

A discussion with our Chairman, Lord Deben, and Sancroft Advisor, Alison Hampton, on investor interest in the current plastics agenda



Sancroft consultant, Ross Lakhdari, is joined by Lord Deben and Alison Hampton to discuss the evolving narrative around plastics from an investor's perspective.

Key points:

- Competing technologies are emerging, and these are making the avoidance of plastic more feasible across the value chain
- Investors should take stock of plastic usage within their portfolio companies as an immediate step
- Resource shortage and resource efficiency remains a material concern of strategic importance
- Non-engagement with this kind of issue can be seen as a proxy for wider management failures within companies – what else are they missing?
- The overall plastics agenda is not a fad – it is here to stay
- Commercial opportunities are emerging as a result of the changing landscape
- Successful investors will take a hold of this issue, and will subsequently benefit when they are trying to sell to the next buyer
- A holistic understanding of the overall narrative is crucial; themes such as food waste and microfibres must be assessed
- Firms must work to protect themselves from future legislation around this topic
- Understanding NGOs is important- they greatly influence end consumers

Firstly, Alison, why should private equity investors engage with the plastics agenda?

Alison: Typically, private equity investors may say that whilst they make their investment decisions based on their own philosophies and theses, that one particular small area like plastics may not be relevant for them. However, I think there are two things to consider.

Firstly, we're starting to see the **emergence of alternative technologies**, which are potentially fruitful grounds for investments. This will provide rich opportunities for people who are looking to fill the gap once plastics are taken out of the supply chain, as more and more large corporates look to replace their packaging with alternatives. At the moment, those opportunities are limited to very early stage seed development growth

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capital opportunities. We're seeing small-scale investments of around about a million pounds into companies which are developing alternatives, and it will probably be some time before those businesses are big enough to attract private equity investors.

However, I think the immediate step for private equity is to start considering **where the plastics debate impacts on their existing investments**. They may be consumer facing businesses that need to maintain their brand reputation by doing something about the issue. Or, they are businesses which may not on the face of it be impacted but are reliant on single use plastics embedded in the supply chain. Potential regulation is going to mean that they need to make investments to provide an alternative, or to look at different ways and business models in order to take them out.

Lord Deben: It's also important for private equity to understand the reason why this is a continuing issue and that this is not just passing as a media fad. It seems particularly important that the media have concentrated on examples where plastics are unnecessary, for example, water in disposable bottles. Questions around certain sorts of packaging, I think, will be a **continuing issue which private equity ought to think seriously about. We are going to become a society that is conscious of resource shortage and a need for resource efficiency.**

Alison: I think what this debate shows is that as investors you need to have an eye to the underlying drivers. I don't think anybody today would be thinking of investing in the packaging business without asking questions about what they're doing to transform. I think 3 or 4 years ago they may not have had that lens. And the question is, what is there today that they're not thinking about that is going to be the plastics issue in 2, 3, 4 years' time?

Lord Deben: Well that's why I think one has to think seriously about this as an exemplar, and, as a way of judging the **capability of management to handle problems like this**. If you take a single example - the very ill-judged public statement by Tetra Pak that said plastics straws are necessary - this was an example of a management that hadn't got it. It should have said we're immediately trying to find an alternative to what we are doing, because frankly people aren't going to allow them to say that. If I were a private equity investor in Tetra Pak - and I use that as a specific example - **I'd be saying to myself, what management allowed that to be said; have they not understood that you live in a different world from the world you were in?**

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For me what matters, and why one should engage in the plastics agenda, is because **it's a continuing agenda**. It will morph of course into other areas, but it is an agenda about resource use; it is an agenda about sensibility to public opinion and public attitudes; and it is an agenda too about how you reuse and recycle. **Just think how different this is from what we would have said years ago when there was a certain demand for the throw-away society, because we thought it created jobs and it was perfectly easy. I think this is a real long-term change and it's a lens through which you should look at all sorts of investment, way outside plastics.**

Alison: And it's interesting for private equity with a typical investment timeframe of 4 to 7 years. But when they come to sell, they're selling to the next person, who is looking at the next 4 to 7 years. **So, your investment decision-making should try to anticipate what the world will look like in 10 – 14 years' time as that's going to impact on potential evaluation.**

Lord Deben: But don't you think also, one should be thinking all the time, at the degree to which those who will buy in 4 to 7 years' time, are interested in these sorts of issues. You can look back 4 to 7 years and realise your limited partners (LPs) were very often uninterested in these issues. And if you're thinking about a 4-7-year timeline and you want to get the best price for what you bought, then I would have thought the plastics agenda is a very important one.

So, from a private equity perspective, how are investors engaging?

Alison: Private equity is a very broad spectrum so let's look at it at its broadest and encompass people like the venture capitalists and the seed investors. I think there is a growing number who are starting to focus on this as a source of investment: an investment thesis and value creation. A fund was recently announced that has been setup to focus specifically on investments in bioplastics and recycling. But it's a small fund – 60 million euro. There are a number of other venture capital and seed outfits that are looking at this technology and how it can help around this agenda as well. **So I think, at grassroots level, there's quite a lot beginning to bubble up.**

For the mainstream investors however, I think it will very much depend upon where they are in their awareness and what sort of investments they have made. There are some who will have significant retail and consumer investment, and food and beverage investments, where this issue is I think rightly front and centre. For example, you have Pret, which was until recently, backed by Bridgepoint. They have taken considerable steps to look at plastics within their operations and premises. They have introduced measures

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such as allowing consumers to refill their water bottles, encouraging reusable coffee cups, and so forth, well in advance of any regulation coming in. I think, as Lord Deben said, **smart private equity investors that can see they have an issue within their portfolio companies are going to be asking management about how they're responding and what they need to do.** What I'm not sure people are doing yet is **investigating where they may be exposed to a potential tax on plastic usage coming in down the line,** further embedded within businesses in which they've invested.

Lord Deben: Don't you think the other thing that some are doing, or ought to do, is use the understanding that they've got as a management measure? I really do believe that this is not just a case of the investors saying, 'what am I exposed to here,' but being able to recognise when managements seem to have missed this. **Because if they've missed this, it's a very good indication that they may be missing other things.** Not just in this area but in general this is a very important gauge, because it is a continuing story.

The second thing is that **the understanding of the consumer is vital here.** It has been very difficult for the plastics industry to get the consumer to recognise just how valuable plastic has been to get fresh food to the individual. We see a world in which it has proved almost impossible to tell that story. This reminds us therefore, **that very often it's not truth but perception that wins, and that's a vital insight for private equity.**

The third thing is, I don't think people have really recognised the more extreme aspects of the plastics agenda, although one or two private equity houses are beginning to think about this. **For example, microfibres, have a much larger impact on the oceans than plastic bottles.** You can see plastic bottles, collect them, and do something about them. Microfibres can't be seen and are now in everything. They recently tested the 15 leading brands of bottled water and found microfibres in all of them. And there is no doubt that this is going to be a future concern.

Alison: And the development of clothing made of recycled plastic has been hailed as one of the great breakthroughs in terms of creating some form of circularity.

Lord Deben: Absolutely. But when washed, it isn't circular at all. And that really has an impact in all sorts of areas. I think it's quite a good example of where the best of private equity comes into play. It isn't just about packaging and the food and drink industry, but investments in a water company or a manufacturer of washing machines. Are they going to be pressed to have different sorts of filters? **And is there in fact a commercial opportunity here?** Can I produce the first washing machine that guarantees the majority of microfibres are removed?

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The other issue, which I think private equity may well be wanting to think more widely about, **is a world which moves away from fossil fuels**. Don't kid yourself that the world which moves away from fossil fuels also moves away from providing the fundamental raw materials and the price mix that makes plastics so reasonable in price. So perhaps it may be that this is a wake-up call to find an alternative at the beginning of the process? The reason we can make man-made fibres so cheaply is because they're a by-product. It's not the main business, but if it became the main business, could we produce fleeces at this price? Could we package in this way? These are the questions which the best of private equity houses are thinking about because it does depend on their long-term consideration of where they should be putting their money. Not only private equity but pension funds also ought to be thinking very seriously about this sort of thing.

Alison: Well absolutely, because the drop in value inherent in any investment that's based on fossil fuel technology is enormous... The first point is really well made about how management are responding to this because I think many private equity houses are responding. **One of the reasons why they have embraced the responsible investment agenda is because they see how portfolio companies are looking at a range of ESG issues as a really good proxy for good management**. It gives an investor an enormous degree of confidence if your portfolio company management is coming to you and saying we've thought about how this impacts our business and this is what we want to do.

With that in mind, what would you consider, Alison, to be the emerging stakeholder expectations of portfolio companies?

Alison: I think the biggest two that management would be thinking about, are customer expectations and potential government intervention. I think as Lord Deben mentioned earlier, this is just the start of what happens when people begin to understand the resource implications of a resource-constrained world, which is shifting to a low carbon economy. Whether or not you believe that there is a definite customer impact, people's buying patterns change, it becomes much more of a brand reputation issue and I think that will be very important.

And I think in terms of government action, we've already started seeing movements. In 2016, France banned all non-biodegradable single use picnic ware, from 2020. The EU has proposed a potential tax on plastics coming in the next few years and our own Government is expected to ban a range of non-recyclable items.

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So there will be a number of other things like that which management is going to have to get to grips with, and I think understanding what the impact of that is going to be is quite important.

Lord Deben: I think also, one of the problems for investors, is that they tend to see the activities of lobbyists, campaigners, and NGOs as a kind of alien activity that certainly erupts and upsets their quiet organisation and business. **I want them to think of it in a different way, which is to say that all these people are part of a marketplace. They are also in the marketplace - campaigners have to raise money, so they must have campaigns that ring bells with people. So if they ring bells with people and play into people's basic perceptions, this of course, can distort the marketplace and part of what you're trying to do when you're looking forward is recognising where these campaigners are coming from.** Sometimes one must gain the truth, rather than the perception if you're going to get a real answer. So if the real problem is on-the-go packaging and litter, then that's where we ought to be fighting that battle if we're going to keep stuff out of the oceans. If the real problem is that we're not recycling, for example, the foils and films, then we've got to think about banning these items. So, there are all sorts of changes happening. If I were looking at investment, I wouldn't just be looking at new technology in the broader sense, I'd be encouraging someone to come up with plastics which are much more readily recyclable, where you can have film and trays both of which are recyclable and can be put into the same bin. If I can do these very small institutional things, that's where the future comes, and that's where I ought to be putting my money.

Alison Hampton: Or indeed, investing in recycling.

Do you see NGOs as foreshadowing certain issues? If you'd been following them 5 years ago, would you have predicted the plastics issue?

Lord Deben: Well, at Sancroft, we do watch these kinds of issues very carefully! Partly because we tend to be on the side of NGOs, in the sense that many of these arguments are about sustainability, which is what we practice. But also, because there's a wide enough range of organisations for them to pick up things that others don't perhaps. So I wouldn't say it in general because sometimes NGOs don't foreshadow what's coming but do the opposite, they reinforce some prejudice which is just the wrong thing to do. Let's take a simple example: there is a great tendency of NGOs to say that vegetarianism and veganism is really the way forward. At the other end, if we're going to have successful farming, we're going to have to move much more closely to the mixed farming that really regenerates the soil, and we need that soil regeneration, if the soil is going to become a proper sink for the CO₂ and things that are causing climate change. There are some very

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important links here. So I think within that context, if you look at all the NGOs and the development agencies, you can see some of the things that are emerging but not all of them.

Looking forward then, where do you see this agenda going from an investor's perspective?

Lord Deben: Well I think the basic thing for investors to remember is that transparency and traceability are going to be absolutely central to tomorrow's world. And nobody can now not be transparent. The idea that you can say commercial in confidence is laughable – because there is no such thing and that is the difference. And if I were investing in a number of kinds of companies today, **I would be thinking about blockchain and AI.** And once you have a satisfactory mechanism to blockchain which can be easily applied, those who do not use it, I think, will find themselves excluded from very large numbers of prestigious markets. So those are the kind of issues that I would press on.

And it's clear that private equity has, and continues to be, a force in the plastics industry, so it'll be interesting to see the most successful ones who can anticipate those changes and risks that are facing them today.

Alison: For me, I think the thing that resonates most strongly is Lord Deben's point from earlier on - this is a real wakeup call for anybody who thought that various sustainability issues are an investor driven fad. That world has gone completely. I think any private equity investor should be looking to understand what the sustainability and broader impacts are, and how societal changes are going to affect the investment environment.