

SOCIAL IMPROVEMENT

Barking up a new tree

Addressing social issues can yield value creation opportunities, says Blue Wolf Capital founder and managing partner **Adam Blumenthal**

Blue Wolf Capital founder and managing partner Adam Blumenthal cut his dealmaking teeth on industrial transactions, many in heavily-unionised companies, in the late 1980s. This gave him an appreciation of the need to engage with constituents and align stakeholder interests to build stronger mid-market companies, a value he embedded in the DNA of Blue Wolf.

Following the successful final close of the firm's oversubscribed fourth fund, Blumenthal shares how a focus on the 'S' in ESG has unlocked investment opportunities and driven value creation across Blue Wolf's portfolio companies.

Q You recently closed Fund IV at its \$540 million hard-cap after less than four months in market. How do ESG principles play into your value proposition for investors?

We're a private equity fund, we have a broad set of institutional investors who expect private equity-like returns from our investments. We believe ESG principles allow us to find reasonably-priced opportunities

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with differentiated value creation strategies that other people who don't look at things this way simply overlook.

In today's society, many people are deeply troubled by a lack of solutions to large, visible problems and a lack of constructive ways to engage in those. When you adopt ESG principles and integrate them into value creation strategies, you tap into that frustration on the part of managers and investors, and that causes them to be more committed and creative. That's what ultimately drives returns, and it also drives the innate satisfaction that people should get from work when they're building something that has sustainable value.

The impact we have is not only in the identification of strategies and opportunities, but it's in the motivational power that comes from aligning work with other frustrations people have as human beings and allowing them to address those through their job while creating value and being competitive. If you can do that, the finest people in the world will drop everything to help make it real.

Q What are some of the ways Blue Wolf goes about addressing those problems?

We own a saw mill in Dixie County, the poorest county in Florida, and we are the largest private sector employer in the county.

We make a point of reaching out to the high school there and making sure there are employment opportunities for people near the top of their class. Why? It's not always easy

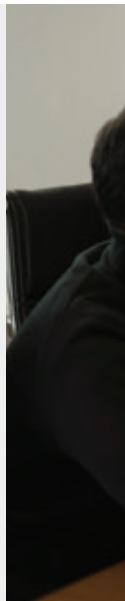
USING THE RIGHT TOOLS

The key to a successful ESG strategy is ensuring you ask the right questions, says **Adam Blumenthal**

For Blue Wolf Capital Partners, ESG was never a last minute box to check. Since the firm's founding in 2005, Blue Wolf has looked for opportunities to invest where implementing ESG principles are aligned with the objective of creating value for its limited partners.

Now that the firm has grown to more than \$1.2 billion in assets under management and is about to invest its fourth institutional fund, Blue Wolf realised it needed to formalise its evaluation and treatment of ESG to allow for replication of its principles. The firm created a volunteer working group, comprised of vice-president Bennet Grill, lead operating partner Rick Winegar, chief financial officer Joshua Cherry-Seto and senior advisor Michael Musuraca, which worked with a consultant to develop a formal process for articulating and measuring ESG objectives. The result of this collaboration is Blue Wolf's proprietary ESG diligence toolkit, which it now applies to every prospective investment. Here's how the toolkit works.

Beginning with the initial presentation to Blue Wolf partners, the investment team is prepared to discuss a target company's ESG business and reputational risks, and value creation opportunities. To do this, the team uses a standard list of 40 questions that allows for rapid identification of material risks and opportunities deserving further focus. As diligence progresses, the team obtains relevant documents and discusses issues with management to further assess these areas. The materiality scan is critical – deal teams need to be laser-focused on underwriting





*Diligent approach:
Blue Wolf's
proprietary
toolkit helps staff
articulate ESG
objectives*

a business plan, and the toolkit helps transform broad ESG questions into needle movers that strengthen the underwriting

The questions initially cover a broad spectrum of issues:

- **Environmental** Blue Wolf evaluates environmental considerations at the target and across its supply chain, including energy and natural resource usage; permitting and regulatory compliance; sustainability; and environmental impact on groundwater and soil, looking for red flags, risks requiring mitigation, and opportunities for cost savings, value creation, and competitive advantage.
- **Social** Blue Wolf does a broad review of human capital management, including both metrics and policies related to turnover, health and safety, employee development and opportunity, labour relations and diversity. It also reviews a company's history of, and potential for, stakeholder alignment and conflict and other potential community impacts, and the level of knowledge about its supply chain.

- **Governance** Blue Wolf reviews board of director composition, meeting frequency, and inclusion of independent members. When, as in a carve-out or founder-led company, there is limited history of these measures, Blue Wolf identifies a governance strategy. The firm looks at executive job descriptions and responsibilities, with an eye toward clear objectives and performance-linked pay. Blue Wolf examines firm-wide policies related to compliance, including oversight of ethical contracting, corruption and bribery prevention, and protection of confidential customer information.

This process is reviewed – and often delved into more deeply – prior to the issuance of a Letter of Intent, again at the presentation to the Blue Wolf Investment Committee (IC), and lastly, as part of final due diligence and recommendation to the IC. As investments reach closure, Blue Wolf and its management teams discuss the observations and incorporate the results into long term value creation and risk management plans. ■

to get somebody to move to Dixie County, so somebody who has family and roots there is much more likely to be a good long-term employee. And the social problems of rural America are widely documented. How do you address them? How do you find a quality workforce in that community? You do it by integrating career ladders and a visible future for people from the time they're 17 years old. We create a vibrant business, we get a skilled, talented, dedicated workforce that's stable, and we create a community that's more resistant to social problems. If you didn't do it, you would have trouble attracting the workforce that can produce a high-quality, consistent product.

In our minds, the 'S' part of ESG is all about knowing your people and finding ways to strengthen the company by aligning your interests and theirs.

Q How do you draw a link for your investors between ESG and value creation levers?

We look for opportunities to invest where implementing ESG principles are aligned with the objectives of creating value for our investors. There are many value-creation activities that are non-ESG related, and we think excellence in those is critically important. But we particularly look for opportunities to deploy ESG principles where they're additive, where having the best supply chain in the industry is a competitive advantage, where having the lowest turnover rates in the industry is a competitive advantage, where reducing energy usage improves our cost structure and so makes us a first-quartile producer in a commodity industry. In those situations, we can invest and align the ESG principles with the investment thesis.

Q How does this approach open up investment opportunities?

Many of the things people see as social concerns are in fact opportunities for »

» companies to meet needs and improve their own organisations by thinking about the negative effects and how to mitigate them.

We own a rapidly growing urgent care business in Brooklyn, New York is a state which by regulation historically strongly favours not-for-profit models of healthcare delivery, and which has some gaps in healthcare delivery in lower-income urban and rural areas. If you see those regulations as barriers to entry, then if you figure out how to deliver a service within that regulatory environment, you've built an organisation which has great barriers to entry because other people didn't see it, didn't have the orientation.

Q Blue Wolf was an early supporter of the UN-supported Principles for Responsible Investment. Why is an industry-wide body important?

When we were a smaller firm we just said: 'This approach, these values, this understanding of the kinds of investments we want to make, it's just in our DNA. As we've grown – we have more portfolio companies, they're larger, we have a larger team – it's important to have principles, and to articulate principles which are widely understood and communicated so that people know what to do. The great advantage of a system like the PRI is that by articulating a set of principles, it

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allows both firms and the industry as a whole to shift their perspectives.

As you try to apply the PRI principles, you discover ways of creating and unlocking value that you wouldn't have thought of otherwise. That will ultimately organically put a lot of substance behind this effort.

Q Have many of your peers in the mid-market adopted the same approach?

There can be a greater adoption of our approach and there won't be crowding out of opportunities.

We've grown from zero to \$1.2 billion in assets and commitments, so that's evidence there's a material opportunity. We make investments that are generally low multiple and not highly leveraged because the approach we're taking allows us to find

differentiated, off the run dealflow, and see opportunities others might not.

If you ask a large consumer products company – Apple or Unilever – 'what do you know about your supply chain?' they know where everything is made. Because they operate very much in the public eye, understanding their carbon footprint, understanding their supply chain is a critical part of building value for their shareholders because it helps them build a stronger company, grow market share, improve quality, get greater acceptance by their customers.

Those ideas, which are now very well accepted in large parts of the global economy, haven't permeated mid-market private equity. The insight we have is those ideas help us build stronger companies in the mid-market, companies that will have better opportunities to exit because they'll be attractive candidates, but also companies that just in and of themselves will be more competitive because they'll know their own business better.

Q What's your advice for dealing with multiple stakeholders with differing viewpoints?

You have to have a clear vision, you have to communicate well, and you have to understand that communicating well means not only understanding your position and ensuring that other people understand it, but listening to them. If you look at non-economic stakeholders as people who have objectives, and you listen to those objectives, you need to identify the conflicts with your objectives because you have to be realistic, but you also have to listen for the areas of alignment and you have to build on those.

Everyone who has ever tried to work in a difficult unionised industrial environment has learned that incentives are very important. The power of alignment and incentives to really change quality and productivity, and the experience of both the employee and the customer, is remarkable. ■



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