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TPG, Ares Bolster ESG Efforts

By Tom Stabile
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Ares Management and TPG Capital each have built up dedicated internal resources to track environmental, social, and governance factors in the investment process, a further sign that ESG may be shifting into the private equity mainstream.

Professionals from both firms outlined the higher profile of these practices in their outfits on a panel exploring the expanding presence of ESG in private equity last week at an Informa conference in San Francisco.

ESG has not yet become an industry standard, but may be headed in that direction, said panelist Kirk Hourdajian, advisor for sustainability and ESG at TPG, citing a recent comparison with the business quality movement of the 1980s through management tools such as Porter's Five Forces and Six Sigma.

"You don't hear it that much anymore [because] quality has been nicely integrated into business," he said. "There isn't the quality guy – 'Oh we're doing a deal, let's bring in Quality Mike'…We say maybe over time… our roles will be part of the way we do business."

Reviewing ESG matters has become an ongoing feature of the investment vetting process at Ares, rather than a single checkpoint that might result in a "veto" on a deal, said panelist Caroline Zouloumian, managing director and head of ESG at the firm.

"It's not so drastic as a veto because the process is so long," she said.

While that approach to make these factors a routine ingredient is most typical for private equity, ESG has acquired an image of being a roadblock, said Ryan Miller, consultant at Malk Sustainability Partners, who moderated the panel.

"I think there's a conception that ESG is this world where you have someone on your team, and they'll come into an investment committee meeting and [say], 'No, no, no – we can't invest in this company,'" he said. "That's not the way it works in reality."

Indeed, ESG reviews often line up with other assessments of potential acquisition targets, Hourdajian said, citing a strong correlation between prospective portfolio companies that have poor sustainability characteristics and weak management or financial statements – including a recent firm on which TPG decided to pass.

"We had all of our [ESG] talking points ready," he said. "We didn't even need to [present because] the financials were so poor."

ESG review teams typically aim to calculate "business value" through three lenses, Hourdajian said. One is cost savings from implementing strategies that use less energy, waste services, or water, which is typically easy to calculate.

Another is estimating ESG-aided revenue growth through activities such as the introduction of a sustainable product line, which can be a difficult calculation, Hourdajian said.

"Squishy it is," he said. "Can you really put your finger on it and say sustainability grew top-line [revenue] 2%? It's hard, but you can try."

The third is risk mitigation, or costs avoided by virtue of having sound business practices, Hourdajian said. While it may be easy to calculate the "business value erosion" from exposure to a major failure, such as negligence at a supplier's factory that results in workplace fatalities, it is difficult to estimate a dollar amount of savings from dodging such problems, he said.

At Ares, bringing those perspectives into investments involves participating in the weekly deals due diligence meetings on Monday mornings, Zouloumian said. She gets advanced notice of what is coming through the deals pipeline, while also working with portfolio companies on ESG matters post acquisition.

While Ares also looks at ESG factors on its debt and real estate teams, the main effort is in its private equity group, she added.

"In private equity, I tend to be much more involved [and] have more control and influence in that sphere," Zouloumian said.

TPG has five full-time professionals handling sustainability and ESG initiatives who get involved in deals due diligence, ongoing portfolio company improvement, and even the exit process by highlighting the "sustainability narrative" of a particular firm the fund manager is preparing to sell or take public, Hourdajian said.

Even mid-sized private equity shops are working on ways to integrate sustainable practices into their investment processes, said panelist Dave Tausheck, who recently left a post as v.p. for compliance and risk management at Genstar Capital, where he helped to build the firm's first ESG policy over the past two years. The firm now has a similar approach of including ESG factors in pre-acquisition deals due diligence and through improvements at portfolio companies, he said.

The "main driver" in setting up the program was "getting senior managers on board to buy into the program, making the case for sustainability to them, so that they see it as more than just tree-hugging," Tausheck said. "[W]e were then able to trickle it down to the deal teams [and] work with the deal teams to… figure out the best and most effective way to get at ESG issues."