

KEYNOTE INTERVIEW

Preparing for ESG regulation



While compliance with regulation needs diligent preparation, these efforts can be harnessed to create sustainable value from a greater focus on climate change, say 3i's Céline Maronne and Sophia Walwyn-James

Q 3i will be reporting in full alignment with the TCFD framework for the first time this year. What are you doing to prepare?

Sophia Walwyn-James: While this is our first year reporting in full, we have been producing reports which follow the structure of the Taskforce on Climate-related Financial Disclosures (TCFD) since 2018.

We began asking our portfolio companies to measure their carbon footprint as early as 2020 and have seen incremental progress each year since. All of this means that we have been able to build on our baseline over time and

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preparation has not required a sudden leap.

Instead, our focus has been on ensuring that climate and emissions reduction considerations are integrated into what we do.

We established a 3i ESG Committee in 2022 which includes representatives of 3i's Executive Committee and which reports directly to the 3i Group CEO. This means we now have senior oversight as well as senior input into what we are doing. In the same year,

we completed a simple gap analysis and launched several initiatives that have enabled us to meet the reporting requirements, while also ensuring that a focus on climate change is embedded across the organisation. This is important, because we believe that everything we do to prepare for upcoming regulation should be done not only for reporting purposes, but also to influence the wider business and the way that we invest.

For example, last year we provided climate change training to all our employees, and later repeated the process for executives at our portfolio companies.

Céline Maronne: We have also made a commitment to join the Science-Based Targets initiative (SBTi), cementing plans to reduce our own corporate carbon footprint and demonstrating a level of ambition to our portfolio companies. This also arms them with a clear framework to follow as they consider their

own emissions reductions strategy.

As we progress towards mandatory TCFD alignment for 3i Group, we are also formalising the way that we manage ESG across the portfolio. For example, we recently rolled out a software tool to improve the way we collect, analyse and benchmark ESG data.

Q What are some of the positive changes you have seen as a result of an increased focus on climate change for 3i's infrastructure business?

CM: We have seen a number of positives, most notably around origination. The energy transition is by far the most significant megatrend underpinning our infrastructure investment strategy. The opportunities are significant across every subsector, from transportation and energy to digital and social infrastructure. Our most recent investment was in UK biogas producer Future Biogas. That business is helping its customers deliver on their own climate goals. For example, it recently announced a partnership to develop a plant for AstraZeneca. This allows AstraZeneca to source part of its energy needs from biogas, and to reduce its reliance on fossil fuels.

Other portfolio companies have been able to access new markets underpinned by sustainability-related trends. In Denmark, Esvagt's growth strategy is driven by growing the fleet of vessels supporting the offshore wind sector. In the Netherlands, Joulz, which leases energy equipment to industrial and commercial customers, has broadened its offering to incorporate rooftop solar and electric vehicle charging infrastructure. In the UK, ESP, which acquires and maintains last mile utilities connections, has become a leader in supporting the EV charging infrastructure market to rollout and connect to the grid more quickly.



Energy source: 3i-backed biogas producer Future Biogas is working with customers to help them deliver on their own climate goals

Q What challenges are you facing in integrating climate change across your investment activities?

CM: This is a rapidly evolving area which presents a challenge because we are constantly needing to upskill. Much of what we are putting into practice today has, until recently, been conceptual. We use our influence at the portfolio company board and our direct interactions with portfolio companies to help them understand and deliver on the growing expectations of their stakeholders.

Our infrastructure portfolio companies face particular challenges because in some sectors there are no proven emissions reduction pathways available. The technology may not yet be fully developed or cost efficient. It can be difficult to set concrete targets when you are not in possession of the full picture. The financial trade-offs that decarbonisation can entail are now also coming into play and this can be particularly difficult if a business has competing priorities at a point in time.

SWJ: It can also be challenging in due diligence. As mid-market investors, we are typically working with SMEs whose level of maturity and internal resources dedicated to the topic can be varied.

However, we are lucky in that the private equity industry recognises these challenges and so we benefit from collaboration with our peers through initiatives such as Initiative Climat International (iCI), which we joined in 2022. iCI is a body of over 250 private equity firms globally that have come together in a spirit of sharing the challenge, developing technical frameworks, guidance and support mechanisms. This means we can move forward in the knowledge that what we are doing is aligned with our peers – we are all moving in the same direction. It also means we can give clear guidance to our portfolio companies, knowing that their efforts will be recognised by future owners.

Q How have you seen climate-related practices driving value in your private equity portfolio?

SWJ: I think a focus on climate can be an interesting lever both in terms of driving revenues and reducing costs. For example, our premium pet food business MPM delivered cost savings when it carried out an environmental review of its product packaging. The intention was to improve recyclability, which increased from 87 to 91 percent. But in taking materials out of the packaging and reducing product weight, the company also delivered an annual cost saving of around \$300,000.

In addition, we now also have three B-Corp certified portfolio companies. The B-Corp label is an extremely useful way to communicate a company's values and priorities and can be an important differentiator, particularly in a competitive consumer market. It can also be highly beneficial for attracting, engaging and retaining talent.

Meanwhile for our B2B companies it is becoming important to demonstrate that they enable their clients to achieve their own sustainability goals. The EcoVadis medal scheme has been a helpful way for companies to demonstrate they are making progress each year. We have 10 portfolio companies using the scheme and two progressed to reach platinum status at the end of last year, putting them in the top 1 percent in their industries.

Q How is your portfolio adopting the Science-Based Targets initiative framework?

CM: The reaction has been very positive. The SBTi provides a clear framework which both 3i and our portfolio companies can follow as we seek to deliver decarbonisation ambitions. It provides credibility because the targets are in line with the latest climate science. They are validated by an independent body and progress must be reported both regularly and publicly.

Three of our infrastructure portfolio companies are finalising science-based targets. We are seeing that having a credible decarbonisation strategy is increasingly being viewed as a differentiator by B2B customers and this is an effective way to communicate that intent.

As more 3i companies become SB-Ti-aligned, we will be able to leverage our portfolio of around 50 businesses, providing case studies as to how to set and deliver on targets which will make the journey more efficient for companies joining our portfolio.

Q How is 3i approaching sustainability themes outside of climate?

CM: There are a number of sustainability themes emerging outside of climate and one that we are starting to focus on is nature. There is a recognition that nature considerations will rapidly catch up with climate in becoming a core component of ESG. Nature is a multi-dimensional topic and can be complex to implement across different sectors within a portfolio. This year we will be starting with a materiality

assessment to inform future strategy.

We also consider material social topics including health and safety as well as gender equity, in particular because some of our businesses operate in industries with structural gender imbalances.

SWJ: Another area of focus this year will be human rights. That is partly being driven by the EU Corporate Sustainability Due Diligence Directive (CSDDD) which is putting a lot of emphasis on how companies interact with people, not only in their own operations but also in their supply chains and through their products. While human rights is an area we have focused on as part of 3i's Responsible Investment Policy for over a decade, it is clear that expectations around this topic are increasing. We are responding by educating and upskilling ourselves with human rights training planned for all 3i employees, led by a subject matter expert with over two decades' experience in this area.

Q Where would you say private equity is in terms of its ESG credentials today?

SWJ: Sustainability is an important and enduring theme for the private equity industry. This is an asset class that is uniquely placed to influence its portfolio companies thanks to what is typically a majority ownership position, board representation and hold period of at least several years. I also think the industry is setting the bar high, in part due to the demands of LPs and regulators. Unlike the public markets, therefore, which have faced extensive media scrutiny around the topic of ESG in the last year, private equity has established high standards for itself and is taking clear strides to meet those standards in the coming years. ■

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SOPHIA WALWYN-JAMES

Céline Maronne is the director leading work on sustainability in 3i's infrastructure team and Sophia Walwyn-James is ESG and sustainability director within the firm's private equity team