Equity Initiative (GPEI).