



ESG Integration in Early-Stage Private Equity Investment Processes

Qualitative Insights from SME-Focused GPs in
Germany

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Abstract

Amid growing pressure to address sustainability impacts, the integration of Environmental, Social, and Governance (ESG) principles has become standard for financial market participants. While ESG integration is well established in public markets, its application in Private Equity (PE) remains underexplored. Literature marks early-stage investment processes — particularly Due Diligence (DD) — as key for embedding ESG, with studies covering efforts across developed and developing PE markets. Despite Germany’s role as the European Union’s (EU) powerhouse and its large base of Small and Medium-Sized Enterprises (SMEs) facing financing constraints and decarbonisation needs, the German PE sector has received scant academic attention. This thesis explores how German PE firms targeting SMEs integrate ESG during early-stage investment stages, using a qualitative design based on 12 Semi-Structured Interviews (SSIs). The study finds that, while ESG has become an institutionalised factor in early-stage investment practices within German mid-market PE, its application remains fragmented and mainly shaped by external compliance pressures. This compliance-first logic drives risk-focused DD practices, with financial rationales prevailing and ESG’s strategic motivations remaining secondary — further constrained by SME’s limited ESG maturity. Looking ahead, amid geopolitical and regulatory turbulence, the study highlights a sector in transition: while ESG’s strategic relevance is expected to persist, a shift toward more outcome-driven and pragmatic application will be essential to translate compliance into tangible results.

Keywords: ESG, Early-Stage Investment Process, Private Equity, Due Diligence, Germany, SME

Title: ESG Integration in Early-Stage Private Equity Investment Processes: Qualitative Insights from SME-Focused GPs in Germany

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Sumário Executivo

Diante da crescente pressão por sustentabilidade, a integração dos princípios Ambientais, Sociais e de Governança (ESG) tornou-se padrão no setor financeiro. Embora consolidada em mercados públicos, sua aplicação em Private Equity (PE) permanece pouco explorada. A literatura destaca as fases iniciais do investimento — especialmente Due Diligence (DD) — como chave para integrar ESG, com estudos em mercados desenvolvidos e emergentes. Apesar do papel central da Alemanha na União Europeia (UE) e de sua base de Pequenas e Médias Empresas (PMEs) enfrentando restrições financeiras e necessidades de descarbonização, o setor alemão de PE recebeu pouca atenção acadêmica. Esta tese explora como firmas alemãs de PE que investem em PMEs integram ESG nas fases iniciais do investimento, com base em 12 entrevistas semiestruturadas (SSIs). Os resultados mostram que, embora o ESG tenha se tornado um fator institucionalizado no mid-market alemão, sua aplicação segue fragmentada e guiada por pressões externas de conformidade. Essa lógica de compliance conduz DD centradas no risco, com racionalidades financeiras prevalecendo e motivações estratégicas permanecendo secundárias — agravadas pela limitada maturidade ESG das PMEs-alvo. Diante das turbulências geopolíticas e regulatórias, o estudo destaca um setor em transição: embora a relevância estratégica do ESG deva persistir, uma aplicação mais pragmática e orientada a resultados será essencial para traduzir a conformidade em impactos tangíveis.

Palavras-chave: ESG, Processo de Investimento Inicial, Private Equity, Due Diligence, Alemanha, PME

Título: Integração de ESG nos Processos de Investimento Inicial em Private Equity: Perspectivas Qualitativas de GPs Focados em PMEs na Alemanha

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List of Abbreviations

AUM	Assets Under Management
AI	Artificial Intelligence
CSR	Corporate Social Responsibility
DACH	Germany, Austria, and Switzerland
DD	Due Diligence
EC	European Commission
EBA	European Banking Authority
ESG	Environmental, Social, and Governance
EU	European Union
ETFs	Exchange-Traded Funds
GDP	Gross Domestic Product
GHG	Greenhouse Gas
GPs	General Partners
IC	Investment Committee
KPIs	Key Performance Indicators
LBOs	Leveraged Buyouts
LPs	Limited Partners
PE	Private Equity
PRI	Principles for Responsible Investing
SFDR	Sustainable Finance Disclosure Regulation
SME	Small and Medium-Sized Enterprises
SRI	Socially Responsible Investing
SSIs	Semi-Structured Interviews
UN	United Nations
US	United States
VC	Venture Capital

1 Introduction

The long-term viability of financial investments is contingent upon stable economic systems, which themselves depend on a healthy society and a sustainable planet — making sustainable development an economic necessity (United Nations (UN) Global Compact, 2004). However, the integrity of global well-being is increasingly undermined by the degradation of environmental and social systems, driven by, among others, unsustainable production and consumption patterns (Gupta et al., 2024; Scatigna et al., 2021). In response, actors in finance, policy, and law have begun aligning capital flows with sustainability goals (Ng, 2021). Within this transformation, adopting ESG principles has become a key mechanism for creating long-term value while addressing ecological and social risks (Kaźmierczak, 2022; Kim et al., 2022).

In the EU, ESG integration is well established in public financial markets, supported by regulatory frameworks such as the EU Taxonomy and the Sustainable Finance Disclosure Regulation (SFDR) (Sipiczki, 2022), and a growing market offering sustainable financial products such as green bonds and ESG-labelled exchange-traded funds (ETFs) (ElBannan, 2023; Ng, 2021). Over time, this ESG momentum has extended into private markets, where both Limited Partners (LPs) and General Partners (GPs) increasingly expect demonstrable ESG performance (Crifo & Forget, 2013; Drobetz et al., 2024). While practices remain fragmented due to lower transparency requirements, the PE industry has evolved significantly since the global financial crisis — with ESG factors now viewed as central rather than peripheral (Indahl & Jacobsen, 2019; Noh & Park, 2024). Today, ESG factors are increasingly integrated at the early stages of the investment cycle, particularly DD (Ljungqvist, 2024), serving both risk mitigation and value creation purposes (Abraham et al., 2024; Golovcsenko & Ming, 2023).

Given an institutional environment marked by firm commitments to low-carbon transition and climate action, the German PE market is no exception to this shift, with investors pushing for greater ESG practices (Preqin, 2022). Although domestic PE growth has lagged behind other European markets, its low penetration signals significant growth potential (Bienek et al., 2024; PwC Germany, 2024). This becomes particularly evident given the German economy's reliance on its large SME base — accounting for 99.6% of all domestic businesses, or around 2.5 million firms (European Commission (EC), 2022; OECD, 2024a) — a segment where PE financing has gained major importance in recent years (Peskes & Tang Zheng, 2024). As many SMEs struggle to secure the capital needed to meet rising ESG demands and transition to sustainable business models, PE firms have emerged as key partners, offering financial flexibility, operational expertise, and long-term strategic support (OECD, 2022; Zhou, 2024). Despite this relevance,

limited academic attention has been paid to ESG integration within the German PE landscape. While earlier research has examined ESG integration in PE markets across the Nordics (e.g., Kruse, 2022; Olsen & Enbusk, 2023), Spain (e.g., García Domic, 2022; Torremocha Gaytán de Ayala, 2023), or the broader DACH region (Germany, Austria, and Switzerland) (e.g., Pöhlmann, 2022), no study has yet focused exclusively on the German PE context.

This thesis addresses this gap by exploring how German GPs targeting SME investments integrate ESG considerations into their early-stage investment processes. It provides empirical insights into the drivers, practices, and challenges of ESG adoption, thereby contributing to both academic understanding and practical application. The research follows a qualitative, exploratory design based on SSIs with professionals active in the German mid-market segment. Considering recent macroeconomic developments — including the return of protectionist and anti-ESG rhetoric in the United States (Alhamis, 2025) — this study also considers how current external developments shape ESG sentiment and expectations for future industry development.

The remainder of this thesis is as follows: Chapter 2 reviews the extant literature, while Chapter 3 outlines the methodology. Chapter 4 presents the findings, followed by a discussion in chapter 5. Finally, chapter 6 concludes with key insights, limitations, and avenues for future research.

2 Literature Review

2.1 The ESG Phenomenon

2.1.1 From SRI to ESG: Evolution and Characteristics

While the link between corporate governance, stakeholders, and the wider socio-environmental context has been recognised for years (Pollman, 2024), the growing demand for sustainable development has made ESG principles central to both academia and practice (Li et al., 2021).

The acronym ESG first gained prominence in 2004 through the UN's *Who Cares Wins* report, offering guidance on ESG integration across financial markets and decision-making processes (Chen et al., 2023; UN Global Compact, 2004). Conceptually, however, its roots trace back to the 1960s and 1970s, commonly linked to Socially Responsible Investing (SRI) and Corporate Social Responsibility (CSR) (Mitra & Bui, 2024; Townsend, 2020). SRI traditionally applied exclusionary or inclusionary screening based on different sets of criteria and promoted shareholder activism to strengthen CSR (Crifo & Forget, 2013). Over time, partly due to the limitations of negative screening, SRI evolved into ESG — a more integrated approach using sustainability factors as non-financial indicators in investment decisions (Li et al., 2021; Zaccone & Pedrini, 2020). While academia acknowledges the shared roots of CSR and ESG (e.g., Chen et al., 2023; Mitra & Bui, 2024), they differ in purpose: CSR rather serves as an internal framework for responsible conduct, whereas ESG provides measurable criteria to assess sustainability performance, mainly from an investor's perspective (Każmierczak, 2022).

Despite ESG having emerged from its niche to a commonly adopted standard (Bebic et al., 2025), it remains an ambiguous concept without a universally accepted definition, as variations in the selection of ESG indices and dimensions contribute to inconsistencies in interpretation (Li et al., 2021). Moreover, the fact that the three letters ESG are often followed by different terms such as '(ESG) issues' or '(ESG) factors' only adds to the conceptual ambiguity (Pollman, 2024). Given the inherently non-exhaustive nature of ESG factors and issues, their significant overlap in key components such as GHG emissions, child labour, and shareholder rights (e.g., European Banking Authority (EBA), 2021; Principles for Responsible Investment (PRI), 2018), as well as the frequent synonymous use of both terms in prior field research (e.g., Hoellermann, 2020; McCahery et al., 2022; Zaccone & Pedrini, 2020), this paper adopts the same approach to avoid terminological misconception and confusion.



Figure 1: ESG dimensions with exemplary factors (Source: own illustration based on PRI, 2018)

2.1.2 Mainstreaming ESG: Impact on Financial Markets

Growing concerns over global challenges such as social inequality and climate risk, and the resulting scrutiny of environmental and social costs linked to economic activity (Scatigna et al., 2021) have pushed ESG from a niche concept into a mainstream standard across the financial ecosystem (Kim et al., 2022; Pollman, 2024). In doing so, ESG has succeeded where traditional SRI fell short: it overcame the barrier to mainstream investing (Townsend, 2020).

On the one hand, ESG is viewed as a non-financial investment approach that helps companies mitigate risks (Li et al., 2021), as ESG factors may negatively impact financial performance by triggering credit, market, or liquidity risks (EBA, 2021). As demand for more granular and context-specific ESG information to assess investment risks increases, jurisdictions with more advanced ESG practices — such as the EU — have responded with regulatory frameworks like the SFDR and the EU Taxonomy to enhance transparency (Mitra & Bui, 2024; Primec & Belak, 2022), while similar classification efforts have also emerged from the private sector (Scatigna et al., 2021). In this vein, a key milestone was the 2005 launch of the UN PRI, which attracted over 2,300 signatories with US\$80 trillion in Assets Under Management (AUM) by 2019 (Townsend, 2020). Since then, numerous frameworks and rating systems have been developed to assess ESG issues and Key Performance Indicators (KPIs) (Chen et al., 2023; PRI, 2018).

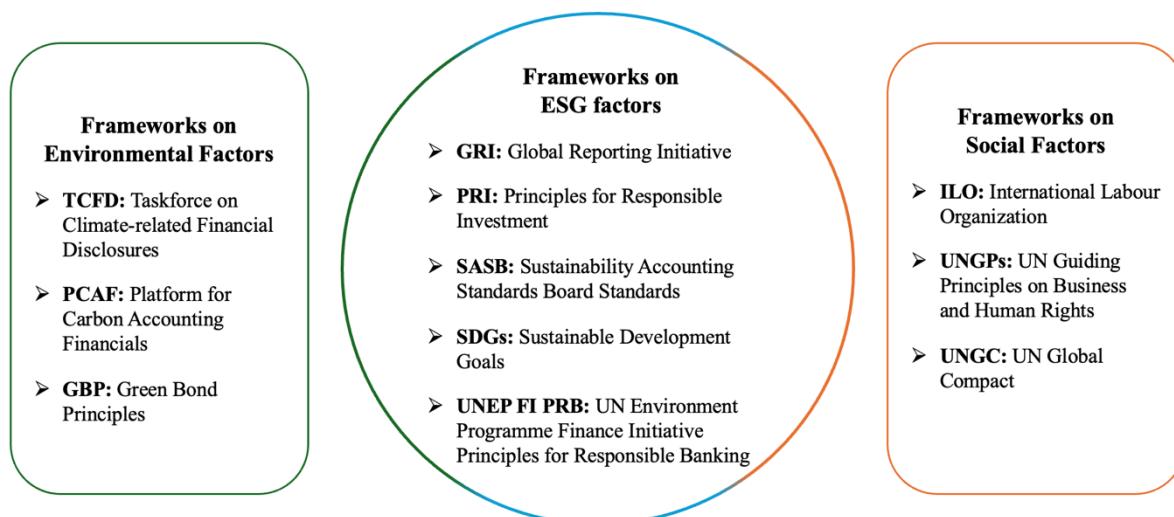


Figure 2: Overview of ESG frameworks commonly used by institutions (Source: own illustration based on EBA, 2021)

On the other hand, integrating ESG factors is gaining recognition from financial institutions not only due to its potential to mitigate risks but also for its ability to unlock opportunities for higher returns (Limkiangkrai et al., 2017; Zaccone & Pedrini, 2020), with meta-studies showing that strong ESG performance is linked to benefits such as lower costs of capital (Chen et al., 2023). As investors seek to capitalise on these dynamics, investment vehicles marketed under the ESG label have attracted trillions of dollars in inflows (Busch et al., 2016; Pollman, 2024), having fuelled a rapid expansion of AUM in the ESG market over recent years (Scatigna et al., 2021). Across the financial sector, varied actors — ranging from asset managers to commercial banks and PE firms — have developed green financial products, including sustainable ETFs and green bonds (ElBannan, 2023; Ng, 2021), with the latter serving, for instance, to finance environmental projects while lowering the issuers’ capital costs (MacAskill et al., 2021).

However, where there is light, there is also shadow. ESG has become a contested field, with political actors increasingly instrumentalising it for broader ideological purposes (Pollman, 2024). In the US, critics — particularly from the Republican side — depict ESG as a tool of liberal elites promoting a decarbonisation agenda framed as risk management (Hilson, 2024). Recent anti-ESG rhetoric warns that prioritising ESG could undermine shareholder value and calls for refocusing on profit maximisation over societal or ecological aims (Sætra, 2024). The return of Trump-era economic policies is expected to intensify tensions between short-term profit motives and long-term sustainability ambitions, challenging ESG investors to adapt to a shifting political, regulatory, and economic environment (Alhamis, 2025; Bebic et al., 2025).

2.2 Private Equity

2.2.1 Fundamentals and Evolution of Private Equity Investments

2.2.1.1 Private Equity: Unique Characteristics of an Alternative Investment

PE is a form of corporate finance that operates beyond the confines of regulated capital markets, primarily aiming at the acquisition of privately held, unlisted companies — commonly referred to as portfolio companies — with the strategic goal of reselling them at a later stage (Peskes & Tang Zheng, 2024; Scheuplein, 2022). Unlike conventional investments in publicly listed firms, PE is classified as an alternative investment, typically characterised by limited liquidity and higher risk, mainly due to the lack of a readily accessible trading market (Cumming & Zhang, 2016; Skully, 2007). At the same time, PE provides distinct benefits, including increased portfolio diversification and the potential for superior returns that exceed those of public markets (Mundi & Kumar, 2023; Peskes & Tang Zheng, 2024).

While the asset class is commonly segmented into four core subcategories — buyouts, Venture Capital (VC), mezzanine financing, and distressed investing — PE is often used as an umbrella term for the first two, representing the most significant and impactful types of PE activity (Metrick & Yasuda, 2011; Scheuplein, 2022). However, a clear distinction between the two is crucial: VC focuses on high-risk, early-stage investments in businesses at the concept, startup, and/or market entry phases, whereas buyout targets established firms, acquiring majority stakes to drive growth through active involvement (Peskes & Tan Zheng, 2024; Pitkänen, 2022). In this vein, PE is frequently associated with Leveraged Buyouts (LBOs), a strategy in which majority control of a mature company is obtained through a combination of limited equity and substantial debt financing (Kaplan & Strömberg, 2009). Reflecting prior research and aligning with the scope of this study on PE firms targeting SME investments, PE is herein more narrowly defined as buyout or growth equity investments aimed at acquiring majority ownership to drive value creation within portfolio companies (e.g., Gompers et al., 2016; Scheuplein, 2022).

From a practical perspective, PE firms (GPs) act as intermediaries: they manage the fund, acquire and oversee companies, then exit and return profits to investors like pension or endowment funds (LPs), who provide capital but have no role in daily management activities or investment decisions (Abraham et al., 2024; Ljungqvist, 2024). This structure aligns the interests of both parties, as GPs typically invest their capital alongside LPs and are compensated through carried interest based on the fund's performance (Blackstone, 2021; Peskes & Tang Zheng, 2024). The funds generally have a lifespan of around 10 years, with a fixed fund size

defined at inception (Metrick & Yasuda, 2011). The lifecycle traditionally consists of three stages: (1) the acquisition phase, where GPs identify and acquire target companies; (2) the holding phase, lasting around 4 to 7 years, where value creation is pursued through operational improvements; and (3) the exit phase, where portfolio firms are sold, and returns are distributed to LPs (Crifo & Forget, 2013; Ljungqvist, 2024).

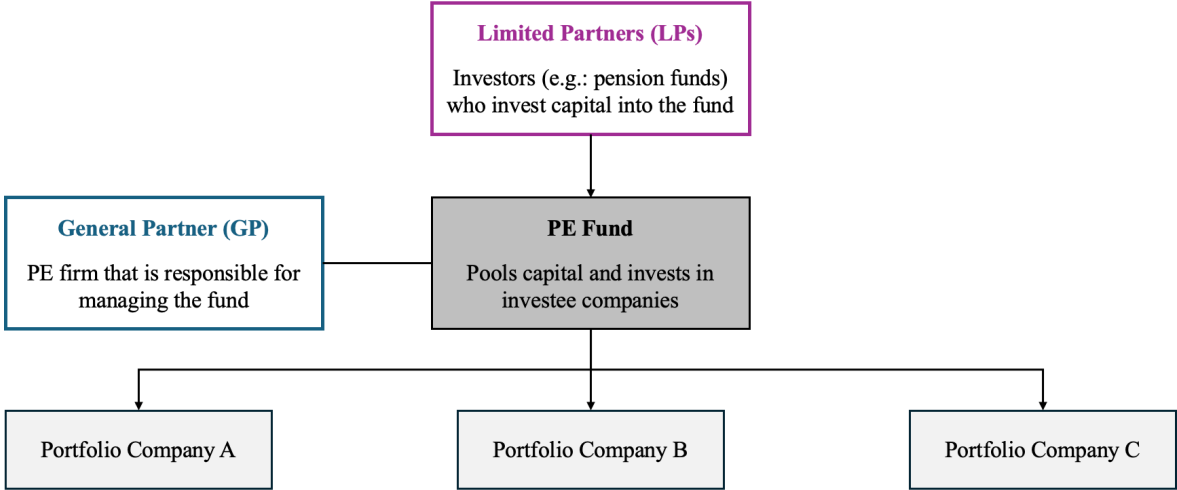


Figure 3: Simplified structure of PE funds (Source: own illustration based on Blackstone, 2021 and Crifo & Forget, 2013)

2.2.1.2 Adapting to Change: The Evolution of Strategic Focus in Private Equity

While PE investments have experienced significant growth in recent years, evolving into an industry worth several billion dollars (Peskes & Tang Zheng, 2024), the idea of investing in non-public assets has existed for centuries (Ljungqvist, 2024), with the first discussed LBO dating back to 1919, carried out by the Ford Motor Company (Hurduzeu & Popescu, 2015).

It was not until the 1980s, however, that the rise of the high-yield junk bond market triggered a wave of LBOs targeting larger companies, bringing first broader recognition to the PE industry (Indahl & Jacobsen, 2019; Ljungqvist, 2024). At that time, value creation relied mainly on financial engineering — combining significant debt with equity stakes to incentivise management and enforce cost discipline — and governance engineering, which gave PE firms board control and enabled more active involvement than in public companies (Gompers et al., 2016; Kaplan & Strömberg, 2009). Nevertheless, as the economic environment shifted and interest rates rose alongside a recession toward the end of the decade, many of these deals failed, marking the end of this first wave of large-scale PE activity (Ljungqvist, 2024).

While the mid-2000s saw a renewed rise in PE activity, driven by a resurgence of LBOs and record fundraising, this momentum was yet again abruptly disrupted by the global financial

crisis, resulting in a severe liquidity shortage in its aftermath (Crifo & Forget, 2013; Kaplan & Strömberg, 2009). In response to the market uncertainty from 2008 onward, the PE sector increasingly recognised that relying solely on financial restructuring was no longer a viable value creation strategy, prompting a shift toward operational improvements within portfolio companies (Pöhlmann, 2022). PE Firms began to leverage sector-specific expertise to identify opportunities and implement tailored value creation initiatives to enhance performance across portfolios, with leading PE firms today commonly targeting specific industries (Kaplan & Strömberg, 2009). Not least, this period marked the early integration of ESG considerations, as GPs gradually expanded their strategic focus to include wider stakeholder interests considering, for instance, growing environmental or social challenges — externalities traditionally of second priority in the early PE industry (Crifo & Forget, 2013; Indahl & Jacobsen, 2019).

As of today, this strategic shift has proven most valuable in an investment landscape shaped by geopolitical tensions, economic headwinds, and rising interest rates, which have reduced the appeal of traditional debt financing and positioned PE as a more flexible and resilient alternative (Scherer, 2024). The PE industry is now at a pivotal point, poised to drive economic growth despite ongoing disruptions, with digitalisation and Artificial Intelligence (AI) becoming core elements of modern strategies — enabling GPs to leverage data to refine decision-making, enhance efficiency, and secure competitive advantages (PwC Germany, 2024). Moreover, the relative importance of ESG has steadily grown, now even benchmarked against financial KPIs, as both LPs and GPs place greater focus on the ESG performance of their portfolio firms (Abraham et al., 2024; Drobetz et al., 2024). Driven by rising investor pressure to monitor and disclose ESG progress, PE firms ever more recognise that improving sustainability can reduce costs and generate new revenue streams (Entraygues & Shandal, 2024; Seow, 2023), with novel technologies further supporting this development by providing transparency tools to identify better and manage exposure to ESG-related risks (Indahl & Jacobsen, 2019).

2.2.2 Private Equity in Germany

2.2.2.1 Mapping the German PE Market: Untapped Potential in an Industrial Stronghold

Despite Germany's role as the EU's economic powerhouse, accounting for a significant quarter of its Gross Domestic Product (GDP) (Bebic et al., 2025; PwC Germany, 2024), the domestic PE market remains underdeveloped, with institutional investors still relatively hesitant to engage with PE and alternative assets (Preqin, 2022). This reluctance stems from various forces, including a business culture wary of equity investment and risk-taking, a complex regulatory

environment, and a public perception that links equity ownership primarily to job losses and cost-cutting (Bienek et al., 2024). Consequently, German PE investors lag international peers, particularly those in the United States (US) (Preqin, 2022). This becomes evident in a simple comparison: Germany’s projected PE deal value for 2025 is US\$47.39 billion, while the US is expected to reach US\$640.67 billion (Statista, 2024) — roughly 13.5 times the amount.

However, Germany’s modest PE penetration, standing at just 0.27% of GDP, presents a significant growth opportunity — particularly when compared to other leading European markets such as the UK (1.79%) and France (1.09%) (PwC Germany, 2024). This positive outlook is reinforced by a recent analysis by Gain.pro, showing that within the DACH region, Germany contributes 82% of PE entries, followed by Switzerland with 13% and Austria with 5%, with all three hubs for DACH PE assets located in the German cities of Berlin, Munich, and Hamburg (Jain & Zegar, 2024). Viewed in a broader strategic context, the DACH region now ranks as Europe’s second-largest PE market by transaction volume, trailing only the UK and Ireland while surpassing France and the Nordics (Weissbart & Gaab, 2024). Moreover, the DACH market is set to become a major driver of global private capital expansion, contributing to an estimated \$19 trillion in global AUM by 2028 (Preqin, 2024) — with Germany cited as the most attractive PE target market over the next five years (PwC Germany, 2024). Against the backdrop of continued interest from European GPs in German firms (Preqin, 2022), it is no surprise, however, that dominant non-German GPs compete alongside a select group of established German players in the domestic buyout sector (Scheuplein, 2022). This dynamic between German and international GPs is also found to shape the broader DACH market, as seen in the most active PE firms by number of buyouts from 2018-mid-2024:

Investor	HQ	Deal Count
Deutsche Beteiligungs	Germany	45
Triton Partners	Luxembourg	35
Afinum Management	Germany	26
Bregal Unternehmerkapital	Switzerland	26
KKR	USA	25
Main Capital Partners	Netherlands	25
Aurelius Group	Germany	25
Ardian	France	24
Capiton	Germany	23
Deutsche Private Equity	Germany	23

Table 1: Most active DACH GPs by number of buyouts (2018–mid-2024) (Source: own illustration based on Preqin, 2024; HQ information added by author)

To shed further light on the structural characteristics of the German PE market, a recent study by McKinsey & Company found that PE-backed companies based in Germany realised €310 billion in sales in 2023, employed 1.46 million people, and contributed 3.3% to total GDP (Bienek et al., 2024). Considering Germany’s role as a global industrial leader — supported by both large-scale diversified corporates and SMEs, its so-called ‘Mittelstand’ (OECD, 2024a; Preqin, 2022) — it is furthermore unsurprising that industrial assets dominate nearly all PE regions within national borders (Jain & Zegar, 2024). Accordingly, the industrial sector stands out as the largest PE employer, with 476,000 jobs, representing around 32.6% of total PE-backed employment, followed by services with 276,000 employees (18.9%) and healthcare and pharmaceuticals with approximately 250,000 (17.1%) (Bienek et al., 2024).

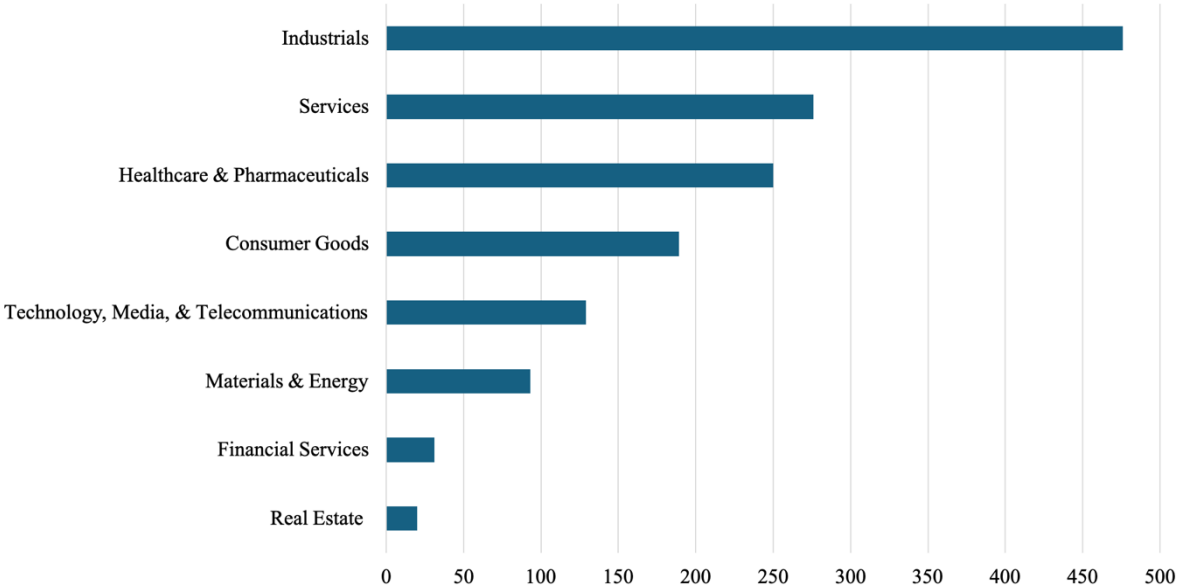


Figure 4: PE-backed employment by sector as of 2024 (in thousands) (Source: own illustration based on Bienek et al., 2024)

2.2.2.2 PE and German SMEs: Driving Growth through Strategic Partnership

Although SMEs are a global phenomenon, serving as the backbone of economic development in both advanced and developing economies (Eggers, 2020; Gamage et al., 2020), Germany’s economic prosperity is particularly tied to its SME strength (OECD, 2024a). With around 2.5 million SMEs accounting for 99.6% of all businesses nationwide (EC, 2022), their scale and relevance not only fuel the country’s capacity for innovation, resilience, and success (Bebic et al., 2025) but also offer an attractive opportunity for PE investment (Bienek et al., 2024).

Within this context, a defining feature is the notion of the German ‘Mittelstand’ — a term referring to local SMEs that has no direct counterpart in other markets (Bebic et al., 2025; Berlemann et al., 2022). This uniqueness stems from a mix of qualitative and quantitative traits,

such as family ownership, limited firm size, and management continuity, with no single criterion alone providing a comprehensive definition (Heider et al., 2021). While recognising this conceptual ambiguity, a pragmatic approach is adopted using ‘Mittelstand’ and ‘SMEs’ interchangeably, in line with existing academic and federal sources (e.g., Federal Ministry for Economic Affairs and Climate Action, 2019; OECD, 2024a). For consistency, the EU’s SME definition is applied — covering firms with fewer than 250 employees, annual turnover of up to €50 million, and/or a balance sheet total of up to €43 million — as the most widely used benchmark in SME-related research (Berisha & Pula, 2015; EC, 2020).

	Employees	Annual turnover	Annual balance sheet
Medium-sized	< 250	≤ EUR 50 mil.	≤ EUR 43 mil.
Small	< 50	≤ EUR 10 mil.	≤ EUR 10 mil.
Micro	< 10	≤ EUR 2 mil.	≤ EUR 2 mil.

Figure 5: Characteristics of enterprises classified as SMEs (Source: own illustration based on EC, 2020)

While the Mittelstand has long been praised for its resilience and stability, playing a key role in Germany’s postwar resurgence and in navigating crises such as the 2008/09 recession (Berlemann et al., 2022), this strength has been severely tested in recent years. External shocks — including post-COVID inflation and mounting interest rates — have increased production costs and restricted SMEs’ access to capital (OECD, 2024b). As SMEs account for roughly 40% of domestic business-related GHG emissions, they are expected to play a key role in achieving national net-zero targets, yet many lack the capacity to meet the growing ESG demands passed down the supply chain by larger firms, with non-compliance potentially resulting in contract losses (Mitra & Bui, 2024; OECD, 2024a). Exacerbating these challenges is SMEs’ limited access to sustainable finance, as they often lack ESG ratings, relevant ESG data, or credible transition plans nowadays required by financial institutions (Flögel et al., 2023; OECD, 2024b). In this light, PE has become a progressively vital source of capital for SMEs in Germany (OECD, 2024a). Unlike traditional lending models with rigid ESG-linked criteria (Flögel et al., 2023), PE combines financing provision with targeted know-how in areas such as governance, digitalisation, and sustainable transformation efforts (Scherer, 2024). In fact, empirical

evidence suggests that institutional investors like PE firms lead to enhanced ESG performance and company valuations by improving both financial stability and operational flexibility within the portfolio firm (Drobetz et al., 2024; Zhou, 2024). This dynamic is mutually beneficial: With 94% of German SMEs being family-owned (Bebic et al., 2025), PE investors can benefit from more stable ownership, reduced agency costs, and long-term orientation — supporting the implementation of value creating strategies (Salerno, 2019).

2.3 ESG Integration in Private Equity

2.3.1 Driving ESG Adoption in PE: From Compliance to Value Creation

Research into ESG integration in PE remains in its early stages, with the specific mechanisms, outcomes, and strategic approaches underexplored (Ljungqvist, 2024). However, the rapid adoption of SRI practices in public markets and the rising importance of sustainable finance have naturally extended into the PE sector (Crifo & Forget, 2013; Pitkänen, 2022). As effective management of ESG risks and the pursuit of opportunities become increasingly vital for securing competitive advantage, it is crucial to examine the underlying drivers of this shift from external and internal perspectives (Indahl & Jacobsen, 2019; Pöhlmann, 2022).

External Drivers

Despite various external factors driving ESG adoption in PE (Zaccone & Pedrini, 2020), the introduction of global disclosure requirements — coupled with rising investor and stakeholder expectations for greater transparency — has shifted ESG from a voluntary add-on to a core priority for GPs (Donau & Müller, 2025; Scherer, 2024). This shift is underscored by a recent study from the Boston Consulting Group, indicating that 98% of investors would decline an investment if the GP lacked credible sustainability commitments (Entraygues & Shandal, 2024). Given the particularly demanding nature of this task for PE firms — as they engage with a broad range of stakeholders through their portfolio holdings — the industry has significantly expanded its ESG disclosures (Abraham et al., 2024). However, the extent of ESG integration varies markedly between regions, with Europe widely regarded as a frontrunner due to binding regulation alongside strong investor and consumer demand for sustainable operations (Mitra & Bui, 2024; Primec & Belak, 2022). In this vein, academia suggests that despite the growing array of ESG disclosure requirements — including metrics like GHG emissions and workplace safety (Scherer, 2024) — such standards may ultimately strengthen the positions of jurisdictions like the EU and UK, as they meet the global demand for credible ESG-aligned investment hubs (Abraham et al., 2024; PwC Germany, 2024).

Internal Drivers

Historically, ESG adoption has primarily been driven by its role as a risk mitigation tool aiming to reduce operational risk and liability exposure (Biermans et al., 2014). This is based on the rationale that regulatory breaches or failures — such as data leaks or mishandling of hazardous waste — can severely undermine a company’s long-term viability (Indahl & Jacobsen, 2019).

Nowadays, however, PE firms have increasingly integrated ESG criteria into fundamental processes like screening and investment evaluation, driven by the growing understanding that ESG not only improves risk oversight but also serves as a lever for long-term value generation and enhanced returns (Kaul, 2023; Peskes & Tang Zheng, 2024). Reflecting broader industry dynamics, the perception of ESG is more and more transitioning from a compliance burden to a strategic value lever as GPs begin to view ESG incorporation more systematically into asset evaluations and the management of portfolio companies (Golovcsenko & Ming, 2023; PwC Germany, 2024). At the portfolio level, PE firms apply operational know-how and sector focus to leverage ESG as a performance lever — enhancing efficiency, reducing costs, and driving growth through positive effects such as improved talent attraction and stronger customer reputation (Abraham et al., 2024; Kaplan & Strömberg, 2009). Although specific value creation pathways are case-dependent and differ across firms and industries, ESG integration can yield a range of financial and strategic benefits — from reducing costs through energy efficiency and lowering regulatory risk to unlocking new growth opportunities via circular models and green premiums — particularly when ESG teams are closely involved within the investment process and portfolio company engagement (Entraygues & Shandal, 2024).

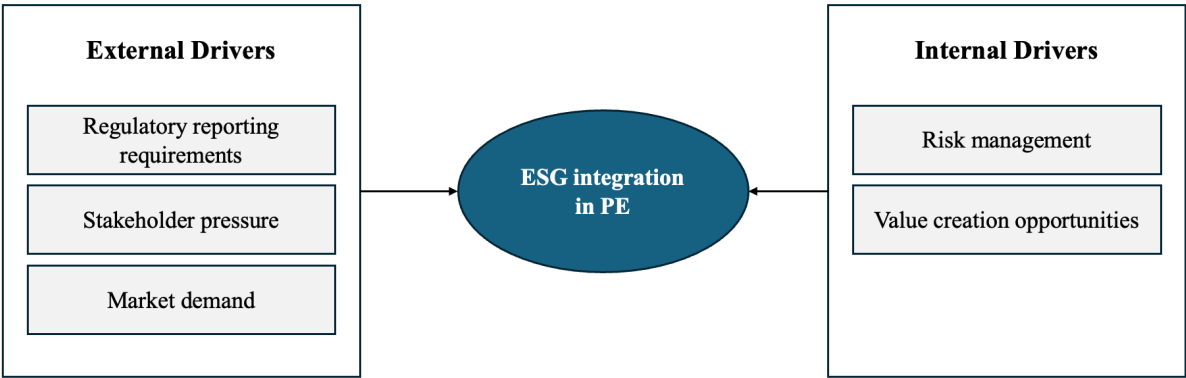


Figure 6: External and internal drivers of ESG integration in PE (Source: own illustration based on reviewed literature)

2.3.2 Shaping Early Investment Processes through ESG Integration

Fundamentally, ESG aspects are embedded across all stages of the PE investment cycle: (1) in the acquisition phase, where potential ESG risks and opportunities can be identified early on; (2) the ownership phase, which provides scope for active ESG engagement and value creation; and (3) the exit stage, where achieved improvements may translate into valuation premiums — highlighting the importance of integrating ESG considerations from the outset (Crifo & Forget, 2013; Pöhlmann, 2022). Supporting this, recent KPMG findings show that a growing number of GPs now address ESG earlier in investment processes (Golovcsenko & Ming, 2023), with ESG presenting a core element within DD procedures (Ljungqvist, 2024). To clarify how these practices are operationalised, the following section outlines ESG adoption across the individual DD stages, typically comprising a preliminary screening followed by an in-depth company-level assessment (Biermans et al., 2014).

Screening

Screening, as an initial filter, is typically divided into (I) negative screening, excluding specific industries, geographies, or companies based on ESG criteria (e.g., tobacco, weapons); (II) positive screening, focusing on investments with strong ESG credentials in areas like clean energy, education, or social impact; and (III) norms-based screening, evaluating alignment with international standards such as the UN Global Compact (Hoellermann, 2020; PRI, 2018). This high-level assessment is to be supported by checklists and sector- and region-specific ESG considerations, allowing GPs to initially assess if a target aligns with their ESG goals before proceeding to a detailed DD (Biermans et al., 2014). The strategic value is evident, as sectors like clean energy or healthcare offer both strong ESG alignment and considerable growth, while others — such as heavy industry — are linked to severe environmental drawbacks like pollution and intensive resource use (Indahl & Jacobsen, 2019; Zaccone & Pedrini, 2020). Still, the landscape is far from binary, as investors nowadays seek to capitalise on opportunities by investing in and transforming underperforming companies into ESG leaders, thereby increasing company value and securing potential valuation premiums (Entraygues & Shandal, 2024).

Company Deep Dive (Detailed DD)

In the subsequent phase, a detailed ESG DD should follow an iterative approach — combining desktop analysis, on-site visits, and continuous coordination between the portfolio company, deal team, and both internal and external ESG experts — to develop a thorough understanding of material ESG issues (Biermans et al., 2014). Large PE Managers typically assess targets

based on GHG baselines, anticipated ESG ratings, and the operational impact of climate risks while considering how shifts in regulation, technology, or market dynamics may influence future performance (Golovcsenko & Ming, 2023). In this vein, ESG materiality has been shown to vary across firms (Kaul, 2023), with a recent survey by PwC Germany (2024) pointing out that environmental issues present the focus for 47% of respondents, trailed by governance (31%) and social topics (22%). Furthermore, Pöhlmann (2022) could uncover that regional differences also play a role: while U.S. GPs often prioritise diversity and engagement with local stakeholders, carbon reduction, in turn, remains a key concern among European GPs, particularly in the DACH region, with social factors seen as of comparatively less priority.

In sum, the growing integration of ESG factors into early-stage investment processes and capital allocation strategies (Busch et al., 2016; Golovcsenko & Ming, 2023) positions PE investments to better align with the PRI’s recommendations to embed ESG into key decision-making stages such as Investment Committee (IC) reviews (Biermans et al., 2014). Amid this dynamic, academia outlines various implications, with some studies arguing that ESG adoption enhances portfolio and ESG performance by favouring companies with strong ESG credentials (e.g., Pitkänen, 2022), while others emphasise that ESG risks identified during DD can be decisive in deciding whether to proceed or abandon an investment altogether (e.g., Pöhlmann, 2022).

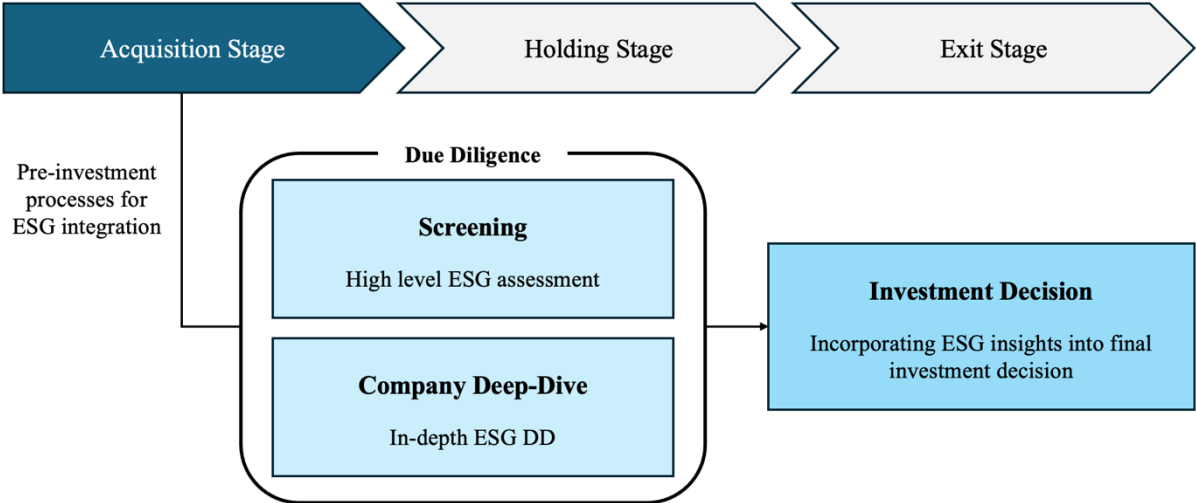


Figure 7: ESG Integration in early-stage PE investment processes (Source: own illustration based on reviewed literature)

2.3.3 Breaking Down Barriers: The Challenge of ESG Integration in PE

Starting down the path toward ESG integration can prove challenging, as differing levels of ESG maturity and regulatory development across regions lead to distinct hurdles in areas such as portfolio engagement or monitoring (Biermans et al., 2014; Mitra et al., 2024). For instance,

Zaccone and Pedrini (2020), drawing on interviews with GPs in Europe and North America, identified barriers to ESG adoption, such as underdeveloped measurement tools, limited data access, time-intensive implementation, and a shortage of professional ESG expertise. Similarly, Ben Noamene (2024) identified comparable challenges in Tunisia, including limited ESG data, lacking internal capacity, and a weak regulatory framework. Despite these regional nuances, the extant literature reveals a recurring set of obstacles that can be grouped into three key areas:

Ambiguity in ESG Understanding and Measurement

First, a central intangible barrier to ESG integration lies in the lack of conceptual clarity around the concept of ESG itself (Li et al., 2021), resulting in inconsistent interpretations among PE firms regarding which factors are deemed material (Stampe & Revelsby, 2022). Given that the notion of sustainability varies across domains and time horizons (Bebic et al., 2025), the absence of a clear definition for ESG strategies and sustainable practices has led to a fragmented adoption landscape across industries and business models (Pöhlmann, 2022). This ambiguity complicates ESG measurement, as the lack of precise criteria makes it hard for GPs to assess outcomes, quantify impact, and translate progress into performance — potentially discouraging engagement when no clear financial value proposition exists (Kruse, 2022; White et al., 2014).

ESG Data Collection and Reporting

Second, which may be viewed as a tangible manifestation of the first hurdle, is the challenge of obtaining consistent, reliable, and comparable ESG data across investments — mainly due to the absence of harmonised standards or industry benchmarks (Lino et al., 2022; Zaccone & Pedrini, 2020). While structured data and focused analysis are key for shaping ESG initiatives effectively (White et al., 2014), translating commitments into measurable outcomes remains difficult, as investors must navigate inconsistent frameworks, tools, and reporting approaches (Lino et al., 2022). Thus, PE stakeholders are left with no standardised set of comparable data to meaningfully assess ESG performance across portfolio investments (Ljungqvist, 2024).

Lack of Expertise and Resources

Third, academia agrees that a key requirement for ESG integration in PE is sufficient in-house expertise, as limited know-how can hinder GPs from advancing sustainability agendas and realising ESG-related value within portfolio firms (Crifo & Forget, 2013; Kruse, 2022). Yet, it has been found that many firms continue to struggle with severe knowledge gaps and a weak grasp of core sustainability principles (e.g., Ben Noamene, 2024; Zaccone & Pedrini, 2020). While Scherer (2024) notes that many PE firms nowadays operate in-house ESG teams, this

capability is most likely confined to larger players with the financial and structural capacity to staff dedicated roles or consult external experts (Hoellermann, 2020). As a result, smaller GPs with few resources still face significant hurdles in effectively addressing ESG topics, especially during phases such as the detailed company deep dive (Biermans et al., 2014; Pitkänen, 2022).

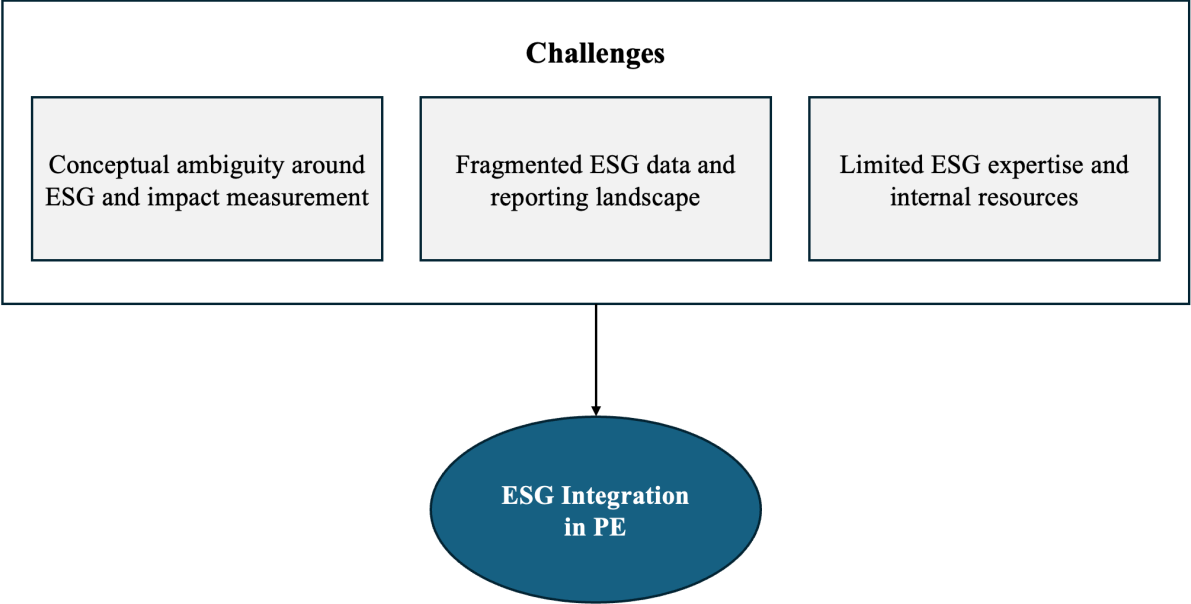


Figure 8: Challenges to ESG Integration in PE (Source: own illustration based on reviewed literature)

2.4 Research Gap and Objectives

After outlining the characteristics and evolution of ESG and PE, the literature review could show notable progress in exploring their intersection. Early contributions include Crifo and Forget (2013), who used qualitative business surveys to examine ESG in the French PE sector. Similarly, Ben Noamene (2024) used SSIs to investigate ESG awareness and integration in Tunisian PE, while Zaccone and Pedrini (2020) analysed motivations, activities, and barriers to ESG adoption among North American and European GPs. Further regional insights have emerged from recent dissertations that map ESG drivers in Nordic PE firms (e.g., Kruse, 2022; Olsen & Enbusk, 2023) and explore integration strategies and impacts in the Spanish context (e.g., García Domic, 2022; Torremocha Gaytán de Ayala, 2023), many of which likewise adopt qualitative methods such as SSIs or questionnaires to generate in-depth, practical insights.

Surprisingly, despite the German PE market’s documented relevance and future potential (e.g., Jain & Zegar, 2024; PwC Germany, 2024), no study has yet examined ESG integration among German GPs. The closest contribution comes from Pöhlmann (2022), who analysed the broader DACH region, focusing on ESG as a potential deal breaker and its role in the ownership phase.

However, a targeted analysis of the German PE market — particularly regarding its implications for the mid-market segment and SMEs facing ESG-related challenges (Scherer, 2024) — remains absent, leaving valuable insights for local PE professionals and SME owners untapped. To address this gap, the present study investigates how German mid-market PE firms integrate ESG considerations into their early-stage investment processes, with a particular focus on the DD phase and the final investment decision. Applying a qualitative, exploratory research design, it examines the key drivers of ESG adoption, strategic approaches to embedding ESG in pre-deal workflows, and core challenges GPs face when assessing SME targets. Drawing on insights from SSIs with professionals active in the German PE/SME segment, the study aims to clarify how ESG shapes early-stage investment processes and how it is operationalised, prioritised, and managed in practice. Finally, it sets itself apart from previous academic work by capturing how recent macroeconomic headwinds — including political developments such as Trump’s second presidency (Alhamis, 2025) — may have influenced ESG-related decision-making and expectations for the future of ESG adoption in the German PE sector.

3 Methodology

This study adopts the methodological framework of Gioia et al. (2013) to develop grounded, data-driven theory across the key stages of research design, data collection, and analysis.

3.1 Research Design

First, a thorough literature review was conducted, as understanding the existing body of literature is essential to designing studies that build on prior work and avoid redundancy (Bryman, 2016). In doing so, it became evident that ESG integration in PE — particularly in the German context — remains at an early stage of academic inquiry. This gap prompted the adoption of a qualitative, exploratory research design, which is well suited to underexamined topics by helping to define priorities, clarify concepts, and lay a foundation for future inquiry (Olawale, 2023). The exploratory approach aligns with the core principles of qualitative research, which emphasise reflexivity, contextual depth, and flexibility over generalisability or rigid procedural frameworks (Lim, 2024). Unlike quantitative methods focused on hypothesis testing, qualitative approaches are better positioned to deepen theoretical understanding through insights generated from field-based investigation (Patton, 2014) — making them particularly appropriate for studying the evolving context of ESG adoption in PE investment processes.

To uncover in-depth insights, this study relied on SSIs, widely regarded as a key method in qualitative research (Kakilla, 2021). SSIs are especially valuable in contexts with limited prior knowledge, as they enable informed participants — those directly involved in the phenomenon — to share experiences and views that would be difficult to access through more standardised methods (Gioia et al., 2013; Rowley, 2012). Their open-ended and adaptive nature supports the exploratory aim of this study, and the methodological openness needed to trace emerging concepts (Bryman, 2016; Olawale, 2023). While questionnaires can produce generalisable data from large groups, they were considered unsuitable here due to their rigidity, limiting flexibility and depth in exploring complex phenomena (Adams, 2015; Rowley, 2012).

In this light, the research logic follows an abductive reasoning approach — distinct from deduction and induction — and is considered an alternative mode of inquiry (Patton, 2014). While induction derives theory from observation and deduction tests theory against specific cases, abduction seeks the most plausible explanation by uncovering hidden causes or drawing novel generalisations from surprising findings (Timmermans & Tavory, 2012). Following Gioia et al. (2013), this study aims to develop a dynamic, data-grounded model based on informant insights, focusing on how emerging themes interact to generate new theoretical understanding.

3.2 Data Collection

As research findings are closely tied to the selection of interview partners (Rowley, 2012), this study's unit of analysis was carefully guided by stakeholder theory, which defines stakeholders as individuals or groups whose interests are linked to or affected by an organisation's ability to achieve its goals (Freeman, 1984). This perspective, which outlines stakeholder relationships, addresses corporate issues such as value creation (Parmar et al., 2010) and is especially relevant for this study, as stakeholder interaction is viewed as central to embedding sustainability in business models (Fobbe & Hilletoft, 2021). Stakeholder groups were derived from the PRI's *Integrating ESG in Private Equity – A Guide for General Partners* (Biermans et al., 2014), which presents early investment processes as a collaborative effort involving internal teams (e.g., ESG and investment professionals) and external parties like consultants or portfolio executives. Reflecting this study's focus on internal ESG integration, the sample was limited to those involved in or supporting internal processes: investment professionals, ESG managers, and selected external advisors, with varying seniority further adding heterogeneity.

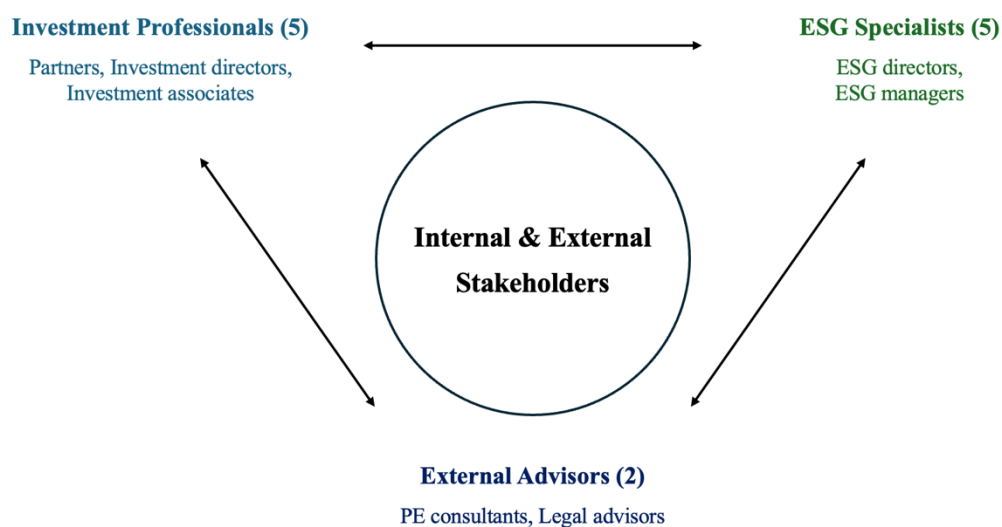


Figure 9: Overview of internal and external stakeholder groups interviewed (Source: own illustration)

Purposeful sampling, or purposive sampling (Patton, 2014), commonly used in qualitative research to identify information-rich cases, was applied using a combination of strategies suited to the study's goals (Palinkas et al., 2015; Suri, 2011). Following Patton (2014), criterion and typical case sampling were applied to identify PE professionals working at firms headquartered in Germany that invest in SMEs while excluding firms with a sole impact focus to reflect typical cases and reduce bias. In total, 45 professionals were contacted via LinkedIn or direct email and received a brief introduction with the study's aim and time commitment (Adams, 2015). Of

these, 20 responded — eight declined, and 12 agreed to participate — yielding a final sample of n = 12 interviews conducted online via Microsoft Teams between April 4 and April 22, 2025. Following best practices in practitioner-oriented research, the interview guide was informed by both literature and field experience (Rowley, 2012). A preliminary agenda was developed to structure the conversations (Adams, 2015), divided into three key interview blocks — Screening, Company Deep Dive, and Investment Decision — reflecting key pre-investment ESG integration stages outlined by the PRI (Biermans et al., 2014). In line with the flexible nature of SSIs, a total of 10 guiding questions were arranged in a fixed order but allowed follow-up prompts to explore responses in depth (Rowley, 2012; Turner, 2010). Interviews opened with a soft opening question and concluded with a future-oriented prompt (Adams, 2015).

Section	Question
Opening Question	Q1. In your view, what has been the key driver for integrating ESG considerations into investment-related decision-making? (e.g. stakeholder expectations, regulation, value creation potential, role of SMEs in the green transition)
Block I: Screening	Q2: Are there any specific ESG screening strategies you have come across or applied when evaluating SMEs? (e.g. exclusion criteria, positive screening, norm-based, or mixed approaches)
	Q3: How is the materiality of ESG factors typically assessed during the early screening phase? (e.g. internal tools, checklists, pitch decks, investment teasers)
	Q4: What are some of the typical ESG-related challenges you observe during the screening of SMEs?
Block II: Company Deep-Dive (Detailed DD)	Q5: To what extent is ESG integrated into the due diligence process before an investment decision? (e.g. formal process, case-by-case, focus on risks and/or value creation potential)
	Q6: Are internal ESG capabilities or external advisors typically involved in ESG related due diligence?
	Q7: Which ESG pillar (Environmental, Social, or Governance) tends to be most material in your experience – and does this depend on the sector or deal type?
Block III: Investment-Decision	Q8: How are ESG-related findings incorporated into the final investment decision? (e.g. part of the investment memo, discussed in the investment committee, benchmarked against financials)
	Q9: Have you witnessed ESG-related findings ever lead to the rejection of an investment opportunity?
Closing Question	Q10: Looking ahead, how do you think ESG integration in private equity will evolve – especially in light of recent political and regulatory pushbacks (e.g. EU scale-back, U.S. policy shifts)?

Table 2: Finalised SSI layout employed in each interview (Source: own illustration)

Before commencing the professional interviews, a pilot was conducted with a subject-matter expert to fine-tune the structure and flag potential issues (Turner, 2010). All interviewees were informed about the voluntary nature of their participation and assured of confidentiality. Informed consent for recording was obtained in advance (Adams, 2015), with all data stored securely and used solely for anonymised coding. At the end of each interview, participants were offered the opportunity to review their transcripts for accuracy and confidentiality, if desired.

In line with recommendations for novice researchers, 12 SSIs — each lasting around 30 minutes — were initially planned, with the flexibility to expand the sample if necessary to ensure data richness while avoiding analytic overload (Rowley, 2012). As coding progressed in parallel with data collection, interviews increasingly produced diminishing returns, with few new codes and persistent overlap in responses. Reflecting Suri’s (2011) guidance that purposive sampling

should conclude upon reaching saturation, data collection was thus finalised after the twelfth interview, as no substantial new themes or concepts were expected to emerge.

3.3 Data Analysis

A key final step in interview-based research lies in the thorough interpretation of the collected material (Turner, 2010). As outlined earlier, this study applied an iterative analytical approach by Gioia et al. (2013), aiming to generate grounded theoretical insights through systematic coding — a process involving the breakdown of interview transcripts into smaller units, the assignment of analytical labels, and the identification of patterns across cases (Bryman, 2016). Following the logic of abduction, the analysis remained open to unexpected findings and allowed for their integration into emerging theoretical concepts (Timmermans & Tavory, 2012).

In line with best practice, transcripts were analysed using computer software with features allowing for structured annotation and category assignment (Rowley, 2012). Initially, data was organised by interview block in Microsoft Word and then transferred to Microsoft Excel for systematic coding and cross-block comparison. Initially, coding focused on identifying 1st-order concepts, closely following respondents’ terminology in line with the method’s informant-centred logic (Gioia et al., 2013). This yielded 225 1st-order codes across all five blocks. As is typical, no early consolidation was attempted, resulting in a large, fragmented set of descriptive codes (Gioia, 2021). In the second stage, these were reviewed and clustered into 41 2nd-order themes and 16 aggregate dimensions to enable more abstract, theory-informed interpretation (Gehman et al., 2018; Gioia et al., 2013), with a special focus on emerging or under-theorised concepts (Gioia, 2021). Data structures for each interview block are presented in the Appendix.

Finally, as subjectivity is inherent in qualitative research, careful attention was paid to potential researcher bias throughout the analysis (Lim, 2024). In line with best practice, the coding process was refined through multiple iterations and reviewed in consultation with a subject-matter expert to challenge assumptions and strengthen interpretive credibility (Rowley, 2012).

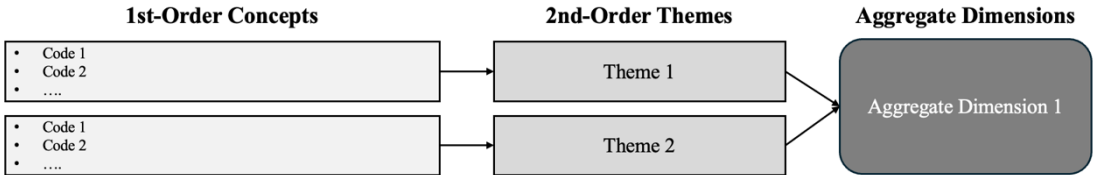


Figure 10: Data structure layout from codes to dimensions (Source: own illustration adapted from Corley & Gioia, 2004)

4 Results

Following the structure of the interview sections, this chapter presents the empirical findings, organised along the aggregate dimensions of each subtopic. The analysis draws on 2nd-order themes and is supported by illustrative 1st-order codes derived from the interviews.

4.1 Drivers of ESG: Mapping External and Internal Motivations

This subchapter outlines the main drivers described by the interviewees to first capture the rationale behind ESG integration in early-stage PE investment processes and highlight how their prioritisation has evolved over time.

Aggregate Dimension I: External Drivers of ESG

A clear majority of interviewees described ESG integration as being driven by external factors, commonly pointing to frameworks such as the EU Taxonomy, SFDR, CSRD, or the Paris Agreement as key catalysts shaping ESG implementation. These instruments were consistently cited as pivotal, either by setting binding compliance obligations or by offering voluntary disclosure standards that gradually became industry norms. While some participants voiced concern over the administrative burden these frameworks entail, others regarded them — particularly standards like the PRI — as essential ‘hygiene factors’ in today’s investment practice. Closely linked to regulatory influence was the role of LPs, who were repeatedly described as passing ESG expectations down the investment chain. Here, some respondents noted that this pressure initially stemmed from more sustainability-focused LP communities in the Nordics, with German LPs increasingly following suit. Here, most interviewees emphasised the interplay between these drivers, highlighting that regulatory mandates and LP expectations often go hand in hand — for instance, when LPs enforce exclusion criteria rooted in regulation.

Aggregate Dimension II: Internal Drivers of ESG

By contrast, only a smaller group of respondents cited internal motivations as the primary force behind ESG integration. The provided rationales were diverse: two professionals pointed to personal values or reputational considerations on the part of founding partners; another highlighted market-driven incentives, such as growing demand for sustainable products or preferential financing conditions from banks. In one case, ESG was framed as a critical aspect of employer branding, seen as increasingly important in attracting next-generation talent — both at the GP level and within portfolio companies. Although some respondents acknowledged ESG’s strategic relevance in follow-up discussions, only two explicitly described ESG as being

tied to value creation logic, noting that this strategic use is still a relatively recent development, with the industry in the early stages of shifting toward such intrinsic ESG motivation.

Aggregate Dimension III: Relevance & Optionality of ESG

Lastly, two interviewees expressed a more cautious view of ESG, describing it as context-dependent rather than universally essential. Their perspective reflected a pragmatic stance: rather than dismissing ESG entirely, they emphasised its varying relevance depending on fund structure and deal type, suggesting that it is not always an indispensable component.

4.2 ESG Screening: Analysing Red Flags and Blind Spots

Turning to the initial stages of the DD process, this section outlines how ESG factors are considered in screening strategies, the practices applied during early assessments, and key challenges encountered — particularly in SME contexts.

Aggregate Dimension 1: ESG Screening Strategies

All interviewees confirmed that ESG screening — in one form or another — is firmly embedded in early investment assessments, predominantly through negative screening anchored in formal policies and internal guidelines. Applied mainly as a risk or compliance filter, it was described as limiting exposure to controversial sectors such as gambling driven by reputational concerns, LP requirements, or ethical standards. Complementing this, four respondents reported additionally applying ESG-aligned sector targeting as part of a positive screening approach — favouring industries inherently linked to ESG trends for both sustainability credentials and financial prospects, provided returns remain uncompromised. Nonetheless, several interviewees emphasised that ESG plays a relatively limited role at this stage, gaining more profound relevance only in later, more detailed DD assessments. Notably, best-in-class screening — actively prioritising ESG leaders — was not reported by any interviewee. As one participant pointed out, ESG screening practices in the industry continue to vary in intensity based on fund type and strategy, with ESG priorities applied more or less rigorously as a result.

Aggregate Dimension 2: Brown-To-Green Strategy

Building on the discussion of screening logic, interviewees were frequently followed up with the question of whether they had experience with brown-to-green strategies — identifying ESG-lagging companies with the potential to transform them into sustainable, higher-value assets. While the strategic rationale was widely acknowledged, with one respondent even describing it as the ‘pinnacle of bridging ESG ambition and value creation’, none reported

applying such strategies in current or past deals. Frequent barriers cited included uncertain return profiles conflicting with pre-agreed financial targets, regulatory constraints (particularly under Article 9 SFDR), and limited alignment with in-house investment logic — leaving such strategies aspirational rather than part of operational screening practice.

Aggregate Dimension 3: ESG Screening Process

When asked about typical in-house ESG screening processes and resources, most interviewees noted that limited, often vague ESG data at this stage made applying structured or standardised approaches across investment deals challenging. Consequently, screening was typically conducted using internally developed, checklist-based methods focused on identifying key risks and ‘blacklist-worthy target companies’. Some interviewees mentioned additional sector- or context-specific analyses using external databases, frameworks like the SASB matrix, or, in isolated cases, physical risk maps for biodiversity or climate risks. Finally, the process was widely seen as reliant on internal expertise, with early ESG assessments handled either by investment teams or dedicated ESG managers, depending on the GP’s setup. Bilateral engagements with external parties were rare at this stage, with only one interviewee noting that such clarifications might occur when unavoidable to address specific ESG concerns.

Aggregate Dimension 4: Challenges in SME Screening

In line with the cited lack of ESG data at the early screening stage, the most common challenge interviewees described in SME contexts was the structural absence of readily available ESG information. Data was often unavailable, low-quality, non-standardised, or difficult to access — tied to the fact that most SMEs are not yet subject to mandatory reporting and typically operate with limited resources, where ESG is approached pragmatically or even seen as a burden. Several interviewees also linked these gaps to the broader ambiguity of ESG itself: without consistent standards or benchmarks — and amid overlapping frameworks — SMEs with little ESG experience struggle to assess what ‘good ESG performance’ means. As two respondents noted, even where data exists, its frequent qualitative nature limits its use in standardised assessments. Thus, evaluating indicators such as CO₂ emissions or energy use often requires significant time and research, with one participant stressing that these efforts must be carefully weighed against the expected return. While these structural issues dominated, a smaller number of interviewees also pointed to GP-internal barriers, such as gaps in ESG expertise or cultural under-prioritisation. Here, a ‘chicken-and-egg’ dynamic was described in one case: ESG data is not produced because it is not valued — and it is not valued because it

lacks a precise definition. Lastly, one interviewee noted that competitive deal dynamics could also constrain ESG screening, as time pressure may limit in-depth clarifications on ESG issues.

4.3 ESG Company Deep Dive: Exploring Processes and Priorities

Moving further along the DD process, this section outlines how ESG considerations are embedded into detailed company assessments, focusing on process formalisation, the expertise and activities involved, and the prioritisation of ESG pillars.

Aggregate Dimension 1: ESG DD Integration Logic

A first common theme emerging across interviewees was that ESG has become a firmly embedded element in the detailed DD stage, described by most respondents as more operationally core than during initial screening. Integration strategies, however, varied: three respondents described a relatively standardised approach using in-house templates or materiality frameworks developed internally or with external advisors, ensuring consistent risk identification and policy alignment. Five others reported a more adaptive, efficiency-driven approach, where ESG scope and depth varied by deal, sector, or available resources. High-risk sectors such as manufacturing were typically cited as requiring deeper ESG assessments due to potential environmental liabilities, while lighter analyses sufficed in low-materiality sectors like services. Across both groups, however, ESG was primarily applied as a risk management tool, with only two respondents explicitly describing its additional use for identifying value creation potential. Finally, two interviewees described ESG integration as limited or ad hoc during buy-side DD, gaining greater relevance only in sell-side processes amid heightened buyer scrutiny.

Aggregate Dimension 2: ESG Expertise & DD Activities

As the interviews progressed to activities and resources employed during the company dee dive, most interviewees described relying on both internal and external expertise, with hybrid ESG models emerging as the common standard. Initial ESG materiality was typically assessed through desk research by internal ESG professionals or investment teams, while external experts were brought in selectively — notably when technical or sector-specific knowledge exceeded internal capacities. As two respondents noted, third-party involvement ensured objectivity and helped meet rising LP expectations for external assurance, with common examples including site visits where environmental risks such as soil contamination or flood exposure required specialist input. However, the division of labour between internal and external actors was not always clearly defined. While most described a pattern where internal ESG teams provided strategic guidance and external consultants handled pre-defined tasks,

some emphasised a setup remains flexible and case dependent. Finally, a minority of two described a fully internalised approach, where ESG was assessed solely by the investment team, focusing predominantly on commercial assessments with limited technical ESG analysis.

Aggregate Dimension 3: ESG Dimension Prioritisation

Concluding the interview block on the detailed DD phase, respondents were eventually asked how they weigh individual ESG pillars, revealing that Environmental and Governance factors were most often prioritised, while social aspects received less emphasis. Some explained the environmental focus by referencing its link to the broader sustainability discourse, though more commonly framed its relevance through a business-case logic: factors such as resource use, CO₂ emissions, and environmental liabilities attracted the sharpest scrutiny due to their measurable, often irreversible impacts and heightened regulatory exposure. While largely framed from a risk perspective, some interviewees likewise highlighted the value creation potential of environmental levers, arguing that their tangible, comparable nature makes them easiest to tie to financial outcomes, such as energy efficiency gains. Governance, in turn, though seen by some as ‘more standardised and less headache-inducing’ due to rigid EU rules, was described as structurally central. Particularly in founder- or family-led SMEs, it was viewed as a key marker of trustworthiness and ‘workability,’ with active ownership and operational change hinging on managerial alignment. Across accounts, however, the shared key theme was that ESG pillar prioritisation is consistently seen as highly context-bound, shaped by each target’s sector, ESG risk profile, and business model. Environmental factors were dominant in industrial settings due to emissions or waste, while in service sectors such as healthcare, social aspects like employee retention or workplace culture gained prominence. One respondent further noted that in software businesses, all three pillars need to be weighted holistically, with employee attraction (S), data security (G), and energy use (E) jointly seen as material in the detailed DD.

4.4 ESG in Investment Decisions: Formalising and Weighing Impact

Building on the objective of assessing ESG’s role in final investment decisions, this section outlines how ESG issues from prior DD are integrated into final decision-making, influence investment outcomes, and are weighted relative to financial KPIs.

Aggregate Dimension 1: ESG Formalisation and Internalisation

Regardless of the level of ESG integration during earlier DD phases, all but two interviewees described ESG integration as a formalised process when making final investment decisions. ESG topics were cited to be commonly documented in a dedicated section of the investment

memo, to be reviewed by the IC or supervisory board. However, formalisation varied: some respondents described a rather holistic approach where ESG aspects were incorporated early and actively discussed — sometimes even informally — before being moved to IC deliberations, allowing greater involvement and refinement even by non-deal leads. More frequently, however, ESG findings were formally prepared and reserved for the IC or supervisory board, where only then did they gain real decision-making weight aligned with the fund's broader strategy. Despite these differences, a consensus emerged that ESG was again primarily framed through a risk management lens, with only two professionals noting that ESG could also positively contribute to the investment decision when value creation opportunities were present. Finally, two respondents mentioned that managing residual ESG risks already formed a key part of this final stage, with mitigation measures, such as 100-day action plans, addressing unresolved issues expected post-acquisition being developed and planned.

Aggregate Dimension 2: ESG's Impact on Investment Decisions

When asked if ESG has served as a deal breaker in final investment decisions, the consensus emerged that ESG risks are a case-specific rather than a standardised rejection factor. Among the majority who had not experienced ESG-driven deal terminations, ESG risks were seen as potentially leading to rejection only in extreme cases, particularly when they posed significant business or reputational threats that severely impacted financial performance. One respondent cited CO₂ intensity, noting that rising CO₂ pricing, regulation, and scrutiny could make a high-emissions profile a threat to long-term viability. Among the few who witnessed ESG-related rejections, governance and compliance failures were described as the most decisive. Trust and integrity were outlined as critical when investing in family-led SMEs; if governance trust could not be established or ESG risks could not be resolved — even without confirmed violations — investments were ultimately rejected. Many respondents explained that ESG rarely acts as a final-stage deal breaker due to early-stage filtering, with most respondents noting that ESG concerns typically triggered rejections during screening where sector-specific 'blacklisting excludes ESG-sensitive targets long before being passed to the IC stage'.

Aggregate Dimension 3: ESG vs. Financial Performance

Finally, when the balance between ESG and financial performance was addressed, respondents overwhelmingly agreed that financial criteria dominate final investment decisions. While it was partially acknowledged that ESG-related performance criteria, such as leadership diversity's known link to stronger outcomes, might subtly support the investment case, the prevailing view

remained that strong financial performance is prioritised and generally seen to offset poor ESG performance but not vice versa. In this context, a small group noted that PE decision-making fundamentally remains opportunity-driven, with ESG often assuming a secondary role or being tolerated as a potential risk if exits are planned before such issues could materialise. Contrasting this majority, a small subset of two respondents noted a visible link between financial and ESG risks, with one interviewee mentioning that identified ESG risks — such as environmental remediation — are sometimes factored into valuations and purchase price negotiations, provided the relevant ESG risks are considered manageable post-acquisition.

4.5 Future Outlook: ESG within a Changing Landscape

The final interview block explored how professionals, amid current macroeconomic challenges and a polarised ESG environment, anticipate the future trajectory of ESG in PE.

Aggregate Dimension 1: ESG Durability & Narrative Reframing

Across nearly all interviews, ESG was seen as retaining long-term strategic relevance despite signs of fatigue and backlash. Many agreed that sustainability awareness has reached an irreversible tipping point, now embedded in policy frameworks, regulation, and firm-level practice. Some pointed to the rise of ESG-specific industries — such as third-party verification services — as further evidence of structural anchoring. Economic logic reinforced this view: investments in low-carbon energy were increasingly seen not just as ethically aligned but also as financially superior, with CO₂-intensive businesses, in turn, facing declining attractiveness or even long-term saleability. One participant framed this shift as a move from ‘compliance box thinking to integrated, multidimensional investment logic’. Still, ESG fatigue was acknowledged. About a third of interviewees observed that ESG had become more of a baseline requirement than a true differentiator, with LP requests becoming more of a formality than a meaningful evaluation. Additionally, geopolitical events such as the Ukraine war and economic uncertainty were seen to reprioritise operational over ESG considerations — including recent discussions on ESG funds expanding into traditionally controversial sectors like defence.

Aggregate Dimension 2: Strategic- & Outcome-Oriented ESG

In parallel, a second theme centred on the expectation that ESG will evolve into a more outcome-driven and strategic practice. Roughly half of the participants predicted that ESG integration will increasingly emphasise real-world impact and measurable outcomes rather than symbolic compliance. While ESG is expected to remain embedded in investment processes, a shift towards materiality and effectiveness was anticipated — more closely reflecting economic

reality. It was suggested that the ‘era of reporting-driven ESG is coming to an end’, as superficial approaches such as checklists or quota metrics are expected to give way to financially material, operational ESG strategies. Supporting this view, some interviewees pointed to the growing appeal of ESG-forward sectors. Firms were expected to increasingly seek opportunities in areas benefiting from megatrends and structural sustainability shifts. Frequently mentioned examples included circular economy, waste management, and renewable energy, with one respondent noting that many sustainability-focused companies founded five to ten years ago are only now reaching profitability and becoming more attractive for PE.

Aggregate Dimension 3: Regulatory Complexity & Need for Pragmatism

Finally, and closely linked to the call for more material ESG, was the critique of the current regulatory landscape. Many respondents voiced dissatisfaction with what they saw as overly complex, bureaucratic, and increasingly detached ESG rules. The rising documentation burden and frequent regulatory changes were perceived as undermining genuine ESG progress — particularly among SMEs navigating upcoming frameworks like the CSRD. Rather than enabling transformation, compliance tasks were seen as generating frustration and resistance. One interviewee proposed that the system should shift away from pre-emptive control toward stricter sanctions for proven negligence while reducing red tape to enable responsible corporate behaviour. Governments were described as key enablers in this shift — not only through more precise regulation but also via incentive programmes that support sustainable investments and ensure ESG efforts result in tangible impact rather than administrative workload.

5 Discussion

This chapter discusses the main findings by comparing the interview results (Chapter 4) with the literature review (Chapter 2). Following the SSI layout, it highlights key themes, cross-cutting insights, and how the findings align with, diverge from, or extend prior research, concluding with theoretical and practical contributions.

5.1 Interpreting the Findings in Light of Existing Literature

Key Finding I: ESG integration remains compliance-driven with limited strategic uptake

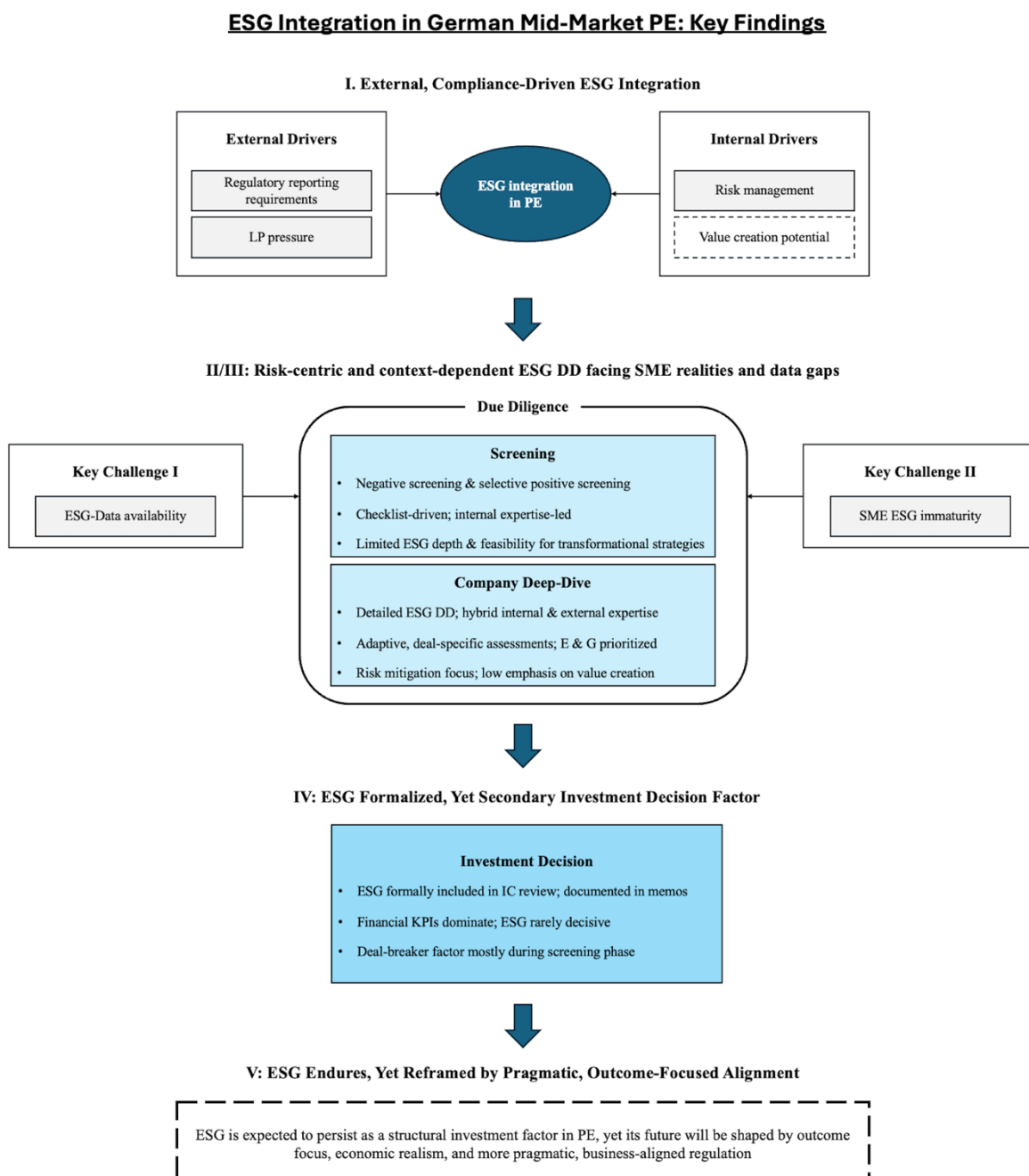


Figure 11: Key findings on ESG integration dynamics in German mid-market PE (Source: own illustration)

While the interviews confirmed Pöhlmann's (2022) distinction between external and internal ESG drivers, they revealed a pronounced imbalance in practice: ESG integration is primarily shaped by external compliance pressures. Regulatory mandates and LP expectations emerged as the two key forces — often closely intertwined, for example, when LPs enforce exclusion rules rooted in EU regulation. This supports Zaccone and Pedrini's (2020) depiction of multi-layered external pressures driving ESG integration in PE and reinforces the view that the EU's regulatory ecosystem plays a decisive role in ESG adoption at the national level. Frequent references to the SFDR, EU Taxonomy, and CSRD underline that these frameworks have introduced disclosure standards and become central levers of ESG implementation — echoing earlier claims in academia that EU policy has established itself as a dominant force in driving ESG engagement in PE (e.g., Primec & Belak, 2022; Scherer, 2024)

While voluntary standards such as the Paris Agreement and the PRI were mentioned as early catalysts, paving the way for initial in-house ESG activities before formal regulation, the impact of internal motivations appeared substantially less influential. Ethical convictions, reputational considerations, or incentives like access to green finance were occasionally cited but rarely tied to value creation logic — a rationale expressed only in individual cases and perceived as still emergent. This contrasts with large parts of the academic literature, which outlines ESG's key role as a lever for long-term value creation beyond its traditional risk focus (e.g., Indahl & Jacobsen, 2019; Kaul, 2023). Moreover, while some accounts pointed to variations in ESG relevance depending on fund type or investment strategy, such views remained outliers. Thus, the broader picture suggests a sector-wide consensus: ESG has become an established component of mid-market German PE firms — but remains primarily rooted in external accountability and risk mitigation rather than being driven by intrinsic strategic motivation.

Key Finding II: Defensive ESG Screening Acts as Gatekeeping Mechanism, Constrained by Structural SME Barriers

The interviews revealed that ESG screening in German mid-market PE remains firmly anchored in a negative screening logic, aiming to exclude sensitive sectors to mitigate regulatory and reputational risks — confirming prior findings from European PE contexts (e.g., Kruse, 2022; Olsen & Enbusk, 2023). While some interviewees reported applying ESG-aligned sector targeting, reflecting trends highlighted by Indahl and Jacobsen (2019), such approaches were consistently described as subordinate to financial KPIs and offered limited transformative ESG guidance. In this vein, brown-to-green strategies — framed by Entraygues and Shandal (2024) as pathways to unlock valuation premiums through sustainability turnarounds and increasingly

promoted by LPs — were unanimously rejected as incompatible with the specific mandates, return expectations, and regulatory classifications shaping national ESG investment strategies. Rather than reflecting a lack of ambition, this suggests a structural inflexibility within traditional PE models, where such approaches remain confined mainly to niche or impact-focused investors operating under fundamentally different mandates and investment logics.

This defensive stance was further reinforced by structural barriers inherent to SME contexts. Despite broadly following the PRI's recommendations for early-stage checklist-based ESG risk assessments (see, Biermans et al., 2014), interviewees emphasised persistent constraints linked to fragmented ESG data and low SME ESG maturity — confirming barriers firmly documented in prior research (e.g., Olsen & Enbusk, 2023; Zaccone & Pedrini, 2020). These factors were found to reinforce each other as key bottlenecks mutually, reflecting the operational realities of SME deal environments, where data scarcity and knowledge gaps limit both feasibility and the business case for more systematic ESG assessments. This reinforces the finding that ESG screening serves less as a lever for transformational integration and more as a procedural gatekeeping tool — challenging more optimistic narratives of ESG as an emerging value lever in PE (e.g., Indahl & Jacobsen, 2019; Kaul, 2023) and outlining how compliance logic, data gaps, and real economy settings structurally constrain more ambitious ESG strategies.

Key Finding III: Detailed ESG DD reinforces a risk-centric, case-specific application logic shaped by hybrid expertise models

First, and marking a clear contrast to the more informal screening stage, the study showed that ESG has become a firmly anchored component in the company deep dive — confirming its previously outlined key role in PE-related DD (e.g., Golovcsenko & Ming, 2023; Ljungqvist, 2024). While elements of standardisation exist, the common pattern reflected a case-dependent approach, adjusting ESG scope and depth by sector or business model — aligning with PRI best practices recommending target-specific assessments (see, Biermans et al., 2014). However, mirroring the screening phase, ESG's role remained predominantly risk-focused, reinforcing Zaccone and Pedrini's (2020) defensive ESG logic while diverging from Kaul's (2023) more value-driven interpretation. Hence, the findings suggest that while the context-dependent application reflects procedural maturity and alignment with industry standards, ESG integration within the DD phase remains defensive, falling short of driving genuine ESG transformation.

Second, detailed ESG DD processes were found to be predominantly executed through hybrid expertise models. Internal teams typically led initial assessments and strategic coordination,

while external specialists were engaged for technical tasks or LP-driven third-party assurance, such as site visits — reflecting both PRI (see, Biermans et al., 2014) and Hoellermann’s (2020) calls for leveraging external capacities as a key PE success factor. However, no clear patterns in task allocation or engagement depth emerged, suggesting that the deployment of external expertise remains flexible and tied to firm-specific routines and resources. While this reinforces ESG adoption’s context-dependent nature, providing flexibility in resource use, it potentially hinders the emergence of more consistent, institutionalised best practices across the industry.

Lastly, the prevailing pattern of context dependency also shaped the prioritisation of ESG pillars. While environmental and governance factors were generally prioritised on a standalone base, weighting was most described as highly dependent on the sector, materiality, and business model of the target company — reflecting prior studies reporting similarly mixed patterns (e.g., Ben Noamene, 2024; Kaul, 2023). This reaffirms Pöhlmann’s (2022) argument that ESG priorities remain strongly shaped by regional and institutional contexts — a dynamic clearly reflected in the German mid-market PE setting.

Key Finding IV: ESG findings are a formal part of investment decisions yet rarely act as decisive levers and remain subordinate to financial logic

The interviews confirmed that ESG has reached an institutionalised status across German mid-market PE firms in the final investment decision. Apart from marginal outliers, ESG findings are routinely documented in investment memos and subject to IC review, reflecting procedural maturity and alignment with best practice (see, Biermans et al., 2014). Moreover, this finding confirms earlier studies’ claims about ESG’s growing relevance in capital owners’ investment decision-making (e.g., Busch et al., 2016; Torremocha Gaytán de Ayala, 2023). While the degree of formalisation varied — with some GPs integrating ESG and personnel more holistically and others reserving ESG deliberation for exclusive IC settings — these variations appear less reflective of differing ESG ambition levels and more indicative of varying governance structures and the degree of ESG integration already applied during the DD phases.

Still, ESG’s formal presence at this stage did not show to translate into decisive influence. Although systematically reviewed, ESG factors were rarely described as standalone deal breakers, functioning instead as context-sensitive risk filters, potentially disrupting investments only in exceptional cases — where unresolved ESG issues threaten business continuity and, thus, financial viability. This supports Pöhlmann’s (2022) framing of ESG as a potential deal stopper, yet nuances his finding by indicating that, at least in the German context, ESG’s most

decisive influence tends to manifest earlier — particularly during the negative screening phase, where controversial targets are excluded long before reaching IC deliberations.

Finally, the findings confirmed a clear ESG–financial performance hierarchy in final decision-making. Strong financials were widely seen as able to offset ESG weaknesses, while robust ESG performance alone was insufficient to compensate for weak financial fundamentals — reinforcing the subordination of ESG to return logic, as also noted by Ben Noamene (2024) and Abraham et al. (2024). Although some respondents acknowledged financial–ESG risk linkages, including valuation discounts or mitigation planning for ESG risks, these remained exceptions rather than standard practice — challenging more optimistic assertions assuming a decisive impact of ESG integration on investment decisions and outcomes, as outlined in prior PE-centred studies (e.g., Pitkänen, 2022). By contrast, the findings suggest that despite its formalised role, ESG remains a subordinate factor in final investment decisions, with its actual influence on investment outcomes remaining limited and opaque in German mid-market PE

Key Finding V: ESG integration is set to endure but increasingly shaped by materiality, economic realism, and pragmatic alignment

The final interview block painted a clear picture of how ESG’s future is understood: not as a fading agenda, but as one undergoing pragmatic recalibration. While earlier studies such as Olsen and Enbusk (2023) emphasised investor and consumer pressure as key drivers, the study findings suggest a different logic. ESG’s strategic persistence now appears increasingly rooted in regulatory anchoring, institutional mechanisms, and the rise of ESG-adjacent industries such as verification services and sustainability data providers. Rather than driven by reputational hype or normative ambition as in earlier years, ESG is becoming a structural element of market logic — embedded in policy frameworks, industry infrastructure, and investment routines.

Political and regulatory dynamics further reinforce this shift. Echoing Alhamis (2025), several interviewees described how policy volatility and geopolitical pressures increasingly pull firms between short-term competitiveness and long-term ESG positioning. ESG’s boundaries seem to shift, as exemplified by discussions on including defence-related assets in ESG-labelled portfolios. The anticipated move beyond symbolic, checkbox-style practices toward more outcome-oriented strategies aligns with Pöhlmann’s (2022) call for better impact measurement and reflects the commonly expressed view that ESG must now deliver tangible value. The fact that around a third of interviewees reported pursuing ESG-aligned sector strategies within their

GP operations — where commercial and sustainability logic are actively combined — suggests that this shift is not only anticipated but already underway.

Finally, while Olsen and Enbusk's (2023) projection of growing regulatory influence on PE appears confirmed, the findings draw a deeper concern: current ESG regulation is marked as overly complex, unpredictable, and detached from operational reality — particularly in SME contexts. Following Alhamis's (2025) warning that policy instability hinders long-term ESG commitments, several interviewees called for simplification, clearer standards, and greater planning certainty that supports rather than stifles genuine ESG adoption. Overall, the findings imply that ESG's future may depend less on the extent of regulation and more on its capacity to enable — rather than obstruct — outcome-driven, strategically aligned investment practices.

5.2 Theoretical Implications

This study advances the academic discourse on ESG integration in PE in several ways. First, it closes an empirical gap by offering one of the first process-level insights into the German mid-market PE segment. Second, it challenges assumptions of ESG as a value creation lever, showing its role remains predominantly risk-focused, with value-oriented approaches limited to a small subset of GPs. Third, it refines the understanding of ESG's procedural embeddedness, highlighting its strong context dependency. While this flexibility, especially in detailed DD, reflects procedural maturity and aligns with best practice, notable heterogeneity in assessment approaches, expertise deployment, and ESG governance — compounded by SME-specific data constraints — points to still firm-specific adaptations rather than convergence toward a uniform industry standard. Fourth, the study sharpens the view on ESG's role in final investment decisions, where it remains formally embedded yet subordinate to financial KPIs and rarely decisive — a pattern shaped by early-stage filtering of high-risk cases and consistent with the less value-driven ESG logic observed. Finally, the study offers a region-specific perspective on an industry in pragmatic transition, where gradual shifts toward more outcome-driven ESG practices are emerging, yet orientation toward more transformative efforts remains bounded by regulatory, market, and operational realities of both GPs and still maturing SMEs.

5.3 Practical Implications

This study offers practical implications for various stakeholders in the German mid-market PE ecosystem. For GPs, it provides a rare peer benchmarking of national ESG integration efforts in pre-investment processes, supporting reflection on internal ESG governance, resource allocation, and balancing compliance-driven approaches and emerging value creation logic. For

LPs, the findings highlight the structural constraints GPs face in SME and regulatory contexts, urging more realistic ESG expectations, tailored oversight, and dialogue grounded in operational realities. For SMEs, the study illustrates which ESG aspects typically become priorities under PE ownership while highlighting GPs' awareness of SME-specific constraints — pointing to where stronger ESG alignment may create added value for both sides. Finally, for policymakers, the findings outline how regulations such as the SFDR translate into real-world PE processes, stressing the need for more consistent, outcome-oriented frameworks that reduce administrative burdens and enable genuine ESG adoption in SME-dominated deal environments. In sum, the study advocates for a more context-bound, pragmatic ESG approach that reflects the diverse realities of the German mid-market PE setting — enabling incremental progress while accounting for structural limitations to more transformative ESG ambitions.

6 Conclusion, Limitations, and Future Research

6.1 Conclusion

This study provides one of the first in-depth insights into ESG integration practices within the German mid-market PE segment, offering a grounded view of how ESG is operationalised in early-stage investment processes. The findings show that while ESG has become an institutionalised and formalised component across screening, DD, and investment decisions, its application remains largely compliance-driven and risk-focused — predominantly shaped by regulatory mandates and LP expectations. ESG’s potential as a strategic value lever, though increasingly recognised, remains underdeveloped, constrained by SME-specific data gaps, institutional barriers, and the dominance of financial KPIs. While some shared patterns in integration logic and investment strategies have emerged, ESG practices and governance structures continue to vary notably across firms, leaving room for further development toward broader convergence around industry-wide best practices. Looking ahead, ESG’s role in the German mid-market PE sector will likely evolve through pragmatic recalibration — moving toward more materiality-driven and outcome-oriented approaches. Realising this shift will require not only more enabling and proportionate regulations but also internal strategic shifts and practical tools that better align ESG ambitions with commercial realities. Otherwise, ESG risks remaining a formalised compliance exercise with limited transformative impact.

6.2 Limitations

As with any exploratory qualitative study, several limitations must be considered when interpreting the results. First, the qualitative design and the narrow sample of 12 SSIs limit the generalisability of the findings, as they reflect the perspectives of a subset of mid-market PE actors, excluding viewpoints from other stakeholders such as large-cap, impact-driven, or international investors active in Germany. Second, the reliance on self-reported data entails inherent biases, as responses may have been shaped by social desirability, retrospective rationalisation, or situational framing — particularly in sensitive areas such as regulatory compliance or internal investment strategies. Third, while offering a process-level view of early-stage ESG integration, the study does not capture post-investment ESG practices or developments across later fund stages, limiting insights into long-term value creation dynamics. Fourth, the findings are context- and time-bound. Conducted in April 2025 amid heightened macroeconomic and political headwinds, perceptions such as the study’s risk-centric ESG lens may reflect temporary conditions, potentially limiting their future validity. At last, despite

rigorous coding and external validation, the author's professional background in ESG and sustainable finance may have introduced interpretive bias that cannot be entirely excluded.

6.3 Future Research

Several avenues for future research emerge from this study's findings and limitations. First, as ESG remains primarily viewed through a risk lens, with more transformative approaches such as brown-to-green strategies still rare due to institutional constraints and return expectations, future studies could examine how specific ESG levers generate measurable outcomes in SME contexts and under which conditions they succeed. Case-based or longitudinal designs would be particularly suited to trace such trajectories and develop practical recommendations that more reliably link ESG improvements to financial or strategic value. Second, given this study's focus on early-stage ESG adoption, future research could adopt a complementary perspective and empirically assess how ESG integration influences exit strategies and valuations. Employing a multi-stakeholder lens, such research could examine how buyers price ESG improvements and how GPs internally assess and position ESG in sell-side processes, helping clarify its financial materiality across the PE lifecycle. Finally, the study revealed significant variation in how ESG responsibilities and processes are organised within GPs — ranging from dedicated ESG teams to ad-hoc handling by investment professionals, differing uses of internal and external expertise, and varying approaches to integrating ESG into final investment decisions. Future research could thus systematically map these governance setups, resource allocations, and decision processes to identify best practices that support more consistent and impactful ESG integration across the industry.

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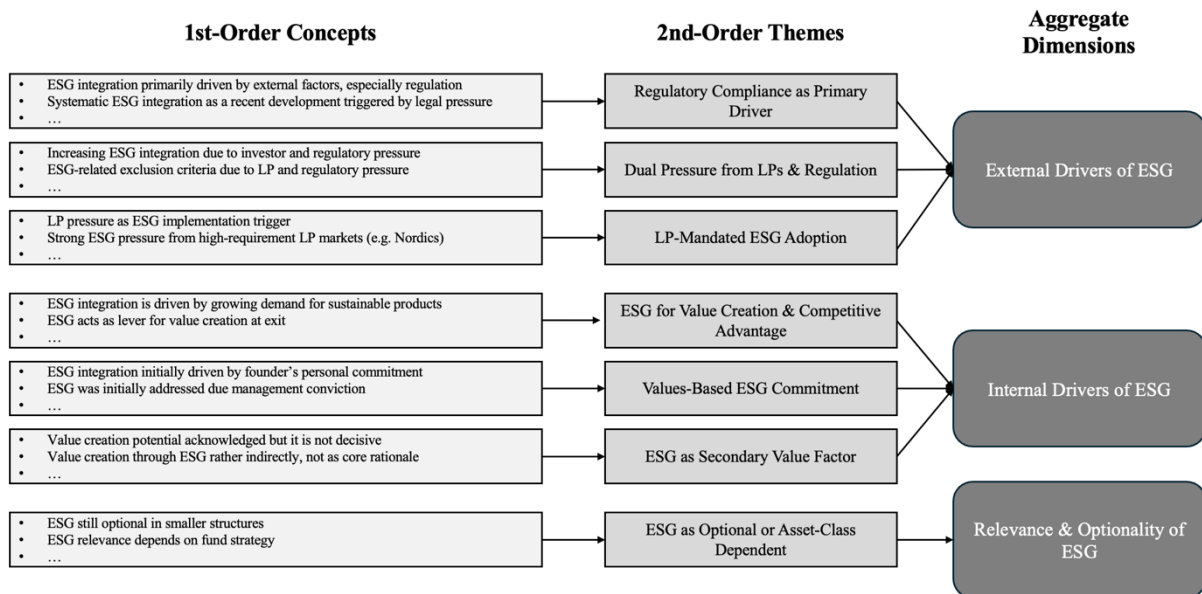
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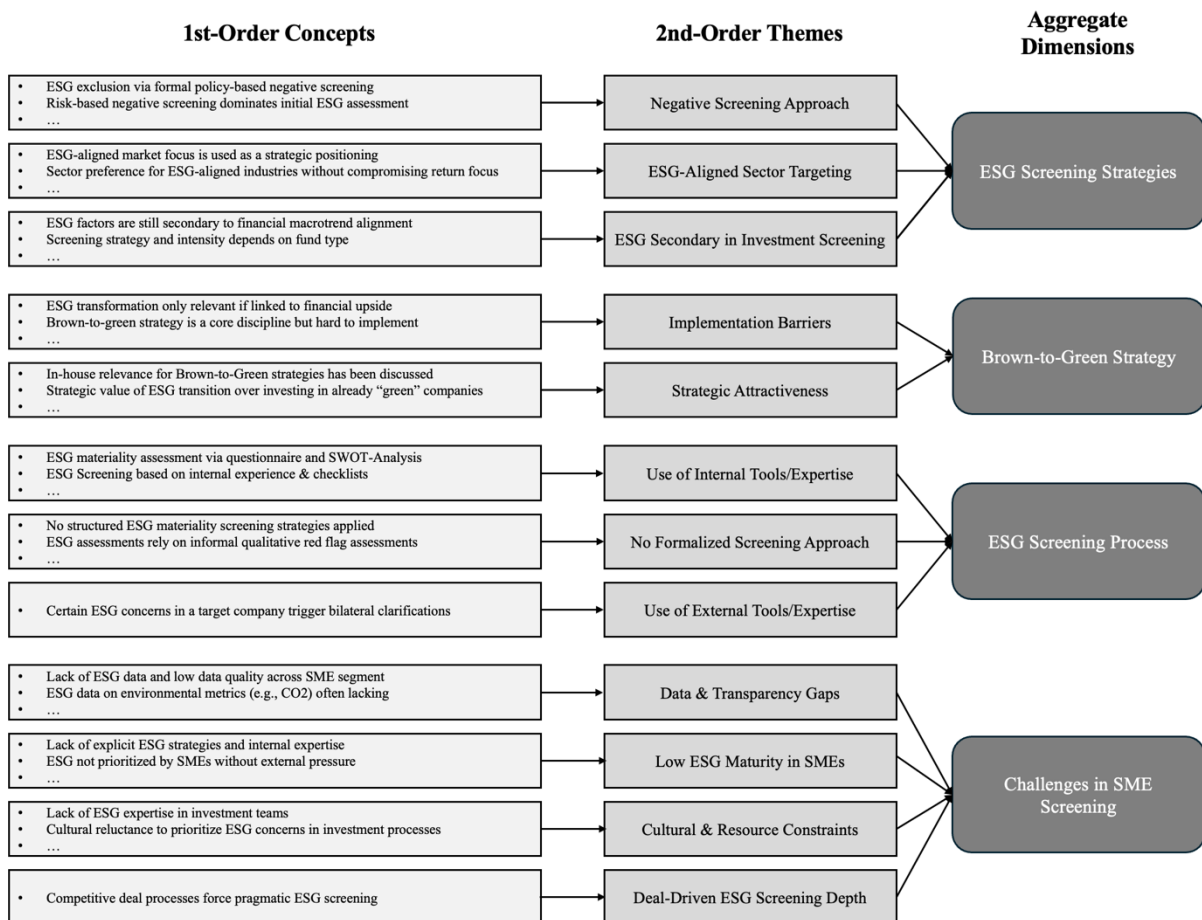
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8 Appendices

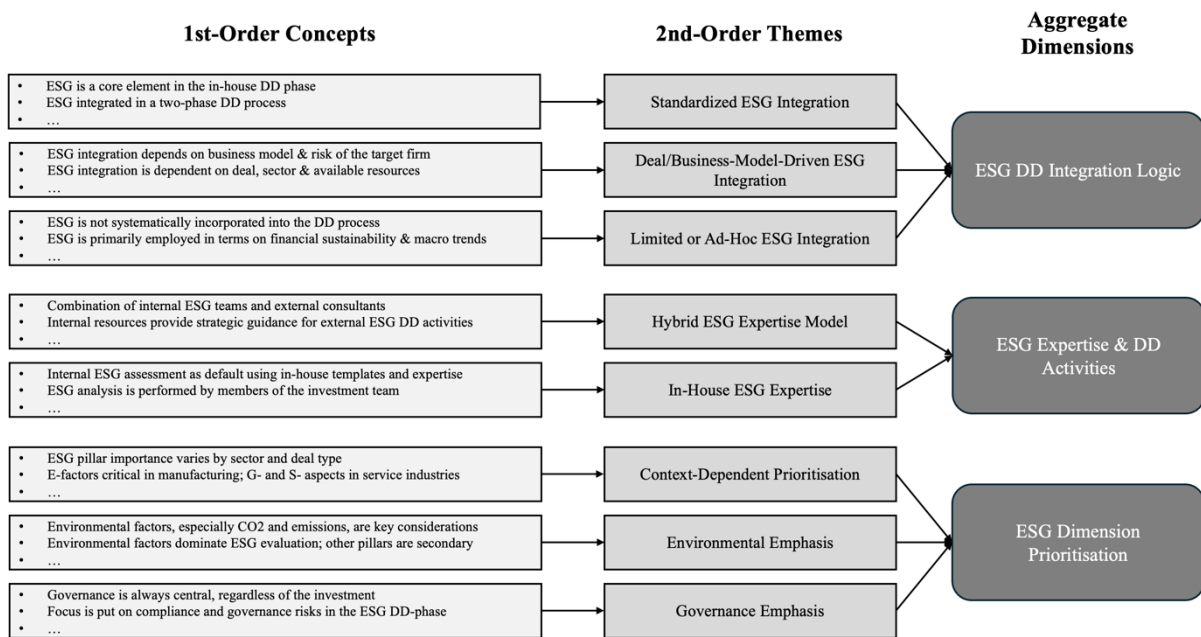
Data Structure: Opening Question – Drivers of ESG



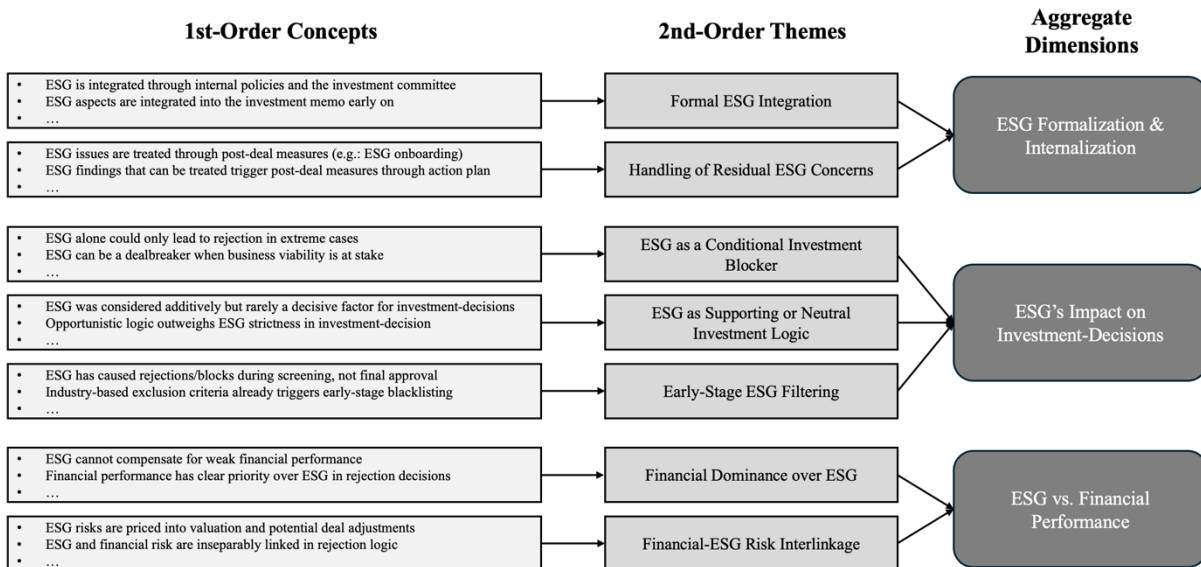
Data Structure: Interview Block I – Screening



Data Structure: Interview Block II – Company Deep Dive (Detailed DD)



Data Structure: Interview Block III – Investment Decision



Data Structure: Closing Question – Future Outlook

