

Center for Sustainable Business



NYU Stern CSB 2023



## Key themes from the LP interviews – a need for improved sustainability analysis and ongoing monitoring of performance

#### **Key Findings from LPs**

#### **Unclear How to Use Sustainability Data**

While LPs have begun collecting sustainability data from GPs and portcos, they often do not look at the data after the initial DDQ exercise

#### **Lack of Standardization / Quality of Data**

LPs report that they receive **inconsistent metrics from GPs** (different data shared for different portcos, different FYs, etc.)

GPs note that they receive similar, yet **non- standardized DDQs**, requiring different answers

Lack of Maturity / Education

While some LPs highlighted advanced sustainability reporting practices, many are just beginning their sustainability journey and others view it as a tick-the-box exercise

#### **Relevant LP Quotes**

- "Establishing consistent metrics that any GP could report on would be helpful, in order to establish a minimum baseline and allow for aggregation"
- "Wishes there was a common scoring framework in the industry like GRESB as current scorecard is basic

   would rather aggregate real data instead of assessment scores"
- "In regard to the DDQ, see some benefit of an academic institution denoting the most important questions and most material issues by sector"
- "It is all about activating the sustainability data, so that it can play a larger role in exits"
- "To the extent that existing tools like PRI DDQ and SASB could be combined to triage where they should focus time on specific investments, that would be helpful"
- "See issue of the same things being asked in slightly different ways in the DDQ"

## NYU Stern CSB Assessed LP Processes Across the Investment Lifecycle

Defining Internal Strategy

**GP Initial Assessment** 

GP / LP Agreement GP/PortCo Ongoing Assessment

**LP Reporting** 

#### Current Practice

- · ESG in investment policy
- Starting to define what ESG metrics to track
- Defining owner of ESG function
- DDQ (ILPA + PRI)
- ESGDCP
- · DDQ assessment model
- ESG scorecard
- Discussions over 1 yr period
- LPA
- Side letter

- Rely on sustainability reports
- Collect minimal ESG reporting data from portcos and GPs
- Most don't do anything with the data they collect (best in class aggregates data from LPs and reports back)

## Limitation / Issues

- General lack of sophistication in regard to including sustainability
- DDQ often not standardized; often lacking key sustainability questions
- Lack of understanding of how "mature" GP is on sustainability
- LP has limited influence on what it can require in LPA or side letter
- Lack ability to aggregate real data instead of assessment scores
- No current continuous assessment process
- GPs and portcos sending ESG data to LPs but report they aren't looking at it

## Areas of opportunity

- Intro guide for LPs
- ILPA addendum tool that identifies key sustainability questions and assesses PE firm sustainability maturity
- Best in class examples
- Define what sustainability data is relevant
- Outline performancebased metrics for ongoing monitoring
- Best in class examples

# CSB pulled the most important sustainability questions from the ILPA DDQ as the basis for the analysis

#### **Logic Flow of LP Tool**



Input GP DDQ responses into the LP tool for the **90 selected sustainability questions** (75 ILPA questions + 15 CSB additions)

Scoring

Ascribe a score of 0-3 for each question dependent on completeness of each GP response, scores are weighted by impact category and rolled up to a total score; total score indicates beginner vs. expert

Impact Categories: (CSB's Responsible Investing Framework)

Sustainable & Responsible Investment Policies

Management & Human Capital

Fund Management Strategy & Innovation

Societal Impact

3 Heat Map Output

Review the resulting "scorecard," which provides an average score per impact category; the output sheet also includes weaknesses (where score = 0) that might require more consistent reporting from the GP

4 Critical Non Conformities

**CSB denoted 7 critical questions** that may require thorough review before proceeding with an investment, user reviews these key areas (option in earlier analysis for user to add/remove questions from this list)

Ongoing

Monitoring

Review short list of performance-based metrics (aligned with EDCI) to collect from GPs; CSB included graphs and sample data to illustrate these outputs

### **Heat Map Example with Category Descriptions**

| Average Score |  |
|---------------|--|
| 1.4 out of 3  |  |
| 1.3 out of 3  |  |
| 1.9 out of 3  |  |
| 1.9 out of 3  |  |
| 1.7 out of 3  |  |
|               |  |
| 53.3          |  |

#### **Bucket**

Sustainable and Responsible Investment Policies
Management and Human Capital
Fund Management
Strategy and Innovation
Societal Impact

<-- WEIGHTED TOTAL SCORE

#### **Scoring Definitions:**

Total score of less than 30 is defined as remedial. Total score between 31-50 is defined as beginner. Total score between 51-80 is defined as advanced. Total score of greater than 80 is defined as expert.

## Sustainable & Responsible Investment Policies

• A sustainable and responsible investment policy defined by firm priorities and monitored implementation

## Management & Human Capital

• Management approach is guided by a robust responsible investment strategy and diverse and ESG-credentialed senior leaders

#### **Fund Management**

• Fund management practices with respect to handing dry powder, subscription lines of credit, additional fundraises, and reporting

### Strategy & Innovation

• Describes the firm's capabilities in meeting its sustainable investment policy throughout its pre- and postinvestment processes

#### **Societal Impact**

 How well the PE firm and its portfolio companies are contributing to positive impacts and reducing negative societal impacts

### The ongoing monitoring section of the tool denotes outcomeoriented performance metrics to be collected by the LP

#### **Need for Ongoing Monitoring**

LPs noted a need for consistent metrics that GPs could report on and a desire for real data – practitioners would like for sustainability data to play a larger role in exits.

A strong sustainability metric is performance-based and outcome-oriented while attached to specific commitments and targets. CSB used EDCI metrics as the basis for a short list of the most important sustainability metrics to be tracked across industries.

#### Process:

- CSB expanded each EDCI metric to include specific commitments and targets
- Included a few additional categories: Circularity, Water Use, and Sustainable Sourcing & Procurement

LPs can use the ongoing monitoring section as an educative piece to see what type of data (+ related commitments and targets) they can be tracking or as an actual data input and tracking exercise.

#### **EDCI Metrics (Section Aligned with EDCI)**

The <u>ESG Data Convergence Initiative</u> is the major sustainability data standardization effort within PE.

#### **EDCI Metrics:**

- GHG Emissions (scope 1, scope 2, scope 3)
- Renewable Energy (% renewable energy usage)
- Diversity (% women on board, % women in C-suite, % underrepresented groups on board, % LGBTQ on board)
- Work-Related Accidents (injuries, fatalities, days lost due to injury)
- Net New Hires (net new hires (organic and total), turnover)
- Employee Engagement (employee survey (yes/no), employee survey response rate)

## Ongoing monitoring using performance-based metrics

| Source | Category                                 | Sub-<br>category      | Description  | KPI 1   | KPI 2  | KPI 3   |
|--------|--|-----------------------|--|---|--|---|
| EDCI   | GHG<br>Emissions                         | Emissions by<br>Scope | (1) Commitment to net zero based on 2030 and 2050 goals, scope 1, scope 2, and scope 3 emissions aligned with SBTI, (2) reporting to TCFD/ISSB, and (3) third-party audited (4) Data for last year at minimum up to 3 years recommended  | Scope 1, 2 and 3 emissions,<br>numerical value with<br>benchmark  | Findings from TCFD<br>reporting  |   |
| EDCI   | Renewable<br>Energy                      | Conclimad             | (1) Total fuel consumed, (2) percentage natural gas, (3) percentage renewable (a) Targets for 2030 and 2050 (b) base year (c) performance to time-based targets [revised SASB metric]  | Total fuel consumed,<br>numerical value with base<br>year against target  | % natural gas, fuel<br>consumed with base year<br>against target                   | % renewable, fuel consumed with base year against target  |
| CSB    | Diversity                                | Composition           | Percentage of employees by historically underrepresented group by level<br>in current year (a) Short- and long-term targets with a defined period (b)<br>base year (c) performance to time-based targets   | % of employees historically underrepresented, by level  | Performance against target<br>and against baseline                                 |   |
| EDCI   | Work-related<br>Accidents                |                       | Total recordable incident rate (TRIR) for (a) full-time employees, (b) part-time employees, (c) contract employees, and (d) short-service employees  |   | Total recordable incident rate, part-time employees                                | Total recordable incident rate, contract employees  |
| EDCI   | Net New Hires<br>& Turnover              |                       | Voluntary and involuntary turnover rate for (a) direct (b) contract (c) migrant employees in current year (a) Short and long-term targets with a defined period (b) base year (c) performance to time-based targets  | Voluntary and involuntary<br>turnover rate, direct<br>employees against targets   | Voluntary and involuntary<br>turnover rate, contract<br>employees against targets  | Voluntary and involuntary<br>turnover rate, migrant<br>employees against targets  |
| CSB    | Circularity                              | Circularity           | Percentage of products made from (1) recyclable materials (2) recycled material and 3) reused materials from production/end of life (a) Short and long-term targets with a defined period (b) base year (c) performance to time-based targets  | % of products made from recyclable materials against target   | % of products made from<br>recycled materials against<br>target                    | % of products made from<br>reused materials from<br>production/end of life<br>against target                                |
| CSB    | Water Use                                | Water Use             | (1) Total water withdrawn, (2) total water consumed (3) volume of<br>wastewater treated and released; percentage of each in regions with<br>High or Extremely High Baseline Water Stress (a) Short and long-term<br>targets with a defined period (b) base year (c) performance to time-based<br>targets [revised SASB metric] |   | Volume of wastewater<br>treated and released,<br>numerical value against<br>target | % of total water consumed<br>in regions with High or<br>Extremely High Baseline<br>Water Stress against target              |
| CSB    | Sustainable<br>Sourcing &<br>Procurement | Cartifications        | (1) Percentage of products sourced by all suppliers that are certified to a third-party environmental and/or social standard (2) percentages by standard (a) Short- and long-term target with a defined period (b) base year (c) performance to time-based targets   | % of products sourced by al<br>suppliers that are certified to<br>a third-party environmental<br>and/or social standard<br>against target | by standard (standard 1 -  | l% of products sourced by all<br>suppliers that are certified,<br>by standard (standard 2 -<br>user defined) against target |