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Why failing to do the right thing will cost you

Three industry experts tell Bruno Alves how incentives, supply chain management, profit sharing, sensible tax policies and cutting carbon emissions help make you a responsible operator

You cannot ask for a more auspicious sign, on the day we're hosting the second edition of our Licence to Operate roundtable, than to open the *Financial Times* and find buyout titan Guy Hands talking about just that.

Private equity is "not fit for purpose for the world we now live in", Hands told students in a speech at a conference on alternative investments. The industry "got too insular", too money-obsessed, talking only among itself about "the funds we raised and the pay cheques received".

Terra Firma, the firm he founded, started to bother him come 2017. "People fought against each other to take as much of the pie for themselves as they could," he said. "Most of the people working in Terra Firma were only there for the money."

Hands sounded bitter; the culture he described, somewhat ugly. Worse, the picture he painted appeared to validate the concerns of the likes of US presidential hopeful Elizabeth Warren, campaigning to put the industry on a very tight leash.

Fortunately, our three roundtable participants – Antin Infrastructure Partners' Simon Söder, Ardian's Raphaëlle Muhlmann-Eytan and NTR's Rosheen McGuckian – are in a more positive mood when we congregate in Antin's London offices. They are, however, well aware of the problems Hands described.

"We don't invest in companies, we invest in the assets, which means we're the actual stewards," starts McGuckian. "And we're very conscious we are private sector owners of infrastructure that is important to society. So, our view is that we have a range of stakeholders – our LPs, regulators, banking partners, but also our communities – that are effectively giving us this licence to operate."

Good stewardship

McGuckian continues: "Being a good steward is a conscious decision we make every day. And the only way we can instil that in staff is through [company] culture. It starts with recruitment and then it's about instilling in staff that every decision they make – from investment to how they manage assets or build programmes – involves choices. And they can either take shortcuts or do things the right way."

As an investor in companies, Ardian has to find ways to inculcate those values across its portfolio. "All the chief executives of our portfolio companies have part of their variable incentive based on ESG," explains Muhlmann-Eytan. "We think that's something that makes a radical change in the culture of the companies. It also has a cascading effect, with other people within the companies having incentives based on sustainability KPIs."

For Söder, the sort of controlling stakes Antin tends to take plays a crucial role in the firm's ability to influence how its businesses operate. He also stresses the importance of having a strong environmental, social and governance framework in place, with regular reporting and surveying of portfolio companies against predetermined targets.

"But any framework is not going to be perfect, so I think you need to have a culture and conviction that you are wanting to do business in the right way," he points out. "It's a more intangible thing, but I think it's equally important alongside the frameworks and the reporting. That has been the founders' conviction from day one, and it has filtered through the organisation."

PHOTOGRAPHY: **JULIAN WINSLOW**

Simon Söder

Partner, Antin Infrastructure Partners

Söder has more than 16 years' experience in principal investing, mergers and acquisitions, and corporate development, working across the infrastructure, transport, energy, telecoms and industrial sectors. He joined Antin in 2014 and is a board member of the firm's Fund II portfolio company Eurofiber and of Fund III portfolio companies FirstLight Fiber, Lyntia and Sølvtrans. Previously, Söder was senior vice-president in the infrastructure, utilities and renewables team at Macquarie Capital.

Raphaëlle Muhlmann-Eytan

Director, asset management, infrastructure group, Ardian

Muhlmann-Eytan joined Ardian in 2007 as a product manager in the investor relations team. From 2010 to 2018, she was senior investor relations manager and a member of Ardian Comex Sales. In 2018, she joined Ardian's infrastructure asset management team, where she engages with portfolio company teams on sustainability programmes, such as health and safety operational excellence, carbon reduction roadmaps and energy efficiency.

Rosheen McGuckian

CEO, NTR

McGuckian was appointed chief executive of NTR in April 2013. Since joining NTR in 2008, she has held a number of leadership roles, including most recently the group business development director and chief executive positions in solar development and waste management platforms within the group. Prior to joining the firm, McGuckian was chief executive of GE Money Ireland. Before joining GE in 2002, she led the business transformation initiative for Irish utility ESB Power Generation.

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>
> **SIMON SÖDER**
> **Antin Infrastructure Partners**

A crucial point for any manager with a diverse portfolio of companies is the ability to share best practices, Söder argues. "A key part of what our head of ESG does is share best practices between our portfolio companies," he explains. "In 2019, we formed an ESG Club composed of representatives of our portfolio companies who meet once or twice a year to share knowledge and expertise on common ESG-related matters. Certain companies, for example, are quite advanced in how they manage health and safety issues. So, the ability to have [portfolio] companies learn from each other is very effective." That is a practice Ardian also engages in, Muhlmann-Eytan points out.

Accountability is equally important. At Antin, Söder stresses there is no handing over of responsibility. This means whoever has done a deal then stays on the board of the acquired company and is responsible for tracking and improving on the issues that need to change.

Muhlmann-Eytan says Ardian takes a similar approach: "It's definitely part of the duty of the senior members of the investment team to work on these topics with the top management of the portfolio companies. When it comes to the asset management team, it is their job to set measurable and concrete actions."

She offers an example: "We've been working with Ascendi, our road concessionaire in Portugal, and since last year, they have implemented a bonus for their sub-contractors tied to health and safety KPIs. That bonus is present in 100 percent of their sub-contracts. That's something we supported, as a majority shareholder. So, it's not just about changing the culture of a company – it's also about changing the culture of the ecosystem around that company."

McGuckian agrees that influencing the supply chain is key, even if it can sometimes be tricky.

"One of the things we said was that our tier one suppliers – anyone we spend €25,000 or more with per annum – need to sign up to the equivalent of the UN Sustainable Development Goals. That turned out to be a very interesting exercise, because we had to ask our people to go out and talk to everyone from law firms to quarrymen and hauliers and get them to sign up for this – and they were unsure how these conversations would go. In the end, we got about 90 percent compliance, so win certain cases, we have not renewed their contracts."

Engaging stakeholders

McGuckian's and Muhlmann-Eytan's examples shed some light on the realities of trying to influence a large number of stakeholders. But supply chains are only one part of the puzzle. As Söder points out, there are several others. "There's the communities where the businesses operate," he says. "There are the customers, who sometimes are a subset of those communities, but not always. And then there are the regulators and policymakers, who in infrastructure are always going to be important stakeholders."

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> **RAPHAËLLE MUHLMANN-EYTAN**
> **Ardian**

Muhlmann-Eytan stresses the importance of being aligned with public partners. "We are shareholders of six airports in Italy working closely with the public authorities," she explains. "For instance, in Milano Airport we are partnering with the municipality to help reduce carbon emissions, promoting public railway transportation over taxis and cars for the [airport] commute. That requires significant capex, though, so it's good we're aligned."

Söder says Antin likes to take a local approach, whenever possible. That often means meeting with regulators in person, "so we're not just faceless investors sitting somewhere".

It also means supporting "employees in the businesses that we own [that] have specific initiatives, or sometimes NGOs they'd like to work with locally". And, of course, it means engaging with employees directly, through anonymous surveys for example, "to get more of an objective picture of what's going on in the business, which can be quite revealing".

McGuckian knows the impact NTR's assets have on their communities.

"We build wind turbines and not everybody likes turbines in their local area, so we're always very careful," she says. "As part of the investment due diligence, we try and ascertain what was the community feedback, even for something that already has planning permission. We'll then make a determination based on that."

Local employment is an important consideration for the NTR chief executive. "That's one of our key metrics and that is usually [more important] during the construction period," she says. "In fact, it's one of the KPIs for our contractors, to keep them focused."

For Ardian, profit sharing is high on the agenda – for its own employees and those of its portfolio companies.

"It's very straightforward," explains Muhlmann-Eytan. "At Ardian, all full-time employees have part of their remuneration linked to the results of the company. This was part of French regulation, but we decided to make it global. That means that every year, the company allocates a portion of its profits to each of its employees. Regardless of seniority, whatever their function, they will get the same amount [from this allocation], depending on the profit [level] of the company."

At the portfolio company level, the profit sharing plays out when successful exits occur. "Full-time employees have been getting between one and four months of salaries as a one-off, exceptional remuneration when we exited from Kallista, Indigo, Encevo and Luton Airport, for instance."

Being a green citizen

While all the above measures are positive, have any of our roundtable participants found themselves thinking about industry practices that might have been perfectly acceptable a few years ago, but merit a second thought these days? Excessive debt is one example that came up during last year's roundtable, a practice none of our participants seems particularly keen on.

"As our sector gets more competitive, you have to be careful about certain vendor models being put in front of you because they make some pretty extreme assumptions around how long these assets are going to last without any investment being put into them," McGuckian answers. "They also make assumptions around tax benefits where, again, you could try and convince yourself they are correct, but if that's not the case you're going to find you have a problem."

"I agree," Söder says. "At Antin, we think aggressive tax planning is not the responsible thing to do. As everyone [does], we make sure we structure our investments as efficiently as possible, but we're definitely not on the aggressive side. Today, more than ever, I think that's going to be scrutinised. And it's a very sensitive topic, which just reinforces our view that you should take a sensible approach on these topics."

Although on board with the above, Muhlmann-Eytan points to the emphasis being put on climate change and carbon emissions reduction as a definite change to business as usual: "We have been measuring the carbon emissions of all our portfolio companies and we are focusing our efforts on reduction."

"We have specific action plans at the portfolio level," Söder says, "but also at the GP level. For example, we have measured our carbon footprint and we have changed our travel policies to make sure that we, as a firm, think about how often we fly. We've also invested in a carbon reduction project in South America focused on reforestation, to try and offset the footprint that's inevitably going to be part of our business."

As the only 100 percent renewables investor around the table, McGuckian's whole business is about fighting climate change. That doesn't mean building renewable assets is the only thing a renewables investor can do.

"You can do a lot of recycling and we have, in fact, refurbished some of the wind turbines used in one of our earlier wind farms in Denmark," she points out. "We've also refurbished some of our smaller wind turbines and put them to work in Northern Ireland. But of course, the tendency with wind turbines is to go bigger and better so you can't necessarily expect all of them to be refurbished."

Somewhat ironically, considering its line of business, NTR is the only manager around the table to have had assets directly affected by climate change.

"One particular wind farm we invested in has elevated foundations and waterproof membrane on the lower parts of the tower because we believe there's going to be

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ROSHEEN MCGUCKIAN
NTR

potential for a more than one in 200-year chance of flooding," McGuckian says. "That type of additional capex can only impact the valuation to the ultimate vendor. That's a classic example of something you wouldn't have thought of 10 years ago."

Do LPs care? Yes, by geography

Although some LPs – think Bill Watson, First Super's chief executive – are passionate about licence to operate and ESG, the reality is these issues are still not high up on the agenda for most. Our recent *Perspectives 2020* survey, which polled 146 institutional investors, found only a third of private market LPs saying analysis of a manager's ESG credentials was a major part of their due diligence. When LPs do care about these issues, they seem to care very much by geography, with Europe comfortably in the lead, a minority of US investors showing interest and Asian LPs, for the most part, not especially worried.

Although all our roundtable participants agree that engagement fluctuates by geography, Muhlmann-Eytan says Ardian has seen LP demands linked to ESG due diligence increase by eight times over the past five years.

Söder also points to the irreversibility of the current direction of travel: "In infrastructure, investing responsibly and with ESG at the heart of decision-making is generally the right thing to do – both from a financial and moral perspective – keeping in mind the nature of the assets and the potential downside if you don't. And then I think there's another aspect that's maybe harder to quantify, which is that the potential pool of buyers [for your assets] that's going to care about these issues is only going to grow."

The latter should negate any lingering faux tensions between profit and licence to operate. But if push comes to shove, would our participants actually walk away from a deal? They all answer in the affirmative. And as McGuckian points out, deals can also walk away from you.

"Sometimes, whatever needs to be fixed – whether it's health and safety or a need to mitigate habitat issues – can become a valuation point," she says. "In which case, [an acquisition target] may say, 'Thanks very much but we're going with someone else that is willing to keep [our] value [intact]'. And that's a choice we need to be prepared to make. We're long-term investors. We don't want a curveball [thrown at us] three or four years down the line." ■