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MOORE NEWSLETTER

The Importance of Considering ESG Performance in Mergers and Acquisitions

In the current fast-paced business landscape, environmental, social, and governance (ESG) factors have become critical elements of corporate strategy, especially within the realm of mergers and acquisitions (M&A). As stakeholders increasingly advocate for responsible corporate practices, the integration of ESG considerations into M&A processes has shifted from being a discretionary option to a critical necessity.

Enhanced value creation

Research consistently shows that companies exhibiting strong ESG performance tend to outperform their peers in terms of financial stability and long-term value creation. This adherence to ESG principles can lead to better financial performance, increased stakeholder trust, and a more resilient business model.

Furthermore, companies that emphasise ESG considerations tend to cultivate a more dedicated customer base. Today’s consumers are increasingly informed and concerned about the ethical implications of their buying decisions. By demonstrating a commitment to ESG principles, companies can effectively differentiate themselves in a competitive market, enhancing brand loyalty and improving customer retention.

Regulatory compliance

As governments and regulatory bodies globally enforce stricter ESG disclosure requirements, companies engaged in M&A must prioritise compliance to mitigate potential legal and financial repercussions.

Given the evolving regulatory landscape, organisations must proactively incorporate ESG considerations into their M&A strategies. Failing to address these considerations could result in significant delays, damage to reputation, and legal issues that may threaten the success of the M&A process.

Risk management

Integrating ESG factors into the due diligence process helps identify potential risks associated with target companies. This assessment involves evaluating environmental liabilities, social impacts, and governance practices, allowing for the discovery of hidden risks that may not be evident through traditional financial analysis. For instance, companies that neglect environmental issues may incur substantial remediation costs or suffer reputational damage, adversely affecting their overall valuation.

Additionally, social factors such as labour practices, community relations, and diversity and inclusion initiatives are critical in evaluating a target company's long-term sustainability. A thorough understanding of these elements enables acquirers to mitigate risks related to negative public perception or employee dissatisfaction, which can significantly hinder the success of the integration process.

The role of ESG assessments in due diligence

To optimise the advantages of M&A and mitigating associated risks, it is essential to include ESG assessments in the due diligence process. This involves evaluating the target company’s ESG performance, identifying potential liabilities, and understanding how these factors align with the strategic objectives of the acquiring company.

Recommendations for incorporating ESG in due diligence

1. **Conduct comprehensive ESG assessments**: Evaluate the target company's environmental impact, social responsibility initiatives, and governance practices. Evaluation may include a review of recent ESG / sustainability reports, employee engagement surveys, and compliance records.
2. **Engage stakeholders**: Engage key stakeholders, including investors, employees, and community representatives, to gather insights regarding the target company's ESG performance and reputation. This engagement fosters transparency and cultivates trust among stakeholders, which is critical for the success of any M&A.
3. **Analyse industry trends**: To maintain the relevance and comprehensiveness of the assessment, it is essential to stay informed about industry-specific ESG trends and regulatory requirements. Additionally, understanding the competitive landscape can provide valuable context for evaluating the ESG performance of the target company.
4. **Develop a remediation plan**: If potential ESG issues are identified, create a plan to address these concerns post-acquisition to mitigate risks and enhance value. This proactive approach demonstrates a commitment to responsible business practices and can improve the overall integration process.
5. **Monitor and report**: Following the acquisition, it is crucial to consistently track ESG performance and communicate progress. This practice not only promotes accountability but also bolsters stakeholder trust in the newly established organisation.

Engaging a third-party expert

According to a recent survey, almost 70% of respondents regarded ESG as highly strategic in mergers and acquisitions. However, many are uncertain about how to implement that understanding. Specifically, 43% indicated they incorporate ESG into M&A discussions only occasionally, rarely, or very rarely, while 39% do not have well-defined metrics for assessing ESG.

Involving a third-party expert for an unbiased evaluation can enhance the credibility of the ESG assessment. The third-party expert can assist in the following areas:

1. **ESG due diligence**: Investors can collaborate with the third-party expert to perform comprehensive evaluations of target companies, identifying potential ESG risks and opportunities that enable them to make well-informed decisions. This due diligence process may involve analysing environmental impacts, social responsibilities, and governance practices.
2. **Regulatory compliance guidance**: The third-party expert may provide valuable insights into the latest ESG regulations, assisting clients in effectively navigating compliance requirements. This support keeps investors informed about evolving regulatory frameworks, ensuring they stay compliant throughout the M&A process.
3. **Stakeholder engagement strategies**: The third-party expert may assist in developing strategies for engaging stakeholders, ensuring that their concerns and expectations are taken into account during the M&A process. This level of engagement is essential for cultivating trust and promoting a positive corporate culture after the M&A.
4. **Post-merger integration support**: The third-party expert may offer guidance on integrating ESG practices into the newly formed entity, helping to align corporate culture and operational strategies with sustainability goals. This support extends beyond the initial acquisition phase to ensure long-term success.
5. **Training and capacity building**: The third-party expert may assist in providing training sessions and workshops for personnel of the target company to enhance their understanding of ESG principles and practices. This capacity-building effort empowers organisations to cultivate a culture of sustainability and responsibility.

Conclusion

In conclusion, the importance of considering ESG performance in mergers and acquisitions cannot be overstated. By incorporating ESG assessments into the due diligence process, companies can enhance value creation, ensure regulatory compliance, and effectively manage risks.

Moore ESG services

Why work with us?

We are a global advisory network, with offices and member firms across the globe. Our team is composed of professionals with practical and solid knowledge and experience. They are certified holders or members of professional bodies such as HKICPA, ACCA, CRISC, CISA, CIA, CFA, CESGA and Certified ESG Planner.

At Moore, we understand the complexities of integrating ESG considerations into M&A processes. Our team of experienced ESG consultants is dedicated to helping organisations assess and enhance their ESG performance during M&A.

Our clients range from SMEs to listed companies from a wide variety of industries, and public sectors including government bureaus and authorities. Through our extensive sector knowledge, we provide comprehensive advice to suit each client’s goals.

To find out more, please contact one of our experts below:

PATRICK ROZARIO
Advisory Services
Managing Director
T +852 2738 7769
E patrickrozario@moore.hk

CHRIS CHAN
Advisory Services
Director
T +852 2738 7726
E chrischan@moore.hk

KENNETH MA
Transaction Services
Director
T +852 2738 4633
E kennethma@moore.hk