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Problems and Possibilities of Private Equity and Environmental Sustainability

Katherine N. Elliot

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By Katherine Elliot

Abstract

This paper addresses the relationship between the American private equity industry and environmental sustainability. The connection between large financial industries and the environment is one that is often viewed negatively, especially in terms of private equity. As an industry that measures success with exponential economic growth and gaining the largest financial returns, environmental impacts are often sidelined. This paper explores the potential private equity has to incorporate environmental sustainability into the core of its business. Chapter 1 lays out the fundamentals of how the Private Equity industry operates. It also establishes what has caused firms to begin to adopt sustainability. Data from Ernst & Young's report "Understanding PE's Impact on the Community" creates a baseline for this section. Chapter 2 employs history to understand the evolution of the relationship between private equity and sustainability. This is done by recounting the development of corporate philanthropy, corporate social responsibility and corporate sustainability. Chapter 3 establishes where current private equity firms stand on sustainability by examining their current practices. This is done through using principles of sustainable business outlined in different sustainability reporting systems. Examined are the four largest private equity firms in America: Blackstone, Warburg Pincus, The Carlyle Group and KKR. Chapter 4 identifies common missteps in behavior among private equity firms from a sociological perspective. Lastly, chapter 5 concludes by proposing sustainable solutions that private equity firms can incorporate into their operations and into and their portfolio companies.

Keywords: private equity, business, sustainability, corporate social responsibility, ethics

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Introduction

Greta Thunberg, young Swedish climate activist, captured massive public attention in 2018 when she began standing outside the Swedish parliament to call for stronger action on global warming. In the weeks leading up to and after the Climate Strike in 2019, her activism headlined newspapers worldwide. At the UN Climate Summit in New York in September 2019, she stated "The eyes of all future generations are upon you. And if you choose to fail us, I say – we will never forgive you." Such powerful statements captivated individuals worldwide and garnered the attention of businesses. An article from *The Guardian* reported shortly after the Climate March that "corporations have seen a spike in investment in carbon offsetting over the last 18 months."[1] While Greta's actions were not the initial impetus for businesses to start considering the natural world, her actions have certainly recollected their attention.

According to the UN's Millennium Ecosystem Assessment, "approximately 60% of ecosystems services are being degraded or used unsustainably, including fresh water, capture fisheries, air and water purification, and the regulation of regional and local climate, natural hazards, and pests."[2] Leaders from NGOs, governments, scientific organizations, as well as business guided the synthesis of this report. With the looming threats associated with ecosystem degradation, it is clear that everybody has a responsibility to take actions to improve the quality of the environment, including big business. Different industries are often cited as the main cause of mass environmental degradation. However, it is now the role of these big businesses to act upon our current climate crisis. This includes those companies in industries that may not have a direct connection to the environment, specifically the private equity industry.

[1] Sandra Laville, "'Greta Thunberg Effect' Driving Growth in Carbon Offsetting," *The Guardian,* last modified November 8, 2019, accessed December 1, 2019, https://www.theguardian.com/environment/2019/nov/08/greta-thunberg-effect-driving-growth-in-carbon-offsetting

[2] Millennium Ecosystem Assessment, *Ecosystems and Human Well-Being: Synthesis,* Web 2005, ix

In the realm of the financial world, Private Equity (PE) firms are essentially a money making middle man. To summarize, PE firms raise capital from sources such as private investors and pension funds and invest them into different portfolio companies. The goals of these investments is generally to grow these companies to increase the value of their investments and raise more money for the PE firm itself within a 3-5 year timeline. Sometimes the relationship between the PE firm and portfolio company ends with an exit that results in an increased value within the portfolio company and a positive return on investment. However, a lot of the time their relationship ends with the portfolio company bankrupt (the strategy is called a Leverage Buyout Transaction and is discussed in detail in Chapter 1) Further, the PE firm generally does not claim any sort of responsibility for the bankruptcy, leaving people involved with the portfolio companies unemployed and with immense amounts of debt. Because of PE's emphasis on getting the greatest Return on Investment (ROI), no matter the ethical, environmental or social cost, the industry has gained the reputation of being greedy, stingy, and immoral.[3] Despite the negative perceptions, there have increasingly been a number of PE firms that have augmented their development of sustainability programs and initiatives. This begs the question: How could an industry that values financial return on such a short-term scale over anything be sustainable?

In terms of individual companies – including those in PE – developing a more sustainable approach to business is no longer just an option, but a necessity in order to mitigate risks associated with climate change. Those companies that are unable to adapt and create more sustainable business models will not be able to survive in an era of scarce resources and environmental degradation. The same goes for PE firms. The business model PE firms generally operate on is currently incredibly unsustainable. This paper explores the details of this

[3] Return on Investment (ROI) is the ratio between the net profit and cost of the investment. A high ROI is indicative of a highly efficient investment.

unsustainability and also proposes a new model for a more sustainable PE system. If PE is able to develop more sustainable operating procedures, then companies across other industries may follow suit and can easily transition to more sustainable models.

This paper examines Private Equity and sustainability. Specifically, the integration of sustainable principles into core PE models. Chapter 1 details how the PE industry generally lays out the fundamentals of how the Private Equity industry conducts itself, including the beginning of PE's integration of environmental considerations. Chapter 2 tells the history of corporate philanthropy, corporate social responsibility and corporate sustainability over time. Chapter 3 use multiple perspectives to showcase PE's current understandings of sustainability by examining the policies of the four largest Private Equity firms in America, Blackstone, Warburg Pincus, The Carlyle Group and KKR. Chapter 4 identifies common missteps among PE firms from a science-based, sociological and business perspective. Lastly, chapter 5 concludes by proposing sustainable solutions that Private Equity firms can incorporate amongst themselves and their portfolio companies.

Chapter 1: Relationship Between Private Equity and Environment

In the last decade, there has been widespread public attention on the role different industries should play in combating environmental issues. Integrating sustainability into a business model will be more effective in certain industries over others. For example, industries that produce physical goods, such as the fashion industry can focus their efforts on making their supply chains more sustainable. Even companies in the fossil fuel industry have started to invest in and develop renewable energy technology to ensure the longevity of their company. However, in terms of the financial sector, the role that companies play in the environmental crisis is less obvious. In order to make the connection clear, this chapter lays out the fundamentals of Private Equity, while also establishing the impact Private Equity currently has on the environment.

Private Equity Basics Few people outside of the financial sector have a comprehensive understanding of what Private Equity (PE) is and does. Despite this, PE has a great amount of influence on the American economy. According to a report published by accounting giant EY, by the end of 2017, the net value of PE-owned companies exceeded US $1.8 trillion and PE-backed activity is estimated to generate around 5% of the US's GDP.[4] This is because PE firms invest in a variety of industries, including manufacturing, software, technology, healthcare, data, oil & gas, construction, engineering, and transportation. In the simplest terms, a Private Equity company provides funds to another company in lieu of that company seeking funds on the stock exchange or bank loans. Capital from PE firms is preferable to the aforementioned options because companies need to meet a very specific set of requirements to be eligible for the stock exchange and bank loans often come with high interest rates. The expression 'private equity' references equity which is not listed [on the stock market] and whose exchange is not regulated.[5] Private Equity firms began to have major influence on the economy in the late 1970s and early 1980s, following changes in financial regulations and tax laws and a rise in the idea of a "conglomerate merger." The conglomerate merger could "envelope manufacturing and marketing firms without falling afoul of government antitrust enforcement efforts."[6] This became the model that most PE firms embraced. One regulation that had significance was the 1979

4 Peter Witte, "Understanding PE's Impact on the Economy," *EY*, last modified 2018, accessed November 14, 2019, https://www.ey.com/Publication/vwLUAssets/ey-understanding-pes-impact-on-the-economy/$File/ey-understanding-pes-impact-on-the-economy.pdf

5 Cyril Demaria, *Introduction to Private Equity: Venture, Growth, LBO and Turn-Around Capital*, 2nd ed. (John Wiley and Sons, Ltd., 2013).

6 Daniel Scott Souleles, *Songs of Profit, Songs of Loss: Private Equity, Wealth, and Inequality* (Lincoln, NE: University of Nebraska Press, 2019) 15.

adoption of a “Prudent Man Rule” that allowed PE to invest pension funds.[7] Today, PE companies receive most of their funding from pension funds, life insurance companies, university endowments, sovereign wealth funds, and wealthy individuals. In order to determine which companies to invest in, PE companies consider many different variables.

The investment and acquisition of a company for a PE firm can be incredibly delicate. The choice of which companies to invest in boils down to their profitability. Target companies (prospective portfolio companies) will have demonstrated strong growth with undervalued assets, generated a steady stream of cash, and have good prospects for a successful exit from the investment in a three-to five-year period.[8] Currently, PE operates on short-term ideals, they are not looking to maintain stake in a company, but instead sever the relationship in a few years after collecting money for their firm. An article published in the Harvard Business Review underscores that the primary reason behind private equity’s growth and high rates of return is their standard practice of clearly mapping out their exit strategy. Buying to sell in a few years offers the opportunity for companies to generate huge annual investor return in the first few years (as much as 25%) and then sell when the ROI is more modest, say 12%.[9] Another thing PE firms look for when choosing their portfolio companies is how volatile the particular industry is. The more consistently profitable an industry is, the less risky the investment, and thus PE firms are more likely to invest in companies in that industry. PE firms spread their portfolio companies across a multitude of different industries in order to mitigate risk. While these strategies are general consistent in all PE firms, different types of firms have different intentions behind their investment methodologies.

7 Douglas Cumming, ed., *Private Equity: Fund Types, Risks and Returns, and Regulation*, vol. 10 (John Wiley and Sons, 2009).

8 Eileen Appelbaum and Rosemary Batt, *Private Equity at Work: When Wall Street Manages Main Street* (Russell Sage Foundation, 2014): 43.

9 Felix Barber and Michael Goold, “The Strategic Secret of Private Equity,” (Harvard Business Review, September 2007).

Generally speaking, there are three standard PE strategies:Venture Capital (VC), Growth Capital, and Leveraged Buyout (LBO) Funds. VC funds set out to "provide financing to high growth potential firms that cannot access the public equity markets or secure traditional debt financing."[10] Companies that are in their early days but have the potential to scale large growth are often the target of VC firms. The Growth Capital strategy takes an opposite approach by investing in companies that are already leaders in their respective industry. These investments are low risk and aim to increase the value of a firm's investment portfolio. Lastly, an LBO transaction is when a PE firm buys out the majority control of a mature firm. Generally, the PE firm finances their stake in portfolio company with only 10-40 percent of the firm's actual equity, and the rest from borrowed money from banks that specialize in LBO financing.[11] In the early stages of PE, venture capital was the most popular m ode of investment. However, in later years, LBO financing became increasingly dominant, as Figure 1.1 demonstrates.[12] Many of the

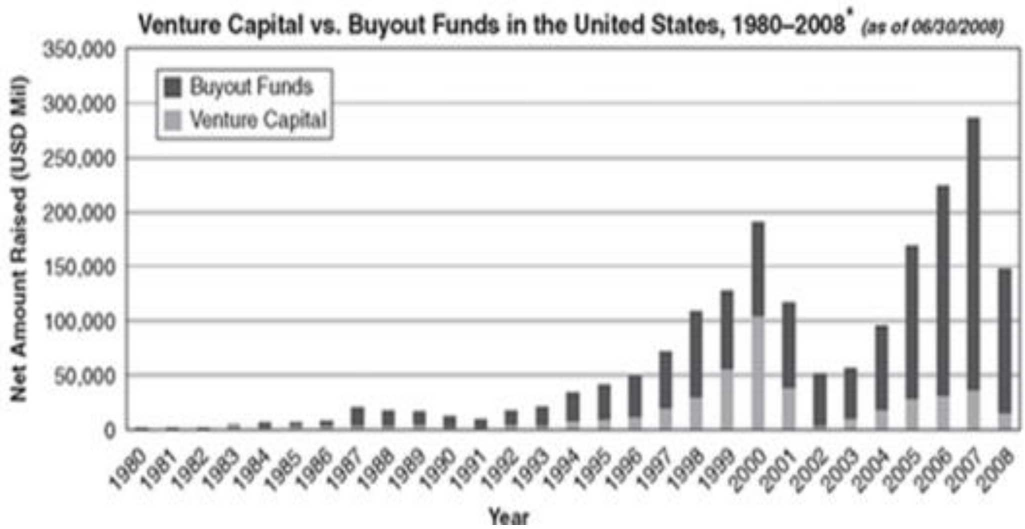

Figure 1.1: Venture Capital vs. Buyout Funds in the United States, 1980 - 2008

industry standard practices listed above contribute to PE's negative public image.

10 Douglas Cumming, ed., *Private Equity: Fund Types, Risks and Returns, and Regulation*, vol. 10 (John Wiley and Sons, 2009).

11 Paul A. Gompers, Victoria Ivashina, and Richard Ruback, *Private Equity: A Casebook (*Anthem Press, 2019): 4-5.

12 Ibid.

Perceptions of Private Equity As LBOs became the standard methodology among PE firms, the reputation of the PE industry became increasingly negative, especially amongst those outside of the business world. In 2012, Rolling Stone magazine published an article titled, "Why Private Equity Firms Like Bain Really Are the Worst of Capitalism." Bain Capital is the PE venture of global management consultancy firm, Bain & Company, founded in 1984 by former presidential candidate Mitt Romney. The article uses incredibly negative language when describing the procedures of the company. For example, when describing cost-cutting (often initiated after the completion of an LBO) the article states that "the private equity guys start swinging the meat axe, aggressively cutting costs wherever they can - so that the company can start paying off its new debt - by laying off workers and cutting capital costs."[13] The article further categorizes the actions of PE as predatory and immoral. People from outside of the PE world see it as an industry whose sole motivations are solely money and greed, and that only the exclusive few that are allowed to be a part of it.

PE also has a reputation for being an industry only accessible to certain populations, specifically white men. According to Bloomberg.com, women only make 19.1 percent of all PE firms, a statistic that has been the same since 2017. Permira, a European PE firm, had one of only a few female partners, Cheryl Potter, step down after two decades at the company. She described her experience of feeling isolated, as she was often one of the only women in the room.[14] While many PE companies make efforts to recruit employees from a variety of backgrounds, statistics prove that despite their efforts, the internal makeup of PE firms is still homogenous. This is due

[13] Josh Kosman, "Why Private Equity Firms Like Bain Really Are the Worst of Capitalism," *RollingStone.com*, last modified May 23, 2012, accessed October 30, 2019, https://www.rollingstone.com/politics/politics-news/why-private-equity-firms-like-bain-really-are-the-worst-of-capitalism-241519/.

[14] Syed, Sarah. "Private Equity's Diversity Problem Isn't Getting Better." *Bloomberg*, last modified March 5, 2019, accessed September 12, 2019, https://www.bloomberg.com/news/articles/2019-03-05/private-equity-s-diversity-problem-isn-t-getting-better.

to two reasons: a company's inability to create a more inclusive office culture and the lack of desire of people of diverse backgrounds to want to work in an industry where they feel they will not be represented.

Due to the mechanisms of PE, it also has a reputation for being a very short-term focused, volatile, and stressful industry. Companies are usually bought and sold with the intention of being important to PE firms for only about 5 years. Because of this quick turnaround, portfolio companies are constantly changing, as well as financial conditions and parameters. All of these factors combined make PE very high stakes - with the potential to lose money always present. Although firms can invest across various sectors, an investment is still an investment, with the potential to produce less than the original amount. While those inside PE firms will claim to try to "create value" within their portfolio companies, their reputation produces the conception that ROI is the only important goal. Although there is the potential to make a lot of money as an employee in a PE firm, many individuals resent the metrics that dictate PE, especially amongst the younger generations. Thus, they seek out positions in other industries in an attempt to enter an industry that has a larger focus then making money and is less stressful. Despite the volatile nature of investments, the foundations of PE largely remain static. Because of this, people do not think that PE as an industry with a lot of room to innovate. A career in PE is considered safe, which many job-seekers are not looking for. Despite its reputation, industry leaders in PE often vocalize their desire to change.

A Changing System Leaders in PE are very aware of their negative reputation. In an article detailing the Milken Institute Global Conference held in Beverly Hills in 2019 leader of Blackstone, Stephen Schwarzman, directly addressed these negative perceptions of PE. He claimed that PE was not an industry fueled by maximizing ROI, but instead focused on creating increased value within their portfolio companies.[15] Despite the satirical tone of this account, the fact that PE leaders are making an attempt to address these issues represents new changes within the PE industry. This change comes in response to a multitude of factors.

PE began to gain immense power in the 1980s. As stated earlier, firms began to adopt a conglomerate merger model and Congress relaxed pension fund restrictions and capital gain taxes. However, in recent years, scholars have begun to question if PE holds the same power that it used to. In a study published by AQR, a capital management firm, they seem to "offer as attractive of net-of-fee return edge over public market counterparts as it did 15-20 years ago from either a historical or forward-looking perspective."[16] Essentially, PE's returns on investment are not as drastically large in comparison to other options that exist within the financial sector. This is especially true from the perspective of portfolio companies looking for investments. The chart below illustrates the closing valuation gap between PE portfolio companies and publicly listed companies. While PE firms traditionally had the potential for massive monetary return, companies can now list publicly and receive similar returns. However, there has been some backlash to these claims. In a counter article published by the Institute for Private Capital, the authors conclude that "private equity returns have been higher in every single vintage year…"[17] In fully examining PE's loss of power, it is important to consider how PE's sole focus on ROI demonstrates a short-sightedness in light of our environmental crisis.

The marriage of sustainability and PE is not one that people may think would come naturally, especially since many big businesses consider one of the main perpetrators in

15 Lawrence Delevingne, "Super-Rich Private Equity Stars Are Upset about Their 'Lousy' Reputation," *BusinessInsider.com*, last modified May 3, 2017, accessed October 12, 2019.

16 Antti Ilmanen, Swati Chandra, and Nicholas McQuinn, "Demystifying Illiquid Assets: Expected Returns for Private Equity," (*AQR Capital Management*, January 31, 2019).

17 Gregory W Brown and Steven N Kaplan, "Have Private Equity Returns Really Declined?" (*Frank Hawkins Kenan Institute of Private Enterprise Report*, April 2019): 3.

contributions to climate change. However, in recent years, certain business leaders are calling attention to this connection and advocating for change. Larry Fink, CEO of BlackRock – a global investment management corporation – releases a statement each year addressing other CEOs regarding important issues. In his 2019 letter, Larry Fink highlights the importance of focusing on long-term growth and profitability. He reasons that "the global landscape is increasingly fragile and, as a result, susceptible to short-term behavior by corporations and governments alike."[18] The fragility that Fink refers to is present in many current issues, including political dysfunction, the increasing role of technology, and climate change, all of which contribute to increasingly volatile and uncertain market conditions. Fink tells companies that by not considering threats such as climate change in business decisions, a company is inherently making themselves more risk-prone. Businesses must not only consider what will make them profitable, but also what they can do to a) mitigate the risk that climate change may bring and help their company survive in the long term, and b) the role that their individual company can play in the larger fight to combat these issues. Larry Fink states that it is the responsibility of CEOs to make this a priority within their organizations. If they do not, they will not be able to survive and be profitable as the market changes in response to our global climate crisis.

In response to this letter, 155 companies across a multitude of industries signed a statement that promised to integrate aspects of Larry Fink's message into their business models. This would include delivering value to their customers, investing in their employees, dealing fairly and ethically with suppliers, supporting local communities, and generating long-term value

18 Larry Fink, "Larry Fink's 2019 Letter to CEOS: Purpose & Profit," *BlackRock*, last modified 2019, accessed October 3, 2019, https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter

for shareholders.[19] Although very few of the companies that signed were PE firms, one of the largest PE firms in the world, The Carlyle Group, was one of the signatories. Although PE may be further behind other industries in integrating sustainability into their models, this signature is an indication of recognition of the role that PE plays in environmental degradation and the need for change.

While there are practices across the PE industry whose intention is to combat environmental and social issues, many of these standards lack the potential to create significant change. Most PE firms have some form of Corporate Social Responsibility (CSR) program in place. Generally, CSR programs help a company be more socially responsible, and many focus on philanthropy and volunteer efforts. While this may seem beneficial, CSR programs are often less effective because they are separate from core business models. This separation epitomizes an antiquated way of doing business: that purpose and profit are separate. A more integrated model would not only make a company more profitable in the long-term, but also allow it to act as an institution for good. Currently, companies are shifting away from CSR models to "ESG" sustainability models. ESG help investors identify environmental, social, and governance risks and opportunities within their portfolios.[20] However, it is often secondary to other measures such as ROI. There is also a lack of standardization in terms of what ESG and sustainability means to companies. The next chapter of this paper discusses the history of both CSR and corporate sustainability programs and how they developed into what they are today.

[19] "Statement on the Purpose of a Corporation," *Business Round Table,* last modified 2019, accessed November 12, 2019, https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans.

[20] Eric Moen, "MSCI ESG Rankings," *MSCI*, last modified 2019, accessed November 13, 2019, https://www.msci.com/documents/1296102/1636401/ MSCI+ESG+Rating+Brochure-V3.pdf/f2b4a27a-58f5-42c7-880b-cf8201039eaa.

Chapter 2: History of Corporate Social Responsibility and Sustainability

History of Corporate Social Responsibility Business leaders have been philanthropists for centuries, often acting as patrons of art, churches, schools and community projects. Thinking back to the Medici family in Florence, who funded many of the most famous artists of the Italian Renaissance, we see an example of a successful combination of business and community engagement. While CSR began to truly take shape in the 1950s, there have been versions of it since the Industrial Revolution. In the latter half of the nineteenth century, business began to uncover the connection between employee happiness and productivity. Thus, companies made efforts to compensate employees beyond their base salary. For example, 0 piano manufacturers Steinway & Sons bought 400 acres of land in 1870 and built infrastructure – such as housing, a church, a library, a school, a fire house and a post office – in close proximity of their main factory in NYC.[21] These efforts not only kept employees close to their workplace, but also enriched their quality of life. Additionally, following criticisms of the emerging factory system in Great Britain and America, which blamed large factories for social problems including labor unrest, poverty, slums, and child and female labor, large manufacturing companies began to develop welfare aid programs. However, whether these efforts were to actually aid factory workers or improve the business' reputation is unclear. Either way, the actions of these companies depict some of the first instances of CSR.

At the turn of the century, there were also instances where businesses began to reflect a certain amount of corporate social responsibility, although they did not explicitly define it as such, and businesses with socially responsible goals began to appear. One such example is the

[21] Joanna Eng, "Steinway Village: How Pianos Shaped the History of Astoria," *Brownstoner*, last modified February 14, 2013, accessed November 13, 2019, https://www.brownstoner.com/queens/arts-and-culture/steinway-village-how-pianos-shaped-the-history-of-astoria/

establishment of the YMCA. Although the YMCA was a business, its mission was to provide community-related welfare and social programs. Supporters of YMCAs expanded to include entire companies instead of only individuals. [22] Following the worldwide economic crisis of the 1920s and 1930s, business leaders moved from a 'profit maximizing management' phase to a 'trustee management phase' in the development of social responsibility.[23] This transformation reflected the vast poverty and social challenges that business leaders had to contend with with during The Great Depression. Since the economic turmoil was so widespread, even the wealthier groups in society had to confront it. Additionally, social issues were at the helm of public interest. Trusteeship saw "corporate managers taking on the responsibility for both maximizing stockholder wealth and maintaining an equitable balance among other competing claims, such as claims for customers, employees and the community." [24] This new responsibility mostly took shape as philanthropic donations. Prior to the 1900s, corporate giving had a negative reputation and was only permitted in support of causes that directly impacted the company itself. However, as public opinion came to see corporations as institutions similar to the government, their responsibility to fulfill social obligations increased, and thus so did their corporate giving.[25] Despite the emergence of this recognition, most businessmen generally did not perceive social responsibility as essential to their business and thus did not participate. This disposition governed the formation of CSR in the 1950s.

As previously mentioned, CSR fully began to resemble its current form after the 1950s. Patrick Murphy, Professor Emeritus of Management at the University of Notre Dame, classified

[22] Morrell Heald, The *Social Responsibilities Of Business: Company And Community 1900-1960*, (Transaction Publishers, 1970): 14.
[23] Archie B. Carroll, "A History of Corporate Social Responsibility: Concepts and Practices," *The Oxford Handbook of Corporate Social Responsibility* (Oxford Press, February 2008): 3.
[24] Robert Hay. "Social Responsibilities of Business Managers." *The Academy of Management Journal* 17, no. 1 (1974): 135-43.
[25] Carroll, "A History of Corporate Social Responsibility," 90.

the development of CSR in three distinct periods: the ‘awareness’ era, ‘issue’ era, and ‘responsiveness’ era.[26] During the awareness era from 1953 to1967, recognition of the responsibilities of business in community affairs became more widespread. In 1953, Howard R. Bowen published a book entitled Social Responsibilities of the Businessman that revolutionized perceptions of the role of business in society. His thesis rests on the belief that businesses now served as vital centers of power and affected the lives of citizens. Thus, he discussed the obligations that businesses have to citizens, and how they must guide decision-making processes.[27] Although businesses did not fully adopt Bowen’s philosophy, his book began the modern discussion on CSR.

The period from 1968 to 1973 represents the ‘issue era’ because companies began focusing on specific social problems such as urban poverty or pollution. This materialized in increased and more directed philanthropy efforts. Following Bowen’s examination of social responsibilities, management scholar Keith Davis expanded the definition of CSR. He argued that socially responsible business decisions can have long-term economic benefits.[28] Despite this academic expansion, CSR remained focused on philanthropy. Two leaders in corporate giving were Dayton Hudson (now known as the Target Corporation) and Cummins Engine Co., who both donated five percent of their pre-tax profits to charities.[29] Despite these donations, this era produced more discussion than action.

Lastly, during the responsiveness era from 1974 to1980, companies began to implement CSR internally by taking actions such as altering boards of directors, examining corporate ethics, and

26 Patrick E Murphy, “Corporate Social Responsiveness : an Evolution,” *University of Michigan Business Review* 30 (1978): 19-25.
27 Carroll, “A History of Corporate Social Responsibility,” 91.
28 Keith Davis, “Can Business Afford to Ignore Social Responsibilities?,” *California Management Review* (April 1, 1960): 70-92.
29 Carroll, “A History of Corporate Social Responsibility,” 94.

using social performance disclosures. The 1970s were a hallmark era for literature and research regarding CSR. Expanding on previous notions of CSR, the Committee for Economic Development (CED) articulated three circle notions of social responsibility: a) the inner circle which includes the clear-cut responsibilities of economic function – products, jobs and economic growth, b) the intermediate circle which exercises this economic function with an awareness of social values and priorities and c) the outer circle in which business should become involved in actively improving this social environment.[30] This categorization helped clearly define the obligations that businesses had beyond their basic economic function. In the third volume of their book, Conceptual Foundations of Business, Richard Eels and Clarence Walton – whose research topics ranged from business history, the concept of a corporation, ownership, and governance – dedicated an entire chapter to developing a broader perspective and understanding of the evolution of CSR.[31] Including a definition and discussion of CSR in a textbook style piece of literature marked a momentous achievement in the institutionalization of CSR. At this point, it became something that was not only well-known within businesses, but expected.

CSR began to morph from talk to action in the 1970s. Businesses began to understand the expectation that they develop CSR programs, and thus were more active in that realm. This was both a response to the institutionalization of CSR and the formation of departments of government that enforced social regulations, such as the Environmental Protection Agency (EPA), Consumer Product Safety Commission (CSPC), Equal Employment Opportunity Commission (EEOC) and the Occupational Health and Safety Administration (OSHA).[32] Companies began to make strides towards more directed philanthropy by prioritizing issues

30 Committee For Economic Development, “Social Responsibilities of Business Corporation,” 1971.
31 Carroll, “A History of Corporate Social Responsibility,” 88.
32 Ibid.

relevant to their business models. In 1973, two business scholars, Henry Eilbirt and I. Robert Parket, set out secure data on current CSR trends in major U.S. corporations.[33] Their findings concluded that 56 percent of the firms surveyed reported a CSR officer, 34 percent a committee, and 10 percent of employees report that CSR work is a part of their daily tasks. The top issues addressed were education, minority hiring, and ecology (see Figure 2.1). The survey also gaged

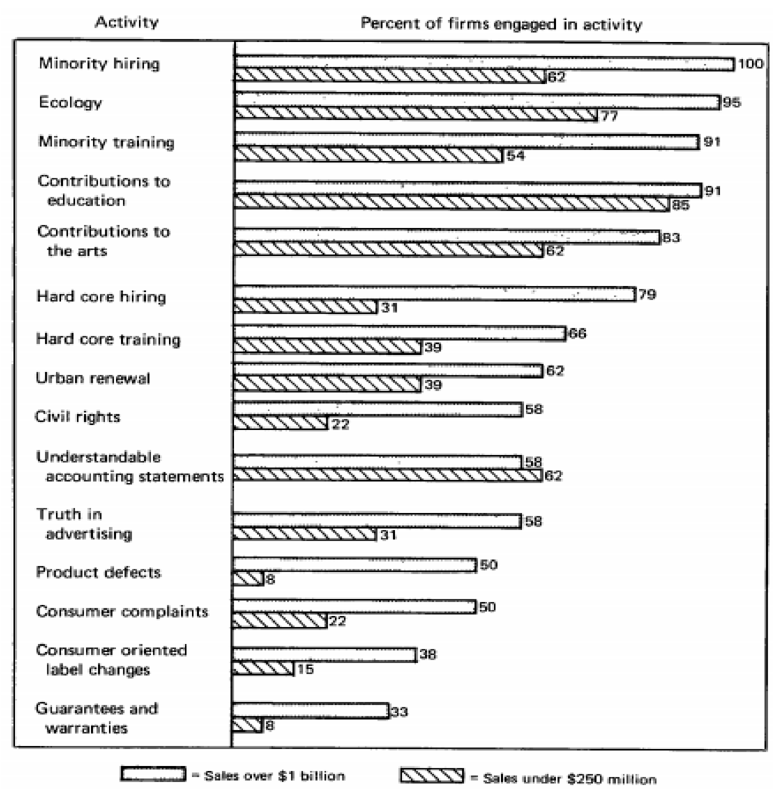

Figure 2.1: Results from Henry Eilbirt and I. Robert Parket Survey

the level of shareholder importance within the companies. The researchers found that companies that make under $250 million a year were less likely to have CSR oriented positions. Companies that made over $1 billion a year were more likely to have CSR activities, but were also more likely to provide extensive rationale for their socially responsible decisions to their shareholders. While it was also reported that stakeholders prefer social activities within the companies they

33 Henry Eilbirt and I. Robert Parket "The Current Status of Corporate Social Responsibility," *Business Horizons* (1973): 5.

invest in, this conclusion demonstrates the hesitation of businesses to fully commit to extensive CSR programs without extensive monetary comfort. This survey provides an accurate snapshot of the level of commitment businesses felt to CSR activities in the 1970s.

Following the 1970s, CSR became standard practice in businesses. It was no longer optional, and CSR activities became required in order for companies to be ethical. Ronald Regan's presidency further legitimize CSR when he urged business to pick up the slack as he cut federal and state funding of social service programs. This was a major development because Regan was preaching that the primary vessel for social responsibility should be business instead of government (whether this is justified or not is an entirely different discussion). [34] With the power of business on the rise, negative perception of business also began to increase. As business ethics scandals involving bribes and illegal practices came to light, deceptive advertising, financial fraud, and transparency issues drew public attention. The general public began viewing large corporate entities as evil and put less faith in CSR practices. This was due in large part to the loose definition associated with CSR. Each piece of contemporary literature defined CSR differently. Although it is easy to identify commonalities in the different descriptions of CSR, it is also easy to understand why the general public could not articulate what CSR was or what role it played in companies. By the 2000s, CSR began to splinter off into more specific disciplines such as business ethics, corporate citizenship, sustainability, and stakeholder management. Despite this division, many companies still use CSR today as their term to describe their contributions to society. Due to its relevance to current environmental issues, this paper will only examine the evolution of corporate sustainability in the next section of this chapter.

[34] Carroll, "A History of Corporate Social Responsibility," 94.

Corporate Sustainability In recent years, sustainability has become a pressing mandate of businesses across all sectors. Previously, environmental concerns fell under CSR jurisdiction, which manifested in forms of philanthropy. However, as the expectation that businesses actively work to prevent and find solutions to environmental problems became more prevalent, the notion of corporate sustainability became more popular on both the side of the company and consumer. At first, corporate sustainability appeared within the concept of sustainable development, which "The Brundtland Report" popularized. The United Nations published this report that defined sustainable development as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs." [35] This became pivotal in drawing the connection between environmental concerns, the future, and social justice. In business contexts, maximizing growth had been the governing principle. "The Brundtland Report" broadened allowed businesses to examine the purpose of exponential growth if the future existence of the world was not guaranteed. This leads to the concept of intergenerational equity as "the responsibility to future generations to leave the planet's life-support systems in at least as good as shape as what we enjoy now." [36] As the connection between the environment, business, and the future became more apparent, the notion of corporate sustainability expanded to "embrace the wider scope of business's operations and processes and applied to business's global role in development" [37] especially in terms of environmental, economic, and social criteria.

The complexity of sustainability became increasingly accepted in the 1990s. However, it followed the same trajectory as CSR when certain businesses adopted the language of

35 World Commission on Environment and Development.. "Our common future," (*Oxford University Press*, 1987).
36 G. Tyler Miller and Scott Spoolman, Living in the Environment: Principles, Connections, and Solutions, 17th ed., Belmont: Brooks/Cole Publishing, (2011): 26.
37 Carroll, "A History of Corporate Social Responsibility," 92.

sustainability without much action to back it up. Unlike CSR, companies favored sustainability because it did not imply that the company had any sort of "responsibility" to do something. Instead, it is more neutral in that it is logical - take care of the present to take care of the future – which no person would be opposed to. [38] Despite sustainability being a popular topic for more than 30 years, the "fluffiness" of the term still threatens its legitimacy today. Claiming that a practice is sustainable is incredibly broad. To be truly sustainable, the practice needs to deeply consider the specific contexts – geographic, social, political, environmental etc.- in which it occurs. In response to the elusiveness of the term "sustainability", different rating systems were developed to accurately depict how sustainable a product, practice, or entire corporation is. Sustainability-oriented rating systems are further developed in the next chapter.

Chapter 3 – Principles of Sustainable Business: Private Equity Case Studies

Sustainability reporting has direct links to John Elkington's principles of the Triple Bottom Line (TBL). In 1998, he proposed that instead of a singular bottom line, profit, there should be three: profit, people and the planet.[39] This definition allowed businesses to consider ways to measure not only their profit, but other impacts as well. Although some modern critics view the Triple Bottom Line as "overly reductionist and not allowing for the holistic principles of sustainability to be assessed," it still provides a starting point for measuring sustainability. [40] TBL helped dawn a new era of transparency for businesses. Currently, many TBL principles appear under Environmental Social Governance (ESG) considerations.[41] In the late 2000s and early 2010s, many businesses began voluntarily self-reporting on their own sustainable practices.

[38] Ibid.
[39] John Elkington, *Cannibals with Forks: The Triple Bottom Line of 21st Century Business* (New Society Publishers, 1998).
[40] Suzanne Benn, Melissa Edwards, and Tim Williams, *Organizational Change for Corporate Sustainability* (Routledge, 2014).
[41] ESG criteria are a set of standards for a company's operations that investors may use to screen potential investments. Environmental criteria include ways a company works to prevent environmental degradation. Social criteria examines how a company manages employees and stakeholders, as well as impacts in its local community. Governance evaluates the leadership and general practices of the company.

Today, about 95 percent of the Global Fortune 250 voluntarily publish reports that disclose their performance in social, economic, and environmental realms.[42] While self-reporting is a good step, it also allows for an extreme amount of subjectivity on the side of the business. A company can choose what to report and what to omit, thus potentially only focusing on good aspects. Because of this, organizations were founded dedicated to the standardization of sustainability frameworks for companies.

The three most popular sustainability reporting frameworks within PE are the Carbon Disclosure Project (CDP), Dow Jones Sustainability Indexes (DJSI), and Sustainability Accounting Standards Board (SASB). CDP runs a global environmental disclosure system that measures and manages a company's risks and opportunities on climate change, water security, and deforestation.[43] Companies who choose to disclose their rating using the CDP's Online Response System (ORS) receive a score of A-F that reflects their impact on the environment and attempts to offset that impact. The DJSI is both a rating system and a prestigious membership for publicly-traded companies. In terms of its rating component, the DJSI is an additional measure of environmental, social and governmental factors within the index that measures financial global stock performance, known as the S&P Global BMI. Out of the 10,000 companies in the S&P Global BMI, the top 10% most sustainable companies from 61 different industries gain admission to the DJSI index.[44] The final framework, SASB, is a standardized methodology for reporting sustainability performance through the Form 10-K (an annual report required by the SEC that gives a comprehensive summary of a company's financial performance).[45] SASB has developed a materiality map which, according to the SASB website, "identifies sustainability

42 Carroll, "A History of Corporate Social Responsibility," 92.
43 "What We Do," *CDP*, last modified 2019, accessed December 10, 2019, https://www.cdp.net/en/info/about-us/what-we-do.
44 "Dow Jones Sustainability Indices: DJSI index family," *RobecoSAM AG*, last modified 2019, accessed December 10, 2019, https://www.robecosam.com/csa/indices/djsi-index-family.html.
45 "Mission," *SASB*, last modified 2018, accessed December 10, 2019, https://www.sasb.org/governance/

issues that are likely to affect the financial condition or operating performance of companies within an industry.” SASB is particularly important to the financial sector, including PE, because it not only takes into account ESG factors but goes another step to establish why those factors pose financial risk to investors.

Even though these standards exist, many businesses do not voluntarily report using the aforementioned metrics. This is due to a) the lack of desire to change b) a lack of resources to measure the data needed to fulfill such metrics, and c) the fear that earning a low rating will garner a negative public image for the company. All three of these reasons apply to the field of PE. Further, even if a PE firm does consider some of the metrics of the aforementioned rating systems, most do not make the data publicly available. This demonstrates a lack of transparency and creates further issues when an outsider attempts to gain a comprehensive understanding of how much of an impact the PE industry has on the environment and how effective their sustainable efforts are.

Generally, the industry retains the CSR mindset of the 1980s, which devalues sustainability by separating it from the core mission and instead focusing on philanthropic efforts. The industry lacks dedication towards becoming more sustainable. In an industry that prioritizes short term profit margins and goals, why would they care about the long-term effects of their actions? The next sections will focus on the existing relationship between sustainability and PE through an analysis of the initiatives of four of the world’s largest PE firms: Blackstone, Warburg Pincus, KKR, and The Carlyle Group.

Blackstone Blackstone is the largest private equity firm in the world. It has $174 billion assets under management, 98 portfolio companies, and over 250 PE professionals. Some portfolio companies include Bumble, Michaels, Hilton Worldwide, and Versace. While PE is a large component of Blackstone, the firm also invests in real estate, hedge fund solutions, and credit. With all of these components of its business combined, the company has a total of $554 billion assets under management as of 2019. Peter G. Peterson and Stephen A. Schwarzman founded the company in 1985. Schwarzman is still the CEO and is also the Chairman of the Strategic and Policy Forum under Donald Trump.[46] Uniquely, Blackstone is a publicly listed major PE firm. In 2007, it went public after a $4 billion initial public offering.[47] Despite having so much prominence and longevity in the financial sector, its focus on sustainability is recent and greatly lacks standardization.

Blackstone concentrates most of its sustainability efforts in the realms of energy and water consumption. Blackstone's Chief Sustainability Officer, Don Anderson, directs most of these efforts. Anderson is not only the Chief Sustainability Officer but is a high ranking member of Blackstone's Operational Team. Blackstone concentrates its sustainability efforts within its portfolio companies, less so internally. Blackstone claims that its first-tier intervention tactics, such as measuring energy with handheld tools, motivating and verifying portfolio company efforts, and controlling outdoor air quality, reduced energy consumption of portfolio companies by a minimum of 15%.[48] Its approach to sustainability boils down to maximizing cost-saving for a particular portfolio company. In an interview, Anderson stated that his mission is to find utility bill cost reductions, demonstrating that he directs his efforts at initiatives that will save the most money.[49] In terms of quantification, Anderson also stated that he aims for around $100 million a

46 David Carey and John E. Morris, *King of Capital: The Remarkable Rise, Fall, and Rise Again of Steve Schwarzman and Blackstone* (Crown Publishing Group, 2010): 45-56.

47 Jenny Anderson, "Blackstone Founders Prepare to Count Their Billions," *The New York Times*, last modified, June 12, 2007, accessed November 13, 2019, https://www.nytimes.com/2007/06/12/business/12blackstone.html

48 Don Anderson, "Sustainability: Myth, Madness, and Magic" (*Blackstone*, 2019).

49 Abby Schultz, "20 Minutes with Blackstone Chief Sustainability Officer Don Anderson," *Barrons.com*, last modified January 28, 2019, accessed November 13, 2019, https://www.barrons.com/articles/20-minutes-with-blackstone-chief-sustainability-officer-don-anderson-01548698616.

year in value creation in the form of energy cost savings, water cost savings, and value creation on the real estate side. Blackstone claims to use “key performance indicators” based on different ESG principles in order to measure the success of their efforts but does not disclose what these indicators are or how they measure them. There is also little mention of the role sustainability plays in the process of acquiring deal companies, only after their acquisition is sustainability a consideration. It currently does not report any information based on established standards, such as SASB or CDP.

Despite positive statements in its report, such as “sustainability is directly tied to our business mission”, it is evident that sustainability more of an afterthought than an essential part of PE at Blackstone. It still bases most of its process on metrics such as ROI, which can be useful, but are often not holistic enough to encompass environmental concerns. Blackstone also does not disclose how much it invests monetarily in sustainability efforts or what sorts of major environmental harm its portfolio companies produce. While developing metrics can be difficult, if Blackstone was truly committed to sustainability it would attempt to make it simpler by investing in Research and Development. Further, as previously stated, most of Blackstone’s sustainability efforts are focused on its portfolio companies, not the company itself. This demonstrates a lack of desire to change on the part of Blackstone and also perpetuates PE’s negative and stingy public image. Despite this overall theme, Blackstone has developed a large Impact Investing Venture that seeks to deliver positive financial impact while addressing four specific themes: health and wellbeing, financial access, sustainable communities and green technologies. [50] This venture, which launched in May 2019, was actually a direct result of a call

[50] Blackstone Press Release, “Blackstone Launches Impact Investing Platform,” *Blackstone*, last modified, May 6, 2019, accessed November 21, 2019, https://www.blackstone.com/media/press-releases/article/blackstone-launches-impact-investing-platform.

to action which appeared in a letter from Larry Fink, the CEO of Blackrock, (see Chapter 2). While this venture demonstrates a step in a more sustainable direction, it remains to be seen if Blackstone will actively work to implement impact investing principles into the whole company and has a genuine commitment to becoming a leader in sustainability.

Warburg Pincus Founded in 1966, Warburg Pincus is the oldest PE firm in the world. Its founders are Eric Warburg, who came from a banking family, and Lionel Pincus, previously of an investment bank. Lionel Pincus was not only in charge of Warburg Pincus up until his death in 2009, but also played a large role in changing federal regulations on investing, which allowed PE to grow as big as it did through the 1980s and 1990s.[51] In terms of their size, in 2019 Warburg Pincus was the fifth largest PE firm in the world. It has $77 billion in assets under management and primarily focuses on raising growth capital, as opposed to late or early stage investments.[52] Its investments stretch across all areas of the world, including a recent China-Southeast Asia fund that is estimated at $4.25 billion dollars. Warburg Pincus also invests in companies across a variety of industries including technology, business services, healthcare, energy and real estate.[53] Despite having such a long-standing influence in PE, Warburg Pincus' attention to sustainability is very recent. It established an Environmental, Social, and Governance (ESG) program in 2014 and it still remains relatively small within the company. Internally, the firm's Chief Administrative Officer, a member of the firm's Executive management group, oversees ESG efforts. There are also two dedicated ESG professionals: the Director of ESG and a Senior VP of Public Policy & Political Risk. An ESG committee, composed of professionals from a variety of different sectors of the business, meets "several times a year" according to

[51] Geraldine Fabrikant, "Lionel Pincus, Who Helped Bring Investors to Private Equity, Dies at 78," *The New York Times*, last modified October 11, 2019, accessed November 13, 2019, https://www.nytimes.com/2009/10/12/business/12pincus.html.
[52] "Environmental, Social and Governance Report," *Warburg Pincus*, last modified 2019, accessed November 10, 2019, https://www.warburgpincus.com/content/uploads/2019/07/Warburg-Pincus-ESG-Brochure.pdf.
[53] Ibid.

Warburg Pincus' sustainability report. Warburg Pincus also has connections with organizations such as Business for Social Responsibility, the Council on Foreign Relations, and the business Council for International Understanding. While these details demonstrate a level of dedication on the part of the company, it is impossible to measure the effectiveness of these employees and this committee due to a lack of reported results. However, in terms of reporting and guidelines, Warburg Pincus does mention some efforts to set responsible investment guidelines. It mentions ESG integration at both the due diligence phase (pre-investment) and the ownership phase. How much weight ESG metrics have over ROI is impossible to gage based on the available information. Warburg Pincus also mentions its own set of ESG metrics in terms of managing risk, achieving efficiency and reduction in costs, and identifying new market opportunities, but never clearly lays out what these metrics entail. It also continues to invest in entities involved in oil and gas discovery and production, such as Antero Resources Corporation, which is an unsustainable industry. However, Warburg Pincus does mention the use of the Guidelines for Responsible Investing set forth by the American Investment council, which helped inform the creation of Warburg Pincus' own metrics. Despite its efforts, it is evident that Warburg Pincus is taking a more passive role in developing sustainability within its portfolio companies and the company itself.

With the information set forth, it seems that Warburg Pincus' approach to sustainability borders on uninvolved. In its 2019 sustainability report, Warburg Pincus includes about 25 pages on its different portfolio companies and what they are doing in terms of sustainability. For example, a company called Ant Financial Services Group is incentivizing green consumer behavior by offering a greening mobile payment platform called Ant Forest. Warburg Pincus merely reports on what these companies are currently doing but not on how it influences its portfolio companies to be more sustainable or addressing what portfolio companies may be participating in unsustainable practices. It also do not address if it is taking any lessons from portfolio companies and integrating them into its PE business model. Warburg Pincus also aligns some of the actions of its portfolio companies with UN Sustainable Development Goals (SDGs) (see Figure 3.1 for reference).[54] For example, Warburg Pincus aligns the mission of portfolio company Mosaic, which "provides financing solutions for residential solar" with SDG #7 about

Figure 3.1 UN Sustainable Development Goals

affordable and clean energy. Besides creating the connection between this solar company and the SDG, there is minimal discussion on the importance of SDGs to the overall business model. Thus, the inclusion of this comparison seems more like a marketing ploy than an actual commitment. While Warburg Pincus does openly discuss their sustainability efforts, it is virtually impossible to determine how effective they have been and what the level of commitment to sustainability is throughout the whole company.

The Carlyle Group Formed in 1987 by William E. Conway Jr., Daniel A. D'Aniello, and David Rubenstein in Washington D.C., the Carlyle Group specializes in corporate PE. From

[54] "Sustainable Development Goals," *UN Sustainable Development Goals Knowledge Platform*, last modified April 10, 2018, accessed November 12, 2019, https://sustainabledevelopment.un.org/?menu=1300.

2014 to 2019 the Carlyle Group was the largest PE firm by capital raised, until overtaken by Blackrock. According to its website, the company has $222 billion assets under management across 365 investment vehicles, with more than 1,775 employees in 33 offices worldwide. The Carlyle Group is one of few PE firms that publicly trades on the NASDAQ stock exchange, completing an initial public offering in 2012 at $22/share.[55] Carlyle invests primarily in aerospace, defense & government services, consumer & retail, energy, financial services, health care, industrial, real estate, technology and business services, telecommunications & media, and transportation. Some well-known companies it has held stake in include Hertz, Dunkin' Brands, Beats, and PA Consulting. Carlyle clearly exhibits a commitment to sustainability, but still has a long way to go.

The Carlyle Group established a distinct ESG program in 2014 after hiring Jackie Roberts, a former employee at the Environmental Defense Fund. However, it has had a Responsible Investment policy since 2008 which draws on international standards, including the UN Principles for Responsible Investment and the UN Global Compact. These guidelines help the firm consider the "implications of investments and enable them to be good stewards of the capital committed to them by their investors."[56] Citing these two UN sources as the basis for their policy helps legitimize Carlyle's guidelines. Carlyle also discusses the iteration of its responsible investment policy throughout each phase of its investments: due diligence, ownership, and exit. It also voluntarily cites using the SASB materiality matrix, which was not true of the previous companies discussed. Carlyle also emphasizes its commitment to helping its portfolio companies, both old and new, by increasing its capacity for sustainability by explicitly

[55] Linette Lopez, "The Carlyle Group Priced Their IPO At $22 A Share," *Business Insider*, last modified May 2, 2012, accessed November 30, 2019, https://www.businessinsider.com/the-carlyle-group-went-public-at-22-a-share-2012-5)
[56] "Guidelines for Responsible Investment," *The Carlyle Group*, last modified 2018, accessed November 30, 2019, https://www.carlyle.com/sites/default/files/Guidelines_for_Responsible_Investment.pdf.

investing in their R&D departments. In order to demonstrate its commitment to R&D it uses the example of one of its transportation portfolio companies: AxleTech. Carlyle claims to have supported AxleTech through a transition from traditional powertrain systems to more efficient powertrain systems for electric vehicles. Despite mentioning the existence of guidelines and policies, Carlyle did not provide any specific details or state how highly it prioritizes them when making investments.

A pivotal aspect of increasing a company's sustainability is not letting the idea of perfection hinder progress in the right direction. This is something that Carlyle does not seem to understand. All of the information that is available in terms of its progress regarding sustainability lacks acknowledgement of the unsustainable components of its business. While other PE companies do similar things, Carlyle's attempt to disguise negative actions is much more extensive. For example, one of the first things that Carlyle mentions in its sustainability report is that in 2018 it was officially carbon neutral. However, further examination of this claim reveals that its main office in Washington D.C. is carbon neutral, but not any of their other locations or portfolio company locations. In the same vein, Carlyle claims to be collecting data on Key Performance Indicators (KPIs) in order to measure and assess ESG markers. However, these KPIs are being researched and developed through Carlyle's European leadership, thus it can be assumed that the data that it haa is only from Europe and that most other offices do not measure . Lastly, Carlyle does not disclose any data that it has collected based on the KPI rubric or responsible investment policies. Highlighting the places where its ESG programs fall short and setting goals to expand it and improve it would help increase transparency within Carlyle. In an industry that the general public already views as deceptive, not acknowledging the unsustainable aspects of their company will hurt Carlyle in the long run.

KKR KKR, formerly known as Kohlberg Kravis Roberts & Co, was founded in 1973 by Henry Kravis, George R. Roberts, and Jerome Kohlberg Jr. According to its 2018 sustainability report, KKR has a total $194.7 billion in assets under management, of which the PE sector manages $81.3 billion. KKR has a reputation for completing some of the most significant LBOs in all of PE's history. This includes the 1989 LBO of RJR Nabisco at $25 billion. At the time, this takeover led to many questions about the integrity of LBO transactions and caused many to question the morality of such actions. Following the transaction, TIME magazine published an issue with the CEO of KKR on the cover and questioning the "buyout craze" of the late 80s.[57] KKR's largest industries for investment include industrials, financial services, retail & consumer, and technology.[58] KKR has invested in many well-known companies which include Dollar General, Alliance Boots, Regal Entertainment Group, and Toys R US. In comparison to all of the PE firms analyzed in this report, KKR is the most advanced and dedicated to sustainability. However, that does not mean that it is anywhere near completely sustainable.

In 2008, KKR established its ESG platform in partnership with the Environmental Defense Fund (EDF), which included bringing on Elizabeth Seeger, a former employee of the EDF, to head the efforts. Seeger is currently a member of the Sustainable Accounting Standards Board (SASB) that is an "independent standards board that is accountable for the due process, outcomes, and ratification of the SASB standards, including any changes." [59] Because of this, KKR heavily draws on SASB's industry-specific standards when informing its ESG principles. This has specifically manifested into an attention to "material issues" in terms of ESG.

[57] "A Game of Greed." *Time*, December 5, 1988.
[58] "*2018 ESG, Impact and Citizenship Report*," last modified 2018, accessed November 30, 2019, https://kkresg.com/assets/uploads/pdfs/2018-ESG-Impact-and-Citizenship-Report.pdf.
[59]"Mission," *SASB*.

According to KKR's 2018 sustainability report, materiality helps them identify a) where to focus the Firm's efforts, and b) where its portfolio companies should focus theirs. This focus on materiality helps fuse the world and language of sustainability with the world of finance. Especially from a shareholder perspective, this fusion will help the concept of sustainability seem more accessible and realistic. However, one thing that is not clear is if KKR recommends SASB standards for each portfolio company, or just the ones that seem to most easily fit these standards. In a section of their sustainability report titled "Determining Material Issues", KKR states that "applying the concept of materiality to individual portfolio companies helps [the firm] establish which companies to engage with and which issues to address." From this statement it is clear that only certain companies are held to ESG standards. It is also unclear how heavily KKR takes SASB standards into account as opposed to metrics such as ROI. Yet, KKR seems to be more open to transparency then other PE companies. As one of the primary shareholders of Toys "R" US, which went defunct in 2018, KKR addressed its failures in terms of innovation, management, and the brand's footprint, which ultimately lead to its downfall and the loss of hundreds of jobs. Although it only included one example of failure, the acknowledgement of the firm's faults and intention to improve demonstrates an elevated level of transparency.

Following in Blackrock's footsteps, KKR founded its own separate impact investing venture which launched in 2018 called KKR Global Impact. This venture is directly dictated by the UN SDGs and funds businesses that have the potential to work to achieve some of these goals. KKR even went as far as picking certain SDGs that they think best align with their target investment areas. These include clean water and sanitation, affordable and clean energy, responsible consumption and production, and climate action. [60] Although this impact investing

60 KKR. "2018 ESG, Impact and Citizenship Report," 2018.

venture is separate from the core practices of KKR, it does allow for there to be more specialized personnel working on these efforts within the overall firm. With a wider focus, this will hopefully create a larger positive impact on KKR itself, portfolio companies, and society, and will encourage KKR to fully integrate ESG standards into every investment they decide to make. However, this separate venture also poses the possibility to maintain its position as an accessory to the core business model of KKR, echoing CSR models of the past. Although, its 2018 Sustainability Report mentions increased attention to ESG impacts, it is impossible to gage if it is in the process of truly pivoting strategies as a whole. While starting an Impact Investing venture demonstrates a step in a positive direction, KKR must demonstrate their commitment to becoming global sustainability leaders and stepping away from traditional practices in lieu of more sustainable ones.

Chapter 4: Private Equity Behaviors: A Sociological Perspective

After examining the current state of four of the largest Private Equity firms in the United States it is now important to identify some of their common shortcomings. Anthropological, sociological, and psychological analysis helps to focus this examination on the behaviors that perpetuate certain practices within PE. While it is clear that some PE firms are more progressive in their sustainability efforts, many of their faults fall into similar categories. Identifying these common behaviors is a key step in understanding why the PE industry seems averse to sustainable principles and how to guide the PE industry in a more eco-friendly direction. The commonalities include themes of paternalism, under-utilizing science and goal setting, a lack of transparency, selectivity, and participating in behaviors that go against long-term well-being.

Paternalism The entire PE industry has paternalistic foundations and thus, paternalism seems to seep into nearly every aspect of individual PE firms. Paternalism is the “interference of a state or an individual with another person… motivated by a claim that the person interfered with will be better off or protected from harm."[61] It takes form on an individual level (ex. a parent making decisions for their child), a governmental level (ex. a government creating restrictions for civilians), and within the private sector. Private Paternalism limits freedoms of employees, clients, or customers with "intermediate deadlines, progress reports, production targets, 'attendance' requirements during working hours, frequent evaluations, and mandatory health/retirement benefits."[62] In attempting to create large returns for their portfolio companies, PE companies employ paternalistic tactics. Portfolio companies must adhere to specific goals and strategies that the PE investor imposes. Thus, PE firms in many ways act as puppet masters for their portfolio companies, dictating their decisions and relying on their previous experiences. However, in an age where the environmental crisis necessitates fast and drastic innovation PE's paternalistic, "know-it-all" attitude prevents firms from fully integrating sustainability into their business models.

Paternalism inhibits PE's adoption of sustainability in three ways: 1) by not looking to portfolio companies for innovation, 2) by not allowing industry collaboration, and 3) promoting a culture of skepticism. First, PE firms focus heavily on incorporating their own tactics into portfolio companies to maximize ROI. As a result, PE firms often do not reflect on how the sustainability-oriented practices of their portfolio companies may be beneficial to the operations of the PE firm . For example, Warburg Pincus' sustainability report acknowledges the sustainable initiatives of their portfolio companies, such as Ant Financial Services Group who is incentivizing green consumer behavior.[63] Warburg Pincus could adopt this concept and create a

[61]Gerald Dworkin, "Paternalism," (*Stanford Encyclopedia of Philosophy* February 12, 2017).
[62] David Laibson, "Private Paternalism, the Commitment Puzzle, and Model-Free Equilibrium," (*Harvard University*, February 1, 2018): 2.
[63] "Environmental, Social and Governance Report," *Warburg Pincus.*

platform for their own employees or for their portfolio companies, but does not aim to learn for their portfolio companies. Paternalism also prevents radical collaboration. Competition within the private equity industry prevents big players from collaborating. Companies believe that their policies and approaches are better than others and thus do not seek external guidance. Fortunately, this competition does not extend to sustainability tactics. The entire industry would benefit if PE leaders would put pride aside and met frequently to discuss what is working and what is not working in their individual firms. Lastly, many firms remain skeptical about whether sustainability can create value in the PE realm. The unique tactics of PE firms allowed them to generate an incredibly large amount of assets and gain immense power in the financial sector. Because of their previous success, many PE firms still look to the past as justification for their methods instead of adopting new and innovative approaches. As concern over resource scarcity grows, these methods will not generate as much profit in the coming years as they did previously. The skepticism that grows out of paternalism is holding the industry back from making any substantial changes to their business models.

Under-utilization of Science and Science-Based Goal Setting Science and business have traditionally been in opposition to each other. Science often employs methodical inquiries that take extensive periods of time to complete. PE, on the other hand, is much more volatile, relying on short time scales and game-time decisions. Throughout all of the PE sustainability reports, there was a lack of scientific data and backing to merit sustainability changes. This demonstrates that PE still does not fully see the value in integrating scientific principles into the core of their business. PE could benefit from drawing on empirical principles through the use of the Scientific Method. At its core, the scientific method is a recipe for learning about the world in a systematic, replicable way: start with a general question based on observation or experience; form a hypothesis that would resolve the puzzle and that also generates a testable prediction; gather data to test the prediction; and finally, evaluate the hypothesis relative to competing hypotheses.[64] PE firms need to view sustainability as a process that involves multiple hypotheses, tests, and innovation. In practice, firms could identify sustainability-oriented problems within their companies and then test different methods of solving it using various sustainable practices. While some firms, such as KKR, understand this idea at a surface level, most do not value failure as a part of the process that can provoke necessary adjustments to the hypothesis. That is the only way companies would incrementally and holistically improve.

PE firms also currently do not ground their sustainability goals in science, but instead pursue the path that will build a public opinion of them as a “sustainable company”. All four of the firms analyzed mentioned a goal to make their company more sustainable (ex. Blackrock and KKR wished to grow their impact investing ventures). However, what was lacking overall was a basis for these goals in hard science and measurable progress. Science is telling us that in order to maintain life on this planet there needs to be a decrease in carbon emissions, waste production, and sea level rise, among other issues. PE firms should pursue goals that address specific and demonstrated environmental needs, such reducing Greenhouse Gas Emissions, reducing their energy footprint, reducing shipping mileage, etc.. Bold, science-based goals let the public know that a particular company is serious about their commitment to sustainability. Many PE firms are hesitant to set these goals for a number of reasons, the first and foremost being a fear of failure. However, a goal is just a goal. Missing a goal allows the company to reevaluate and reconsider how to meet their target the next time. Another reason is a lack of accessible tools that measure environmental impacts, such as carbon emissions. This inaccessibility is due to a lack of

64 Duncan J. Watts, “Scientific Thinking in Business,” (*MIT Technology Review*, January 22, 2014).

standardization of sustainability metrics and methods To remedy this, it is incredibly important that PE firms follow the path of other companies in an attempt to increase standardization. An example of this would be adopting a tool, such as Autodesk's Corporate Finance Approach to Climate-stabilizing Targets (C-FACT) tool. This tool helps companies "create their own path and set of goals."[65] Science-based goals should be suitable for portfolio companies as well as PE firms. Grounding goals in science will allow PE firms to develop achievable goals and reportable markers of progress.

Lack of Transparency and Insight Across multiple industries today, there are immense pressures to increase transparency coming from regulators, politicians, journalists, and the general public. The marriage of transparency and PE is not one that comes easily – an industry that has 'private' in its name is bound to tend towards secrecy. PE reacted to this growing demand by releasing various reports in an attempt to disclose the inner workings of their business and make their content more digestible. However, a critical review of these reports reveals vague language, a lack of standardized metrics, unrealistic goals, and few measurable results.[66] Each report for the four companies analyzed reads in a similar way. The general public reads these reports with a certain level of skepticism, assuming that they are not comprehensive and exclude the unsustainable aspects of business. Even in the case of KKR, is a more sustainable PE firm, the company only reports on their investments in those companies that are making sustainability efforts.[67] Because of the tendency to only report on things that fit the sustainability mold, readers may make the assumption that a PE firm is being untruthful in their report and is hiding their negative impacts on the environment. While it makes sense that PE

65 Andrew S. Winston, *The Big Pivot: Radically Practical Strategies for a Hotter, Scarcer, and More Open World* (Harvard Business School, 2016), 1733.

66 Jill M. D'Aquila, "The Current State of Sustainability Reporting A Work in Progress," (*CPA Journal*, July 2018).

67 "2018 ESG, Impact and Citizenship Report," *KKR.*

firms would not want to drape reports in all of their failures, companies are missing an opportunity to create value through increasing transparency.

Transparency enables trust, productivity, innovation, and cross-industry relationships. All of these factors are incredibly important for PE's image to the general public and for potential and current portfolio companies. In our current times, there is increasing demand for companies to go beyond basic transparency and adopt radical policies. Ecological transparency becomes radical when its analysis "encompasses the entire life cycle of a product and the full range of its consequences at every stage, and presents that information to a buyer in ways that demand little effort."[68] In other words, radical transparency raises awareness of the hidden ecological consequences that a consumer may not know about. Clearly, radical transparency is much more easily transferable to consumer-based goods. Reporting and tracking the impacts of physical products is much more straightforward then when the product is an entire company, in the case of PE. In a blog post from Graeme Faulds, a director of Private Market Solutions at eVestment, the author discusses the difficulty in adopting radical transparency in its current form into PE. According to Faulds,

> "…the flow of information between industry participants has been effective…fund managers are not always rushing to volunteer information, but when requested they were obliging… What those within the industry need is not necessarily greater transparency, but greater insight. Transparency is about seeing through something, whereas insight is about perceiving clearly, or understanding deeply, a complex situation."[69]

68 Daniel Goleman, *Ecological Intelligence: The Hidden Impacts of What We Buy* (Broadway Books, 2010): 79)

69 Graeme Faulds, "The Transparency Illusion: What Private Equity Investors Really Want," *eVestment,* last modified November 18, 2013, accessed December 18, 2019, https://www.evestment.com/transparency-illusion-private-equity-investors-really-want/

In order to make transparency work for the PE industry, there needs to be a fundamental shift of aiming for radical insight instead of radical transparency. Promoting greater insight will generate less fear surrounding PE and help build outside trust of the industry.

Selectivity In accordance with previous CSR models, businesses would chose when and where to use their companies for social good. However, as examined earlier, this CSR model is antiquated. Companies are now highly pressured to integrate ESG concerns at the core of their business models. PE is no exception. However, current trends delineate that there is still a large amount of selectivity amongst PE firms in terms of how and where to apply ESG considerations. While PE firms may use ESG considerations, such as waste management, water use, energy use, and resource use, in the preliminary stages of their investments, it is evident that if a potential portfolio company seems to promise immediate financial returns, any ESG considerations take a back seat. Amongst the four PE firms analyzed, this occurs to varying degrees. KKR and The Carlyle Group would more heavily consider ESG components, while Blackstone and Warburg Pincus would not. A specific example is Blackstone's recent funding of Future Lifestyle Fashion (FLF), one of India's largest fashion businesses.[70] Blackstone invested in FLF despite the fact that it manages many brands that produce clothing unsustainably, such as Indigo Nation and Champion, and are a part of the fast fashion trend. Despite the fact that Blackrock's sustainability report contains promises to integrate sustainability into the core of their business, investments like FLF tell another story. Instead, PE firms only rely on ESG considerations with companies that already incorporate sustainability at their core.

70 ET Bureau, "Blackstone Invests Rs 1,750 Crore in Future Lifestyle Fashion," *Economic Times Markets*, last modified November 15, 2019, accessed December 17, 2019, https://economictimes.indiatimes.com/markets/stocks/news/blackstone-invests-rs-1750-crore-in-future-lifestyle-fashion/articleshow/72069009.cms?from=mdr)

Since PE firms often own a controlling interest in their portfolio companies, they have tremendous influence on how these companies operate. Because of this, current patterns of selectivity are not necessary and come from an unwillingness to change. PE firms could require their portfolio companies to adopt approaches to ESG management and help guide the companies along that process. Many well-known brands, such as Burger King, Dell, GoDaddy, Hertz, and J. Crew come from industries with significant ESG impacts and are backed by PE investments.[71] However, PE backers do not hold these companies to any sort of sustainability standard. Instead, PE firms only act when it comes to generating financial returns through traditional methods, such as cutting employment, growing the size of the company, increasing presence in new markets, etc. While selectivity still seems to work now, as environmental degradation increases and the risks of not considering ESG concerns rise, PE firms will have to reanalyze their approaches to sustainability management.

Lack of Acknowledgement of Long-Term Impacts and Well-Being Humans are generally short-term minded; it is incredibly difficult for humans to imagine their decisions impacting generations that will exist when their individual life is over. PE reinforces this short-termism. PE is an industry that was founded on very short-term metrics. PE firms typically exit companies in 5-10 years, stock prices can flux instantaneously, and short-term profits are a central goal. Because of this, it makes sense that PE professionals would have a hard time shifting towards a more long-term mindset. Despite the fact that this mindset may be difficult to shift away from, it goes against long-term logic of survival. In order to assess which financial decisions are justifiable and which ones are not, PE needs to make intergenerational equity a core component of their business. Intergenerational equity is the duty to provide a standard of living

[71] John Hodges, "Private Equity Has Room for Growth on Sustainability," *GreenBiz*, last modified July 16, 2014, accessed December 13, 2019, https://www.greenbiz.com/blog/2014/07/16/how-private-equity-can-progress-sustainability.

to future generations that is at least as favorable as the one enjoyed today.[72] When making investments, PE firms need to start asking themselves how an investment may have negative impacts beyond the lifespan of the firm's involvement. This need does not come from a CSR model, but from the demand that all industries actively contribute to the maintenance of the human race.

Referring back to Larry Fink's 2019 letter to CEOs, Fink underscores the idea that "companies must navigate the complexities of a late-cycle financial environment – including increased volatility – which can create incentives to maximize short-term returns at the expense of long-term growth."[73] Fink is demonstrating that, despite the temptation of aiming for short-term financial returns, focusing too heavily on short-term goals has the potential to severely diminish the value of companies in the long-term. PE firms may be asking the right questions about the relevance of PE in 20 years, the maintenance power in light of the environmental crisis, and the mitigation of some impacts the environmental crisis may cause, but do not have a strong enough impetus to find adequate solutions. If these questions are not at the core of every decision a PE firm makes, the entire industry will cease to exist in the upcoming years when resources are less plentiful and other industries have pivoted to more sustainable methods.

Chapter 5: Different Approaches to a Sustainable Solution

After analyzing the current relationship between PE and sustainability, it is clear that there is a growing desire, coming from internal and external pressures, to pivot the entire industry towards sustainability. To varying degrees, different PE firms integrate sustainability into the day to day operations of their business. Despite initial efforts, there is still a lot of

[72] G. Tyler Miller and Scott Spoolman, Living in the Environment: Principles, Connections, and Solutions, 17th ed., Belmont: Brooks/Cole Publishing, (2011): 246.
[73] Larry Fink, "Larry Fink's 2019 Letter to CEOS: Purpose & Profit."

improvement that needs to occur to truly make an impact. Below are some recommendations of actions for both within the PE sector and outside of it that would support, encourage, and hold the industry accountable during this much needed transition.

Within Private Equity One of the easiest places to start for a PE firm is with their relationship to their portfolio companies. PE firms must require that all portfolio companies have a minimum approach to ESG management before investing in them.[74] Setting a hard standard ensures that ESG components receive consideration in the initial investment process. This usually results in the adoption of a Responsible Investment (RI) framework. This is a four-fold process composed of 1) defining the objectives of the framework, 2) identifying specific ESG factors and risks, 3) implementing ESG objectives and putting ESG systems and processes in place, and 4) assessing existing portfolio companies for ESG factors.[75] Additionally, PE companies should set their initial standards for portfolio companies but also set goals to incrementally raise their standards as the firm integrates sustainability more thoroughly. This will not only help the PE firm to develop a more sustainable portfolio but will also help the firm become more comfortable acting as an impetus for sustainable change within their investment companies. Portfolio companies will also be attracted to a PE firm if it has high sustainability standards. Receiving an offer of investment from a sustainable PE firm will positively impact the reputation of the potential portfolio company. PE firms must also require that portfolio companies report publicly on their ESG efforts. This is especially important because PE firms

[74] John Hodges, “Private Equity Has Room for Growth on Sustainability.”
[75]Mariya Stefanova, *Private Equity Accounting, Investor Reporting, and Beyond: Advanced Guide for Private Equity Managers, Institutional Investors, Investment Professionals, and Students*, 2nd ed. (FT Press, 2015): 59.

have so many direct and indirect stakeholders that are not always explicitly addressed (demonstrated in Figure 5.1 below).[76] Standardizing portfolio company reports about sustainability efforts and environmental impact will help develop a greater understanding of how

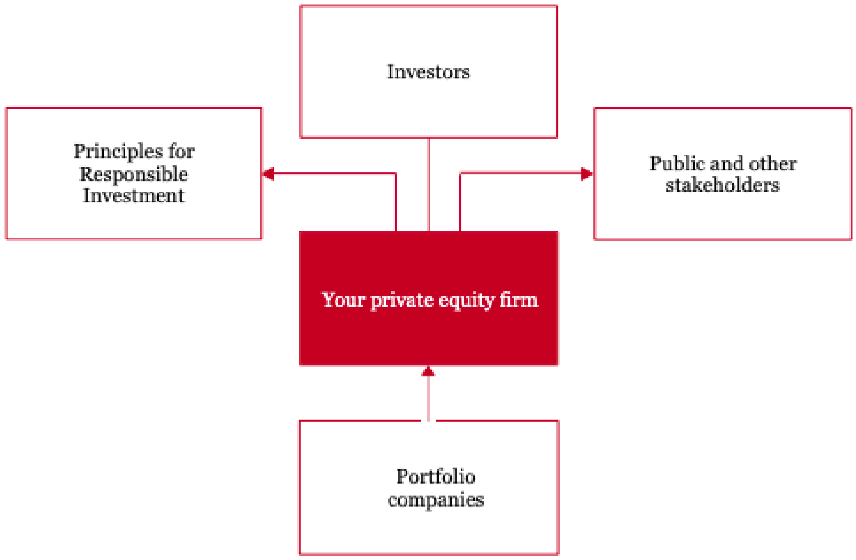

Figure 5.1 Chart of Private Equity and Stakeholder Relationship

vast the negative environmental impacts of PE's firms are, which is currently incredibly difficult to gage.

Getting an accurate measure of the environmental impact of individual PE firms proves to be very difficult. This is why, in transitioning to more sustainable models, it is pivotal that there are efforts to aggregate relevant information, which in fact most portfolio companies already report.[77] To do this, PE firms must require that portfolio companies publicly report in the first place, as discussed above. The mandated use of rating and reporting tools that already exist would help increase standardization across the entire PE industry. Such tools include the CDP, DJSI, and SASB frameworks. Requiring that portfolio companies report according to these metrics allows the PE firm to more easily aggregate information and is also a first step the firm

[76] "ESG Considerations for Private Equity Firms." *PwC*, 2015.
[77] John Hodges, "Private Equity Has Room for Growth on Sustainability."

can take in becoming an agent for increased sustainability within other companies. Some PE firms may currently be attempting to get their portfolio companies to report on these metrics. However, they are not currently including this information in their public reports. In order for this information to be useful to all of the stakeholders involved in these investments, it is pivotal that PE publicly report this information to further the sustainability efforts of the entire industry.

Aggregating information on portfolio companies, as well as publicly reporting, will allow the sustainability efforts of PE companies to shift away from empty language and promises to more data-based analysis. Using increased ESG disclosure will help spur a more data-driven discussion.[78] The principles of sustainability can often seem vague and theoretical. Grounding this discussion in data will allow sustainability to seem more familiar and appealing to those within PE who are already used to discussing financial data. Allowing PE professionals to understand exactly how much of a negative environmental impact their companies are contributing may spark more urgency in the sustainability discussion. Posing the risks of not fully integrating sustainability in terms of financial metrics, ex. how much money, jobs, and land will be lost from climate change, will also help breach currents gaps of understanding that exist between PE professionals and sustainability professionals. Using data can also, at certain points, open up the discussion to the positive impacts PE is receiving from their sustainability efforts. For example, many ESG programs actually lead to cost reduction due to energy savings, recycling, resource efficiency, and so on.[79] PE firms also make positive impacts in terms of job creation, community development and preservation efforts. While these positive impacts often do not offset negative impacts, having positive data to couple with negative data encourages companies to continue to invest in those positive ventures.

[78] Ibid.
[79] Mariya Stefanova, *Private Equity Accounting, Investor Reporting*, 56.

All of the suggestions above may seem incredibly daunting to some PE firms. Because of this, it is pivotal that firms seek outside help in making the transition to sustainability. Today, all of the major management firms have ample sustainability-focused consulting operations. Such firms are Deloitte, McKinsey, PwC, KPMG, and Ernst & Young. Their product offerings include sustainability strategy consulting, reporting and communications efforts, sustainability risk assessment services, responsible supply chain and product life-cycle assessment advisory, energy and carbon strategy, and water strategy advisory.[80] These consultants will not only identify areas of strength and improvement in terms of sustainability, but they will also aid PE firms in setting both radical and realistic goals based on data interpretation. Increasingly, ESG considerations are acting as major factors that either encourage or discourage investor interest. Because of this, it is incredibly important to seek guidance before it becomes the norm.

To ensure a smooth and adequate transition to more sustainable practices, it is important that PE firms dedicate adequate personnel. Most PE firms currently have some version of a Chief Sustainability Officer (CSO), whose main responsibility is to help develop a sustainability strategy as well as map out how changes will be made and unify subcultures within the firm..[81] While creating and appointing this person is a good step that represents a turning point in terms of dedication to sustainability, the position should only be a starting point. As the organization increases its commitment to sustainability, she/he would become less central in later stages of sustainability. The CSO's transformation can be separated into three distinct stages: 1) Compliance, 2) Efficiency, and 3) Innovation. During the Compliance and Efficiency stages, the

[80] Leon Walker, "Top Sustainability Consulting Firms: Deloitte, McKinsey, PwC," *Environment Energy Leader,* last modified October 28, 2019, accessed December 19, 2019, https://www.environmentalleader.com/2013/05/deloitte-mckinsey-pwc-lead-sustainability-strategy-consulting/

[81] HBS Working Knowledge, "What Do Chief Sustainability Officers Do?," *Forbes*, last modified October 8, 2014, accessed December 19, 2019, https://www.forbes.com/sites/hbsworkingknowledge/2014/10/08/what-do-chief-sustainabilty-officers-do/#4795dd1a33ab

CSO performs a generic set of activities such as formulating and executing a sustainability strategy, identifying material sustainability issue, learning from external sources, reporting sustainability data, managing stakeholder relations, and educating employees about sustainability.[82] In order to move into the innovation stage, the PE firm must hire sustainability-oriented people on all teams, regardless of the department, creating a network of sustainability professionals. I the Innovation stage, CSO's do not engage in the activities previously mentioned, as the firm would "take a proactive and transformational approach to sustainability rather than the more reactive approach that characterizes the first two stages."[83] In order to increase sustainability efforts, PE firms must view the CSO position as transitional and continue to hire personnel in all departments that can help increase the holistic influence of sustainability in the entire firm.

Outside of Private Equity In an ideal world, PE companies would make the above changes themselves. However, it would be short-sighted to not acknowledge the reluctance, hesitation and doubt that exists amongst industry professionals. Because of this, it is important to make sure that entities outside the industry continue to put pressure on and engage with the sustainability efforts of PE firms. Government intervention would immensely increase the time and resources PE companies put towards their sustainability efforts. While the private sector has a larger role to play in transforming the world's economy, the public sector still has an important role to play in both encouraging and managing this transformation. The government has the opportunity to use the tax system to steer private capital towards green investments. An existing example is the Business Energy Investment Tax Credits (ITC) program, which incentivizes

[82] Kathleen Miller and George Serafeim, "Chief Sustainability Officers: Who Are They and What Do They Do? ," *Leading Sustainable Change*, (Oxford University Press, March 20, 2014): 3
[83] Ibid.12.

investments in renewable energy sources by allowing tax credits up to 30% of the initial investment.[84] Implementing taxes or user fees could for investing in activities that have "external" costs (environmental trade-offs not accounted for in the market) would also be beneficial. These "instruments create an incentive that lessens the external costs and provides revenues that can help protect the damaged ecosystem services."[85] Examples include taxes on investments in fossil fuels or fast fashion companies. The government also has the opportunity to aid research and development efforts to develop standardized and detailed sustainability metrics. Currently all of the sustainability reporting efforts are voluntary – whether internally at a company or through organizations like SASB. The US government should work towards a "federally-led initiative to help determine the metrics that organizations would be required to disclose much like the decades-long process that resulted in generally accepted accounting principles."[86] This would eventually lead to an established entity to assess and report these metrics, such as a "National Commission on Sustainability Metrics."[87] As mentioned in Chapter 2, the PE industry was able to gain power through the relaxing of financial rules and regulations. At this point in time, it is important that the public sector not continue these lax regulations when it comes to sustainability and work to actively manage the transition from an unsustainable to a sustainable economy.

Outside responsibility also falls on the potential portfolio companies themselves to seek investments from more sustainable PE firms. Portfolio companies are in a difficult spot in that

84 "Business Energy Investment Tax Credit (ITC)," *DIRE*, last modified 2018, accessed December 20, 2019, https://programs.dsireusa.org/system/program/detail/658)

85 Millennium Ecosystem Assessment, *Ecosystems and Human Well-Being: Synthesis*, Web 2005, 96.

86 Alison Miller and Maureen Loman, "Measuring and Reporting Sustainability: The Role of the Public Sector," *Sustainability Policy and Management*, (Earth Institute Colombia University, August 2014).

87 Steven Cohen, "The Role of Government in the Transition to a Sustainable Economy," *Huffington Post*, last modified February 10, 2013, accessed December 20, 2019, https://www.huffpost.com/entry/the-role-of-government-in_b_4759621)

they need funding from an outside entity in order to grow. However, in the initial stages of seeking investments it is important that portfolio companies establish their own Responsible Investor strategies to evaluate the PE firms that may potentially fund them. Some evaluating factors can include other portfolio companies, the availability of public ESG information, the depth of sustainability tactics, etc. In an age where the market for socially and environmentally conscious enterprises is continually growing, developing a company based on ESG values may be a pivotal component of a portfolio company's longevity. If PE firms find their offers being turned away due to their unsustainable reputation, it forces them to reevaluate their operational strategies. Morally, portfolio companies should want to seek investment money from responsible enterprises and PE firms. It not only improves the image of their company but creates value outside of financial metrics.

Conclusion

Despite its negative reputation, the private equity industry has the potential to have an enormous impact on the current environmental crisis due to its influence on the American economy and the unique relationship between a PE firm and its portfolio companies. In an era where sustainability in all industries is of the utmost importance, private equity holds the keys to making widespread and meaningful change.

However, there has been little attention to addressing the specific challenges to integrating sustainable business models into the private equity industry. The primary goals of most firms are to maximize profit and increase short-term ROI. At a fundamental level, these tenets seem incompatible with models that prioritize social good, ethical business transactions, and awareness of long-term environmental effects. Sustainable initiatives in private equity must overcome industry-wide paternalism, an aversion to science-based goals and metrics, and a lack of transparency.

Traditional models of corporate social responsibility and corporate sustainability are not sufficient to push private equity firms towards more eco-friendly practices that have long-term, positive impacts. They tend to either focus on hyper-specific issues, such as air pollution, or employ vague, non-scientific language to describe the company's successes. Private equity needs a tailor-made model of sustainability in order to effective combat harmful practices and maximize its potential for change.

The suggestions in Chapter 5 comprise a model for sustainability that addresses issues unique to the private equity industry. This model advises companies on how to appropriately use rating systems, the best methods for communicating sustainable initiatives to the public, how to make room for sustainability professionals in firms, and how to utilize their relationships with portfolio companies to implement new programs and policies in a variety of industries. Sustainable private equity firms have the potential to influence countless companies that receive their funding, as well as change negative attitudes about the environment at the highest levels of business and finance. A workable sustainability model is necessary to begin making positive changes.

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