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From short-term profits to long-term value: Incorporating ESG in private equity

A qualitative analysis of ESG implementation into the investment process of Nordic private equity firms

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Från kortsiktiga vinster till långsiktigt värde: Införandet av ESG i private equity

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Sammanfattning

Konceptet Enviromental, Social and Governance (ESG) har blivit en fråga av växande betydelse och relevans, med hållbarhets-relaterade investeringar som skjutit i höjden under det senaste decenniet. I Sverige utgör private equity en stor del av kapitalmarknaderna. Detta gör private equity till en spännande fallstudie av utvecklingen av ESG i investeringsprocesser. Detta examensarbete analyserar hur olika nordiska private equity-bolag arbetar med ESG inom investeringsprocessen. De grundläggande orsakerna till ESG:s uppgång och den snabba utvecklingen inom den här typen av investeringar hittades via en kvalitativ studie baserad på semistrukturerade intervjuer med åtta private equity-bolag och sju med traditionella- och investeringsbanker. Enligt resultaten drivs det nuvarande incitamentet av mer betydande kunskap om ESG-relaterade risker och möjligheter, vilket förändrar personliga övertygelser och lagstiftande förväntningar. Med tanke på sektorns möjlighet att påverka förändringar inom sina företag via styrning-, operationella-, finansiella- och ESG-metoder, fann de intervjuade en gemensam syn till sitt förtroende att ESG kommer ha ett betydande långsiktigt inflytande på private equity-industrin. Även om private equity-branschen är medveten om hållbarhet, har intressenterna ännu inte kommit överens om definitioner och de mest effektiva sätten att införliva det i investeringsverksamheten. ESG utvärderas praktiskt taget helt för typiska private equity-företag under förinvesteringsprocessen, ofta känd som screeningsfasen. Även om specialiserade hållbarhets- och påverkanspartners är integrerade i investerings-processen, kan deras konkurrenter lära av dem, eftersom de har lyckats med det. Skillnaden mellan intressenter illustrerar att hållbarhet inom private equity fortfarande är ett pågående arbete, driven av de olika intressenternas specifika intressen och ambitioner.

Nyckelord

ESG, Private equity, Impact investing, Regleringar, Investeringsprocess, Hållbara investeringar.

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Abstract

The concept Enviromental, Social and Governance (ESG) has become an issue of growing importance and relevance, with sustainability-related investments soaring in the recent decade. In Sweden, private equity represents a large portion of the capital markets. As a result, private equity is an intriguing case study in developing ESG investments. This thesis analyzes how different Nordic private equity companies work with ESG within the investing process. The fundamental causes of ESG's ascent and the momentum of the investing theme were found via a qualitative study based on semi-structured interviews with eight private equity associates and seven with traditional- and investment banks. According to the findings, the current incentive is driven by more significant knowledge of ESG-related risks and possibilities, altering personal beliefs and legislative expectations. Given the sector's possibility to influence change inside their investment firms via governance-, operational-, financial-, and ESG-methods, the respondents found a point of agreement in their confidence that ESG would have a substantial long-term influence on the private equity industry. Even though the private equity industry is aware of sustainability, stakeholders have yet to agree on definitions and the most effective ways to incorporate it into investment operations. ESG is virtually entirely evaluated for typical private equity firms during the pre-investment process, often known as the screening phase. While specialized sustainability and impact partners are integrated across the investment process, their peers may learn from them since they have successfully done so. The disparity among stakeholders illustrates that private equity sustainability is still a work in progress, driven by the varied stakeholders' specific interests and aspirations.

Key-words

ESG, Private equity, Impact investing, Regulations, Investment process, Socially Responsible Investments.

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List of acronyms and abbreviations

CAPEX Capital Expenditures

CEO Chief Executive Officer

CSR Corporate Social Responsibility

DCF Discounted Cash Flow

DD Due Diligence

EBITDA Earnings Before Interest and Tax, Depreciation and Amortization

ERM Environmental Resources Management

ESG Enviromental, Social and Governance

GDP Gross Domestic Product

GP General Partner

GRI Global Reporting Initiative

KPI Key Performance Indicator

LBO Leveraged Buyout

LP Limited Partner

NFRD Non-Financial Reporting Directive

PE Private Equity

SDG Sustainable Development Goal

UN PRI United Nations Principles for Responsible Investment

UNEP FI United Nations Environment Programme Finance Initiative

US SIF Forum for Sustainable and Responsible Investments

VC Venture Capital

YoY Year-over-Year

Chapter 1

Introduction

This section seeks to provide overview of how Enviromental, Social and Governance (ESG) topics have grown and begun to play a more prominent role in the financial analyses of today's financial market participants. After, the problem formulation regarding ESG integration in the Investment process is presented, followed by the research purpose, questions and delimitations, and the thesis structure.

1.1 Background

Climate change poses a severe threat to the world, and this is a long-standing worldwide issue in which humans continue to have a harmful influence on the environment. Two worldwide multi-stakeholder initiatives, the 2030 Agenda for Sustainable Development and the Paris Agreement, are helping to address this global sustainability challenge. They are two significant global incentives for people to care about environmental, social, and governance concerns (ESG issues). The 2030 Agenda for Sustainable Development establishes seventeen global goals that address all of these elements of sustain-ability (SDGS UN 2015), whereas the Paris Agreement concentrates on the environmental aspect. To have a reasonable possibility of succeeding, the agreements have to be significantly enhanced or over-delivered by additional national, sub-national, and non-state efforts (Rogelj et al. 2016).

The Paris Agreement sets out just how all parties must work together to decrease the effects of climate change, with the primary objective of keeping global warming well below 2 degrees Celsius per year, preferably 1.5 degrees Celsius, relative to pre-industrial levels. (ibid.) Recognizing that achieving this goal will considerably decrease global warming's impacts. Adequate, sustainable finance measures are

important components that must be undertaken to achieve this aim. Capital must be allocated to initiatives in line with the Paris Agreement. It is essential to minimize the hazards of global warming, where stakeholders will be forced to make large-scale investments to cut greenhouse gas emissions considerably (Kunreuther and Michel-Kerjan 2007). On the other hand, the current economic trajectory is not in line with the environmental objectives of the EU or the Paris Agreement. Few industries run at net-zero emissions or cut emissions at the required rate (Bataille 2020).

Auditors have been issuing so-called sustainability ratings or ESG ratings for some time now, at the request of authorities and organizations, to provide deeper insight into companies' sustainability work (Escrig-Olmedo et al. 2019). These have been carried out following the standards established by prominent institutes. Now, enterprises with more than 250 employees or reported assets of more than 170 million SEK publish sustainability reports to demonstrate how the company addresses sustainability challenges (Herzig and Schaltegger 2006). Sustainability reports have proved valuable in offering further insights into organizational sustainability. (Berg, Koelbel, and Rigobon 2019), Research is being conducted to promote transparency and comparability between enterprises (Tamimi and Sebastianelli 2017).

The EU taxonomy (Published June 20th, 2020) is one of the EU's most recent and broadest legislative initiatives, aiming to quantify a company's actions further and demonstrate how they comply with the Paris Agreement. The EU taxonomy is set to go into effect on January 1st of this year, which means that all companies that satisfy the size threshold will have to demonstrate how their operations, for example, are under the Paris Agreement's 1.5-degree aim (Taxonomy 2021). Therefore, this new area of ESG is an upcoming and exciting area for quantifying and increasing transparency. A debate on quantifying sustainable investments and genuinely seeing their impact is a natural next step in this matter, as is understanding how sustainability affects the financials analysis. This area has yet to be fully explained.

Traditional financial analysis and investment processes have not included environmental, social, and governance (ESG) considerations (Hayat and Orsagh 2015). ESG-related concerns have been seen as externalities, and as a result, market prices have not reflected ESG (Young 2013). Integrating ESG into investing practices, on the other hand, is becoming more widespread (Boffo and Patalano 2020). ESG integration has progressed from its roots in concentrating on avoiding unsustainable or immoral investments. Because ESG concerns may impact the risk and return of investments and their financial performance, ESG issues should be examined for

a more full and informed investment analysis (Hayat and Orsagh 2015). Research in ESG shows that companies should thoroughly comprehend the impact of ESG on the value of their business to invest successfully for the future (Giese, Lee, et al. 2019). Decision-makers could speed change and prioritize investments with the certainty that they are both leading in their market and producing long-term value when they are armed with quantitative data (M. Porter, Serafeim, and M. Kramer 2019). In the media and the financial market, ESG considerations and their integration into company processes are gaining popularity. Investors from developed countries and emerging and frontier markets are increasingly interested in companies' environmental, social, and governance performance. Investors are increasingly demanding that corporations include ESG data in their regular reports, alongside financial performance data (Landau et al. 2020). M. M. Miralles-Quirós, J. L. Miralles-Quirós, and Valente Gonçalves (2018) find that the market typically perceives ESG performance favorably, even in developing countries like Brazil.

National financial authorities have started evaluating and implementing sustainable finance standards such as ESG taxonomies, as ESG practices become more common in investments. The regulations aim to increase the transparency and consistency of ESG processes and direct more resources to long-term investments. The EU's sustainable finance taxonomy is one such example. Global Reporting Initiative, Carbon Disclosure Project, Sustainable Accounting Standards Board, UN Global Compact, UN Principles for Responsible Investment, and the Task Force for Climate-related Financial Disclosures, to name a few, are among the many ESG-related initiatives created to address ESG in investment practice and among corporations (Campbell, Fisher, and Stuart 2012) (Boffo and Patalano 2020). (O'Dwyer and Unerman 2020).

ESG-conscious businesses are assumed to be more concerned about their influence on the environment and the well-being of their workers and other stakeholders. Companies that meet high ESG performance requirements are well-respected in the community and generally well-managed. Various ESG certifications and investment products have been developed in response to investor interest in ESG aspects. One of the most well-known organizations that strives to encourage the inclusion of environmental, social, and governance considerations into the investment process is the United Nations Principles for Responsible Investment (UN PRI). More than 2,000 financial institutions have signed the PRIs and pledged to follow its main principles in their daily operations. According to data from the Forum for Sustainable and Responsible Investments (US SIF), worldwide investors held 11.6

trillion dollars in ESG assets in 2018, up 43 percent from only two years previous. Worth noticing that the Nordics have been at the forefront of environmental, social, and governance ESG innovation.

One of the most crucial components of the Investment process has always been a firm's valuation, and in determining a company's value, numerous aspects must be considered. Some of the relevant information utilized in the fundamental analysis includes financial performance, such as profits and book value of a firm. Other non-financial information, such as a company's environmental, social, and governance performance, is thought to play a role in determining its market value. (Barth and McNichols 1994), (Bebchuk and Cohen 2005). Particularly as interest in corporate social responsibility and ESG investing has grown in recent years (Pinney, Lawrence, and Lau 2019). Traditional valuation methodologies are commonly seen as viable. However, they must be used rigorously to reflect how a firm is seen by its workers, regulators, consumers, and investors, as well as the possible implications for cash-flows (Henisz, Koller, and Nuttall 2019).

Company valuation may be used for various purposes, including determining a firm's fair worth, establishing partner ownership, taxes, and even divorce proceedings. Determining the economic value of an entire firm or corporate unit is known as business valuation. Business value, among other things, is a critical component for corporations in charge of acquiring alternative assets and merging with other companies. Business owners typically turn to professional business assessors for an unbiased assessment of their company's value (Fernández et al. 2002). Although investors, regulators, and framework developers are becoming more concerned and concentrating their efforts on including environmental, social, and governance factors in an investment, practical implementation challenges persist (Hayat and Orsagh 2015), and ESG efforts differ between investors. Because investment managers tend to disregard information that is difficult to combine into financial statistics, ESG may be difficult to quantify financially, complicating the incorporation of ESG into investing practice (Arjaliès and Bansal 2018). Financial numbers are the financial services industry's principal calculation devices. Evaluating the market worth of a company's assets determines its usefulness to investors. (Sciarelli et al. 2021), (Hayat and Orsagh 2015), and (Arjaliès and Bansal 2018), this poses a challenge to ESG integration. Overall, there is a practical barrier to incorporating ESG into investing practices and a conceptual challenge in integrating ESG into what defines investment practice.

Historically, the private equity industry lags behind other financial market

participants regarding sustainability and ESG reporting (Buckby 2020). Still, attitudes change as more investors see the advantages of mixing ESG with investing. According to Bain (2022), during the previous five years, 80 percent of global private equity investors have expanded their attention to sustainability (Yang 2019). Furthermore, according to an Environmental Resources Management (ERM) study, 93 percent of the general practitioners believe that focusing on ESG issues would result in excellent investment prospects (James 2020). Whereas most Nordic General Partner (GP) currently have an environmental policy, the number of GPs with such an ESG-focused investment plan has grown.

1.2 Problem

For businesses and investors, the ability to quantify the actual and potential risks, losses, benefits, and rewards associated with ESG decisions have remained elusive. There has not been a way for the Chief Executive Officer (CEO) and boards of directors to link ESG to business valuation. How can significant investments and fundamental changes to corporate structures and culture be justified if there is no empirical evidence that they will directly impact shareholder value, total shareholder return, net present value, or individual rates of return? ESG issues are important and valuable, but they can become even more valuable when they can be quantified and valued using traditional and customary methods.

According to the initial, sustainable investments in the more prominent private equity business are still in their infancy. The critical reasons for this are (i) a shortage of quantitative data proving a relationship between ESG and long-term returns and (ii) the absence of a complete and consistent reporting system for analyzing long-term performance or impact (Bain 2022). One may argue that the EU and other interested parties know that these two obstacles prevent the private equity sector from adopting a holistic approach to sustainability. According to a financial consulting firm, PwC (Jain et al. 2021), the EU Taxonomy might be a first step in resolving the investment industry's lack of transparency and uniformity. Ethos International's Malin Lindfors Speace emphasized that the Taxonomy is not yet complete and cannot be regarded as a comprehensive framework for assessing sustainability. According to PwC (2021), the regulatory drive for conformance with the EU Taxonomy may act as a trigger. Therefore, demand for financial assistance programs has increased significantly in Sweden. Numerous papers and industry related studies discuss the need to invest ecologically and climatically appropriately.

When it comes to quantifying the influence of sustainability on firm value, academics have failed to establish common ground. As a result, institutional investors and other relevant parties are left in the dark when analyzing and evaluating private equity companies' long-term goals and performance, particularly before allocating cash or putting investment mandates. Given the industry's diversity of ESG approaches, there is a need for clarity in the methodology utilized by sustainability-focused businesses. This area was used to develop the study subject for the current thesis.

This thesis, given the above, investigates how investment professionals interpret and use ESG in their everyday jobs. This area is noteworthy since environmental, social, and governance have permanently been excluded from the investing area. As a result, it is worth digging deeper into these concepts in Swedish private equity firms. On the other hand, the research faces difficulties valuing things that are not clearly defined and measured and on which there is no general agreement. Building on this is also challenging because ESG does not have a single creator or definition. Fixed definitions are challenging to find, and the numerous websites, scorecards, speeches, podcasts, and white papers that mention ESG in various ways do not help. However, there are, as previously mentioned, several frameworks that can be used right now. The thesis is motivated by the subject's relevance, heterogeneity in the industry, and the fact that there have been a limited amount of articles explaining how private equity firms consider these aspects and no academic publications regarding the implications for their ESG investing practices in the Nordics. An extensive literature review, as well as interviews, will be conducted to analyze this topic. The following research questions can be addressed:

- How do private equity firms integrate ESG into the investment process?
- What can private equity firms learn from other financial institutions about integrating ESG into the investment process?

1.3 Purpose

The purpose of this master thesis is to investigate if there is a growing trend of including ESG as an investing criterion within the private equity sector. If this momentum is found in the industry, then the goal is to understand how ESG is understood and used by investment practitioners on a qualitative level. General partners, financial advisers, and other critical stakeholders' perspectives

have been incorporated for a comprehensive approach. Additionally, perspectives from other significant stake-holders in linked financial institutions will also be included, specifically traditional banks and investment banks. By presenting a comprehensive study of the causes, possibilities, and constraints, this thesis adds to the current but limited literature on the issue. Furthermore, the thesis is well-positioned to disseminate information on how Swedish private equity firms integrate ESG in investing to generate growth, exit values, and returns.

1.4 Delimitations

This master's thesis focuses only on Nordic investors and financial market players. The master thesis concentrates only on the investors' viewpoint and how ESG and investment processes influence them. Consequently, the investor viewpoint focuses on private equity, banks, asset managers, and other investors.

The thesis' scope is confined to the goals mentioned above. Hence it will not explore whether a private equity firm's sustainability strategy is a sound investment approach. However, one of the primary goals of this thesis is to increase awareness and encourage a more comprehensive conversation about sustainability in the financial sector and private equity. Another limitation stems from the private equity industry's lack of publicly accessible data. All data behind the thesis's study cannot be revealed due to confidentiality concerns. Sensitive data has been anonymized to allow the reader to better understand and share to the degree feasible.

1.5 Structure of the thesis

There are seven sections to the thesis. The first, and current section, includes a background to the problem and the problem. Section two and three examines previous literature on relevant and related topics, such as an introduction to private equity, the Nordic private equity sector, and the concept of ESG, and examines investing practices and ESG inclusion, firstly a more general background and after that more in-depth around ESG in private equity. The methodology on which this thesis is built is explained and explored in the fourth part. The findings of interviews with various players in the Nordic private equity market and adjacent financial institutions are presented in section five, followed by a discussion of the research questions in section six. Finally, the last part, part seven, offers some closing observations, limitations, and suggestions for further studies.

Chapter 2

Theory and literature

This section contains the general background and theory. A review of previous literature on ESG, investment practices, and private equity will be included insection 2.1,2.2 and 2.3.

2.1 General background and theory

2.2 Background on ESG

Environmental, Social, and Governance (ESG) is a system for assessing a company's sustainability that investors may use as a guideline when making investment decisions. ESG results from a rise in sustainability consciousness and demand for sustainability reports. The rating attempts to assess environ-mental management, social concerns, and corporate governance are the three topics that ESG encompasses (Young 2013). Carbon emissions, climate change, nonrenewable resources reliance, civil rights, poverty, health, biodiversity, fraud, and bribery are a few examples of environmental, social, and governance challenges (ibid.).

As a result of these changes in corporate reporting methods, an increasing number of standard-setters, certifiers, and assurance providers voluntarily have emerged. The Global Reporting Initiative (GRI)(Initiative 2012), on the other hand, has emerged as the de-facto standard for measuring and publishing corporate environmental and social data (Young 2013). In 2020, GRI was used by 80 percent of the 5200 firms that comprised the world's 100 largest corporations in 52 countries (KPMG 2020).

Academic interest in management, corporate social responsibility, and business ethics literature has increased due to the ESG phenomena. (Cederberg 2019). The

ESG accounting literature has generally concentrated on the preparers of ESG data rather than the consumers of ESG data (Young 2013), including problems such as the discrepancy between reported and natural business behavior (Adams 2002).

Integration of ESG into investing practice has grown more popular in recent years. Companies are increasingly disclosing their ESG data and performance as part of their standalone sustainability report, annual reports, or, most recently, integrated reports. Consequently, ESG disclosure has become a key source of information due to integrating ESG concerns into investing practices.

Whether corporate governance regulations improve corporate performance is a widely discussed topic. Externalities, or costs associated with ESG concerns, have typically not been included in the investment process and, as a result, have not been reflected in market pricing. These may be thoroughly evaluated via ESG integration in the investing process (PRI 2011). Stapledon (1996) demonstrated in 1995, corporate governance laws increased business performance, which has led to a shift in the financial sector because people want long-term financial value and investments that match their values (Giese, Nagy, and Lee 2021). ESG factors have become more critical in investing due to this shift.

2.3 Overview of investment practices

Determining the economic value of an entire firm or corporate unit is known as business valuation. For many reasons, including selling value, establishing partner ownership, taxation, and even divorce procedures, company valuation can be used to evaluate the fair worth of a firm (Hayes 2019). Professional business evaluators are frequently consulted by business owners seeking an impartial appraisal of their company's worth (Fernández et al. 2002).

Many studies have looked at the processes and information utilized in the investment process as part of the investing practice stream of study. Because fund managers are the principal financial market decision-makers who play a vital role in allocating economic resources, most investment-process studies focus on them. Abhayawansa, Aleksanyan, and Bahtsevanoglou (2015), Winroth, Blomberg, and Kjellberg (2010), Demirakos, Strong, and Walker (2004) are examples of research that concentrate on the financial analysts.

Valuation is an important aspect of the work done in the financial world. Compared to comparable assets, valuation is described as "the evaluation of an asset's worth based on criteria considered to be relevant to future investment returns"

(Stowe et al. 2007). Investors need valuation abilities to confidently determine their investments' risks and rewards (Damodaran 2012). The current portfolio theory (Markowitz 1968), the capital asset pricing model (Lintner 1965), (Mossin 1966), (Sharpe 1964), and the three-factor model are only a few examples of important risk and return theories that have influenced investing practice and, more particularly, valuation (Fama and French 1993).

A few approaches to analyzing a corporation include the discounted cash flow model, discounted economic profit model, adjusted present value model, capital cash flow model, and equity cash flow model. (Damodaran 2012). However, since valuations depend on cash flows rather than accounting-based results, the Discounted Cash Flow (DCF) model is widely employed by investment professionals (ibid.). The DCF model uses the weighted average cost of capital to arrive at an enterprise value by discounting future free cash flows accessible to all investors.

Revenue growth, profitability, and invested capital forecasting are essential to predicting free cash flow (ibid). The capital asset pricing model is helpful to investors because it can be used to compute the necessary return (Stowe et al. 2007). This return is required as an input for discounting future cash flows using the weighted average cost of capital to assess the current value of an investment (ibid.). The equity value may then be determined by subtracting debt and any non-equity claims on cash flows. The simple valuation approach of multiple valuations is often employed as a supplement to DCF valuation (Demirakos, Strong, and Walker 2004). Multiple valuations may be employed to assess the correctness of the DCF value. This approach may be used to see whether a company's performance is projected to vary from that of its peers (Damodaran 2012). According to multiple valuations, comparable assets should sell at similar prices (ibid.). Price to earnings is a common multiple, although additional examples include enterprise value to Earnings Before Interest and Tax, Depreciation and Amortization (EBITDA), EBITA, or EBIT (ibid.).

Several studies, however, have shown that investment decisions are not solely based on the outputs of calculation and valuation models but also on a variety of other factors that influence investing behavior. Obtaining relevant data is essential for an investor's task while doing valuation and economic research. According to (Abhayawansa, Aleksanyan, and Bahtsevanoglou 2015), fund managers' essential source of information is information obtained through private discussions with corporate leaders. Additionally, investment managers desire confidential data received via direct interaction with invested businesses because it provides a competitive

edge (ibid.) or helps them cope with the uncertainty created by limited public information (Mennicken and Power 2015). Laws, organizational environment, portfolio, perceived investment possibilities, and market premises allude to market limits and opportunities connected to share price, trading volume, and following other investors' conduct, which may influence investors' fundamental opinions about companies. Furthermore, investors' fundamental beliefs may be altered for qualitative elements based on quantitative data (Coleman 2015).

Furthermore, social pressures and obligations on fund managers may motivate managers to make an excellent first impression (ibid.) or induce them to behave based on tales that undervalue risks and overvalue possibilities (Taffler and Tuckett 2010). Finally, investors' decision-making and investing habits might be influenced by their emotions (Forstmann and Burgmer 2018).

Other research has highlighted the limits of quantitative assessment techniques in investment processes, particularly given the uncertainty that investors face and the relevance of biases and judgment. Heuristics and cognitive biases, in general, are fundamental notions in behavioral finance, as developed by Kahneman and Tversky (2013). Coleman (2015) discovered that institutional investors rely heavily on heuristics and that qualitative data and analysis are favored above quantitative data and analyses. Furthermore, finance theory may be of little practical use to fund managers because the quantitative theory of finance demands data about the future that is not accessible. It overlooks qualitative information and fund managers' talents and aims. In the early 2000s, investment analysts saw the discounted cash flow model as essential, but the technical usefulness was restricted, according to Demirakos, Strong, and Walker (2004). Consequently, analysts relied on multiples to determine if the market price was reasonable.

The findings suggest that investing is more complicated than applying valuation methods mechanically. As valuable data collection is integral to the job, various organizational and social factors can influence valuation. Judgment is utilized to assist investors in their research. Moreover, several studies examine individual investment practitioners' work and use terms like financial templates, sensemaking, and calculative frameworks to concentrate on their understandings and interpretations.

Financial templates are memory structures shaped by the analyst's knowledge and used to "set the scene" for the study. The financial templates may shape the analysis based on their information, such as notions of normal corporate behavior, industry-specific standards, frequent difficulties for a given firm and industry, and, finally, ready-made judgments of whether the investment is appealing. When

financial analysts evaluated firms, Bouwman, P. A. Frishkoff, and P. Frishkoff (1987) discovered that they employed financial frameworks.

To conclude, valuation is a necessary component of investment management. Investment analysis and decision-making may be influenced by gathering usable data, organizational and societal circumstances, investment practitioners' judgment and biases, and individual understandings.

2.4 Background on private equity

The financial sector relies heavily on Private Equity (PE), which comprises both Venture Capital (VC) and Leveraged Buyout (LBO) (Demaria 2013). According to (J. W. Wilson 1985), the VC businesses as we know them began in the 1940s with the founding of two American VC firms, American Research and Development Corporation and J.H. Whitney and Company. The PE business flourished in the 1980s and 1990s, partly due to success stories like Microsoft and Facebook, reinforcing the impression that VC was the future funding solution. LBOs are derived from the corporate bond market, sometimes as "junk bonds", which first appeared in the 1970s and 1980s. Banks' criteria for borrowers were substantially lower back then than now, making it simpler to get loans. As more individuals understood that junk bonds might be used to fund firm acquisitions, interest in them grew. Consequently, the LBO market went off like a rocket (Demaria 2013).

According to Kaplan and Schoar (2005), VC and LBO investments in PE in the United States surged from 10 billion USD in 1991 to 180 billion in 2000 USD, partly due to the IT boom. This boom was since, among other things, family-owned businesses were dismantled, making the previously available options for management to operate the business for self-profit more difficult. Increased PE has been linked to more transparency and better knowledge of the financial system, according to Toms, N. Wilson, and Wright (2015).

Limited Partner (LP) is the most common form of private equity (Kaplan and Stromberg 2009). They raise private cash from one or more private equity firms. The funds are so-called closed-end funds, in which investors agree to give cash and management fees to the private equity firms. In addition, institutional investors in the funds include pension funds, donation funds, insurance firms, and affluent people (ibid.). The PE funds are only active for a limited time, while the PE firm continues to operate long after the funds have been closed. The fund's lifespan is typically ten years. However, it may be extended for up to three years, depending on when the final

portfolio firm is sold. This lifespan is attributable to various variables, including market conditions (ibid.). The PE business makes decisions about the portfolio company because the funds mainly serve as a source of finance for the investment (ibid.). The investment phase, in which the fund's equity is invested in portfolio firms, may take five years. Then, after around five years of ownership, they want to generate a profit for investors. Although investors have limited input in how private equity firms operate and grow their portfolios, certain fundamental constraints are on deployed capital. In turn, private equity firms are rewarded primarily in three ways. The first is collecting an annual management fee based on earned capital and a portion of the money utilized when the investment is realized. The second method is to get a share of the fund's return, known as carried interest or carry, typically about 20 percent. The third method is to receive various agreed-upon fees from portfolio businesses (ibid.).

Kaplan and Strömberg (2009) further explain how a loan-financed purchase (LBO) attempts to invest in firms with significant growth potential. An LBO's equity financing is provided by investors who contribute funds to private equity firms. The PE firm accounts for a minor portion of the funding, while investors contribute most of the funds (Crifo and Forget 2013). As a result, the PE firm can execute the deal without taking too much risk with its capital. Furthermore, according to Kaplan and Stromberg (2009), the PE firm purchases most of the business in a typical LBO deal. When the purchased firm is publicly traded, a premium is paid on top of the current share price, typically between 15 and 50 percent (ibid.). Before the financial crisis in 2008, the buyout procedure was traditionally funded with 60–90 percent loans but has now shifted to 50 percent (Ivashina and Kovner 2011). The balance is covered by equity, the money raised from investors in this instance.

Different forms of loans are used to finance the capital, depending on the loan financing amount in the investment. Traditional bank loans, corporate bonds, and mezzanine loans are examples, according to Kaplan and Schoar (2005), where lenders take varied risks depending on the security of the loans (ibid.). They also said that PE firms make three distinct modifications to add value to their portfolio company. These are categorized as financial, governance, and operational changes. In an LBO, when the quantity of loans in the firm grows dramatically, the financial change relates to how the company's capital structure changes. The term "change in governance" refers to how a private equity firm alters how the business is run to maximize value. The operational transformation focuses on how private equity firms may add industry experience when they take over a portfolio business. They

often have a vast network of connections to tap into for economies of scale and possible investments (ibid.). According to Pearl and Rosenbaum (2013), typical LBO prospects include businesses with consistent and robust cash flows and a robust asset base owing to the massive loan funding required for the purchase. They also recommended the following qualities: strong cash flows, a solid and defendable market position, growth potential, efficiency opportunities, Low Capital Expenditures (CAPEX), Strong asset foundation, management that is capable, and complete due diligence is carried out prior to a prospective LBO, which can be seen of as an examination of the firm where investment options are considered. Within the firm, both dangers and strengths are investigated. The criteria, as mentioned earlier, are, therefore, something that is considered at an earlier level in the investment process since this usually is one of the final phases in the investment process (ibid.).

Chapter 3

Theoretical framework: ESG in Private Equity

This section delves into environmental, social, and governance (ESG) concepts in private equity. Sections 3.1, 3.2, 3.3, 3.4, and 3.5 showcase profitability and sustainability, including ESG in the investment process, sustainability in private equity investing, the relationship between ESG and private equity, and lastly, ESG investment strategies in private equity.

3.1 Profitability and sustainability

According to Löhman and Steinholtz (2003), many people believe a corporation cannot take responsibility while still making money; however Löhman and Steinholtz (ibid.) argues that this is a false dilemma. They say that solid connections with workers and stakeholders are critical to success and that prosperous businesses cannot afford to disregard their external connections. Many studies have been conducted on the link between profitability and long-term viability, with the metrics of return on equity and total capital utilized. When the findings were collated, however, they were equivocal. The majority of the papers had good outcomes, while the majority of the articles had neutral outcomes and a few had adverse outcomes (Borglund, De Geer, and Hallvarsson 2009). Is it lucrative for businesses to operate in the field of sustainability? Friedman (1970), believing that it led to agent issues, in which the corporation strayed from its primary goal of profit maximization. This corporate image, according to Grankvist (2009), is relatively antiquated. He argues that, although today's entrepreneurs feel that organizations should participate in their main business, they believe it should be done long-term. Sustainability is becoming

an increasingly integrated aspect of the business model as market openness improves and firms' social activities are more directly tied to their performance.

In their research, Nollet, Filis, and Mitrokostas (2016) discovered a U-shaped association between Corporate Social Responsibility (CSR), or ESG with today's definition, and profitability. According to the report, CSR might be costly at first and only rewarding when a specific level of investment has been done. As relationships with stakeholders strengthen, CSR becomes more lucrative, eliminating expenses (ibid.). According to Barnett and Salomon (2012), stakeholders have a significant effect on profitability generated by CSR, both from connection with the firm and their impression of it. Stakeholders will have an easier time understanding the firm's choice to work on sustainability concerns, for example, if they have faith in the organization. They also discovered that firms that included CSR in their corporate governance had the most beneficial results since it conveyed strong signals to stakeholders about the company's long-term commitment. Furthermore, the firms that had the most significant connection with their stakeholders from the start were the ones that gained the most money from CSR efforts since sustainability work could be utilized to create long-term partnerships. Similarly, they discovered that firms with a worse relationship with their stakeholders earned less on CSR since their sustainability activities did not look genuine (ibid.). Ameer and Othman (2012) stated that sustainability efforts got more lucrative with time in the firms examined.

As stated by Borglund, De Geer, and Hallvarsson (2009), many organizations may be scared of dealing with CSR activities because they see it as a significant expenditure. This mindset is especially proper for small businesses with limited financials. On the other hand, they argued that this method might be risky since the risk is that CSR would become a barrier to entry for small businesses while giant corporations profit and acquire competitive advantages.

3.2 ESG into the investment process

There is very little quantitative ESG research in the investment world. Investors want to quantify ESG data in order to use it in financial analyses in financialized accounting, according to some studies, as Mitchell et al. (2015) claims. Furthermore, financial materiality impacts which ESG concerns institutional investors pay attention to, according to Young (2013). Eccles, Ioannou, and Serafeim (2014) also discovered that the absence of comparable quantitative measurements supplied by corporations obscured the risks to investors' portfolios. According to Alfonso-Ercan (2020), the

absence of a comprehensive ESG assessment also makes it difficult for investors to integrate ESG aspects. While ESG disclosure was necessary for investment processes, it was not adequate for public disclosure, according to Barnett and Salomon (2006). However, ESG information was obtained via private interactions with investee firms. Private contacts are valuable sources of ESG information to complement the gaps in publicly available ESG reporting.

In reality, Beunza and Ferraro (2019) discovered that ESG data is often utilized as an additional criterion rather than being quantified and incorporated into financial analysis. ESG data is seen differently by fixed-income and equities investment managers, according to the authors. While fixed-income investors attempted to include ESG criteria into their financial models, equities investors resorted to ESG as a visual aid. This strategy allows for a non-financialized study of ESG data. The difficulties of incorporating ESG into investor organizations extend beyond merely collecting and interpreting data. According to Juravle and A. Lewis (2008), market aversion to ESG might influence perspectives on implementing ESG in firms. Apostolakis et al. (2018) discovered that combining financial and ESG topics is beneficial in theory, although not always in reality. ESG and financial issues, for example, have their divisions. This split arose because ESG was initially used to avoid investments that are not respected for financial materiality. As a consequence, including ESG was meaningless.

Yamahaki (2019) stressed the need for intentional action to incorporate ESG into investing firms, as integration does not happen by itself. ESG was included by investing associations in collaboration with investors. The findings show that institutional work promotes responsible investments by; educating investors, decoupling with ESG integration tools, providing a place for investors to interact with firms they invest in, punishments from regulations will be lifted, and laws regulating investors' joint activities will be clarified, and standards will be embedded in everyday practices.

Investors' approaches to acquiring ESG information may have ramifications for ESG integration since ESG integration is a relatively new investing strategy. Investors must actively deal with ESG integration in general. Du Rietz (2014) examined how financial analysts incorporate corporate governance into investment assessments, focusing on the ESG component of corporate governance. First, financial analysts' discourse was influenced by calculative conceptions about incorporating corporate governance into the investment process and the link between financial performance and corporate governance. Second, calculative aspects,

such as graphs and regression analysis, were employed to operationalize corporate governance integration. Despite certain anomalies, they attempted consistency between company governance and the more comprehensive investing concept. To distinguish information from irrelevant accounts, institutional investors established an epistemic object or what they intended to learn about; according to Tan (2014), analysts spent a significant amount of effort classifying data and searching for unaccounted accounts. In other words, people's perceptions about what information is significant to the analysis influence how information is obtained and utilized.

Cederberg (2019) utilized actor-network theory to build sustainable investing methods. ESG data integration into valuation models and techniques of organizational integration was referred to as ESG integration in this research. Integrating ESG into investing procedures, according to Cederberg (ibid.), intensified the tension between ESG and finance, resulting in obduracy. Furthermore, ESG was "in the middle," i.e., even though ESG was "present" in numerous contexts, it had no impact on the decision made.

The study of ESG integration focuses on investors' efforts to financialize ESG, how investment companies integrate ESG, and the challenges they face. Individual investors' understanding and less common is consideration of ESG in their daily job and how this may affect how ESG is implemented into investing practice.

3.2.1 Sustainability in private equity investing

As the significance of sustainability in society has increased, so has the importance of sustainable private equity investments (Bain 2022). Three sub-categories of sustainable investment are ESG investing, SRI, and impact investing (Grim and Berkowitz 2020). While these groups are related, their objectives are very different. SRI, as described by Renneboog, Ter Horst, and Zhang (2011), is used to enhance company strategy, local communities, and shareholder activism. In order to achieve the objectives mentioned above. Investing in an SRI framework adheres to a set of ethical guidelines. ESG investing, on the other hand, is defined by (Leins 2020) as an investment philosophy focused on ESG concerns. ESG investing, unlike SRI investing, analyzes a more extensive set of criteria. Impact investing, according to (Barber, Morse, and Yasuda 2021), is defined as investments that seek to bring both social and environmental benefits. Sustainable investments have yet to be defined uniformly by academics and business practitioners. While Cooper and Schlegelmilch (1993) implies that investment styles are a personal decision, Bilbao-Terol et al. (2013) contends that sustainable investments properly capture all intended

non-financial outcomes. PitchBook also demonstrates that "sustainable investment" is a catch-all term.

According to academics, SRI first appeared in the United States throughout the 1970s and 1980s due to non-financial concerns (L. D. Brown and Caylor 2006) (O'Barr and Conley 1992). Socially responsible investment frameworks first appeared in Scandinavia in the 1960s, according to Bengtsson (2008). SRI gained in popularity as these goals were more publicly acknow-ledged. By the early 2000s, it has become a worldwide practice (Schueth 2003). In 2010, the Social Investment Forum Foundation projected that socially responsible investments totaled USD 3 trillion. In the United States, 5 trillion EUR was reported in Europe (Von Wallis and Klein 2015). Responsible investing is a strategy and practice of making Investment processes that include environmental, social, and governance problems (UN PRI, 2019). The United Nations' Principles of Responsible Investing, published in 2006, are now widely accepted as a basis for responsible investing. As a result, the link between ESG and financial success is formalized.

The absence of a standardized structure for long-term investments has fostered doubt among private equity investors (Bain 2022). ESG performance, in contrast to the apparent objectivity of financial returns, may be subjective in the absence of defined assessments. There is no commonly acknowledged quantitative analysis on returns and sustainability due to weak performance-based measurements and the inclusion of sustainability as the significant investment factor in private equity contracts. According to research on the efficacy of active ownership engagement initiatives, legitimacy is the most crucial feature for a successful discourse. Despite concerns with agency and information asymmetry Morrell and Clark (2010), the industry's focus on stewardship and active ownership implies it is a suitable match for responsible investment. GP may reduce the risk of investment and increase the value of the investment by meticulously adding ESG aspects into their investing approach. PE companies that effectively integrate ESG opportunities and risks into their investment strategy and value generation methodology, according to Indahl and Jacobsen (2019), will likely boost returns while reducing risk exposure.

Cumming and Johan (2007) said there had been an increasing demand from PE investors for investments to be made in line with SRI, i.e., ethical, moral, and environmentally sustainable investments. They could also observe that organizations having a centralized investment role, such as a Chief Investment Officer, were more concerned with SRI while making investment choices. They also discovered that more prominent institutional investors were more likely to concentrate on SRI

or ESG concerns since they projected a higher risk-adjusted return from these investments. Entrepreneurs that do not deal with SRI or ESG in their businesses, according to Crifo, Forget, and Teyssier (2015), have restricted access to PE funding owing to a lack of work on sustainability concerns. They also claimed that these businesses would have a higher cost of capital, resulting in decreased shareholder value.

3.2.2 The link between ESG and private equity

According to research published by the British Private Equity and Venture Capital Association (BCVA 2014), sustainable investment in the PE industry has grown. They said that public corporations working on sustainability concerns received more attention in the past, but that pressure has lately been applied to privately held companies and their investors. Sustainable investments have been a growing focus for private equity firms, according to research by Crifo and Forget (2013). SRI was utilized for strategic goals rather than charity, creating value, and improving enterprise risk management. Among other things, they also demonstrated that PE firms focused on ESG problems for the same purpose, namely, to boost profitability instead of ethical or social concerns. According to BCVA (2014), as the PE sector focused more on sustainability concerns, they viewed it as a chance to set themselves apart from rivals while also uncovering new business prospects. According to the survey, risk management and growing investor pressure were the two most potent driving causes behind PE businesses' readiness to engage on sustainability concerns. Large organizations were more likely to do sustainability work, according to Crifo and Forget (2013), since they had more access to finance, which gave them more opportunities to obtain the required knowledge. Consequently, they discovered in their research that many private equity firms lacked the necessary knowledge in the form of human capital to explore these challenges profitably.

Corporate governance follows the "Anglo-Saxon" tradition. On the other hand, other stakeholders must depend on legal and contractual safeguards. According to M. Jensen (2001), serving a single target audience is efficient. Aside from that, Jensen contends that managers should report to shareholders since they are subject to less contractual protections than other stakeholders. Companies have focused on boosting profits and financial returns for their shareholders, according to Friedman (2020) contention that "the social duty of business is to maximize its profits." corporate governance is changing this. Since GP decision-making and investment processes have been hampered by a restrictive concept of fiduciary

obligation (Schröder 2004), a larger vision of corporate governance includes a fiduciary duty to a broader set of stakeholders has lately been contested.

In the case of imperfect contracts, M. Jensen (2001) assertion that shareholders are the most vulnerable stakeholders is based on a mistaken belief. According to Parmar et al. (2010), investing in staff training and R&D to deliver higher quality and safety goods to consumers may result in direct shareholder benefit (2010). As a result, the meaning of fiduciary obligation has been broadened by regulators (Sullivan 2015). According to the PRI, United Nations Environment Programme Finance Initiative (UNEP FI), and Generation Foundation, due diligence requirements of loyalty and prudential necessitate that ESG problems be examined (ibid.). To meet fiduciary responsibilities, investors must achieve strong ESG performance in the firms or organizations they invest in (ibid.). The scope of fiduciary obligation and the issue is widened since limited partners' usefulness is maximized rather than their earnings.

3.2.3 ESG investment strategies in private equity

Three basic responsible investing methodologies are often utilized in private equity and venture capital. Product-focused (thematic) strategies, economic target group strategies, "double-bottom-line" strategies, and process-focused (ESG screening) strategies are all examples of this kind of strategy (Zaccone and Pedrini (2020); Dilla et al. (2016)). The methodologies allow for incorporating environmental, social, and governance factors into investment choices and evaluating ESG data when selecting investment objects. These methods may also assess how venture capital firms handle environmental, social, and governance concerns. However, since each firm is unique, the techniques for implementing ESG standards may change. Furthermore, implementing ESG will be challenging and time-consuming due to company variances and various portfolio firms' markets (ibid.).

Product-specific or thematic approaches: Venture capital firms choose portfolio businesses whose goods or services provide long-term answers to society's issues using this strategy (Zaccone and Pedrini (2020); Dilla et al. (2016)). They search for items that benefit the environment, demography, welfare, and fair trade. When investing in a specific industry or geographic location, investors must consider if ESG problems provide any unique risks or possibilities (Crifo and Forget 2013). Venture capitalists prefer to invest in firms that do research or produce novel technologies, according to Lockett, Murray, and Wright (2002). Using this strategy, investors may target their funding to locations with the highest chances for socially

and ecologically sustainable solutions. This method may be used to make investments at both the early and late phases of the investment cycle, with Bérubé, Ghai, and Tétrault (2014) believing that investing early in the cycle can provide greater financial returns while also establishing an atmosphere favorable to new idea development.

Economic demographics and "double-bottom-line" tactics: The venture capitalists and private equity firms use this method to target investments toward specific goals such as low- and middle-income areas, social entrepreneurs, and minority-owned businesses (Zaccone and Pedrini (2020); Dilla et al. (2016)). The emphasis is mainly on social concerns or improving the environment in a particular location. The method is commonly used to enhance developing nations' economic and social development. Concentrating on investments' environmental and social consequences may lead to identifying previously undiscovered markets (ibid.).

Process-focused investment or environmental, social, and governance (ESG) screening: This strategy incorporates a comprehensive review of an investment object's ESG activities into the Investment process (Zaccone and Pedrini (2020); Dilla et al. (2016)). The method entails considering aspects that might have a favorable or negative influence on the investment to reduce investment risks. Investors may concentrate only on businesses that practice strong corporate governance and environmental management. ESG screening may as well involve selecting firms that strive for long-term viability or the restriction of investments in specific kinds of enterprises that engage in potentially immoral industries, such as the weapons industry. Because venture capitalists are likely to join the boards of portfolio firms, investing in businesses that can incorporate environmental, social, and governance factors into their operations makes ethical corporate culture much simpler. (ibid.).

Chapter 4

Method or Methods

4.1 Research Design

Saunders, P. Lewis, and Thornhill (2015) utilized the metaphorical analogy of an onion to explain the research philosophy and methods, with philosophy and approach to theory development as the two outer layers, peeling down to data collection and analysis as the center. The layers used in this investigation are described in detail below, as seen in figure 4.1 The research design is predicated on the concept of a qualitative study, with the fundamental justification for this being the usage of different data sources. Various sources of evidence are used to prove legitimacy. Constructing validity is also a means of determining which operational measurements are most appropriate for the master thesis. Furthermore, there is a shortage of data to assess with a quantitative methodology. As a result, a qualitative research strategy is used in this thesis.

The structured research design is emergent, which means the author is free to revise the original study plan throughout the process (e.g., change the research question or alter the data collection process). The purpose of the emergent design is that new information about the topic may be revealed while this thesis is being written. The author must then be permitted to adjust the study strategy in light of the eventual modification. The methodologies were selected to match the study approach since the issue is new and lacks the data necessary for quantitative analysis.

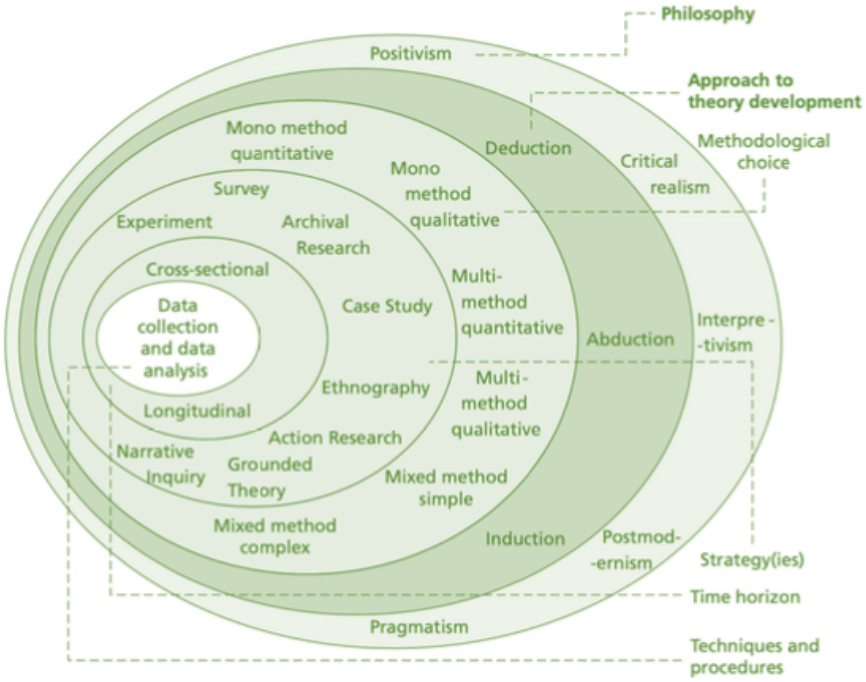

Figure 4.1: The research design based on the research onion by Saunders, P. Lewis, and Thornhill (2015).

4.2 Research Process

The primary empirical data was collected through semi-structured interviews and supplemented by additional public material in this study. The core empirical data was acquired via semi-structured interviews and supplemented by extra public information, while the problem formulation and theoretical background were developed through a literature study. The data were evaluated using thematic analysis, in which codes were used to create themes and correlations, which served as the foundation for drawing findings. Thematic analysis is a method for analyzing qualitative data that is both methodical and flexible (Braun and Clarke 2012). Figure 4.2 shows an example of this procedure, and it should be noted that it was an iterative process. As a result, the literature review and subsequent analysis of all acquired data and ultimate findings changed iteratively as the data collecting continued.

Figure 4.2: The research process of the thesis

4.3 Data Collection

Empirical data was mainly collected using semi-structured interviews, which are a standard data collecting method for descriptive studies aimed at explaining attitudes and underlying thinking (Saunders, P. Lewis, and Thornhill 2015).

In addition, conducting interviews is an effective way to get an exhaustive understanding of a complicated issue while also gathering viewpoints from many players (Blomkvist and Hallin 2015). In the literature review, many different stakeholders were found to link ESG to financial value. This link was determined to be a suitable method for the researchers' goal of extensively understanding the challenges and context from the perspective of financial service representatives.

4.4 Secondary Data collection

The literature review is recognized as a crucial tool for gathering data. This review is achieved using databases and searches for relevant studies, which are then chosen after a rigorous evaluation and sorting for the most referenced, newest, and most relevant publications. The goal of the literature review was to establish a framework for this investigation, with theoretical knowledge serving as a backdrop for the empirical data obtained. This review was done to supplement the researchers' contextual information and confirm, add to, or refute earlier results in this study.

As a consequence, data is obtained to clarify ideas, establish hypotheses, investigate topics, and widen the research field's scope (Yin 1994). The information should filter and bring up fresh and current ideas. This data set comprised peer-reviewed papers that have been published in scholarly publications. Expertise and theories on valuation models, ESG, sustainable finance (SRI), the European Commission, and others were assembled. The resources' trustworthiness may be determined thanks to the complete evaluation method.

4.5 Interviews

The empirical data from semi-structured interviews follow a basic format with questions and may depart from it to meet the context and accommodate the interviewee (Kallio et al. 2016). The interview questions were split into two categories based on the respondent: the first focused on the private equity firm and the interviewee. In contrast, the second focused on other relevant financial institutions. The critical interview questions were not changed throughout the study procedure to guarantee precise and comparable responses.

Both open-ended and closed-ended questions were asked in the interview. Open-ended questions encourage the interviewee to provide detailed, lengthy responses (Fylan 2005). The responses to these questions gave information that sparked a lively debate about the findings. The interviewee was asked to respond to the closing questions concisely. Receiving the responses in a consistent format makes it easier to compare them systematically and effectively.

Employees at private equity firms in the Swedish markets were chosen as interview subjects since the study issue was centered on them. Approximately half of the businesses in this research meet that criterion, are private equity firms, and do business in Sweden. To broaden the range of expertise and other insights, the remainder of the respondents are from neighboring organizations in the same sector. Analysts, sustainability responsible, fund managers, and other professionals were among the respondents, with a particular emphasis on financial analysts due to their expertise. The variety of interviewees was advantageous since it led to a wide range of responses from various viewpoints. A simulated interview with a peer was held prior to the actual interviews, according to Goodell, Stage, and Cooke (2016). The intelligent verbatim transcription approach was used to transcribe all interviews (Eppich, Gormley, and Teunissen 2019).

A broad interview question battery was designed and utilized in all of the interviews before they were conducted (see Appendix A). This was performed to boost productivity and guarantee that important factors were not overlooked. Except for the vital question, the interview questions were modified depending on the position and purpose of the interview, with the primary objective of understanding how stakeholders react. Consequently, the interview guide served as a starting point for each interview, with some changes made dependent on the topic and objective. All of the interviews were with experienced internal stakeholders in the Nordic financial industry. Throughout this master's thesis, all 15 respondents and financial

companies are kept anonymous. Table 3.1 shows the results of 15 interviews, 8 with private equity associates and 7 with traditional banks and investment banks.

The interviews were performed remotely using Zoom video conferencing software with the recording or over the phone using the voice memo app on an Apple iPhone. The interviewees' consent was sought before the recordings started.

Table 4.1: Information about interviewees and the interviews.

Interviews			
Interviewee	**Position**	**Company**	**Length**
A	Head of ESG data	Private equity company A	45min
B	Head of ECM	Investment bank A	27min
C	Analyst	Investment bank B	28min
D	Financial Analyst	French bank A	36min
E	Analyst	Private equity company B	39min
F	Analyst	Private equity company C	35min
G	Director	Private equity company D	24min
H	Found manager	Nordic Bank A	35min
I	Financial advisor	Private equity company E	40min
J	Financial associate	Nordic Bank B	31min
K	Investment manager	Private equity company E	25min
L	Head of responsible investments	Private equity company E	36min
M	Sustainability lead	Private equity company F	25min
N	Found manager	Nordic bank C	33min
O	Director	Investment bank B	40min

4.6 Data analysis

The thematic method that was used comprised the data analysis technique. All interviews were transcribed and categorized. While more interviews were being conducted, an outline of recurring issues was obtained. Following that, the data was examined thematically by grouping codes and citations into themes, searching for similarities, contrasts, and repetitions of the data while investigating how respondents saw and viewed ESG as part of their profession. Since themes may derive both implicit and explicit significance from textual material, they are helpful for various purposes, and thematic analysis is a potent tool for appraising data in qualitative research. Guest, MacQueen, and Namey (2011) defined written formalized as a consequence, using themes may be recommended. The empirical themes were connected with theoretical notions, and when fresh empirical insights were acquired, new theoretical concepts were given and then divided depending on the stakeholder. This method follows the abductive technique.

The advantages of utilizing thematic analysis, according to (Saunders, P. Lewis, and Thornhill 2015), include combining relevant data taken from multiple transcripts, testing ideas based on themes and patterns, and
formulating conclusions. Because this research includes several interviews, resulting in many separate transcripts to be evaluated, this technique is judged appropriate because it aids in integrating the data from diverse interviews. Following the conclusion of all interviews, the topics for this master's thesis were determined.

4.7 Data quality

It is vital to assess the research quality of the work done in terms of validity (internal, concept, and external validity) and reliability ((Miles and Huberman 1994), (Solarino and Aguinis 2021)).

4.7.1 Validity

Internally, externally, and constructively, the master thesis's validity must be assessed (Yin 2009). The logic and justifications that support the conclusions and recommendations are referred to as this. Construct validity is assessed throughout the data collection process by ensuring data triangulation. It entails gathering information from various sources, including Multiple semi-structured interviews and a literature review in this case (Gibbert, Ruigrok, and Wicki 2008). A literature review was used to gather and compare current fieldwork and find process interactions, which resulted in these various theoretical ideas.

External validity indicates that hypotheses and results apply not just to the instance or setting under study but also other situations(ibid.).

4.7.2 Reliability

Transparency and repeatability are two characteristics of reliability((Miles and Huberman 1994), (Solarino and Aguinis 2021)) For a study to be duplicated (or tested) by other researchers, and it must be transparent and replicable. This theory is contingent on how the technique and procedures are explained and documented effectively.

For this master thesis to achieve high reliability, the research design, research method, data collection, and data analysis have all been carefully considered. The

protocols for interviews and the key themes and related codes discovered through data processing have been shared in data collection methods.

4.7.3 Ethics and Sustainability

During the research process, the ethical issues were considered by Vetenskapsrådet's (The Swedish Research Council) rules (Vetenskapsrådet 2002). The Swedish Research Council has identified four distinct research principles: (1) the need for information, (2) the need for permission, (3) the need for secrecy, and (4) the need for appropriate usage. (1) Prior to the meeting, each interviewee was told of the purpose of the interview. It was added to the interview procedure to ensure that each interview had the same purpose. (2) Each participant could remain anonymous throughout the study. Prior to the interview, each subject decided and agreed to the maximum duration of the interviews. Throughout the interview, any participant might leave or interrupt it. Before beginning the interviews, the participants were asked whether they consented to the audio and video recording. (3) Confidentiality is ensured by the anonymity of each respondent. Each interviewee was given a unique ID and remained anonymous throughout the master's thesis. The identities of all firms are kept hidden. (4) Finally, all information acquired was used strictly for the research and the preparation of this master thesis, in compliance with the excellent use requirement.

Aspects of long-term viability should be explored. As a capital shift toward sustainable investments develops, sustainability tied to the financial sector, specifically private equity, is a significant facet of sustainability explored in this master thesis. This facet has a significant impact on society since private-sector capital allocation provides a chance to invest in long-term solutions that will improve the quality of life for future generations. The proposals and findings of this master's thesis are intended to bring fresh insights into the private equity investing process.

Chapter 5

Results and Analysis

This section is divided into three parts, first findings regarding the current state of the private equity market and its development. Then the results are presented and followed by a section interpreting the results.

5.1 Current state of the private equity market

In 2021, private equity established a new milestone in almost every way. The value of buyout deals and exits soared to unprecedented heights (Bain 2022). General partners (GPs) experienced the industry's second-best fund-raising year, concluding a five-year run that saw 1.8 trillion dollars in buyout money raised. Funds increased payments to LPs and continued to outperform all other asset classes in terms of returns. Overall, private equity placed a forceful exclamation point on what has turned out to be a decade of great success, notwithstanding the prolonged economic uncertainties brought on by the Covid-19 outbreak. The pandemic had done nothing to dampen the industry's progress, except for three months in early 2020 when dealmaking nearly came to a standstill. Covid, if anything, accelerated the process. Teams have been more efficient at the fund level due to reduced travel. (According to a recent capital study, over half of LPs have recently made fund commitments with GPs they have never seen in person.) At a macro level, public and private investors have reaped the benefits of trillions of dollars in monetary stimulus pushed into the global economy by central banks since March 2020 to offset the consequences of Covid-related shutdowns (ibid.).

Like the rest of the world, private equity and venture capital investment in the Nordic area reached new highs last year. PE activity soared to new heights after a downturn the previous year, thanks to an unprecedented number of acquisitions.

Outsized rounds and a surge in late-stage investment delivered spectacular outcomes on the VC side. In 2021, the Nordic private equity market registered 1,064 transactions totaling €108.3 billion, representing Year-over-Year (YoY) gains of 101.1 percent and 175.2 percent, respectively (Pitchbook 2022).

According to a recent Rolander Berger research, Christof and Thorsten (2022), respondents anticipate that the relevance of sustainable business models in the PE sector will continue to increase dramatically, with 80 percent of those polled believing that it will be essential or imperative in the next five years. The most significant reasons for this are environmental concerns (68 percent) and brand image/reputation (50 percent).

5.1.1 Development of ESG and Impact investing in Nordic PE industry

When opposed to public market funds, institutions have historically placed less pressure on private equity companies to include ESG factors in their investing procedures (ibid.). As a result, it might be claimed that the private market has lagged behind the public market when incorporating ESG into investing plans. However, this has begun to change in recent years, mainly due to increased regulation. On the other hand, the Nordic nations were the first to embrace SRI and are considered frontrunners. To comprehend why Nordic PE and asset management engaged among the first to embrace SRI, one must look at the larger cultural and political context (Messelt 2019). Nordic people are noted to have a close affinity with nature and live in dependence on it. The Nordic nations were early proponents of equal rights and robust government institutions in sociopolitics. These long-held principles have made their way into the private investment world, fueling the emergence of ESG integration.

Executive management buy-in is essential for PE investors to effectively incorporate ESG into their investing procedures (Buckby 2020). Considerable funds have been seen as becoming more advanced in the ESG efforts due to dedicating money to ESG governance (ibid.). On the other hand, smaller funds are seen as having the strategic flexibility to swiftly integrate, increase awareness of, and adopt ESG in their investment activities. Moreover, all financial professionals should take on ESG responsibilities simultaneously (ibid). Nordic PE firms companies are still implementing pay and incentive plans connected to financial success and ESG performance. An international firm, Private equity company F, which in the last

two years has started to have an impact, found sad this:

"Our impact fund has the same financial requirements as our regular funds. We do not believe that investing in impact companies requires us to "sacrifice" financial returns. I would argue that it is quite the opposite. We have invested in companies that can be called impact companies for a long time. Our historical performance shows that they have done better than the average in our portfolios." - Sustainability lead, Private equity company F."

GPs, LPs, and more strict laws are driving the demand for ESG integration in private equity, according to several interviews. About five years ago, Nordic ESG investment surged, as evidenced by the tenfold increase in ESG discussions in fundraisings (Buckby 2020). Using unique ESG-focused investment models and thematic investment strategies based on long-term megatrends, several GPs are garnering capital from institutional investors. GPs are more likely to emphasize ESG on their organizational agenda when ESG talks are included early in the fundraising process.

To separate themselves from rivals and attract funds more readily from institutional investors with more green investment mandates, Nordic private equity companies are altering their investment strategies to include ESG. The extent to which PE businesses incorporate sustainability varies. How they interpret the link between financial return and ESG return or effect determines their degree of ambition.

5.2 Interview results

5.2.1 ESG focus

ESG focus among traditional private equity firms

Given the focus on improving governance mechanisms, some investors consider active ownership sustainable (ibid.). As part of the active ownership model, private equity firms assist the management of their portfolio companies via board engagement and business and operational control. Negative ESG screening has traditionally been used by generalist businesses to approach sustainability in their investing strategy, and the main emphasis has been on compliance and risk management. Regulatory pressures and LP expectations have driven generalists to be more open. In recent years, fund due diligence processes has included ESG-related questions in their reporting and responses. Furthermore, several generalist companies have launched additional impact or sustainability funds. There were

roughly 740 ESG-committed funds in the alternative markets in 2020, tripling from 2011. In the case of private equity funds, Assets under management with ESG commitments have increased from USD 92.7 billion in 2011 to USD 1,503 billion by 2020, according to (Fan 2020). PE firms in the Nordic region have moved their attention from legality and are now investing in businesses that contribute to long-term growth.

"In the investment part, we evaluate sustainability and impact in the due diligence process when we evaluate companies and think about new investment themes, such as those related to, most notably, climate change and other such issues. We will refer to the second part as the "image." It is the case with our existing businesses. We assist our companies in using sustainability as a value-creating "leverage" and structuring our reporting process. So much time spent talking with companies and deciding how to best report" (Director, Private equity company D)

ESG focus among dedicated sustainability and impact general partners

The Nordic private investment scene is breaking new ground concerning the number of actual impact and sustainability private equity companies. Due to the lack of a standardized strategy for sustainable investing in the investment business, the following section provides an overview of two of Sweden's major sustainability-focused PE companies' investment methods. One was interviewed, and the other was provided as a contrast.

"Thematic equity company A" (Named anonymized) and Private equity company E are two notable general practitioners with a sustainability emphasis. Thematic equity company A is a private equity firm that participates in thematic ESG investment and is focused on impact investing in creating a social effect in under-represented regions.

"Thematic investment pays off, which has become even more apparent during the Covid-19 pandemic and Europe wanting to decree dependency on Russian oil and gas. Firms that provide effective and long-lasting services to society are gaining ground." Financial advisor, Private Equity Company E Unlike private equity firm E, Thematic equity company A is a thematic ESG investor. This comparison implies that Thematic equity company A invests in macroeconomic trends relevant to sustainability. Thematic equity company A has chosen three main topics to establish the breadth of its investment environment, all of which align with the Sustainable Development Goal (SDG)s Technology-enabled businesses, demographic changes,

and resource conservation. Macro-social drivers of change such as growth in population, aging populations, scarcity of resources, and shift to renewable energy sources inform the investment themes. They are predicted to transfer into appealing market features. With a specific investment focus, the business may become an expert investor in the chosen topics and, as a result, establish firms that are leaders in sustainability in each industry via active ownership. Thematic equity company A has closed two funds thus far. The first fund closed in 2017 and the second in 2019, with around SEK 5 billion and SEK 7 billion in committed money, respectively (Thematic equity company, n.d.). The second fund's size indicates institutional investors' increased desire to invest sustainably. One person from Thematic equity company A sheds light on how the LP community is getting more knowledgeable when addressing ESG in the fundraising of the second fund and how the Thematic Equity Company works.

In a Grant Thornton research, A's theme approach resulted in financial and value creation success (Buckby et al., 2021). Thematic equity company A may also convey how their portfolio firms look to external stakeholders to help solve environmental and socioeconomic concerns because of their connection with the SDGs. The business has effectively conveyed how ESG is integrated into its investment process throughout the investing cycle. Turning to the drivers of change, Thematic equity company A has defined six trends and patterns that drive the three strategic investment themes and assist portfolio companies in connecting with the SDGs. ESG is significant throughout the sourcing and due diligence process; it is also an essential component of the Thematic equity firm A's idea of active ownership. Future-proof companies are built during the holding term in collaboration with the management team, and the patented Thematic equity company A methodology is employed to create operational value. Four pillars support the model: (1) High-Performing Organization, (2) Scalable, Agile, and Data-driven Execution, (3) Purpose-driven Strategy, and (4) Resilience Building. Together with a company-specific roadmap, these pillars help plan how value is produced. Thematic equity company A also contributes knowledge, money, and a unique toolkit to management's value generation plan, as described in a support model. Management and the board of directors have been held responsible under Thematic equity company A model for meeting financial and SDG-related Key Performance Indicator (KPI)s. In light of this, each portfolio company's sustainability KPIs are unique, meaning they are used to track development over time rather than for comparative comparison. Thematic equity company A has made significant contributions to improving ESG reporting

transparency in the Nordic PE space. Most notably, promoting their new PE model and demonstrate how ESG integration helps to improve risk-adjusted long-term earnings.

Another private equity company in Sweden, Private equity company E, focuses on impact private equity. A deal with a Nordic bank provides the firm with funding and a strategic partner in the field of impact investment. The strong partnership enables private equity firm E to use the bank's ESG and impact research expertise and its network and investor relations team. Together, this enabled the formation of a private equity company that could benefit from the founder's previous experience with another PE firm and the banks' history and resources. "The company has the objective to achieve the same or greater returns as the conventional private equity business while using the same toolkit, except more sustainability and impact analytics. We ask ourselves: What is the impact of each company we invest in? What impact do they have on people's everyday lives, society, and the environment? We should follow in the footsteps of previous private equity companies, except that we should be purpose-driven and have a goal. We should be able to quantify it, and it must be specified from the start. There is a difference here at our company because there would be sustainable deals; however, they have no effect. Those would be avoided." Financial Advisor private equity company E

Through active ownership, Private equity company E invests in companies that contribute to positive social impact with equity tickets ranging from EUR 25-150 million via their product or service offering. Staying industry-neutral allows Private equity company E to maintain a broad potential market of possible targets that contribute to at minimum one of the Sustainable Development Goals.

"All businesses must achieve one or more SDGs. Moreover, they must address social issues and provide a function. That has an impact." (Head of Impact, Private equity company E) Measurable environmental or societal impact is a vital part of the value-generating process that Private equity company E for each firm in the portfolio.

"For the analysis of impact, we have a partnership with Nordisk bank B, and we can say that is a partnership, may sound a bit distant, but right now we have 5-6 + our intern who helps us with that work so that most we do ourselves together with them. Then, if we want to do, e.g., a factory inspection, for example, around hazardous material or something like that. There we have industry specialists in just that, but otherwise so, have this team as well as full in-house expertise to do the analysis" Head of impact, Private equity company E The firm's patented impact assessment technique evaluates the portfolio company's present and possible future impact on

an environmental and social scale for each possible investment.

While the firm's commitment to one or more of the SDGs serves as the beginning point for the study, the framework encourages the advisory team to identify the extent of impact and areas where the firm may enhance its development to have a more significant impact. In particular, the impact is identified and leveraged as a value lever to raise revenues, decrease operating expenditures, and generate actual brand value. While acting as an impact investor, Private equity business E does not participate in charity efforts, ensuring that financial returns are not jeopardized. "Some people believe that you cannot earn money while doing good. However, I believe it can be integrated, and in the future, it may be a must for profitability." (Investment manager, Private equity company E) ("Private equity company E" is not willing to sacrifice return to make an impact." (Head of Impact, Private equity company E) "Regulations and private equity's desire to distribute money to tackle societal issues drive institutional investors' interest in impact investing.

There may be more alignment and transparency in sustainability activities and impact reporting throughout the value chain. We want to assist portfolio corporations (PC) use their money correctly by bridging the gap between research and meaningful impact measures. As a result, communication with investors and management from the outside is streamlined, and impact reporting is prioritized. The goal is to connect 25% of management's bonus, or "carry," to the success of impact Key Performance Indicator (KPI)s in order to strengthen management commitment and responsibility. Today 10% of our carry is connected to our companies reaching their impact KPI:s. This effect KPI goal achievement is assessed regularly and is a requirement for the discount we get on our LBO financing." – Head of impact, Private equity company E "Management approves the impact KPIs and the value generation strategy before investing. When it comes to impact, I believe this is unique. Partnership and management buy-in is critical for growth and success." (Financial advisor, Private equity company E)

ESG focus among other financial institutions

When considering the whole private equity shareholder group, it becomes clear that the sector has a significant economic influence. According to a survey by SVCA (2020), the Swedish private equity business has raised Swedish Gross Domestic Product (GDP) by close to 5 percent since 2007, equating to SEK 230 billion. As a result, the strategies and ambitions of Nordic private equity companies have an unavoidable impact on the whole economy.

From an academic standpoint, there is a case to be made that private money plays a particularly crucial role in global sustainable development. Private equity may be considered one of the most significant financial players in the transition to a sustainable economy due to the scale of the market and the more significant potential for effect. Although the actual size of the private equity market is challenging to measure (G. W. Brown and Kaplan 2019), there is little question that it is significant. GPs in private equity have more power over their portfolio firms than in public markets, and they are not confronted with the same information imbalance. Furthermore, although a private equity fund's lifespan is typically restricted to ten years, this is a far longer time to execute change than the public market's pressure to improve performance in every quarterly report.

"Private equity, or privatized markets, may play a larger role in sustainable investment than public markets. The knowledge imbalance between the company and investors is often less acute in private marketplaces. As a result, private markets may be able to cope with a wider range of requirements and be more proactive than public markets." Nordic Bank B's Founding Manager

Getting firms more sustainable may be seen as minimizing negative externalities in an economic model, which means that all stakeholders are making progress. However, it is crucial to highlight that there may be distributional impacts among stakeholders in certain
circumstances. The Non-Financial Reporting Directive (NFRD) seeks to reduce these factors by including the idea that sustainability is accomplished not just by contributing to a single sustainable sector but also by not damaging another in a significant way.

Consumers and workers are two more stakeholder groups to whom PE businesses must pay increased attention. Both organizations stress the issue of ESG, claiming that businesses should be more ecologically and socially sensitive and well-governed (Granth Thornton, 2020). Consumers, particularly millennials, are shifting their purchasing habits in terms of sustainability (ibid.). This concept correlates to higher customer loyalty, as assessed by the Net Promoter Score statistic (ibid.). According to Jacobs and Robey (2020), a 2020 Sogethi poll, 79 percent of customers are altering their purchasing habits due to social responsibility, inclusion, or environmental effect. Consumers are rewarding sustainable businesses with their buying power and loyalty in this setting. Because Baby boomers will transfer $40 trillion in wealth to millennials, this is essential for private equity companies to consider when evaluating investment prospects. As a result, ESG integration should be seen as a

value creation lever and a chance to attract tomorrow's customers.

"It begins with people wanting to invest their money differently from previous generations, forcing institutions to change." Retail investors are a significant factor that many people overlook. More investors, in my opinion, need to adapt to the new interests of younger generations " Financial associate Nordic Bank B.

When it comes to recruiting and maintaining top people, a company's ESG commitment has become more critical. Employee loyalty grows for purpose-driven businesses similarly to customer loyalty (Buckby 2020).

"Recently, we have been thinking that all of these people joining the workforce will have a different agenda than people previously had. Of course, this will put pressure on us to provide a competitive salary and walk the walk and demonstrate that we have good intentions. A sustainable-term vision." Nordic Bank A is a financial associate.

"Everyone working cannot be a sustainability expert, but everyone must be unskilled in this area. As a result, I have developed a renewed interest in my work. Something about which I try to learn as much as possible and share my knowledge with colleagues. I am proud to work for a company that has incorporated sustainability into our transactions. It also feels better to explain to others that we work for sustainability rather than just making as much money as possible." Investment Bank Financial Analyst A

Final Conclusions:

- Regulatory pressures and LP expectations have driven generalists to be more open in their reporting and react to ESG-related queries during fund due diligence procedures in recent years.
- The Nordic private investment landscape is pioneering concerning the number of true sustainability and impact private equity firms.
- Companies that contribute to resilient and essential services for society, are coming out stronger.
- Among the dedicated sustainability partners, none is willing to sacrifice the financial return for sustainable performance.
- GPs in private equity have more power over their portfolio firms than in public markets and they do not face the same information asymmetry.

5.2.2 EGG integrated into the Investment process

ESG in the Investment process among traditional private equity firms

The degree to which the examined private equity firms deal with sustainability varies. However, all interviewees said that they had a declared sustainability policy. On the other hand, they did showcase a lack of standardized processes when analyzing companies.

Indicating a significant focus on the Due Diligence part of the transaction. When asked how Respondent O analyzes ESG information, the respondent said, "We try to have different processes in place, of course, but just like with everything else we look at when we look at companies, the legal part of the financial part and the marketing part. There are many different such streams, so we have that we, of course, learn more about and want to know everything about, but often need to bring in some advisor and consultant to keep track of everything."

"We have an investment policy," said respondent E. If you look at that specific branch of what sustainability is in the investing process, we have a very defined policy. I would say it is nicely thought out. Of course, you keep it up to date once a year. We are constantly up to speed if anything occurs regarding rules that may be relevant to consider based on international treaties. "Having a policy is vital, but it is much more crucial that it be successfully executed in what you do." In addition, the

reply said, "[...] to help our staff, who are, of course, not just specialist sustainability experts, we have also put-up certain tools in the investment process." They must be able to utilize and be supported by these in investment choices when sustainability is part of the decision-making process."

Respondent F said they joined the PRI around two to three years ago and reported after that. Furthermore, the responder perceived this as a hygiene issue that needed to be addressed. Respondent F said that they actively engage with sustainability concerns. They first brought in external support in the form of a highly educated person about the topic who had previously worked with similar issues in the PE environment. "[...] we engaged for a project and got help to put out the basis for our whole sustainable thinking," the responder said. It stems from how we approach new investments and what we need to consider when evaluating a firm for the first time." Respondent F also thought it was good to seek outside assistance to work on these difficulties from a third party.

Respondent E stated that they primarily invested in smaller companies and thus did not have the exact expectations of working with sustainability issues as larger companies. "We do not have the type of company that requires it," the respondent added. There is now a law and regulations requiring larger companies to have an environmental policy and guidelines and report on them." In addition, the respondent stated that they still had "environmental thinking" and were involved in sustainability issues to the extent that they could. He stated that they are willing to consider investments in environmental technology.

Respondent E stated, "We invest in companies with 10–50 employees, so it is difficult to focus on sustainability when thinking about the business." Furthermore, the respondent stated that they were particularly interested in e-commerce businesses.

Prior to investing, all companies believed they were conducting Due Diligence (DD) on the potential investment. Traditional companies, such as Private Equity A, B, and C, have previously worked exclusively with financial, legal, and commercial due diligence but have recently begun experimenting with specific ESG due diligence. Previously, this type of screening, which could be described as environmental due diligence, was only performed on companies with a significant environmental impact.

ESG in the Investment process among dedicated sustainability and impact general partners

True sustainability and impact companies/foundations had a much more standardized ESG incorporating process than traditional private equity firms.

On the other hand, Respondent N mentioned one big issue they deal with "[...] a big challenge is the follow-up of our companies. We have an extensive portfolio with upwards of 80 companies and how to create scalable solutions that help companies use sustainability offensively and create value. Imagine, e.g., creative product development rather than basic risk minimization or something else that, in the end, may not be forward-thinking and value-creating in the same way. Thinking new about products or business models and stuff, that is where it is fascinating."

Respondents described the screening step before investment from Private Equity E & F. "[...] it is essential that we take into account certain aspects that are more critical already in the screening phase. In order to be able to dismiss early, so we do not put time and focus on companies where we see that it does not have enough ESG and impact according to our criteria," said respondent E.

Respondent A said, "We say that we have a positive impact. It is our slogan, and we stand behind it; what do we mean by it when we say something like it? It is high tailgating, and we want to be a driving force. Was a so-called frontrunner in sustainability and drive, be involved, and drive the agenda to influence and bring about a behavior change and how we view investments. How do we look at returns? Where does the return come from? It is some form of "do good" think in everything we want to be good citizens and contribute to society if you say so. We create jobs, pay taxes, and are part of society globally, and we have a portfolio of many companies."

ESG in the investment process among other financial institutions

All respondents said that there is a greater emphasis on sustainability and that societal awareness has risen, implying more obligations.

Respondent H stated that they dealt with the issues in various ways, adding, "It is very much about profiling and demonstrating that these issues are important to us and that we pursue them." We have many employees, many offices, and we fly a lot. Then we offset this by purchasing emission rights. We did this primarily because of stricter requirements and society as a whole."

Respondent E believed that sustainability work always created value and stated

that there would be no profitable companies that choose to ignore sustainability in the next 20-40 years. "We will help a company that has the potential to work with these aspects; we will never choose a company that is completely unsustainable," he continued. This theme is a fundamental tenet of our investment philosophy. We want to work with companies that we can be proud of. Unsustainable, for example, if they have some Human Rights issue, that is a no from us. Something like that in the supply chain would eventually lead to the company being unable to operate its business.

When it came to what kind of value sustainability created, the respondents had scattered opinions. Some considered it profitable, and others believed that it mainly contributed to the value creation of soft values. Respondent G focuses on forecasted results "For us, ESG must always be able to connect to something logical and underlying. Then I would say that this is probably the case because they, e.g., have many emissions today. The rules will be tighter in the future, so they will probably have to spend more money on opening up and investing in it so that they will probably earn less in the future because they have to adapt. Therefore, I do not believe that they will earn 100k EBITDA, which then says that they do this year. I think this will go down in the coming years. Consequently, I am not willing to value this that much for this company. This idea should always be a common thread." Respondent A described how their sustainability work aligns with what the investors want. "In my opinion, a good ESG agenda would only give a premium to the company in a possible sales process, where you have large investors who want to place their money responsibly. You can benefit from a company having a positive sustainability point of view, whether they are doing something environmentally outstanding or have a very positive social agenda. Even on the stock market and so on, in my opinion, you can never hurt rather the opposite."

Final Conclusions:

- Traditional private equity firms indicate a significant focus on the Due Diligence part of the transaction regarding ESG.
- Generalist companies have previously worked exclusively with financial, legal, and commercial due diligence but have recently experimented with specific ESG due diligence. Previously, this type of screening, which could be described as environmental due diligence, was only performed on companies that had a significant environmental impact.
- When compared to traditional private equity firms, dedicated sustainability and impact companies/foundations had a much more standardized ESG incorporating process.
- All respondents believed that sustainability work always creates value. When it came to what kind of value sustainability created, there were scattered opinions among the Bank respondents.
- One respondent thought that ESG must always be able to connect to something logical and underlying. Another said that good ESG agenda would only give a premium if the investor wants to place money responsibly. Meaning that the premium comes from the investor's interest.

5.2.3 Interest for ESG

Interest for ESG among traditional private equity firms

Several respondents said their understanding of sustainable development in the private equity industry had grown significantly. Respondent G said that the trend began in 2007–2008 and added, "When I started in PE, no one spoke about ESG and Responsible Investments to that level." Then it is like this; there are various reasons it has become such a significant problem, both for us in business and general. One of the first shots, in our opinion, has come from our investors.".

Continuing on this, Respondent A said that there had been significant progress in the previous five years. "The circumstances that present with PE have led to quicker growth," the respondent stated. It has something to do with the fact that we have investors and all of this, their interest, the common interest along the value chain, etc." Furthermore, the respondent said that it is critical for the whole business to

collaborate and explore sustainability concerns, not only for themselves but for the entire PE industry.

Respondent G followed with, "I can only really speak for PE, but for PE, the interest in ESG is tremendous. We get a lot of pressure from our investors about just this, so this is something we discuss in every group meeting and when the company meets as a whole. It is in what we do ourselves, and what criteria we have for companies we invest in. It is very conscious, and I would say that we are not unique in the PE industry."

Interest for ESG among dedicated sustainability and impact general partners

Respondent F said, "[...] I believe it can only contribute to something good and speedy growth by somehow disseminating this and collectively establishing expectations for private enterprises." Respondent F also said that the industry had made significant progress on this topic, which he views highly beneficial. "It is quite intriguing," said one respondent, "since traditionally everyone has been pretty private about how they function, but specifically around ESG, there is an enormous degree of openness." [...] That was not available a few years ago. ESG, in particular, has become a phenomenon in which everyone is united in some way. "I believe it is a lot of fun and intriguing, and I think we can learn a lot from each other."

Respondent M said that consumer and business desire for sustainable solutions is a crucial driver in pushing development ahead but, on the other hand, also warned of a risk. There is a chance you will push it too far. Then it will be bad as well since it is done for the wrong motive." "If you do things like this [deal with sustainability concerns], you have to be persuaded that it is good and cease some things that you do to receive a nice article or favorable words."

Interest for ESG among other financial institutions

It was also emphasized that there are several rules and regulations governing, among other things, emissions. Respondent A asserted that statutory legislation would not be repealed and that sustainable development is thus a reality. Furthermore, the answer went on to say, "In the Nordic nations, there are stringent labor standards, and there are more and more overseas Europe against firms with legal headquarters here but manufacturing in, for example, Asia. There will be laws addressing what is known as contemporary slavery or child labor. There are many laws, and it is not going away."

Respondent C said, "ESG in our work will be explored further. The crucial point is that the ESG criteria have a meaningful impact, such as carbon dioxide emissions. Not only as a selling point" Furthermore, respondent C also said that the interest would grow globally.

Respondent D believes that working with sustainability is, to some part, a generational problem. Sustainability is a lesser priority for "conventional" venture investors. He thought that the younger generation was more conscious of the need for sustainable development and that this mindset might propel the issue ahead in the commercial world. According to all respondents, investor interest has grown, with PE firms concentrating on LBOs feeling the most pressure from investors. Respondent D went on to say that this had been a long-standing tendency. Most viewed it as more significant pressure, with investors pushing for sustainability concerns more aggressively than previously, while there are still variances.

"There are typical, within the investment group, people who function as opinion leaders. Once they start asking for something, everyone else hooks up," said respondent O. The reply noted that investors required more significant information than previously, mainly publicly traded corporations. "[...] if they [investors] perceive that we do not take these aspects into consideration, they cease cooperating with us, while the stock exchange may be a bit more for visibility." A shareholder or modest saver should not cease purchasing H&M shares because the company reports for visibility."

Respondent N also saw increased investor pressure: "It may be claimed that investors are in charge; they have pushed these problems fairly strongly." Respondent N went on to say that it has been more straightforward for them to deal with sustainability since investors have better appreciated the importance of the job. "We see no contradiction among our investors, and they are very much on that train," he said. "Today, it is quite simple to receive a hearing for a focus on sustainability and ESG; there are few who challenge it."

Final Conclusions:

- The traditional firms pointed out that the interest for ESG is vast, and they are not unique in the PE industry for their considerable interest.
- There had been significant progress in the previous five years ESG, in particular, has become a phenomenon in which everyone is united, more or less.
- The majority believed that ESG is fun and intriguing and that they can learn a lot from their peers. Especially the sustainability-focused companies pointed out that the crucial point is that the ESG criteria have a meaningful impact.
- The banks agreed that there is a hearing for a focus on sustainability and ESG; there are few who challenge it.

5.2.4 Themes identified and interpretation of the interview results

Principal–agent problem

The agent issue was defined by M. C. Jensen and Meckling (1976) as a conflict of interest in which the company's expected returns and profits might be harmed if management did not behave in the long-term best interests of the shareholders. External investors fund the investments made by PE firms in order to increase their profits. As a result, there may be a disconnect between investors and management in the portfolio firms of the PE fund, with management making choices that do not maximize investors' wealth. On the other hand, the respondents highlighted how investors made high demands followed up on and reported frequently. This thought may help alleviate the agent issue by requiring PE firms to provide total transparency to investors, who can then guarantee that the firms behave according to their wishes.

Furthermore, PE firms must maintain positive relationships with their investors since these relationships are vital for future investments. As a result, the agent issue in private equity portfolio businesses is less common than, say, in publicly traded companies where shareholders have a more distant connection with management. Any agent issues between the portfolio company's management and the PE firm, which wants to maximize returns for its investors, might occur.

According to respondent O, long-term sustainability work at a firm may signific-

antly influence company value, but it is expensive in the near term. The answer went on to say that shareholders should concentrate on long-term value creation rather than short-term earnings. When M. E. Porter and M. R. Kramer (2006) believed sustainability work to be in line with the agent issue, he was one of the skeptics. He said that the corporation works with sustainability rather than profit maximization since these concerns are costly.

According to M. C. Jensen and Meckling (1976), the agent dilemma involves difficulties such as short-term advantages that may hurt the organization in the long run. CSR concerns should be omitted from this problem based on these assumptions since, according to Wang and Sarkis (2017), they are expensive in the near term but may produce long-term value in the organization. Respondent O indicated that while sustainability is difficult to quantify in monetary terms, its value should be measured in soft values rather than the outcome, as measured by financial ROI. Eisenhardt (1989) proposed that agents may be rewarded or managed in order to alleviate the issue of agents. When the principal chose to reward the agents, he meant that it should be done based on their activities rather than the outcome. They could make short-term judgments to maximize their profit since they were riskier than the principals. Because sustainability is difficult to quantify in monetary terms, rewarding actors based on the outcome of sustainability is challenging. Since of the challenges in identifying the relationship to financial success, such a compensation scheme may lead agents to choose not to engage with sustainability because they perceive no personal advantage. According to Eisenhardt (ibid.), A performance-based incentive system is not preferred since it is influenced by more elements than simply the agent's activities. Companies, for example, cannot control floods or earthquakes. Therefore, sustainability is a global phenomenon that relies heavily on external causes. To inspire agents to work with sustainability, they must get compensated for what they can affect. The principals might also opt to monitor the agents' progress in their sustainability efforts, which all PE respondents said is becoming more prevalent. Investors are increasingly requesting more information on how firms work on sustainability, which might lessen information asymmetry and the agent issue.

Furthermore, as previously stated, most respondents said that more organizations are not working on sustainability because they lack the necessary expertise. This comment was something Barnett (2018) mentioned as necess-ary for effectively and profitably dealing with sustainability. The difficulty with agent theory is that agents might seem to have more knowledge and skill than they have. This concept

might indicate that sustainability concerns are not being appropriately addressed since genuine expertise is missing. Sustainability work is only lucrative when done correctly, and this might imply that portfolio firms do not maximize profit from sustainability work if they lack the necessary capabilities (ibid.). This idea would imply that the principles' worth is not maximized.

Respondent F said that their company would fail if they established unsustainable businesses. They would lose investors, and their profitability would suffer as a result. This statement contradicts Friedman's claims that ESG concerns contribute to the agent dilemma. However, respondent M pointed out that investing in sustainability concerns is expensive; therefore, seeing a return on investment is critical. He argued that the issue is more complicated than just determining if it provides value or not and that it varies from instance to situation. For example, Respondent B noted that sustainable solutions might provide more monetary value in consumer-facing businesses due to strong demand. The conclusion that may be reached is that private equity firms try to build long-term, sustainable businesses. The degree to which it addresses ESG concerns is determined by profitability and the value it provides to investors. In the same vein, the degree to which the agent issue occurs in the PE sector might be discussed. Several responders stressed the necessity of being able to fulfill and meet the needs of investors. They can contribute funds to investments and might opt to relocate money if the PE firms do not match their standards.

Competence

One of the most important aspects of dealing with ESG, SRI, Impact, or any other challenges is that staff have appropriate competence. SDGS UN (2015), they must be addressed properly. Furthermore, to successfully work on the difficulties, human capital in the form of personnel with knowledge in the area is required. The majority of respondents said that it is possible that there is a lack of expertise and that, as a result, activity on sustainability concerns in portfolio firms is restricted. According to the respondents, more and better skills are required to expand sustainability work in the PE industry. To address this matter, businesses should consider how they can effectively deal with these difficulties, including whether they need a dedicated person to deal with them or whether they may benefit from outside knowledge in the form of consultants.

Respondent B believes that for firms to adapt their investing approaches to sustainability, the culture around them must change. Respondent N expressed that environmental matters should not be pursued to gain favorable publicity. He said that

problems should not be pushed too far, or the firms' effort would be for the wrong reasons. Respondent G said they hired an outside consultant to create a framework for their sustainability efforts, which they subsequently implemented. In addition, respondent G said that bringing in external advisors might help get more people involved in these problems. Respondents E and F highlighted how their private equity firms act as advisors in their portfolio businesses, contributing information and serving on the board. They have little control over what should and should not be emphasized in organizations with such a position. Therefore, it is up to the portfolio firms' management and investment managers to execute sustainability initiatives.

According to Respondent F, whether or if PE firms work or urge portfolio businesses to address these challenges and to what degree will be a matter of interest. Interest must be shared not just by the management but also by the PE firms' investment managers. When investors require that portfolio firms utilize their invested cash in a certain way, one conclusion may be that the sustainability effort must provide value for the concerns to be on the table. In his research, Barnett (2018) discovered that the connection between a company's stakeholders significantly influences whether ESG helps to greater profitability or not. They thought that ESG profitability differed from one firm to the other. Sustainability choices had a more substantial effect when a positive interaction between stakeholders and complete openness throughout. This effect is because the corporation may more effectively communicate its commitment to sustainability, resulting in beneficial outcomes. According to the respondents, PE firms have a tight connection with management and investors. Management in the form of them actively engaging with corporations and investors that want continuous reporting. Investors have a high degree of openness and credibility since they may direct how the project is carried out. Barnett's (2018) research may be used in the private equity industry, where the intimate ties would boost profits from sustainability efforts.

Respondent J said that he feels there will be more sustainability work in the future, owing to a generational shift. A younger, more conscientious generation would take over from the archetypal private equity, which feels that sustainability work does not provide value to investors. In conclusion, it all boils down to a desire to work on specific problems and a feeling that it is worthwhile. Another factor that might improve competency is training, which, as previously said, Private Equity E supplied. It might be corporate governance or sustainable development training, for example. They, among other things, gave information to workers and portfolio firms on how to deal with these difficulties in the workplace. The ability to

teach their personnel in areas other than those they are experts enhances awareness and expertise in various areas. This idea would be consistent with Eccles et al. (2011) research, in which they discuss the significance of dealing effectively with sustainability challenges to reach profitable outcomes.

Overall view on ESG in private equity

Several GP respondents, including respondent C, said they have an ESG-related investing policy. The interviews suggest that PE firms prioritize sustainability problems before investing than when screening plays a significant role in the ownership phase. The screening phase is based on SRI and tries to identify the initial selection techniques before investing. The private equity firm chooses possible investments and rejects others depending on various factors. In this situation, a corporation that does not satisfy specific sustainability or ethical norms may be an example.

Respondent E replied that they do not have a specific investment exclusion list. They have not declared certain industries they would not invest in. On the other hand, the reply said that numerous hazards in the firms are considered throughout the screening step, including ethical and moral concerns. The responder replied that because of this, as long as they obey all rules and regulations, an exclusion list would be unnecessary.

One explanation for less focus on sustainability concerns during the ownership phase might be because PE firms face more substantial expectations from investors during the investment process than during the ownership term. Respondents also said that this is when they have the most power to influence. Respondent E said they could not walk inside the firms and "micro-control" them since management is already in place. Even if the PE firm has standards for its management, they are typically not related to sustainability but rather to financial success. As a result, choices on sustainability problems, such as how much of them should be integrated into the company, remain primarily in the hands of management, despite the precise impact of PE firms. On the other hand, it has been seen that there is a reason for getting involved in sustainability issues that respondent M expresses. "Getting order on the ESG aspects that can be seen as hygiene aspects to be able to focus on the real impact" to improve how sustainable a company is perceived as sustainable is something that increases the value of the company and gives a premium on exit.

Respondent, I said they provide knowledge to the portfolio firms and urge management to work on these challenges. This statement might explain why

portfolio firms are putting less emphasis on sustainability, partly because management does not regard sustainability as a value but rather as a cost that harms the bottom line, but partly because of a lack of skill in integrating sustainability into management. This angle is an older perspective since earlier research has been unable to forecast what premium sustainability would be in the long run, especially for businesses that include environmental, social, and governance into their operations.

Most respondents said they noticed a change in how sustainability concerns are handled in PE now vs. in the past. Therefore, this is relevant to what the respondents said about their working styles. They said that investors are putting more pressure on them to cooperate with ESG. They also thought it set them apart from other PE firms and made them more appealing to investors. Several respondents noted that more considerable risks are assessed in firms where they perceive a prospective investment, among other reasons. Respondent A associated increased risks with ethical and moral concerns, such as the possibility of underage labor or other modern-slavery circumstances in the workplace, which might be considered during sustainability efforts. However, a company can not be excluded from the exclusion list unless there is, for example, a clear framework for ESG in other aspects related to sustainability. However, only the significant risks are evaluated in the screening phase. In conclusion, it can be shown that sustainability concerns are becoming more popular to engage with, even for PE firms, and the majority of respondents expect that this trend will continue in the future. This trend is mainly due to rules and regulations and rising investor demand and demands.

Final Conclusions:

- The majority of the GP respondents said they have an ESG-related investing policy.
- The interviews suggest that PE firms prioritize sustainability problems before investing than during the ownership phase when screening plays a significant role.
- One explanation for less focus on sustainability concerns during the ownership phase might be because PE firms face more substantial expectations from investors during the investment process than during the ownership term.
- Even if the PE firm has standards for its management, they are typically not related to sustainability but rather to financial success.
- The majority of respondents said that they noticed a change in how sustainability concerns are handled in PE now vs. in the past.
- Something that the respondents believe is mainly due to rules and regulations, but also due to rising investor demand and demands.

Chapter 6

Discussion

The following discussion is about the introduction's research questions. These questions are explored based on evaluated resources, data, and conducted interviews. The insights offered in this part represent both the interviewees' and the writers' perspectives. The debate, however, stays objective, and the conclusion is delivered in section 6.

6.1 Addressing the research questions

6.1.1 First research question

The first research question concerns how private equity investors bring environmental, social, and governance factors into their investment thesis and strategy. It is expressed as follows:

How do private equity firms integrate ESG into the Investment process?

Despite their importance, several monetary players find it tough to compare and harmonize data across businesses. The newly proposed Taxonomy establishes a basis for uniformity, but many parties, notably in the private capital sector, remain doubtful that it will address the problem. Furthermore, an overall philosophical concern, namely, what is ESG, must be addressed. According to the literature research and interviews, there is currently no single standardized way of addressing and assessing ESG activities. Because there is currently no consensus on the subject, developing a consistent measuring method is challenging. Financial players are used to operating accounting and other standardized frameworks. However, with ESG

increasingly on the agenda, one would wonder whether it is essential to address ESG similarly to other, more readily observable areas. The issue of how it might operate in practice has become even more evident due to this research. However, an opposing concern arises: will ESG be recognized as essential if it is not monitored and compared? Especially in finance, where replicability and measurability are so important. Should ESG be considered a significant subject inside the private equity sector? To bring the debate back to the research topic, if a business is seen as an appealing and lucrative private equity target. It will be able to raise funds regardless of whether it is sustainable or not since there will always be investors looking for quick profits. A business that is sustainable but unprofitable, on the other hand, will not be an excellent private equity target and will not be able to receive private equity funding based on the foundation criteria of PE. Instead, these companies are more suited to philanthropic investment, where profit and growth are less important.

As a result, the more significant issue is whether ESG can be successfully incorporated into today's capitalist society. Given the industry's strength from last year vs. the present post-pandemic and Ukrainian conflict market, what is a sustainable investment in PE? Sustainability-focused GPs gain from greater exit values if the significant demand for these assets translates into an ESG premium at the exit. The value drivers become the GP's reputation and the asset's "sustainable" designation rather than the activities undertaken to achieve sustainability or effect. One may ask whether the incentive is appropriate. Another problem in private equity is that somebody must be held accountable for ensuring that funding is directed into ESG assets. Although it is a hotly debated issue, there is no consensus on who should take accountability. GPs may be in the greatest position to persuade companies to become more environmentally friendly. Is it, however, the GP's responsibility? What about the rest of the financial sector? When new laws, such as the EU taxonomy, limit where and how institutions may participate, cash may flow into less regulated industries like private equity. The conventional idea of a general partner's primary responsibility is to maximize financial return for their investors. As a result, whether or not the GP can monetize sustainability is a factor to consider. It becomes a matter of whether ESG can be monitored and if capitalists should drive it.

6.1.2 Second research question

From the interviews, a view of some institutional investors' views was shown. Even the institutional view on ESG is not as standardized as one might think. Several remarks emphasize the need to collaborate with environmental variables and incorporate these concerns into daily actions. Reports and websites show how to strive toward sustainability by incorporating ESG concerns into the workplace. Less is mentioned about how ESG problems are applied to investing activity. Interviews with investment managers and employees reveal that each investor's responsibility is to evaluate ESG problems throughout the due diligence and screening process for direct investments. This finding indicates that ESG is not considered in these critical investing processes. Regarding post-investment operations, each firm's board of directors is responsible for addressing ESG problems. Much of the focus falls on regulations and following the interest of investors. This discussion leads to the second research question

What can private equity firms learn from Banks about integrating ESG into the Investment process?

Although the Swedish market has various sustainable investment systems, some are used to convey ESG initiatives or as sounding boards, not to guide the funds' investment choices. None of the respondents say the systems have had no impact on their investing approach. Companies with high ESG ratings and certifications simply result from their significant ESG efforts and serve as evidence. The demand from their investors drives the selection of systems and the amount to which they are employed.

Implementing regulation might speed up the eventual capital allocation towards green investments by providing a general definition. However, the investors are never said to follow regulations such as the EU-taxonomy definition without conducting their due diligence on an investment case. Therefore, the EU Taxonomy is a step in the right direction toward solving the problem of various definitions. It does not solve the problem entirely.

Following the literature and interviews, institutional investors should show their stakeholders and regulators how they address ESG in their investment portfolios. This idea implies that figuring out how to report ESG as an industry will be critical. Strong financial markets may be fueled by ESG reporting. This concept is because solid disclosure and transparency standards help reduce the risks of investing in the

most troublesome nations, where governmental institutions and governance are often lacking, and businesses are generally more diminutive. While the NFRD has proven that Europe is leading the way, new ESG legislative changes are developing in every area, with many of them focusing on disclosure and reporting requirements.

Demand drivers are pushing ESG integration, according to the interviewees. Stakeholders increasingly demand institutional investors to show how they include ESG in their investment portfolios and initial public offerings (IPOs). Allocators are supporting businesses that can show how they can defend against the world's most pressing sustainability concerns, such as public health crises, inequality, and climate change, all of which represent significant commercial risks. Companies and institutional investors in the power and utility industry perceive potential growth due to corporate investments in decarbonization, coal reduction, and renewable energy.

In response, company management teams and boards are embracing ESG in ways that are sweeping the financial markets. Many companies prioritize sustainability when forming corporate structures, executing M&A agreements, or raising cash via initial public offerings or bond issuances. It is a sign that businesses identify a way to use an excellent environmental or social effect to promote growth and greater stock valuation.

Banks, regular and investment banks, also face more pressure from investors. This concept is partly due to a growing realization that ESG variables, particularly climate change, are real risks that must be addressed. Investors also want to know that their money will continue to provide a return. Banks are also coming under pressure from their clients and the general public. Customers desire to bank with a company that shares their values and beliefs; in particular, younger generations are claiming to be picking their bank based on its ESG credentials, which was confirmed from the interviews.

Take, for example, the transition risk. Bank executives recognize that the "new reality" will force them to shift their financial resources to greener, more sustainable businesses, and investments. They also recognize that they cannot just turn off the lights; they still have vast books of business tied to loans and instruments to 'brown' assets. Firm executives will have to weigh their commitment to support the ESG shift against their fiduciary responsibility to shareholders as long as those brown assets continue to create earnings for the bank.

Banks, regulators, and politicians are all dealing with the full scope of the unexpected effects of their transition toward more ESG-focused corporate practices. Refusing to extend loans on existing coal mines, for example, might help banks

improve their carbon reporting. However, when mines collapse and unemployment rises (which, in turn, has a tremendous influence on retail lending and possible impairments in that market), it might have severe societal consequences. Having the expertise, knowledge, and data to map all of those possible outcomes is proving difficult.

While COVID-19 has delayed progress, it is obvious that banks are still very committed to the ESG goal. New items and models are being invented, tested, and marketed. Investors include ESG risks in their credit analysis. Firms respond to rising demand for green, social, and sustainability bonds, which issuers use to finance environmental and social initiatives. ESG concerns are also becoming more significant for businesses seeking to go public. Corporate sustainability strategies have become crucial for companies trying to shore up their balance sheets by entering public markets via IPOs.

According to the preliminary study question, private markets can find it simpler to incorporate ESG than conventional assets. When incorporating ESG into their decision-making, private market managers benefit from direct ownership and relatively extensive development timelines in critical ESG-related areas. As a consequence, public markets seem to play a crucial role. As more asset managers urge corporations to make beneficial contributions to society in addition to financial success, this may start to alter. ESG is becoming a critical area for private market managers to flourish and justify their views as they aim to distinguish themselves.

Chapter 7

Conclusions and Future work

The last chapter, Chapter 6, summarizes the findings of the research. This chapter offers the conclusion based on the findings, analysis, and discussion. As well as future work suggestions and limitations

7.1 Concluding remarks

The concept of ESG in the private equity business is a highly debated issue. This thesis aimed to dissect how ESG-related activities and value creation processes might be implemented into the investment cycle of private equity companies without sacrificing financial returns. Returning to the original research question, how do private equity companies incorporate environmental, social, and governance factors into the investment process? This thesis illustrates the lack of a consistent viewpoint. Even though all stakeholders stress the significance of investing responsibly while making a positive social impact, the degree and type of engagement vary greatly. There are only a few sustainability-focused general practitioners. The emphasis of investment among these GPs spans from theme ESG investing to impact investing. The businesses' respective investment criteria in congruence with Sustainable Development Goals (SDGs) and their mindset toward fiduciary responsibility, Specifically, to maximize financial rewards while having a long-term impact, are standard for these firms, as shown by the interviews. According to institutional investors' conversations, most see their fiduciary role as purely financial. Negative screening is still the most frequent strategy for sustainable investment today, with growing regulatory restrictions projected to lead to additional developments. Limited partners also have opposing views on the link between sustainability and financial results. LPs seek evidence of a favorable link between financial gains and sustainable

investments to feel more comfortable giving resources to such ventures. Investors are expected to achieve accountability by adopting a consistent structure for communication and reporting. The investment community has received the recently introduced EU Taxonomy, which stands for the first effort at linguistic standardization surrounding sustainability-related measurements; however, its applicability for private equity and their portfolio companies remains unclear. Delegations and regulations will also assist other stakeholders and limited partners review and comparing how ESG aligned with the investment operations of the general partners.

ESG (environmental, social, and governance), once a niche subject in the private equity business, is now pervading the investing landscape, forcing alternative asset managers to radically restructure how they approach the investment process and communicate with clients. It argues that private capital may be the catalyst for change, and PE might benefit significantly from future legislation and access to green finance. The PE industry has the unique opportunity to choose which companies not to invest in while banks are under pressure from consumers, allocators, and other stakeholders to reform. Private equity firms may take the lead and construct their businesses around ESG. They may need to look to their peers and organizations for guidance on doing so; otherwise, they will be reactive rather than proactive if they follow the laws.

Finally, relating to the concept of ESG, there is a variance in how stakeholders see the relevance of various ESG efforts. The most effective technique for increasing ESG, according to data and conversations with GPs, is to invest in sectors, products, and services that already have a sustainable perspective. That is to say, the business concept is already viable. These firms can grow their influence and contribute to a better world by receiving money. However, many believe private equity investments in less sustainable companies with a sustainability strategy have a more significant effect when addressing the issue with other prospective stakeholders. According to the interviews, conventional GPs know that transitioning from more minor sustainable businesses to a more sustainable agenda entails transition expenses, reducing a GP's willingness to invest. Private equity funds should help regular companies become more sustainable with their tremendous impact potential. Although there are no barriers to pursuing both methods, the divergence between stakeholders demonstrates that sustainability in private equity is still a work in progress, driven by diverse stakeholders' particular objectives and goals.

Final Conclusions:

- Spite of the fact that the private equity sector is aware of sustainability, stakeholders have yet to agree on definitions and the most effective means for incorporating it into investing procedures.
- Sustainability activities are essential to value development levers, according to the discussed sustainability-niched general partners. They have a track record of success that backs up their claim that there is no trade-off.
- Limited partners hold opposing views on their fiduciary responsibilities and the possible return trade-off connected with sustainability.
- Regulation and enhanced openness are expected to make measurability and comparison easier in the future.
- The divergence between stakeholders demonstrates that sustainability in private equity is still a work in progress, driven by diverse stakeholders' particular objectives and goals.

7.2 Limitations and further research

This thesis has shown how Nordic private equity companies incorporate ESG into their investing procedures and refine the issue with perspectives from Nordic banks. When starting this thesis, there were no signs of the war that would break out on the 20th of February 2022 between Russia and Ukraine. The war and the uncertainty about the future, particularly the financial market's impact, made it challenging to find interviewees willing to take time for an interview while trying to "put out fires" in their daily work. Therefore, they have even less time to devote to their already demanding job. As a result of the difficulty in locating and scheduling meetings with PE employees, the scope was expanded to include additional stakeholders from other financial institutions to conduct a sufficient number of interviews for robust qualitative interview results. Besides this, three significant flaws have been found considering the originality of the issue and the methods used in this thesis. These constraints provide new avenues for investigation.

The first constraint is the definition of ESG and the measures that go with

it. It has been challenging to separate the distinctions between ESG and other related subjects like impact or sustainable investment since industry practitioners have developed their definitions for ESG. As a result, comparisons and measures are intrinsically challenging. ESG-related KPIs may broadly be utilized for comparisons across time at a given portfolio firm rather than for relative comparisons. However, standardization is likely to rise due to the EU's new regulatory framework. Given that the sector will be obligated to report on these defined KPIs, this offers up chances for future study. Since the EU Taxonomy is not yet completely defined and data must be gathered over several years, functional studies will take a few years.

The difficulty of pinpointing the exact impact of ESG is a second barrier. The whole business is influenced by incorporating ESG into the corporate strategy. Given the correlation, quantifying how ESG activities have influenced return when separated from other initiatives is challenging. ESG valuation methods are a hot issue in academia right now, and this thesis emphasizes the necessity for further study.

The semi-structured interview approach results in a third constraint. The interviews demonstrate how various GPs may help boost exit returns by establishing an ESG-based investing thesis and approach. The material was gathered using qualitative interviews, which means that the participants' perspectives might skew the information. Even though this thesis attempted to describe the situation objectively, this is the case. This research cannot generate general inferences due to the number of GPs questioned. As a result, other students and professors are urged to participate in additional research by broadening the aim of the study. To get a sample suitable for quantitative analysis using relevant conclusions, a larger sample of GPs and LPs should be questioned. While this thesis focuses on demonstrating ESG and how such activities provide value, other academics could try to produce a study that focuses on demonstrating how sustainable initiatives may jeopardize a GP's return potential.

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Appendix A

The interview exists in two versions depending on who is being interviewed. Control group A are persons who have any connection to Private equity, e.g. fund manager while control group B works for a company or organization but does not necessarily have to work with private equity.

Formalities

- Recording of the interview
- GDPR form
- Anonymity

Interview A

General questions:

- Vad är din jobbtitel? Kan du berätta lite om vad du gör på dagarna? *What is the title of your job? Could you please inform me about your everyday activities?*
- Kan du förklara processen när du/ni analyserar/investerar i ett företag, steg för steg? Är det någon skillnad när du börjar kolla på ett ett nytt bolag jämfört med när ni fortsätter rapporteringen på ett bolag som ni tittat på tidigare?*Could you walk me through the steps you take when analyzing/investing in a company? Is there a difference between starting to cover a new firm and continuing to cover an existing one?*
- Vilken typ av data är viktig för din analys? T.ex. nyckeltal som du finner viktiga?*Which kind of data are critical in your analysis? For example, what critical ratios are significant to you?*
- Är ESG inkluderat i din analys? Hur analyserar du ESG information? Vad är anlendingen till att analysera ESG? *Is ESG taken into account in your analysis? How do you go about analyzing ESG information? What is the goal of ESG analysis?*
- Om ESG factorer analyseras, vilken roll har ESG relaterat till finansiella analysen? *What role does ESG analysis play in relation to financial analysis if ESG factors are considered?*
- Vilka aspekter av din analys vill investerare see när du presenterar den? Är ESG något som du är intresserad av? *Which aspects of your analysis do investors want to see when you present it to them? Is ESG something you're interested in?*
- När du kollar på ett företags hållbarhetsrapporters, vilka standarder eller dylikt är du intresserad av? Kollar du på några externa ESG källor? Får du något intern support gällande ESG? *What standards or similar factors do you look for in a company's sustainability report? Do you consult any other ESG resources? Do you have any ESG support from within your company?*

Valuation questions:

- Hur arbetar ni med värdering? Multipel, DCF eller marknadsmetoden? *How do you work with valuation? Multiple, DCF or the market approach?*

- Hur beaktar ni aspekter som ESG vid värdering av bolag? *How do you consider aspects such as ESG when valuing companies?*

Appendix A

Interview B

- Vad är din jobbtitel? Kan du berätta lite om vad du gör på dagarna? *What is the title of your job? Could you please inform me about your everyday activities?*
- Hjälper du kollegor med analyser av bolag? Om så fallet, hur gör du detta? *Do you assist your coworkers with company analyses? If so, how would you go about doing it?*
- Hur ser du på den nya EU-taxonomin? What are your thoughts on the EU's new taxonomy?
- Hur påverkar EU-taxonomin ditt arbete? Hur kommer den att påverka ditt arbete? How does the EU taxonomy affect your work? How will it affect your work?

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