KEYNOTE INTERVIEW

More than a glossy brochure


Responsible investment must be defined and quantifiable, say 3i private equity director Rupert Howard and infrastructure partner Tim Short

SPONSOR
3I

Q What does responsible investment mean to 3i?

Rupert Howard: On the private equity side, we see responsible investment as a core part of investment due diligence. I cannot envisage a world where a business that is not responsible has a significant role to play in the future. Given our potential for longer hold periods, it is therefore essential that we support companies acting in a socially responsible and sustainable way. This is what consumers are increasingly demanding and any business that is not moving positively in that direction will be left behind.

Tim Short: It is much the same for 3i's infrastructure business. By the very nature of the asset class, we are investing in long-life assets and, as Rupert says, you cannot do that successfully without taking the sustainability of the business model into account, in the broadest sense. That clearly involves taking a responsible attitude towards all stakeholders.

Q What global mega trends has the covid-19 crisis highlighted and how does that inform responsible investment?

TS: The energy transition – from fossil fuel sources to greener, less carbon-intensive alternatives – is a key theme for a number of our infrastructure portfolio companies. Covid-19 has affected demand for all types of energy through the various lockdowns, which has highlighted one of the implications of this trend: the impact of intermittent sources of renewable power such as solar and wind on electricity grid stability. For our portfolio company, Infinis, which generates electricity from landfill gas, this has meant an opportunity to offer new flexibility services that play a key role in alleviating the issue.

Q What has covid-19 taught us about resilience?

TS: The disruption that covid-19 has caused has shone a light on the operational resilience of different business models. Some of that has been about the ability to adapt to remote working, of course, but in other cases it has exposed the benefits of having a diverse customer mix versus single points of failure. We own a business called Ionisos which owns and operates cold sterilisation facilities. The pandemic resulted in reduced demand for sterilising surgical, cosmetic and veterinary products but this was largely compensated by an increase in demand for sterile medical PPE and packaging.

Q What other sectors are affected by responsible investment themes?

RH: Responsible investment and sustainability are themes that play across all sub-sectors, and particularly so in the consumer sphere. Whether they are buying food for themselves, their families and pets or even a garden shed, consumers increasingly want to know that the products they are buying have been responsibly sourced. It forms an increasingly key part of their purchase decision.

This plays out across our two most recent private equity investments. GartenHaus, a specialist online retailer of garden buildings which we backed in September 2020, sources its timber from sustainably managed forest areas, which is something consumers are actively looking for when they buy these products. MPM, a leader in premium natural pet food and an investment we completed in December 2020, knows its customers want to understand exactly what they are feeding their pets, in the same way you or I would want to know the ingredients going into our food. MPM uses limited ingredients, which are immediately recognisable – for example, chicken breast, rice and water.

Q How do you approach diligencing the responsible credentials of a potential investment?

> *"It is vital your management teams are onboard"*
>
> **TIM SHORT**

RH: This is a key part of our evaluation of any business from the start. During an investment process recently, I was asked whether responsible business practices were integrated into the culture of the organisation or simply something the company was doing because it knew that it should. That level of detail is important because, ultimately, we are custodians of these businesses. If the management team is not looking at its operations and driving responsible practice throughout the organisation and its culture, then positive change is simply not going to happen.

TS: Responsible investment cannot be thought of as a separate diligence item. It spans all the diligence workstreams. It is a mindset with which you approach a business plan and assess a management team. It is also a lens through which you can look at value creation opportunities. All these things contribute to a final investment decision.

Q How do you work with management teams to ensure a business continues to improve its credentials?

RH: We own majority or significant minority stakes in our businesses, sit on the board and drive the board agenda, and therefore have ample opportunity to ensure management teams remain focused on this. We do a granular ESG assessment of all our portfolio companies, including detailed input from a specialist advisor. We track progress regularly through our detailed portfolio monitoring discussions to ensure we are seeing improvement, and we share learnings across the portfolio. We have previously done this around plastics and the circular economy for example, by bringing together companies that operate at different stages of the plastics lifecycle, together with experts from two fast-moving consumer goods companies. In 2021 we will focus on carbon, to support our portfolio in measuring and addressing its footprint.

Q What advice would you give a firm just embarking on a more formal responsible investment journey?

RH: First, define what you mean by responsible investment and ensure everyone in the organisation buys into that. Second, make sure you quantify, track and benchmark your progress. It is easy to say you are making improvements in the companies you back, but unless you have a way of measuring that and holding yourself to account, your responsible investment practice will lack substance.

TS: Responsible investment does not begin and end with a glossy brochure. It is the ongoing quantification, that allows you to set and measure yourself against targets, that makes a difference. It is vital your management teams are onboard, and in fact incentivised, around responsible business practices. That is when you will see real change.

Q Will we ever reach a stage where responsible investment is simply the expected standard?

RH: I really hope so. Certainly, where you have limited partners, or shareholders like we do, demand for responsible investment from your ultimate principal is so high, that it seems reasonable that will be the case. Of course, there will always be those who put responsible investment practices further up the agenda, but I am pleased with the direction in which things are heading. More and more people are being serious and taking actions about responsibility, rather than just saying they are serious. ■