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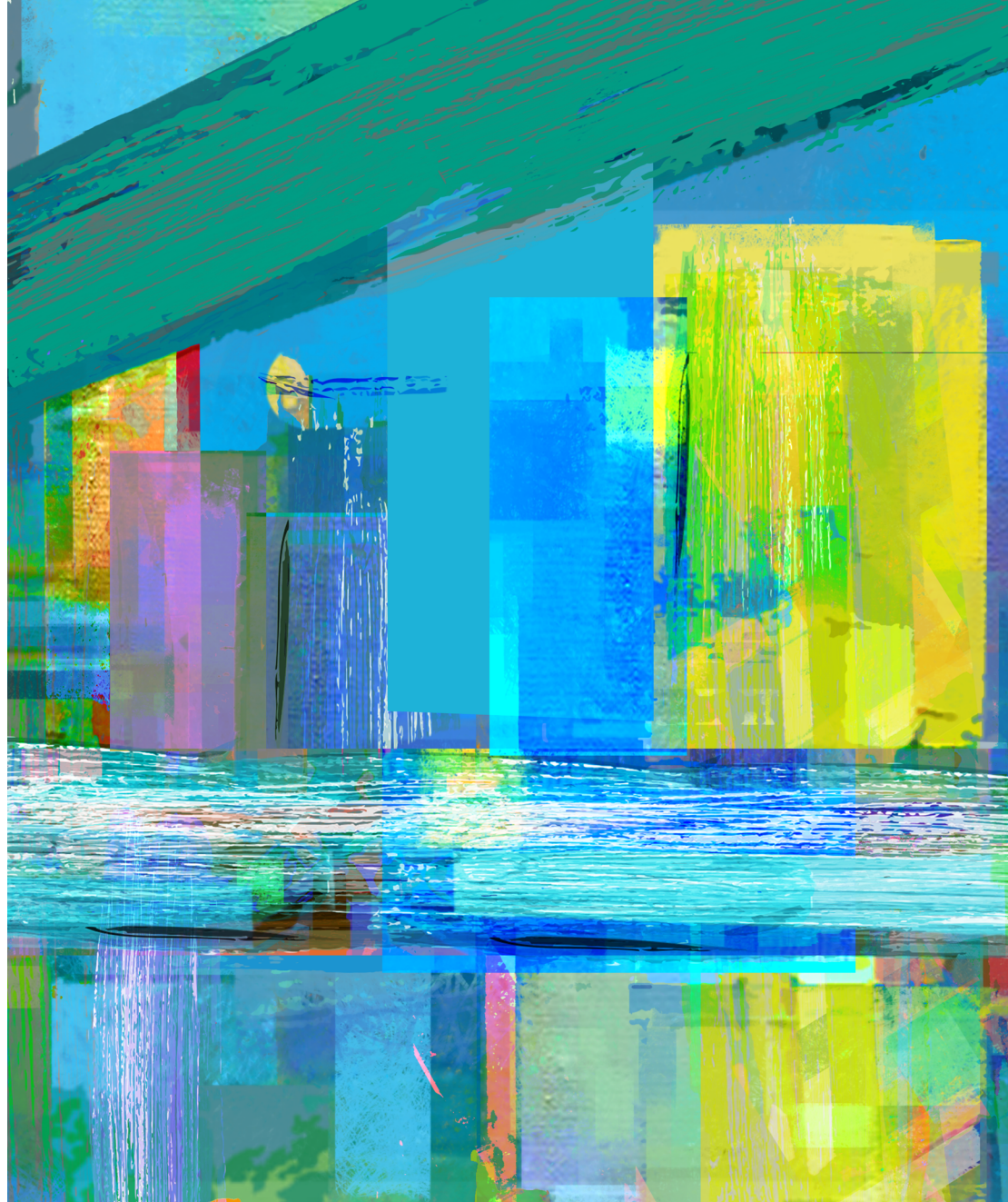


## ESG in M&A pulse survey

**ESG's evolving role in corporate M&A decisions**

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# Introduction

Environmental, Social, and Governance (ESG) is rapidly becoming a core focus area as companies reassess strategy and evaluate operations. Just a few years ago, ESG efforts might have been driven by investor demands or the desire to avoid specific risks. Today, every business must anticipate and weigh trade-offs on how a range of ESG issues, including climate change and equity concerns, are shifting customer preferences and creating new business opportunities, or eroding existing revenue and value.

Mergers and acquisitions (M&A) strategy and execution can no longer exist in a silo, separate from a company's ESG efforts and commitments. Issues like the energy transition are core to growth and creating a competitive stairway to the future, leading to an increasing number of transactions with ESG at the core of the investment thesis.

We commissioned a survey to understand executives' latest perspectives on ESG. The survey was designed to assess both how companies are incorporating ESG into strategy and execution for acquisitions and divestitures and gaps between planning and execution.

Our research clearly shows that executives and managers recognize the importance of ESG in their M&A activity. However, appreciating the importance of these topics is not the same as knowing how to address them. Decision-makers will benefit from understanding the relevance of ESG across each aspect of the deal and the importance of integrating ESG into their competitive strategy.



# About the research

We surveyed 250 leaders in June 2022 at corporations with revenue of at least \$500 million. Private equity, not-for-profit, and public-sector organizations were excluded, and our respondents were balanced between C-suite executives and senior- and mid-level managers.

Company size (in terms of annual revenue) was balanced while geographical representation centered on North America (60%), Europe & Middle East (20%), and Asia-Pacific (20%).



# M&A decisions are being shaped by ESG

ESG moved toward the center of business strategy in recent years. Corporate leaders today recognize and weigh ESG in M&A decisions. Two-thirds of those surveyed consider ESG to be of high or very high strategic importance in M&A activity, while just 5% say that it's negligible, of low importance. In our practice, our leading clients are evolving ESG diligence requests away from a risk focus, toward a combination with commercial and growth issues.

Companies are acting on this strategic view: 88% of respondents have evaluated their business portfolio with an ESG lens. A subset are focused on improving their ESG profile; 32% have already made an acquisition, and a further 32% say they are actively pursuing an acquisition. The numbers are similar for divestitures: 83% have evaluated their portfolio, 22% have already divested assets to address ESG goals, and 28% have started a divestiture process.

Across industries, survey results confirm the market activity we are observing among our clients. A large majority of energy, resources, and industrials companies (90%) say they are acquiring companies or assets to gain exposure to commodities and capabilities needed for a global low-carbon future, while 85% also noted that they may divest assets that produce carbon-intensive products.

While offloading such assets can aid “rapid portfolio decarbonization” and the achievement of climate-related targets, it is important to be cognizant of potential reputational risks associated with a divestment strategy of this nature, and often there is value in the transition of these assets, as opposed to clear divestment. Consideration should be given to whether there are ongoing opportunities to leverage existing ESG capabilities to progress the ESG credentials of the divested asset.

Similarly, among consumer companies, 89% say they are seeking to acquire brands and capabilities that are sustainable, ethical, have a low-carbon footprint, and show positive social impact.

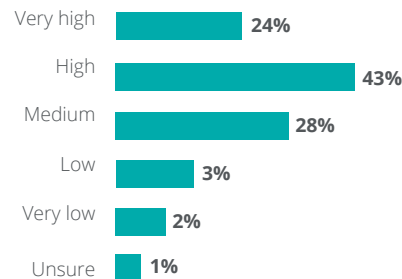


Respondents in financial services and in technology, media, and telecommunications have the strongest inclination to review their portfolios for ESG-related acquisitions (93% and 100%, respectively) and divestitures (88%

and 95%, respectively). These industries' high exposure to end customers and changing consumer preferences is likely affecting their tilt toward ESG (figures 1–3).

### Importance of ESG for M&A strategy

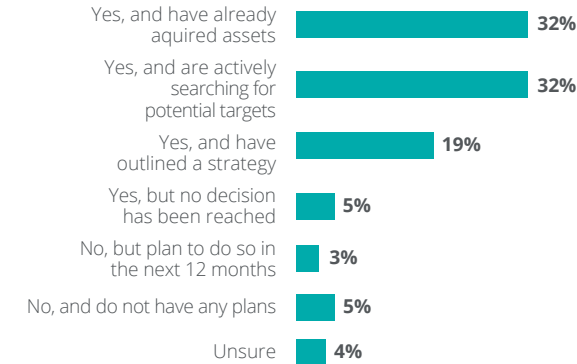
**Figure 1**  
**Currently, how much strategic importance does your organization place on ESG in the context of M&A strategy?**



Majority (67%) of respondents place high or very high strategic importance on ESG in M&A.

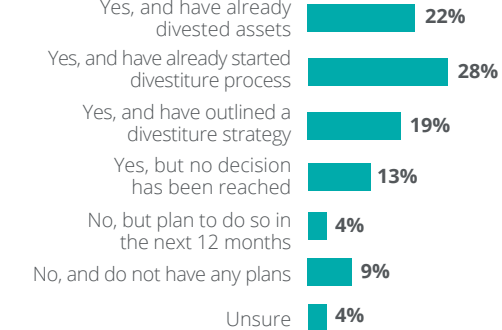
(N=250)  
 Source: Deloitte, "ESG in M&A pulse survey: ESG's evolving role in corporate M&A decisions," June 2022

**Figure 2**  
**Has your organization evaluated its portfolio from an ESG perspective to determine whether it should acquire assets to improve its ESG profile?**



Almost nine out of ten (88%) respondents' organizations have considered or completed acquisitions to improve their ESG profile.

**Figure 3**  
**Has your organization evaluated its portfolio from an ESG perspective to determine whether it should divest assets to improve its ESG profile?**



Eight out of ten (82%) respondents' organizations have considered or completed divestitures to improve their ESG profile.



Today's investors are interested in how companies take advantage of changing customer preferences, emerging business opportunities, or potential risks and opportunities that ESG considerations help identify:

- What acquisitions or divestitures are required to reach our net-zero or other ESG commitments?
- What type of acquisition will deliver capabilities or assets to help us capitalize on opportunities created by customer interest in sustainable products and the transition to a global low-carbon economy, or to address under-served markets and communities?
- What potential legal, regulatory, or reputational ESG risks exist within a specific target, and do we have the capabilities to assess them appropriately?

Our survey finds that respondents are somewhat equally split between having had the experience to proceed and not proceed with a potential acquisition due to a target's ESG performance (figure 4).

About a third of companies abandoned a potential divestiture because of challenging or negative feedback from potential buyers on the ESG profile of the divestiture. In our experience, sellers are often unprepared to provide data or present on the ESG attributes. For example, we recently supported a transaction where the seller was unable to answer primary questions such as the impact of temperature increase on the product, laws on their workforce, etc. Treating ESG as part of the vendor due diligence would have helped alleviate this issue.

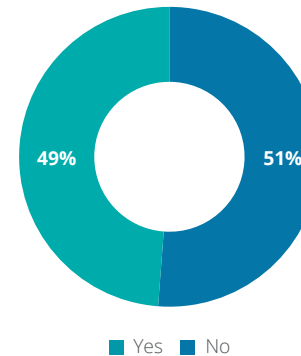
Where ESG was previously considered a risk-profiling exercise, ESG is increasingly viewed as core to value creation. An ESG assessment or established framework can assist with answering these questions ahead of a transaction and avoid key financial, regulatory, or reputational risks that are inconsistent with the

buyer's own ESG commitments. A variety of stakeholders (regulators, lenders, co-investors, ratings agencies, etc.) are requesting information and analysis. Embedding ESG from the outset also supports the identification of positive synergies and potential value-creation levers.

### Influence of ESG on signing and completing M&A transactions

Figure 4

**Has your organization ever decided to not proceed with a potential acquisition because of concerns about the target's ESG performance?**



(N=250)

Source: Deloitte, "ESG in M&A pulse survey: ESG's evolving role in corporate M&A decisions," June 2022



# Integrating ESG in deal-making

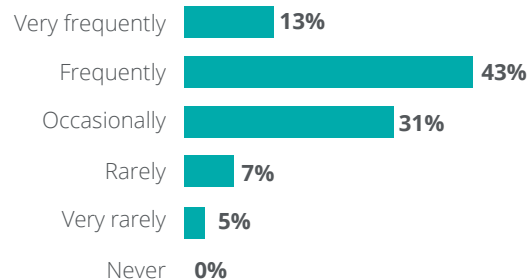
Once corporations fully embrace ESG goals and considerations as vital to their M&A activities, the next issue is how well they execute on that insight. Are ESG topics fully integrated into the discussion as the organization seeks to identify merger targets or make decisions about divestitures? On this point, the data in our survey paints a nuanced picture.

ESG topics are often a part of the discussion within companies during M&A transactions. Yet, 43% say that ESG topics are only occasionally, rarely, or very rarely part of the M&A conversation (figure 5), despite viewing ESG as important.

## Impact of ESG on M&A transaction diligence and planning

Figure 5

### How often is ESG a topic of discussion and consideration in ongoing M&A transactions?



(N=250)

Source: Deloitte, "ESG in M&A pulse survey: ESG's evolving role in corporate M&A decision-making," June 2022

In our experience, companies are increasingly acknowledging you cannot be all things to everyone. This leads to each company defining their own approach. Executives have to determine goals that fit their company's business and strategy. With this in mind, we see due diligence starting to evolve too; from a focus on risk-based red flags to a commercial focus with growth perspectives mixed with operational due diligence to understand how to meet reduction goals, overlaid with a value-creation lens.

No one is served well if corporate development acts on a potential acquisition or divestiture without ESG expertise or late consultation. Accordingly, M&A teams need to proactively embed ESG within the deal life cycle. Core to this is tapping into ESG expertise to help inform strategy and decision-making. ESG should be properly integrated into every aspect of M&A activity, from target selection to due diligence to post-close integration. Fit-for-purpose ESG goals should be built into the plans for all areas of the business, inclusive of M&A.

Our survey also highlighted tensions over how ESG is integrated into M&A decisions. While 92% of respondents measure the deal's impact on the company's ESG profile, only 39% have clearly defined metrics for that purpose, while 53% use varying means to assess the impact, depending on the situation (figure 6).

It's worth noting, based on our experience with clients, that some respondents who say they have defined methods for assessing ESG may be working with





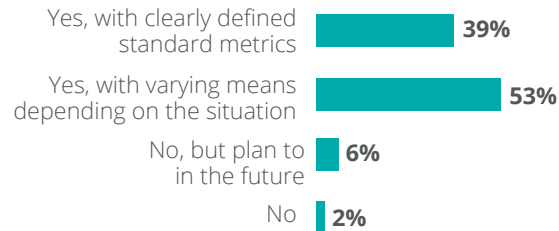
checklists with limited scope. As much as metrics are desirable, a fully formed picture of the ESG considerations that might be relevant to M&A decisions will sometimes demand more complex and complete assessments.

Yet, about one-third (27%) of respondents claim to have a very high level of confidence in their organization's ability to accurately evaluate the ESG profile of a potential target, while almost half (47%) say they have above-average confidence (figure 7). In this case, more often than not, executives base their view on the short-sighted experience of their own organization's practices, rather than comparisons of what great looks like across a variety of organizations.

### Impact of ESG on M&A transaction diligence and planning

Figure 6

**Does your organization measure the impact a potential acquisition or divestiture will have on your organization's ESG profile?**



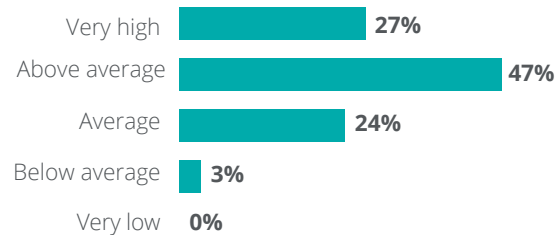
(N=250)

Source: Deloitte, "ESG in M&A pulse survey: ESG's evolving role in corporate M&A decisions," June 2022

These results complement other recent Deloitte research. The *Deal in focus: Heads of M&A survey 2022*, which focused on Australia and New Zealand, highlights that the pain points associated with embedding ESG into M&A include quantifying the value, finding the right data, and translating ambition into action. There is an ongoing maturation in the market on the subject of how to embed ESG into deal-making and how to connect ESG to core business priorities to create value. As ESG data is increasingly standardized, it is expected that quantification practices that help define the link between ESG and value creation will continue to evolve.

Figure 7

**What is your organization's level of confidence to accurately evaluate a potential acquisition target's ESG profile?**



# Operationalizing the effort

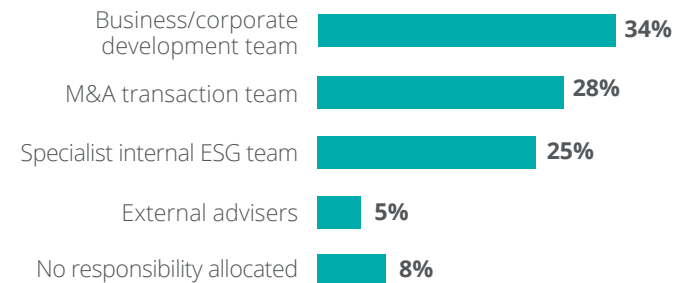
Our data demonstrates that while there is broad alignment that ESG should be considered in deal-making, there is also broad uncertainty about how best to integrate ESG into M&A decisions and who is responsible for doing so. Our experience in this field suggests companies are struggling with how to incorporate the long-term nature of ESG issues with immediate concerns. Discounted Cash Flow (DCF) is highly sensitive to the first five years, but climate concerns are often based off views of 15–25 years. For example, some organizations have shifted to focusing on the revenue upside of ESG through new products or a cost-only view for investment decisions. Responsibility is generally assigned to one of three groups (figure 8): Business/corporate development team (34%), the M&A transaction team (28%), or specialist internal ESG team (25%).

Interestingly, C-suite executives are more confident than other managers that an ESG assessment is properly handled. Just 2% of C-suite respondents say responsibility for assessing potential ESG impact has not been allocated, while 15% of senior and middle managers say the same.

## Impact of ESG on M&A transaction diligence and planning

Figure 8

**Who is responsible for assessing the potential impact an M&A transaction will have on your organization's ESG profile?<sup>1</sup>**



(N=250)

<sup>1</sup> One response reflecting "Other (please specify)" (0.4%) was removed from the visualization to clean up appearance.

Source: Deloitte, "ESG in M&A pulse survey: ESG's evolving role in corporate M&A decisions," June 2022



Asked how prepared the organization is to discuss its ESG profile, or that of a specific asset, and how it drives value (figure 9), 84% say they are prepared or very prepared, as compared to just 7% who say they are unprepared or very unprepared. Again, in this question there is a discrepancy between the C-suite and others, with 30% of non-C-suite managers saying they are unprepared or neither.

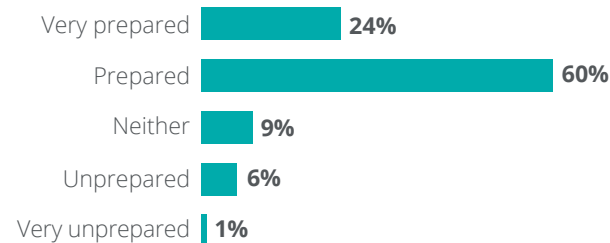
In our experience, responsibility remains diffused, though many have started to hire an ESG program manager or leader. These ESG leaders have a difficult path, as they work with peers in traditional functions such as HR, Engineering, and Legal while also running a change management program of education on how ESG creates value with business unit and C-level leaders.

These responses tell a cautionary tale, suggesting that organizations need to continue to embed ESG considerations into M&A strategy. Establishing an ESG team and hiring an ESG leader isn't enough if other parts of the organization then decide that the expertise should remain siloed within that group or don't understand its relevance to business. It also indicates that while boards and investors have made it clear to the C-suite that ESG must rise to the top of their strategic considerations, that direction may not yet have reached the rest of the organization. All parts of a company must play their role, including the M&A leadership. Accountability must be established that rises all the way to the C-suite—which must set the tone and lead on these matters.

### Influence of ESG on signing and completing M&A transactions

Figure 9

**How prepared is your organization to discuss its (or certain portfolio asset's) ESG profile with other organizations in terms of how it drives value for your organization?**



(N=250)

Source: Deloitte, "ESG in M&A pulse survey: ESG's evolving role in corporate M&A decisions," June 2022



# Conclusion: Seeing the stakes

Companies are increasingly asked by their stakeholders, including investors, employees, customers, and the wider community, to focus on the role the business plays in society—to demonstrate purpose. That means they must first decide what elements of ESG provide a competitive advantage. A strategy without considering trade-offs is not a strategy. Second, be prepared to measure, address, and explain key ESG factors ranging from the company's carbon impact to its labor policies to its record on governance matters such as board diversity and compensation. Stakeholders are demanding comfort as to how businesses will continue to deliver value sustainably.

Corporate leaders must demonstrate that they recognize how ESG commitments can drive business success and understand the link today between ESG and value creation. Our survey data shows that organizations have growing confidence that they are capable of pushing this through their M&A strategy and execution.



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The authors and contributors wish to thank the following individuals for their contributions: **Michaela Baca**, **Sean Cannady**, **Ralitza Dountcheva**, **Emma Farrell**, **Pranjal Gupta**, and **Charlie Kerhin**.

This survey was issued in the United States and the survey on which it is based was conducted in the United States.



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