ESG due diligence

The new lens for private equity boards

Board Leadership Center (India)

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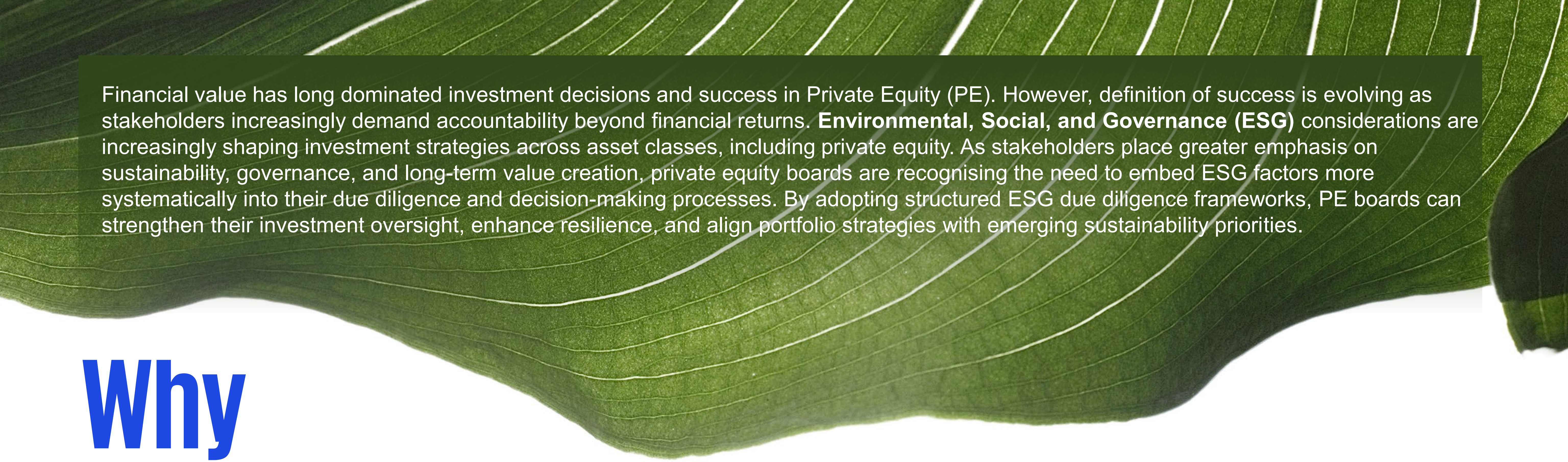


Financial value has long dominated investment decisions and success in Private Equity (PE). However, definition of success is evolving as stakeholders increasingly demand accountability beyond financial returns. **Environmental, Social, and Governance (ESG)** considerations are increasingly shaping investment strategies across asset classes, including private equity. As stakeholders place greater emphasis on sustainability, governance, and long-term value creation, private equity boards are recognising the need to embed ESG factors more systematically into their due diligence and decision-making processes. By adopting structured ESG due diligence frameworks, PE boards can strengthen their investment oversight, enhance resilience, and align portfolio strategies with emerging sustainability priorities.

Why

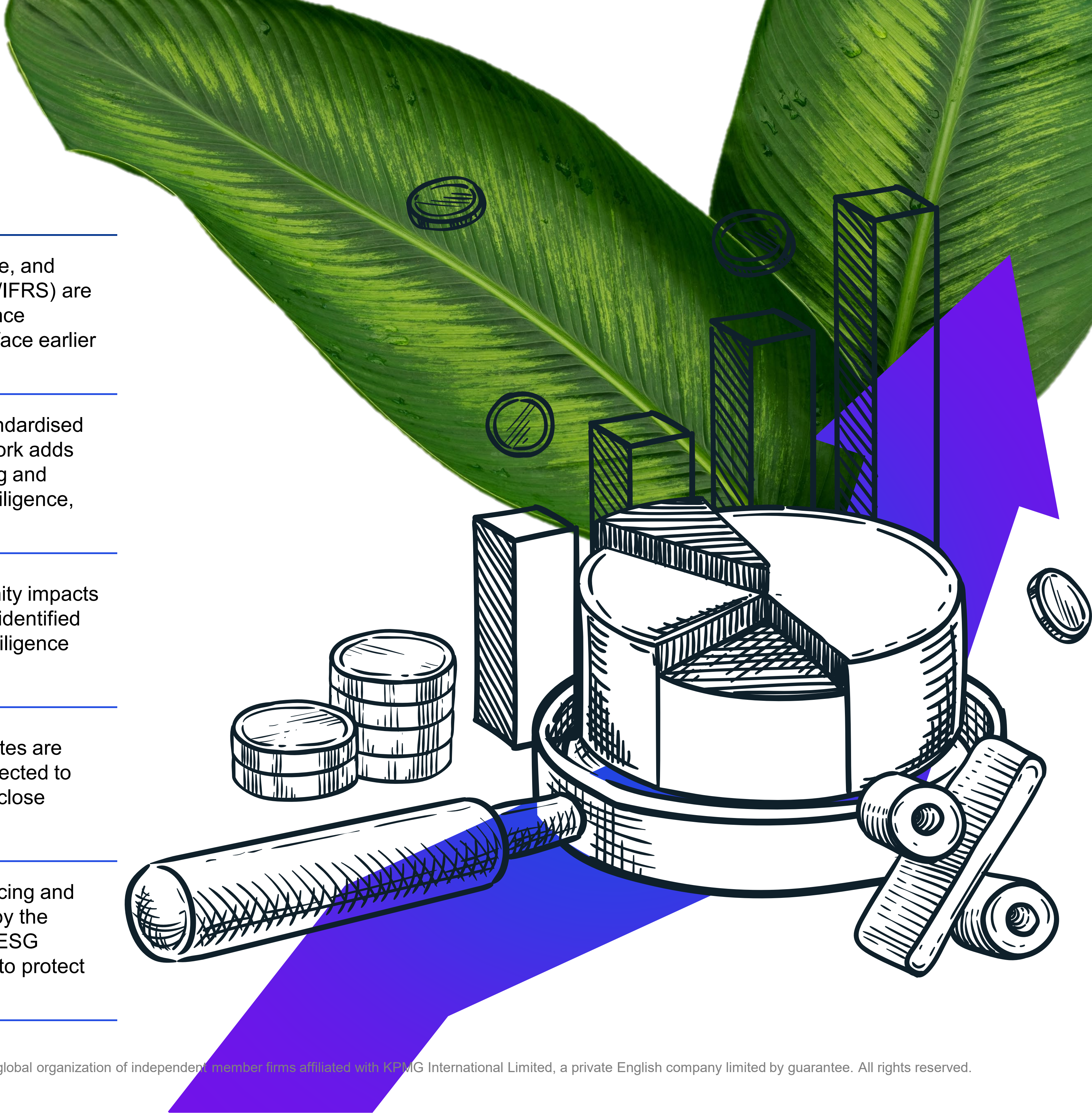
ESG now matters in Private Equity (PE)?

Private equity is exposed to ESG considerations. Unlike listed companies, where markets often price in non-financial risks, PE investors absorb them directly. Even minor governance lapses, regulatory breaches or social controversies can rapidly erode value.
For boards, the implications are immediate: **ESG is influencing which assets qualify for investment, how they are priced, and whether they remain attractive to future buyers.**

Investor expectations are converging with regulatory mandates. Global Limited Partners (LPs) are directing capital toward funds that demonstrate credible ESG integration. In India, SEBI's Business Responsibility and Sustainability Reporting (BRSR) requirements align with global standards and cover areas ranging from environmental performance to inclusive growth. This is creating a benchmark that private companies seeking capital or preparing for future listings may need to align with. The Reserve Bank of India has also issued guidance on environmental and social risk management, including norms for green deposits and financing of sustainable projects — signalling that regulator view ESG as integral to systemic stability.

Stakeholders — from regulators to employees to consumers — are pressing portfolio companies to demonstrate responsible practices. For PE boards, ESG is therefore emerging as a determinant of **capital access, operational resilience, and competitive positioning.**

Tipping points accelerating ESG due diligence in Indian PE



Regulation and standards	In India, regulations are evolving toward deeper, quantitative, and value-chain disclosures. In parallel, global standards (ISSB/IFRS) are raising the bar. ESG exposures are now expected to influence valuation and liabilities, pressing boards to ensure they surface earlier in the deal process
Investor and capital pressure	Global LPs and sovereign wealth funds are embedding standardised ESG due-diligence expectations. SEBI's ESG debt framework adds third-party reviews and post-issuance reporting. Fundraising and refinancing increasingly hinge on credible, auditable ESG diligence, requiring board alignment and strategic oversight
Value-chain and operational risks	Supplier labour practices, Scope 3 emissions, and community impacts are now material to disclosures and insurance coverage. If identified late, such risks delay or derail deals. Boards must ensure diligence extends beyond the target company to its wider ecosystem
Technology and data transparency	AI-driven analytics, satellite checks, and global data templates are lowering costs and raising diligence quality. Boards are expected to integrate ESG findings into valuation, warranties, and post-close planning to preserve reputation and maximize exit options
Reputation and litigation risk	ESG controversies in India have already influenced IPO pricing and triggered litigation. Exit prospects are increasingly shaped by the quality of ESG diligence. Boards are expected to integrate ESG findings into valuation, warranties, and post-close planning to protect reputation and preserve exit options.

ESG directly impacts valuation, risk, and returns

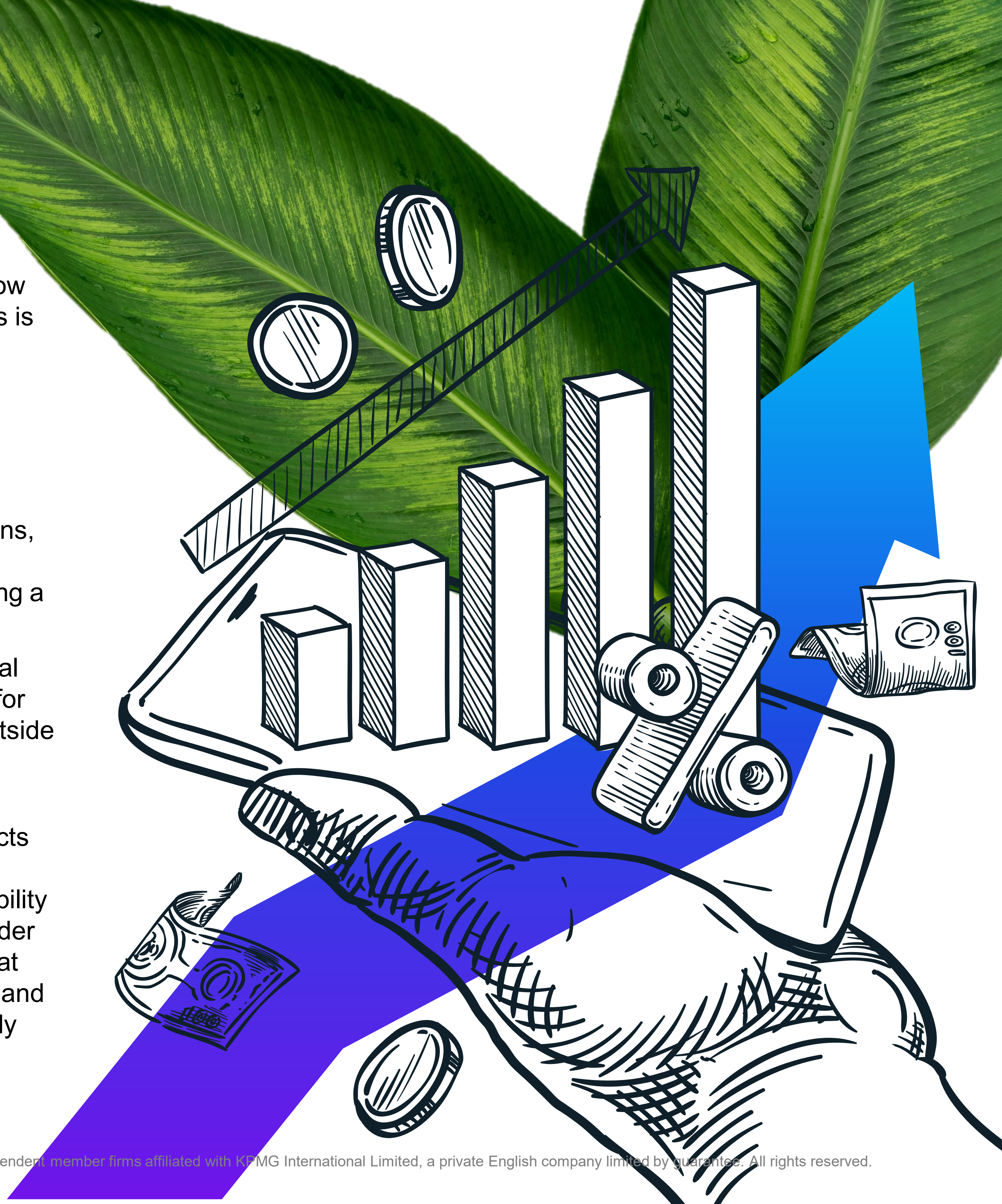
In private equity, financial diligence has traditionally defined investment outcomes. ESG now fundamentally shapes valuations, risk assessments and long-term returns. For boards, this is not about compliance language; it is about value creation and value protection.

Valuation: Companies with stronger ESG profiles are increasingly commanding premium valuations during exits and acquisitions, with buyers and LPs viewing them as lower-risk, future-ready assets

Risk: ESG gaps are surfacing as material risks in diligence. Weak governance, poor disclosure, or exposure to environmental liabilities can slow transactions, depress valuations, or, in some cases, deter capital altogether. A majority of Indian CEOs **(56 per cent)**[1] acknowledge that stakeholder ESG expectations evolve faster than their strategies, creating a strategic execution risk directly absorbed by the PE investors

Returns: CEOs embedding ESG into strategies **(57 per cent)**[1] expect measurable financial returns within three to five years. This highlights that ESG is not merely a cost but a lever for sustainable performance. The implication is clear. ESG is no longer a soft metric sitting outside financial analysis. Boards overlooking ESG in diligence are effectively ignoring material financial risk

Increased trade prospects: Robust ESG policies can significantly enhance trade prospects by aligning businesses with the regulatory expectations of key markets like the European Union, where ESG compliance is increasingly mandatory. The EU enforces strict sustainability standards—such as the Corporate Sustainability Reporting Directive (CSRD), Carbon Border Adjustment Mechanism (CBAM), the EU Taxonomy, and the Deforestation Regulation—that require trading partners to demonstrate environmental responsibility, social accountability, and ethical governance. Companies that proactively integrate ESG into their operations not only gain access to these regulated markets but also build trust with stakeholders, reduce risk exposure, and position themselves as preferred partners in global supply chains.



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The board's evolving role

For private equity boards, ESG is reshaping oversight responsibilities. Traditional governance models assumed that management teams carried operational accountability, while boards acted primarily as financial stewards. Now, boards must oversee ESG as an integrated component of strategy, risk management and stakeholder trust.

Key shifts:

- **From compliance to resilience:** ESG is not only about meeting disclosure norms but about anticipating disruptions — regulatory changes, climate impacts, or community resistance — that can alter an asset's trajectory.
- **From red flags to opportunity mapping:** Boards are expected to treat ESG diligence not just as risk detection but as a lens to identify growth opportunities — from access to sustainable finance to differentiated exit premiums.
- **From passive review to active questioning:** Investors, regulators, and communities expect boards to probe ESG assumptions with the same rigour as financial projections.

ESG rarely offers black-and-white judgments. Disclosure may appear strong while performance lags, or risks may be geographically specific. Boards must balance hard data with contextual judgment, guiding management toward credible improvement pathways rather than simplistic yes/no decisions.

Ultimately, boards are evolving from compliance gatekeepers to enablers of sustainable value creation.

Leading practices PE boards can apply

- Launch a **100-day ESG plan** post-investment to set priorities early in the **hold cycle**
- Treat ESG findings as **pricing levers** in deal models, not side notes
- Include ESG milestones in **value-creation plans, report KPIs to key stakeholders** and track them quarterly
- Use SEBI's BRSR framework as a **benchmark** for portfolio readiness, even before listing
- Tie **exit preparedness** to ESG performance — buyers and LPs expect it
- Engage management on **judgment calls** where ESG trade-offs lack clear rules
- Link part of **management incentives or bonuses** to ESG outcomes tied to investment strategy.

Conclusion

ESG in private equity is reshaping deal evaluation, ownership, and exit strategies. Indian PE boards must transition from compliance-oriented oversight to value-driven enablement.

The risk lies in treating ESG as a checklist. Fragmented efforts dilute impact. Boards must embed ESG into the investment thesis, safeguarding portfolio value while unlocking exit premiums, building investor confidence, and asserting leadership. In the next cycle of Indian PE, success will hinge not just on financial engineering, but on the board's ability to weave ESG into the blueprint of value creation.

Questions for PE boards to consider

1. Which ESG factors, if mishandled, could materially undermine our ability to exit at a premium?
2. Are we confident our current due diligence uncovers **hidden ESG liabilities** in supply chains, contracts, or communities?
3. How do we distinguish between **ESG compliance for optics** and **ESG strategy that drives value**?
4. In a contested deal, would our ESG lens give us an **advantage in pricing discipline** or expose blind spots?
5. How prepared are we to defend our ESG stance to **LPs, regulators, and the media** under scrutiny?
6. What is our threshold for walking away from a deal where ESG risks remain unresolved, despite financial upside?

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