



THE PROMISE OF PRIVATE EQUITY

Environment, Society, and Corporate Governance—New Criteria for Success in Private Equity Investments

CASE STUDIES FROM EMERGING MARKETS

THE PROMISE OF PRIVATE EQUITY







Environment, Society, and Corporate
Governance—New Criteria for Success
in Private Equity Investments

CASE STUDIES FROM EMERGING MARKETS



PREPARED BY ENVIRONMENTAL
RESOURCE MANAGEMENT

Table of Contents

	FOREWORD ACKNOWLEDGMENTS EXECUTIVE SUMMARY	v vii 1
	CASE STUDY 1 América Latina Logística	4
	CASE STUDY 2 Mengniu	16
	CASE STUDY 3 Morion	22
	CASE STUDY 4 Reclamation Group	27
	CASE STUDY 5 Terapia	32

Foreword



IFC is committed to investing in and financing ventures that are financially, environmentally, and socially sustainable. To show the benefits of a triple bottom line approach to investing, we have produced five case studies that show you can make money and thereby meet the demands of the commercial marketplace and still be environmentally and socially responsible. In fact, we show that environmental and social responsibility will support and enhance the achievement of financial imperatives.

And what better place to look for success stories than within the private equity industry, whose clear imperative is achieving financial returns for investors in a highly competitive environment?

The five case studies come from five private equity managers with whom IFC has invested: GP Investimentos in Brazil, CDH China Fund in China, Quadriga Capital in Russia, Brait Capital in South Africa, and Advent International in Europe. In each case the environmental and sustainability aspects were integral to core business competencies, contributed directly to profits, and were implemented for commercial reasons.

We hope these stories will inspire you and provide ideas that both enhance the success of your own investing and contribute to a sustainable future.

A handwritten signature in black ink, appearing to read 'Haydeé Celaya'.

Haydeé Celaya

Director

*Private Equity & Investment Funds Department
International Finance Corporation*

Executive Summary

THE PROMISE OF PRIVATE EQUITY

BACKGROUND

Five case studies of companies exhibiting good examples of different aspects of “sustainability” were drawn from the portfolios of private equity funds in which IFC was an investor.

The definition of sustainability was the triple bottom line concept, broadly defined. This term refers to the concept of triple bottom line accounting, i.e., that for-profit corporations could consider three levels of accounting, traditional profits as well as environmental and social effect accounting, an idea proposed by John Elkington in 1998.¹ Implicit in the concept as applied herein, however, was recognition of one of the criticisms of the triple bottom line theory: that it may potentially be harmful to a business to divert attention from its core competencies. Rather, as will be seen below, the sustainable attributes noted in this study were integral to core competencies and sound business management, contributed directly to profits, and were implemented purely to foster the business case.

The five companies selected to be case studies are shown in table 1, next page.

KEY FINDINGS

As noted above, the concept of sustainability in this study was based on the triple bottom line approach, with the caveat that aspects of sustainability identified would likely reflect good business management and directly contribute to the bottom line, as would be expected in what were primarily emerging market businesses operating in their host country marketplace (e.g., not exporting or part of multinational supply chains). This concept was confirmed early on in the process of researching IFC’s portfolio for case studies, when it became apparent that positive social and environmental aspects of individual companies were an integral part of good business management, as opposed to a separate or parallel end goal. In all cases

1. Elkington, John, 1998, *Cannibals with Forks: the Triple Bottom Line of 21st Century Business*, Capstone Publishing, Oxford. 407 pp.

TABLE 1.
THE COMPANIES AND THE FUNDS

Company	Sector	Location	Ownership	Investment Fund
América Latina Logística (ALL)	Transportation and logistics	Curitiba, Brazil	Public	GP Investimentos
Mengniu	Dairy products	Inner Mongolia, China	Public	CDH China Fund
Morion	High technology instruments	St. Petersburg, Russia	Privately held	Quadriga Capital
Reclamation Group (RECLAM)	Metal and other waste recycling	Johannesburg, South Africa	Privately held	Brait Capital
Terapia	Pharmaceuticals	Cluj-Napoca, Romania	Privately held	Advent International

studied, the companies pursued these “sustainable” initiatives because they increased profits and performance.

A number of themes were identified that were replicated across the five case studies. The themes and the cases to which they apply are presented in table 2, (page 3). The bottom lines of the table present the five firms’ recent financial performance and illustrate that the implementation of the measures identified coincided with strong financial performance. The data are presented as growth percentages as opposed to actual numbers, as three of the five companies are privately held.

Highlights of how the themes were manifested in each case are presented below, and the full case studies are presented in the ensuing chapters.

- At four of the five companies (ALL, Mengniu, Morion, and RECLAM) the CEOs/founders were the source of the drive for excellence that resulted in the identified programs on which the case studies focus. In the case of Terapia, the private equity fund viewed brownfield development as an opportunity

rather than an obstacle for the transaction.

- Two companies, Mengniu and RECLAM, were dependent on supply chains for which there was competition, and a key part of their business success was a direct result of their ability to capture a significant market share of an independent supply chain, in both cases consisting at least in part of small entrepreneurs, via fair pricing and programs that fostered the economic growth of microenterprise suppliers.
- Three of the companies had very strong programs designed to optimize worker commitment and performance. Two companies (ALL and Mengniu) were highly ranked in their respective country’s competitions for most popular places to work. The third, RECLAM, in addition to sponsoring sports teams and other worker extracurricular programs, was extremely effective in designing direct financial reward programs that both benefited the workers and resulted in dramatic improvements in worker performance and revenue generation for the company.

- Both ALL and Morion applied programs to reduce waste and energy consumption. ALL, primarily a railroad company, was able to significantly reduce diesel fuel consumption through application of improved logistics management via technology, awareness raising and training, and its annual “Diesel Cup” competition, in which locomotive engineers compete to use the least amount of fuel without any dropoff in on-time performance or decrease in health and safety performance. Morion invested in equipment upgrades and re-engineering of the plant to reduce water and energy consumption, and the subsequent savings in operating costs rapidly paid back the initial investments and improved profitability.
- All five companies had proactively adopted various international environmental and other international standards, though only Morion was a part of a global supply chain where such certifications were required. The other four companies willingly adopted these standards and the associated costs for

certification and reporting as part of their CEO's drive to create a world-class company.

- Three companies were involved in different aspects of recycling. Metal and now other disposable product recycling is RECLAM's central business ("the aboveground mine" in the words of the founder and CEO). Morion invested in recycling its product water, both to recover heat and save energy and to reduce raw water costs. Terapia is involved in the cleanup and recycling of contaminated industrial site as a sideline to investing in a former state-owned pharmaceutical company.
- Three of the companies were formerly moribund state-owned enterprises that were completely turned around and reinvented as dynamic and profitable private

sector businesses, in part through the programs described herein.

- As can be seen in table 2, four of the five companies for which financial data are available have experienced very healthy growth in revenues and EBITDA.

METHODOLOGY

IFC contracted Environmental Resources Management to carry out the identification and preparation of the case studies. As stated above, the goal was to identify cases exhibiting a range of aspects of sustainability. Additional selection parameters were broad geographic and sector diversity.

The case studies were identified via interviews with IFC staff in the Private Equity Funds Department. An initially

long list was gradually reduced to a short list of leads, and then to the final five through additional interviews with IFC staff and discussions with the investment funds staff. The companies, and in most cases the investment funds, were visited during 2005. To develop the cases, a variety of materials were used, ranging from investment reports for the two publicly traded companies to news stories and interviews.

For three of the companies (ALL, Morion, and RECLAM), the CEOs were the primary sources of information. For the other two, company staff and investment fund staff provided the information. The staff of IFC, of the investment funds, and of the companies were enormously supportive during the process.

TABLE 2.
SUSTAINABILITY THEMES FOUND ACROSS THE FIVE BUSINESS CASES

Theme	ALL	Mengniu	Morion	RECLAM	Terapia
CEO leadership	+	+	+	+	
Fostering microenterprise development in the supply chain		+		+	
Optimizing workforce commitment	+	+		+	
Eco-efficiency/energy conservation	+		+		
Proactive adoption of international Environmental, Health, and Safety standards	+	+	+	+	+
Recycling			+	+	+
Privatization	+		+		+
Financial performance	1997-2004	1999-2003	1997-2005	2000-2004	2001-2004
Revenue growth	200%	1343%	500%	282%	156%
EBITDA growth	1560%	1740%	1660% ^a	810%	180%

^a EBIT data, not EBITDA.