KEYNOTE INTERVIEW

Integrating ESG into value creation is essential

A sustainable approach to investing goes hand-in-hand with higher returns, say CVC managing partner Jean-Rémy Roussel and ESG director Chloë Sanders

CVC Capital Partners ("CVC") has more than $80 billion under management across private equity and credit, and fully integrates ESG considerations into its approach to creating value across its investments. Here, Jean-Rémy Roussel, managing partner and head of private equity operations, and Chloë Sanders, ESG director, explain CVC's approach to ESG across its investments.

Q How does CVC integrate ESG into its value creation plan, and why?

Jean-Rémy Roussel: When we invest in a company and set out to grow value, we don't just look at the more obvious factors such as cashflow, sales and profitability, we also look at more fundamental value drivers, such as: how to gain market share through sustainable and responsible value creation. ESG plays a critical role in this.

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We sit down with a company's management team and look at how we can really improve the 'value fundamentals', as well as considering costs. You can grow market share simply through your customers being satisfied, and therefore being more likely to recommend you and give you repeat business.

We see five levers that feed into this: workplace, community, marketplace, environment and governance. Some of these levers will not necessarily improve short term profitability, but they will make a difference in the medium and long term. You are unlikely to achieve a higher price when the time comes to sell the business if you have just cut costs; you have to improve the value fundamentals of the company.

Q What are the first steps in improving the value fundamentals?

JRR: When we work with management teams, the first thing we do is to focus on the customer – we collect data on customer satisfaction and look at where we are falling-short against the competition. If you go into a company with negative customer feedback and five years later that feedback is positive, then most likely you will have grown market share and created value.

We then survey employees and look at how we can retain talent and improve the engagement and satisfaction of the workforce – finding ways to understand and build on employee values and motivation is essential. For example, we will look at a company's engagement with the community and environment and encourage the company to engage on environmental initiatives, community projects, training and education. You get higher employee engagement if you hit on the core values that you want to be known for.

On climate change and environmental considerations, it is possible to source very sophisticated data on the current consumption of natural resources and the carbon footprint of a business. This forms the basis for agreeing with the business on what they are going to improve and how. If you can do that while making long term costs savings and also improving the quality of the product or service, then you are able to significantly impact customer satisfaction and have an environmental impact.

Broadly speaking, governance means focusing on the rules of engagement and making sure your business conduct and ethics and compliance are all in good order. All of this is common sense because it is absolutely the right thing to do. And if you get it right, it leads to lower risks for the company and better financial results. It's as simple as that.

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>
> **CHLOË SANDERS**

Q How do you balance the long-term nature of ESG strategies with the shorter, four- to five-year hold periods of most private equity investments?

JRR: That is a question that is often asked by management. If you think about the long term, even the medium term, then there is no trade off in having better products, more engaged employees and a more positive impact on the environment. If people tell me that they cannot make changes because of the short-term financials, I ask them to think again, because there will be benefits down the line. Sometimes you have to take a short-term hit in order to genuinely address an issue like customer satisfaction, but we are happy to support that, even if it's a five to 10-year payback horizon. So we are laying the foundations for long-term, sustainable growth and value creation that will endure long after our period of ownership comes to an end.

And if you explain clearly your long-term strategy to employees and customers and they understand and see you are doing the right thing, you will also begin to gain their trust and loyalty. Setting the right tone from the top is critical.

Q Can you give an example of a portfolio company where ESG has been at the heart of the value creation strategy?

Chloë Sanders: A good example is Continental Foods, one of Europe's leading food companies, which was acquired by CVC Fund V in 2013 and sold last year to GB-Foods. During the time of CVC's investment, the company made significant strides in growing its market share. At the heart of this was creating better, healthier recipes across Continental's portfolio of European food brands, and focusing on improving the efficiency and sustainability of operations and customer experience.

This quote from the CEO of Continental Foods, Thomas Bittinger, sets out his perspective on ESG: "The business strategy should always encompass ESG, as the levers you need to work on to improve a business are the same as those required for an increased focus on ESG," he says. "To compete strongly in the market, a company needs to produce great products within an agile and efficient organisation. To achieve this, a full range of ESG issues, from employee engagement through to energy efficiency, can, and should be, considered."

Q How do you adapt your ESG approach to different types of businesses and industry sectors?

JRR: The principles are broadly the same whether you are selling to consumers or other businesses, and whether you are selling goods or services. The biggest adaptations are on the operations side, looking at the end-to-end supply chain and ensuring a focus on those topics that are most material to the business.

The approach to employee culture is something that you might adapt for a particular location or country, where diversity can mean different things in different places. It is the same with the environment and community engagement, where employees and customers will have different ideas, but the fundamentals are the same. In terms of reporting and measuring progress you adapt the ratings and what you measure, but the key is to measure key fundamental factors for the business such as employee engagement or environmental impact so that you know your starting point, and can then set targets to improve on. If you measure and monitor ESG factors, you can manage them.

Q What mechanisms do you have in place to monitor ESG dimensions in your portfolio businesses?

JRR: There are three ways. First, the operations team are working on the investments with the deal teams, talking with management, giving them three to six months to develop their new corporate strategy with new financial objectives and a complete value creation plan that includes sustainable and responsible growth. At subsequent board meetings we review progress against these objectives on an ongoing basis.

Second, we have non-financial metrics to measure, using external programmes to track progress on topics such as customer satisfaction and employee engagement, environmental impact, community initiatives, anti-bribery and corruption policies, and so on. For customers, we will look at net promoter scores, which measure the willingness of customers to recommend a company's product or service to others. For employees, we use questionnaires which can be very effective at measuring progress. For example, if you buy a company and 70 percent of the workforce say they would not recommend it to their friends as a place to work. But you turn that around so that when you come to sell several years later and 70 percent say they love working for the company and feel they are properly paid and rewarded, then that is a better company.

When it comes to additional topics such as sustainable procurement, environment and ethics, there are ratings available from well-respected providers that help track the progress companies are making. Finally, we have our own assessment process, where we collect reports from companies and ask our external auditors to conduct periodic reviews to validate the answers given.

Chloë Sanders: On the internal assessment process, we are engaging with lots of different companies across a broad range of industries. There are certain questions that apply to all companies and others that are more bespoke. It is not a cookie-cutter approach.

Q What drives you to make this a priority? Are you under pressure from LPs to increase your ESG focus?

CS: I've been engaging with investors on ESG for nearly 10 years and more recently I've observed a significant increase in interest and depth of understanding of ESG topics. Those investors interfacing with us on ESG are sophisticated and are asking for far more detailed information about portfolio companies, wanting to understand more about our overall approach to the big global challenges. A lot of that comes from obligations in respect of their own ESG commitments. As long-term signatories to the PRI and more recently as a member of the PRI Private Equity Advisory Committee, we are actively involved in the finance industry's dialogue on these topics. And, of course, it isn't just our investors: our portfolio companies, management teams, partners and employees demand it of us precisely because it is the right thing to do.

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JRR: Investors have become much more attuned and expert at asking questions, and more determined to invest in investment managers that make this a priority. They have responsibilities of their own and we encourage them to ask questions and get engaged, private equity has a huge reach and the industry can have a significant impact. I fundamentally believe there is no trade-off between returns and ESG; they go together in creating value. Of course you want to improve the financials, but by focusing on all the inputs you know that you are going to leave the company in a better shape than you found it, which means you have a strong investment and of course you get better financial results. I would also add that ESG itself is a growing, attractive industry. Just as we want to measure how our portfolio companies are performing on key ESG credentials, so many other companies across the global economy increasingly need to track their own metrics. That's why we recently invested in environmental ratings group EcoVadis to tap into this growing demand. ■

Q You put customer satisfaction at the heart of your ESG strategy. Can you give an example of how this works?

CS: A good example is CVC's investment in Sunrise Communications, the Swiss telecoms provider. When we made that investment in the complex and challenging European telecoms market in 2010, its customers weren't very happy, particularly about the pricing structure in place at the time.

CVC helped to turn the customer experience around by investing in a quality improvement plan and pioneering flat rate tariffs and differentiated price plans. By improving the overall customer journey, we were able to achieve much higher satisfaction levels and significantly improve the company's reputation and brand positioning. At the same time, to ensure that the needs of employees were also being met, we implemented a comprehensive employee engagement programme and added customer satisfaction and employee engagement targets to the senior management teams bonus conditions. These improvements culminated in Sunrise winning industry awards for best telephony network and best customer service and attracting world champion tennis player Roger Federer as a brand ambassador. Ultimately, CVC was able to generate considerable value on the back of that ahead of a listing on the Zurich stock exchange in 2015.