KEYNOTE INTERVIEW

Why human capital is central to ESG

The pandemic has propelled human capital to the forefront of the conversation on ESG priorities moving forward, says Partners Group's Carmela Mondino

Last year was quite the year. While the coronavirus pandemic had serious implications for everyone's health, for private equity investors, covid-19 brought the wellbeing of their portfolio companies to the fore and, in particular, their performance on key environmental, social and governance topics. While the future course of the virus and the shape of the economic recovery remain unclear, we asked Carmela Mondino, head of ESG and sustainability at Partners Group, to tell us what she sees on the horizon for the fast-evolving responsible investment landscape.

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Q In conversations with GPs, climate change and diversity and inclusion consistently come up as priority topics. Looking forward, are there other ESG areas where GPs are directing their attention?

There are three big ones: covid-19 and its impact on society; regulatory developments; and people. Coronavirus has made GPs more aware of their ownership obligations and their impact on portfolio company employees. As an industry, there is scope to improve how we engage with employees and take a more active role. This is ultimately part of our licence to operate.

At Partners Group, in response to the pandemic, we launched an employee support fund set up with donations from employees across the firm and management. We already had a plan to launch a stakeholder benefits initiative, and then when the virus hit, we directed those efforts towards helping portfolio company employees facing specific hardships caused by the pandemic. These included individuals who had lost a spouse, lost income or who needed to stay home because they could not afford childcare. It was an emergency response, but how to support employees under our stewardship is a conversation we need to have more frequently going forward. As a firm, we are always thinking about how we can be a good employer of those people that have embarked on this journey with us.

Q What does better employee engagement mean at the operational level?

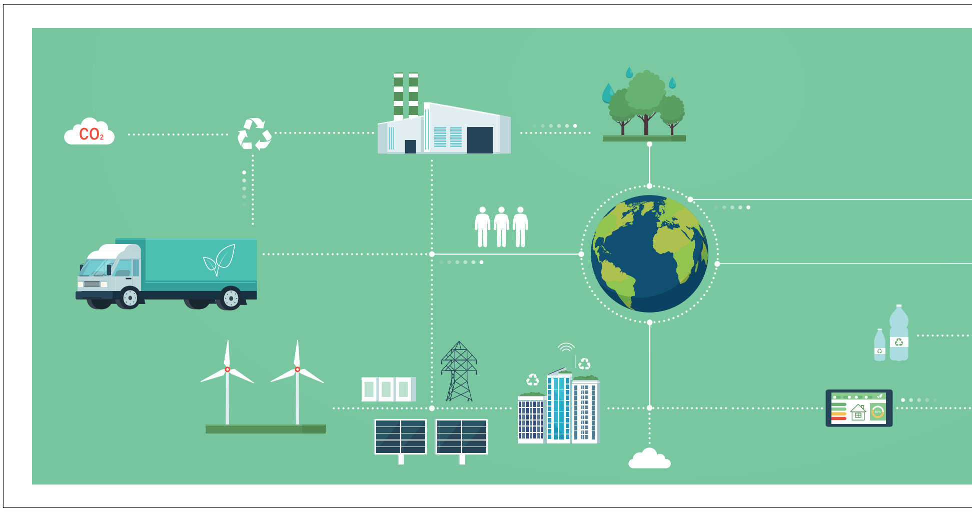
It depends on the circumstances of the company, the industry and the business model. For example, it could be about providing day care at a particular business to enable better staff work-life balance. In another example, it could take the shape of a bonus scheme or distributing shares or specific benefits. It is a broad concept but can be highly impactful.

Q What ESG-related regulatory developments are in the pipeline?

The European Union's new reporting and transparency regulations around sustainable finance come into force this year. From a thematic perspective, there is also a greater focus on human rights, particularly in due diligence. Investors will have to stay close to the topic, especially in countries where there is not a law like the UK's Modern Slavery Act. For instance, the US administration is taking a stand against imports of Chinese cotton over forced labour concerns. The move is related to the US-China trade dispute, but it is also a huge human rights issue and supply chain risk.

Q Where are the gaps in ESG implementation and how can these be filled?

ESG is not simply about mitigating risks and cost savings, it is about having a tangible impact. Customers are now asking for increased sustainability across the supply chain. That is a gap we are starting to fill. Partners Group's transformational investing approach actually embeds ESG into the strategy of our companies – we no longer view ESG as a separate workstream. For instance, if you own a company that has any sort of exposure to plastics, you cannot outsource this risk to the ESG team and announce a project on reducing packaging. It must be part of your investment approach and strategy.



Another gap is around reporting and benchmarking performance. Each firm has their own agenda and priorities. From a measurement perspective, it is difficult to get high-quality data from portfolio companies. We work very closely with portfolio companies, hold quarterly ESG meetings, and an annual validation meeting to discuss the information they have provided based on our 12 key metrics, which is useful to dig into any assumptions they have made. The whole process is time consuming, but it is time well spent.

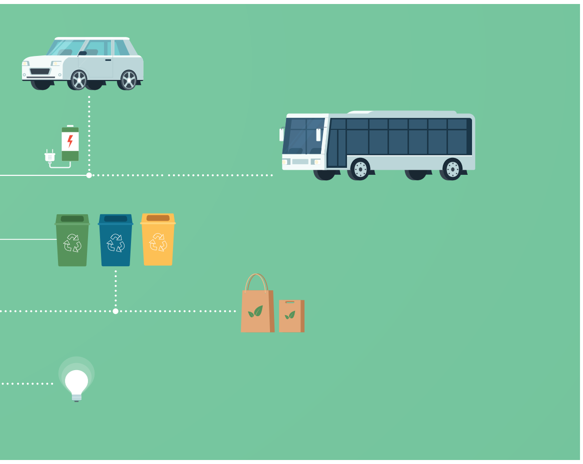
Q How do you keep up with ESG developments and decide the direction you take as a firm?

There are a lot of ESG topics and there is always going to be one that is really hot. It is important to be practical and focus on what is going to create value for a business and its stakeholders. We ask companies for their carbon footprint because it is important for them to understand their contribution to climate change and to have initiatives to reduce it, to mitigate risk and lower costs. We then need to think about how often we ask for this information, and to understand what will move the needle and what is simply nice-to-have. We need to keep in mind materiality and how important a specific topic is for a particular company.

At the industry level, there are platforms and forums through which ESG professionals engage with each other and exchange information. People are open to networking and sharing, and that helps steer the ESG conversation. I talk a lot with my peers. It is important to stay in touch with people, but it is also important to exercise some discernment to filter out the noise and establish priorities. We do that by connecting with the firm's values. Partners Group is a responsible investor and focuses on investing in assets that have broad positive stakeholder impact. Starting with our charter, we try to think about who our ultimate beneficiaries are, what they want and why they choose Partners Group to get it. This approach helps me understand where I should target my energy.

Q There seems to be a merging of the ESG and impact worlds. How do you see this overlap developing?

They are definitely converging or going in that direction. At Partners



Q What are the key innovations in ESG and responsible investing?

Good data is the basis for any decision-making process and technology is key to gathering it. For example, using new software, you can gather data and improve fleet routing in a logistics company. In retail, you can develop an app to engage with staff, or use it to track health and safety metrics, analyse trends and predict future incidents in order to improve your programme. A restaurant chain that is developing a dashboard to see sales could use the same technology to better monitor its stock and reduce food waste.

Overall, we are seeing the digitisation of ESG. These initiatives go hand in hand with the digitisation of businesses. To have a meaningful impact you need to think at scale, and technology and digitisation enables you to have more scale. It is very powerful.

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Group, when we think about impact, we think about a business's products and services and whether they support the United Nations Sustainable Development Goals. For us, ESG is related to practices, which any company in any industry can adopt, and implementing a programme to improve them.

As an investor, if you looked at impact through the perspective of business practices, that would limit your investable universe to businesses that were already demonstrating positive impact. The beauty of private markets, compared to public markets, is that as owners, we can directly influence the way companies operate. If you identify ESG issues during due diligence and your period of ownership, you can instigate change and make a great contribution to the way a business is run.

The SDGs are useful for understanding where the gaps are; but there is a risk that as more people talk about impact, firms overuse the SDG logo or force things on companies where there is not a pressing need for them. There are businesses that are neutral in terms of impact.

For example, a restaurant chain may not be feeding the poor, but it is not causing harm either. You can see ESG and impact overlap if you quantify the link between ESG initiatives and SDG outcomes. For instance, you match energy efficiency to SDG 7 – affordable and clean energy.

Q What is next for ESG and responsible investing?

ESG will become more strategic. As professionals, we are leveraging what we have learned from other value creation topics, such as digitisation, and applying that to ESG.

Still, it remains quite a mixed field, ranging from firms with a high level of expertise and ambition that realise ESG creates value and should be implemented, to firms at the other end of the scale that are still getting their heads around it. It will take longer for them to get onboard. Managers that do not proactively put in place a programme will have to pursue an ESG agenda in the end because the regulator asks for it or their clients insist.

Previously, the private equity industry had to make the case for sustainability, and to explain why it is good, for instance, to treat employees well to reduce the risks and costs associated with high staff turnover – in addition to being the right thing to do. With the coronavirus pandemic, private equity has had to take ownership of ESG. As an industry we are becoming more mature and continue to evolve our sustainability agenda in step with society more broadly. ■