EXPERT Q&A

Managers continue to up their efforts with colleagues and communities, despite the economic challenges, say Paul Woods, director of sustainability, and Jan Wade, group chief people officer, at Arrow Global

Prioritising the 'S' of ESG

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Q Will rising inflation and interest rates increase the threat of ESG neglect – in particular the 'S' of ESG?

Jan Wade: Absolutely not. We are very committed – our ESG approach, and the 'S' especially, sits at the heart of our heritage and our values. The economy and the global situation has been quite volatile for the last three years and we have continued with a firm commitment to the position we want to take. That has been a longstanding approach that we have taken both as a PLC and now as a private equity-owned business, and we are aligned with our owners TDR Capital as well.

There are economic pressures but we have consistently taken a socially responsible approach with our colleagues, communities and customers, and we continue to have an active dialogue with them. During covid and also at the moment, we have been clear on our position, providing cost of living support to our colleagues and increasing our activities in our communities, which our colleagues have been keen to engage with. We are planning our approach for 2023, aware of the inflationary pressures. Our strategy of making sure we are doing what we can to support people remains unchanged. Clearly, we are ambitious, and we want to deliver really strong results for our investors as well. But, if anything, we are now focused on the 'S' more than ever.

Paul Woods: More broadly, from an investment perspective, social factors should be embedded into all risk management and investment decision-making frameworks. Organisations need to be able to understand and quantify social considerations alongside any other investment criteria, irrespective of the economic cycle, because if a manager is going to generate a long-term return, neglecting the 'S' is going to create problems down the line. This is now so embedded in most firms' investment approaches that it is unlikely to slip away.

Q Is the 'S' a differentiator or hygiene factor when raising investor capital?

PW: Increasingly, we see investor sentiment pushing these topics up the agenda, with investors asking more questions and demanding more rigour, both during due diligence and in ongoing reporting. We have moved beyond the hygiene factor approach. The direct linkage between investor concerns and capital raising is maybe more difficult to assess, but as an area of concern that needs to be adequately addressed throughout the lifetime of an investment, this is at the front of investor's minds and will increasingly be a key differentiator.

JW: As we are building and scaling our platform, we are very conscious that we need to hire and develop people with expertise in ESG products, strengthening the capabilities that we already have in-house.

Q How do company-wide ethics deliver accretive results to investors?

PW: Company-wide ethics are important to both long-term returns and performance track record. Clearly, an inability to properly understand and action concerns around the 'S' factors of ESG is more than likely going to result in the manifestation of some reputational risk for the business or the portfolio. An ability to look at how the company has performed over time, and record that change, demonstrates the right culture and management controls.

With non-performing loans and the purchasing of distressed assets, there are often elements that need to be addressed on day one of our acquisition of a portfolio. So that forms part of our investment decision-making, but also

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>
> **PAUL WOODS**

the plans we make for the life of the investment. This has to be a long-term approach, with governance around it, to be accretive for investors. For Arrow, our selective investing, underwriting insight and proprietary dealflow, underpinned by an ethical lens, drives sustainable, long-term attractive risk-adjusted returns for our investors.

JW: In the last 12 months, we have really bolstered our approach to this, aligning our governance with our investment decision-making. We have strong leadership; it is really strongly integrated into everything we do. Arrow has always embraced the benefits of strong governance, both for our own perspective and because of the confidence it gives our investors.

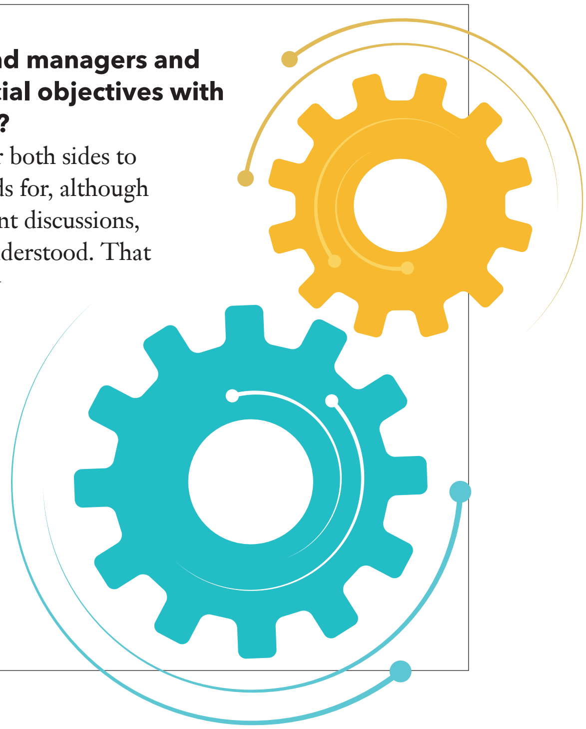
Q Should the industry give precedence to 'S' over 'E' and 'G' or does it depend on the investment strategies?

PW: On the investment side, clearly where we have well-defined investment strategies that are delivering on specific 'S' or 'G' outcomes then that defines itself.

More generally, we are seeing a

Q Is it important for fund managers and investors to align social objectives with their core business model?

Paul Woods: It is important for both sides to understand what the other stands for, although by the time you get to investment discussions, it is likely that is already well understood. That alignment becomes increasingly critical when you are trying to drive specific investment outcomes that require a different level of emphasis and transparency around ESG. We will see a move towards more specific standards and certifications that provide investors with more comfort and understanding.



greater integration of the three elements of ESG. For example, a transaction that might help to finance residential real estate development will come with a raft of social and environmental considerations, both in terms of environmental impact and in terms of social opportunities to provide affordable housing, additional infrastructure, schools and so on.

JW: When I think about our strengths in terms of ESG, I think the three strands are really inter-related. Our approach is based on our heritage and that strong governance approach to investments and the way we operate our business.

Striking the balance in terms of 'S' and 'E' across our portfolio is evolving – we will see further developments around what we are doing on environmental impact. We are very focused on the 'S'. That is driven at a corporate level and at a 'local, local' platform level by our colleagues. This isn't just a corporate position; we have 2,500 colleagues who are really focused and engaged, so it is at the heart of what we are. We are pleased with our position on ESG but we want to build our commitments and contributions across all three aspects.

The local, local model we possess is a differentiator for us and for our investors. Our local platforms are empowered to generate unique investment opportunities. There is a huge amount of pride over how they operate and how integrated they are into their territories, so as much as investments are driven locally, so are many of our ESG activities across all the countries we operate in.

Q Is it important to benchmark and report on 'S' priorities? What do you consider best practice in this space?

JW: For the last few years, we have been very mindful that every organisation has its own perception of how it is doing in this area. But ESG does require you to challenge yourself on that thinking, so external benchmarking is very important. On the 'S', we chose to have an external audit of how we are doing on diversity and inclusion. We partnered with The Clear Company, a D&I consultancy, and their findings shaped our strategy going forward.

We have also partnered with other external providers that can provide us with insights into best practice. On the social side, going through covid, we partnered with an external provider to benchmark what we were doing on the office environment and hybrid working, and our response to the cost of living crisis has been based on what we feel is right considering our values and external benchmarks. So, we use those external voices all the time because we feel it is dangerous to be too inward-looking – we always want to be stretching ourselves and improving what we are doing.

PW: Generally, what I have seen across the investor space is maybe less consistency around what people want to talk about under the 'S', because priorities vary so much. The level of regulation also varies across our markets, whether in relation to treating customers fairly or other areas such as data privacy.

There are obviously attempts under initiatives like the UN Sustainable Development Goals and the Global Compact to use global frameworks to align activities to the priorities of counterparties, but the challenge is that those can be so broad that we risk losing sight of what each company is doing; while investors need to be able to compare one opportunity against another in a consistent way. People need to understand both the qualitative and quantitative data being shared, and we will see more alignment on that and progress on standardisation of metrics.

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> **JAN WADE**

Q How do you engage senior leaders with 'S' programmes – do you appeal to their hearts and minds, or is it much more commercially driven?

PW: There are formal and informal approaches. From a more structured standpoint, we do operate a sustainability and ESG forum, which we benchmark against other firms. That is about getting a cross-section of the leadership group around these topics on a regular basis and providing them access to external subject matter experts to educate and raise awareness on key topics.

JW: We have very clear priorities across our group – we emphasise the local, local model but we also have 12 clear strategic priorities and a clear focus on those. This discussion starts from when we engage with candidates and onboard them around how we do business and what is important to us. We are clear about our expectations and values, and that runs right through to rewards decision-making. We pay attention to hearts and minds and we promote an environment of learning on this.

PW: For the industry as a whole, driving the right behaviours raises questions for individual firms, particularly around remuneration and linking performance to ESG. Every organisation has to work out how their systems can encourage and recognise positive contributions. ■