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Private Equity Index 2023

November 2023

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About the Deloitte PE Index

Private equity has long been a driving force behind the UK economy, providing the capital, expertise and strategic guidance to stimulate cross-sector growth.

Today's landscape is evolving rapidly, with stakeholders demanding more than just financial gains. Increasingly, investors are looking for Private Equity firms to be catalysts for change, aligning their strategies with social and environmental responsibility to create a more sustainable future.

Against this backdrop Deloitte has carried out a detailed analysis of the performance of 92 PE-backed businesses in the consumer sector across three key dimensions of business success, commonly known as the triple bottom line, of people, planet, and profit.

With a combined turnover of £124bn and 625,000 employees, the companies we have analysed – and the Private Equity houses supporting them – have the scale and capacity to drive significant change.

Through our research we have collected and analysed over 5,500 data points on 32 metrics across people, planet and profit for the first iteration of the Deloitte PE Index. We plan to further automate the index and scale to cover the, c.500 and growing, PE-backed companies in the UK that have over 250 employees and £100m+ turnover.

The individual scores for the companies assessed show a huge discrepancy across the underlying metrics and across people, planet, and profit categories; with room to improve for all. Having delved into the detail, we can provide critical information to help form investment strategies that are defensible, predictable and profitable both today and in the rapidly-evolving economy of tomorrow.

Traditionally, PE has been associated with short-term financial gains, often at the expense of environmental, social, and governance (ESG) considerations. However, as we stand on the precipice of a world beset by climate crises, social inequities, and governance failures, it is incumbent upon us to rethink the way capital is deployed.

Private Equity, with its immense influence, agility and capability, has the power to lead the charge for a more responsible and inclusive economy.

This report is more than just a collection of data and metrics. It's a testament to the evolving nature of finance, and a recognition that the triple bottom line – people, planet, and profit – is not merely a buzzword; it is the compass that should guide our investments and shape our future.

In conclusion, this Deloitte Private Equity Index report is a call to action.

It is a call for greater transparency, accountability and urgency of action throughout the UK economy. It is only through this clarity that we can build trust and confidence among key stakeholders, unlocking a new era of responsible investing; one where profit is not the only motivation but where a thriving planet, a just society, and creating great places to work are integral to success.

Whilst today, significant focus and effort is given to profitability, investors are already adjusting valuation metrics to account for the impact a company has on society and the planet (both good and bad) and we expect that this valuation adjustment will continue to be a bellwether for good companies and identify them from poorer ones. Therefore, focus on the three components of the triple bottom line will, in our view, in the future increase overall valuations.

Anne Marie Laing,
Partner, UK Private Equity Consulting

Creating the Deloitte PE Index

In creating the Deloitte PE Index we assessed 92 companies across 5,500 data points to create a score for each of people, planet and profit, with a maximum of 100 for each category, for a total of 300. By intentionally evenly weighting each of the three "P's", we set out to understand the balance between metrics and how investing in one area might impact others.

Methodology

We selected the population for the Deloitte PE Index based on UK headquartered, private equity backed companies with over 250 employees and greater than £100 million revenue. We chose these criteria to create a population with full statutory financial statements, streamlined energy and reporting disclosures, and gender pay gap disclosures. From this population we selected the 92 companies engaged in consumer business[1] for our first iteration of the index.

The metrics we chose for assessment have been identified as being of critical importance to PE houses, investors, and companies, like those in the ESG in Private Capital Survey and the ESG Data Convergence Initiative. We endeavoured to balance the metric selection between disclosures which could be reasonably expected from a private company, and what the market leaders are doing, particularly around people and planet.

For people and planet measures, companies were assessed across twelve metrics for each category, which were a mix of binary criteria (e.g. policy exists in the public domain or does not) and numerical performance (e.g. mean gender pay gap %). Some numerical performance metrics had set thresholds that needed to be reached to score certain points (e.g. companies who increased their YOY absolute direct GHG[2] emissions, scored zero points for that metric). Where data could not be sourced by the team, companies were assigned a score of zero for that metric.

PEOPLE

"Positively impacting all stakeholders"

Key metrics included: Employee growth, gender pay gap, females as a proportion of management, supplier code of conduct, pension contribution and others.

PLANET

"Protecting our natural capital"

Key metrics included: Environmental policies on water, biodiversity and circularity, net zero ambition, reduction in absolute emissions/emission intensity, renewable energy use and others.

PROFIT

"Maximising economic impact"

Key metrics included: EBITDA growth and margin, wages, social security as a proportion of revenues, return on capital base and others.

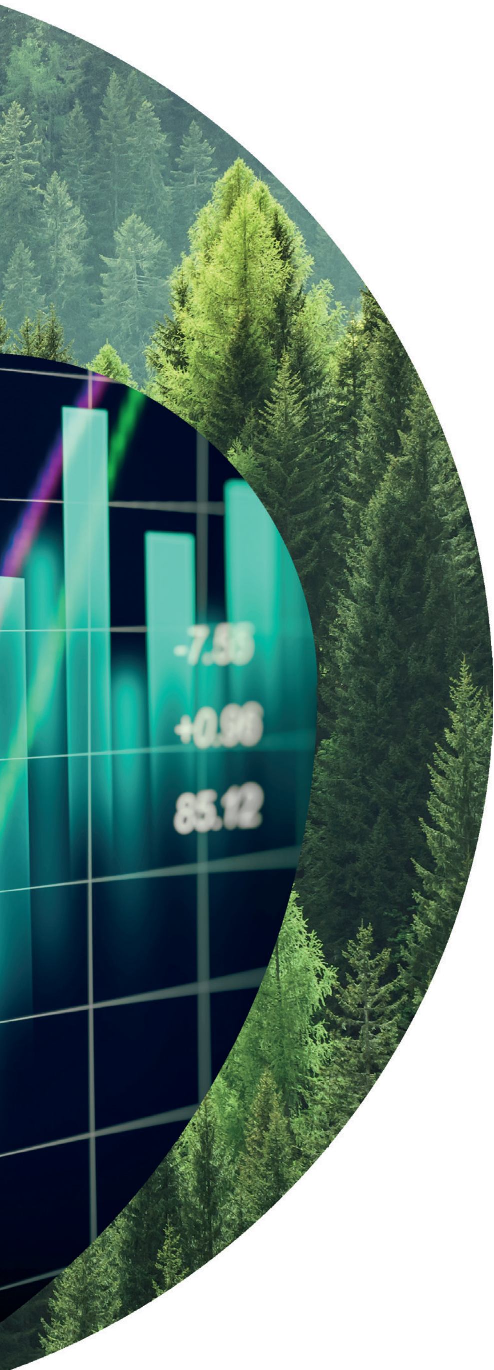
For profit measures, companies were assessed on their most recent annual financial performance and for some metrics how this compared to their performance either one or three years prior to that. We used eight metrics of impact across growth, profitability, return and economic contribution. Performance was compared across the entire index population with some metrics having a minimum threshold to achieve points.

Once scored, weightings were applied to each metric to calculate a score out of 100 for each of people, planet and profit. The total score out of 300 represents a company's score on the Deloitte PE Index. We also calculated median scores for each subsector, enabling the companies in the index and their sponsors to understand how they are performing against peers. This information is not shared in this report.

We used the data behind the index to investigate potential themes, linkages, and value drivers across the triple bottom line. These results are presented below.

1 For the purposes of the pilot Deloitte PE Index, "consumer businesses" include consumer products, retail, residential construction, consumer transportation, hospitality, private education, and leisure

2 Greenhouse Gas (GHG)



Our approach to future indices

The lack of transparency and consistency in reporting of the non-financial metrics – a key finding not only of this exercise but also of the Deloitte ESG in Private Capital Survey – made assessing performance a labour-intensive endeavour, taking several months to complete. Despite the arduous nature of the task it is one which Deloitte sees great value in, given:

- The scale of the transformation being undertaken within UK, European and global economies to reach net zero and the scale of opportunity it presents for PE firms and their portfolio companies to demonstrate value creation for society.
- The increasing need for businesses to demonstrate value through ESG or the triple bottom line.
- The need for a transparent and manageable form of benchmarking to bring consistency to disparate ESG data processes within Private Equity markets has never been clearer. Our recent survey found only 36% of PE funds are using the same benchmarking provider.

While this iteration of the PE Index has focussed on consumer businesses, we intend to further automate data collection, and encourage sponsors/companies to submit their data directly, allowing us to expand the number of companies and industries we analyse in future.
The benefit of an independent, consistent peer read-across should enable the sector, as a whole, to continue to drive transformational impact.

As data quality and availability increases, due to shifts in market expectations and widening regulations, such as the Corporate Sustainability Reporting Directive (CSRD), Task Force on Climate-Related Financial Disclosures (TCFD) and Task Force on Nature-Related Financial Disclosures (TNFD), the Deloitte PE Index will become an ever more reliable benchmark of value creation in private markets.

In future iterations of the index, we look forward to adapting our metrics and the baseline expectations behind them to focus more on action and improvement, as companies continue to embrace a wider definition of value in their strategies and operating models and improve the transparency and reliability of sustainability reporting.

Balancing the triple bottom line

The index revealed significant variation in individual company performance across the assessed metrics, indicating that companies are facing challenges in balancing their impact across the three dimensions of people, planet, and profit.[3]

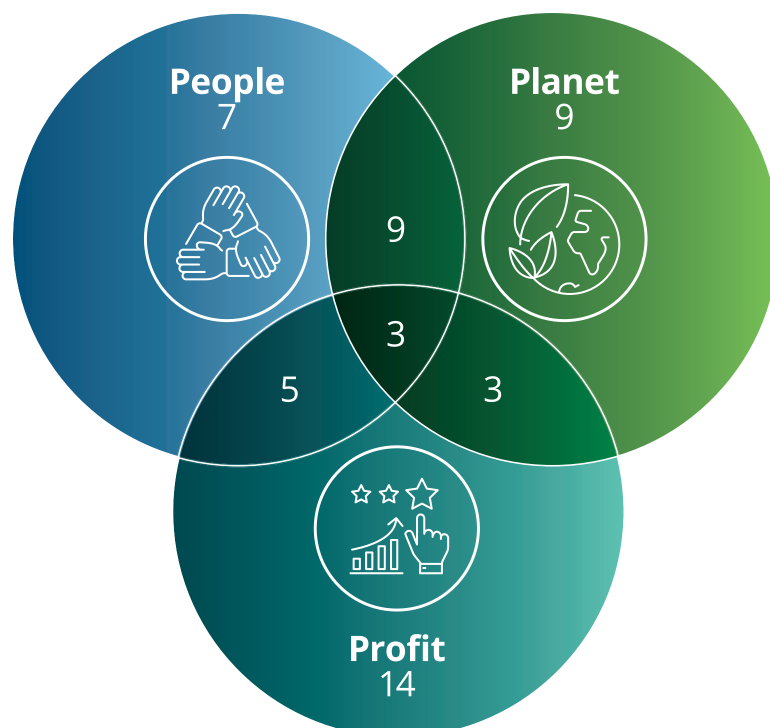
Even the highest-ranked company within the index failed to score consistently across all three metrics, achieving scores of 69% for profit and 68% for planet - but just 38% on the people metric.[4]

Only three companies scored in the top quartile across people, planet and profit.[5] This reiterates the challenge of driving value for all stakeholders and finding a balance across the triple bottom line.

Nearly half (46%) of the indexed companies did not score in the top quartile of any category, while 22% of the companies scored in the top quartile of two or more categories.

This demonstrates the disparate performance of companies in the index and a growing divide between those creating value for multiple categories of stakeholders and those that are not.

Figure 1: Top performers in the index
Cross-over of companies scoring in the top quartile for each category of triple bottom line value



3 All scores calculated for the index were based on publicly available or widely available licensed data. If data was not discovered in the public domain on a best endeavours basis for a particular metric, the company was awarded 0 points for that metric. This resulted in some very low scores which might not necessarily reflect poor performance, but instead lack of transparency and inaccessibility of data.

4 The scores of the highest-ranked company within the Index - 69% for profit, 68% for planet and 38% for people – were all within the top quartile of their respective category in the index.

5 The top quartile was calculated as the top 25% of the index scores. There may be a differing number of companies per quartile due to tied scores.

Figure 2: Range of scores across the index

Range and quartile view per category of triple bottom line value

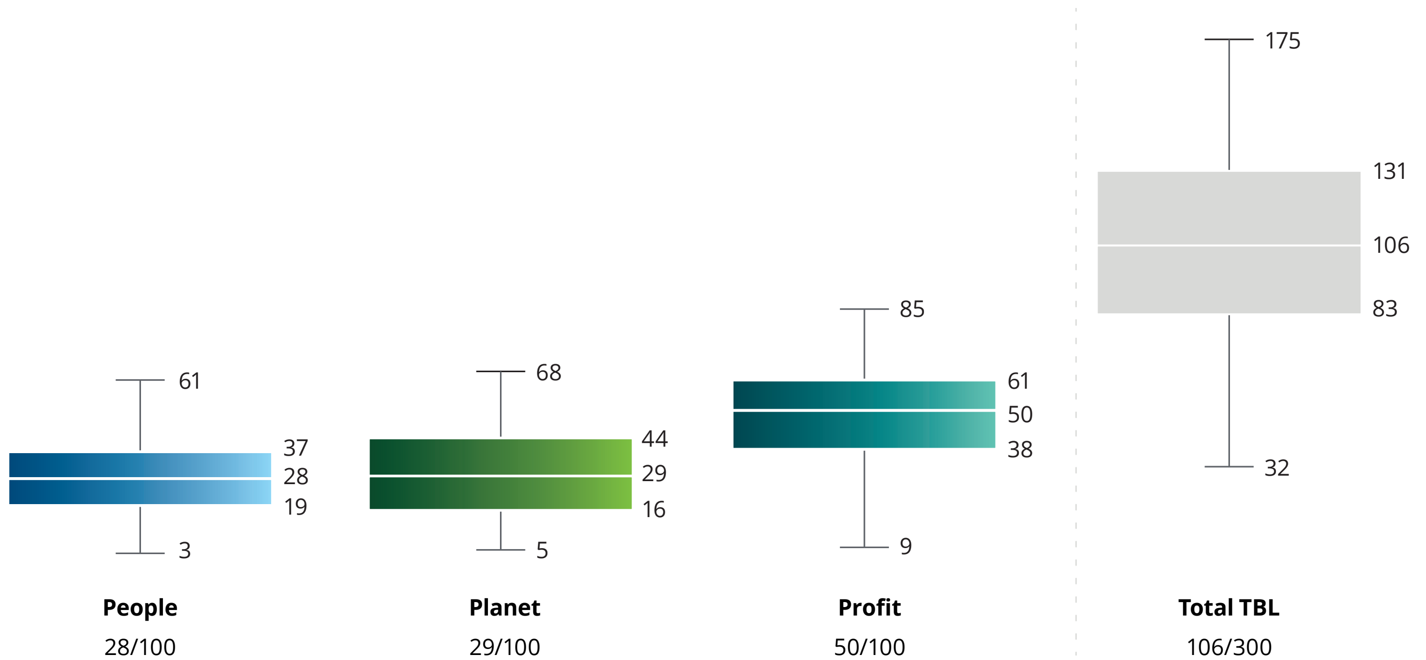


Figure two (above) shows the top, median and bottom score for each category as well as the upper and lower quartile whiskers. The results show the huge disparity between the highest and lowest scoring companies in each of the three categories. The median profit score was 50 points, much higher than the median people score of 28 points and 29 points for the median planet score. In other words, nearly half of a company's points on the index came from their profit score despite accounting for only one third of the available points.

These scores are driven from data which was obtained in the public domain and are a representation of the public persona of the companies assessed. Some of the disparity in scores is a result of deviation in performance, while in other instances the differences are exacerbated by a lack of data in the public domain.

That said, the scores are not necessarily surprising given Private Equity has been traditionally measured on returns to equity holders first, so their emphasis has been on profit maximisation to maximise equity value. We expect this to shift as more Private Equity funds unlock societal value creation for all stakeholders and value multiples adjust for impact.

Companies with a larger number of employees scored higher in planet and people suggesting larger companies have better or more established policies, or that they have the resources and budget to spend on better quality disclosures than smaller companies.

We were able to obtain information for the vast majority of profit metrics for all companies, therefore scores tended to be higher in this category, particularly for metrics such as EBITDA margin and wages as a proportion of revenue. Data for people and planet metrics was much more disparate.

Profit scores are based on outside-in assessment of financial measures for a sector still recovering from the impacts of COVID 19 and a cost-of-living crisis.

With the top scores for each category of 61/100 (People), 68/100 (Planet) and 85/100 (Profit) and an overall top score of 175/300 – there is clearly room for all companies to improve their performance across all metrics within the index.

Key findings

Key findings – across the triple bottom line

PEOPLE

2.7%

median employer pension contribution. **Employees appear to be opting out of company pension schemes.**

10.5%

the weighted **average mean gender pay gap** for indexed companies – **lower** than the UK average of c.13%.

5%

the proportion of companies in the index led by females. This lags behind the FTSE100 (10%) and the FTSE250 (6%).

PLANET

33%

the proportion of companies who **reduced absolute direct greenhouse gas emissions.**

54%

the proportion of companies assessed with a **publicly-stated net zero ambition.**

85%

the proportion of companies that are **yet to assess their climate impact** on a TCFD basis.

PROFIT

4x

Companies with a Female CEO had four times higher EBITDA growth (33% compared to 8%) and marginally higher YOY employee growth.

5.8%

the median **annual growth in employees** for the indexed companies

70%

the proportion of companies who scored **more strongly in profit** than any other metric.

People

Pensions

We calculated employer pension contributions as a proportion of wages to measure action taken to help employees secure their financial future and help reduce the burden on the public pension pot.

The companies with the highest pension contributions were in traditionally unionised subsectors like transportation and education. As many as 80% of the companies in the index contributed less than 5% of wages to their employee pension scheme, which could affect their talent retention over the long term.

The mean pension contribution for the index was 3.2%, while the median contribution was 2.7% of wages. Assuming employers are paying the statutory minimum of 3% to employees, a company's contribution level below 3% implies that employees are opting out of pension contributions. Opting out could reflect several things:

1. Employees opting to self-invest for their retirement savings due to personal or financial planning considerations.
2. A lack of financial literacy education from employers to help their employees understand the importance of saving for the long-term. And/or
3. Wages that do not meet the increased cost of living so employees are maximising their take home cash and forgoing matched pension contributions.

Given the median average salary for the indexed companies was £27,581 (below the UK average of c. £33,000 but above the UK average of £22,964 for accommodation and food services), the lower pension contributions are likely reflective of an issue across the sector. Either way, employees are missing out.

Gender Pay Gap

Private equity is outperforming on gender pay gap despite lagging on female representation in management (discussed below). The weighted average mean gender pay gap for the 625,000 people employed by the indexed companies was 10.5% which is lower than the UK average of c.13%.

Companies with female CEO's reported roughly the same gender pay gap and improvement as the their male-led peers (between 1%-2%). The data also showed that there was no statistical correlation between female representation in management and a company's mean gender pay gap, or gender pay gap improvement. This suggests that better female representation in management does not always equate to action on gender pay issues.

On average we found that the higher a company's mean gender pay gap, the lower their gender pay gap improvement was - suggesting that there is a divide between companies who are actioning gender pay issues and those that are not.

Our research also showed that the higher a company's average wage, the higher their mean gender pay gap.

Overall Private Equity backed companies and their sponsors appear to be focussed on improving the gender pay gap with 54% of indexed companies recording year on year reductions in their mean gender pay gap, but at 10.5%, there is still a way to go.

Planet

Carbon emissions

Only 33% of companies in the index decreased their absolute scope 1 and 2 (direct) greenhouse gas (GHG) emissions in the past year. Of those companies, 1/3 (11% of the total population) reduced their direct absolute emissions by 10% or more, the annual mathematical reduction rate required by most sectors to keep global warming below 1.5C. Concerningly, on average companies increased their direct absolute emissions by 15%.

Although absolute direct emissions increased, 75% of the indexed companies decreased their direct emissions intensity[6]. Interestingly, companies that reported larger reductions in emission intensity had higher EDBITA growth over the period, suggesting that companies that are growing, are doing so in increasingly sustainable ways. For the companies that reduced direct emissions intensity, the median reduction was 21% over the past year.

The reduction in emissions intensity but not absolute emissions reflects that the average indexed company experienced growth and is taking some – but not enough – climate action.

The consumer sector, and wider economy, must decouple growth from emissions production to enable companies to generate economic prosperity and jobs while protecting the planet.

Net zero ambitions

While the highest scoring planet metrics were in relation to total scope 1 and scope 2 emissions, where 91 companies disclosed thier GHG emissions, only 54% of indexed companies had a publicly stated net zero ambition.

Of the 50 companies with public net zero ambitions, five were approved by the Science Based Target initiative (SBTi) and thirteen were committed to or in the process of setting an SBTi approved target. As the SBTi Absolute Contraction Approach to target setting used by many companies includes an annual reduction in absolute emissions, companies may struggle to achive SBTi net zero target verification unless they alter their business models to decouple growth from emissions production.

Companies with publicly stated net zero targets increased their absolute emissions less and reduced their emission intensity by more – suggesting that having a net zero target does lead to greater climate action.

6 Absolute direct emissions intensity calculated for the purposes of the index as direct emissions per £1m turnover.

Climate and reporting regulations

The regulatory landscape is constantly evolving, but increasing scrutiny around sustainability means UK PE firms with £5 to £50 billion AuM are required to publish a TCFD report by 30th June 2024.

However, our analysis suggests that despite a requirement for these reports to be produced at both a house and product/fund level, only 15% of the portfolio companies reviewed assessed their climate impact on a TCFD basis. This leaves a significant gap for sponsors who will need to consolidate this information at the house and fund level.

In addition to climate scenario analysis and risk assessment at the investment level, PE houses will be required to report the scopes 1, 2 and 3 emissions of their investments under TCFD.

Of the indexed companies, 50% reported on some form of scope 3 emissions, but of that 50%, only half reported more than one category of scope 3 emissions (there are 15 recommended by the GHG Protocol), highlighting that the majority of businesses currently lack a thorough supply chain assessment.

Profit

Female-led businesses

Only 5% of companies in the index were led by female CEOs compared with 10% of the FTSE 100 and 6% of the FTSE 250.

However, companies with a Female CEO had 4x higher EBITDA growth (33% compared to 8%) and marginally higher YOY employee growth.[7]

The average number of women in executive teams for the index was 28% which is in line with the FTSE 100 at 29% and is marginally greater than the FTSE 250 at 26%. However a quarter of companies in the index had only one female in the exec, while 13% had none.

In the face of increasing scrutiny of diversity at the board and exec level by investors, Private Equity houses will need to continue to strive to improve the representation of women and people from minority backgrounds within the executive teams of portfolio companies.

Workforce growth

Despite a common perception of Private Equity, two thirds of companies increased their headcount in the past year. The median growth in employees was 5.8% across the index; this represents 44,800 new PE-backed roles in the most recent year.[8]

The indexed companies grew their workforce by a mean of 11.8% and median of 5.8%. Median workforce size was 2,069 in current year vs 2,002 in prior year (average of 6,793 vs 6,306 in PY).

The total number of people directly employed by the indexed companies was 624,919, roughly 2% of the UK workforce. With this size and scale of workforce, Private Equity has the potential for a huge impact on employees in this country by focussing on creating value for its people.

Importance of profit

Striking a balance between profitability and social or environmental impact is essential for businesses. We analysed which metrics were connected to EBITDA growth and EBITDA margin. Across the population, there was no relationship between the size of a company and EBITDA growth or revenue growth, both in terms of number of employees and revenue.

When looking at the last three years[9], 52% of indexed companies experienced both top-line and margin growth. This compares with 13% of companies who had margin expansion but lower revenue, 18% of companies who had revenue growth but margin shrinkage, and 16% of companies whose top-line and margin both decreased. 65% of the indexed companies had margin expansion over the period, implying these companies had efficiency or productivity improvements and/or were able to pass on input cost inflation to customers.

It is worth noting that of the 65% of companies who expanded margin over the period, 68% of those did so while also increasing employee headcount. More impressively, 27% of those companies (16 total companies/ 17% of the total index) expanded margin, grew headcount and reduced absolute direct GHG emissions; a strong indication of triple bottom line value.

While a positive impact on people and the environment is paramount, continued profitability empowers companies to invest in sustainable practices, innovation, and furthering their positive influence. Profits can be a force for good when channelled toward creating lasting change.

Re-investing profits in this way can ensure a balance is struck between short term returns and medium to long term value creation. This is particularly important for Private Equity firms, for which the average holding period is approximately eight years, given the economy in which companies are purchased today will not be the same one in which they are sold tomorrow.

> "16 total companies (17% of the index) expanded margin, grew headcount and reduced absolute direct GHG emissions; a strong indication of triple bottom line value"

7 We note the population of female CEOs (5/92) was not a large enough data set to draw any significant conclusions from this finding, but also note that it is broadly in line with various studies conducted in recent years into this topic.

8 Employee number data refers to most recent year (either FY22 or FY21) vs previous year (either FY21 or FY20) depending on what information was available. Not all the employee number increases will be new jobs created as some headcount addition was a result of acquisition.

9 Last three years for growth is a comparison between the most recent annual report for a company (FY22 or FY21) and three years prior to that.

Key findings – sector analysis

While completing the analysis, we noted a difference in scores between metrics that measured the attitudes, policies and ambitions of a company and those that measured the actions the company was taking. Many of the differences were echoed within subsectors, providing an interesting lens to view who is talking about improving triple bottom line value and who is taking action to deliver it. In general, many subsectors are more vocal about their ambition towards the planet than people but are taking slightly more action on people metrics.[10]

People

There is a general lack of transparency on people policies, ambitions, and attitudes across consumer subsectors resulting in overall lower people scores across the index.

The consumer transportation subsector is the index leader in both people policies (attitude) and actions as they have higher scores on gender pay gap, gender pay gap reduction and pension contributions. This subsector is also highly unionised.

Within the retail subsector, the data shows a lack of policies or transparency on policies around human rights, supplier codes of conduct, ethical trading initiatives and alignment with the UN Sustainable Development Goals. The actions by retailers to improve their people value are also low, but this is a consistent issue across the consumer sector.

Planet

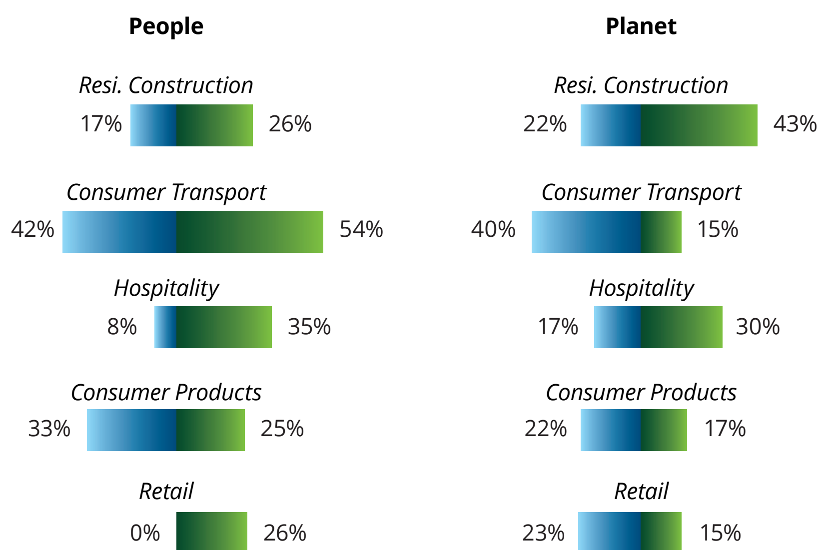
Due to shifting consumer preferences, retail and consumer products companies have been more vocal about their attitude and ambition toward the environment. However, they have delivered the weakest performance across the index in actions taken to reduce their environmental impact. This disconnect between attitude/ambition and action may change as the Competition and Marketing Authority increasingly cuts down on greenwashing and unfounded sustainability claims.

Consumer transportation companies had some of the most developed planet policies and reporting in the index but were weakest when it came to actions to reduce their environmental impact. Given the transportation subsector produces 24% of the UK's total GHG emissions, significant improvements are required to align planetary ambitions and action.

On the contrary, residential construction and hospitality companies had the largest environmental impact reduction (actions) in the index but had some of the least developed planet policies and reports (attitude/ambition).

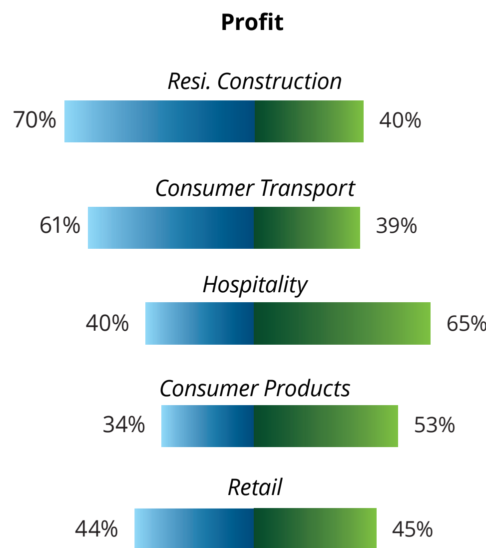
Figure 3: Attitude, Ambition and Action
Subsector performance across attitude/ambition and actions based on the median score as a percentage of total points available.

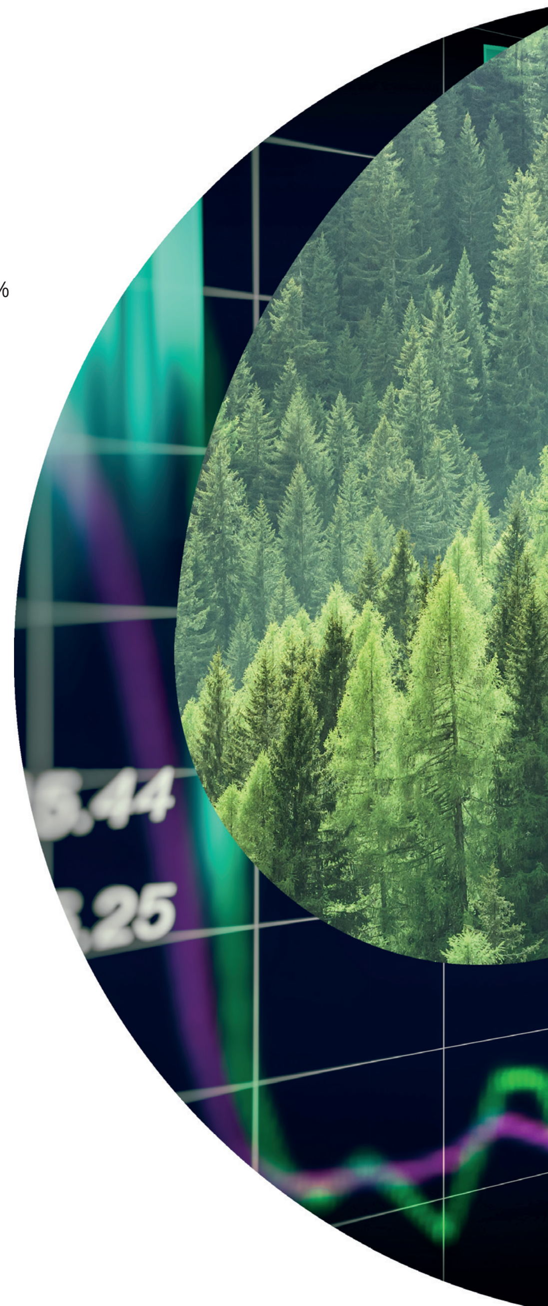
Polices/Attitudes Action



10 We measured people and planet attitude and ambitions as the policies a company has in place and publicly discloses, membership in sustainable/ ethical organisations, publicly available reports and ambition statements and their baseline GHG emissions. People "actions" were measured as workforce growth, gender balance, gender pay gap and actions to improve it, ethical certifications achieved, and other actions taken to benefit employees, those in the supply chain, and wider society. Planet "actions" were measured as reduction in emissions, use of renewable energy, and other steps the company is taking to reduce environmental impact.

Figure 4: Profit vs Economic Contribution
Subsector performance across traditional measures of profit and economic contribution based on the median score as a percentage of total points available.





Profit

We also compared performance of each subsector between the more traditional measures of value in the profit category (profitability, return and growth) and the economic contribution of a company (wages and social security). There was an interesting discrepancy between most subsectors performing well in one category and not the other.

The low growth, profitability and return scores of consumer products, reflect a subsector still emerging from the impacts of COVID19 and an ongoing cost-of-living crisis.

Residential construction and transportation companies scored highly on the traditional measures of profit due to market demand and economic factors, but scored lowest on economic contribution.

Hospitality and consumer products companies had a higher economic contribution as wages and social security make up a larger proportion of their overall turnover.

In addition to subsector performances, there were clear winners and stragglers across most of the metrics. Our intention is not to share this information as part of this report but we would be happy to discuss the results with the companies in the Index and their sponsors.

Conclusion

Ultimately Private Equity value creation is a factor of a multiple and profit. While not all triple bottom line investment will maximise profit, we expect that in the future, companies who can deliver people and planet value can achieve a higher multiple (or lower discount factor) and therefore a higher equity value than those companies who focus solely on profitability.

Anne-Marie Laing

Get in touch

Contact the team today to discover how your portfolio companies are performing across the triple bottom line of people, planet and profit, and identify opportunities for sustainable value creation.

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