



Rhodes Business School
Leadership for Sustainability

MASTERS THESIS

The Challenges and Opportunities in ESG Integration in Investment Activities for
Private Equity Firms/Funds in South Africa

Cuma Velile Dube

Supervisor

Leticia Greyling

*A thesis submitted in partial fulfilment of the requirements
for the degree of Master of Business
Administration*

12 November 2020

ORCID ID: <https://orcid.org/0000-0003-2622-8997>

Abstract

Responsible Investing (RI) is an investment strategy that considers not only the economic but also the environmental, social and governance (ESG) issues in the investment analysis and post-investment activities. The consideration of ESG issues is aimed at generating long-term risk-adjusted financial returns and a positive social and environmental impact. This research seeks to contribute to the study of responsible investment (RI), as it relates to private equity investments, an area not well researched. This research also seeks to contribute to the academic literature on responsible institutional investment in South Africa; the opportunities it presents to optimise portfolios, as well as the means with which the challenges faced in integrating ESG factors in investment activities may be overcome. More specifically, the challenges and opportunities for the integration of ESG factors in the investment process were investigated through the experiences of a small sample of South African private equity firms. The sample of private equity firms that participated in this research are signatories of the United Nations Principles of Responsible Investing (UNPRI). Representatives of the participating firms were interviewed in line with the qualitative research design and the post-positivist paradigm of this research. The research design and paradigm are chosen to explore the experiences of practitioners in their integration of ESG issues in the investment process. This research shows that the challenges to ESG integration for the private equity firms considered have remained largely consistent over the last ten years. The challenges include industry skills and knowledge gap and the lack of reliable and comparable ESG data at the portfolio company level. The Opportunities presented, by adopting responsible investing as an investment strategy, are rooted in protecting the downside (risk management) and in finding new value creation opportunities. In summary, it was found that the participating firms continue to face significant capacity challenges in overcoming the challenges to mainstreaming ESG in investment processes. Further research may explore whether the challenges and opportunities that persist from the findings of this research are pervasive throughout the entire sector and whether innovative ways have been found to overcome the challenges have been found by private equity firms that are not signatories of the UNPRI.

Declaration of Authorship

I declare that this research is my work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration at the Rhodes Business School. It has not been submitted before any degree or examination in any other University. I further declare that I have obtained the necessary authorisation and consent to carry out this research.

Acknowledgements

I could not have come this far without my family. The support I have received has been overwhelming and had made it impossible for me to give up when it would have been easier to do so. My mother, who has always been my rock, was a superhero throughout this journey. My big sister and deputy Mom, without whom I would not have made it this far, is my superhero too.

To my supervisor, Leticia Greyling, you only wanted to see me do the very best I could do, and I appreciate your patience and guidance throughout this journey.

To the respondents to this study; all of you did not have to take so much time of your days to help me. I was received warmly and with a keen interest in what I wanted to learn from you.

Thank you.

List of Acronyms

BVCA	British Private Equity and Venture Capital Association
CDC	Commonwealth Development Corporation
CFA	Chartered Financial Analyst
ESG	Environmental, Social and Governance
GHG	Greenhouse Gas
GP	General Partner
GRI	Global Reporting Initiative
JSE	Johannesburg Stock Exchange
LP	Limited Partner
LT	Long-term
PE	Private Equity
PRI	Principles of Responsible Investing
RE	Renewable Energy
RI	Responsible Investing
SASB	Sustainability Accounting Standards Board
SAVCA	South African Venture Capital and Private Equity Association
SRI	Socially Responsible Investing
TCFD	Task-Force Recommendations on Climate-Related Disclosures
UN	United Nations
UNPRI	United Nations Principles of Responsible Investing

List of Figures and Tables

Figure 1: Integrating ESG in Private Equity. Source: UNPRI (2014;10).	16
Figure 2: Ownership practices for ESG Integration. Source: UNPRI (2014;14)	17
Figure 3: Prepared Transcript for Coding	41
Figure 4: Coded Interview for sorting	41

Table of Contents

Abstract	1
Declaration of Authorship.....	2
Acknowledgements	3
List of Acronyms	4
List of Figures and Tables.....	5
Chapter 1: Introduction and Overview	9
1.1 Background	9
1.1.1 The United Nations Principles of Responsible Investing and ESG Integration.....	9
1.1.2 The Evolution of Responsible Investing	11
1.2 Private Equity and ESG Integration (Responsible Investing) as an investment strategy .	12
1.3 The Challenges and Opportunities around ESG Integration.....	18
1.3.1 Problem Statement.....	18
1.3.2 Research Objectives and significance of the study.....	19
1.3.3 Research Methodology.....	20
1.4 Conclusion	21
Chapter 2: Literature Review	22
2.1 Introduction	22
2.2 Key ESG Integration (Responsible Investing) Challenges	24
2.2.1 Introduction	24
2.2.2 Shareholder short-termism	25
2.2.3 ESG Knowledge and Skills Gap	27
2.2.4 The ESG Data Challenge.....	28
2.3 Key ESG Integration in investment (Responsible Investing) Opportunities	29
2.3.1 Introduction	29
2.3.2 Risk Mitigation	30
2.3.3 The market opportunity in addressing sustainability issues.....	31
2.3.4 Private Equity Resources and Capabilities for a Competitive Advantage.....	33
2.4 Conclusion	34
Chapter 3: Methodology, Methods and Techniques.....	36

3.1	Methodology and Paradigm	36
3.2	Methods and Techniques	37
3.2.1	Data Collection and Sampling	37
3.2.2	Data Analysis.....	39
3.3	Ethical Considerations of the Research	42
Chapter 4: Results.....		43
4.1	Introduction	43
4.2	Brief background on the firms and the experience of the respondents	43
4.3	Challenges to ESG Integration for South African Private Equity Firms	45
4.3.1	Shareholder Short-termism	45
4.3.2	The Skills and Knowledge Challenge	47
4.3.3	The ESG Data Challenge	50
4.4	The Opportunities of ESG Integration for private equity firms in South Africa	51
4.4.1	Risk Mitigation	51
4.4.2	Opportunities for solutions investments through ESG Integration	53
4.5	The Impact and meaning of the UNPRI on Private Equity in South Africa	54
Chapter 5: Discussion and Recommendations		57
5.1	Discussion.....	57
5.2	Key ESG Integration (Responsible Investing) Challenges	58
5.2.1	Shareholder short-termism	58
5.2.2	The Skills and Knowledge Challenge.....	58
5.2.3	The ESG Data Challenge.....	59
5.3	Key ESG Integration (Responsible Investment) Opportunities.....	60
5.3.1	Risk Management	60
5.3.2	The market opportunity in solving sustainability issues	61
5.4	ESG Integration and Private Equity	62
5.5	Recommendations	63
Chapter 6: Conclusion		66
6.1	Limitations of the Study	69
References.....		71

Annexure A: Interview Schedule..... 78
Annexure B: Consent Form..... 81

Chapter 1: Introduction and Overview

1.1 Background

1.1.1 The United Nations Principles of Responsible Investing and ESG Integration

The Principles of Responsible Investing (PRI), supported by the United Nations (UN) have the mission of creating an economically efficient and sustainable global financial system, that rewards long-term responsible investing, to create long-term value for the environment and society as a whole (UNPRI, 2016).

The ambitious goal of the United Nations Principles for Responsible Investment (UNPRI) is to change the financial sector into a more sustainable one. The UNPRI signatories, representing over US\$80 trillion in assets under management (AUM), makes the principles of the UNPRI an important enquiry from an institutional point of view (Hoepner, Majoch and Zhou, 2019). The Principles of Responsible Investment are a United Nations-supported initiative that seeks to encourage the consideration of environmental, social and governance (ESG) issues by institutional investors. Key to the principles for responsible investing is the view that investors should act in the long-term interests of their beneficiaries by integrating ESG factors (UNPRI, 2014). It is for this reason that being a signatory to the UNPRI is a key determinant of participation in this research and a proxy for an investor to be considered responsible and engaged in responsible investing by considering ESG issues in their decision-making.

Responsible Investing (RI) is an investment strategy that considers not only the economic but also the environmental, social and governance issues in the investment analysis and post-investment activities to generate long-term risk-adjusted financial returns and a positive social and environmental impact (Przychodzen, Gomez-Bezares, Przychodzen and Larreina, 2016). The strategy is based on the understanding that strategic decisions, which include decisions on which investments to make and the appropriate level of engagement with portfolio companies - post-investment, are based on both financial and non-financial information (Esch, Schulze

and Wald, 2019). The information, both financial and non-financial, is weighted, prioritised, and managed per their materiality. Materiality is defined by the Global Reporting Initiative (GRI) as an assessment of the relevant sustainability issues that reflect an organisation's most important economic, environmental, and social impacts (GRI, 2015). The integration of both financial and non-financial ESG information is essential to the enquiry of an organisation's ability to create value over time (IIRC, 2013). ESG integration in the investment process, according to Khan, Liu and Oino (2019), involves using ESG-related data with traditional financial performance metrics to make sustainable investment decisions.

According to Przychodzen et al. (2016), stakeholders around the world have made known, to both asset owners and managers, their ESG concerns and the expectations that the capital markets are to contribute toward addressing these concerns. ESG issues have become more important due to increasing awareness of the externalities that result from business activities that affect both the environment and society (Cubas-Díaz and Martínez Sedano, 2018). In private equity, by the end of 2013; 130 limited partners and 150 general partners from just two (2) in 2008, became signatories of the UNPRI (UNPRI, 2014). This growth is also supported by the fact that, as of June 2017, institutional and private investors representing a portfolio of about US\$5.45 trillion in assets have divested from fossil fuels (Peeters, Uwase, Van den Broeck and Mattan, 2017).

The motivations behind the adoption of the PRIs by asset owners and asset managers, in general, have been thoroughly investigated by Majoch, Hoepner and Hebb (2017) and Hoepner, Majoch and Zhou (2019), who found that asset managers are significantly influenced by the values of management and the pursuit of organisational legitimacy. According to Majoch et al. (2017), managers explained their decision to sign the PRI as being because the values of the PRI reflected their values and those of their firms. They also stated that the legitimacy of the PRI conferred legitimacy onto their own responsible investing activities. In addition, these asset managers are affected by "*normative, cultural-cognitive and regulatory aspects*" (Hoepner, Majoch and Zhou, 2019, p.1) where social backgrounds are aligned to the values of the movement toward responsible investing (RI); studied, both from the stakeholder salience perspective, analysing internal motivations; and from using public, country-

level data for a better understanding of these motivations from an institutional setting perspective, respectively. This research seeks to investigate beyond the motivations of being a signatory of the UNPRI, to the challenges and opportunities around integrating ESG issues, according to the principles, into the investment process by private equity firms in South Africa, more specifically.

1.1.2 The Evolution of Responsible Investing

Responsible Investing has developed from a practice that focussed primarily on the exclusion of certain types of sectors, markets and companies to a practice that actively seeks to develop certain characteristics in a portfolio company (Caplan, Griswold and Jarvis, 2013). According to Viviers (2014), responsible investing in South Africa marked its 21st anniversary in 2013, and therefore 2020 would mark its 28th anniversary. US\$462 billion out of a total US\$480 billion is managed in terms of an ESG integration strategy with private equity being dominant only in thematic investment strategies (Davies, 2016). The difference lies in that ESG integration in investment processes includes active management of ESG issues while working with the management team, thematic investing is a top-down approach in which companies are excluded based on predetermined ESG themes even before engagement (Sustainable Investment Team, 2019). Socially Responsible Investing and Responsible Investing is often used interchangeably (Del Bosco and Misani, 2011; Crifo, Forget and Teyssier, 2015; Yan, Ferraro and Almandoz, 2019), because both may be defined as investment strategies that constitute approaches that include ethical and ESG issues, along with standard financial considerations in the investment process (Herringer, Firer and Viviers, 2009).

The idea of aligning financial investment goals with socially responsible values is not a new one. Socially responsible investing has been a strategy available to investment managers for decades (LaBella, Sullivan, Russel and Novikov, 2019). The foundations of socially responsible investing, which is the consideration of social and environmental issues in the investment decision process, can be traced back to the religious movements of the 18th and 19th century who sought to align their investments with their religious beliefs (Dziawgo, 2019). This foundation, of necessity, involved the exclusion of investments in tobacco, alcohol, and gambling companies, etc.

The foundation above developed into an investment practice within ethical parameters that avoids industries considered sinful, and the divestments starting with the Vietnam War and later the Apartheid government of South Africa (1960/70 and 80s). These divestments were followed by an improved sense of environmentalism, and the belief that companies had to be more responsible for their role and impact on society (corporate social responsibility) (Dziawgo, 2019). Socially responsible investing emerged as a concept in investing amid growing concerns over corporate responsibility, and as ESG factors became central to the sustainability of a company (Tripathi and Bhandari, 2014). What followed this emergence is what we now understand to be responsible investing. Responsible Investing was developed to not only analyse companies based on ESG factors but also engage companies to change business practices where they have not performed according to those ESG factors (shareholder activism), focussing on more than just the financial benefits (Dziawgo, 2019). A key feature of what we understand to be responsible investing today is the emphasis on the governance of these companies and the ESG issues that are material to the company (Tripathi and Bhandari, 2014).

1.2 Private Equity and ESG Integration (Responsible Investing) as an investment strategy

The private equity investment model involves raising capital into a fund organised, generally, as a limited partnership for the purchase of a share (Divakaran, McGinnis and Shariff, 2014). The share may range from a strategic minority, - to majority ownership, of an operating company that is not listed on a public exchange to influence the running of the business (Divakaran, McGinnis and Shariff, 2014). Private equity is particularly a good fit for responsible investing because of its long-term investment approach and “stewardship-based style” (UNPRI, 2014). RI and shareholder activism are integral parts of the corporate sustainability agenda in the financial sector, where investors use their shareholder activism to better the value of the investments over time (Oh, Park and Ghauri, 2013). In this way, the contribution of private equity investors on the growth, performance and investment outcomes of portfolio companies and the portfolio has been significant (Manigart and Wright, 2013). Responsible private equity, like all other ESG focussed asset classes – meaning investment

vehicles that integrate ESG into the investment process - are driven mostly by the values of the investors behind them (Majoch, Hoepner and Hebb, 2017). Asset owners in this sector often want to make a positive impact with their financial resources (Camelia, 2019) as well as to achieve long-term sustainable risk-adjusted returns. The objectives of these asset owners are based on the promise that ESG integration into the investment process can be a source of competitive advantage (UNPRI, 2016).

The private equity industry has evolved from the emergence of leveraged buyouts in the 1980s that prioritised cost-cutting in their post-investment engagement. The industry developed to focus on operational efficiencies in the 1990s and then the large institutions we saw expand into different asset classes and develop new expertise in the 2000s (Indahl and Jacobson, 2019). More recently, it has begun moving toward the effective management of externalities and ESG issues (Indahl and Jacobsen, 2019). This evolution has also been the case locally, as private equity has grown quite significantly in South Africa as an asset class (Van Niekerk and Krige, 2009). This growth may be attributed to the suggestions in the literature that it offers higher returns and diversification benefits (Van Niekerk and Krige, 2009). Responsible private equity, defined as the integration of ESG factors in investment decision-making by private equity firms, is motivated by risk mitigation as well as the belief that ESG improvements lead to operational efficiencies (Del Bosco and Misani, 2011). Be that as it may, the integration of ESG factors into the investment process amounts to an investment strategy that has implications for the approach, skill requirements, activities, and performance of the firm.

For any investment professional in an investment firm, the key consideration toward any investment strategy is whether it will be commercially meaningful (Aggarwal and Elembilassery, 2018). From its emergence as an investment strategy, and not just an add-on to the investment process, investors and firms have asked whether it is finance-worthy (Kotsantonis, Advisors, Pinney and Serafeim, 2016). This research stops short of evaluating the relationship between ESG integration and financial performance; the research in that area is plentiful, evidenced by a study by Atz, Van Holt, Liu, and Bruno, (2020), aggregating evidence of this relationship from over one thousand studies published between 2015 and 2020. What is of concern to this enquiry are the barriers to ESG integration for the private equity firm as well as the

opportunities that present themselves once ESG integration is achieved in the investment process that may contribute to improved financial performance. This is investigated because though responsible investing has been a feature in the investment field in South Africa for more than 28 years, responsible investing or ESG integrated assets under management make up less than half (44 percent) of total assets under management in private equity in South Africa (IFC, 2011).

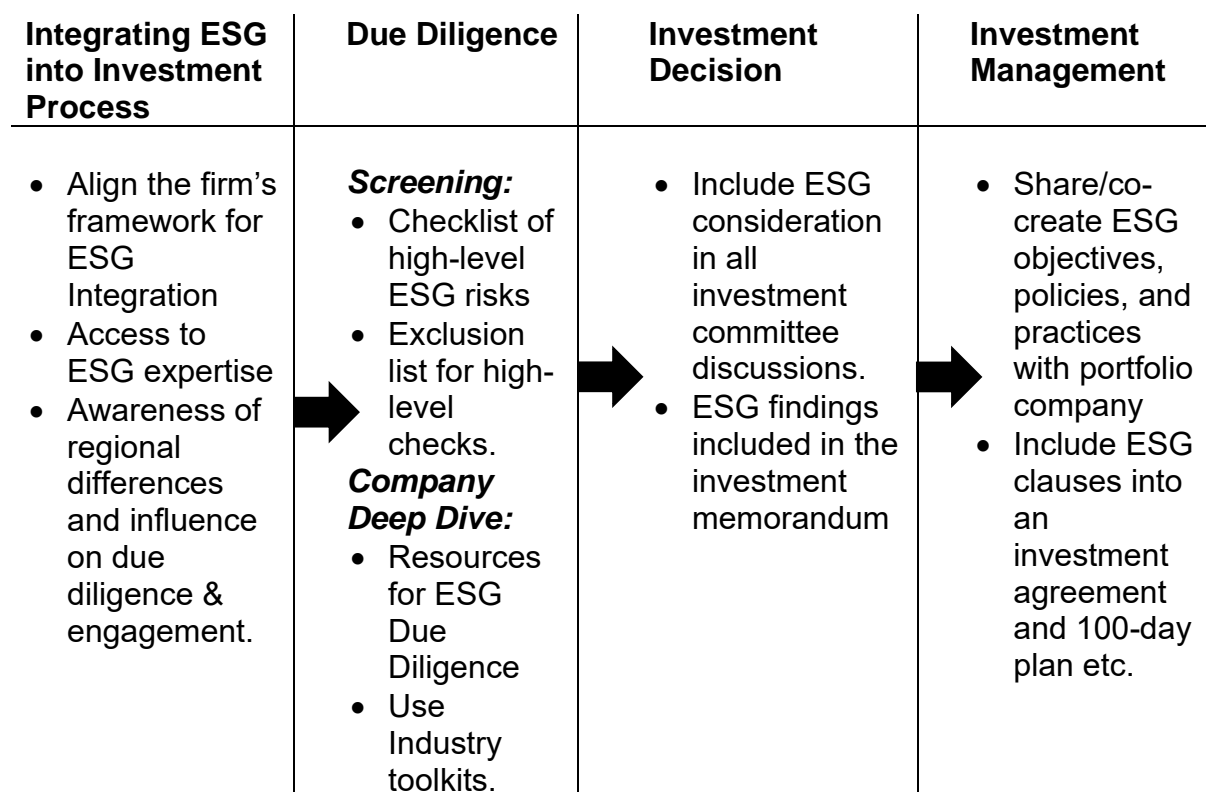
The most prominent responsible investing strategies are negative screening (investments are excluded based on a set of predetermined ESG criteria), positive screening (investments are included based on them being a good example of predetermined ESG criteria). In addition, the best 25 percent in terms of ESG ratings are chosen and shareholder activism; by filing petitions and voting at annual general meetings including engagements with management teams on ESG issues (van Duuren, Plantinga and Scholtens, 2016). In addition to discussing the challenges and opportunities around ESG integration in the investment process for the private equity firm, this research also explores how the strategy is pursued by private equity firms in South Africa.

“Public Equity”, being stocks traded on public exchanges, e.g. the Johannesburg Stock Exchange (JSE), has traditionally been the asset class that has been the platform from which responsible investing, as a strategy, has been pursued (Del Bosco and Misani, 2011). From it, many instruments have been developed to grow the strategy; like the development of ESG screenings and the methodologies behind the due diligence investigations of firms, indices, and listed equities (Del Bosco and Misani, 2011). With more and more asset owners asking accountability questions around the social and environmental impact of investments by private equity fund managers, there has been a growing interest in responsible investing amongst participants within the asset class and an appreciation that private equity may face the same challenges and opportunities as public equity (Del Bosco and Misani, 2011).

ESG integration into the investment process is increasingly becoming the norm within the private equity asset class with general partners beginning to recognise the benefits of having structured approaches to ESG integration toward responsible investing (Hampole and Korngold, 2019). According to Hampole and Korngold (2019),



structured approaches to ESG integration include having policies, management systems, reporting templates and stakeholder engagement processes to keep up with evolving needs and concerns. However, without a universally accepted standard for the various elements of this structured approach, further research is required around the details of these approaches and how they help determine whether a good investment has been found (Khan and Liu, 2019). A good investment may be described as one that is well-placed to deliver superior long-term risk-adjusted returns while solving, or at the least, not contributing to an environmental and social challenge (Khan and Liu, 2019). For signatories of the UNPRI (2014), the UNPRI has developed a guide to a structured approach to ESG integration for private equity. The table below seeks to summarise this guide from the UNPRI (2014) for what is involved in integrating ESG into private equity investments. The following represents the investment process for the private equity firm where ESG considerations can be made at each stage of the process (see Figure 1). From the pre-investment stage where ESG considerations are made in aligning the investment philosophy for ESG integration and assessing the resources available to the firm, to the post-investment engagement with portfolio companies and the 100-day post-investment plan for the business and associated agreements. The process below shows how ESG considerations are made at each stage and not merely at the beginning of the process, or the end as an add-on that informs the post-investment engagement alone and not the investment decision itself.

Figure 1: Integrating ESG in Private Equity. Source: UNPRI (2014;10).



The process outlined above may be used with other investment vehicles; however, may lend itself more to the private equity model due to its stewardship style and long-term investment horizon (UNPRI, 2014). The private equity team is more engaged with the companies they are invested in, often sitting on the boards of these companies and seconding executives to help in the execution of corporate strategies. In support, the UNPRI (2014) provides a framework to govern this engagement with portfolio companies in a meaningful way. Figure 2 below summarises this framework in which the private equity firm is guided in its post-investment engagement for the execution of the ESG programme and monitoring of the company’s performance.

Figure 2: Ownership practices for ESG Integration. Source: UNPRI (2014;14)

Ownership	
Engagement	Monitoring
 <ul style="list-style-type: none"> • Collaborate with a portfolio company to set up an ESG programme. • Leverage board of portfolio company to implement ESG programme • Conduct regular site visits and meetings with the management team. 	 <ul style="list-style-type: none"> • Define company-specific ESG indicators • Prioritise ESG issues in the short to medium term • Ensure ESG considerations are consistently on the board agenda • Provide tools to monitor and measure ESG practices. • Collect ESG developments from portfolio company and include in the annual review • Monitor ESG in internal review meetings.

The opportunity for engagement and monitoring, as shown above, is different for the investment manager invested in listed equities, whose engagement with the company is often limited to the annual general meeting and quarterly earnings calls, for example. This limited engagement is also true for investment firms and financial institutions that are primarily providers of debt. Investors in listed entities and providers of debt may be constrained to high-level positive or negative screenings at the pre-investment and due diligence stage of the process in their efforts to integrate ESG considerations due to this limited engagement with portfolio companies (Heese, 2005). The private equity model being is well-suited for the integration of ESG issues in the investment process and considering the sustainability and financial benefits of responsible investing from a value and risk perspective discussed in Chapter 2, may constitute a competitive advantage in terms of the resource-based theory (also discussed in Chapter 2).

The challenges and opportunities to ESG integration for private equity firms in South Africa are investigated through the lens of these guidelines and the features of a structured approach to ESG integration. The literature in the following Chapter (Chapter 2) is also reviewed through this lens, and the private equity asset class is discussed in terms of its suitability for ESG integration and therefore constituting a

competitive advantage over other asset classes if it were to fully implement this investment strategy assuming that ESG integration in the investment process leads to superior risk-adjusted, long term returns (Davies, 2016).

1.3 The Challenges and Opportunities around ESG Integration

1.3.1 Problem Statement

Many factors may be attributed to the delay in the mainstreaming of responsible investing in private equity in South Africa. These factors may include the perceived risk of the negative impact of full ESG-related disclosure (Amaeshi and Grayson, 2009), and interference in the investment decision-making process by shareholders (with their traditional shareholder short-termism approach) (Harber, 2017). However, the positive aspects to responsible investing in private equity have certainly been apparent and useful - for example; reducing risk by inspiring better controls and improving the operational efficiencies of portfolio firms as well as promoting sustainable growth in the long term (Vidal and Fernandez, 2015). A study of how fund managers are integrating ESG factors into the investment process has revealed that, for the most part, ESG information is used for red-flagging and to manage risk (van Duuren, Plantinga and Scholtens, 2016). According to Del Bosco and Misani (2011), responsible private equity can go further than that it may be used to invest in business opportunities in the broader field of sustainable development - green products and services, community investments, renewable energy and bottom-of-the-pyramid initiatives.

However, the heterogeneity of definitions, practices, and strategies for ESG integration has resulted in institutional complexity for firms within the private equity asset class (Yan, Ferraro and Almandoz, 2019). private equity funds and their managers have resorted to developing their in-house screens to make sustainability-smart investment decisions (Cadman, 2011; Cubas-Díaz and Martínez Sedano, 2018). Furthermore, according to Herringer et al., (2009), the key challenges facing responsible investing in South Africa include:

- RI funds often must compete with short-term incentivised asset classes for investment, whereas the true positive value and return benefits of RI funds are only realised in the long term.
- There is a shortage of skilled professionals with both deep ESG knowledge and financial skills to manage the RI investments themselves and to support portfolio companies with the development of sustainable business practices.
- There is a lack of ESG data available on and from unlisted companies in South Africa.

Furthermore, Davies (2016), in his study on private equity and responsible investing looking into the trends and opportunities, also lists the key barriers to ESG integration as limited knowledge and skills among analysts (to assess key ESG issues), the challenge of collecting ESG data, a lack of common reporting frameworks and opposition to ESG programmes internally due to short-term performance concerns. In Chapter 2 the challenges and opportunities are discussed further in an attempt to establish that the challenges and opportunities identified by Herringer et al., (2009) and that is seemingly supported by Davies (2016) are the key challenges and opportunities to ESG integration into the investment process by private equity firms in South Africa. The challenges outlined briefly above, according to Davies (2016) and Herringer et al., (2009) are explored in this research to determine their role in the mainstreaming of responsible investing as an investment strategy for private equity firms in South Africa.

1.3.2 Research Objectives and significance of the study

This research seeks to contribute to the study of responsible investment (RI), as it relates to private equity investments, an area not well researched, while also contributing to the academic literature on responsible institutional investment in South Africa. In addition, it seeks to contribute to the literature around the opportunities responsible investing presents to optimise portfolios, as well as the means with which the challenges faced in integrating ESG factors in investment activities may be overcome. This research builds upon the work of Herringer et al. (2009) – who initially investigated challenges in the local context in this regard – in discussing and exploring

the key challenges facing RI, but with a keen focus on private equity investments in South Africa. Furthermore, this research seeks to respond build on our understanding of the key challenges facing RI in South Africa.

The main aim of the research is to investigate the key challenges and opportunities in the integration of ESG factors in investment and post-investment activities of South African private equity firms as presented, more generally, by Herringer et al. (2009). The research objectives are indicated below:

- To investigate the key challenges experienced by South African private equity firms in the integration of ESG issues in their investment activities.
- To identify and discuss the benefits and opportunities that ESG integration presents in investment activities.
- Explore and discuss approaches taken (by South African private equity firms) to overcome some/all challenges and optimise the opportunities associated with ESG integration.
- Make recommendations to private equity firm managers for improved ESG integration into their investment activities.

1.3.3 Research Methodology

To achieve the research objectives, this research paradigm is post-positivist (De Vos, Strydom, Fouché and Delport, 2011) in which the experiences of practitioners are the basis upon which knowledge around the research question is constructed (De Vos et al., 2011). Post-positivism as a paradigm is chosen because it emphasises meaning, and with an ontology that opens up more options for data collection to truly explain the experience of the sampled private equity firms in integrating ESG in investment processes (Henderson, 2011). Post-positivism lends itself to the research methods used in this research in that it assumes that knowledge is socially constructed and perhaps even provisional (Cooper, 1997). More on the research methods and techniques used in this research are discussed in the section hereafter.

This research follows a qualitative research design in which the objective is to achieve an emphatic understanding of the subjective experience of each participating private

equity firm in integrating ESG into the investment process (De Vos et al., 2011). The methodology is phenomenology, at the root of which is to understand ESG integration as it is experienced by participating firms and provide a descriptive account of that experience (Ibid). The purpose is to understand the challenges and opportunities associated with ESG integration in the investment process from the point of view of the private equity firm (Webster, 2007). The research methodology is presented in more detail in Chapter 3 of this report.

1.4 Conclusion

The mainstreaming of responsible investing strategies is aspirational and is generally measured by the number of assets under management aligned to the UNPRI and other frameworks. Increased awareness of the impact business has on the environment and society has made responsible investing an important consideration when capital allocated. While private equity firms have made progress in adopting the strategy, ESG aligned assets under management in the industry are still at 44 percent according to the IFC. This research seeks to understand the challenges and opportunities to the growth of these assets from the perspective of practitioners, considering that the private equity model is well suited to the strategy.

In Chapter 2, the literature around the key challenges and opportunities are reviewed, guided by the challenges and opportunities identified by Herringer et al., (2009) and Davies (2016). The challenges are identified as being short-termism, a gap in the skills and knowledge around ESG in investment professionals in the asset class and a lack of comparable, coherent, and accurate ESG data. The opportunities are determined to have been; risk mitigation and economic opportunities in addressing social and environmental issues.

Chapters to follow include the research methodology in Chapter 3, and the results of the study are presented in chapter 4. The discussion of the results and the conclusion are found in Chapters 5 and 6, respectively.

Chapter 2: Literature Review

2.1 Introduction

Herringer et al. (2009) sought to explore the growth and development of socially responsible investing in South Africa, investigating the factors that impacted its growth and development in the local investment sector. According to Herringer et al. (2009), socially responsible investing (SRI) involves the pursuit of both financial and social objectives while integrating ethical and ESG considerations into investment decisions and post-investment activities.

Herringer et al. (2009) identified the key challenges facing responsible investing in South Africa and discusses several opportunities that exist in adopting the investment strategy of integrating ESG considerations into investment processes. The purpose of this study is to explore whether the key challenges and opportunities in responsible investing are also true for private equity as an investment model and experience in South Africa. The following review of the literature, therefore, will discuss private equity as an asset class and ESG integration into the investment process by private equity investors. Furthermore, this section will seek to review the literature around the key challenges as identified by Herringer et al. (2009) as well as the opportunities that exist when investing responsibly. In conclusion, from the literature review, this research aims to have a conceptual foundation from which to analyse and discuss the findings of the research.

According to Herringer et al. (2009), the key challenges facing responsible investing (ESG integration) in South Africa include:

- RI funds often must compete with short-term incentivised asset classes for investment into funds, whereas the true positive value and return benefits of RI funds are only realised in the long term. Khan and Liu, (2019) ascribe the challenge to shareholder short-termism, which is at odds with an investment strategy using long-term performance measures.

- There is a shortage of skilled professionals with both deep ESG knowledge and financial skills to manage the RI investments themselves and to support portfolio companies with the development of sustainable business practices. A global study of ESG incorporation by investment professionals revealed that only 10 percent of investment professionals had received training in the incorporation of material ESG data in investment decisions by 2015 (Khan and Liu, 2019).
- There is a lack of ESG data available on and from unlisted companies in South Africa. This is supported by global studies which suggested that barriers to ESG integration include a lack of universal standards for measuring ESG performance and the lack of ESG performance data (Efimova, 2018).

However, responsible investing and the integration of ESG factors into investment practices has and will continue to present opportunities to further sustainable development objectives and the investment objectives of private equity firms (Hoellermann, 2020). ESG integration has gone a long way in responding to increasing societal demands that firms not only deliver financial returns but also conduct business in a responsible way (Oikonomou, Platanakis and Sutcliffe, 2018). In addition, responsible investing is based on the view that the great challenges facing the world are also big investment opportunities because the demand for solutions to these challenges is growing (Indahl and Jacobsen, 2019).

The following sections in this review of the literature will discuss private equity and ESG integration further. This research will also attempt to discuss short-termism and its impact on ESG integration into investment processes at private equity firms that generally have a long-term investment approach. The skills and knowledge gap, as well as the ESG data challenges in general, and how it affects private equity firms looking to invest responsibly. These are discussed as the key challenges to ESG integration emerging from the literature reviewed for the study.

2.2 Key ESG Integration (Responsible Investing) Challenges

2.2.1 Introduction

According to a study conducted by PWC cited in Davies (2016), which sought to measure the extent to which the private equity industry was embracing responsible investing, 88 percent of limited partners believed RI added value. 71 percent of limited partners would decline to allocate capital based on ESG concerns, and 97 percent of limited partners believed the significance of RI in the sector would increase in the following two years. However, 69 percent of respondents (both limited partners and general partners) were not using an ESG disclosures framework. Reasons given in the study for this low level of integration and reporting include challenges around processing large volumes of ESG data and the additional burden of reporting requirements on fund managers. As noted above, in the previous chapter, the challenges explored by Davies (2016) are rather similar to those expressed by Herringer et al. (2009), suggesting that the needle on improving ESG integration in investment processes had not moved much in seven years. Davies (2016) lists the barriers to ESG integration as; internal opposition to ESG programmes due to short-termism. Challenges around the collection, quantification, and assessment of ESG data. The lack of knowledge and skill of analysts and there not being a common reporting standard. Additionally, the expense of undertaking ESG due diligence is also listed as a key challenge by Davies (2016).

According to Bailey, Klempner and Zoffer (2016), though investors have shown their commitment to integrating ESG into their investing by signing up to the UNPRI, they have struggled to put that commitment into practice. This was in a study looking to recommend what investors can do to improve their ESG integration efforts and bring ESG teams closer to core investment activities within the firm. In discussing the barriers to ESG integration in investment activities, Bailey et al. (2016) argue that firms struggle with access to reliable information on material ESG factors. Firms struggle with building the skills and tools required to run the appropriate analysis of portfolio companies and their exposures to ESG risks and unpredictable shocks. Finally, in appreciating the need to use a long-term ESG outlook as investors with long-term

investment horizons that are vulnerable to the ESG decisions management teams make.

Though many challenges confront the integration of ESG into investment activities, the literature is supportive of the key challenges highlighted by Herringer et al. (2009), as they are consistently expressed in the literature relating to developing responsible investment practices across the investment sector in general, and private equity as an asset class. The most prominent integration challenges are namely, dealing with short-termism, the development of the knowledge and skills of analysts and investment teams and the reliability and accessibility of reliable and comparable ESG data. The sections that follow seek to explore the literature further on these key ESG integration challenges.

2.2.2 *Shareholder short-termism*

When balancing the investment decision equation, time is of the essence, with responsible investing being long-term oriented it is often at odds with the fact that financial markets tend to lean toward short-termism (Amaeshi & Grayson, 2009). Short-termism can be defined as when managers who are under pressure from shareholders to perform, serve shareholder needs by focusing on achieving short-term profitability at the expense of longer-term sustainability (Duruigbo, 2012). This approach often leads to an overvaluation of short-term gains and the undervaluation, or any valuation at all, of long-term results (Duruigbo, 2012). The approach is often bolstered by the pressures that come with quarterly reporting and the need to keep earnings growing quarter-on-quarter.

However, an interesting tension emerges in the literature when discussing the phenomenon of *shareholder short-termism*. The tension often emerges within the broader debate of shareholder power. Dent (2010) argues against the criticism around greater shareholder power on the basis (which is one of many) that shareholders are generally short-term oriented. The criticism is aptly captured in a quote used by Dent (2010) of an assertion by The Aspen Institute's Corporate Values Strategy Group that: "concern about excessive short-term pressure in today's capital markets that result from an intense focus on quarterly earnings and incentive structures that encourage corporations and investors to pursue short-term gain with inadequate regard to long-

term effects” (Dent, 2010, p. 105). Subsequently, Dent (2010) argues that the desires of shareholders to maximise share value is the best way to secure and measure the long-term sustainability of the company.

This perspective does not consider the broader universe of business risk as to the sustainability of the company in the long term is not dependent on the share value in the short-term to medium-term alone (SASB, 2020). To understand this wider view, a broader stakeholder perspective is required with all stakeholders seated around the table as co-creators of value to realise shared value. This is an approach commensurate with the integration of ESG issues (broader risk universe) in investment activities (value-creation) (Efimova, 2018). Khan and Liu (2016, p. 5) describe a theory of the “productive coalition model” in which it is argued that the interests of a wider range of stakeholders must be considered, as “residual claimants of a company” when managing the business. This perspective is important because even those stakeholders who do not have a financial stake in the business are impacted by its operations and may contribute to its sustainability by granting or revoking its social license to operate in the long term. According to Bailey et al. (2016, p. 6), “[a]ll investors ought to consider material ESG factors ... the long-time horizons and broad market exposure of institutional investors means that they are particularly vulnerable to the good or bad ESG decisions of the companies in which they invest.”

The academic literature seems to confirm that in many instances, private equity has been used as a means to increase the short-term profitability of portfolio companies to transfer wealth at the expense of long-run value (Guyatt, 2005; Harford and Kolasinski, 2014, and Polman & Tómasdóttir, 2020). This is, of course, is contrary to the stated approach of private equity of being a long-term steward and partner of portfolio companies (UNPRI, 2014). It is this tension between private equity’s long-term orientation and short-term performance pressures that adds layers of complexity in evaluating the impact of ESG integration which relies on putting in place long-term measures (Khan and Liu, 2019).

2.2.3 ESG Knowledge and Skills Gap

ESG issues introduce a level of complexity into the investment process that is often difficult to articulate and to integrate (Amaeshi and Grayson, 2009). A global study of ESG incorporation by investment professionals revealed that only 10 percent of investment professionals had received training in the integration of material ESG data in a way that helps investment professionals make sense of how to achieve short-term earnings without neglecting the “low frequency but high impact risks” to business sustainability in the long-term (Khan and Liu, 2019). Khan and Liu (2019) further argue that fund managers may not be able to assess companies beyond conventional financial terms.

A study by Viviers et al. (2009), looking into the development and growth of responsible investing in South Africa had found that one of the major barriers to the growth of the local RI sector is the lack of RI expertise in the local sector. The local RI sector seems to be in short supply of the combination of financial skills and deep ESG knowledge amongst fund managers and analysts. A review of the literature has revealed that not a lot has changed in terms of addressing the skills gap challenge to the adoption of responsible investing. This remains a challenge across all asset classes over the last 15 years and not unique to South Africa from the time of the “Mainstreaming Responsible Investing” report of the World Economic Forum in 2005.

It is argued in industry publications that over the last two decades, responsible investing professionals have been generalists and what has become an urgent need is for specialists to fill out the breadth and depth (Wallis and Dudley, 2019). The implication being that with ESG integration having become the majority investment strategy, deep ESG knowledge is required across all disciplines within the investment community (Wallis and Dudley, 2019). According to Herringer et al. (2009), constant education around ESG needs to be pursued to keep up with the increasing demand for the maturing strategy.

2.2.4 *The ESG Data Challenge*

The ESG data challenge can be summarised by the following features of the obstacles for investment managers; there is a lack of transparency in ESG reporting as well as standardisation, differing methodologies by ESG data providers which lead to differences in ESG scores, and lastly, there are no platforms in most markets that allow companies to see how they are evaluated to modify their reporting and how they manage their ESG data (State Street, 2019). In exploring the relationship between information asymmetry (where one party has better information than the other in a transaction) and socially responsible investment, Rhodes (2010) argues that these asymmetries in the market hinder the further development of responsible investment. The importance of accurate ESG information is stressed further by Ailman, Edkins, Mitchem, Eliopoulus and Guillot, (2017) as valued by investors because it reveals the risks that are specific to that portfolio company in a way that traditional risk assessments cannot. Additionally, ESG data is useful in comparing the quality of management teams across the portfolio, based on how ESG factors are identified, managed, and reported. The ESG data challenge is important because responsible investing depends on integrating ESG data with the methods and information that are key to traditional financial analysis (Hanson et al., 2017).

The lack of standardisation and transparency in ESG reporting has led to ESG disclosures of really poor quality. A study is reported to have found 33 percent of investors do not use the information provided regarding ESG performance, because of its quality (Camelia, 2019). Where the provided information is unreliable, the data must be gathered manually. Gathering data on the ESG performance of a company is difficult and includes site visits, meeting with the management of the company as well as those responsible for sustainability/ESG and then verifying what you find with all internal and external stakeholders (e.g. suppliers, distributors, consumers, employees, etc.) (Santhosh, 2019). Quality data is crucial to good investment analysis (State Street, 2019). The challenges relating to the quality of the data is even more important when you consider that, according to a CFA Institute ESG survey, more than 73 percent of investment professionals have reportedly integrated ESG factors into their investment processes (Efimova, 2018).

Additionally, because there is no standardisation, ESG data providers and users have derived their methodologies and standards, leading to a lack of comparability in the market. Furthermore, companies are left to decide for themselves what to measure, manage and disclose/report to investors (State Street, 2019). ESG integration is held back by a lack of standards to measure ESG performance and has led to an integration effort that is largely at the discretion of investment professionals or the management of the investee company without a clear system in place to facilitate it across the entire investment sector (Efimova, 2018).

ESG factors are not easily quantifiable and comparable, as this research has argued above, and therefore comparability cannot be leveraged to contribute toward data quality (Amaeshi and Grayson, 2009). When data is comparable, platforms can be created to compare and contrast the ESG performance of investee companies and therefore allow companies to see how they are measured and how to manage ESG data and initiatives and report ESG data in decision-useful ways (Ailman et al. 2017).

2.3 Key ESG Integration in investment (Responsible Investing) Opportunities

2.3.1 Introduction

With an increasing number of private equity firms integrating ESG into their investment processes, firms have adopted two main approaches being risk management and value creation (Zaccone and Pedrini, 2020). The interest is growing in ESG factors, and private equity firms are increasingly integrating them into their investment activities as they learn more about how to navigate the challenges associated with ESG integration in investment processes, particularly for the benefits associated with better controls and risk management (Zaccone and Pedrini, 2020).

In addition, ESG integration in investment activities presents an opportunity in participating in the market opportunity in the real economy associated with private sector engagement with the Sustainable Development Goals (SDGs) (Han, 2020). According to the United Nations Department of Economic and Social Affairs (2020), the market opportunity of achieving the SDGs is worth US\$12 trillion in the four largest sectors that represent more than half of the real economy.

The following section of this chapter reviews the literature on risk mitigation and the market opportunity benefits of ESG integration in investment processes as key opportunities for private equity firms.

2.3.2 Risk Mitigation

Laurel-Fois (2018) would argue that integrating ESG into the investment process offers the investment manager superior risk controls. This is achieved through the benefit of having more information about the companies that are the targets of investments. With more information, the investment manager can choose less risky investments and thereby improve financial performance (Laurel-Fois, 2018). The disclosure of ESG data is argued to contribute to the lowering of the volatility of the investment and thereby reducing investment portfolio risk for the investment manager (Przychodzen et al., 2016). Again, the principle here is that with more information, the risk and value assessment can be more accurate and thereby better decisions can be made about the investment. Responsible investing is, therefore, useful in reducing risk through better control that comes with more information (Vidal and Fernandez, 2015).

Additionally, the impact of ESG integration on risk may be seen at the portfolio company level. This is important because ESG integration in the investment process for the investment manager extends to the post-investment engagement with the portfolio company (see Figure 2). There appears, from the literature, that there is a benefit to be gained through corporate social responsibility in which firm risk is reduced by managing the expected financial, social, or environmental risks that could have an impact on the cash-flows of a business (Jo and Na, 2012). Considering the above, and the portfolio-level benefits, the risk mitigation benefit of integrating ESG into the investment process can be achieved before the investment is made as well as after the investment is made, i.e. throughout the deal cycle (SASB, 2020).

From the early literature, the argument has been made that to not manage non-financial risk, in the way in which ESG integration enables you to, puts shareholder value at risk and even limits opportunities for further investment (Heese, 2005). A study on the value of non-financial disclosures in emerging markets has revealed that

these are important to the evaluation of a company's risk profile and "ultimately its capacity to create long-term value, thereby alleviating their inbuilt information disadvantage" (Chauhan and Kumar, 2018, p 33).

According to Zaccone and Pedrini (2012), investment strategies often hinge on two key considerations; risk and value creation. These considerations would suggest that the benefit of responsible investing as an investment strategy offers the benefit of better risk management through access to more information and a broader understanding of business risk as well as contributing to the portfolio company's ability to create superior returns in the long run. ESG integration into the investment process (the cycle from pre-investment to post-investment engagement) offers opportunities for superior performance at the portfolio company level as well as at the investment portfolio level (Hoellermann, 2020). The private equity firms that successfully integrate ESG issues and adopt responsible investing practices are most likely to do better financially while also lowering their risk (Indahl and Jacobsen, 2019). The potential impact of ESG risk management on performance is acknowledged by investors (Johnson, Mans-Kemp and Erasmus, 2019).

2.3.3 The market opportunity in addressing sustainability issues

Responsible investing is seemingly, and often, interpreted to be limited to the incorporation of ESG aspects to the standard risk-return considerations in the evaluation of investee companies (Johnson, Mans-Kemp and Erasmus, 2019). However, greater opportunities lie in emphasising that the scope includes investing responsibly in environmental and social solutions. ESG integration in the investment decision where the decision is not just about how the investee company does business, but also the "sustainability" of its product or service. In other words, impact investing.

According to the Global Sustainable Investment Alliance, \$18 trillion was allocated to ESG investment strategies versus \$1 trillion allocated to investments seeking to find solutions to ESG issues. In Canada alone, from 2010 to 2017, responsible investment funds grew 400 percent, doubling again in 2019; yet the investments in renewable energy have seen declines since 2019, and there has generally been a decline in

investments in social and environmental solutions (Cook, 2020). According to Cook (2020, p. 2), only between 5-15 percent of funds allocated to RI assets are invested in climate and/or social solutions while the rest goes to traditional investments that have been “tattooed with the labels ‘sustainable’, ‘ESG’, and ‘low-carbon’”. The decline in investments for solutions to social and environmental issues, despite the growth in allocations to RI funds, would seem to represent an opportunity for “good investments” in sustainable products and services over and above just companies that behave responsibly regardless of whether their products and services solve environmental or social problems, directly. The market opportunity associated with investments in solutions to social and environmental issues, or investments aligned to the SDGs, is estimated at being worth \$12 trillion by the UNDESA (Han, 2020).

The investment context is important to consider here, with the following features; 50 percent more food and energy will be needed by 2030, as well as about 30 percent more water while governments will have to combat climate change and facilitate the transition from fossil fuels to renewable sources of energy (Bell, Lino, Thomas, Szilvia, Christina, Voula and Paula, 2018). This is the worst possible time for investments into environmental and social solutions to be on the decline (Cook, 2020), where there will be an obvious and increasing demand and therefore, tremendous upside potential. For example, in the European Union alone, what is referred to as the “bioeconomy” is responsible for 18 million jobs, ranging from agriculture to energy with the following emerging subsectors; materials and chemistry (Bell et al., 2018).

Lastly, in South Africa, the turning point, in terms of appreciating the role of financial capital in addressing social and environmental issues, can be traced back to the establishment of the South Africa National Task Force for Impact Investing as recently as in 2018 (Ducastel and Anseeuw, 2020). The task force, which includes banks, regulators, and asset managers, is aimed at empowering investors in building the infrastructure for sustainable investment that intentionally addresses social and environmental challenges. The opportunity is bolstered for local funds as the potential of impact investment to play a unique role in Africa’s response to social development, and environmental sustainability is substantial as well as by the advantage of having the necessary ecosystems in place for impact investing in South Africa (Mogapi, Sutherland and Wilson-Prangley, 2019).

2.3.4 Private Equity Resources and Capabilities for a Competitive Advantage

In discussing both the challenges and the opportunities that present with the integration of ESG factors, the firm is analysed from the resources and capabilities side of the firm; studying its ability to develop new capabilities in RI and the competitive implications of those capabilities (Barney, 2001). According to Del Bosco and Misani (2011), private equity is uniquely placed to help portfolio companies support society while achieving the necessary financial returns. A position that is attributable to private equity's "stewardship-style" of investing (UNPRI, 2018). In private equity, the involvement of the general partner in the running of the business, influencing policy, strategy, and reporting is not "shareholder activism"; it is part of the investment package from the very beginning of the engagement. These idiosyncratic capabilities and private equity's unique investment model position the private equity firm to leverage ESG integration in the investment process as a source of competitive advantage following the resource-based theory of the firm (Le Nadant, Perdreau and Bruining, 2018). Private equity firms are in a good resource position in terms of their long-term outlook and an investment model that is characterised by in-depth engagement with portfolio companies to gain a competitive advantage over other asset classes and investment strategies. From a resource-based theory perspective, the private equity model is better suited to maximise the benefit of better risk controls in portfolio companies due to greater engagement with portfolio companies than any other investment model, thereby being a source of competitive advantage (Le Nadant, Perdreau and Bruining, 2018).

The resource position of the firm is constituted by the strengths and weaknesses of that firm and is the foundation of what we understand to be the concept of strategy (Wernerfelt, 1984). By resources, what is referred to are all things related to the strengths and weaknesses of a company including, knowledge and skilled employees, efficient procedures, capital, business models etc. (Wernerfelt, 1984). The resources and capabilities of the firm are important to our understanding of where the firm finds and sustains a competitive advantage (Barney, Ketchen and Wright, 2011). Where this research can assume that ESG integration in the investment process leads to superior risk-adjusted returns, the argument can be made that the distinctive

competencies and resources of the private equity firm lend themselves to ESG integration in investing and are may therefore become the basis for competitive advantage (Peteraf, 1993).

Where other asset classes are faced with the challenge of redefining strategic communications with investee companies to influence responsible corporate behaviour (Uysal, 2014), private equity as a business model has specialisations that promote advantages in their engagement with portfolio companies at all phases of the transaction (Le Nadant, Perdreau and Bruining, 2018). The model allows for conversations to be focused on the integration of ESG factors and the change in corporate behaviour at the firm level to be had more readily to exploit emerging opportunities and/or address emergent risks. This can be achieved by leveraging existing and well-established tools within the asset class like the “100-day plan” as an integral part of the post-investment and engagement programme. The relationship between private equity and portfolio companies is largely driven by trust, based on a track record of post-investment growth and performance of portfolio companies that is generally higher than non-private equity-backed companies (Manigart and Wright, 2013). It is from this foundation that opportunities can be effectively pursued, and challenges overcome in the integration of ESG issues in a way that, may not be achieved within the other asset classes and post-investment configurations.

2.4 Conclusion

The integration of ESG issues into an investment process presents challenges for private equity firms/funds in South Africa that are not unique to the asset class. However, the private equity model may be better placed to overcome these challenges by leveraging existing capabilities and tools in a way that other asset classes may not.

The ESG data challenge and a lack of skills and expertise around the integration of ESG factors is a cross-sectoral issue in financial services and may require just a willingness to invest in a range of possible solutions. However, an investment in skills in this area may be catalytic. In addition, it has become clear from the literature that the greatest source of private equity’s competitive advantage is its long-term

orientation and that also lends well to the integration of ESG factors into the investment process.

Furthermore, the benefits of having more information are helpful to the evaluation of risk and the ability of investors to design post-investment strategies for portfolio companies. The literature has shown that the engagement model of private equity firms/funds is incredibly important to the behaviour and performance of portfolio companies. Therefore, the additional information that is made available by implementing this investment strategy (ESG integration) may be a tremendous source of competitive advantage for private equity firms and their portfolio companies.

Chapter 3: Methodology, Methods and Techniques

3.1 Methodology and Paradigm

The research paradigm is post-positivist (De Vos, Strydom, Fouché and Delport, 2011) in which the experiences of practitioners are the basis upon which knowledge around the research question is constructed (De Vos et al., 2011). Post-positivism as a paradigm is chosen because it emphasises meaning, and with an ontology that opens up more options for data collection to truly explain the experience of the sampled private equity firms in integrating ESG in investment processes (Henderson, 2011). Post-positivism lends itself to the research methods used in this research in that it assumes that knowledge is socially constructed and perhaps even provisional (Cooper, 1997). More on the research methods and techniques used in this research are discussed in the section hereafter.

This research follows a qualitative research design in which the objective is to achieve an emphatic understanding of the subjective experience of each participating private equity firm in integrating ESG into the investment process (De Vos et al., 2011). The methodology is phenomenology, at the root of which is to understand ESG integration as it is experienced by participating firms and provide a descriptive account of that experience (Ibid). The purpose is to understand the challenges and opportunities associated with ESG integration in the investment process from the point of view of the private equity firm (Webster, 2007). It is chosen to be compatible with an enquiry into the experiences of participants and to gain a proper understanding of those experiences from multi-dimensions (Panhwar, Sanaullah and Asif, 2017). Furthermore, the qualitative approach is used to achieve a contextual understanding, combining context-sensitivity and rigorous explications of the challenges and opportunities to ESG integration in the investment process through the experiences of the participants (Azungah, 2018). It is through this lens that the methods and techniques used in this study were considered and chosen.

3.2 Methods and Techniques

Research methods are chosen and designed to achieve the aims of the paradigm and the research question (Cooper, 1997). The research methods chosen for this research are considered appropriate in pursuing the research objectives, being;

- To investigate the key challenges experienced by South African private equity firms in the integration of ESG issues in their investment activities.
- To identify and discuss the benefits and opportunities that ESG integration presents in investment activities.
- Explore and discuss approaches taken (by South African private equity firms) to overcome some/all challenges and optimise the opportunities associated with ESG integration.
- Make recommendations to private equity firm managers for improved ESG integration into their investment activities.

In the sections below the methods and techniques used in this research are described to respond appropriately to the research questions and the aims of the paradigm and research methodology.

3.2.1 Data Collection and Sampling

Data for this research was collected by in-depth, semi-structured interviews with an investment team member of target organisations to gain insight into their experience of ESG integration and to test the theoretical propositions around ESG integration drawn from the literature, as described by Pearse (2019). According to De Vos et al. (2011), the guided interview is ideal for getting comprehensive and comparable data. The interviews were organised around ESG integration and RI specifically while allowing for flexibility in scope and depth to unearth an authentic account of the challenges and opportunities faced by RI practitioners in private equity firms (Ibid). The aim was to also explore the complicated cultural and institutional settings within which ESG is integrated by PE firms and how that contributes to overcoming the challenges and/or exploiting the opportunities (Azungah, 2018).

An interview guide (see annexure A) was prepared to guide the conversation and pursuit of the research objectives, and in unearthing an authentic account of the experience of the firms in integrating ESG into the investment process, the questions posed to the representatives of sampled firms included the following:

- In what ways were stakeholders and asset owners supportive or not of investment strategies with long-term performance measures?
- Whether ESG integration in the firm had Board and stakeholder support?
- To describe how the firm was suited to ESG integration and responsible investing?
- How the capabilities and resources in the firm for responsible investing were being nurtured and developed?
- What they would describe have been the key challenges to ESG integration in the investment processes of the firm?
- What would they describe as being the benefits of ESG integration in the investment process, in their experience?

The interviews were of a purposive sample of three of the six private equity firms, as of the 26th of November 2019, who were signatories of the UNPRI in South Africa based on firms listed as signatories on the directory of the UNPRI found on its website (UNPRI, 2019). Purposive sampling was used to select respondents for their features of being investors in the private market and had committed to ESG integration in their investment philosophy (De Vos et al, 2011). Purposive sampling is used to select respondents who can “purposefully inform an understanding of the research problem of the study” (De Vos et al. 2011, p. 392). In addition, the investment professional responsible for ESG integration and reporting within the firm was interviewed in line with the objectives of the sampling method (Ibid). Whether these firms were indeed private equity firms was confirmed by visiting the websites of each and cross-referencing company information with the directory of private equity firms found on the South African Venture Capital and Private Equity Association (SAVCA) website (UNPRI, 2019; SAVCA, 2020). This sample represented 50 percent of the population of private equity firms or funds focused on unlisted investments who are signatories of

the UNPRI according to the UNPRI directory of signatories (UNPRI, 2019). Signatories of the UNPRI are chosen because of the requirement upon them to publicly report on their efforts toward ESG integration (Ibid), which lends to their legitimacy as RI practitioners. The anonymity of the participants from each firm has been maintained, and proprietary information regarding firm-specific processes and tools has been excluded from this report.

The interviews were conducted once written permission was obtained from the leadership of target organisations, and the written consent of research participants. A single member of the investment team at each South African private equity firm was interviewed to explore the research objectives.

The interviews were conducted over online conferencing platforms because South Africa was under a “level 4 lockdown” under the “risk-adjusted strategy” of the National Coronavirus Command in response to the global pandemic (National Command Council, 2020). Interviews conducted on these platforms were recorded and transcribed. Transcription was done using Otter.ai (Otter.ai, 2020) an artificial intelligence-powered cloud-based software used to generate rich text meeting notes and transcriptions (Su, 2019). Once the interview transcriptions were generated, the transcriptions were transferred into an Excel spreadsheet and organised for coding using Excel functions (Ose, 2016).

Detailed notes were also kept throughout the interview to give the participant a summary of the interview to approve to raise the credibility of the research (De Vos et al., 2011). In addition, interpretive rigour is sought by demonstrating by explaining how interpretations of the interviews were achieved, and quotes from the interviews are included in the report to support the findings (Fereday and Muir-Cochrane, 2006). The organisation was the primary unit of analysis.

3.2.2 Data Analysis

The data from the interviews were analysed using theoretically-driven coding; to report upon the patterns within the data (Pearse, 2019), and to bring about structure, order,

and meaning while actively searching for cases that confirm or disprove initially formulated themes (from the literature) to increase credibility (De Vos et al., 2011).

A deductive thematic analysis (Bryman and Bell, 2014) of the interview transcribes, was conducted to test the validity of the themes identified in the literature as well as a means of testing the reliability of the codes (Pearse, 2019). In this context, reliability refers to coding the “same units of data in the same way” (Syed and Nelson, 2015). A continual re-reading of the interview transcripts and field notes also helped develop themes and highlights throughout the process (De Vos et al., 2011). It is akin to pattern recognition where the themes that emerge from the data become units of analysis (Fereday and Muir-Cochrane, 2006).

The method presented by Ose (2016), where Microsoft Excel and Microsoft Word are used to structure qualitative data, was relied upon for this study and comprised of a ten (10) step process, which was as follows:

1. Collect the data (interviews),
2. Transcribe the interview file that was recorded,
3. Load the word transcript onto Excel,
4. Prepare the file for coding,
5. Code in Excel,
6. Prepare the coded interview for sorting,
7. Sort the data,
8. Transfer quotes and references from excel to word,
9. Sort the text into a proper structure, and
10. Analyse the data.

Figure 1 below is an image of step four (4) in the process where the interview transcribes were prepared for coding having copied the transcribed interview into an Excel spreadsheet and separated it into two columns. The first being the tag representing the speaker and the second column being what was said in the interview (Ose, 2016). Figure 2 illustrates the transcribed once coded using Excel functions and ready to be sorted for further analysis.



Figure 1: Prepared Transcript for Coding



Figure 2: Coded Interview for sorting

Semi-structured interviews were conducted to encourage the telling of an authentic story from a credible source with adequate experience. A review of the literature around responsible investing, ESG integration and mainstreaming, shareholder activism, sustainability data management, and the performance of responsible investing funds was conducted and served as the statement of the theory to be tested (Pearse, 2019). By employing a deductive, qualitative approach (Ibid), this research seeks to confirm or reject whether the key challenges and opportunities identified by Herring et al. (2009) and the literature reviewed. The key challenges and opportunities, identified in the literature reviewed, are explored through the experience of South African private equity firms that are signatories of the United Nations Principles of Responsible Investing (UNPRI).

The trustworthiness of a qualitative study is often very difficult to evaluate (Elo, Käariäinen, Kanste, Pölkki, Utriainen, and Kyngäs, 2014). For this research the process outlined by Elo et al. (2014) including a checklist consideration in how the data collection method and analysis is described to give the reader a clear understanding of the overall trustworthiness. The checklist developed by Elo et al. (2014) proposes questions the researcher must ask himself during the preparation, organisation, and reporting phases of his or her analysis of the data to improve trustworthiness.

3.3 Ethical Considerations of the Research

To achieve successful research and practice, the ethical aspects of researching with human participants must be handled appropriately (De Vos et al. 2011). The overall objective is to be transparent and honest with respondents and subsequently present a full and true report (Frechtling and Boo, 2012). Participants were sent a consent form which they signed (See Annexure B). Rhodes ethical clearance and approval was obtained in terms of the policies of Rhodes University and the Rhodes Business School.

Participation in this research was voluntary, and informed consent was obtained from each of the participants representing their firms. In obtaining their consent, the objectives of the research were explained in full including the expected duration of the interviews and that they could withdraw their consent at any time (De Vos et al. 2011).

Four key considerations were made in handling the ethical aspects of the research. These considerations were made throughout the research process, beginning with the design stage, obtaining ethical clearance and conducting the interviews. These were; whether any harm would come to the participants, if they truly felt their participation was voluntary, how anonymity would be maintained, and if the researcher was completely honest and transparent with the respondents at all times (Bryman and Bell, 2014).

Chapter 4: Results

4.1 Introduction

The interviews were designed to be conversational, aligned with qualitative research approaches (Azungah, 2018), to get the story behind their experiences of integrating ESG into their investment activities and not tick-box responses to the challenges and opportunities as presented by Herringer et al. (2009).

The results cover the challenges and opportunities experienced by the firms in the effort to integrate ESG into investment processes. This is followed by a discussion with the participants. Their responses are presented below of the opportunities and benefits they have faced in their integration of ESG in the investment process.

This chapter of the research presents the results of the interviews with the investment managers participating in the research and representing the firms/fund that are the focus of this enquiry. The results of this research are presented, firstly, by way of tables to present the high-level responses to the specific challenges and opportunities discussed above. This is then followed by a presentation of how each of the challenges and opportunities was discussed in the interviews. This chapter is then concluded with a discussion of the results before recommendations are made in the chapter that follows below.

4.2 Brief background on the firms and the experience of the respondents

Each of the respondents to the interviews has extensive experience in capital markets and the investment space more specifically. They represent their firms in their positions as leaders of the ESG integration effort, as chief investment officers and/or portfolio managers in their respective firms have been at the forefront and leading teams in the investment process and the integration of ESG factors in the decision-making.

- Firm 1 represented by Respondent 1 offers investments – both listed and unlisted – across equity, multi-asset class funds, infrastructure, debt, and private equity funds. Respondent 1 leads the unlisted division, which includes private equity and infrastructure investments. Firm 1 has been a signatory of the UNPRI since 2007.
- Firm 2 represented by Respondent 2 uses a fund of private equity funds strategy focused on the South African midmarket sector. The fund holds a diversified and transformed portfolio of South African medium-sized companies. Firm 2 has been a signatory of the UNPRI since 2007.
- Firm 3 is an established private equity company that invests responsibly in the fast-moving consumer goods, business services and inclusive tech-enabled financial services sectors. Firm 3 has been a signatory of the UNPRI since 2017.

Respondent 1 – (Firm 1):

“I’m a chartered accountant by profession and been in the investment space for about 15 years now. I head up unlisted investment at ... in South Africa... I currently also uptake managing a team. I’m also responsible for making investment decisions and across the different funds, one being what we call a sector-agnostic impact fund or high impact credit fund. And then other ones are the renewable energy equity fund, a renewable energy debt fund, the next one, an infrastructure equity fund.”

Respondent 2 – (Firm 2):

“My experience is, I guess, I’ve got over ten years’ experience in M&A - mergers and acquisitions, capital markets, restructuring and integration, I guess from my time in the UK with Deloitte working primarily in the oil and gas space and the mining, resources and energy space. And, I guess more recently I have spent the last two and half years at the firm, investing in the private equity space, and before that, two years heading up a corporate finance team at Deloitte in the western cape.”

and,

Respondent 3 – (Firm 3):

“So it was 2010 when I joined ..., which at the time was a corporate finance business, basically doing deal-making and matching, sort of, your projects and companies to equity providers, I mean, essentially what we were doing was building a pipeline for our capital-raising process because we were at the same time, starting to, to produce documentation to go and seek third party capital into, you know, not to raise a lot of capital for fun.”

The results of the study are presented below in order of, firstly, presenting the experiences of the private equity firms with the challenges associated with ESG integration. Secondly, the results of the interview concerning the opportunities are presented and finally, what ESG integration and being a signatory of the UNPRI means to the South African private equity firm.

The challenges and opportunities presented are in line with the key challenges and opportunities emerging from the literature, and the participating firms were asked to reflect upon them based on their experiences with integrating ESG in their investment processes as signatories of the UNPRI (2019). The challenges include; short-termism, the lack of adequate skills and knowledge and the ESG data challenges. Opportunities presented in the results are associated with risk mitigation, value creation and the investment opportunities associated with solutions investment.

4.3 Challenges to ESG Integration for South African Private Equity Firms

4.3.1 Shareholder Short-termism

For the participants, in their experience around shareholder expectations, pressures and relationships are diverse and not completely consistent with how this challenge is described in the literature. For example; reporting in the private equity firms represented here is not used to implement short-term incentive programmes or as part of a short-term incentive structure that pressures investment managers to pursue short-term gains but is merely a management tool.

When asked about the relationship with stakeholders and whether there was pressure to report quarterly as a means of incentivising short-term gains at the expense of the long-term sustainability of the investments, the respondents to the study, responded in this way:

Respondent 1:

“Yeah, no, we report monthly in terms of performance. more granular detail performance we put on a six-month basis. So, what we've done in the underlying investments...

Our institutional investors are supportive of pursuing the long-term strategy. They are because an unlisted investment is when you lock them into some strategies, and they are generally long-term in nature.”

Respondent 3 had an interesting perspective based on his experience with shareholders in the management of his funds:

“I want to pose a question back, why are you drawing a link between ESG and long term? investing requirements? I don't necessarily see it the same way. And, and I don't think it's, you know, from our perspective, several requirements are placed on us, you know, principally its returns and, you know, performance. Timing for us is less of an issue if the performance and the returns are there so our principals are happy for us to be invested for a longer period, as long as the returns current and future justify, you know, the longer hold period.”

The feedback from investment professionals representing private equity firms suggests that the experience of private equity firms with shareholders is divergent from the literature (Duruigbo, 2012; Dent, 2010). Shareholders and the broader stakeholder group are aware of the long-term nature of the investment where ESG factors are integrated. They (Shareholders and the broader stakeholder group) are happy with the long hold periods to achieve the responsible investment objectives.

4.3.2 The Skills and Knowledge Challenge

The literature (Viviers et al., 2009; Khan and Liu, 2019; Wallis and Dudley, 2019), and more specifically referring to Herringer et al. (2019) alludes to a shortage of the combination of skills that include finance skills and deep ESG knowledge. The investment managers who were part of this study were asked to comment on this challenge, based on their experience in private equity in South Africa. The question was asked in a manner that also sort to elicit a response on the suitability of the private equity model for the integration of ESG. Furthermore, whether the suitability of the private equity model was a source of competitive advantage with the integration of ESG in the investment process and finally, the extent to which training is conducted toward developing the combination of skills required to mainstream ESG integration in the asset class. Their responses are outlined below.

Respondent 2:

“The skills are not there... I think everybody’s, we’re a bit behind the curve in terms of global practice, around ESG, so it’s also about investing in those skills at a private equity manager level, and also at an investee company level and this not being just an afterthought, ESG has been an afterthought in the investment.”

The extent of this challenge is further elaborated on by this same respondent in recounting the complexities that are presented when integrating ESG in private equity:

“ESG is very difficult to, the challenge you have with ESG integration into your strategy is that it’s not one size fits all. So everybody understands the financial return dynamic and you can compare a portfolio company in the energy sector - you can compare returns there – and you can compare companies in the manufacturing sector and the retail sector, easily. But when it comes to ESG integration and measuring the success of ESG across different sectors and your manager group, that you’ve invested in, it’s very challenging to do that because each will be invested in a different sector and there are different ESG aspects to consider outside of governance. Governance is probably going to be the only consistent thing.”

However, still, the private equity model is considered well-suited for the integration of ESG once the ESG knowledge gap is filled because the sector does have;

“... highly skilled individuals that can support diverse companies in that journey, around sustainable investing.” (Respondent 2).

The skills and knowledge gap around ESG integration for private equity firms sampled for this study that are signatories is not an exception to the rule but appears to be endemic. This is supported by the following response by Respondent 3:

“It's unless you either hire somebody who's got that skill set, or you hire consultants who got the skill set, it's not easy. Because it's fairly, it's unlikely and I mean, that sort of combination of skill sets may exist in the future but the current landscape... There are a few experienced private equity people who've also got, sort of, deep understanding of the ESG landscape and how to integrate it because it's relatively new. And because it's so, then you end up tending to have two camps in an organisation where you've got the private equity fund managers and the commercial big deal executives and deal doers etc. Now, some instances, they can work against each other or they can sort of coming into conflict because, you know, ESG people will be wanting the fund managers to be focusing on ESG.”

Finally, a strong theme that emerged in the interviews with investment managers that are a consequence of the skill and knowledge gap for private equity managers; is the language around ESG seems vague for them and thus difficult to translate into an investment programme.

Respondent 3:

“I think generally the inhibitor is just actually an understanding and an appreciation of the, you know, the ESG factors and requirements of, of the transaction transacting side of the firm. You know, people just don't have a basic knowledge and understanding. They just hear ESG, but they don't know what that means practically. I do find ESG people can't explain it at a practical

level. You know, the language tends to be quite vague and sometimes the two can't talk to each other, you know, and understand each other."

The link between the capacity within the asset class for ESG integration is raised as a source of great difficulty in the full integration of ESG in investment and post-investment processes;

Respondent 1:

"I think the key challenge is that you know, it's quite... can be quite an intensive part of the investment process and then also the intentions or some of the recommendation that comes out of due diligence on the ESG side can be time-consuming. And yeah, sometimes it is difficult to document like; it's an endless list, we need to have a framework in place to make sure that you can ensure the company can kind of adhere to some of the best practices and then from there, you can kind of just tweaking and improve, but all of them on different stages. And so, you need to have a dedicated resource in my mind or an external service provider that can assist in terms of execution."

Respondent 3:

"I think the reason why it hasn't happened in other firms, and maybe our firm, as an example, it's because ... there isn't a real deep understanding of ESG and why it's important and a belief that it's necessary component of our investment process. So, the way we treat it is; well it's something we've got to do. So once everything, all the other important stuff is done, we'll just top up on the ESG side of things and get the ESG reporting done."

As a result, even private equity firms that are signatories of the UNPRI have not fully integrated ESG into investment processes and there are tremendous constraints on the investment managers to be able to integrate ESG in any meaningful way.

This is even with the guidance from the UNPRI (2014); the experience is still a difficult one without the proper data to help translate the guidance into action items, metrics, and measurement tools. We review the responses around the data challenge in the next subsection.

4.3.3 The ESG Data Challenge

The ESG data challenge was dealt with during interviews by seeking to understand the relationship with portfolio companies as it relates to influencing what is measured and reported upon there. The first challenge to overcome, which is linked to the skills and knowledge gap challenge, is to determine the way to engage portfolio companies in the post-investment stage on ESG issues. Respondents in the study revealed their reliance on external organisations to assist in determining what data to collect and how to go about collecting it.

Respondent 2:

“We do speak to ESG consultants. And we also conduct our sort of research, so we just recently had a conversation with CDC (CDC Group DFI) on how they measure ESG across portfolio companies and managers because it’s very difficult to get to a consistent, consolidated view because at the fund of fund level. So, we’ve taken part in some research and gotten some tools and guidance from them which we are now incorporating into our processes as well.”

For respondent 1, it is more the lack of data before they can deal with the quality of the data:

Respondent 1:

“So, like ESG, companies will do minimum compliance with legislation. And then from there, you can kind of see in terms of what else is needed. But it’s not so it’s like you have to tell them what to do with what you need from them, or they’re not going to give you information.”

For Respondent 2 the data challenge is key to the mainstreaming of ESG integration on many fronts. Particularly in terms of getting more private equity firms to participate and even become signatories.

Respondent 2:

“Until those private equity firms see the benefit of being transparent around what they are achieving, from an impact perspective and the ESG perspective and allowing the industry body – so SAVCA is the industry body – allowing that industry body to gather that data, interpret that data, and then present that data in a form that shows what impact, private equity has as a result of what it is doing, you’re not going to get the adoption of ESG in certain process...”

In the following section below, this research presents and discusses the results of the interviews as it relates to the opportunities that are presented by adopting a responsible investing investment approach by integrating ESG into investment processes. This chapter is concluded by presenting the views from the respondents on the state of ESG integration in private equity, what ESG integration means to a South African private equity firm and a brief discussion of the findings.

4.4 The Opportunities of ESG Integration for private equity firms in South Africa

4.4.1 Risk Mitigation

All the respondents are in alignment with the literature and the view that ESG integration is a powerful tool in understanding the broader universe of business risks. When the open question around what the benefits and opportunities were around responsible investing as an investment strategy; risk mitigation and a better understanding of the risks at the portfolio company level were almost always the first point made in terms of benefits of investing in this way.

Respondent 1:

“Think it's, you know, just asking questions a different way. The key other factors in the business that might potentially have a different impact. So, as I said to him as a director in the portfolio companies, as portfolio managers for some of these companies, you actively involved in them anyway. So, they felt

like, you know, we can ask important questions to the guys and try to put it in (ESG reporting systems). So, you kind of knows exactly what is happening. And, you know, you know where the shortcomings are, and you're likely to work alongside management to get the businesses to better footing specifically from an equity perspective.”

What is also clear from this response is that the integration of ESG in the post-investment programme enhances the engagement with portfolio companies.

Respondent 2:

“Ultimately, your key focus is then, like I said is on the downside, so want to make sure that you are covering yourself from an environmental and social aspect, that nothing untoward is going to happen that is going to materially have an impact on the value of the business. Whether that be a potential fine, whether it be labour unrest etc, you know, you want to make sure that all of the things are in place that you are not going to get no issues, that there is no disruption to the business.”

And lastly:

Respondent 3:

“... and, the other area is, you know, we've, we've done in, you know, detailed ESG screening at a couple of our portfolio companies where the insights gained from those have either sort of putting to bed potential risks, so they've sort of been a good risk mitigation exercise, or they've identified, identified sort of, you know, potential USPs or value creation opportunities.”

The key contribution to risk mitigation that is gained from this investment strategy is from having more information about the portfolio company as well as the operating environment at your disposal. It is this information that can also point to opportunities in the market for value creation by solving environmental and/or social problems. This is referred to as solutions investments in the literature and is discussed above in the literature review of this study (Section 2.3.3).

4.4.2 Opportunities for solutions investments through ESG Integration

The respondents to the study briefly acknowledged the opportunities for solutions investment do become apparent and are also inherent to the investment strategy and the integration of ESG into investment processes in the following ways:

Respondent 1:

“So, there's a lot of screening already going on, you know, in developing an investment strategy and a process, and philosophy. So out of that, you know, a lot of the noise is taken away so you kind of left with a good quality opportunity set that you can, can work with. And from there after the negative screening, it is to make a positive impact through the ESG to improve the business.”

This strategy of identifying opportunity in the solutions to the environmental issues has led the firm represented by this respondent to launch renewable energy equity and debt fund, in response to increased demand for renewable energy.

Respondent 2:

“What has become quite evident as of late, is that transformation is big... you know, where private equity can play a huge role, in terms of impact and outcomes is on transformation. You could put that under the social aspects, I guess, of ESG. A lot of the managers are now calling it ESGT (T = transformation). So, it's a South African nuanced ESG in that transformation becomes part of your integration plan. And so, a lot of pension funds are using private equity as a vehicle to advance the transformation of the economy.”

Respondent 3:

“We've identified sort of, you know, potential USPs or value creation opportunities. So yeah, I think, on the whole, you know, the work we've done around it has been, in some instances, created opportunities or been positive.”

4.5 The Impact and meaning of the UNPRI on Private Equity in South Africa

When it comes to the impact that the UNPRIs have had on the way private equity firms have made their investments and engaged portfolio companies, the outcomes from sampled firms are an attitude toward the PRIs being an additional burden on the investment managers not yet adding much value to their investment activities, other than additional protection on the downside.

Respondent 1:

“Look, I think it's different. The UNPRI in my mind is much more like a listed equity thing, a listed asset owner versus an unlisted asset owner. It hasn't changed much, you know, there's not much support that... Managers get to kind of improve on many of these things. Separate questions used to fill in these things etc. and some roundtable discussions on certain topical issues. It's been rather minimal actually.”

However, there has been some agreement that the development of universal standards on the integration of ESG over and above on how the integration process plays out along the investment cycle may be useful to investment managers. This may provide clarity on what the benefits are and how it contributes to value creation as well as provide benchmarks that investment managers can aim for with demonstratable benefits to their businesses. This need is illustrated by the following responses;

Respondent 3:

“I would say the same standards might be beneficial. Because, you know, the people can it's a bit like having the B.E.E codes, the codes are clear. And the way of verifying against the codes has evolved into generally a sort of accepted or standardised form, but at least you know, in this instance, you could have a set of standards which are clear your minimum standards, which you know, over time, one could, a way of verifying through the use of tools or reporting could be developed. But I suppose the starting points could well be a set of standards.”

Respondent 1:

“So as a fund manager, you buy into the principle to buy into the, into the values of actually having good ESG practices embedded in the business, and that's part of the philosophy, and you know, sometimes, you know, it's questions like how long is a piece of string? You know, how far do you go? How much is big enough?”

From these responses, being a signatory to the UNPRI (2019) means protecting the downside, identifying opportunities, and investing in a way that aligns with the values of the firm. As in the words of the first respondent representing Firm 1: *“So as a fund manager, you buy into the principle to buy into the, into the values of actually having good ESG practices embedded in the business...”* and respondent 3 representing Firm 3, who said: *“... they've sort of been a good risk mitigation exercise or they've identified, sort of, you know, potential USPs or value creation opportunities...”* The integration of ESG into investment processes is still perceived as an additional burden on fund managers at private equity firms with marginal benefits and not viewed yet as a source of competitive advantage by practitioners at private equity firms represented in this study.

From the findings of the study, it would appear that the experiences of private equity firms sampled and that are signatories of the UNPRI are aligned only to a certain extent with the reported challenges around ESG integration as reported by Herringer et al. (2009). For instance, shareholder short-termism may not be a challenge for the private equity firm in integrating ESG factors into the investment process as the modern shareholder is investing for the long-term in the fund. Furthermore, from the responses what is revealed is that the timing is less important to shareholders and the focus is on the value being created and the transparency of the investment team.

Where there is alignment with the literature is in the challenges to do with the skills and knowledge to effectively integrate ESG in the investment process and the ESG data challenges. In addition, respondents have largely confirmed the benefits of ESG integration from a risk management perspective and the market opportunity inherent

in ESG solutions investing with two of the three firms actively involved in investing in companies that seek to solve environmental and social issues. Of additional concern to the firms participating in this study is a lack of a universal standard for the integration of ESG integration and reporting with every firm having its in-house approach.

The South African private equity firms that participated in this study admit that they still have a long way to go in terms of fully integrating ESG into investment processes. At least one of the respondents attributed the slow pace of integration and ultimately the mainstreaming of ESG in investment decision-making in the asset class, to a lack of oversight from asset owners and institutional investors.

Respondent 2:

“Yes they want that and they want to see that, but when it comes to investing and holding the manager accountable, for what it is doing from an ESG perspective and responsible investing, there is less oversight and less challenge of the manager in terms of what the outcomes are. So, you want to do the right thing, but you are not following up to ensure that the manager is doing what he said he would be doing in terms of why you have given him capital. And that is partly driven by the fact that ESG is very difficult...”

What has come out clearly from the interviews and subsequently what is inherent in the responses is the link, for the most part, between the challenges faced in practice and those that are expressed in the literature as well as the maturity of the responsible investing investment strategy within the private equity asset class in South Africa.

Chapter 5: Discussion and Recommendations

5.1 Discussion

The results of the study, of the sampled private equity firms, reveal a state of responsible investing that is surprising in that ESG considerations remain add-ons as evidenced in the responses from participants in section 4.3.2. This is also considering that at least two of the participants to the study have been signatories for longer than a decade, and the challenges faced by the asset class remain largely unchanged, in terms of the data challenge and the lack of skills and knowledge, first identified by Herringer et al. (2009) and again by Davies (2016). This research reveals that, unlike in the Herringer et al.'s (2009) study, short-termism is not found to be a significant challenge to the integration of ESG in the investment process but rather a lack of a universally accepted standard for a structured approach to ESG integration as described by Hampole and Korngold (2019). The private equity investment managers considered in this study are also not convinced of the investment benefits of ESG integration (see section 4.3.2), viewing the integration of ESG factors not as part of the investment strategy but as an additional compliance box to be ticked. This view perhaps poses the most significant challenge to the mainstreaming of ESG integration and responsible investing. In this section, this research discusses the findings of the study in light of the key challenges and opportunities emerging from the literature and the responses from investment professionals representing private equity firms in South Africa. The discussion begins with comparing and contrasting the key challenges and opportunities emerging from the literature and the findings of the study in the order in which they were presented in Chapter 4.

5.2 Key ESG Integration (Responsible Investing) Challenges

5.2.1 *Shareholder short-termism*

The challenges facing the investment sector have changed very little from the time over the years, according to the literature, comparing the challenges presented by Herring et al. (2009) and Davies (2016). The challenges of short-termism however seem not to be a challenge that the private equity asset class must contend with due to differing expectations from shareholders on when to see returns from their investments (see section 4.3.1). According to respondents, the shareholders commit to and are locked into an investment strategy for the long-term and where ESG integration is that strategy, very little pressure is felt for short-term gains. This may be supported by the investment life-cycle of private equity firms that includes a phase in which the private equity firms must manage portfolio companies and increase their value over time to exit the investment at a higher valuation than when entered into (Zaccone and Pedrini, 2020). This invariably is not a short-term endeavour and any tool that may improve the ability of the private equity firm to perform in the post-investment phase is welcomed by shareholders. One respondent went as far as to state that the process of ESG integration has helped identify value-creating opportunities that were not obvious initially (section 4.3.1). Furthermore, Investors in private equity firms are investing in unlisted investments and understand that these investments are generally long-term in nature (Hoellermann, 2020).

5.2.2 *The Skills and Knowledge Challenge*

The private equity firms considered, however, still face the challenge of seemingly unbridgeable skills and knowledge gap. Respondent 2 quite simply put it as the skills are just not there. This challenge is consistent with what was found by Viviers et al.'s (2009) study, that the integration of ESG issues is not easily achieved due to a lack of fund managers and analysts with both deep ESG knowledge and financial skills in the local investment sector (Viviers et al., 2009). In addition, very few investment professionals are receiving training around ESG and how to integrate ESG data in investment decisions (Khan and Liu, 2019). Respondents have echoed this in their account of the reality and the importance of investing in those skills (see section 4.3.2

and 4.3.3). From the intersection of private equity and ESG integration over the last 15 years (Zaccone and Pedrini, 2020), ESG integration has largely been an afterthought with any investment in gaining a better understanding of how to integrate material ESG data has been shallow or outsourced. In section 4.3.2. Respondent 3 noted a reliance on consultants to do work of integrating ESG but lamenting conflicts between deal teams and ESG teams on what to prioritise. An ideal situation would arguably be where the ESG team and the deal team are not separate. Where ESG integration is an integral part of the deal-making process and investment decision (UNPRI, 2014). ESG issues are treated as an afterthought or a conversation to be had once the important work has been taken care of in the investment process (see section 4.5, Respondent 3).

In response to challenges around the skills and knowledge gap, Respondents are relying on external consultants and development finance institutions (section 4.3.2). There is also very little evidence the UNPRI is targeting the skills gap either (UNPRI, 2019). It may be an important area of enquiry to determine the very nature of the skills gap and to address it meaningfully. Is it technical, in terms of translating the metrics in reporting tools providing into investment strategy target and key performance indicators for managers and portfolio company management teams? The Chartered Financial Analysts Institute (CFA Institute) has begun to offer an elective module and certificate in ESG investing (CFA Institute, 2021). The development of the module by the CFA institute may, in time, provide a pool of professionals with the deep ESG knowledge and finance skills. The literature suggests that this challenge may exist mainly at the portfolio company level creating information asymmetries that make decision-making and ESG integration difficult to achieve (Rhodes, 2010).

5.2.3 The ESG Data Challenge

This study sought to explore the nature of the ESG data challenges as articulated in the literature (State Steet, 2019) by exploring the experiences of private equity firms. Private Equity firms rely on consultants and multinational institutions to find the tools and methods to measure ESG performance across their portfolios and individual portfolio companies. Respondent 2 remarked that it was difficult for the firm to get a consistent and consolidated view at the fund of fund level (section 4.3.3). In addition,

industry bodies must be empowered by private equity firms by being transparent with ESG data in a manner that aids comparability and consistency across the unlisted investment sector (Respondent 2, section 4.3.3).

This is consistent with what was found by State Street (2009) that the lack of transparency in ESG reporting and standardisation made the data available difficult to rely on for fund managers (State Street, 2009). The information asymmetry reported by Rhodes (2010) appears to be the root of the ESG data challenge, based on the responses to the study in terms of the difficulty to rely on the data being presented by portfolio companies and to truly understand the risks and opportunities to the investments made. According to Ailman et al. (2017), accurate and reliable ESG data is central to understanding the broader universe of business risk not attainable by traditional risk assessments. The importance of this objective (understanding the broader universe of business risk) is intimately tied to the ability of private equity firms to exploit the opportunities presented with the integration of ESG factors in the investment process (Zeisberger and White, 2014). This is discussed further in the section hereafter, where this research discusses the key opportunities presented with ESG integration in the investment process.

5.3 Key ESG Integration (Responsible Investment) Opportunities

Practitioners have seen some of the benefits and opportunities play out in their investment activities having applied to some degree the responsible investing philosophy. Risk has been managed better, socio-economic objectives have been pursued, and investments in environmental and social solutions have been made and value created from them. This is consistent with the view that ESG integration is pursued risk management and/or value creation by asset managers, as discussed by Zaccone and Pedrini (2020). In the following section, the key ESG integration opportunities as presented in Chapter 2 and the findings of this study in Chapter 4.

5.3.1 Risk Management

The experiences of private equity firms, represented in this study, appear to be consistent with the literature in terms of the benefit of ESG integration in identifying

risk and protecting the downside to investments. Respondent 1 reveals the value of the process in getting to know what the true nature of shortcomings are in the portfolio companies and how ESG integration aids the working relationship toward improving the performance of the business (portfolio company). This research would argue that this is because of the information asymmetry (Rhodes, 2010) being resolved and both parties being on the same page in terms of what needs to be done to achieve long-term performance goals sustainably. In addition, according to Laurel-Fois (2018), having accurate information about target companies allows the private equity firm to avoid riskier investments in the market that could weigh down the performance of the portfolio.

ESG integration is key to identifying environmental and social risks that may have a material impact on the value of the portfolio company (van Duuren, Plantinga and Scholtens, 2016). Social risks may include labour unrest due to poor people management as alluded to by Respondent 2 in section 4.4.1 in the study. ESG integration empowers the investment professional to assess performance across financial and non-financial aspects and to manage social and environmental risks better (Jo and Na, 2012). This appears to be consistent with the experience of investment managers in this study like Respondent 3 who stated; “... *detailed ESG screening at a couple of our portfolio companies where the insights gained from those have ... put to bed potential risks...*” This is supported by the experience of Respondent 1 who commented on the post-investment stage of the investment process as being enriched by ESG integration as investment teams and management teams work better together to improve portfolio company performance by understanding the risks better (see section 4.4.1). ESG integration is effective at risk management but has helped the firms represented in this study identify value creation opportunities as well (Respondent 3).

5.3.2 The market opportunity in solving sustainability issues

The market opportunity in investing in sustainability issues is estimated at US\$12 trillion by the United Nations Department of Economic and Social Affairs in a working paper on the strategic role of the private sector in transforming the real economy (Han, 2020). Respondents to this study representing private equity firms that are signatories

of the UNPRI (2020) have certainly participated in this opportunity with tremendous upside potential (Bell et al., 2018). The investment activities of respondents are consistent with the unique role that they can play in addressing local environmental and social sustainability challenges (Mogapi, Sutherland and Wilson-Prangle, 2019). For instance, respondents to this study are invested in renewable energy projects to address clean and secure energy concerns (see section 4.4.2) and Respondent 2 going as far as arguing for the tremendous role private equity can play in addressing issues surrounding the transformation of the South African economy.

The experience of investment professionals reported in this study is one where ESG integration has revealed potential unique selling points and value creation opportunities to positive effect.

5.4 ESG Integration and Private Equity

The literature reviewed (UNPRI, 2014; Przychodzen et al., 2016; Ailman et al., 2017; Indahl and Jacobsen, 2019; Hoellermann, 2020) is largely consistent with the experiences of private equity firms participating in this study. ESG integration means better risk management, better post-investment engagements that may lead to greater market opportunities. Respondents have revealed just how intensive the process of ESG integration can be and the need for a framework to guide firms, achieve comparability and improve the quality of data available to firms and from portfolio companies. In addition, respondents have been clear on the importance of building a deep understanding of ESG in their firms to fully reap the benefits of ESG integration and overcome the challenges (see section 4.5).

The UNPRI (2020) has played a significant role in the integration of ESG into investment processes at private equity firms; however, one respondent still sees the impact of the UNPRI (2020) as being mostly for listed investments.

This study has revealed gaps in the communication of what ESG integration should mean to private equity and the resources required to mainstream it into the investment cycle. The private equity model remains well-suited for an investment strategy based

on ESG integration if supported with an investment in the right combination of knowledge and skills and the tools to collect the appropriate data. With unlisted investments being long-term investments with a stewardship style to investment management, ESG integration may be a source of competitive advantage for private equity firms. The industry specialisation of private equity firms, as long-term investment stewards, is based on the asset classes specific resources and capabilities that give it an advantage in both the pre- and post-investment phases (Le Nadant, Perdreau and Bruining, 2018).

5.5 Recommendations

The study has brought to light a disconnect between the expectation of where the integration of ESG factors into the investment process in private equity firms/funds should be and the experiences of the firms in this study to some degree. This is considering the suitability of the private equity model for the investment strategy and the maturity of South Africa's capital markets as well as the time that has elapsed from the first time a private equity firm/fund became a signatory.

The first step is to develop and implement ESG guidelines into the deal originations processes where the challenges and opportunities may be made clear (Hoellermann, 2020). The challenges and opportunities explored in this study may have the potential of being catalytic if addressed and exploited, respectively, properly. Therefore, the following recommendations are made for private equity managers considering beginning the journey of integrating ESG into their investment processes and adopt a responsible investing investment strategy for their firm/fund:

- Be deliberate in the implementation of the integration model as described above (Table 1) and by the UNPRI (2018). This involves the integration of ESG conversations at every stage of the investment process as well as the post-investment process. Where the skills and knowledge are not available within the firm to consult external ESG specialists with finance knowledge, were not available, a growing ecosystem of initiatives and organisations exists to provide sustainability-related information, analytics, and other solutions (SASB, 2020). Successful private equity firms surveyed in a study looking into the ESG factor

integration of private equity revealed that top performers have internal committees responsible for ESG topics comprising of top managers from investment teams. Where the knowledge and skills are not available internally, external consultants are consulted extensively (Zaccone and Pedrini, 2020).

- Build an ESG data management model alongside a financial model leveraging the metrics and protocols in international reporting tools like the SASB Materiality Map, the Global Reporting Initiative and the Task-Force Recommendations for Climate-related Disclosures for consistency and comparability. This is supported by a study by Zeisberger and White (2014) in which case studies were conducted on leading global firms. The study found best practice to be a framework focussing on either risk, being programme driven or an integrated approach leveraging existing tools and standards (Zeisberger and White, 2014). These standards may play an important role from the due diligence stage where ESG metrics are identified to inform post-investment plans by general partners and the reporting by limited partners while conveying the company's strategic value throughout and on exit (SASB, 2020).
- Create the demand for ESG integrated investment analysis programmes at institutions of higher learning. Going as far as investing in the development of these programmes as well as participating in their delivery to build the capacity within firms to integrate ESG into investment processes more meaningfully. Universities guide the research and development agenda in our societies, and where a business has not been able to solve problems, they look to universities or the innovative start-ups that are born out of them (Puzzonia, 2018). Collaboration with institutions of higher learning may yield the innovative frameworks and tools we need to improve the analysis of non-financial aspects alongside the financial aspects in an integrated manner.

Private equity firm managers may benefit from participating in industry body events and working groups like those hosted by the UNPRI (2020) in South Africa to learn more about frameworks and cross-sectoral ESG ratings tools to improve their ESG integration in investment activities.

Finally, there is a growing number of boutique-ESG research firms that specialise in the collection, monitoring and measurement of ESG data. Deeper collaboration with these firms may be an appropriate response to the ESG data challenge and the emerging challenge of being able to organise data in a way that is comparable and reliable.

Private equity firms represented in the study have exploited a number of the market opportunities associated with solutions investments, and this can be scaled for greater performance and impact on the local (South African) social and environmental challenges. Greater investment is required in developing the skills and knowledge to overcome shortcomings in the quality of ESG data, and greater collaboration between firms, institutions of higher learning and government is required in this regard as well (IIRC, 2013). According to Le Nadant, Perdreau and Bruining, (2018), the private equity asset class has been successful in specialization in buyouts based on the specific resources and capabilities of these firms. The long-term investment outlook of private equity firms and their stewardship style to investment management are also potential sources of superior ESG integration performance (UNPRI, 2014). From a resource-based theory perspective, ESG integration is a source of competitive advantage for private equity firms.

Chapter 6: Conclusion

The main aim of this research was to investigate the challenges and opportunities around ESG integration (Responsible Investing) for South African private equity firms/funds. In doing so, the research aimed to pursue the following research objectives:

- To investigate the key challenges experienced by South African private equity firms in the integration of ESG issues in their investment activities.
- To identify and discuss the benefits and opportunities that ESG integration presents in investment activities.
- Explore and discuss approaches taken (by South African private equity firms) to overcome some/all challenges and optimize the opportunities associated with ESG integration.
- Make recommendations to private equity firm managers for improved ESG integration into their investment activities.

In addition, the literature reviewed revealed some opportunities and benefits that included risk mitigation and commercial opportunities in investing in environmental and social solutions (Zaccone and Pedrini, 2020). It was the objective of this research to investigate whether private equity managers in South Africa agreed with these opportunities and benefits. In addition to exploring their experience with the integration of ESG factors in the investment process and being signatories of the UNPRIs.

The results of the study on the sample of private equity firms considered confirmed most of what was in the literature, more specifically, the primary objective of exploring the challenges and opportunities presented by the literature reviewed for this study. However, it is found that short-termism is not a key issue for the private equity firms considered, rather, the focus is on transparency and the return generating from a shareholder perspective. Furthermore, the study found that the relationship between the private equity investment manager and the UNPRI is one of an additional layer of compliance checks and a burden to her and her investment process. ESG is not nearly

as integrated as could have been expected of a mature sector in a mature capital market with years of UNPRI (2020) engagement behind it.

From 2009, the key challenges remain to be the knowledge gap and a lack of understanding of where ESG fits in, in investment analysis and the post-investment programme with the portfolio company. At the most, ESG integration serves as a tool to protect against the downside; but does not contribute meaningfully to the value creation equation for the South African private equity investment manager. Plenty of that may be attributed to a lack of understanding. This speaks to the challenge of there being a lack of data to interpret and inform the process, as well as a lack of skills that combine finance and deep ESG knowledge across the sector and within the asset class.

Finally, the opportunities that are presented cannot be fully exploited without having overcome the challenges to ESG integration. Investments in environmental and social solutions, for example, are valuable for their ability to not only generate returns but also create value for the broader stakeholder universe. This is unlikely if the investment managers behind them are unable to identify these opportunities and collect the data required to make the investment decision (SASB, 2016). Furthermore, ESG integration reveals more information and more information leads to safer investments, better management of portfolio companies and the ability to be more responsive to changing needs and environments (Van Niekerk and Krige, 2009). All of these contribute positively to the long-term sustainability of the firm/fund as well as the portfolio company.

Private equity firms need to be more deliberate in their ESG integration efforts at all stages of the deal cycle. This can be accomplished through the facilitation of ESG conversations at each stage. Where the skills and knowledge are not available internally, use external consultants and the growing ecosystem of sustainability-related initiatives. This provides the added advantage of helping to develop internal skills through these engagements that must be followed by recognition and ESG-linked reward structures (Hoellermann, 2020). It is also recommended that the skills and knowledge gap in the sector may be overcome through partnerships with

institutions of higher learning in creating demand for these skills while developing programmes that will be relevant for the market and the asset class.

In addition to helping with the development of sector skills and knowledge, the ecosystem of sustainability-related organisations and initiatives may be helpful to the development of ESG data management models alongside financial models. These initiatives include those like the SASB Materiality Map and Standards, the British Private Equity and Venture Capital Association (BVCA) Responsible Investment Toolkit and the Commonwealth Development Corporations Group (CDC) ESG Toolkit for Fund Managers (SASB, 2020).

The recommendations proposed in this research are aimed at contributing to the efforts of private equity firms in overcoming the challenges they face: the skills and knowledge gap and ESG data challenges described in Chapters 2 and 4 of this report. In addition, by overcoming these challenges, a more meaningful engagement with the UNPRIs may be an outcome of more meaningful integration of ESG considerations in the investment process. A key role of the UNPRI is to help companies and funds “gain competencies to improve their understanding of issues, risks and opportunities” (Hoellermann, 2020 p. 162).

Finally, the integration of ESG factors in the investment process presents many opportunities. If aligned to the strategy and the operations of the funds and portfolio companies, a trade-off between financial returns and ESG performance can be avoided (Hoellermann, 2020). It has been found in this research that ESG integration provides great downside protections and reveals opportunities in solutions investments.

This research contributes to the literature on the integration of ESG factors in the investment process of South African private equity firms. The objective of this research is to shed some light on the experiences of South African private equity firms in their integration efforts and their engagement with the UNPRIs. In so doing, this research attempts to provide meaningful ways in which the challenges identified in the literature can be overcome and the opportunities exploited for superior risk-adjusted and solutions-driven returns.

Further research may be required on a larger sample of private equity firms not limited to signatories of the UNPRI (2020) to determine the penetration of ESG integration (responsible investment) in South African private equity and whether those firms that are investing responsibly are outperforming their peers, firstly, and secondly the market.

6.1 Limitations of the Study

Although the private equity firms represented in the study are 50 percent of the private equity signatories to the UNPRI, and that is significant because it represents a public declaration of a commitment to ESG integration, they are not representative of the asset class as a whole. Signatories of the UNPRI were selected because of their responsibilities to the principles around transparency and to further the mainstreaming of ESG considerations into investment processes (UNPRI, 2018).

However, since membership to the UNPRI isn't necessarily a limitation to private equity firms raising RI funds from institutional investors, there are many more private equity firms that have marketed their funds as responsible and ESG integrated. These firms may have very different experiences, challenges and may have identified a very different set of opportunities. Furthermore, the study is limited in perspective due to having only interviewed a single member of the investment team, albeit the member responsible for ESG integration and reporting at the firm.

These firms/funds were excluded from the study because they may indeed employ an RI strategy, but they are not "bound" by any public declaration of their commitment to society like those who are signatories to the UNPRI and so they were not considered. In addition, we have learnt in this study that institutional investors and asset owners are also unlikely to hold investment managers accountable for RI commitments post allocation. The extra layer of accountability provided by fellow signatories and the UNPRI as an organisation adds to the credibility of our sample as RI practitioners.

It may be a worthwhile enquiry to measure the penetration of the responsible investing investment strategy within the private equity asset class as a whole and to investigate

the challenges and opportunities of the strategy amongst a larger sample of South African private equity firms/funds.

References

- Aggarwal, D. and Elembilassery, V., 2018. Sustainable Finance in Emerging Markets-A Venture Capital Investment Decision Dilemma.pdf. *South Asian Journal of Business and Management Cases*, 7(2), pp.131–143.
- Ailman, C., Edkins, M., Mitchem, K., Eliopoulos, T. and Guillot, J., 2017. The Next Wave of ESG Integration: Lessons from Institutional Investors. *Journal of Applied Corporate Finance*, 29(2), pp.32–43.
- Amaeshi, K. and Grayson, D., 2009. *The Challenges of mainstreaming Environmental, Social and Governance (ESG) issues in Investment Decisions - A mini-survey of Practitioners' reports*. p.53.
- Atz, U. and Van Holt, T. and Liu, Z. and Bruno, C., 2020. *Do Corporate Sustainability and Sustainable Finance Generate Better Financial Performance? A Review and Meta-analysis*. P.43. Available at: <SSRN: <https://ssrn.com/abstract=3708495>>
- Azungah, T., 2018. Qualitative research: deductive and inductive approaches to data analysis. *Qualitative Research Journal*, 18(4), pp.383–400.
- Bailey, J., Klempner, B. and Zoffer, J., 2016. *Sustaining Sustainability: What institutional investors should do next on ESG*. Available at: <Sustaining sustainability: What institutional investors should do next on ESG> [Accessed 9 Dec. 2020].
- Barney, J.B., 2001. Resource-based theories of competitive advantage: A ten-year retrospective on the resource-based view. *Journal of Management*, 27(6), pp.643–650.
- Barney, J.B., Ketchen, D.J. and Wright, M., 2011. The Future of Resource-Based Theory: Revitalization or Decline? *Journal of Management*, 37(5), pp.1299–1315.
- Bell, J., Paula, L., Dodd, T., Németh, S., Nanou, C., Mega, V. and Campos, P., 2018. EU ambition to build the world's leading bioeconomy—Uncertain times demand innovative and sustainable solutions. *New Biotechnology*, 40, pp.25–30.
- Bryman, A. and Bell, E., 2014. *Research Methodology: Business and Management Contexts*. 3rd ed. Oxford University Press Southern Africa.
- Cadman, T., 2011. The Legitimacy of ESG Standards as an Analytical Framework for Responsible Investment. In: *Responsible Investment in Times of Turmoil*, Issues in business ethics. Dordrecht; New York: Springer.
- Camelia, F.R., 2019. Challenges and Opportunities for Sustainable Finance. *The Journal of Contemporary Issues in Business and Government*, 25(1), pp.1–13.
- Caplan, L., Griswold, J. and Jarvis, W., 2013. *From SRI to ESG- The Changing World of Responsible Investing*. Available at: <<https://files.eric.ed.gov/fulltext/ED559300.pdf>> [Accessed 9 Jun. 2020].

CFA Institute, 2021. *ESG Investing*. [online] ESG Investing and Analysis. Available at: <<https://www.cfainstitute.org/en/research/esg-investing>> [Accessed 9 Aug. 2021].

Chauhan, Y. and Kumar, S.B., 2018. Do investors value the nonfinancial disclosure in emerging markets? *Emerging Markets Review*, 37, pp.32–46.

Cook, J., 2020. *Tattooing 'Responsible' onto Investment Strategies*. [online] Corporate Knights. Available at: <<https://www.corporateknights.com/channels/responsible-investing/tattooing-responsible-onto-investment-strategies-15960216/>> [Accessed 8 May 2020].

Cooper, M.M., 1997. Distinguishing Critical and Post-Positivist Research. *College Composition and Communication*, 48(4), p.556.

Cubas-Díaz, M. and Martínez Sedano, M.Á., 2018. Measures for Sustainable Investment Decisions and Business Strategy – A Triple Bottom Line Approach. *Business Strategy and the Environment*, 27(1), pp.16–38.

Davies, M., 2016. *Private Equity and Responsible Investing: Trends and Opportunities in Sub-Saharan Africa*. Available at: <<https://kudosafrica.com/assets/kudosafrica-private-equity-report.pdf>> [Accessed 9 Dec. 2020].

De Vos, A., Strydom, H., Fouche, C. and Delport, R., 2011. *Research at Grass Roots*. 4th Edition ed. Cape Town: Van Schaik Publishers.

Del Bosco, B. and Misani, N., 2011. Chapter 7: Private Equity as an Emerging Asset Class of Responsible Investing. In: *Responsible Investing in times of Turmoil*, Issues in business ethics. Dordrecht; New York: Springer. pp.113–134.

Dent, G.W., 2010. The Essential Unity of Shareholders and the Myth of Investor Short-Termism. *Delaware Journal of Corporal Law*, 35, pp.97–150.

Divakaran, S., McGinnis, P.J. and Shariff, M., 2014. *Private Equity and Venture Capital in SMEs in Developing Countries: The Role for Technical Assistance*. Policy Research Working Papers. [online] The World Bank. Available at: <<http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-6827>> [Accessed 25 Nov. 2019].

Ducastel, A. and Anseeuw, W., 2020. Impact Investing in Südafrika: In Ermächtigung investieren und Investoren ermächtigen Impact Investing in South Africa: Investing in Empowerment, Empowering Investors. *Historical Social Research / Historische Sozialforschung*, 45(3), pp.55–73.

Duruigbo, E., 2012. Tackling Shareholder Short-Termism and Managerial Myopia. *Kentucky Law Journal*, 100(3), pp.531–584.

Dziawgo, D., 2019. Sustainable finance as a new financial investment model. *Prace Naukowe Uniwersytetu Ekonomicznego we Wrocławiu*, 63(12), pp.23–34.

Efimova, O., 2018. Integrating Sustainability Issues into Investment Decision Evaluation.pdf. *Journal of Reviews on Global Economics*, 7, pp.668–681.

Esch, M., Schulze, M. and Wald, A., 2019. The dynamics of financial information and non-financial environmental, social and governance information in the strategic decision-making process. *Journal of Strategy and Management*. [online] Available at: <<https://www.emeraldinsight.com/doi/10.1108/JSMA-05-2018-0043>> [Accessed 26 Jul. 2019].

Elo, S., Kääriäinen, M., Kanste, O., Pölkki, T., Utriainen, K. and Kyngäs, H., 2014. Qualitative Content Analysis: A Focus on Trustworthiness. *SAGE Open*, 4(1), p.1-10.

Fereday, J. and Muir-Cochrane, E., 2006. Demonstrating Rigor Using Thematic Analysis: A Hybrid Approach of Inductive and Deductive Coding and Theme Development. *International Journal of Qualitative Methods*, 5(1), pp.80–92.

Frechtling, D.C. and Boo, S., 2012. On the Ethics of Management Research: An Exploratory Investigation. *Journal of Business Ethics*, 106(2), pp.149–160.

Global Reporting Initiative, 2015. *Defining Materiality: What Matters to Reporters and Investors*. Available at: <https://www.globalreporting.org/resourcelibrary/Defining-Materiality-What-Matters-to-Reporters-and-Investors.pdf>> [Accessed 11 Sep. 2020].

Guyatt, D. (2005), "Meeting objectives and resisting conventions: A focus on institutional investors and long-term responsible investing", *Corporate Governance*, Vol. 5 No. 3, pp. 139-150.

Han, S., 2020. *Beyond the Business Case: The Strategic Role of the Private Sector in Transforming the Real Economy*. Available at: <https://www.un.org/esa/desa/papers/2020/wp169_2020.pdf> [Accessed 13 Sep. 2020].

Hanson, D., Lyons, T., Brender, J., Bertocci, B. and Lamy, B., 2017. Analysts' Roundtable on Integrating ESG into Investment Decision-Making. *Journal of Applied Corporate Finance*, 29(2), pp.44–55.

Harber, M., 2017. The role of institutional investors in promoting long-term value creation: A South African perspective. *African Review of Economics and Finance*, 9(1), pp.272–292.

Harford, J. and Kolasinski, A., 2014. Do Private Equity Returns Result from Wealth Transfers and Short-Termism? Evidence from a Comprehensive Sample of Large Buyouts. *Management Science*, 60(4), pp.888–902.

Heese, K., 2005. The development of socially responsible investment in South Africa: experience and evolution of SRI in global markets. *Development Southern Africa*, 22(5), pp.729–739.

Henderson, K.A., 2011. Post-Positivism and the Pragmatics of Leisure Research. *Leisure Sciences*, 33(4), pp.341–346.

Herringer, A., Firer, C. and Viviers, S., 2009. Key challenges facing the socially responsible investment (SRI) sector in South Africa. *Investment Analysts Journal*, 38(70), pp.11–26.

Hoellermann, J., 2020. *ESG in Private Equity and Other Alternative Asset Classes: What the Industry Has Accomplished so far Regarding Environmental, Social and Governance Matters*. EIKV-Schriftenreihe zum Wissens- und Wertemanagement. [online] Hostert: European Institute for Knowledge & Value Management (EIKV). pp.1–203. Available at: <<https://econpapers.repec.org/bookchap/zbweikvsw/39.htm>> [Accessed 17 Oct. 2020].

Hoepner, A.G.F., Majoch, A.A.A. and Zhou, X.Y., 2019. Does an Asset Owner's Institutional Setting Influence Its Decision to Sign the Principles for Responsible Investment? *Journal of Business Ethics*. [online] Available at: <<http://link.springer.com/10.1007/s10551-019-04191-y>> [Accessed 26 Jul. 2019].

Indahl, R. and Jacobsen, H.G., 2019. Private Equity 4.0: Using ESG to Create More Value with Less Risk. *Journal of Applied Corporate Finance*, 31(2), pp.34–41.

International Finance Corporation, 2011. *Sustainable Investment in Sub-Saharan Africa: Investment Practitioner Views of Sustainable Investment in Private Equity and Asset Management in South Africa, Nigeria, and Kenya*. [online] World Bank. Available at: <<http://elibrary.worldbank.org/doi/book/10.1596/27446>> [Accessed 12 Sep. 2020].

International Integrated Reporting Council, 2013. *The International <IR> Framework*. [online] International Integrated Reporting Council. pp.1–34. Available at: <<https://integratedreporting.org/wp-content/uploads/2013/12/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf>> [Accessed 10 May 2020].

Jo, H. and Na, H., 2012. Does CSR Reduce Firm Risk? Evidence from Controversial Industry Sectors. *Journal of Business Ethics*, 110(4), pp.441–456.

Johnson, R., Mans-Kemp, N. and Erasmus, P.D., 2019. Assessing the business case for environmental, social and corporate governance practices in South Africa. *South African Journal of Economic and Management Sciences*, 22(1), pp.1–13.

Khan, A.A. and Liu, P.J., 2019. Incorporation of Environmental, Social and Governance (ESG) Factors by Investment Professionals for Measuring Performance of Investee Companies. BAM Conference 2019. Aston University, Birmingham, UK: British Academy of Management. p.17.

Laurel-Fois, D., 2018. Beyond Appearances: The Risk-Reducing Effects of Responsible Investment Practices. *Business & Society*, 57(5), pp.826–862.

Le Nadant, A.-L., Perdreau, F. and Bruining, H., 2018. Industry specialization of private equity firms: a source of buy-out performance heterogeneity. *Venture Capital*, 20(3), pp.237–259.

Majoch, A.A.A., Hoepner, A.G.F. and Hebb, T., 2017. Sources of Stakeholder Salience in the Responsible Investment Movement: Why Do Investors Sign the Principles for Responsible Investment? *Journal of Business Ethics*, 140(4), pp.723–741.

Manigart, S. and Wright, M., 2013. Reassessing the relationships between private equity investors and their portfolio companies. *Small Business Economics*, 40(3), pp.479–492.

Mogapi, E.M., Sutherland, M.M. and Wilson-Prangley, A., 2019. Impact investing in South Africa: managing tensions between financial returns and social impact. *European Business Review*, 31(3), pp.397–419.

National Command Council, 2020. *COVID-19 / Novel Coronavirus*. [COVID-19 Newsroom] The South African Government. Available at: <<https://www.gov.za/Coronavirus>> [Accessed 13 Sep. 2020].

Oh, C.H., Park, J.-H. and Ghauri, P.N., 2013. Doing right, investing right: Socially responsible investing and shareholder activism in the financial sector. *Business Horizons*, 56(6), pp.703–714.

Oikonomou, I., Platanakis, E. and Sutcliffe, C., 2018. Socially responsible investment portfolios: Does the optimization process matter? *The British Accounting Review*, 50(4), pp.379–401.

Ose, S.O., 2016. Using Excel and Word to Structure Qualitative Data. *Journal of Applied Social Science*, 10(2), pp.147–162.

Otter.ai, 2020. *Otter.ai: Otter Voice Meeting Notes*. [Platform] Otter.ai: Otter Voice Meeting Notes. Available at: <<https://otter.ai/login>> [Accessed 27 Oct. 2020].

Panhwar, A.H., Sanullah, A. and Asif, A.S., 2017. Post-Positivism- An Effective Paradigm for Social and Educational Research. *International Research Journal of Arts & Humanities*, 45(45), pp.253–260.

Peeters, H., Uwase, L., Van den Broeck, R. and Mattan, G., 2017. *Impact of disinvestment by asset owners. The case of climate change and fossil fuel divestment*. The Shift asbl | Forum ETHIBEL asbl.pp.1–72.

Peteraf, M.A., 1993. The cornerstones of competitive advantage: A resource-based view. *Strategic Management Journal*, 14(3), pp.179–191.

Polman, P. and Tómasdóttir, H., 2020. What corporates can do to move the financial markets to a longer-term and more responsible mindset. In: *Sustainable Investing: A Path to a New Horizon*, 1st ed. Routledge.p.19.

Przychodzen, J., Gómez-Bezares, F., Przychodzen, W. and Larreina, M., 2016. ESG Issues among Fund Managers—Factors and Motives. *Sustainability*, 8(10), p.1078.

Puzzonia, M., 2018. The Impact of ESG Investment, How Company and University can Collaborate to Realize It with Local Innovation. *Journal of Intercultural Management*, 10(3), pp.171–194.

Rhodes, M.J., 2010. Information Asymmetry and Socially Responsible Investment. *Journal of Business Ethics*, 95(1), pp.145–150.

Santhosh, S.V., 2019. A Conceptual study on Responsible and Sustainable investing in ESG. National Conference on Economic Slowdown: Measures to rEvide the Paranoid. India: Department of Commerce and Management, Kairalee Niketan Golden Jubilee Degree College.pp.48–50.

Sustainability Accounting Standards Board, 2016. *ESG Integration Insights-Q4 2016*. [Quarterly] Sustainability Accounting Standards Board.pp.1–28. Available at: <<http://www.revelio.com/sasb-esg-integration-insights-q4-2016/>> [Accessed 18 Oct. 2020].

Sustainability Accounting Standards Board, 2020. *Integrating ESG Holistically in Private Equity: A Strategic Approach*. Available at: <<https://www.sasb.org/wp-content/uploads/2020/10/IntegratingESGPrivateEquity-101420.pdf>> [Accessed 10 Dec. 2020].

South African Venture Capital Private Equity and Association, 2020. *SAVCA Members*. [online] Southern African Venture Capital and Private Equity Association. Available at: <<https://savca.co.za/member-category/all/>> [Accessed 18 Oct. 2020].

State Street, 2019. *The ESG Data Challenge*. Available at: <<https://www.ssga.com/investment-topics/environmental-social-governance/2019/03/esg-data-challenge.pdf>>. [Accessed 10 Oct. 2020]

Su, J., 2019. CEO Tech Talk: How Otter.ai Uses Artificial Intelligence to Automatically Transcribe Speech to Text. [News Site] *Forbes - Enterprise & Cloud*. Available at: <<https://www.forbes.com/sites/jeanbaptiste/2019/06/19/ceo-tech-talk-how-otter-ai-uses-artificial-intelligence-to-automatically-transcribe-speech-to-text/#7a3998a33872>> [Accessed 13 Sep. 2020].

Sustainable Investment Team, 2019. *50 Terms every Sustainable Investor Should Understand*. [Investment Insights] Schroders. Available at: <<https://www.schroders.com/en/insights/economics/50-terms-every-sustainable-investor-should-understand/>> [Accessed 9 Dec. 2020].

Syed, M. and Nelson, S.C., 2015. Guidelines for Establishing Reliability When Coding Narrative Data. *Emerging Adulthood*, 3(6), pp.375–387.

Tripathi, V. and Bhandari, V., 2014. Socially Responsible Investing - An Emerging Concept in Investment Management. *FII Business Review*, 3(4), pp.16–30.

United Nations Principles of Responsible Investing, 2014. *INTEGRATING ESG IN PRIVATE EQUITY.pdf*. United Nations Principles for Responsible Investment.

United Nations Principles of Responsible Investing, 2016. *A PRACTICAL GUIDE TO ESG INTEGRATION FOR EQUITY INVESTING.pdf*. United Nations Principles for Responsible Investment.

United Nations Principles of Responsible Investing, 2018. *ESG MONITORING, REPORTING AND DIALOGUE IN PRIVATE EQUITY*. Available at: <<https://www.unpri.org/private-equity/esg-monitoring-reporting-and-dialogue-in-private-equity/3295.article>>.

United Nations Principles of Responsible Investing, 2019. *UNPRI Signatory Directory*. [online] Principles of Responsible Investment. Available at: <<https://www.unpri.org/signatories/signatory-resources/signatory-directory>> [Accessed 26 Nov. 2019].

- Uysal, N., 2014. The Expanded Role of Investor Relations: Socially Responsible Investing, Shareholder Activism, and Organizational Legitimacy. *International Journal of Strategic Communication*, 8(3), pp.215–230.
- Van Duuren, E., Plantinga, A. and Scholtens, B., 2016. ESG Integration and the Investment Management Process- Fundamental Investing Reinvented. *Journal of Business Ethics*, 138, pp.525–533.
- Van Niekerk, J.R. and Krige, J.D., 2009. Analysis of sources of return in South African private equity. *South African Journal of Business Management*, 40(4), pp.1–12.
- Vidal, J.A.V. and Fernandez, J.L.F., 2015. THE CORPORATE SOCIALLY RESPONSIBLE INVESTING CRITERIA IN PRIVATE EQUITY: RELEVANCE AND BUSINESS IMPACT. In: *Business Ethics and CSR*. International Academic Conference. Bucharest: Strategica.pp.1–10.
- Viviers, S., Bosch, J., Smit, E. and Buijs, A., 2009. Responsible investing in South Africa. *Investment Analysts Journal*, 38(69), pp.3–16.
- Wallis, E. and Dudney, S., 2019. Bridging the skills gap in Responsible Investing. [Industry Association] *CFA Society*. Available at: <<https://www.cfauk.org/pi-listing/addressing-the-skills-gap#gsc.tab=0>> [Accessed 8 Mar. 2020].
- Webster, M., 2007. Research Methods. *Journal of Business*, 5(3), p.8. Available at <<https://clutejournals.com/index.php/JBER/article/view/2532/>>. [Accessed 13 September 2020]
- Wernerfelt, B., 1984. A resource-based view of the firm. *Strategic Management Journal*, 5(2), pp.171–180.
- Yan, S., Ferraro, F. and Almandoz, J. (John), 2019. The Rise of Socially Responsible Investment Funds: The Paradoxical Role of the Financial Logic. *Administrative Science Quarterly*, 64(2), pp.466–501.
- Zaccone, M.C. and Pedrini, M., 2020. ESG Factor Integration into Private Equity. *Sustainability*, 12(14), p.5725.
- Zeisberger, C. and White, B., 2014. ESG in Private Equity: A Fast-Evolving Standard. *Global Private Equity Initiative*, pp.1–46.

Annexure A: Interview Schedule

INTERVIEW SCHEDULE RHODES BUSINESS SCHOOL

“The Challenges and Opportunities around Environmental, Social and Governance (ESG) Integration for the South African Private Equity Firm”

1. Opening

- a. **(Establish Rapport)** – Introductions and handing over of the signed informed consent form – Thank you for having agreed to be interviewed for my research and I am looking forward to the conversation. The interview is semi-structured and feels free to tell the story of your experiences in integrating ESG in the investment cycle at the firm and the challenges faced.
- b. **(Purpose)** – I would like to ask you a few questions about private equity as an asset class, the ESG journey of your firm once becoming a signatory of the UNPRI, as well as the challenges and opportunities ESG integration at the firm has presented. This interview will be recorded, and your responses transcribed and coded to organize yours and my thoughts. I will send you a copy of the summary of this interview to confirm and approve. All participants, as well as their firms, will be kept anonymous and any firm-specific (proprietary) information around processes and tools will be left out of the report.
- c. **(Motivation)** – I hope to learn from the real experiences of RI Practitioners the challenges and opportunities around ESG integration and confirm or reject the key challenges and opportunities that emerge from the literature. This research is toward my MBA degree and hopes it will contribute to a better understanding of ESG and the role that private equity investments can play in mainstreaming ESG investing based upon the resources and capabilities that are unique to private equity firms.
- d. **(Timeline)** – The interview should take between 30 – 45 minutes. Are you available to answer some of these questions at this time?

(Transition: Let me begin by asking about your role in the firm, your background as well as your experience; as an investment professional and with responsible investing as a field)

2. Body

A. Stakeholder Interests

1. Are the shareholders and asset owners in private equity supportive of investment strategies that use long-term performance measures? Please explain/elaborate on your answer.
 - a. **(possible probing questions):** Is the firm under pressure to perform financially quarter-on-quarter? Please explain/elaborate on your answer.
 - b. What's the timeframe within which you are expected to deliver returns on investments in portfolio companies? Please explain/elaborate on your answer.
2. Does ESG integration in the firm have broader Board and stakeholder support? Please explain/elaborate on your answer.

B. PE Resources and Capabilities

1. In what ways are private equity firms suited to ESG Integration and Responsible Investing?
2. In what ways are those capabilities nurtured and updated from time to time?
 - a. How many employees in the firm have undergone ESG training and to what extent?

C. Key Challenges to ESG Integration for the firm

1. What have been the key challenges for the firm in integrating ESG into investment processes?
 - a. Data from investee companies?
 - b. Skills in investee companies and in the firm itself?
 - c. Other?
 - d. What guides or tools are you using to make ESG investment decisions?

D. Key Opportunities to ESG Integration for the firm

1. What have been some of the benefits of ESG integration for the firm/fund?
 - a. Has the risk-return profile changed in any way for the firm?
 - b. Has investee company engagement improved?

- c. Has there been a notable improvement in financial performance?
- d. Other?
- e. What are the firms' sustainable investment goals?
- f. What has been the impact of being a signatory to the UNPRI?

2. Closing

Provide a summary of the conversation.

(Maintain Rapport) Thank you for your time and for participating in my research. Is there anything else you think would be helpful for me to know?

I will provide a written summary of our conversation and email it to you to have a look at and confirm.

Annexure B: Consent Form



PARTICIPANT INFORMED CONSENT

INFORMED CONSENT DECLARATION (Participant)

Project Title:

"The Challenges and Opportunities around ESG Integration for South African Private Equity Firms"

Cuma Velile Dube from the Rhodes Business School, Rhodes University has requested my permission to participate in the above-mentioned research project.

The nature and the purpose of the research project and of this informed consent declaration have been explained to me in a language that I understand.

I am aware that:

1. The purpose of the research project is to identify and discuss the key challenges and opportunities around ESG integration for the South African private equity firm.
2. The Rhodes University has given ethical clearance to this research project and I have seen/ may request to see the clearance certificate.
3. By participating in this research project, I will be contributing towards to understanding the challenges and opportunities in ESG Integration in South Africa in order to mainstream responsible investing in South Africa.
4. I will participate in the project by sitting for an interview with Cuma Velile Dube and answering questions he may have on my experience regarding ESG integration and responsible investing.
5. My participation is entirely voluntary and should I at any stage wish to withdraw from participating further, I may do so without any negative consequences.
6. I will not be compensated for participating in the research, but my out-of-pocket expenses will be reimbursed.
7. There may be risks associated with my participation in the project. I am aware that
 - a. the following risks are associated with my participation: *The discussion of firm proprietary tools and processes.*

- b. the following steps have been taken to prevent the risks: *Cuma has committed to excluding any information regarding firm specific tools and processes and in maintaining my anonymity at all times.*
 - c. there is a 5% chance of the risk materializing.
8. The researcher intends publishing the research results in the form of it being in the university's research repository with the possibility of academic publication. However, confidentiality and anonymity of records will be maintained and that my name and identity will not be revealed to anyone who has not been involved in the conduct of the research.
 9. I will not receive feedback/will receive feedback in the form of an email with a summary of findings regarding the results obtained during the study.
 10. Any further questions that I might have concerning the research or my participation will be answered by Leticia Greyling (l.greyling@ru.ac.za)
 11. By signing this informed consent declaration, I am not waiving any legal claims, rights or remedies.
 12. A copy of this informed consent declaration will be given to me, and the original will be kept on record.
 13. Request to take pictures, video and voice recording for this study

I, [REDACTED]..... have read the above information / confirm that the above information has been explained to me in a language that I understand and I am aware of this document's contents. I have asked all questions that I wished to ask and these have been answered to my satisfaction. I fully understand what is expected of me during the research.

I have not been pressurised in any way and I voluntarily agree to participate in the above-mentioned project.

		2020.05.12
.....
Participants signature	Witness	Date

Rhodes University, Research Office, Ethics
 Ethics Coordinator: ethics-committee@ru.ac.za
 t: +27 (0) 46 603 7727 f: +27 (0) 86 616 7707
 Room 220, Main Admin Building, Drostdy Road, Grahamstown, 6139