M&A and ESG: The Due Diligence Process

Amy Wojnarwsky | Wednesday, October 6, 2021

Environmental, social and governance (ESG) factors have become a growing focus for companies and their stakeholders. In our first co-authored blog post of this series, EPOCH Pi and McDonald Hopkins discussed the growing importance of ESG to companies and their stakeholders and the impact this can have on corporate value overall ranging from cultural alignment to environmental, social and governance risks that are most material to a business and ultimately its long-term financial value.

The emphasis of ESG factors by a company can have a positive impact on corporate performance and governance of a company, and this emphasis leads to increased pressure on dealmakers to consider ESG elements in a transaction. The growing trend to embrace ESG factors is having a dramatic impact on how M&A is conducted. As a gating issue, many dealmakers are beginning to narrow their M&A targeting lens to sustainability and ESG-focused companies as they receive more pressure from their investors to support these initiatives.

Once a target is selected, ESG can play an influential role in the due diligence process of M&A transactions. ESG due diligence can help buyers identify ESG-related risks which may impact the overall deal structure and valuation. Industries like energy, manufacturing, healthcare services, or food production will likely have some form of sustainability initiatives established prior to a sale, and these industries typically encounter greater ESG due diligence from buyers than other industries which are less traditionally ESG focused.

Companies that have an emphasis on sustainability and traditional "E" metrics from ESG can maximize the value of their business by working with their advisors before going to market to ensure compliance with regulatory matters and improving their ESG metrics.

Working with their advisors prior to going to market enables potential sellers to ensure that they have mandatory environmental and regulatory licenses and permits to minimize the risk that a potential buyer's diligence would result in a decreased purchase price. Additionally, outlining the company's ESG priorities, initiatives, and measurements in the marketing materials used in the selling process helps to highlight the strength of the company's "G", which is always a positive factor in valuation. As Warren Buffet is credited with saying, "You can pay a lot of money for a really good business if you are reasonably sure it is a really good business."

Click here to read the full article on the EPOCH Pi website.

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