MORRISON FOERSTER

AVCJ

Asia Funds ESG Survey 2022

Navigating the ESG Maze

Contents

Methodology

In the third quarter of 2022, on behalf of Morrison Foerster, AVCJ surveyed 100 Asia-headquartered Fund General Partners (GPs) with USD 1 billion+ AUM to gain their insights on how environmental, social, and governance (ESG) considerations are impacting their investments and the market. The respondents came from private equity funds, credit and special situations funds, sovereign wealth funds, insurance asset managers, and pension funds. By geography, 35% of respondents were based in China/Hong Kong, 25% in Japan, 15% in India, 15% in South-East Asia, and 10% in other Asian jurisdictions, including Taiwan and South Korea. All responses are anonymous, and results are presented in aggregate.

Additional interviews were conducted with leading Asia GPs: Haide Lui, Head of Investor Relations at Ascendent Capital; Maruping Mangwedi, Executive Director at Affirma Capital; Ivo Philipps, Chief Operating Officer at Affirma Capital; Tang Zongzhong, Head of Sustainability at BPEA EQT; Lisa Chaves, Managing Director and Head of Investor Relations in the Americas at CBC Group; Lan Kang, Managing Director and Head of Portfolio Management at CBC Group; Donald Tang, Managing Partner at Celadon Partners; Lincoln Pan, Partner and Co-head of Private Equity at PAG; Jonathan Tang, Vice President, ESG at PAG; and Kyung-Ah Park, Managing Director of ESG Investment Management at Temasek.

FOREWORD:

ESG in Asia— Navigating the Maze

Environmental, social, and governance (ESG) issues are of growing importance for businesses—and their key stakeholders—around the world. The need to navigate the maze of climate change, equality and diversity, accountability, and transparency are all driving ESG forward.

We are delighted to share MoFo's inaugural Asia Funds ESG Report, "Navigating the ESG Maze," in conjunction with AVCJ. In this report, based on a survey of 100 Fund General Partners (GPs) from across Asia, we examine the extent to which GPs in Asia are now embracing these ideas, as well as sharing insights from GPs and sovereign wealth funds that we interviewed separately and that are more advanced in their ESG journey.

Where Are We Now?

"Sustainability is at the core of our investment decisions," one respondent to our survey declared. But do such claims stand up to scrutiny?

Certainly, fund managers are re-evaluating their approach to ESG and almost all have at least started on their ESG journey. Every respondent on our survey says that they take ESG criteria into account when making investment decisions, with more than two-thirds describing it as a deciding factor. However, Asia GPs are generally behind other areas of the world on ESG adoption and practice, and while significant progress has been made in the past few years, there is still a long way to go.

Words vs Deeds

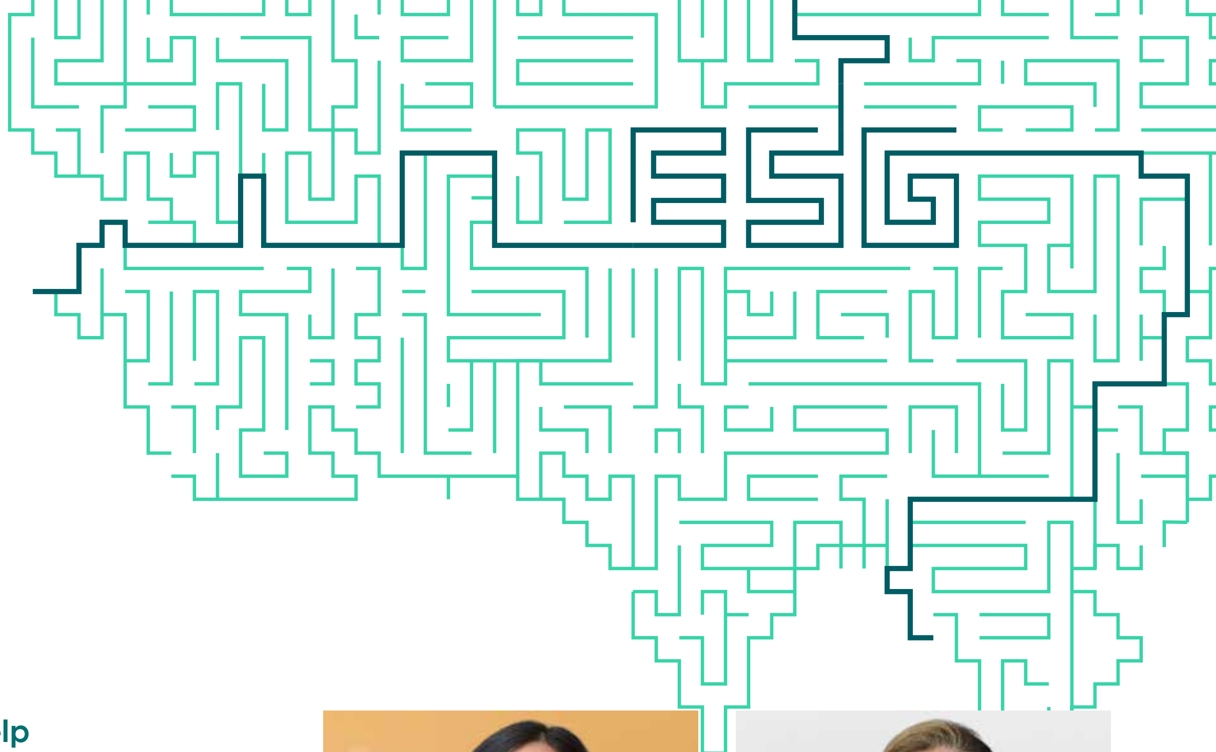
While there has been progress, there is mismatch between ESG words and deeds in Asia. Our findings reveal that many fund managers are still at an early stage of their journey through the ESG maze—they have begun to put policies in place but are not necessarily embedding that work in operations and decision-making.

For example, most respondents say they are focused on communicating the importance of diversity, equity, and inclusion (DE&I) internally, but only a third have committed financial support to improve diversity in their leadership.

This is potentially dangerous. GPs in the region will increasingly be at risk of accusations of "greenwashing," the same criticism applied to many businesses and investors in Europe and the United States, where regulators are now working hard to tackle such concerns.

GPs must therefore move quickly to drive their ESG practices forward with substantive policies, actions, and third-party verifications throughout the investment cycle or find themselves lagging significantly behind peers. But whatever they commit to, they must do it well. Therefore, selecting some key areas to focus on will serve fund managers better than trying to achieve everything at once.

Where will the pressure come to effect this change? There continues to be regulatory pull to adhere to the latest regulatory requirements, but limited partners, shareholders, investors, customers, and employees are also asserting their influence more and more. If fund managers ignore these pressures, the gap between those that are actively engaged in ESG and those that are at the early stages of their journey is only going to increase, leading to potential competitive disadvantage.



How MoFo Can Help

We hope that you find our report useful—and we believe that this is the first report of its kind in Asia. The results of our survey enables fund managers to benchmark their ESG journey against peers, along with providing some practical action points for navigating the ESG maze.

The final section of this report covers seven critical pathways that we believe fund managers should take to move forward on their ESG journey, covering everything from supply chains to climate considerations in investments to linking compensation of investment professionals to meeting ESG KPIs. We have also developed an online ESG quiz to help funds gauge where they are along the journey. The five-minute survey is anonymous, and the results include a short report benchmarked against our market data. Click on the QR code to get started.

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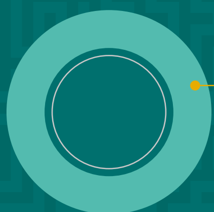
The MoFo team works closely with many funds in Asia on their ESG commitments and fully integrates advice on making and meeting ESG commitments in its representation of GPs on PE investments and acquisitions. We are here to help you with all aspects of your ESG journey, including advice, training, and insights. Please visit our ESG and Private Equity resource centers or contact us at esg@mofo.com to find out more.

Key Findings

Many Asia-based GPs are incorporating ESG into their business and investments, but how far are they along their journey through the ESG maze? According to our findings:

ESG is increasingly a consideration in operations and investment decisions— but for the majority of GPs, much of it remains superficial at best.

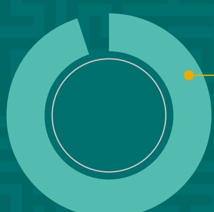


100%

of respondents factor ESG criteria into their decisions about potential investments, with **69%** saying ESG can be a deciding factor.

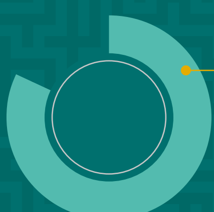
62%

of funds have an ESG committee, but only **22%** have a dedicated ESG professional, and just **14%** link investment team compensation to ESG goals.



95%

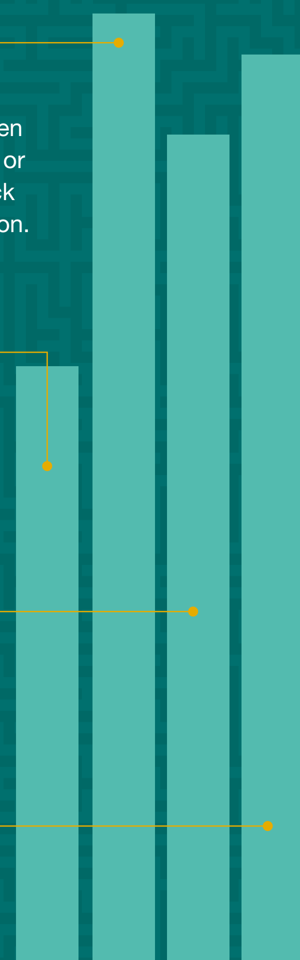
of funds say that there are no industries that are off-limits to investment (but **40%** say they will always invest in companies with positive ESG credentials).



82%

have invested in companies with negative or neutral ESG credentials, intending to increase the target company's valuation by improving its ESG credentials.

GPs see the benefits of improved ESG practices for reputation and investment opportunities—but is it all talk and not enough action?



95%

of these fund managers concede the issue of greenwashing has never been raised about their company or funds, which reflects the lack of regulatory bite in the region.

60%

of respondents say they promote some investment activities as "green."

83%

agree that positive ESG metrics increase a target's valuation.

91%

have found that positive ESG metrics help smooth disposal processes.

Diversity, equity, and inclusion (DE&I) is rising up the agenda—but relatively few investors are taking decisive action.

88% say that communicating the importance of DE&I issues internally is the top action they have taken to promote improved DE&I in their organizations.

Only **50%** say they are committed to diverse representation in leadership.

Only **33%** have made a financial commitment in this area.

ESG compliance is not yet an essential part of diligence and deal documentation—the industry needs to catch up.

46% of respondents conduct ESG due diligence on every deal, with a further **46%** doing so on most deals—but much of this relates to policymaking rather than measurable results.

29% less than a third of respondents always require the inclusion of clauses in investment documents to enhance or ensure ESG compliance.

59% of respondents consider climate change in their ESG due diligence—a surprisingly low figure.

ESG Survey

What do these findings mean, and what do funds need to do in practice? Take our short online quiz to find out where you are along your ESG journey.

ESG Podcasts

Go to page 30 for seven pathways to help you advance your ESG journey, including a focus on supply chains, greenwashing, ESG-linked executive compensation,LPs and ESG, DE&I, increasing valuations through ESG, and climate-driven investment decisions.

PART 1

Fund Level: ESG is Essential, but the Industry is still Finding its Way Through the ESG Maze

The big picture on ESG is increasingly coming into focus in Asia, but it is still early days. Drill down into the detail and it's clear that for most GPs, ESG-related initiatives are all talk but no bite, begging the question: Are ESG efforts in the region just window-dressing, or are they producing measurable results?

ESG-related considerations are starting to transform how GPs, investors, and funds in Asia think about their operations and investments. Many are developing ESG policies, and some have allocated additional resources and invested in talent to drive progress.

At the same time, our survey reveals a significant gap between intention and action. While most agree that ESG is important, few have done the work to implement actual change—however, there are a number of GPs that are forging ahead. Unless others put in a concerted effort to catch up, the gap will widen with significant competitive disadvantage to those that are lagging behind.

SUMMARY

62% of funds say they have an ESG committee, but…

only **22%** have a dedicated ESG professional…

and only **14%** say their investment team compensation is linked to ESG goals.

If firms in Asia want to incorporate ESG in their investment strategies, they need to bring more dedicated resources in-house and not treat it as a mere compliance issue.

Figure 1. Do you have a Dedicated ESG Committee and/or a Person who is Dedicated to Overseeing ESG Matters Relating to your Operations and Investments? (Select One)

ESG Structures are Improving, but Can They Deliver?

Based on our research, growing numbers of GPs in Asia are building frameworks to address and manage ESG imperatives. Almost two-thirds of respondents (62%) say they have set up an ESG committee that is dedicated to overseeing ESG matters relating to the firm's operations and investments. A further 29% have appointed a specific person to perform a similar role, and 8% have both an ESG committee and a key individual in place.

In some cases, such structures are driving valuable impacts, as explained by the managing director of a firm based in Hong Kong: "Having a committee dedicated solely to ESG provides more accurate views of the ESG framework that companies are following. It helps in ascertaining the critical elements of their individual ESG policies and practices, which is important when conducting pre-investment or annual reviews."

The managing director of a firm in India agrees, adding: "Our committee is introducing more standardized measures across the organization—we want a more uniform approach."

In other cases, however, there are question marks over the effectiveness of these arrangements.

ESG Committees

One issue is whether the committee has the right mix of people, including investment professionals and those with sufficient seniority. Almost all respondents (95%) say their committee includes a mix of investment and back-office professionals.

There is also the matter of focus. Among respondents with an ESG committee, 61% say it is not dedicated solely to ESG matters. Similarly, among those with a dedicated individual overseeing ESG matters, only 22% say this person is employed by the firm and focuses solely on ESG—and more than half (54%) admit their staff have wider-ranging responsibilities. A further 24%, meanwhile, rely solely on external consultants.

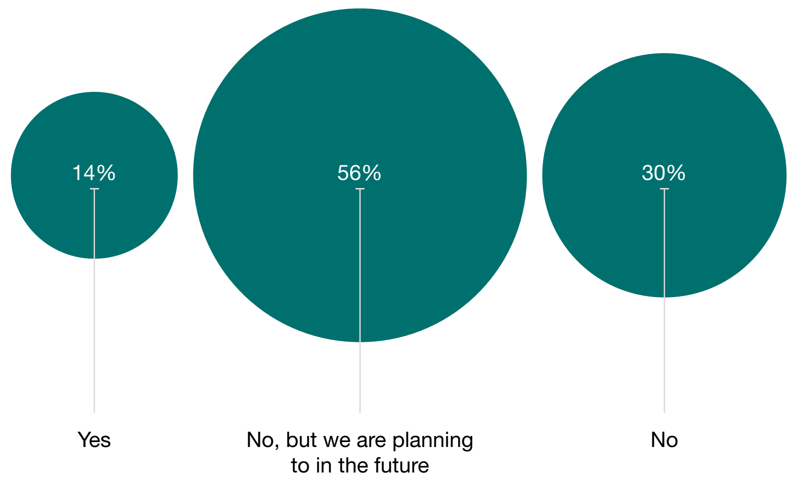
In effect, this means that just 8% have someone working within their organization who looks after ESG matters and nothing else.

There is no one-size-fits-all model, particularly given the absence of a regulatory framework in Asia against which to benchmark structures. However, GPs will need to be careful they do not treat ESG as a box-ticking exercise. It must be incorporated into investment decision-making, rather than treated as a mere compliance issue.

Investment Professional Compensation and ESG KPIs

For now, the lack of a clear link between ESG and remuneration may indicate that most GPs are not yet seizing the initiative. Only 14% of respondents say their investment team's compensation reflects the extent to which ESG goals or targets are met, while 56% claim to have plans to implement such a policy in the future.

Figure 2. Is Investment Team Compensation Linked With the Achievement of ESG Goals or Targets in Your Organization?



> "Linking investment professional compensation to ESG KPIs should help to drive behavioral change but such links must be objective and measurable."

Yemi Tépé and Susan Mac Cormac, Morrison Foerster

■ This is one of our seven featured pathways. See page 32 for further insights on this.

Avoiding Greenwashing: The Benefits of Engaging Third-Party Consultants

Working with third-party consultants, as some are now doing, will also become increasingly important especially as regulatory pressures grow. Such consultants not only bring their own expertise to the table, particularly in areas such as data, but also provide independent verification, which could be useful in countering greenwashing criticism. The findings suggest that regulators and LPs in Asia are not at the stage where they are pressuring funds to provide third-party verified data—but that will change in the years ahead.

> "More regulations are on their way in many Asian jurisdictions, which will help closer align the Asia markets to the EU, UK and U.S. However, there is still a lot of ground to cover, no doubt with some twists and turns along the way."

Vivian Yiu and Matthew Dunlap, Morrison Foerster

■ This is one of our seven featured pathways. See page 31 for further insights on this.

INTERVIEW

“Three Years Ago, you could Get Away with Telling Stories . . . but LPs Rightly Want More”

In conversation with Lincoln Pan, Partner and Co-head of Private Equity, and Jonathan Tong, Vice President, ESG of PAG

Q. How does PAG manage ESG at the fund management level?

Jonathan Tong: PAG is an alternative investment firm focused on Asia Pacific. I joined last year and sit at group level, providing support on a wide range of ESG issues—DE&I, carbon emissions, corporate social responsibility, and more.

I was specifically asked to help our Private Equity (PE) business design a framework for integrating ESG into its investment decision-making process and the way in which it manages and monitors the portfolio. We now have a dedicated PE ESG committee, which is responsible for overseeing the implementation of the ESG framework.

Lincoln Pan: Jonathan’s role is a new one for us. Traditionally, ESG sat under compliance, and our primary focus was to meet the requirements of our regulatory bodies. It was more of a box-ticking approach, but we were increasingly keen to think about how to drive value through ESG too, both from an organization and portfolio companies’ perspective.

We decided to add someone of Jonathan’s caliber because we felt we needed more thought leadership from the center. ESG should be part of what everyone does, and we wanted someone who would push thinking forward across the whole group.

Q. How is that shift going, from a compliance-only lens on ESG to an approach that considers value creation too?

Lincoln Pan: Three years ago, you could get away with telling stories—you gave your LPs a glossy brochure and that was enough. But LPs rightly want more. There is a tremendous demand for data, but also to hold people accountable for ESG commitments and progress towards a more sustainable future.

Jonathan Tong: That data is increasingly important in the value creation process. As we become more data-minded, we can really understand the impact of our work, and where we need to apply an approach to drive change. We know what the numbers mean—we understand the story they are telling—and they tell us something about the business itself. Then you can build a strategy and an implementation plan to drive further improvement.

Q. What do those strategies entail?

Jonathan Tong: We want to support our portfolio companies on their ESG journey. That’s an important part of my new role, to work with them as they pursue sustainability targets and other ESG objectives. That’s hopefully where my expertise can make a difference.

In practice, every company has different issues to confront. If we invest in a financial services business, it is going to have a different set of material issues to a manufacturing business. It’s a question of working with the businesses to understand their specific challenges and to identify where we can help.

INTERVIEW

"Our Primary Focus is on Robust ESG Integration"

In conversation with Ivo Philipps, Chief Operating Officer, and Maruping Mangwedi, Executive Director of Affirma Capital, an independent emerging markets private equity firm

Q. How do you embed ESG into the investment process?

Maruping Mangwedi: It starts by linking the ESG approach to investment strategy—accepting that you can't consistently deliver the returns you're hoping for without doing that. For example, the members of our ESG committee also take part in the firm's monthly portfolio management committee meetings and undertake deep dives on the portfolio to monitor ESG performance.

We know what questions to ask because ESG factors are integrated into our due diligence program before any transaction proceeds. We'll agree and document an ESG plan and put contractual undertakings into deal documentation where required—and agree to a 100-day strategy or value creation plan before we close the transaction. Our monthly portfolio meetings are an opportunity to measure progress against those plans.

Ivo Philipps: We typically invest in a company for five to seven years and ESG issues will develop and change during that period. But if you don't take steps to ensure that ESG factors are taken seriously from the start, and invest with an ESG mindset, it won't happen. Then, when you come to the exit, potential buyers will identify any shortcomings.

Q. What sort of systems and policies does that require?

Ivo Philipps: It requires a suitable governance structure and a systematic approach—that's why we operate with the committees and the due diligence policies that we've put in place. But we should recognize that some of this is about language. Often, we're asking our businesses to talk about something they've been doing for years but haven't thought about in an ESG context, or to collect the data that enables it to be assessed.

Maruping Mangwedi: It really helps to be proactive at the start of a transaction, which means that the policies and structures are in place, but you also need the deal team to engage with the management team, setting out what those policies mean and what's expected.

Sometimes people think something can't be done—then you link it to the actual business plan, and the picture becomes clearer. We're very focused on why an ESG factor is so significant. Yes, it's the right thing to do, but also it may impact your supply chain or operating efficiency or your ability to achieve your business plan.

Q. So it's about value as well as risk?

Maruping Mangwedi: I think it's crucial to have a multidisciplinary approach. Some of the pain points in the ESG process occur when there is too much of a top-down compliance approach, which can lead to the relationship between an ESG committee and deal teams becoming acrimonious.

In our case, no deal can get through our investment committee unless the ESG committee has signed it off, but our primary focus is on robust ESG integration. There is a risk assessment and that's important, but there also must be a plan for how we intend to proceed with ESG, and why.

Best Practices and Good Governance Policies have an Unexpected Focus

SUMMARY

87% of funds have policies relating to labor practices, but . . .

only **18%** have policies relating to anti-corruption.

Firms need to recognize what is covered by ESG—including areas that may not seem like part of the equation, such as anti-money laundering and anti-corruption practices.

While policy is only part of an effective ESG strategy—it must translate into practice as well—firms also need to think carefully about the broad range of issues that fall under the ESG umbrella. Our research suggests some important areas of ESG are in danger of being overlooked.

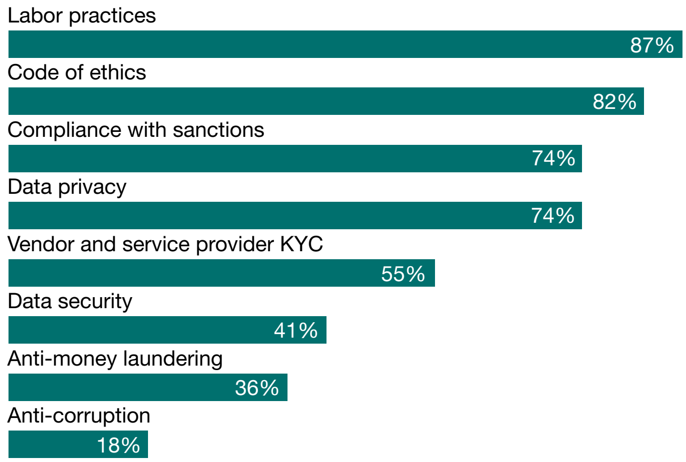
Labor and Data Privacy

At the fund level, GPs are most likely to have ESG policies in place around labor practices (87% have done such work) and codes of ethics (82%). Almost three-quarters (74%) say they have also developed policies for both data privacy and compliance with sanctions.

Regulatory

On anti-money laundering practices and anti-corruption, by contrast, the figures are much lower. Only 36% and 18% of respondents, respectively, say they have done policy work in these key concerns for governance. Many firms will, of course, have looked at these areas in the past, given their regulatory responsibilities, but the low numbers here may suggest GPs are at risk of taking too narrow a view of ESG. These findings would look very different if asked of respondents in the United States or Europe, where regulation keeps governance front of mind.

Figure 3. What "Good Governance" or Compliance Practices and Policies do you Already Have in Place at Fund Level?



Climate Change

In other areas, too, there is evidence that ESG work is at a relatively early stage for many GPs. On sustainability and climate change, most of the policies described by respondents are relatively basic, with an emphasis on quick wins around reducing energy consumption and increasing recycling.

While these initiatives are certainly worthwhile, few respondents offered anything more specific beyond these basic policies, again highlighting the difference between policy and action. More work will be required to deliver substantive gains in this area.

"With COP27 and recent extreme global weather events, climate is likely to become top priority to fund investments with many exploring what a net zero pledge means for them and their portfolio companies."

Ruomu Li and Susan Mac Cormac, Morrison Foerster

■ This is one of our seven featured pathways. See page 34 for further insights on this.

DE&I is an Early Priority—but has it Moved Beyond Talk?

SUMMARY

88% of funds communicate DE&I policies internally, but. . .

only **33%** have made a financial commitment to DE&I.

Diversity issues are becoming increasingly important for firms, but they must move beyond lip service if their efforts are going to change the culture.

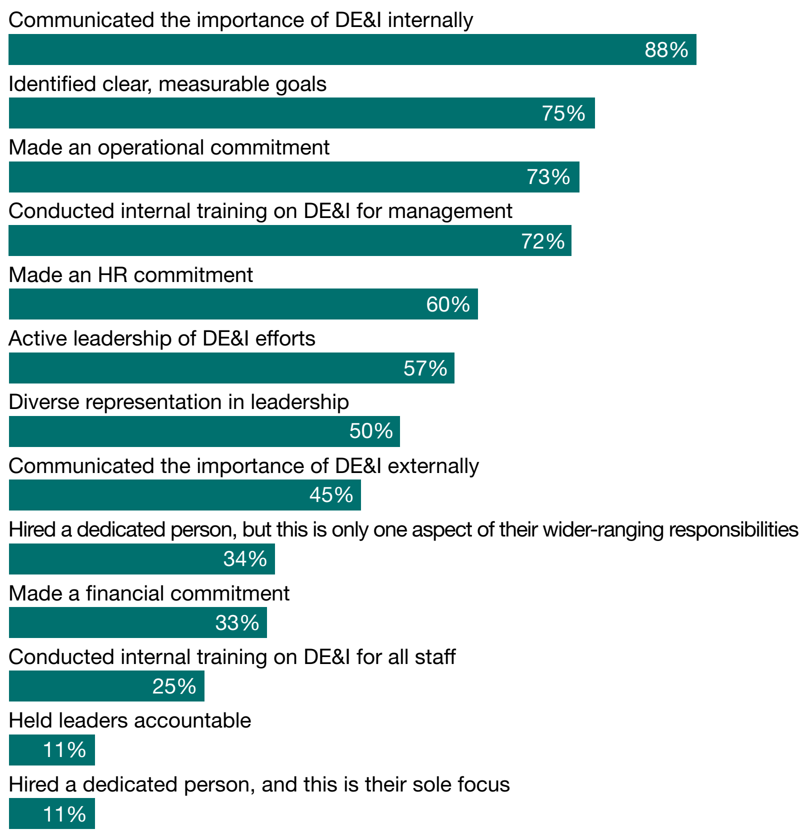
One striking finding is the seriousness with which many fund managers are now taking issues around diversity, equity, and inclusion (DE&I).

The action taken most frequently by GPs to promote DE&I within their organizations is to communicate its importance internally, with almost nine in 10 claiming to do such work (88%). Other common actions include: the identification of clear, measurable goals (75%); making an operational commitment (73%); and conducting internal training on DE&I for management (72%).

By contrast, only 50% of GPs say they are committed to diverse representation among their leaders, and only 33% have allocated financial resources to DE&I work. Just 11% have appointed a dedicated person to manage the firm's DE&I efforts, or to hold senior leaders accountable in this area.

It may be that firms in the region are conscious of the increasing regulatory focus on DE&I issues—in areas such as female board representation, for example—and eager to be seen to be responding. But firms must be careful they are not simply paying lip service to these ideas. For now, only a minority of GPs seem to be taking genuine action on DE&I concerns.

Figure 4. What Actions have you Taken Around Diversity, Equity, and Inclusion (DE&I) Within the Organization? (Select All That Apply)



"It's great to see that DE&I is a clear priority for many respondents. I sit on MoFo's Women's Strategy Committee and have seen how, over the years, women's issues and other DE&I considerations have gained importance and traction, but there's still lots more to do to convert policy into action."

Shirin Tang, Morrison Foerster

■ This is one of our seven featured pathways. See page 33 for further insights on this.

INTERVIEW

"Doing Well by Doing Good, That's What GPs and LPs can Work on Together"

In conversation with Haide Lui, Head of Investor Relations at Ascendent Capital

Q. How mature is the ESG debate in Asia?

Haide Lui: There's a hierarchy to that answer. On the one hand, many of the businesses in the region, particularly in Greater China (where we are), are only starting to think about ESG issues. On the other hand, our investors are adopting increasingly sophisticated frameworks and reporting tools for these issues, particularly our European and Australian and, increasingly, our U.S. LPs.

At the same time, different investors have different areas of focus within ESG topics. Some are more interested in the human and social side, for example, gender equality, fair employment practices, and retention of women. Others are focused on environmental and sustainability. There is an increasing number of LPs who have either already achieved or are committed to a specific date to reach carbon net zero operations and encouraging their GPs to track and reduce their carbon footprints. Many of those LPs are requesting more granular reporting and are ready to give specific direction on where they want things to go.

ESG matters to us personally as a business. Many of us have worked in world-class global firms and support the perspective of giving back while generating strong financial returns—we naturally lean in when thinking about our place in the world.

Q. Where does diversity, equality, and inclusion come into that?

Haide Lui: DE&I has become a real area of interest, particularly for our North American LPs. They're focused on race, gender, as well as sexuality. Gender is interesting because there is now an assumption that we are seeing greater equality, but that is not necessarily the case in all markets. I have seen information requests become more detailed, and more demanding of GPs to be thoughtful about firm policies, as well as measuring the effectiveness of those policies. For example, whether there is measurable year-on-year impact on recruitment, retention, and promotion of female staff, diversity of senior team members, etc. By requesting for very specific information on various metrics, LPs can raise awareness and make change in the world through GPs and their portfolio companies.

Q. What about other areas of DE&I?

Haide Lui: Modern slavery is a good example. When we first began receiving questionnaires about slavery, it wasn't at all top of mind, but that prompted us to really investigate the issue—it was a great learning opportunity to understand the subject. Even though it's not prevalent in our focus sectors, it was eye-opening to learn about the industries and circumstances that increase the likelihood of trafficking. There is increased awareness in our deal team on this issue, and that in itself is additive to being a good corporate citizen.

Q. Where do you see this debate heading?

Haide Lui: The next generation is much more aware of environmental and social issues and the power that we all have to make a difference. I think increasingly businesses will see that if they're doing good for the world, they'll be perceived by consumers more positively, which is something they can take to market. That's going to be particularly important as the next generation of customers starts to increase its purchasing power. I get the sense that younger people are far more engaged with these issues, even in Asia, which is at an earlier phase of development on these concepts. As that generation becomes the decision makers, this is going to matter more and more. Doing well by doing good, that's what GPs and LPs can work on together.

PART 2

Portfolio Level: Finding a Way Through the ESG Maze is an Imperative as Well as an Opportunity

Many GPs in Asia are considering ESG at various points in the investment and portfolio management lifecycle—but much more needs to be done at the portfolio level to catch up with Europe and the United States.

Investors are beginning to work with their portfolio businesses on ESG matters at each stage of the investment process. This is encouraging and has the potential to deliver positive benefits in each portfolio business and drive virtuous circles of improvement.

However, for many GPs, work is still at a nascent stage. Discussions are underway, some policies are being implemented, and attitudes are beginning to shift, but all this talk needs to be translated into tangible action to bring Asia-headquartered GPs in line with their peers in Europe and North America.

1. Deal Selection: For Most Firms, Very Little is Off Limits

At the portfolio level, ESG begins with the investment professionals who decide which companies to target for investment or acquisition. More often than not, only funds with a clear mandate for an ESG-driven investment strategy will automatically exclude businesses that do not meet ESG criteria. According to our survey, 95% of GPs say there are no industries that are strictly off-limits to fund managers. Nevertheless, ESG comes into deal selection in a variety of ways.

Not least, GPs recognize the clear risks of putting their money into businesses with a weak ESG record. The potential for reputational damage or a compliance failure that will erode value is obvious. The risk of being left with stranded assets is also a growing concern, particularly in sectors exposed to the transition towards cleaner energy. The responsibility of GPs to their LPs in this regard is very real.

In combination, such risks will therefore increasingly give fund managers pause when considering investments. Indeed, 40% say they now always invest in companies with positive ESG credentials, and 60% say they sometimes invest in such businesses.

> "LPs are starting to demand greater ESG accountability from their Asia-headquartered GPs and are expecting them to integrate ESG into their operations, demonstrate good corporate governance and actively measure and report on ESG performance. LP pressure will provide a pull towards ESG that GPs may not be able to ignore."

Serena Tan, Morrison Foerster

■ This is one of our seven featured pathways. See page 32 for further insights on this.

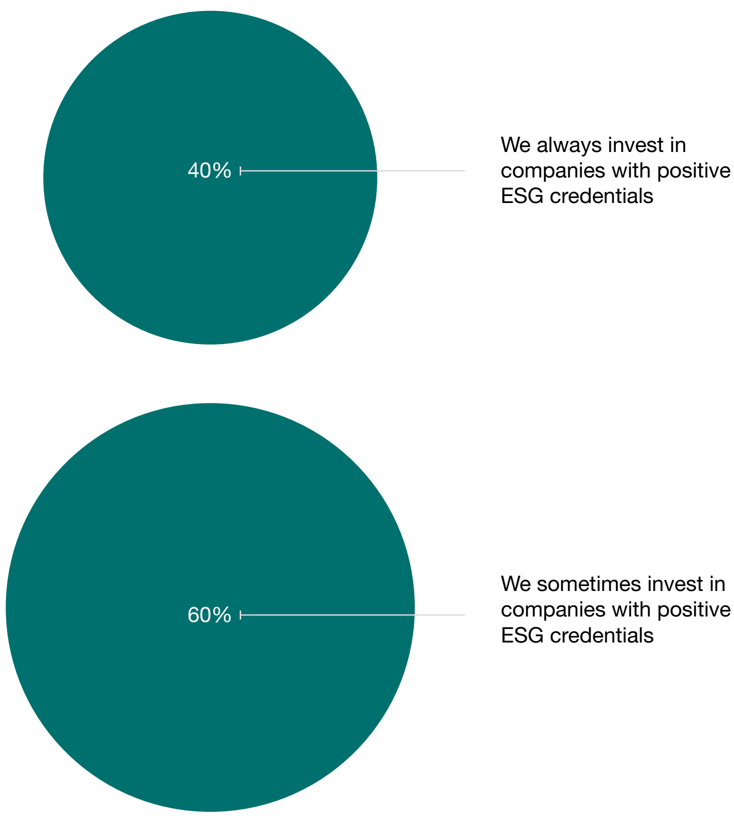
SUMMARY

95% of funds say that there are no industries that are off limits to investment, but . . .

40% will always invest in companies with positive ESG credentials.

Investment opportunities sit on both sides of the ESG fence: some may seek to create value by improving poor ESG performance in an investment, while others will celebrate the high ESG standards in their targets to raise reputation and value.

Figure 5. To What Extent do you Select Investments Because the Portfolio Company has Positive ESG Credentials?



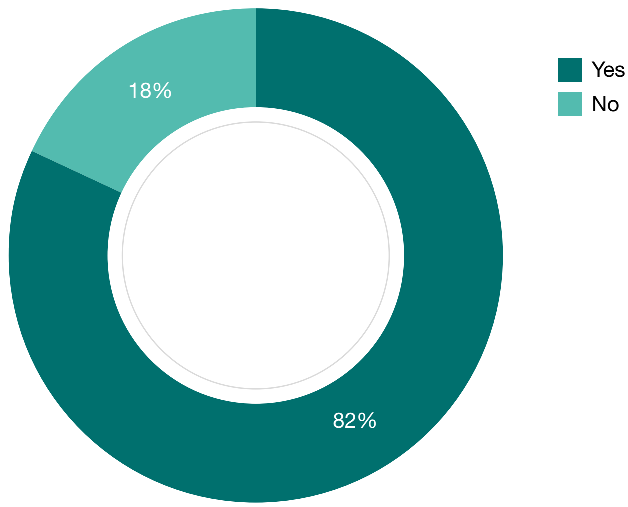
Equally, it is possible to make the investment case from a different angle—could GPs grow their portfolio's value by acquiring businesses struggling with ESG issues and helping them to improve? Many in this research believe so: 82% say they have invested in companies with negative or neutral ESG credentials based on a plan to increase the target company's valuation by improving its ESG credentials.

"We could pursue better ESG standards after the investment was completed and thereby increase the value," says the managing director of a firm in Singapore. "For example, there were businesses in the energy sector that had negative credentials, but we took up the challenge and introduced decarbonization strategies in these businesses."

Moreover, in certain areas of the market, ESG is just beginning to become a factor, and there may be advantages for GPs able to help such businesses become first movers. As the CEO of a firm in Japan explains: "We are planning investments in mid-cap companies, and these are companies that do not have strong ESG ratings. We can work on creating a more feasible and practical ESG framework."

The bottom line is that GPs across the region are only now beginning to work out how to build ESG into their deal selection activity. For some, the importance of ESG to stakeholders may drive a more rigid approach when deciding which industries or businesses should be avoided. Others will focus on helping portfolio businesses improve their ESG performance, particularly where it creates value. Either way, ESG will now loom large in deal selection.

Figure 6. Have you Decided to Invest in Companies that have Negative or Neutral ESG Credentials Due to a Strategy of Increasing the Invested Company's Valuation by Improving its ESG Credentials?



INTERVIEW

“Today, Across Many Different Industries, it Pays to be More Conscientious”

In conversation with Donald Tang, Managing Partner of Celadon Partners

Q. How do ESG issues influence your investment approach?

Donald Tang: Ten years ago, companies had to decide whether to invest some margin into doing the right thing. Today however, across many different industries, it pays to be more conscientious. Part of that is because consumers and governments care more, and regulations require it. Technology has also improved: solutions to certain ESG-specific problems in many areas have become commercially viable.

For a confluence of these reasons, I believe every PE firm needs a real understanding of ESG matters.

Q. What does that mean for your portfolio?

Donald Tang: Unlike other firms that are focused on sectors such as technology, we’re much more interested in traditional industries. They may appear to be less sexy, but they’re also less fully valued with very high operating leverage and when new technologies arise, these businesses can be transformed—both from an efficiency perspective and in terms of ESG considerations. For example, we own a business that makes knitted uppers for footwear companies; if we use automation, we can become much more efficient, and we can also reduce waste to almost zero to support the environment.

In fact, in this portfolio company, the majority of its production is made from recycled plastics recovered from the ocean. That’s not simply because it’s the right thing to do or because consumers insist we do so. It’s also more profitable because it offers us an opportunity to differentiate ourselves from the competition. That’s what drives the business.

Q. How important are these issues to investors?

Donald Tang: It depends on the investor. For us, though, it’s not about adopting a feel-good approach that enables more dollars to be raised. There isn’t a standard approach right now for what to track, or how to measure, especially for things that are harder to quantify. And, ultimately, this is not a marketing story. There are real risks and real opportunities for impact. For sustainability itself to be sustainable, it must be core to the business proposition. It needs to drive profitability or reduce risk.

Q. How do ESG considerations come into play during the deal process?

Donald Tang: There are many sectors impacted by ESG considerations, and we try to understand where the risks lie, where change is needed, where technology enables a new approach, and where there are opportunities for growth. ESG decisions are an integral part of our investment analysis and diligence process.

What makes the world exciting today is that the assumptions that underpin many industries are changing. Whereas, before, the supply chain was solely optimized around lowest cost and massive volume, many other considerations have become important today—environmental footprint, robustness against disruption, and so on. That creates opportunities for incumbents to be upgraded or for new players to take over. Understanding that is critical for long-term success as an investor.

2. Pre-Investment Due Diligence: How Diligent are Firms When it Comes to ESG?

If ESG is increasingly a material issue for businesses in Asia, potential investors in those businesses will want to have a clear idea of any ESG risks or dangers. According to our survey, most respondents say ESG is frequently a feature of their due diligence work: 46% say they do ESG due diligence for every deal, while 46% say it is common in most transactions.

So far, so good—but what does this diligence entail? For example, 41% say ESG is just another consideration in their standard due diligence work, while only 39% conduct separate due diligence specifically on ESG. That suggests that some fund managers are not being rigorous enough or that they are simply rebranding some of their traditional diligence work as ESG-related.

Another question is where GPs are looking during due diligence. Labor practices (88% of respondents) and DE&I (84%) are most commonly included in ESG due diligence, while climate-related issues (59%) fall much further down the list.

It may be that these investors are focused on deals in fast-growth sectors such as technology or financial services, where businesses are perceived as having smaller carbon footprints. Still, the lack of focus on climate issues nonetheless seems short-sighted, particularly as companies come under more pressure to look beyond the carbon emissions for which they are directly responsible.

Overall, consensus of what ESG due diligence should cover—and even how it should be conducted—appears to be lacking in Asia. That may reflect the infancy of the ESG debate in the region and the lack of a fully developed regulatory framework to provide a benchmark. But it will need to be addressed.

SUMMARY

92% of funds undertake ESG due diligence on most or all deals. . . even though it is not necessarily clear what that due diligence work entails.

There is a risk that most GPs are not rigorous enough in their ESG due diligence, or that they are only giving a nod to ESG in their traditional diligence work.

Figure 7. Does your Fund Conduct ESG Due Diligence on Investments?

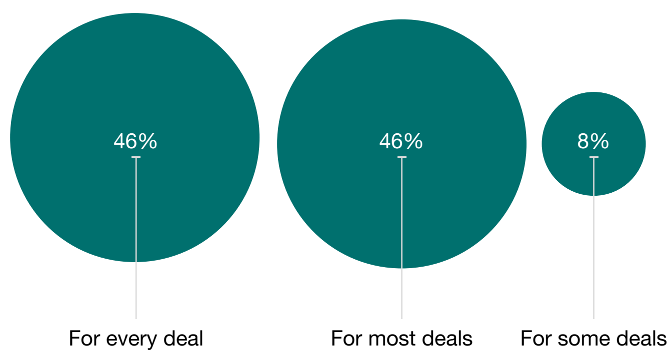
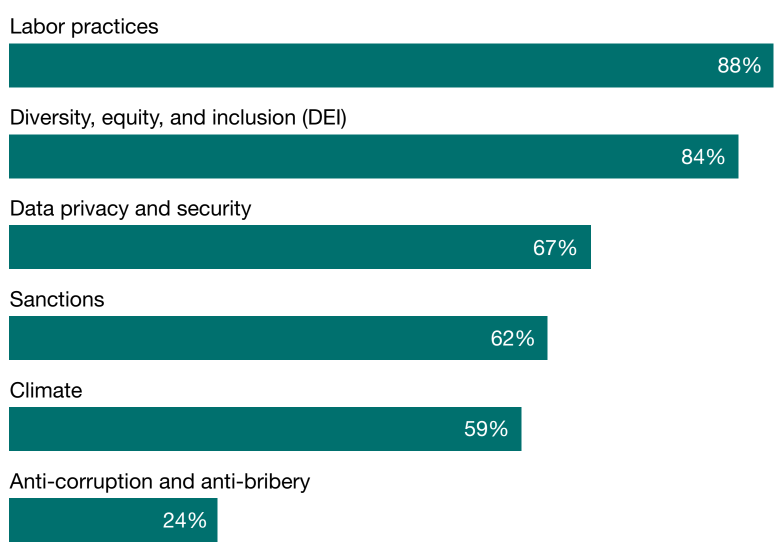


Figure 8. What Specific Areas are Included in the ESG Due Diligence?



INTERVIEW

“We have a Due Diligence Questionnaire that we’ve Developed that Relates to ESG”

In conversation with Lan Kang, Managing Director and Head of Portfolio Management, and Lisa Chaves, Managing Director and Head of Investor Relations in the Americas, at CBC Group.

Q. What role does ESG play in your investment decisions?

Lisa Chaves: At a fund level, we have an ESG committee, and we’ve increased our resources by hiring an ESG consultant based in London. We’ve developed a vision for ESG, so now it’s a question of how we execute on that vision.

In practice, the ESG committee is responsible for the oversight of the ESG issues and providing relevant insight and guidance. To that end, the ESG committee has worked with our external ESG consultant to create a comprehensive due diligence questionnaire tailored to all our sub-sectors—biopharma, medtech, and services. This questionnaire must be completed by the investment team prior to our investment committee. If there are any deal killers, we will not move forward with an investment.

Q. What kind of issues are you looking for?

Lan Kang: When we invest in a company, we collect ESG-related information via this three-part questionnaire. On the environmental side, we look at compliance, liabilities, effluents, emissions, waste management, supply chain management, etc. For social, we ask about minimum wage and social security compliance, HR management processes, health and safety compliance, etc. And on governance, we look for board effectiveness, anti-bribery and corruption, cyber security and data protection, those sorts of things.

We review that questionnaire quarterly and make additions to the template, because the issues are evolving all the time. We’re looking to gather as much information as possible.

Q. What about after you’ve invested?

Lan Kang: Our ESG work certainly doesn’t stop at the point of investment. We have an ESG taskforce, comprising people from a range of disciplines, and we work closely with individual portfolio companies on their ESG efforts. Our role as investors and, sometimes, as an incubator, is to help build bigger and stronger companies, so we incorporate ESG into that work. At the beginning, it might be quite preliminary, but as the company grows, we have a framework to help them measure key parameters.

Q. Do you find portfolio businesses receptive to this focus on ESG?

Lan Kang: It varies by industry and by individual company. ESG may not be the management team’s top priority, and they may have other challenges to deal with, so we calibrate our approach. If a company is very young, we don’t impose a large number of ESG criteria on them—we integrate an approach to ESG gradually over time so that we’re not putting a burden on management. Communication is crucial.

Lisa Chaves: I think we’re doing a good job of educating the portfolio businesses. We do annual reviews that focus on ESG, so they get used to the kind of questions that are important and begin to understand why we’re asking them. We make the link between ESG and how it drives value.

3. Investment Documentation: GPs Risk not Taking ESG Covenants Seriously

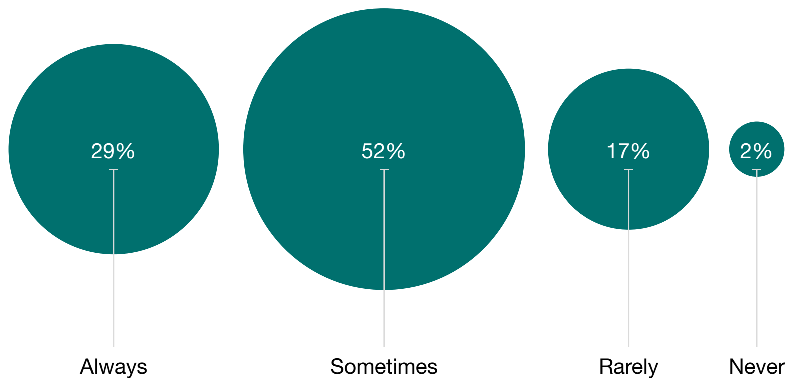
SUMMARY

only **29%** of funds always include ESG clauses in investment documentation

only **38%** instigate regular ESG reporting

The lack of teeth in deal documentation (and lack of transparency, as most respondents do not require ESG KPI reporting) makes the risk of greenwashing a significant problem for many firms.

Figure 9. How Frequently Does your Fund Require the Inclusion of Clauses in Investment Documents to Enhance or Ensure ESG Compliance?



If GPs are serious about driving ESG improvements in the portfolio companies in which they invest—as many profess to be—it is important that they find mechanisms for holding these businesses to account.

In the United States, for example, it is increasingly common for fund managers to include ESG provisions in investment documentation. This not only sets out a clear expectation on key ESG issues, but also provides the fund with a means to push back against accusations of greenwashing, an area where regulators in other parts of the world are increasingly active.

In Asia, by contrast, such provisions appear to be significantly less common.

Just 29% of GPs say they always require the inclusion of clauses in investment documents to enhance or ensure ESG compliance. More than half (52%) require these clauses "sometimes", and a minority (17%) say they rarely include such requirements.

Even among funds that do go down this route, their approach varies widely. While 86% say they require portfolio companies to institute a compliance framework and policy process, only 58% imposed specific covenants on these businesses to remedy ESG shortfalls or problems. The implication is that,

Figure 10. Which of the Following do you Include in Investment Documents? (Select All That Apply)

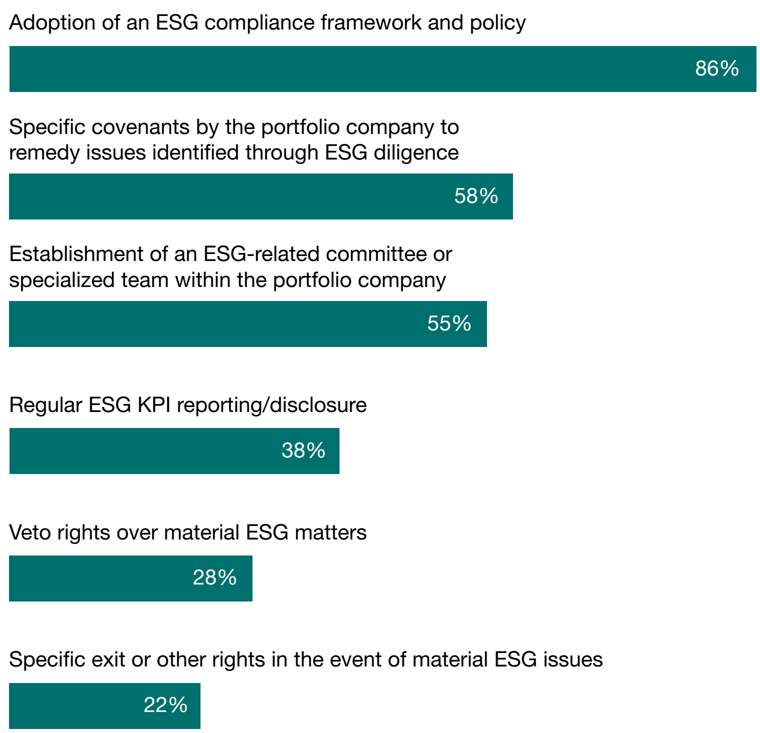
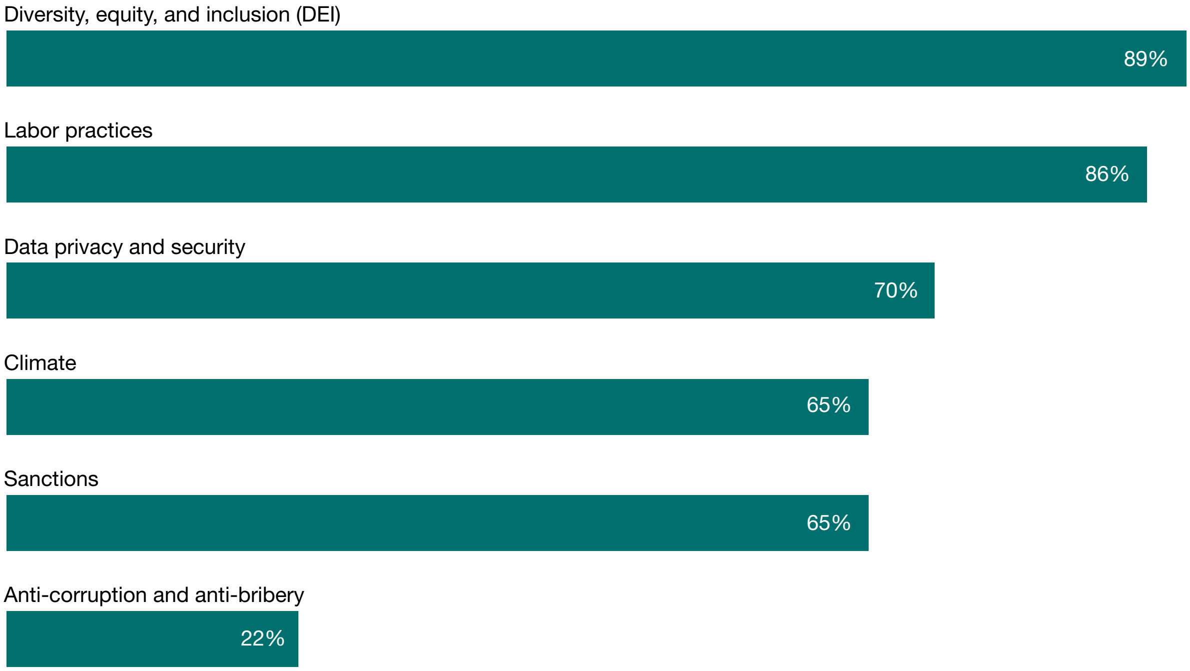


Figure 11. If you do Regular ESG KPI Reporting/Disclosures, in which of the Following Areas do you Generally Require Regular ESG KPI Reporting/Disclosure?



while GPs are ready to force portfolio companies to consider ESG issues, they are not yet routinely requiring them to act on the problems they may have.

This may reflect the fact that concerns about greenwashing—especially at a regulatory level—have yet to gather pace in Asia. The danger is that GPs give the impression that they do not always follow through on policy or intent with significant action.

It is also concerning to note that many GPs are not prioritizing transparency or visibility in their portfolio businesses. Only 38% require regular reporting and disclosures on ESG KPIs. Among those that do, the most common areas included are DE&I (cited by 89%), labor practices (86%) and privacy and data security (70%).

This opacity will become increasingly problematic as ESG scrutiny intensifies. More GPs must be ready to implement tougher reporting requirements. Those already doing this work with portfolio companies should look for opportunities to expand what is covered by reporting and disclosure.

4. Portfolio Management: Accusations of Greenwashing Will Only Grow in Future

It's clear that many GPs now see an opportunity to leverage ESG as a potential competitive advantage: 60% acknowledge that they promote at least some of their investment activities as "green."

For now, most of those claims are going unchecked. Just 5% of GPs say they have seen the issue of greenwashing raised either about the fund itself or one of its portfolio companies. But that seems unlikely to hold.

The direction of travel from regulators in other parts of the world—and from other key stakeholders, including limited partners and even the public—is very clear. The increasing scrutiny of claims about ESG performance seen in both the United States and Europe, particularly in the environmental arena, will spread to Asia.

As a result, there is a very real risk of regulatory clashes on the horizon. Increased scrutiny will expose shortfalls, which will be potentially embarrassing to any GPs currently keen to promote their activities without concrete, measurable action to back it up.

That risk is all the more real given GPs' admissions of their own lack of scrutiny: only 54% of respondents have policies on ESG communications or green claims by portfolio companies, typically overseen and verified by their ESG committees.

"At times, companies release claims that are unsupported by actual evidence. They do so to raise their market image," says the managing director of a firm in China. "We keep a close watch on portfolio company operations because investors will question us if these claims turn out to be false. The main policy is to support these claims with factual evidence."

Unfortunately, many others are not confronting this risk.

Bear in mind that ESG scrutiny will increasingly go beyond the GP's immediate portfolio. Nine in 10 investors say they scrutinize and improve the ESG compliance of participants in their supply chains.

SUMMARY

95% of funds say they have never been pressed on greenwashing but that may change rapidly—and sooner than expected

Regulatory and greater LP scrutiny around ESG claims will likely emerge in the next few years, and firms need to be prepared to verify green claims by scrutinizing the claims of ESG performance of their portfolio companies and even those of participants in the supply chain of their portfolio companies.

"Regulators in the US and the EU/UK are beginning to put the onus on companies to diligence their supply chains for various ESG issues. Companies and funds with portfolio companies operating in Asia must consider the current impact of these regulations on them and the requirements and restrictions imposed by Asian jurisdictions."

Chen Zhu and Stacey Sprenkel, Morrison Foerster

■ This is one of our seven featured pathways. See page 31 for further insights on this.

Figure 12. Is your Organization Committed to Reporting on ESG Compliance About the Following Areas in Respect of Your Portfolio Companies?

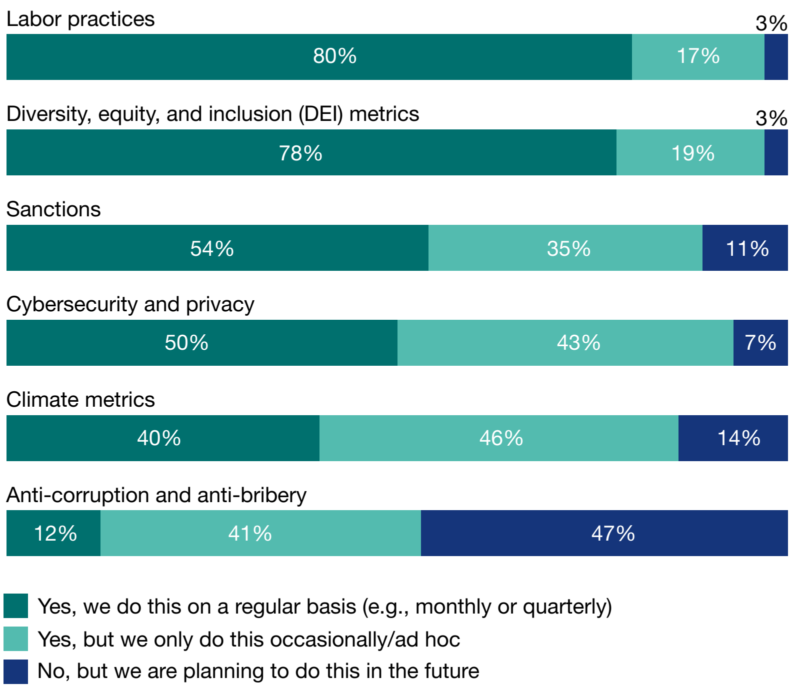
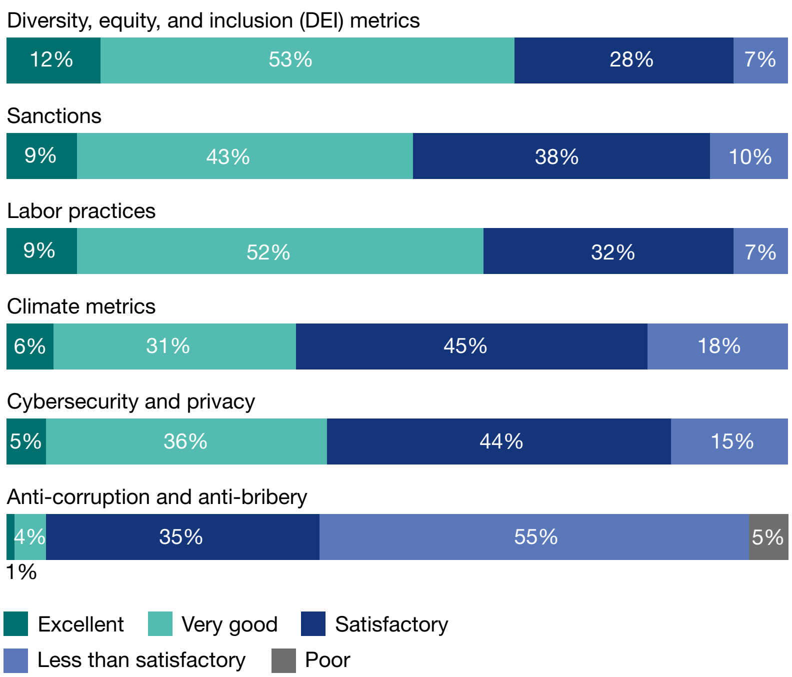


Figure 13. For Each Area that you Report on, How Would you Assess the Quality of the Available Data?



But this work is challenging; in other parts of the world, for example, businesses are grappling with how to get visibility of Scope 3 emissions data, and other aspects of supply chain performance can be even harder to assess. Asia headquartered GPs will struggle with these issues too—simply asking a vendor or supplier to, say, sign a document confirming it is committed to focus on ESG issues will not be enough.

Reporting

On reporting, meanwhile, GPs are most committed to making periodic disclosures on ESG compliance on labor practices (cited by 80% of respondents) and DE&I (78%) in their portfolio companies—though, in both cases, just under 20% say they do so only on an ad hoc basis. By contrast, 47% do no reporting at all on anti-corruption and anti-bribery issues.

One major issue here is the availability of data. The lack of reporting on anti-corruption and anti-bribery is undoubtedly connected to the difficulty of securing reliable information—60% of respondents describe their data in this area as unsatisfactory or even poor.

Moreover, while 82% consider the quality of available data they receive in other areas—including climate metrics—to be at least satisfactory, questions remain. There is little agreement in the region on how to define or standardize key ESG metrics, and no regulatory guidance. To be fair, this sort of consistency has only recently emerged in the United States and Europe, as regulators set out taxonomies and ESG accounting standards. GPs in Asia may be receiving ESG data, but it would be complacent to assume it is of sufficient quality.

Worries around data give rise to another issue. One way for fund managers to drive improved ESG performance in their portfolio would be to push for remuneration policies that tie executive compensation to this requirement. But that requires reliable and objective data on which to measure performance. As a result, only 12% of respondents say they always include covenants that link executive compensation to ESG metrics (though 41% say they do so “sometimes”).

INTERVIEW

“Greenwashing is Going to Climb the Agenda in Asia”

In conversation with Tang Zongzhong, Head of Sustainability at BPEA EQT

Q. Are you concerned that greenwashing is coming under greater scrutiny in Asia?

Tang Zongzhong: We take this issue very seriously. In Asia Pacific, regulators have not yet begun to confront the greenwashing question, but we have LPs from all around the world, including Europe and North America, and they are really focused on this. Also, Baring Private Equity Asia is now part of EQT, which is a listed company and that brings new responsibilities.

Greenwashing is going to climb the agenda in Asia Pacific. Right now, a lot of businesses and investors are at a very low starting point—they’re just working out how to think about ESG, but they haven’t got much further than setting an ambitious target and publishing a glossy report. That’s not going to be enough—we have to think about this as an operational performance issue.

Q. How can businesses operationalise ESG in that sense?

Tang Zongzhong: It starts with having the data, because that’s how you measure the work you’ve been doing and its impact. We’ve just hired a data specialist to focus on ESG data alone, because we felt that if we didn’t have that expertise, we wouldn’t even be able to get to the foundational part of ESG.

Q. Do portfolio businesses have the data you need for ESG?

Tang Zongzhong: It varies. We’ve invested in several listed companies, taking them private, and many of them have done a good job on data and reporting. But, with others, particularly smaller, privately owned companies, we’re starting from scratch. One of the first things we have to do once an investment completes is set up data tracking systems.

Still, it can be difficult. It’s not just a matter of having those systems, you also need expertise. It’s quite a technical job to calculate the company’s carbon emissions. Businesses need help with that.

That’s one way we can add value as an investor, sharing our own experience and ideas that have worked at other businesses in which we have invested.

Q. Are those ideas welcomed?

Tang Zongzhong: We’re getting a warmer welcome than in the past; the trend is going in the right direction. There are some companies that really get ESG—they feel the pressure from their customers, their peers and other stakeholders, and they’re coming to us to ask for help on how to do better.

That said, there is also a group of companies that don’t really believe in ESG. They know they must do it, so they’ll work with us, but they’re not convinced about the business case. We have to work harder with those businesses—to show them the benefits they can look forward to, such as more affordable finance.

5. Exit Stage: Helping a Portfolio Business Deliver on ESG May Lead to an Easier and More Profitable Exit

Many GPs are already seeing evidence of the benefits of ESG in potential investments: 83% believe that a target with positive ESG metrics will be valued more attractively (including 20% who believe the premium is significant). At the sale point, moreover, 91% say the deal process for a business with positive ESG metrics is likely to run more smoothly.

This makes sense. As acquirers of all types incorporate more ESG work into their due diligence, deals involving businesses with a particular issue are likely to be delayed as acquirers assess what remediation will be required and figure the costs of such remediation into the valuation of the target.

On valuation, bidders may be prepared to pay more for businesses they consider less risky—they may even see the value-accretive potential of businesses performing strongly on ESG. That potential might include the ability to build more trusted relationships with customers, for example, or to secure greater resilience through self-sufficiency on energy.

At the other end of the scale, our research also suggests GPs are keen to offload businesses where they are worried about an ESG problem or exposure—83% of respondents say they have pursued at least one divestment or exit in the past 24 months due predominantly to ESG-related issues or concerns.

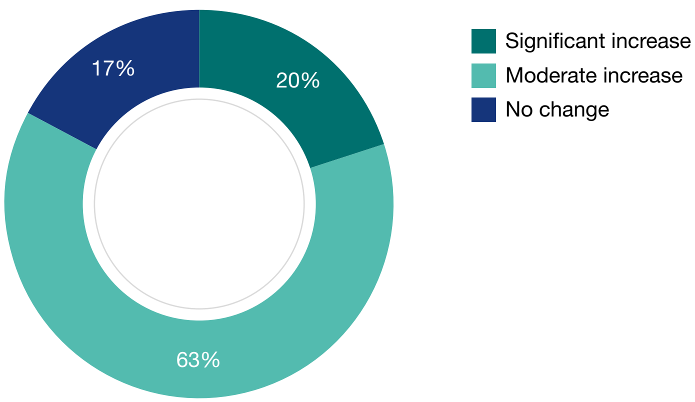
SUMMARY

83% of funds think positive ESG metrics increase valuations

81% think positive ESG metrics smooth the disposal process

While the evidence remains anecdotal, there's no doubt that firms believe ESG can create value in their portfolio and streamline exits.

Figure 14. In your Experience, What is the Effect of Positive ESG Metrics on a Target's Valuation?



"Evidence of a link between an increased focus on ESG and increased valuations would provide funds with motivation to find a route through the ESG maze. There is anecdotal evidence that there is a link, but the industry needs to see more data."

Marcia Ellis, Morrison Foerster

■ This is one of our seven featured pathways. See page 33 for further insights on this.

INTERVIEW

“The Challenge is to Look at ESG not only in Terms of Risk but also as a Driver of Value Creation”

In conversation with Kyung-Ah Park, Managing Director of ESG Investment Management at Temasek

Q. Where does the responsibility for ESG sit within your organisation?

Kyung-Ah Park: Our team, ESG Investment Management, is responsible for driving ESG but ultimately, it’s a responsibility for all of our investment teams, and it’s a remit that is deepening as we expand ESG integration across the investment process.

As we advance our journey, we’ve embedded ESG at the heart of our investment decision-making process. Reflective of this, our team sits within the CIO and Portfolio Strategy Risk Group and partners closely with all our teams across markets and sectors.

Q. What motivated that shift?

Kyung-Ah Park: The challenge is to look at ESG not only in terms of risk but also as a driver of value creation. Because when you integrate ESG strategically across an investment and your portfolio, it gives you the ability to identify key structural tailwinds which you can invest into and also to drive the long-term resiliency and future proofing of your portfolio.

For example, given the climate urgency, we have a target to halve our portfolio emissions by 2030 from a 2010 baseline and to achieve Net Zero by 2050. To do this, we are taking a multi-pronged approach, including investing in climate aligned opportunities and carbon negative solutions, applying an internal carbon price of USD 50 per ton across our investments, and engaging our portfolio companies on climate transition.

For companies, integrating ESG strategically can help strengthen their long-term competitive advantage. For example, if you conserve energy and manage waste efficiently, the benefits will impact the bottom line and improve resilience at a time when energy prices are soaring. If you can think about the pain points of your customers, and the sustainability-oriented products and solutions that you can grow and innovate to help these, that becomes a revenue driver. In an environment where the talent pool is becoming ever more competitive, ESG can be an important differentiator to how you attract, retain, and develop the best people.

Q. How do you pursue those opportunities in practice?

Kyung-Ah Park: There is no one-size-fits-all solution because the investments we make vary in size and by maturity of business as well as across markets. But we do require all investments to undergo ESG due diligence. That looks at material risks, but it also gives us an opportunity to think about post-investment engagement.

In that context, we are starting to apply a value creation playbook more systematically that incorporates ESG. This isn’t a prescriptive template, but rather enables us to think through key strategic levers for engagement as a portfolio company advances its ESG journey. There are also some cross cutting issues and opportunities that are becoming a must-do.

For example, regardless of what type of industry or market you’re in, you’ve got to be thinking about climate risk and opportunities. Similarly, talent management and data cyber security issues cut across sectors.

But you also have to be nuanced, and apply the relevant context tailored to diverse markets, cultures, and practices. On diversity, for example, gender diversity can mean different things in different countries, let alone ethnic or racial diversity. And how do you start interpreting diversity of skills?

Q. Is your focus on driving value creation by delivering tangible results?

Kyung-Ah Park: We're still at an early stage and tangible proof points in the market are also nascent, but it's not rocket science when you look at the direction of travel—whether it be the policy push on ESG and climate or the market pull for sustainable products and services as well as clean technology economics. We're not the only ones thinking this way—you see more and more asset owners and managers targeting 100% ESG integration and portfolio net zero, and these have a material financial implication over time.

Importantly, as an active, generational investor who aims to deliver sustainable returns with future generations in mind, we deploy our capital to catalyze solutions to address the climate urgency and other environmental pain points or social issues. That's not only the right thing to do, but we can do well by doing good so every generation prospers.

"In an environment where the talent pool is becoming ever more competitive, ESG can be an important differentiator to how you attract, retain and develop the best people."

Kyung-Ah Park, Temasek

PART 3

Next Steps for Navigating the ESG Maze

Benchmarking Survey

Where Are You on Your Own ESG Journey?

Every journey through the ESG maze is unique. But how are you doing in navigating the ESG maze? Take our five-minute ESG online quiz to benchmark where you are along your journey. How are you progressing? Where are you facing obstacles?

The survey is anonymous and provides you with a short report to benchmark you against our market data.

7 Pathways to Help you on Your Journey Through the ESG Maze

Here are seven practical ESG pathways that will help you along your ESG journey. There is a short podcast to accompany each pathway.

Supply Chains and a Growing Focus on ESG Due Diligence

Chen Zhu and Stacey Sprenkel, Morrison Foerster

In the United States, EU, and UK, there is a growing expectation for companies and funds to extend ESG due diligence throughout their global supply chains.

In this podcast, we discuss what funds with portfolio companies operating in Asia must do to prepare themselves for further ESG scrutiny in their supply chains and how companies can balance local requirements and restrictions with the requirements being imposed by U.S./EU/UK regulators and LPs.

Fractured Disclosure and Greenwashing Risks

Vivian Yiu and Matthew Dunlap, Morrison Foerster

Our survey findings reveal that many Asia-based fund managers are at an early stage of their ESG journey. Many have policies in place, but these may not be embedded in operations and decision making. This is potentially dangerous as Asia fund managers will increasingly be at risk of accusations of "greenwashing," the same criticism applied to many businesses and investors in Europe and the United States, where regulators are now working hard to tackle such concerns.

In this podcast, we explore the lessons that Asia fund managers should learn from their European and U.S. counterparts to avoid future accusations of greenwashing, and we summarize how regulators across the globe have stepped in with proposals for mandatory ESG reporting. This includes recently issued guidance in Hong Kong for SFC-authorized ESG funds to provide ongoing reporting and mandatory ESG governance disclosures.

ESG Investments and the Growth of GP Accountability to Their LPs

Serena Tan, Morrison Foerster and Haide Lui, Ascendent Capital

There is a growing interest in ESG-driven investments amongst Asia fund managers, with every respondent to our survey stating that they take ESG criteria into account on investment decisions. However, there is a mismatch between ESG words and deeds in Asia, with many fund managers having investment policies in place that do not necessarily translate into action.

This mismatch between ESG words and deeds runs a a clear risk of reputational damage, compliance failure, or value decline if fund managers invest in businesses with a weak or overstated ESG record. The responsibility of GPs to get this right for their LPs is very real, and some LPs are starting to demand more reporting on how fund managers are applying ESG in practice. A number of fund managers have already responded by instigating systematic investor reporting on ESG performance, but our survey shows that these are few and far between; there's some way to go for others to catch up.

In our podcast, that is coming soon, we explore what ESG expectations LPs have of their GPs on ESG, and how GPs are responding to increasing demands from their LPs.

Incentives and ESG performance: Linking Investment Professional Compensation with ESG KPIs

Susan Mac Cormac and Yemi Tépé, Morrison Foerster

As firms increasingly embrace ESG parameters as part of investment considerations, the importance of investment professional alignment with ESG objectives is featuring prominently in ESG conversations. One of the ways to ensure alignment is by linking compensation to ESG KPIs.

Based on our survey findings, only 14% of the funds surveyed tied investment team compensation to ESG performance, and 12% tied executive compensation to ESG performance. Incentives are one of the many ways to signal a firm commitment to ESG alignment across the investment lifecycle, and tying compensation to performance on ESG goals is a proven incentive that has bolstered alignment and performance across investment lifecycles.

In this podcast, that is coming soon, we explore the importance of tying executive compensation to ESG performance, as well as some innovative strategies and models for achieving this. We explore goal setting, ESG focus areas, and the levels of compensation that should be tied to ESG performance.

Converting DE&I Opportunities and Challenges into Action

Shirin Tang, Morrison Foerster

Despite diversity, equity, and inclusion (DE&I) rising up the agenda, as of now, only a minority of GPs seem to be taking genuine action on DE&I concerns. Our survey shows that 88% of funds communicate DE&I policies internally, but only 33% have made a financial commitment to DE&I, with only 50% saying they are committed to diverse representation among their leaders. In some cases, firms in the region are conscious of the increasing regulatory focus on DE&I issues—in areas such as female board representation, for example—and are eager to be seen to be responding. But GPs must be careful they are not simply paying lip service to these ideas.

In this podcast, which will be available soon, we explore the maze of DE&I opportunities and challenges that Asia-headquartered funds are navigating in order to convert policy into action.

PART 3: NEXT STEPS

Can an ESG Focus Increase Valuations?

Marcia Ellis, Morrison Foerster

Historically, a focus on ESG has occurred in response to regulatory or market pressures. However, there are a growing number of cases where a focus on ESG has led to increased portfolio company turnover and higher exit valuations. Current data is limited but more examples are emerging showing how a well-thought-through ESG investment strategy positively impacts the bottom line.

For example, some fund managers are using technology to limit environmental impact, save money, and in turn increase the value of the product or service; there is evidence that improving governance increases the exit value of a company, with fewer issues to contend with during the sale; elsewhere, there is growing evidence that diversity, including on company boards, leads to a better understanding of the customer and orientation of the product, which in turn relates to a higher trading price.

MoFo has been supporting funds in driving increased valuation and in this podcast, which will be available soon, we will explore this area of opportunity with a special guest, who has their own story of success in driving value from ESG.

Climate and Corporate Responsibility: Better Late Than Never!

Susan Mac Cormac and Ruomu Li, Morrison Foerster

Recent extreme weather events have further raised global awareness of climate and environmental issues, concerns that will top the agenda at COP27 and other upcoming climate summits.

However, only 59% of the respondents to our survey consider climate change in their ESG due diligence; this is surprisingly low and well below other ESG due diligence considerations. Additionally, most of the environmental policies described by respondents are relatively basic, with an emphasis on quick wins around reducing energy consumption and increasing recycling. While these initiatives are certainly worthwhile, the lack of focus on environmental factors seems short-sighted, particularly as companies come under more pressure from customers, investors, and other stakeholders to prioritize climate change and negative externalities.

In this podcast, we discuss how funds in Asia can better incorporate environmental and climate considerations into every stage of their fund management and investment lifecycle.

What's Next? Upcoming ESG Considerations

The ESG world is constantly evolving and there are significant regional differences. Here is a selection of the maze of ESG criteria that Asia-headquartered fund managers are likely to have to navigate over the next 12 months.

ESG Focus

- ESG matters continue to focus on both compliance, e.g., anti-bribery, sanctions, and privacy, and on newer areas where there is no current regulation.
- ESG requirements are being driven by LPs, consumers, and employees, e.g., climate change, human rights, and diversity.

Third-Party Verification

- LPs may push Asia-headquartered GPs to obtain third-party verification of their ESG claims about themselves and their portfolio companies.

Earlier Adoption of ESG Policies

- ESG policies will need to be integrated into operations in most growth-stage portfolio companies.
- We will likely also see more early-stage portfolio companies adopting ESG principles.

Disclosure Requirements

- In the United States, the Securities and Exchange Commission's climate and cybersecurity disclosure rules will drive changes regarding the monitoring of climate emissions, climate risk, and cybersecurity threats in supply chains and at counterparties.
- The SEC has also announced pending human rights disclosure requirements.
- These requirements will not only impact portfolio companies that plan to list in the United States, but also any portfolio companies that sign contracts with U.S. publicly listed companies, as they will be in the publicly listed companies' supply chains.
- Stock exchanges in Asia have also issued ESG-related reporting requirements, but thus far there has been little focus on enforcement.

Backlash in the United States and Single Materiality

- There is increasing backlash against ESG requirements in the United States, with legislation currently pending in 18 states to penalize asset managers who include ESG provisions in their investment mandates.
- Asia-headquartered GPs will need to tread carefully in dealing with U.S.-based LPs in connection with ESG provisions.
- The best way to address ESG issues in connection with LPs is to focus on "single materiality" – ESG requirements that focus solely on shareholder value.

Double Materiality in the EU

- It will become impossible for Asia-headquartered GPs to secure funding from European LPs, or to invest in European companies, without focusing on "double materiality" – ESG provisions that focus not only on shareholder value but also on all stakeholders impacted by the company and its operations.
- Asia-headquartered GPs will need to walk a tightrope if they aim to secure funding from both U.S. and EU LPs.

Ethical Technology

- We expect new ESG areas of focus to arise for investors and their portfolio companies, specifically in ethical technology.

Meet the Team

How MoFo can help you

The MoFo team can help you with all aspects of your ESG journey, including advice, training, and insights.
Email esg@mofo.com with any of your ESG questions.

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Visit MoFo PE Briefing Room
to explore the hottest topics in the PE space:

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About

Morrison Foerster is an international law firm with 18 offices around the world. We have an exceptionally strong Asia platform and an expansive reach of 200+ attorneys in five offices in key Asian business centers including Tokyo, Beijing, Shanghai, Hong Kong, and Singapore. Our award-winning Asia Private Equity team consists of 50+ PE/M&A specialists who have worked on 160+ PE/M&A deals in Asia with a total asset value of USD 310+ billion in the past five years. Visit our PE Briefing Room to explore the hottest topics in the PE space.

As a firm we have 20+ years of experience in advising clients on ESG, impact and sustainability. Learn more about our ESG capabilities by visiting our ESG hub.

AVCJ has been the leading source of information on private equity and venture capital activities in Asia since its establishment in 1987. Today, AVCJ's suite of information products has evolved from the Asian Venture Capital Journal to include AVCJ.com (Asian private equity portal), the AVCJ Weekly Digest, a daily e-newsletter, Chinese AVCJ, rich media, and industry-leading database and research services.

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