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DELIVERING RESULTS

How values drive value

ESG is not just about mitigating risk, it is also a proven way of boosting returns, says Actis head of responsible investment Shami Nissan

With a heritage spanning over 70 years, Actis's involvement in growth markets has long had an impact on the communities in which its portfolio companies are based. At the heart of its responsible investing ethos is the idea that environmental, social and governance factors not only have a material impact on the businesses it backs, but also that "values drive value". We talked to Actis head of responsible investment Shami Nissan to understand how Actis approaches ESG and how that underpins the way investments are selected, managed and – ultimately – exited.

Nissan: *you need to be agile*

Q Actis talks a lot about how "values drive value". Can you explain what you mean by that?

One of the things about ESG is that very often firms see it mainly as a risk mitigation exercise. That's certainly part of it, as issues such as environmental damage, social unrest or governance shortcomings will certainly affect a company's reputation, add to its performance and distract management time away from running the business. So we do see managing ESG effectively as a way of managing risk. However, it's much more than that. Responsible investment is part of our value creation toolkit, particularly given our focus on growth markets. Many ESG issues are particularly acute in the regions in which we invest and so we see ESG as being intertwined with delivering strong returns to our investors. In our view, there is no compromise; managing ESG effectively is an integral part of how we create value and generate returns."

> ***"A one-size-fits-all approach to responsible investing isn't effective or appropriate. You can't have a stock response***

Q So how does this work in practice?

We have a long track record of responsible investing. We have had dedicated, in-house responsible investment resources from the time we spun out of CDC Group. Since that time, we have developed and honed proprietary frameworks that we have tried and fully tested. We know our sectors and markets well and that's what really sets us apart – we understand the kinds of issues that can crop up in the investments we make.

Even before we invest, our due diligence process is designed to highlight any gaps in ESG management so that, if we decide to invest, we know how we can strengthen those areas of weakness. We also spend a lot of time with the management teams of potential portfolio companies, the CEO in particular, to ensure that they are mentally aligned with us and what needs to be done. We know that managing ESG issues has to come from the top, otherwise the values that drive good performance from a responsible investing perspective won't be properly embedded through the whole business.

We also seek to apply international standards to the businesses we back. In the absence of strong regulatory frameworks and enforcement in many of the markets in which we invest, adhering to these international standards is vital for creating the right conditions for improvement. International Finance Corporation standards, for example, are very exacting and yet we believe that striving to adhere to them brings about sound management practices in our businesses that will drive the right decisions, benefit local communities and ultimately create value for stakeholders and our investors.

Q Can you give us any examples of how responsible investment is embedded in portfolio companies?

Our energy investment business is a great example. We take majority stakes in this sector so our impact is arguably greatest here. So, in our energy infrastructure investments, we always put in place an ESG sub-committee consisting of company management as well as at least one Actis team member. One area this sub-committee heads up is the community investment strategy, which is a long-term commitment to building relationships with local communities and creating shared value. This is part of what we feel gives us and the companies a licence to operate.

We also install a head of ESG at each company. Indeed, in our pan-African energy portfolio company Lekela, the head of ESG was the second appointment after we'd brought in a new CEO – that demonstrates the importance we place on ESG. The ESG head is a dedicated professional who reports directly to the C-suite. Having this role in each of our energy investments helps ensure that good management of ESG issues is embedded even when we are no longer investors.

Energy investing: *majority stakes ensure ESG can have maximum impact*

Q So is this the approach you take in other areas of your investment business?

Energy is slightly different in that we take majority stakes in these businesses, enabling Actis to be the architect of governance. In our PE businesses, we do take significant minority positions across a number of different sectors so this approach wouldn't work. It just shows how a one-size-fits-all approach to responsible investing isn't effective or appropriate. You can't have a stock response to this; as a responsible investor, you need to be agile so that you can manage all situations well – we have over 70 portfolio companies across the regions in which we invest, all facing different issues and challenges.

Q So how do you manage ESG in private equity?

In private equity investments, I spend a lot of time with each sector head to understand the specific issues in each industry and what ESG best practice looks like. Establishing what constitutes best practice is not something you can read in a book – it comes down to knowledge and experience.

Let's take healthcare as an example. Business integrity is a big issue here and therefore a high order concern of ours, especially in pharmaceuticals. We spend a lot of time before investing to determine the company's modus operandi, how it retains relationships, where it draws the line between educating physicians and promoting products and whether management and employees understand why integrity is so important. We have a framework of questions to answer during due diligence, but our view of the company is also formed through face-to-face contact with management. Any gaps we find form the basis of our 100-day plan to improve systems and ethical standards.

It's an approach that works. We invested in Egyptian business Integrated Diagnostics Holdings at a time when it was still run along entrepreneurial lines. Our work to put in place the right systems and procedures meant that the company has now listed on the London Stock Exchange.

Q How do you ensure the management team is aligned with you on ESG goals?

We make sure that management understand that they are undertaking an agreement to manage ESG issues effectively and that they are philosophically with us – we have to ensure we have picked the right partners with which to do business.

Yet we also provide a lot of support to companies. They look to us to provide advice and help them implement international best practice. Our knowledge and experience means they don't have to reinvent the wheel because they can take advantage of, for example, our business integrity toolkit. It's very much up to us to guide them through the journey. By way of example, we recently held an off-site meeting with all the heads of ESG in our energy portfolio companies. That created a platform for these professionals to share best practice and create a global network of contacts. We also have quarterly conference calls that allow ESG heads to talk through experiences and how they have managed to resolve issues.

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UMEME: A CONVICTION THAT RESPONSIBLE INVESTING DRIVES VALUE

In many ways, Actis's investment in Uganda's electricity distribution company, Umeme, in 2005 "demonstrated our conviction that responsible investing drives value", says Shami Nissan. It was the first time the firm had invested in a distribution company and it had suffered from decades of underinvestment. Yet by 2012, the company was ready to list and it has since become one of Actis's most successful investments.

The success was down to a holistic approach to business improvement – with ESG issues at the core of many of the changes. When the firm invested, there were around 25 fatalities a year stemming from people illegally hooking up to the power distribution network and from rotten poles falling. "We'd never invested in a company with such a safety challenge," says Nissan.

Safety first: *Actis invested heavily in replacing the pole network*

What followed was a transformation of the business. "We hand-picked a new management team, established a board of directors – the company hadn't previously had one – and created sub-committees that were responsible for a number of areas, including remuneration and ESG. We also appointed a head of health and safety," says Nissan.

Actis invested heavily in replacing the 20,000km pole network, upgrading them all to the latest safety standards. Importantly, Umeme also embarked on an education programme in local communities. "All company employees were required to conduct talks in schools and communities so that everyone appreciated the issues," says Nissan. "This involved around 16,000 talks a year explaining the benefits and dangers of electricity."

The result was that, by 2015, fatalities had dropped to zero, there were 143,000 new customer connections in that year alone and energy loss fell from 35 percent in 2009 to 19.5 percent in 2015. Sales also increased over the same period from 1,401GWh to 2,458GWh.

The exit process also bore the "Actis hallmark", says Nissan. "The company launched its IPO on the Ugandan stock exchange in 2012 and shortly thereafter cross listed onto the Kenyan market. To ensure a responsible transition Actis worked closely with the Ugandan government and were pleased that there has been both deep retail interest from Ugandans as well as institutional appetite, including the state pension fund which has been steadily increasing its investment in Umeme over the last few years. With these investors, and Umeme's experienced and independent board, we knew it would continue to be in safe hands." In 2016, Actis sold its last remaining stake in the business. ■

Q How do you approach responsible investing in real estate?

Our philosophy is to follow 'green by design' standards. We are committed to developing buildings that are independently certified according to international standards, such as BREEAM, LEED and IFC EDGE. We have built the first green buildings in Lagos, we built the Garden City Mall to green standards in Nairobi and also built to international standards in Accra. There can be a higher cost associated with meeting these standards, but we see 25 percent to 30 percent less energy consumption in these buildings so it is important to do a detailed cost benefit analysis to understand the economics. This obviously has an environmental impact, but is also very important in regions where power supply is intermittent.

This aspect of our real estate philosophy also neatly demonstrates the 'values drive value' point. Not only are the buildings cheaper to run, but they also have high occupancy rates as many companies, especially multinationals, find green buildings more attractive than other similar developments that do not conform to international standards.

Q On the "values drive value" point, what are you seeing at exit? How important are ESG issues to buyers?

ESG has always been a priority for international companies, but it is growing in importance for all buyers now. Our ability to demonstrate that ESG issues have been managed well, that systems and procedures are in place and embedded and that there is a culture of compliance in the companies we are selling does generate value at exit. We know that companies are willing to pay a premium if they know the risks are managed well.

Yet it's also important to us that, however we exit the business, our legacy is retained. Sustainability is not just about environmental standards; it's about creating longevity. We have an exit checklist that looks at areas such as a buyer's track record on ESG issues and what their plans and processes are. We spend a lot of time elevating ESG standards. We want to ensure these are retained long after our involvement. ■