Doing Well by Doing Good - a Pipe Dream or Reality?

A qualitative case study on ESG-integration in private equity investment practices.

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Abstract:

Prior research lacks definitive proof of ESG's impact on profitability, yet there's an increased demand for sustainable investments in private equity. This study investigates how private equity firms navigate ESG and financial considerations in their investments. Using framing theory, we explore the interplay between a financial frame and an ESG-frame. Through a single case study of an ESG-focused PE firm, involving 7 practitioner interviews and analysis of two investment cases alongside public reports, we find that the PE firm aligns with traditional financial practices while adopting an ESG framework akin to SFDR Article 9. We observe a moderate blending of the financial and ESG frame, emphasizing specific ESG-factors impacting returns—E over S and G and prioritizing 'handprint' over 'footprint'. Consequently, both frames are moderately blended and influence the firm's acquisition process and tools used.

Keywords:

Private equity, Acquisition process, ESG, cognitive frames, conflicting frames, frame tactics.

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1. Introduction

Environmental, Social, and Governance (ESG) investing has for some time been at the forefront of institutional investors' minds. However, not until recently have ESG factors been incorporated into their investing criteria (Eccles & Climenco, 2019). In 2006, a UN-backed initiative, Principles for Responsible Investment, was launched and signed by 63 investment companies. The growth of ESG investing since then was highlighted by a global survey conducted by FTSE Russel in 2018. The survey found that by that point, a majority of global asset managers were incorporating ESG considerations in their investment strategy (FTSE Russel, 2018). So what has caused this development?

Several factors are driving the movement towards ESG-conscious investing. Apart from intrinsic industry factors affecting institutional investor behavior concerning ESG, there has been a growing move by financial regulators to implement sustainable practices in financial markets. Specifically ESG taxonomies, approaches, and marketing towards investors have been the subject of increased focus (Boffo & Patalano, 2020). There are also intrinsic industry factors pushing this development. First off, there is a growing demand from asset owners for asset managers with sustainable investment strategies (Eccles & Climenco, 2019). Non-financial outcomes are increasingly important for asset owners. Showcasing this, the head of sustainability at UBS group, Rina Kupferschmid-Rojas pointed out in a Harvard Business Review article that "Our wealthiest clients want to know their investments are making a difference to make the world a better place".

Another factor that has driven this change is the tighter integration of ESG-focused groups within the organization of institutional investors. Nowadays, top management at investment firms are ensuring that ESG analysis is effectively incorporated into the practices of analysts and portfolio managers within the firm. Historically, however, this has not been the case. The espoused sustainability values and strategies put forward by senior management have not always been followed by the analysts who make day-to-day investment assessments. This highlights an issue that is central to our paper, how is the espoused ESG investment strategy practically implemented in the investment/acquisition process of an institutional investor like a private equity firm?

Although there is a breadth of factors driving institutional investors towards sustainable investing, incorporating ESG into an investment strategy is not straightforward and there are different approaches. First off, ESG factors can be difficult to measure monetarily. While for example carbon emissions can be easily financialized according to their market value, other sustainability factors cannot be priced (Arjaliès & Bansal, 2018). According to their research, investment managers tend to disregard non-financial information and thereby risk overlooking ESG criteria. They found that while fixed-income managers tend to attempt to financialize ESG factors, public equity managers instead tend to use visuals such as emojis to represent a potential investment's sustainability. Equity managers felt that a visual representation of ESG was more comprehensible than a financialization of the data. However, there is an inherent problem with this since financial numbers are relied heavily upon when valuing a firm's assets before an investment. This highlights the potential difficulty of taking both ESG and financial considerations into account when making investments.

For this thesis, we have chosen to focus on private equity firms. Private equity firms raise capital from external investors (typically institutions like pension funds), invest the capital in private companies, sell those investments (often several years later), and return the proceeds to their investors. As an incentive, private equity firms earn money by sharing part of the profits that are made on the investments (Snow, 2007). As a result, private equity firms can be seen as the embodiment of a financial institutional investor and face a unique mandate to produce substantial returns within a certain time frame (Seeman et. al, 2021). The recent demand for sustainable investments has also affected the private equity sector, with an increasing awareness of ESG factors when making investments. Overall, prior research finds the correlation between ESG and financial performance inconclusive (Grewatsch & Kleindienst, 2017). This highlights a second central question that this paper aims to examine, how do private equity firms handle the potential clash between financial and sustainability considerations when making investments?

There are existing studies that look at ESG-factor integration in private equity firms, with one finding that an increasing number of PE firms are incorporating ESG factors in their investment strategy (Zaccone & Pedrini, 2020). Furthermore, they surveyed the methods that these firms used to measure ESG. The most common methods used were checklists/questionnaires to understand if the investment prospect follows local ESG regulations and international law, advice from tax/legal advisors, and advice from external ESG advisors. However, this study didn't take a hands-on look at how these espoused strategies took effect in practice. This is a gap in the current research that we aim to fill and goes back to the important question of whether what firms say translates to what they do.

In conclusion, the research question for this thesis is formulated as follows:

How can private equity firms comprehend and practically apply ESG in their investment decisions while balancing financial considerations?

The rest of the thesis is structured as follows: In section 2.1 we review previous literature on traditional investment practices within private equity, ESG within investing, and ESG within private equity. In section 2.2 the concept of framing is introduced, something that is used to understand and analyze our empirical findings and thus answer our research question. The methodology used and also the case company are presented in section 3 followed by our empirical findings in section 4. In section 5, we discuss our findings before presenting our conclusions and suggestions for future research in section 6.

2. Theory

2.1 Literature review

This paper will address several thematic areas. The most central thematic focus lies within the domain of Environmental, Social, and Governance investing. It aims to delve into the underlying motives and real-world implications of ESG investing and consequently, the primary domain under consideration is ESG in investment practices. In the context of reviewing prior literature and research in this field, it is also of interest to undertake an examination of ESG within the broader field of private equity. This endeavor is essential as it serves as the fundamental underpinning for the development and implementation of ESG investment practices within this area.

This section will begin by outlining traditional investment practices within the realm of Private Equity. Thereafter, its relationship with sustainability will be introduced, alongside the research gap.

2.1.1 Traditional investment practices within PE Firms

Value creation in PE can differ from other types of investing. The strongest distinguishing feature of PE from other conventional sources of finance is stage-wise financing (early-stage funding, late-stage funding, etc.) (Tripathi, 2016). Depending on what stage the PE firm chooses to invest, the investment strategy is directly affected (Carter & Auken, 1994). Moreover, the classification of a private equity fund is also based on which state of a company's development the firm chooses to invest (Robinson & Sensoy, 2011).

A private equity firm receives contributions for several purposes from their investors, or limited partners, with the principal purpose being to fund investments. In addition, management fees are charged to their limited partners, often annually, at around 1-3% of the fund's assets under management to pay for salaries, etc. (Stowell, 2010). Meanwhile, a share of the fund profits (usually around 20%) also goes to the PE firm directly, which is called “carried interest”, incentivizing the PE firm to generate profitability within the fund. Investments are often monetized after 5-7 years of holding, which is when the fund manager may receive their profit share or “carry”. Therefore there is a clear alignment of interest between the limited partners and the fund manager, namely generating financial profits/returns. Without strong financial performance, a PE firm will not be able to attract investors and ultimately cease to exist.

As outlined by Kaserer, Graf, and Schmidt (2012), three primary factors for successful value creation within private equity are market timing, leverage, and operational impact. Firstly, market timing embraces the ability of private equity firms to identify trends and industries, which can influence the overall performance of the transaction. Secondly, leveraging the buyout using for example debt, could significantly influence the return on equity employed and can create value for the investing private equity firm. The third, and perhaps most relevant factor for this thesis, operational impact, involves “the ability of private equity firms to set operational improvements in place, for instance by optimizing the portfolio companies ́ operations”. Examples in practice are cost-cutting, optimized product pricing, and management restructurings. If current management for example is incompetent and investors notice potential efficiency gains, the PE firm can utilize its resources and replace existing management with a more competent, experienced, or appropriate management (Stowell, 2010).

Ultimately, a well-established principle in the realm of investing holds relevance in the Private Equity industry: the balance between risk and return. Over the past 2.5 years, substantial progress has been achieved in comprehending the intricate interplay of risk and return in PE (Kortweg, 2022). However, a considerable amount remains unexplored; understanding the pertinent risk factors and their associated loadings, commonly known as betas, continues to pose challenges within the private equity domain.

2.1.2 ESG & investing

ESG lacks a singular, universally accepted definition. At present, *“there is no standard ESG framework, only a broad consensus on the issues covered by it"* (Splawski & Lukacs, n.d) As delineated by Li et al. (2021), this term is deeply rooted in the realm of responsible investing and is characterized by "a strategy and practice that involves the integration of environmental, social, and governance (ESG) factors into the decision-making process and active ownership within investments". Various illustrative factors within these distinct dimensions are mentioned; Water usage and CO2 emissions within environmental, customer and employee satisfaction within social, and shareholder rights within government. Given its formal proposal in 2004, a substantial amount of progress, as well as research on this progress has been developed around the concept in the last 19 years. The research has been very wide, and linked to several other aspects of performance. For instance, its connection to economic performance has been an attractive research topic since the beginning, and significant efforts have been dedicated to comprehending its impact on accounting practices and its influence on the overall valuation of companies. However, these results have been inconclusive with some studies indicating a positive correlation and others an insignificant or negative correlation (Grewatsch & Kleindienst, 2017).

Finally, climate change is now considered a risk to financial stability. Thus, an increased engagement from governments has been witnessed, creating institutions like the Task Force On Climate-related Financial Disclosures (TCFD), and the Network for Greening the Financial System (NGFS) (Coppola, 2019).

Within the world of investing, however, ESG factors are not always witnessed throughout the whole investment process. There is often a discrepancy between the general opinion of its importance, and actual decisions (Solomon, 2013). More specifically, research on institutional investors in the UK shows the recurring presence of ESG as a “frontstage”, with meetings about ESG becoming “*empty theaters, since investors are only concerned about the theater next door, which is where the money is being made*”. Thus, while ESG factors might be regarded as important, a significant number of investors and executives tend to exclude its role in financial investing and tend to ignore it when searching for optimal financial profitability. This is also supported by Barman's research (2018), which suggests that investors will regard the area of ESG as “unstructured”, and demand fully standardized practices before fully committing to it in practice.

Moreover, executives rarely focused on ESG issues unless prompted by stakeholder questions, and a lack of engagement from the executives was observed on several occurrences (Solomon, 2013). For instance, there were cases where executives redirected questions about ESG-Investing to the company's website and promptly updated the website to provide answers that had not been addressed previously, indicating that ESG becomes more of a marketing and discussion tool than something that a company includes in its calculations and considerations when investing.

Finally, other factors could come into play when analyzing why ESG becomes excluded in the screening and investment process. Inadequate or inconsistent data could in some cases be the reason for it not being used in practice, despite it being theoretically valuable (Solomon & Solomon, 2006). This presents a different perspective to the practical exclusion; The initiative may be there but is hindered by insufficient data.This being said, there are forms of sustainable investing that aim to combine sustainability factors with financial return, an example of which is impact investing.

According to the Global Impact Investing Network, (as cited by Barber et. al, 2019) impact investing is defined as "investments made to generate positive, measurable social and environmental impact alongside a financial return.". Impact funds have historically (on average) yielded a lower internal rate of return (IRR) than traditional funds. However, impact investors are willing to forgo some financial performance to pay for the impact. However, there are impact funds that manage to provide competitive risk-adjusted returns while generating a positive sustainability impact. Several impact funds are managed by private equity firms which leads to our research gap.

2.1.3 ESG Within PE Firms & Research Gap

The practical incorporation of ESG principles into accounting and finance, as well as the underlying reasons for their potential exclusion/inclusion, could greatly benefit from empirical examination. As previously mentioned, private equity firms typically raise funds from investors expecting a substantial financial return within a relatively short time frame. Moreover, the use of leveraged buyouts incurs taking on debt which can expedite this need. Furthermore, PE firms receive a share of the profits in the form of a carried interest. As a result, PE firms face a unique mandate to produce substantial returns quickly (i.e., within 5-7 years) (Seeman et. al, 2021). Since ESG is generally seen as separate from traditional investment theory and there is currently no conclusive proof that links ESG investing to financial returns, PE firms may face challenges in reconciling their traditional focus on generating rapid and substantial financial returns with the evolving landscape of ESG considerations in investment. As the demand for sustainable investments increases, it becomes of interest to examine how private equity firms can manage this balance. This is also an area that currently lacks meaningful research.

The prior research on ESG within the private equity industry has focused on espoused ESG strategies proposed by organizations. However, the actual day-to-day actions may exhibit variations. Hence, through the examination of concrete decisions and actions taken by a PE firm during the valuation and acquisition processes, it is possible to bridge the potential divide between theoretical concepts and real-world practices.

This thesis aims to understand how PE firms navigate the potential clash between sustainable investing and generating competitive returns. Furthermore, it also examines if/how PE firms' espoused ESG policies are practically incorporated when investing or if ESG factors are excluded during pivotal acquisition scenarios.

2.2 Conceptual framework

This section will explore the applicable framework employed for examining the findings in this paper, specifically delving into the concept of framing and framing theory. Relevant terms will be defined and discussed, aiming to establish a solid background before applying these concepts in the analysis.

2.2.1 Framing

The concept of framing was initially developed by Burke (1937) and has since then been a popular topic in psychology. Through frames and sensemaking tools, individuals strive to both rationalize and shape their identities to make sense of their actions and values (Goffman, 1974). They are also defined as "schemata of interpretation" that enable individuals "to locate, perceive, identify, and label" occurrences within their life space and the world at large.

Framing occurs on individual levels as well as on macro and meso levels. For instance, the concept has been used when explaining social movements and collective action. Defined as "collective action frames", these are "action-oriented sets of beliefs and meanings that inspire and legitimize the activities and campaigns of a social movement organization"(Goffman, 1974). By creating collective action frames, an organization or movement attempts to attract members and create reasoning behind their opinions, in hope of making progress with the movement. The creation of collective action frames involves several steps. For instance, frame articulation, where slices of observed reality from different situations are gathered to create an attractive narrative and cause, is followed by frame amplification, where this reality or issue becomes amplified and portrayed as more important than other issues by the social movement.

On a neo-institutional level, frames become crucial for an organization to create cognitive coherence and similar understandings of the surroundings, as they "involve the creation of shared conceptions that constitute the nature of social reality and the frames through which meaning is made" (Beckert, 2010). Khaire and Wadhwani (2010) examine the practical implications of this phenomenon by investigating the collaborative efforts of auction houses, journalists, and museums in reshaping the characterization of art in India, transitioning it from being perceived as "Provincial" to being categorized as more "Modern".

While the initiative originated from the producers and owners of the art, the involvement of various actors and intermediaries led to the reclassification of the art under the label of "Modernism." This collective action effectively influences the public perception of the art's value, enhancing its overall worth. The key insight from the paper underscores the significance of stable categories for the ongoing functioning of the market, emphasizing that successful framing efforts can result in intentional reevaluations of the art.

Elaborated upon by Werner and Cornelissen (2014), new frames can radically blend in, moderately blend in, or completely shift with existing ones. During frameshifting, the way new information is organized becomes restructured, and "sensebreaking" occurs, i.e., when the actual meaning of one's actions is broken down by the individual, resulting in self-reflective questions and the search for an alternative framing. Fundamentally, frameshifting consists of subtle indicators. One such indicator is the deliberate use of contrasting language when talking, emphasizing the divergence and "break" from the existing frame. Additionally, frameshifting incorporates analogical mapping, which entails drawing parallels between distinct situations rooted in their similarities. This process establishes connections between analogous scenarios, all of which deviate from the established schema.

Frame blending, on the other hand, is described as "the discursive combination of two separate schemas that share some abstract structure, or as the incorporation of words and elements of one schema into that of another" (Coulson, 2001; Fauconnier & Turner, 2002). In simpler terms, frame blending refers to the integration of two distinct schemas that share common abstract structures. Detecting the occurrence of a frame blending process is often indicated by the use of conjunctive languages such as "and" and "e.g.," which serve to connect two otherwise disparate frames and backgrounds (Werner & Cornelissen, 2014).

One practical illustration of frame blending is the case of The Atlantic Symphony Orchestra, where established frames and perceptions related to the music society were enriched by incorporating terms and descriptions from the business world.

Critics, in their reviews, employed market-related language to assess cultural authenticity, effectively blending frames from the realms of music and business (Glynn & Lounsbury, 2005).

When frames are radically blended, previously unconnected schemas and discourses become completely integrated, and a new hybrid frame overwrites the previous one (Werner & Cornelissen, 2014). Redefining provincial Indian art as modernism serves as an illustration of radical blending. It involves a notable departure from the traditional frame, which categorizes the art as provincial. In this process, two entirely unrelated schemas (modernism, and provincial) seamlessly merge into a unified whole.

If only moderately blended, the new frame may only adjust certain aspects of the original one, without creating a complete overhaul between the two - changes become incremental, not radical. As critics assessed the Atlantic Symphonic Orchestra, the integration of market-related language resulted in a moderate blending of the frames of music and business. Terms and phrases from the business realm were incorporated into the established frame, subtly altering the approach to evaluating the orchestra.

2.2.2 Framing in Private Equity

In the context of a private equity firm operating in a society where ESG factors are gaining increasing importance, framing becomes highly relevant. For instance: Are the traditional frames that define what constitutes a financially healthy company aligning with the frames related to ESG, or are these frames operating independently? Moreover, what ways of integrating, accepting, or rejecting information that is new or contradicts existing frames are there when the firm considers a potential investment? Finally, are there any concrete examples of framing occurring in the valuation and acquisition process within a PE firm? From the perspective of our research, ESG considerations can for example be fully integrated into financial valuation, analyzed more qualitatively (thus diverging from mere numerical assessments), or entirely disregarded.

These different ways of integrating ESG may represent existing frames within a firm, and the dynamic interplay of frames within the financial industry is a pivotal aspect of our investigation.

3. Research Design

The subsequent section will commence with a brief overview of the specific case background and the case company. Following that, the research design and data collection processes will be outlined, before finally explaining the process of analyzing the data.

3.1 Case Background

The case study was conducted on a relatively small Swedish Private Equity firm with an explicit focus on sustainable investments, founded in 2008 by (among others) a professor in environmental sciences and an investment banker. Since its inception, the firm has sought to generate financial returns through sustainable investments. The firm primarily targets Nordic, lower to mid-sized companies that contribute to the long-term health and sustainability of the environment. At present, its portfolio consists of 10 companies divided into two funds, with plans to start a third fund soon based on the success it has demonstrated so far.

Due to the small size of the PE firm, most employees are involved in every investment, albeit to varying degrees. The firm has four key investment themes and is organized into separate teams working to find and make investments within each theme. To ensure a holistic analysis of the firm and its approach to sustainable investing, interviews were conducted with several individuals with different roles and titles.

3.2 Research Design

The objective of this thesis is to understand how private equity firms can incorporate ESG in their investment practices while managing financial considerations. As previously noted, ESG is a broad, non-financial, and general term with no set definition. Therefore, it is imperative to first understand how investment practitioners within private equity define and view ESG to analyze how they incorporate the concept practically. Parker (2003) delineates in an article that in the absence of an objective reality and with a need for an in-depth understanding of a phenomenon a qualitative research method is suitable. Thus, a qualitative research method was chosen.

Understanding the interaction between ESG and the financial context of a PE firm is best done through in-depth case studies (Dubois & Gadde, 2002). Given the need for an in-depth understanding of the view on ESG as well as the implementation of the concept in investment practices, a single-case study was chosen. Our research has led us to the strong belief that private equity firms with a pronounced and well-defined ESG focus are more inclined to embrace ESG-driven decision-making. Consequently, it follows that private equity firms lacking a clearly stated commitment to ESG-focused acquisitions and portfolio companies would not approach their actions from this perspective, especially if those professing an ESG focus fail to do so themselves. Furthermore, analyzing a successful PE firm focusing on sustainable investments allows potential examination of how the firm handles both sustainable considerations in investments while reaching financial goals. As a result, to land useful insights, a single case study on a firm with a strongly stated ESG focus was deemed as the optimal choice of research design. Finally, another criterion for the choice of the firm was access. We received sufficient access to the firm in question and with both criteria fulfilled, a Stockholm-based private equity firm with a focus on sustainable investing was chosen as the case company for the study.

The data was collected on an individual level, primarily through interviews which were then analyzed on an organizational level using framing-theory. Analyzing the data on an organizational level was essential to answer the research question, regarding how private equity firms **as organizations** handle ESG in their investments.

3.3 Data Collection

The data collection process was meticulously designed with the primary objective of capturing a wide spectrum of insights and opinions from diverse roles within the organization, aimed at uncovering potential variations in the perception and significance of ESG across different functional areas. Thus, data was collected through interviews and secondarily through provided documents, described as an efficient way of analyzing qualitative data (Lee & Humphrey, 2006).

Primary Data

Interviewees (7 professionals in total) included stakeholders such as the Sustainability Officer, two Co-founders, investment analysts, an investment manager, and an investment director.

Access to several different levels within the organizational hierarchy provides an understanding of the view on ESG on an organizational level. An inefficient selection of subjects can affect the results and validity of a study directly (Taherdoost, 2016). Thus, to ensure a well-rounded perspective, factors like experience and professional background were considered when identifying interview candidates (Shown in Appendix 8.2). The interviewees encompassed both junior employees with 2-3 years of company experience and senior personnel with extensive backgrounds in the finance sector, boasting over a decade of service within the organization. These varying levels of expertise allowed us to explore ESG-related insights from both seasoned professionals and those newer to the field. The process was initiated with an interview of the Sustainability Officer, a deliberate choice made to leverage their role as a representative of the company's articulated sustainability strategy. With the help of a semi-structured process, insights from the initial interview introduced new paths and concepts possible to explore for subsequent interviews, agreeing with previous research within the area (Doody, 2013; DiCicco‐Bloom, 2006). Thus, it served as a foundational reference point against which the following interviews were compared and played an important role in shaping our follow-up questions and the direction of the study.

Before proceeding with subsequent interviews, access to two specific investment cases was provided, which granted valuable insights into the practical implementation of the ESG strategy. This, in turn, informed the generation of more specific and personalized questions tailored to each interviewee's unique perspective and experience. For example, analysts with direct involvement in the provided cases were probed about their insights, while Co-founders were asked about the firm's evolution over the past decade. After the initial set of answers, spontaneous follow-up questions were asked, as “these generate more validity by encouraging the interviewees to prepare more clarifications about what the questions/issues mean to them” (Bolderston, 2012). All interviews were recorded and subsequently transcribed to ensure the precision and accuracy of the data that would ultimately inform our final report.

As all interviews were held in Swedish, they were also translated before being analyzed further. No interview questions were provided to the interviewees before the meetings.

Five interviews occurred at the firm's office, and two were conducted online via Microsoft Teams, lasting 40-55 minutes each. Despite not being in-person interviews, no negative effects were noted, aligning with findings by Sturges & Hanrahan (2004) on in-person interviews vs. on-call interviews. Contributions in online discussions were comparable to those in face-to-face interviews.

Secondary data

The paper utilizes secondary data, comprising two confidential acquisition cases shared by the firm, along with external reports and statements available on websites. This data serves as a foundational backdrop, enhancing the efficiency of primary data collection (as mentioned above). The cases offer valuable insights into the instruments and systems employed by the firm during the analysis of potential acquisition targets. Upon receiving this data, a comparative analysis was conducted with the primary data. Due to confidentiality reasons, the specifics of these cases will not be revealed in this paper.

3.4 Data Analysis

Following each interview, both researchers collaborated in transcribing and translating the interviews jointly to ensure accuracy and establish a shared understanding for subsequent interviews. These transcriptions became the exclusive data source, with the actual recordings being disregarded.

Upon transcribing and analyzing the cases through the theoretical framework presented above, three prominent themes emerged early: Financial frame, ESG frame, and tools within investment practices. (see Figure 8.4 in the Appendix). Consequently, a thematic approach was employed, which entails "the identification of themes through careful reading and re-reading of the transcribed data" (Dawadi, 2020). The three themes were then iteratively refined and developed as additional interviews and data were transcribed.

Initially, new data was compared to the existing findings, and subsequently, an assessment was conducted to determine whether further analysis was warranted. While there were instances where new data introduced additional avenues of exploration, these were confined to the established themes, often necessitating smaller adjustments to the theoretical framework within the designated categories.

After delineating three overarching categories for the data, discussions ensued iteratively, drawing on our knowledge in the field of framing. Minor adjustments were made, leading to updated partial conclusions. At this stage, the data analysis was conducted in separate segments instead of as a whole. This led to a more abductive approach, where deductive and inductive reasoning were employed to validate or cross-examine established conclusions by integrating new information. In essence, the process involved a continuous interplay between existing insights and incoming data, allowing for the refinement and validation of conclusions (Timmermans & Tavory, 2012). Through this iterative process, a nuanced and contributory conclusion emerged, aligning with the entirety of the analyzed data.

4. Empirical Analysis

This section will begin by delineating the pertinent frames relevant to the analysis of the case company, supported by empirical findings indicating their applicability. Statements and responses regarding the firm's objectives will also be presented. In section 4.2, statements from interviewees will be compared to more tangible processes such as the two real-life cases and other tools, including their ESG scorecards and screening processes.

4.1 ESG and the financial frame

Since its creation, the firm's mission statement has been to generate attractive financial returns while investing sustainably. Quickly apparent from the interviews is the presence of two distinct frames influencing the firm's investment strategy; a purely financial frame whereby their investments should generate competitive risk-adjusted returns for their investors, and an ESG frame entailing that their investments should also contribute to a sustainable world.
When asked what characterizes the firm's investment strategy the sustainability officer mentioned these two aspects/frames:

"Right from the start, the basic idea was that you could invest in companies that generate an attractive financial return while helping and pushing a positive environmental improvement in some way through their products and services." (Sustainability officer)

As noted by the sustainability officer the firm aims to combine these two frames in their investment decisions, not allowing sustainability to compromise financial return and vice versa. However, when asked what characterizes a successful investment they implied that the primary aspect is the financial return for their investors in addition to the sustainability aspect:

"*Firstly, the return, of course, on the investment itself for our investors. It is the financial yield and [...] then we also want to see that [the portfolio company] have made a journey in terms of sustainability." (Sustainability officer)*

This sentiment lays the foundation for further analysis, how does the firm manage the two frames in play? How do they interact with each other and influence investment decisions? To understand this it is important to understand the firm's definition of the two different frames and how they have been formed. From the interviews, it became apparent that they have existed since the firm's creation. When asked about the firm's starting vision, Co-founder #1 answered:

"*Co-founder #2 saw that a segment began to emerge consisting of growing companies with environmental benefits. When I was 3I, we made an investment in a company that grew due to environmental benefits, and then I started looking. [...]We found 700 companies in a week that grew much faster than the generalists did. Then we got the feeling that this was real; if you have an environmental advantage, it can be a growth driver. Our vision stated that companies that have a better environmental product will grow faster than those that don't."*

Co-founder #2, with experience in environmental science, identified an interesting market segment consisting of companies with environmental benefits. Co-founder #1 drew from a personal experience in which an investment grew and performed well due to environmental benefits.

From these personal experiences the two Co-founders saw a potentially attractive investment strategy, all else being equal, companies with a better environmental product will grow faster than those who don't. Here it is evident that this hypothesis was formed through the lens of a financial frame, as they identified an opportunity to **generate competitive returns through investing sustainably**. Additionally, this vision also implies an ambition to combine sustainable investments with profitable investments, signifying an integration of the ESG and financial frames.

Another interesting note is the sentiment that many companies that grow faster than their peers are often those that have a better **environmental product**, not necessarily companies that are more sustainable in general. This implies that the Co-founders identified a specific part of ESG that they believe has the largest impact both on sustainability and financial returns.

In summary, the firm was created when the two Co-founders met and formed a collective hypothesis. They each came from two distinctly different backgrounds with Co-founder #1 being experienced and successful in corporate finance and financial investing and Co-founder #2 being an expert in environmental science. From this perspective they can be seen as protagonists of the two different frames, the financial frame and the ESG frame. The following paragraph will first define the financial frame in play. Thereafter, in section 4.2.1, the firm´s ESG frame will be outlined to allow analysis of the interplay between them throughout the rest of this paper.

4.1.1 Financial Frame

Much of the financial frame applied by the firm has been addressed in section 2.1. With the case company being a PE Firm, traditional practices and theories around the optimal investment strategy are of significant interest to compete in the market. A PE firm seeks to maximize financial returns to investors, and factors like risk & return, market timing, and leverage are all crucial in the firm's operations. This is also not something that the firm denies, apparent in several of the interviews:

"If you look at the general screening, we usually get a list that is categorized based on certain financial criteria. We have a budget and investment criteria to follow. We want profitable

companies and positive cash flows - we sort companies based on profitability." (Investment analyst #1)

The answer above exemplifies the importance of financial factors such as profits and cash flows. It also exemplifies financial risk avoidance, as the firm is interested in somewhat mature companies:

"[...] They can't be completely new and innovative, they need to have been proving themselves a bit already." (Investment analyst #2)

Although the financial valuation methods used by the PE firm are in line with traditional investment practices, common models like the Discounted Cash Flow Model (DCF) are not typically used when valuing companies - According to analyst #1, valuations are solely based on multiples on forecasted financial projections compared to publicly traded industry peers within the same segments. In addition to the valuation, potential possibilities in terms of financial synergies are explored. For instance, strategic additional acquisitions had a relevant role when assessing potential acquisition objects, outlined both by an analyst and a Co-founder:

"We build a case around what we can do with [a certain potential acquisition object], and perhaps how we can find strategic additional acquisitions to it, if relevant" (Investment analyst #1)

"Companies want to do business with us because we have strong management in our portfolio companies, we succeed in making strategic add-on acquisitions, and when we sell the platform companies they are worth more than when we bought them as individual companies." (Co-founder #1)

As discussed in this section, financial return and the possibilities to leverage synergies between the eventual platform company and strategic add-ons (which, in turn, hopefully, lead to an increased financial return) are discussed as two major signs of success for the firm.

4.1.2 ESG-frame

ESG is a broad and general term. When analyzing how the PE firm works with the term, it becomes observable how a specific definition is made, and how the firm focuses on certain parts of the concept. This section will thus discuss the two most visible dimensions that the firm chooses to emphasize: Focusing on E, over S and G, and prioritizing the “handprints” over the “footprints”. In section 4.2, concrete examples of how these dimensions are taken into account in practice are discussed.

A good starting point for the firm's ESG frame is their two funds' SFDR article 9 compliance, certifying them as “dark-green”. Article 9 can also be used as a benchmark for a general industry-wide ESG frame as it is not firm-specific and widely adopted. The sustainability officer mentioned:

“We are, after all, article 9 linked to the SFDR. And thus we must also be able to demonstrate [the sustainability impact of investments] in a much clearer way.” (Sustainability officer)

This certification sets a framework that the firm must follow when managing its funds and is an important factor influencing its ESG frame. The SFDR (Sustainable Finance Disclosure Regulation) is at the core of the EU-created Sustainable Finance Action Plan and intends to “increase transparency and comparability of ESG information for end investors to minimize greenwashing”. In practice, when investing, institutional investors are required to disclose how they manage “sustainability risks in the decision-making process”. The SFDR stipulates that financial products can be classified as Article 9 compliant (“dark-green”), Article 8 compliant (“light-green”), or Article 6 (“all other products”). Article 9 compliant funds must “generally only invest in 'Sustainable investments” and those that have an environmental objective must disclose their EU taxonomic alignment (Morningstar, 2023).

For an investment to be deemed as sustainable in accordance with the SFDR it must do no significant harm, something that is linked to EU Taxonomy minimum safeguards. Furthermore, the fund manager needs to disclose how they consider Principal Adverse Impacts (PAIs). In short, PAIs can be described as a set of 64 indicators measuring the negative sustainability factors that investments, decisions or advice might have.

However, if the fund invests in environmentally sustainable activities they can state this and do not need to follow the previously mentioned requirements (Morningstar, 2023). As a result of the Article 9 certification, the case firm must clearly disclose the sustainability impact of its portfolio companies but also how they have taken sustainability factors into account when making an investment decision, something that this thesis aims to dive deeper into. The firm publishes a sustainability report annually, providing a comprehensive overview of their approach to sustainability, responsible investment policy as well as relevant PAIs and taxonomy alignments of portfolio companies.

In summary, the Article 9 certification regulates that the firm must take environmental, social, and governance factors into account when making investments. However, the empirical evidence gathered showed a prioritization of environmental factors over social and governance factors. This introduces the first dimension focused upon by the PE firm:

4.1.2.1 E vs S and G

From the start, as showcased by the Co-founders starting vision of **environmentally friendly products** driving growth, the environmental part of ESG was (and still is) the most important. When pushed on the relative importance of environmental factors in comparison to social and governance factors it was further evident that environmental factors are more important, at least when analyzing potential investments prior to making an acquisition decision. Co-founder #1 mentioned:

"Our vision stated that companies that have a better environmental product will grow faster than those that don't. Many people think that you should start a fund around [social factors] - avoid child labor in China, for example. [It is] a little more difficult [to see] the financial outperformance around S - maybe [it exists], but [it is] more difficult [to see]." (Co-founder #1)

The firm hypothesizes that there is a correlation between environmentally friendly companies and competitive returns. However, this relationship was not observed for social and governance factors. Therefore, according to the Co-founders, investing in environmentally friendly companies makes sense from a financial perspective.

When asked about the impact of environmental factors on profits the sustainability officer noted:

"[The effect on the environment and the effect on profit] is very much connected. Somehow you want to be able to translate environmental matters into money as well, I think. For us who have been doing this for over a decade, I think it is becoming more and more systematic. And that you can, just as you are doing now, ask: What does this mean? What is a risk that is big and what do you do with it to make it mean something? And is it connected to money or is it just connected to a subjective opinion? [If it is connected to a subjective opinion] then it won't be as important."

On the one hand, this could be looked at from the concept of frameshifting. During frameshifting, the firm undergoes transitions into and out of the ESG frame, contingent upon whether it contrasts with the foundational financial frame. In practical terms, this implies that the ESG frame takes center stage when it aligns with the financial frame. For instance, the firm might emphasize environmental factors while focusing less on social and/or governmental aspects, as positive environmental factors could have a positive financial impact. The focus on elements that harmonize with the financial perspective thus guides the firm's strategic emphasis within the ESG framework.

On the other hand, somehow wanting to translate environmental matters into money indicates incorporating aspects of the ESG frame into the financial frame, an example of moderate frame blending. In the financial frame, growth and profitability are the main factors and therefore there is an ambition to try to measure different factors' effects quantitatively and monetarily. However, from a traditional ESG standpoint, there is an acceptance that many factors can not or should not be financialised. The sustainability officer makes the connection between financial profit and environmental factors signifying that frame blending has occurred. The firm seems to treat environmental factors as financial factors driving growth, signifying an incorporation of the E in ESG into the financial frame. The incorporation of a certain aspect of one frame into another is an example of moderate frame blending.

Although there is an ambition to financialize the effects of environmental factors, this was something that the interviewees described as difficult.

When asked about adjusting cash flows as a means of quantifying the effect of environmental factors investment analyst #2 noted:

"No, that is nothing that we do. We have discussed it out of interest - but it is so difficult. Financials are very straight to the point. Could [quantifying the effect] be done? Maybe, but that would entail a lot of guesswork. Maybe if you can measure emissions in scope 1, 2 and 3 and quantify [them] in emissions rights that have a value…"

It became evident that although the firm chooses to focus on environmental factors over social and governance factors due to a belief in a correlation with profitability and growth, from a pre-acquisition point of view this effect is not separately accounted for financially from a valuation aspect.

The difficulty in quantitatively analyzing ESG can be further explained by a financial dimension mentioned by the interviewees, e.g. the size of the acquisition objects. As the PE firm focuses on small-to-medium-sized companies, time and resources to extensively report the environmental impact are often not sufficient for these objects. As a result, the firm's pre-acquisition ESG evaluation tended to be more qualitative than quantitative, relying heavily on the experience and perspectives of sustainability experts and analysts within the PE firm. This aspect was first discussed by analyst #2, and thereafter by Co-founder #1:

"*…. As we are [sic.] in such a small spectrum [of the market], very few companies of this size have control over [quantified data on sustainability impact], and they often require a certain size to have enough resources to look at this as well…." (Analyst #2)*

"There are regulations coming that all companies must report their environmental impact – but this will take a long time for small companies. [In the future] We will be able to start finding companies that have [quantified data on sustainability impact], but up until this point, we haven't acquired any company doing this [at the outset]." (Co-founder #1)

The quotes above acknowledge the potential for blending the ESG and Financial frames in the future when quantifiable data on sustainability impact becomes more readily available.

According to the firm, the ability to quantify and compare ESG factors with financial factors relies on available data which is often correlated to the size, maturity, and resources of potential acquisition targets. For the PE firm, as stated above, they invest in companies where those resources are lacking and hence lead to a lack of data. By acknowledging the potential to integrate frames, they also note the possibility of blending the frames more systematically in the future. At present the firm views the frames as not fully congruent, and thus not possible to fully blend. When partially integrated, but not fully congruent, moderate frame blending occurs. This supports the evidence that the prioritization of environmental factors within ESG is an action of moderate frame blending.

Nevertheless, as evident from the answers above, the PE firm does not have a reliable system of quantified data to rely on when scanning and evaluating a potential acquisition from an ESG perspective – this analysis becomes subjective and qualitative, and explains why the financial analysis is described by the analyst as straight to the point, while the environmental factors constitute some fact and educated guesswork and thus are separated from each other.

4.1.2.2 Footprint vs Handprint

Further defining the frame that the firm views ESG through, according to the firm's sustainability report from 2022 they frame ESG through two important perspectives, impact (handprint) and operations (footprint). The impact (i.e., handprint) angle relates to the positive **environmental outcomes** that the firm's portfolio companies generate through their **products, business models, and services**. The operations angle (i.e., footprint) relates to how the portfolio companies are run and the **operative impact** on environmental, social, and governance factors. This sustainability approach was echoed by the interviewees when they were asked to describe what ESG and sustainable investing means to them. However, something that was clear from a pre-investment standpoint was that impact (handprint) was substantially more important than the operations (footprint) angle.

“We look from the perspectives of Impact and Operations. Impact is about the value the company creates with its products and services. Operations must also be monitored. This part, operations, is how they work internally and they must keep an eye on that when they work with us and must reduce their footprint.” (Co-founder #2)

Once we become owners, we see to it that by the first year they get infrastructure and metrics and everything like that in place. But they don't have to have everything in place [at the outset].” (Sustainability officer)

The choice of words used implies that the handprint (impact) is the most important while footprint must also be monitored. Furthermore, the operational sustainability impact is something that the firm can affect post-investment and therefore something that is not as important from a pre-investment standpoint. Investment analyst #1 further drives this point home:

“Handprint is the most important thing when we enter a company. The operational part, the footprint, can't be completely terrible, but we can often help them do better. The important thing, however, is "if the company grows, is there a positive climate impact?"

Here it is concretely stated that handprint is more important than footprint, the reason given for focusing on handprint is once again that the operational footprint can more easily be improved when the firm takes an active ownership position post-investment. Whereas the product or service offering is implied to be more difficult to change. However, as expressed by Co-founder # 1, there is another aspect that further explains this prioritization.

“We distinguish between footprint and handprint - footprint is the impact of our operations in terms of direct effect on the environment - handprint is the value we create for our customers. Handprint is the most interesting”

Going back to the starting vision of the firm, Co-founder #1 mentioned that the financial outperformance found from their initial market analysis was from companies that have a better environmental **product** than those who don't. In the quote above, the term handprint is described as the advantage the firm creates for customers. While the firm doesn't financialize environmental factors in its valuation process, our research noted that the financial benefit of a potential investment object's handprint toward customers was articulated. As part of this research, two investments that the firm made were analyzed. When describing one of these where the investment object's product reduced end customers' fuel consumption the investment director said:

"*Then comes the next question, which can be hard to answer: How significant is the impact? I'm pretty confident that people are willing to pay for [the environmental benefit] in the end - it becomes a kind of premium product if we can promote it. Also showing what value it actually has for the customer - to reduce fuel consumption, that they can save costs and the climate - [is] a win-win. I think the economic aspect is important, but environmental aspects often lead to economic effects as well.*"

The investment analyst describes the positive financial effect of an environmentally friendly product. A product's environmental effect can command a premium from the end consumer through for example highlighting savings from reduced fuel consumption, a way to translate the environmental benefit to an economic benefit. This question of how the environmental benefit can produce value for customers proved essential to the firm through our research. Prior to making an investment decision the firm produces a validation memo where the question "How does the environmental impact drive customer value?" is a central concept. This is then followed by the subquestions:

1. *Describe how the company's environmental performance drives value through I) Improved environmental performance and/or costs for customers and/or II) customers' willingness to pay a higher price for the environmental benefit.*

2. *How does the company communicate the environmental benefit to its customers/in its brand building?*

These questions aim to analyze if the environmental benefit can be translated to a potential economic benefit/premium to be generated from the end customer. From this perspective, the choice to focus on handprint over footprint is also made through the financial frame. There is an implied potential economic benefit to environmentally friendly products which can increase profitability within a business.

Once more there is evidence of a moderate blending of the ESG frame into the dominant financial frame. When explaining impact/handprint, investment analyst #2 describes both environmental benefits and economic benefits as linked to each other, signifying a blending of the frames.

As previously mentioned, articulating the monetary benefit of environmental factors signifies treating them as financial factors typically part of the financial frame and thereby evidence of moderate frame blending.

In summary, this section examines which areas the firm has identified within the ESG frame that will generate the best financial returns, based on the dimensions of Product vs Operations, and Environmental vs Social, and Governmental factors. Statements and answers reveal several ways that the firm deals with the two different frames. Initially, it becomes observable how the financial frame takes precedence over the ESG frame as the investment focus hones in on financial potential, even during the evaluation of ESG factors. This can be interpreted through the lens of frameshifting, wherein the firm adopts an ESG perspective only when it does not clash with the more pivotal financial frame. Primarily, however, moderate frame blending is visible when the firm discusses the potential of combining the two frames. For instance, the interviewees describe environmental factors using financial terms such as profitability, treating them as financial factors. To this end, they also articulate the economic benefit of the environmental handprint monetarily to customers. Furthermore, they view the size and development of ESG measures as contributors to the fact that the frames are not fully congruent - yet, the integration is discussed and claimed to be possible if working with larger acquisition objects, or further down in time.

Visible in practice: The firm considers objects from an ESG perspective, but only when they are environmentally focused, and the main ESG benefit lies within the actual product or service offered by the acquisition object as this combination is the one most correlated with financial profitability, according to the firm.

Hereafter, it becomes of interest to investigate whether a similar analysis can be made when analyzing tools used in the investment process. The next section will more concretely highlight certain practices used in an acquisition process, and how these may be evaluated through the concept of framing.

4.2 Practical application and interplay of the frames

This section aims to exemplify the instruments and processes used in practice when the PE firm assesses a potential acquisition object, and how these relate to the frames and dimensions described above. Three specific parts within the firm's acquisition process highlight the interaction of the frames. The focus will thus be on these parts: the screening process, due diligence/scorecard, and valuation.

4.2.1 Screening process

When reviewing the full acquisition process, the firm first conducts an initial screening. This screening process showcased the interplay between the financial frame and the ESG frame. The firm has four key investment themes, and a potential investment should fall under one of these. The four themes are all linked to environmentally sustainable attributes (due to the themes being identifying to the firm they will not be explicitly mentioned). The screening process begins with a thematic screening of the market in hope of finding environmentally attractive objects. Here, aligning with the previous section, there is a notable emphasis on the environmental aspect, mentioned by Co-founder #1:

"We [look at] business opportunities, how we can work with ESG, and above all E, i.e. the environmental side, how we can strengthen our strategy."

When comparing the previous section to actions in practice, the screening process was also influenced by underlying financial considerations. This is evident when reviewing the comments made by the sustainability officer regarding the initial screening:

"*And already here, we look from a sustainability perspective. Because what we are looking for are companies that have products and services [with sustainability benefits] that make them profitable. So that there is something to grow from".*

The sustainability officer notably describes what they are looking for from a sustainability perspective using financial terms such as profit and growth. This emphasizes that the screening is made from both a financial and environmental point of view. When taking two separate frames and combining aspects of one into the other moderate frame blending occurs.

Here, the ESG and financial frames, previously considered separate, become connected when environmental performance and financial performance are seen as synergetic. The presence of financial considerations within the described environmental screening is further visible later in the interview:

"Every Monday we have a meeting with the whole group and then we go through all the new cases. [...] What we are looking for are companies that have products and services that turn a profit. Because then there is something to grow from. They shouldn't be the ones that are completely new and completely innovative, but should have proven themselves somewhat." (sustainability officer)

Here financial aspects such as profitability, growth, and maturity are referenced. The new hybrid frame becomes significantly visible when talking to Co-founder #1 about the screening process:

"[...] Here, many potential objects are filtered out, as we don't think they are exciting or have an environmental advantage. The hard thing is when they have a good model, but nothing to do with ESG. Then we never pursue it, as it is not for us. Same thing if they are too small - exciting, but not for us [...]"

As observed, both the financial and environmental aspects need to be fulfilled, otherwise, the potential object becomes rejected. A financial screening blended with some aspects of ESG might tolerate certain environmental shortcomings, but this hybrid screening approach necessitates approval on both financial and ESG criteria. Social and governance factors are not completely disregarded, in part due to their fund's Article 9 certification. Problematic industries such as gambling, pornography, and weapons are thus excluded in this initial screening, as these industries are problematic from a social point of view due to their adverse effects on the well-being of people. While excluded, the screening does not dismiss companies solely on the excitement of social and governmental factors. Here, meeting the requirements of Article 9 and adhering to more fundamental measures is sufficient.

The environmental component is extensively integrated into the new hybrid frame, whereas the social and governmental aspects are not as prominently incorporated.

The firm, in this manner, selectively incorporates certain facets of the general ESG framework into its financial frame during the screening process, exemplifying a moderate blending of the two frames.

4.2.2 Due Diligence/Scorecard

Further along in the acquisition process the firm conducts due diligence which in part uses an ESG scorecard. The ESG scorecard is used to rate several environmental, social, and governance factors based on the importance of the factor for the acquisition object (materiality) and also their handling of the factor.

Importance/materiality and handling of a specific factor are each ranked on a scale from 1 to 3 with a score of 1 indicating low importance/well handled and a score of 3 indicating high importance/not handled. Rating ESG factors in this way constitutes an attempt to quantify them.

The importance rating in this instance is synonymous with materiality, a concept related to traditional investment theory. A material issue is an issue that has a direct effect on the financial performance of a company. In essence, the importance/materiality rating evaluates how the handling of each factor might impact profitability. Thus, rating the materiality of each factor constitutes an attempt to link ESG factors to financial performance, whereas rating the handling of a factor is purely linked to ESG.

As mentioned in the domain theory, ESG factors are considered non-financial, and quantifying them in numbers is not straightforward. The rating for each factor is set by the sustainability officer, when asked what the ratings are based on she stated:

"I have a lot of experience. I have worked as an accountant with assessments on both environment, work environment, and safety for many years, but you can't expect to have that precision here either."

It is evident that although the ESG factors are quantified into numbers, this quantification is still purely subjective and still qualitative to a large extent. The importance and handling score of each factor is then multiplied to rate factor-specific risks/opportunities for the investment object. This combination signifies a clear attempt at integrating the financial and ESG frame.

Taking two previously unconnected frames and combining them into a single, congruent, hybrid frame constitutes an example of radical blending. Since the materiality rating (the link to financial profit) and handling rating aren't weighted, they are equally influential in impacting the risk/opportunity rating that influences the firm's investment decision. In this way, the financial and ESG frame have been fully integrated into this tool.

However, the practical application and usage of the scorecard still echoes the firm's view on ESG where there is a priority on environmental factors and handprint over footprint. For example, when asked if a red flag on an environmental factor would weigh more than a red flag on a social or governance factor Co-founder #1 answered "absolutely" albeit also noting that "*a red flag is a red flag - there cannot exist bribes, etc. [However], there may not be an anti-money laundering process in place, but that we can implement later.*".

When asked about the relevance of the rating of social and governance factors the sustainability officer answered:

"It's like this, we won't go in and buy companies if there are only big red flags everywhere. If we see that some factors are more red it's because they don't have an employee-manual for example."

Both Co-founder #1 and the sustainability officer imply that social and governance factors are easier to improve post-investment. This traces back to the reasoning behind prioritizing handprint over footprint from an ESG perspective. As such, the practical use of the tool focuses on environmental factors and thus constitutes a more moderate blend of the frames.

4.2.3 Valuation

If the acquisition object makes it past the screening and Due diligence processes, the firm conducts a multiple valuation, using public industry peers. When asked if the multiple valuation is done in comparison with other green companies and if they pay a premium because the acquisition object is green, the investment manager answers:

"No, we want to sell through a premium. Most of the time, the companies themselves don't know that they are fine assets with a lot of potential [due to the environmental benefit of their product] - I think we create and develop this, it's about risk minimization. Our companies are quality assured in that way, which then drives a premium when we sell, hopefully."

The investment manager clarifies that they don't pay a premium for environmentally conscious companies, as it may not always be evident to the market that they provide tangible environmental benefits. Instead, the manager draws a link between environmental benefits and risk mitigation, suggesting that such benefits can potentially command a premium during exit transactions. Once more, the ESG perspective is partly integrated with the financial standpoint, treating the environmental component of ESG as a financial factor that mitigates risk and, ideally, enhances risk-adjusted returns.

In summary, upon scrutinizing the design of systematic instruments such as the scorecard and screening, and valuation process, signs of both radical and moderate frame blending emerge. By assigning equal weight to financial and ESG-attractiveness in their scorecard, both perspectives are given parallel importance in their assessment, suggesting a seamless integration and fusion of the frames. In practice, however, the screening process and materiality calculation emphasized the environmental standpoint over social or governmental aspects, evident from interviewees' reflections and implementations of the instruments. This same prioritization is also evident in the valuation process. Thus, the notion of moderate frame blending gains significance - certain factors of the ESG frame are adjusting the general financial frame, while others receive less emphasis.

5. Discussion

This section aims to highlight the presence of various forms of frame blending within the organization by analyzing empirical evidence through the lens of previous research in framing theory and traditional investment practices.

5.1 Presence of Frame Blending

Previous studies have delved into the impact of framing on organizational actions and perspectives.

The concept of framing has been explored in the context of investments, elucidating the interplay between environmental, social, and governance factors and financial considerations. However, the emerging domain of Private Equity lacks adequate research on the role of ESG in actual practice. This paper aims to fill this gap and contribute to the existing body of knowledge in ESG and financial investing. Specifically, it seeks to examine the diverse methods by which a PE firm understands and incorporates ESG factors into its evaluation process when assessing a potential investment. This paper also involves analyzing the potential clash between generating attractive financial results and investing sustainably, and how the firm navigates this.

Going back to the research question: *How do private equity firms comprehend and practically apply ESG in their investment decisions while balancing financial considerations?*

The empirical analysis is initiated by establishing two distinct frames: a financial frame and an ESG frame (constituting the firm's understanding and definition of ESG). Notably, the financial frame employed aligns with industry norms within the private equity sector, adhering to the principles of traditional investment theory. Conversely, the ESG frame originates from a well-defined, non-firm-specific regulatory framework, specifically SFDR Article 9. Given the firm's assertion of investing sustainably while concurrently achieving favorable financial results, the objective of this paper is to scrutinize the dynamics between these two divergent frames.

Interviews, as well as the instruments designed within the firm, essentially answer the question; Through frame blending. Coulson (2001), and Fauconnier & Turner (2002) exemplify successful frame blending as "the discursive combination of two separate schemas that share some abstract structure, or as the incorporation of words and elements of one schema into that of another". Throughout the empirical analysis, interviewees consistently refer to environmental results when discussing financial results (and vice versa), showing that the two are incorporated with each other.

Moreover, conjunctive language, such as "profitable *while* sustainable" or "financial *and* sustainable success" is observable in all of the interviewees, further indicating the presence of frame blending (Werner & Cornelissen, 2014).

The next step becomes to determine *how* and at what levels these frames interact with each other. When answering this question, it is beneficial to separate the designed instruments and processes from actual descriptions and responses by employees at the firm.

In the initial analysis which focused solely on the designed instruments and processes within the firm, there was strong evidence of moderate frame blending but also of radical frame blending. Both the screening process and valuation process emphasized the link between environmental factors and financial performance, indicating the inclusion of environmental factors in the financial frame and thus a moderate blend of the frames. However, the scorecard part of the due diligence process was structured with an equal emphasis on environmental, social, governance, *and* financial factors which itself manifests a hybridized frame that supersedes the previous one, aligning with Werner and Cornelissen's (2014) definition of radical frame blending. Another indicator of this radical blending is the use of materiality, a term that constitutes more than its counterpart in the default financial schema, profitability. This terminology shift underscores a deliberate departure from a purely financial focus, illustrating the new hybrid frame's intention to integrate both ESG and financial considerations.

Although the scorecard suggests a radical blending of the financial frame with ESG, it is essential to scrutinize how this translates into practical implementations. Consistent with previous literature on traditional investment practices in PE, the firm views its operational impact as significant, suggesting that the firm believes it can enhance the efficiency of current management and resources by leveraging its competence (Kaserer, Graf & Schmidt, 2012). Thus, an attractive environmental *product* becomes of priority, not operational efficiency.

Therefore, weaker ratings within social and governmental factors are often considered less concerning, as this is possible to overcome by leveraging the firm's competence through making changes within the organization. The practical divergence from the designed instruments also results in a shift from quantitative to more qualitative analysis, and the prioritization of the environmental factor over others makes the blending more moderate than radical. More specifically, when describing the concept of moderate frame blending, Coulson (2001) claims that “The contrast may involve only specific elements of schemas so that besides a key element of difference the shift between frames also shares at least some of the same key roles, actions or hypothetical action sequences". This describes the empirical evidence above, as only specific elements of the ESG frame are integrated into the financial frame. It's noteworthy that the firm still meets SFDR Article 9 requirements, indicating a level of moderation, while other aspects (S & G) are included in the new frame, they are not integrated to the same extent.

Finally, the size of the acquisition objects is also possible to analyze through the scope of moderate frame blending. As explained in the empirical section, insufficient resources or maturity often leads to a lack of data and consequently the challenge of the firm combining it with its quantitative financial analysis. This aligns with previous research on why ESG factors become excluded from the financial analysis (Solomon & Solomon, 2006), and indicates the presence of moderate frame blending - the frames are not fully congruent and thus not fully possible to integrate. However, there were no indications of a lack of engagement among the firm’s executives, a mentioned occurrence from prior research (Solomon, 2013). While this prior research found cases of executives referring to non-existing information on websites, the interviews revealed well-educated answers regarding sustainability amongst not only all executives interviewed but generally throughout the firm.

When combining the aspects mentioned above, the firm's approach to integrating ESG into its acquisition process is revealed. Namely, when crafting guidelines and tools, the firm adopts a blended frame, giving weight to both sustainability and profitability. This integrated frame is prominently communicated externally through extensive sustainability reports and acquisitions, as well as internally through specific screenings and scorecards. Similar to how prior research observed radical framing reshaping established categories in art through systems and ratings, the firm redefines performance—treating profitability and sustainability as equally crucial (Khaire and Wadhwani, 2010). However, in its practical implementation, the frames are moderately blended, rather than radically.

Specific aspects of ESG receive emphasis, particularly those presenting clear financial opportunities. In this scenario, the default financial frame takes precedence, incorporating specific elements of the ESG frame (or partially integrating them).

In a financially competitive industry like Private Equity, this approach illustrates one strategy for balancing sustainability with investor returns. By examining environmental considerations through a financial lens, the firm sees it as a factor, akin to other diverse elements in investing, leading to competitive risk-adjusted returns. Actively seeking acquisition targets with this factor and aligning with SDFR article 9 regulations, the firm effectively integrates ESG factors into its core strategy.

The case firm goes against the notion that impact investing leads to a tradeoff with financial returns. They are in the process of raising their third fund, indicating success and attractiveness to investors. In conclusion, the case firm can be seen as an example of how to successfully balance ESG and financial considerations as a private equity company.

6. Conclusion

In the backdrop of ESG's growing prominence in investing, the integration of ESG into traditional investment strategies has witnessed a surge in theoretical exploration over the past decade. This trend extends to the Private Equity industry, a notably financial-centric realm of investing. Existing research on the relationship between financial returns and sustainability remains inconclusive. While positive correlations are evident in some research, there's a tendency among investors to perceive it as a tradeoff. This perception often leads to sustainability reporting being more of a frontstage development, spurred by stakeholder demand rather than genuine interest.

Moreover, there's a notable demand among investors for fully standardized practices in sustainability reporting before wholeheartedly embracing it, contributing to a slower transformation toward a more sustainable industry.

This thesis aims to contribute to the ongoing research on how ESG is implemented within Private Equity firms.

Through an analysis of the acquisition process of a Private Equity firm managing two financially profitable funds, simultaneously classified as "dark green" by SFDR ratings, the paper showcases tools and strategies to effectively navigate the intersection of two objectives: profitability and sustainability. Applying the concept of framing, the firm is observed redesigning traditional financial evaluation tools such as Screening and Due Diligence by integrating ESG and examining it through a wider frame. While the described scorecard is an example of radical frame blending, the practical implementation and screening take a moderate approach. Focusing on specific sustainability aspects and viewing them through a financial lens allows the firm to moderately blend the frames, achieving both objectives without relinquishing control over either. This study underscores that crafting partly hybridized, quantified tools, assigning importance to both financial and certain aspects of sustainable returns is an effective avenue for integrating ESG into the acquisition process. Nevertheless, even within sustainability-focused Private Equity firms, the practical implementation of the broad spectrum of ESG considerations might encounter challenges. To adeptly balance both profitability and sustainability objectives, the study suggests that viewing sustainability through a more narrow focus and interpreting it through a financial lens becomes imperative. This strategic approach allows Private Equity firms to navigate the complexities of ESG integration and maintain a harmonious equilibrium between financial success and sustainability goals during the acquisition process.

6.1 Limitations & Suggestions for Future Research

This study has certain limitations that need acknowledgment. Primarily, it focuses on investigating the strategy and actions of a firm within the Nordic market with a specifically stated focus on sustainability. Conclusions from this organizational analysis may become challenging to generalize, due to the potential influence of unique factors specific to this firm and its investment strategy. For instance, the expertise of executives and employees with prominent backgrounds within the area of sustainability might facilitate the process of combining the two objectives. Thus, success or outcomes observed in this context are unlikely to be universally witnessed in other firms.

Additionally, the examination is confined to an industry in a region recognized for being at the forefront of sustainability efforts.

Different markets across the globe might grapple with more pressing issues within various sectors of ESG, necessitating the adoption of different strategies. Therefore, the findings and insights from this study may not seamlessly translate to industries or regions facing distinct challenges and priorities in the realm of environmental, social, and governance considerations.

A final, potential shortcoming is the empirical evidence that is analyzed. All cases and interviews were decided upon by the firm. While the information provided offers a comprehensive and fair view of the overall organization, the reliance solely on internally chosen cases may present a certain bias. To enhance the robustness of the study and mitigate this potential shortcoming, it would be valuable to incorporate additional material sourced independently. Examining cases that arise under different circumstances or external perspectives could provide a more holistic understanding of how the ESG integration strategy unfolds. This approach could reveal potential discrepancies between the frames, as well as consequences thereof. Incorporating diverse sources would strengthen the study's external validity and enrich the insights derived from the empirical evidence.

Considering the acknowledged limitations, several avenues for future research emerge. Exploring strategies and systems within Private Equity firms operating in different markets, where diverse sustainability challenges are prevalent, could provide valuable insights. This comparative analysis would help ascertain the adaptability and effectiveness of ESG implementation strategies across various contexts.

Furthermore, investigating PE firms with less expertise and education in sustainability could offer a contrasting perspective. Examining cases where traditional values, lack of awareness, or differing priorities may hinder successful frame integration could shed light on potential barriers and varying outcomes.

Finally, future research could benefit from greater independence in selecting interviewees or acquisition cases. A more nuanced analysis, considering potential influences like greenwashing, is crucial. Understanding how external pressures, such as stakeholder demands for sustainability, may impact the integration process would contribute to a more comprehensive understanding of the dynamics between financial and sustainability frames within the Private Equity industry.

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8. Appendix

8.1 List of interviews

Interviewee	Length	Date
Sustainability Officer	54 minutes	23/10-2023
Co founder #1	52 minutes	26/10-2023
Investment Analyst #1	48 minutes	26/10-2023
Investment Director	47 minutes	31/10-2023
Investment Analyst #2	46 minutes	31/10-2023
Investment Manager	51 minutes	10/11-2023
Co founder #2	53 minutes	21/11-2023

8.2 Brief Demographic

Interviewee	Professional Background	Experience at Firm
Sustainability Officer	Non-financial Auditing, engineer	3 Years
Co founder #1	Corporate Finance	14 Years (Start)
Investment Analyst #1	Corporate Finance	2 Years
Investment Director	Investment Banking	12 Years
Investment Analyst #2	Corporate Finance	3 Years
Investment Manager	Investment Banking	4 Years
Co founder #2	Professor in Environmental sciences	14 Years (Start)

8.3 Interview guide

Formalities

- Recording of the interview
- GDPR form
- Anonymity

Example of questions

- How would you describe the firm's long-term strategy?
- What are factors in common for your acquisition objects?
- Are any risks with your industry currently observable? If so, what risks?
- What aspects are you currently prioritizing when assessing potential investments?
- What does sustainability mean to you?
- What classifies a good investment?
- Do you have any specific real-life acquisition or evaluation-case in mind where these factors have played an important role?

To investment practitioners

- What does a typical workday look like for you?
- Which aspects do you focus on when analyzing companies?
- Is sustainability relevant to you in your analyses? So, how?
- Given your smaller size, how much influence do you perceive you have in discussions of potential acquisitions?
- How big of an influence do you perceive the sustainability officer's insights and analysis to have on your decisions?
- How did you account for ESG in this specific case?
- What tools did you use to analyze ESG?
- What were the results of the ESG-scorecard and how did you interpret them?

To the Co-founders

- What was your early vision for the firm?
- How do you feel that the journey you have made has succeeded in reflecting the vision?

8.4 Coding tree