KEYNOTE INTERVIEW

# A customer-centric approach to ESG

*Helping companies chart a path to sustainable growth built on strong ESG principles is a crucial value driver for private equity, say CVC's Jean-Rémy Roussel and Chloë Sanders*

Investors are increasingly focused on environmental, social and governance considerations. Climate change, racial injustice and the covid pandemic are injecting a real sense of urgency in both portfolio company boardrooms and with their sponsors. This isn't just a question of being a responsible business. It also makes financial sense: strong financial performance and sustainability have become inextricably linked, and there's no going back according to CVC Capital Partners' managing partner, Jean-Rémy Roussel, and ESG director, Chloë Sanders.

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## Q Why is ESG important for your firm?

**Jean-Rémy Roussel:** We want to create value in our portfolio companies, but not just in any way possible – our values need to be present in every important decision made. ESG is therefore extremely important to us for three main reasons. First, we find that where management teams have been fully engaged on ESG, the investments have delivered higher than expected returns. When management teams focus on ESG opportunities, they can make significant improvements to the business and more quickly deliver on plans. Over time we have also found strong evidence that an increased ESG focus throughout a company materially increases employee engagement.

The second element is the scale of our impact. At CVC we have more than 85 companies in our portfolio and they employ over 400,000 people, many with dependant families – our firm touches the lives of a lot of people in many countries. If we do this right, so that everyone benefits, employees can feel adequately remunerated, supported and proud of working for their companies. This grass roots philosophy can have a positive and far-reaching impact on society.

Third, if we, as a firm, want to be here in 30 years' time, we must actively drive the sustainability agenda both within our firm and across our portfolio. You need to maintain your social license to operate and reputation as a responsible investor. There is no trade-off between delivering superior returns for investors and creating value in a more sustainable and equitable way for all stakeholders involved. In fact, quite the contrary, one facilitates the other.

### Q How is ESG integrated into your thinking and processes?

**Chloë Sanders:** ESG integration must come from the top – there needs to be a commitment from management to operate sustainably. At CVC we have engaged a corporate social responsibility mindset for many years, and we have continually refined our approach, for example by broadening environmental considerations from traditional topics such as pollution, to seek out opportunities – we are constantly pushing ourselves to do more. We measure our carbon footprint and are taking steps to neutralise it. We are also working with our portfolio companies to establish roadmaps to decarbonise and build offset programmes.

**JRR:** We consider ESG elements as integral ingredients within our portfolio companies' value creation plans (VCP). The engagement of the management team is key here – if you do not have buy-in from management, you will not achieve meaningful results. When working with a management team, we focus on six key priorities that help us track value creation: customer focus, simplification of processes, people and culture, community, environment and governance. They are all non-financial elements because our experience is that financials only provide a rear mirror view, and we want to look to the future. These elements are our lead indicators of proper value creation which will eventually result in superior financial results.

Of these six priorities, we see customer focus as the most important, yet it is not really addressed in traditional ESG metrics, so we decided to include it within more traditional ESG topics in our VCP.

### Q Why do you see customer focus as the most important element?

**JRR:** Many people expect private equity to come into a business and just focus on improving financials by cutting expenses, reducing staff, and being very tough with suppliers – but this is rarely sustainable and not the way we work.

Instead, we start with the customer journey and customer awareness around products and services. This analysis shows a multitude of potential improvements from consumer decision making through to user experience. We can also accurately map the location and size of internal costs of consumer dissatisfaction. So, if you have a business where there are product breakdowns, addressing this problem will reduce inefficiencies. From the number of calls to call centres to the costs of repairing, this reduces costs and ultimately increases customer satisfaction. Getting the customer journey right is a much more engaging agenda for management than pure arbitrary cost reduction. Importantly, savings can also be re-invested in the business.

### Q Can you give an example of this in action?

**JRR:** Zabka, a chain of 7,000 convenience stores, run by about 6,000 franchisees, in Poland, is a nice example. We could see the business had a lot of potential, but it faced many internal challenges, so we sought to address the engagement of two important customers: the franchisees operating the stores and the end consumer.

Two years before our investment, the franchisee churn rate was 37 percent which was very disruptive to the business. We measured the Net Promoter Score KPI, and for Zabka franchisees, it was minus 62, which meant we had a disengaged group of

customers. In response, management recruited a top team who worked closely with franchisees to implement a variety of initiatives including automatic store replenishment. After two years the NPS went up to +19, and franchisee churn reduced to around 10 percent.

To improve end consumer satisfaction, the marketing and category team revamped Zabka's offering with more than 12 different store concepts. The team also improved the product range with products that were better for the planet, such as introducing recycled packaging and using more natural ingredients. Three years on, the customer NPS score has increased from 15 to 47.

Another positive outcome has been the material improvement in employee engagement – over three years the Employee Engagement Gallup score increased significantly (by over 25 percent). If you build customer satisfaction, you create a resilient company that people want to work for. The financial impact has also been excellent – sales growth has climbed 20 percent over the last three years.

### Q The sustainability of supply chains has come under increased scrutiny recently. How are you considering this area?

**CS:** Supply chains are a vital

### Q Where do you see ESG opportunities developing in the future?

**JRR:** The 'E' and 'S' aspects will become as disruptive as the digital transformation we have seen in sectors such as retail or insurance. In four years, who will want to buy a company with an unmanageable carbon footprint? The environmental impact of a company could have a significant influence on its value. Similarly, if a company is unable to demonstrate an inclusive and diverse work force, will it be able to attract or retain talent?

There will be opportunities to buy companies that are currently underperforming on ESG and work with them to improve. If companies do not develop a long-term ESG roadmap, ultimately, they are putting themselves at risk – both financially and reputationally. There is a lot of work we, as hands-on investors, can do to set them on the right path and create value.

component of integrating sustainability into a business. Customers are increasingly demanding transparency, so there is a real reputational risk if you fail to manage your supply chain properly.

**JRR:** Watchmaker Breitling is a good example of how a management team has successfully collaborated with its suppliers to achieve long-term value. Breitling's watches are made using precious metals, diamonds and leather. The company has systems to rigorously track the origin of these materials and is also pursuing the use of more sustainable materials for its products and packaging. For example, Breitling has worked with NGOs to develop straps made from recycled materials such as fishing nets. Its new sustainable and smaller packaging, made from 100 percent recycled plastic bottles, has also been awarded the 'Efficient Solution Label' from the Solar Impulse Foundation. If the customer still wants the more traditional packaging they are able to offset the CO2 impact difference with a donation to Sugi (planting ultra-dense mini forests).

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>
> **JEAN-RÉMY ROUSSEL**

Breitling has materially reduced its CO2 footprint across its production sites and offices and reduced water consumption in its production processes by 50 percent over the last five years. In addition, the business has plans to move to 100 percent renewable energy sources – a decarbonisation programme will be a strategic priority for management in 2021 and beyond.

**CS:** Syntegon (ex Bosch Packaging Technology), is a strong example of an equipment supplier pro-actively collaborating with its customers – several of them, like Nestlé and Mars, have already announced they want to move to 100 percent recyclable packaging by 2025. The company has established a consultancy team to collaborate across the value chain with clients and suppliers to reduce plastics and chemical products in packaging. Early results are already very encouraging and there is no doubt the company will not only continue to grow significantly and profitably, but it will also have a material impact on the environment through reduced energy consumption, CO2 emissions and plastic consumption.

### Q One of the challenges of ESG is measurement. How can this be done effectively?

**JRR:** It is going to take a long time for there to be a global standardisation of company measurement, so our six priorities provide a macro level framework, underpinned by a few core KPIs, such as NPS, quality market standards, carbon emissions, along with industry-specific measures. Each of our investments are unique, so we have to adapt and balance for an individual company's maturity and local practices. We do consider emerging standards, but different investors need different information. By measuring our own KPIs using the six priorities of our VCP we can quantify and measure progress over the course of an investment.

**CS:** Investors want concrete evidence of what we are doing; not just which standards we are using. To obtain an official external validation of the ESG engagement of our companies, we asked EcoVadis, a trusted independent ESG rating agency, to perform an annual rating of CVC at the corporate level and for our portfolio companies by 2021. Its rating covers around 80 percent of our ESG focus areas. We will therefore soon have a consolidated view of all our companies' ESG efforts and progress over time. The aim is to stake a point of departure and then work with companies to improve the scores. The ratings show us a clear indication of where there are improvement opportunities. When there is a silver rating, there is room to move to gold. We recently did an ESG Spotlight webinar where over 25 portfolio companies came to share their experience and offer examples of best practice. We have found amazing levels of engagement of our portfolio companies' executives in sharing and learning from each other. ■