KEYNOTE INTERVIEW

Investing with impact

Private equity's active ownership model means firms are uniquely positioned to help generate positive societal and environmental impacts, says Nordic Capital's Elin Ljung

As active owners of businesses, private equity firms can achieve substantial change in portfolio companies. When sustainability becomes an ever more important factor for customers, regulators and society at large, there is a significant opportunity to support companies through transformation and to build new, more sustainable solutions.

But how can firms achieve this? And what is the difference between firms that invest with impact and those labelled as impact funds?

Elin Ljung, director of sustainability and communications at Nordic Capital, explains what investing with impact means to the firm and discusses the latest developments in this space.

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Q Investing with impact is growing fast? What does this development mean for ESG-committed funds?

The importance of ESG has really accelerated in recent years and, indeed, ESG could prove to be a critical differentiator for funds. A big catalyst for this was the Paris Agreement and the development of the UN's Sustainable Development Goals. These set out the mega-trends and the focus for the future. Private equity firms look for a clear growth path for the next 10 to 15 years and so these initiatives set out where the opportunities connected to the global goals would be.

Another factor that has added weight to this trend is the increased recognition that driving sustainable change and strong ESG performance is not only the right thing to do, but that it also leads to higher equity returns. Together with regulatory changes and a push from policymakers, there is an increasing demand from institutional investors for funds with a strong track record of building sustainable businesses.

Q What role do you think private equity has to play in improving sustainability in businesses and, potentially, in the wider economy?

Private equity firms are in a unique position to drive transformative and sustainable change. Our industry is based on an active ownership model that allows us to engage with portfolio companies. We can have a clear agenda to bring about change and transform companies. That means we can future-proof businesses and help them transition to a digital and low-carbon world.

Private equity is an important part of the societal ecosystem. It creates long-term value by building solid and sustainable businesses, which then provide financial return to the investors, such as pension funds and insurance companies that also have increased their requirements for sustainable investments.

That role is only becoming more important. Alternative investments are growing, and allocations are increasing. The pandemic has further highlighted that investors with a long-term, sustainable perspective can generate strong returns.

"Having a clear purpose and sustainability agenda attracts and retains talent and customers"

Q You draw a distinction between impact funds and those looking to invest with impact. What is the difference?

There is a distinction, although the long-term purpose is the same. Both types of funds focus on driving sustainability. To make progress, any type of GP needs to understand how to invest to scale solutions solving the global challenges in society and how they can transform companies to become more sustainable. At Nordic Capital, our view is that you need to do both to create a world worth living in.

Impact funds focus only on backing and scaling companies with solutions to global challenges. Nordic Capital also looks at this – for example, in financial services, we look to improve financial inclusion, responsible lending and sustainable finance and in healthcare, we see the importance of a strong ecosystem that improves access and results in a better quality of life for people. Nordic Capital also bought a waste management company from an impact fund, for example. But as an ESG-committed fund we can also focus on where we can create value by transforming companies to become more sustainable. To do both is what we call investing with impact.

Q How do you achieve investment with impact?

Since inception, Nordic Capital's investment strategy has always focused on the good of society. Historically, this was more around making sure that any investments would not have a negative impact or be harmful in any way, but now it is more about how we can contribute positively to society. To do that effectively, you need to be able to measure that positive impact and fully integrate that intention into your investment process.

When you are sourcing and looking at particular subsectors, it is vital to understand what ESG-related trends are fuelling growth in these areas. What are the ESG-related risks and opportunities from a financial, operational and reputational point of view? During the investment, that means engaging with the company to establish and monitor a clear sustainability roadmap with ESG KPIs. You need to measure, disclose and drive change. It is a structured and engaged process.

It is important that investment teams are fully accountable and responsible for driving sustainability in the investment process. The ESG experts, meanwhile, are there to support, train and facilitate ways of working to optimise implementation. Together, they identify what the material sustainability-related opportunities and challenges are for each investment and how to create long-term value.

Q What are the challenges in this approach?

The biggest challenge is getting hold of meaningful data to measure material sustainable impact. There are regulations and reporting requirements globally, but there are not really any standards. The ESG Data Convergence initiative will help with this, and the EU's forward-leaning regulations will also bring some harmonisation of approach. GPs following these developments want to be at the forefront of thinking on this and they are driving through practice in this space.

At Nordic Capital, we started collecting ESG data early on, in 2016, using a sustainable software tool and so our companies have been reporting on non-financial data for six years now. That gives us experience and a clear data track record of ESG performance across the portfolio, making it much easier to understand what the trends are and where there are correlations to leverage.

Q What do you see as the most important elements for improving sustainability at a firm and portfolio company level?

You have to start with building ESG awareness in the firm and in portfolio companies. Nordic Capital has run training programmes for more than 830 professionals over the years, so there is a real critical mass and we have built up a lot of capability. This training is mandatory for Nordic Capital employees, for portfolio company board members and for executive management team members. This has helped our firm and our companies understand sustainability from a business point of view and how it can be applied to business plans.

Another key aspect is understanding what ESG practice for each subsector looks like. This helps identify what is material and what drives value for individual companies, so that it can be incorporated into the value-creation plan and benchmarked with peers. To drive real impact, you need to set a clear sustainability roadmap with objectives and KPIs for which people are accountable.

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Q What are the most effective incentives to ensure this happens?

There are two types. One is financial. Here, you can have remuneration linked to sustainability targets to incentivise executives or you can set up ESG-linked finance solutions.

The other type is engagement and motivation. Having a clear purpose and sustainability agenda attracts and retains talent and customers, especially in generation Z where climate activism and sustainability is high on the agenda.

I think you need both types of incentives to recognise that we are all driven by different factors.

Q Can you give any examples of investing with impact?

A good example is ArisGlobal, which Nordic Capital backed in 2019. It is a technology-driven healthcare business, with its largest operations in the US and India, that has developed software to support data-driven decisions in the healthcare system. Its Indian operations make use of a lot of data centres, which consume a lot of energy. The issue is that energy in India is heavily reliant on coal and oil and the supply is not reliable. By investing in solar panels and implementing energy-efficient technology, ArisGlobal was able to create resilient renewable energy supplies and reduce its energy consumption. Through these investments ArisGlobal reduced its energy consumption by 45 percent and its carbon footprint by 55 percent in less than one year.

Another key area for many health-tech companies is the importance of high cybersecurity, which ArisGlobal has invested into. Nordic Capital has supported ArisGlobal to become a much more resilient, sustainable business, reducing its costs in only two years. This demonstrates that you can show results quickly from operational, financial and climate perspectives. ■

Q How do you see the sustainability agenda developing in private equity over the coming years?

There are many stakeholders pushing the agenda and it is accelerating fast. In private equity, LPs are requesting higher levels of ESG disclosure, and they are increasingly requiring GPs not just to state their intent to integrate ESG, but to demonstrate that this has happened.

Regulators and policymakers are also driving this forward. As this develops further, you will be able to benchmark and show how sustainable you really are. It will become more evident who is actually driving sustainable change and supporting the transition to a low-carbon economy.

The key element in all this is full integration of ESG factors into the investment process and value-creation plans – that is how we will see most change. More and more firms are setting KPIs to monitor and support change. There are so many studies now that demonstrate how high ESG standards help generate high equity returns and so we will see further developments in directly correlating ESG with financial returns.