




ESG metrics that matter

Leveraging ESG data contributes to enhanced outcomes for private equity investors



KPMG Private Equity 2023

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Considering Environmental, Social and Governance factors (ESG) as part of the investment process continues to move up the priority list for private equity investors. Today, general partners (GPs), limited partners (LPs), and portfolio companies all regularly apply an ESG lens to investment and asset management decisions. In fact, ESG integration at each stage of the investment lifecycle is becoming critical to raising capital, generating value, identifying risks and commanding higher multiples. Several factors are driving this momentum: demand from asset owners and investors; the development of ESG reporting standards and frameworks for the industry; and perhaps most of all, growing acceptance that investments that consider ESG criteria can yield stronger and more sustainable commercial opportunities.

ESG gains momentum as investment factor

As ESG practices mature, attention is turning to role of ESG data to inform decisions and actions for enhanced financial outcomes. There is growing momentum among private equity stakeholders, including regulators and standard-setters, to enhance the authenticity, transparency, and accountability of ESG strategies. Elevating the rigor of ESG reporting to that of financial reporting is a crucial step toward this outcome. Establishing a consistent approach, identifying relevant ESG metrics, and measuring and reporting progress are the foundation of that effort, which will enable more informed investment and management decisions by private equity sponsors.

KPMG is an advocate for consistent and transparent ESG reporting in private equity. Our engagements and conversations with ESG leaders from some of the industry's most prominent GPs and LPs confirms that effective use of ESG information can help drive resilience, growth and returns in private markets. To that end, we are helping develop new approaches and frameworks for private equity investors to assess financially material ESG metrics during pre-deal and ownership decisions, through the lenses of risk mitigation and value creation, while considering qualitative factors such as organization maturity, hold-period and geographic location.

This paper draws on KPMG's extensive ESG advisory and reporting experience to share insights and advice to help private equity stakeholders tackle a major industry challenge—making sense of the all-encompassing ESG data demands—and put a leading-edge approach to ESG metrics into practice. This experience makes the case that effective use of qualitative insights and quantitative ESG metrics will help drive resilience, growth and returns in private markets. KPMG is also contributing to leading climate and sustainability reporting, including the TCFD¹ and the ISSB², to further advance disclosure standards and analysis of ESG and climate information.

1 Source: TCFD Implementation Considerations for Private Equity (BVCA, 20 Oct 2022)

2 Source: ED/2022/S1 General Requirements for Disclosure of Sustainability-related Financial Information and ED/2022/S2 Climate-related Disclosures (KPMG International Limited, 29 July 2022)

Beyond reporting: Enhancing the value of ESG data

There is growing recognition that ESG data can identify opportunities to create value as well as mitigate risk across private equity portfolios. As the ESG maturity and performance of a company plays a greater role in PE investment decisions and ownership, stakeholders across the ecosystem are seeking more ESG information, demanding greater disclosure and facing the challenge of how to incorporate the analysis of ESG data into their wider processes.

However, more data and disclosure aren't consistently leading to better decisions and outcomes. While many PE stakeholders are aligned in the purpose of ESG information to drive more sustainable long-term investments, there are a variety of views on what information is most relevant and approaches for tracking, measuring and acting on that information. The result is the time-consuming process of collecting a large scope of data, and limited focus on the strategic use of the data.

The demand for ESG data continues to rise as ESG reporting and regulations increase in number and scope. Private equity firms, and their investors, have a significant opportunity to navigate the universe of ESG metrics and reporting requirements and focus differently on the most material ESG metrics—those tied to value preservation and creation—and use them to inform decisions during critical parts of the investment process.

In our experience, what ESG metrics are available and relevant, and how they are used, are not uniform. Instead, they depend on factors specific to each investment, including sector, geography, and the maturity of the company. The exception is climate data, which is a common area of focus among GPs, LPs, and regulators, though has some sector specific nuances making cross sector comparisons difficult. The degree of ownership in a portfolio company also influences the ability of the PE sponsor to obtain this information.

We have identified common baseline considerations and recommendations we believe are essential starting points for the PE industry to identify material ESG metrics to influence more business outcomes. In the following pages, we examine various challenges hindering the industry from obtaining and using material ESG data and share recommendations for tackling those challenges, enabling managers to focus on performance improvement through use of ESG metrics.



Data Collection and Reporting

CHALLENGES

Managing data volume. Incremental to regulatory mandates, the volume of LP requests for ESG information is significant. Many GPs are responding to hundreds of unique LP ESG questionnaires each year, with inconsistent information being requested, and questions increasingly targeting detailed fund- and investment-level data. This puts an immense burden on GP resources and has an impact on their ability to direct resources towards analyzing and acting on issues that the ESG data highlights.

Access to data. Given the different levels of maturity and varying levels of ownership interests within a portfolio, the market does not always have the access to ESG data needed to achieve alignment with divergent demands.

Data quality. Good decisions cannot be made with bad data. Private markets, and many public companies for that matter, have not yet developed reporting infrastructure such as technology and internal controls that yield reliable, consistent and transparent reporting.

The ability to aggregate ESG data. GPs are being asked by investors to provide fund level data about ESG strategies and their impacts. However, investment-level data tends to be highly specific to each company and sector. Aggregation across the portfolio does not always enable meaningful fund or GP-level comparisons.

OPPORTUNITIES

Inventory existing ESG reporting and identify gaps: Understanding the ESG reporting landscape, both across a private equity fund, or with a portfolio company, is critical before making changes to the ESG reporting strategy.

Take the following actions:

- Evaluate the financial implementations of ESG commitments made in qualitative reporting: Consider how ESG issues manifest in financial statements. For example, will the GP or portfolio company make a capital expenditure to meet an ESG goal that will be recorded in a financial document or factor into future financial plans and analysis? Are these risks material enough to disclose separately?
- Check the public domain—from annual reports, press releases, marketing materials and websites—for information that has already been disclosed about ESG-related issues, risks, strategies, commitments and goals. And look through a wide lens: It is common for organizations to present ESG information without highlighting it as an ESG component, or to present what should be the same content in different ways for different purposes—e.g., marketing vs. compliance.
- Identify synergies across reporting: identify common data elements across reporting requirements as this is critical to efficient and accurate reporting.

Assess ESG data quality and processes: Good data yields authentic reporting and informed decision making. Determining comfort with the reliability of the data and claims made about process and policy is essential for the private equity industry to earn trust with stakeholders and make sustainable investment decisions.

Start by evaluating if:

- the right data is being aggregated
- supporting documentation exists;
- sufficient investments have been made to monitor completeness and accuracy of data and achieve established goals and commitments;
- processes and data collection have enough rigor to consistently evaluate ESG risks, opportunities and data at all stages of the investment lifecycle;
- the reporting strategy sufficiently links data to outcomes enabling a more transparent, authentic story.

Focus data collection efforts. Certain factors limit a GP's ability to obtain decision-critical ESG data from portfolio companies. For example;

- the degree of investment will impact the level of influence a GP has over the portfolio company, including access to ESG information;
- the ESG maturity of investment will determine if portfolio companies even have the quality ESG data they are asked to provide; and
- the hold period of the investment will influence how decision-critical GPs view certain ESG data, given that ESG issues tend to be longer term fixes.

Focus your efforts on areas in which access to quality data is a realistic expectation and with companies for which quality ESG data is a business imperative in the nearer term.

Case study



Enhancing the relevance and rigor of ESG reporting

Client challenge: Understand whether selected portfolio company metrics on emissions, human capital and other ESG-related areas were relevant and consistent with regulations, LP expectations and whether such metrics would stand up to assurance.

KPMG solution: A global PE firm sought KPMG's help to assess the current state of its ESG reporting practices, relative to LP and regulatory disclosure

requirements and assurance readiness. We presented recommendations and observations to improve reliability, consistency, and transparency. This included recommendations related to policies and methodology, data management, and reporting and disclosure. The PE firm is now able to establish policies and procedures for ESG measurement and reporting, creating rigor, transparency, and accountability in its ESG operations.

OPPORTUNITIES

Bolster technology platforms: Early adopter technology systems are already struggling to handle the task of monitoring, managing and reporting ESG information at the intensity demanded by today's stakeholders. Further, the same ESG data is coming from multiple systems thus increasing the risk of inconsistencies in each reporting use case. Firms and companies need modern platforms, applications and solutions that supplement existing technology infrastructure to capture, manage, analyze and report non-financial data at scale, creating a single source of truth for ESG data (much like a general ledger used in financial reporting). This may require implementation of third-party software with customized tools specific to PE ESG data needs.

Consider assurance options: Similar to non-financial reporting, assurance over the integrity of ESG data, metrics and processes can help PE firms enhance accountability and engender stakeholder trust and confidence. With professional-standard review processes, independent third-party accountants can advise industry participants with respect to the rigor and objectivity of ESG measurement and reporting methodologies, policies and procedures and issue an assurance report on ESG performance and operations.

Case study

Developing a technology-based solution to enable streamlined data management and reporting



Client challenge: Design and implement a bespoke technology solution to collect and manage reliable ESG and impact data to support underwriting, portfolio management, and reporting to multiple stakeholders.

KPMG solution: Our client, a large global asset manager, recently launched a new impact fund. They evaluated off-the-shelf ESG reporting solutions and felt they lacked the flexibility and nimbleness to quickly adopt to evolving fund and regulatory requirements. As expectations for disclosure of ESG-related information evolves, the client wanted to identifying synergies in common disclosure requirements across different regulations and

frameworks and have a single repository for data. KPMG enabled the configuration of the client underwriting application to make its pre-and post-investment ESG and Impact data management significantly easier, timelier and nimbler. The application is deployed on an enterprise ready no-code platform, enabling the flexibility to respond to evolving ESG regulations and market standards faster than traditional approaches. Further, the application is integrated with client systems such as DealCloud, Pitchbook and SSO, and can be further integrated with the applications and systems of the asset manager and portfolio companies.

Engage with portfolio companies: Develop policies, trainings and standard operating procedures that educate and facilitate data collection and reporting for portfolio companies. Supporting portfolio companies in their reporting will help enhance GP reporting. It will also provide GPs with information on portfolio companies that is valuable for managing risks and opportunities and, if relevant, readying for an IPO.

Case study



Enhancing and streamlining TCFD reporting

Client challenge: Meet TCFD reporting requirements in an efficient, streamlined manner.

KPMG solution: KPMG advised a large investment firm on TCFD reporting readiness, including carbon emission calculations and target setting. Using our comprehensive TCFD readiness diagnostic, we established data and disclosure gaps and provided short, medium, and long-term decarbonization targets for the firm and funds, including how these targets and reporting would integrate with TCFD. Our guidance on carbon emission calculations helped enhance the quality of the firm's eventual TCFD report. Additionally, we identified synergies between TCFD disclosure requirements and other regulatory requirements to streamline reporting for multiple use cases.



CHALLENGES

Multiple regulatory requirements. There are numerous evolving ESG standards and regulatory proposals globally, with inconsistent definitions and mandates and little tailoring to the needs of private markets. KPMG notes the recent convergence around the International Sustainability Standards Board (ISSB) proposals (which incorporates SASB and the work of the VRF and IIRC)³, as well as increasing alignment to the Securities and Exchange Commission's (SEC) climate proposal, the Corporate Sustainability Reporting Directive (CSRD) and Sustainable Finance Disclosure Regulation (SFDR) legislation—all of which are influenced by the Greenhouse Gas Protocol (GHG-P) and the Task Force on Climate-Related Financial Disclosures (TCFD). Even so, PE stakeholders may be subject to several different reporting requirements depending on geography and sector.

Broad ESG requests by investors. Our conversations with PE clients indicate GPs are being inundated by a wide range of LP data requests. The web of reporting between LPs, GPs and portfolio companies is highly complex. In a market craving greater specificity about what ESG attributes to apply to areas of private equity assets, LP questions are increasingly unique, granular and broad in scope, seeking more detailed ESG data at the fund and investment level. Many LP's have started to leverage industry initiatives such as the ESG Data Convergence Initiative (EDCI)⁴ to ask some common questions of the GP's they invest with. However, limited overall consistency in data requests and definitions is preventing development of comparable, decision-useful reporting.

Pinpointing the most decision useful metrics. There is a growing disparity between the information requested for ESG reporting purposes and the information needed to tell a portfolio company's ESG story. Lack of clarity exists regarding how LPs use ESG information, including how they use data as a mechanism for understanding and driving financial outcomes. There is also disconnect between the ESG data needed to drive value and advance GPs' other business imperatives—such as improving investment-making and managing the owned portfolio in line with firm and fund level ESG targets—and data needed by LPs to evaluate and select GPs.

3 Source: IFRS Foundation completes consolidation with Value Reporting Foundation (IFRS, 01 Aug 2022)

4 Source: ESG Data Convergence Initiative website

OPPORTUNITIES

Understand why and how ESG data is used:

As private market participants apply a value-led approach to determining the ESG metrics to track and report against, understanding the unique circumstances and goals of the portfolio company providing the data is crucial. Regulations provide a good baseline of what information to collect. The specific use case, some of which are detailed below, will inform which ESG metrics are most relevant to enable effective and efficient data collection, measurement and decision-making. Identifying synergies in data and reporting requirements across these use cases and geographies will also enable efficiencies in the reporting process.

- **Determine first what gaps exist** relative to pending regulation and investor demand. Also consider what is appropriate to disclose to investors, targets, regulators and others.
- **Create a process to fulfill regulatory requirements**, claims and commitments: From a risk lens, think about governance in place to ensure commitments are being fulfilled.
- **Pre-deal:** Conducting ESG diligence of a target company's ESG performance gives the GP an initial view of its ESG maturity, risk profile, and potential opportunities that could influence the purchase price or decision to invest.

- **Ownership:** Understanding the ESG maturity of a portfolio company and the ESG factors most material to operations at the start of the hold period enables the GP to establish an action plan and track progress in areas that will have the greatest impact on operations and financial performance.
- **Exit:** A portfolio company's ESG maturity and performance can influence a buyer's decision and the price they are willing to pay.
- **LP and regulatory reporting:** LP's request ESG data to monitor against their own ESG approach, commitments, and expectations of their investors and beneficiaries. PE firms and funds are subject to a growing number of regulatory requirements that mandate the collection and disclosure of additional ESG metrics.

Case study

Elevating the role of climate data in diligence



Client challenge: Enhance its existing due diligence program to analyze the impact of its climate strategy on potential acquisitions.

KPMG solution: KPMG initially assisted this client, a global alternative asset manager, to establish a fund-level climate strategy. Next, the client requested our assistance to operationalize the strategy starting with diligence. This included establishing a program that identified the data to be collected and assessed in diligence to determine the target's alignment against the fund's climate objectives, analysis of the associated costs and viability of performance

improvement plans, and consideration of LP reporting needs. The final approach enabled the client to use a data driven approach to analyze climate risks and opportunities faced by the target company, review the target's current decarbonization pathway, the maturity of its current ESG data reporting process, and assess its performance relative to peers. As a result, the client is able to collect relevant climate-rated data to assess alignment with its climate ambition, including required capital and operational expenditures, and data collection and reporting enhancements, ahead of the acquisition.



OPPORTUNITIES

Understand value beyond compliance: For all reporting inventories, consider the opportunities ESG data can deliver. Although ESG reporting is often seen as a high-level risk mitigation exercise. The library of reporting data presents an opportunity to use it to retain competitive advantage and transform to address the needs of investors, customers, vendors, and employees. The goals of value preservation, value creation and the identification of strategic opportunities start with data. How can this data be analyzed to make better decisions and enhance value stories? Is it aligned with the business strategy for executing ESG imperatives material to the business and correlated with sector focus?

Additionally, the intersection of public and private market ESG data demands raises expectations for reliable ESG data (e.g., private companies may be in the supply chain of public companies demanding such information). Regulatory attention is placing more demand on accountability and evidence. Education about the correlation between ESG topics and sustainable financial performance is creating demand for greater transparency. And, standardizing ESG reporting is enhancing the degree to which potential investors are seeking data demonstrating an ESG link to long-term sustainable performance in their portfolio companies. In other words, though PE firms may not yet be legally obligated to provide ESG data, adhering to the major standards and frameworks is already becoming strategic business priority.

Conduct a greenhouse gas inventory: Among the numerous and diverse set of ESG criteria being measured in private funds and companies, quantifying greenhouse gas (GHG) emissions are a consistent priority among investors and regulators and receive a significant amount of scrutiny. PE firms and portfolio

companies should have a complete understanding of their current GHG emissions inventory, including potential risks and opportunities for the cash flow streams of the business. Depending on the nature of the business and current state of GHG reporting, this could be a major undertaking.

Case study



Developing a climate strategy and implementation plan

Client challenge: Establish a firm-wide climate strategy with a clearly defined approach to measure progress and communicate performance.

KPMG solution: KPMG helped a global asset manager establish its first climate strategy to create a consistent firm-wide vision and approach. We worked with senior leaders across the firm to build consensus around climate ambitions that defined their overall approach and considered nuances of different asset classes and stakeholder needs. A critical component

of the strategy development included defining performance targets and an approach to measure and report progress. This included determining the data needs, metrics and methodologies, sources of data, and plans to improve the quality of data. As a result of this work, the firm has focused its data collection efforts beyond regulation to information that provides meaningful insights on progress to achieve its commitments and relationship to financial performance.



CHALLENGES

Focusing on relevant issues and regulations:

There is no one-size-fits-all approach to ESG data, management, usage or reporting, which complicates efforts to drive value from the real metrics that matter to each individual organization. Nor is there one single person in any organization with all the knowledge and the skills needed to address effective implementation of the firm's ESG strategy alongside today's intense reporting needs. For these reasons, many GPs and privately-held companies lack an ESG data strategy, instead relying on ad-hoc processes to respond to LP and regulatory requirements. This results in the tracking of metrics which are high in volume but often not decision-useful.

OPPORTUNITIES

Establish strategy and governance: To drive value from ESG data beyond compliance requires a clearly defined strategy and mechanisms to ensure the strategy is followed. To determine what ESG factors are most relevant for each business segment and the business as a whole—and also set order of priority and oversee the implementation of reporting revisions—create a cross-functional task force with clearly defined roles and responsibilities. The group, which may have multiple levels of hierarchy, should include individuals responsible for sustainability strategy and business resiliency, corporate governance, including legal compliance and regulatory reporting, data and technology, accounting policies, and process and controls. It is also important to consider structures that allow for a bespoke approach for each industry, since many PE firms that invest across several sectors.



Case study



Identifying what to measure and current capability to effectively do so

Client challenge: Determine the ESG maturity of new portfolio companies and the ESG factors material to their operations.

KPMG solution: Our client requested our support to develop a materiality and maturity assessment framework to assess several recent acquisitions. Using the proprietary KPMG ESG Blueprint application, we developed an approach to identify the most important issues for each of the portfolio companies and their maturity in collecting and reporting this information. This allowed the client to understand

what is collected, and current quality and reliability of the data. Our recommendations also included the updates required to align the portfolio companies' approaches to collecting and using ESG metrics with the GP and regulatory expectations. One of the most enlightening results was providing the GP with a more consistent approach to determining the most material issues to the companies in which it invests, and added additional reporting elements that may not have been captured as part of previous data collection and reporting efforts.



How KPMG can support your ESG data management journey

KPMG helps PE firms develop and adopt an approach that streamlines multiple LP and regulatory reporting requirements, enabling value beyond compliance. Our suite of solutions and tools leverage technology, analytics and strategy to focus ESG reporting activities on metrics and information that matters the most throughout the different stages of the investment life cycle. We assist firms to:

- **improve relevance and reliability** of ESG data;
- **develop a data strategy** to both comply and analyze progress to achieve goals and targets; and

- **apply insights** to decisions during pre-deal, ownership, and LP and regulatory reporting; and
- **accurately and transparently report on risk** and opportunity management with data that engenders trust

We help clients improve consistency, reliability and relevance of ESG data being produced, tracked, monitored and reported by incorporating leading practices. Our support aligns to the different phases of the reporting journey: collect, analyze, monitor, report, and assure. All services are tailored for GPs, portfolio companies, and specific ESG and climate investment funds.

We can assist PE firms to streamline their ESG reporting journey and quality data collection by:

1 Inventorying existing ESG reporting. Prepare a detailed inventory of your ESG data needs based on key factors including client driven ESG and climate objectives and commitments, LP reporting needs, our understanding of regulatory requirements identified, and leading practices. Identify synergies across reporting priorities and streamline data collection and reporting.

2 Conducting a gap assessment. Review current data collection and reporting practices relative to standards, stakeholder demands and industry leading practices.

3 Developing a roadmap. Create a plan that articulates the purpose and methods for collecting ESG data, considering existing and recommended technology platforms and internal control considerations to yield reliable, transparent internal and external reporting.

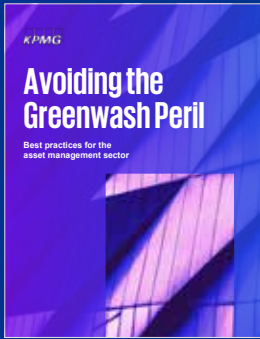
4 Engaging portfolio companies. Provide training and program-level process and reporting guidance to ensure consistency and accuracy of data reported.

5 Developing assurance-ready reporting. Understand the data quality and provide insights on assurance-ready data, methodologies, process and disclosures that are relevant to the organization and align with the organization's strategy, commitments, and regulatory requirements.

6 Providing assurance. Provide assurance over disclosures in accordance with standards.

The private equity industry is uniquely positioned to advance ESG initiatives and drive positive global change. This results from its substantial capital and assets, significant reach across industry and markets, and foundational philosophy to generate returns by building long-term business resilience. As pressure builds on GPs and portfolio companies to disclose more information on ESG-related risk and opportunities to LPs, targets and the markets, the volume and variety of ESG data across the vast web of reporting is often overwhelming.

Related insights



Avoiding the Greenwash Peril: Best practices for the asset management sector



ESG as an asset: Private equity considerations from the SEC's climate proposal



Climate risk in the financial statements – Handbook

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