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How ESG is Affecting Private Equity

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Our Lippes Mathias Private Equity Team recently attended on a seminar on the growing impact of Environmental, Social, and Governance ("ESG") issues on the private equity space. Here are the top five items we took away from the seminar:

1. **Expansion into U.S. Market.** European Limited Partners/investors have been requesting ESG data from Private Equity funds for a number of years, and there has been an increasing trend towards US Limited Partners/investors (and even certain lenders) asking for this information as well.

2. **Primary Focus.** While U.S. Investors are heavily focused on "Social" factors - such as diversity and inclusion or pay equity policies – and "Governance" factors – such as implementation of decision making procedures or cyber-security action plans – European investors are also beginning to focus on "E" factors – such as carbon neutrality. Given that the European market has been slightly ahead of the U.S. market in adoption of ESG review, astute

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clients may want to take note of this trend to stay ahead of the curve in the U.S. market.

3. **Governance Specific Issues.** With respect to Governance factors, interest has expanded from simply looking to see if a fund or potential target had policies in place (like a cyber security protection plan) to inquire as to both how the policies are enacted in day-to-day operations and how the plans have impacted the applicable business. Effectively, parties are no longer satisfied with knowing there is a plan in place – they want to know if the plan has been successful. In this regard, policies such as anti-bribery and anti-slavery can be incredibly important for certain businesses conducting business internationally.

4. **Valuation Impact.** ESG factors are currently being treated as "technical" due diligence items, rather than an inherent part of valuation. However, a company with a "good" ESG report could stir up more interest in the market (which would indirectly impact valuation as it would lead to a more competitive sale process). Additionally, a Company with a "poor" ESG report could flag or underscore issues (such as a mis-alignment between company executives and the rest of the Company) that are proverbial deal-breakers.

5. **Proactive Steps.** Panelists suggested having internal board meetings (both for Private Equity firms and their portfolio companies) focused on ESG matters at least once per year. They also suggested placing a senior-level party in charge of effectuating the ESG action plan to ensure it is seen through to fruition. The panelists had noted that ESG issues / follow up oversight are often assigned to a junior employee, which can lead to a lack of effective progress.

We are currently working with various clients on ESG aspects of transactions and business operations. If you would like to discuss in further detail, please contact John J. Koeppel (jkoeppel@lippes.com) or Sean P. Balkin (sbalkin@lippes.com), members of our Lippes Mathias Private Equity Team.

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