Sustainability Toolkit

Key Considerations for M&A and Joint Venture Transactions

Conducting environmental, social, and governance due diligence in the context of M&A and joint venture transactions is a critical step in the risk assessment process of potential transactions.

Here are the key questions and issues you need to consider:

What is the purpose of conducting sustainability or ESG due diligence? +

What are the key steps in ESG due diligence of a target in M&A transactions? +

What are some of the principal areas of ESG due diligence focus? +

What are the main benefits of conducting ESG due diligence of an M&A target? +

How does ESG due diligence for joint ventures differ? +

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What is the purpose of conducting sustainability or ESG due diligence?

The review of sustainability risks in the due diligence process involves the identification, quantification, and evaluation of environmental, social, and governance risks associated with a proposed transaction.

- Once these ESG risks are identified, the acquirer can decide what mitigation measures should be taken to reduce or eliminate these risks, or alternatively, adjust the price or terms of the agreement to reflect the impact of the identified risk on the value of the business or asset.

- Due diligence of sustainability risks can take many forms, from reviewing documentation concerning environmental, social, and governance matters as they relate to a proposed transaction, to engaging in an on-site investigation with technical experts to better understand the risks of a proposed transaction.

- The structure of the due diligence inquiry will vary by transaction type and industry.

What are the key steps in ESG due diligence of a target in M&A transactions?

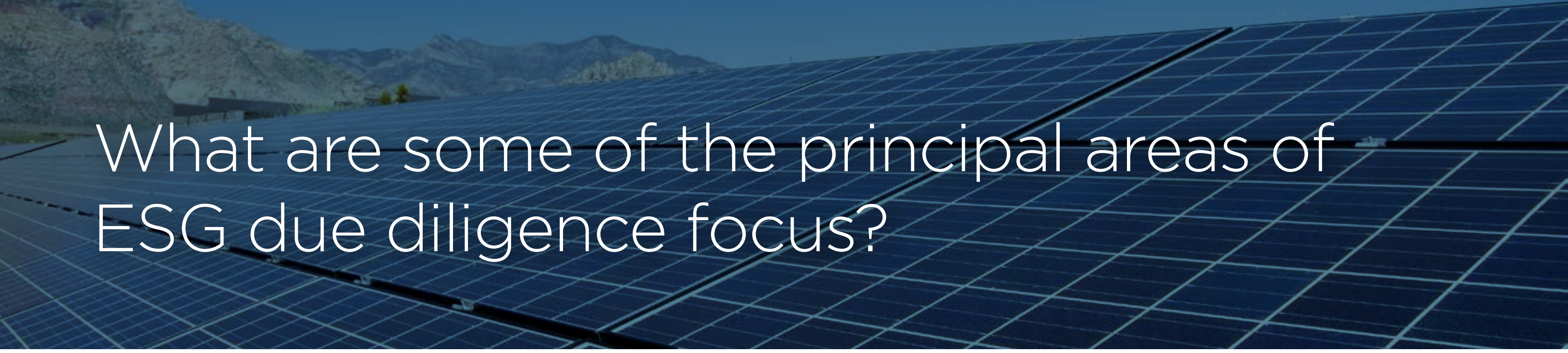
- Decide whether ESG issues may be material to the proposed transaction.

- Include ESG issues as a part of the due diligence review process.

- Identify ESG risks based on the target's industry, geography, specific operations, and business model.

- Gain an understanding of the target's ESG risk management objectives and opportunities.

- Once target-specific risks are identified, conduct enhanced due diligence involving consultation of local or technical experts, as necessary.



What are some of the principal areas of ESG due diligence focus?

In general – whether the target is a public or private company:

- Many ESG issues will be addressed as part of customary environmental, employment, labor practices, and human rights compliance due diligence.
- But supplemental diligence should also analyze the target's business through a sustainability lens and consider:
  - Sustainability considerations and demands of the target's customers and suppliers, and the ability of the target to meet or impost such demands;
  - Cultural values and tone of management and workforce relations and compatibility of those with the values and tone of the acquirer;
  - Social implications of post-merger integration strategies and potential repercussions that could affect realization of synergies.

In addition, when the target is a public company:

- Compare disclosures in the target's voluntary sustainability reports with its SEC filings and look for material conflicts or omissions between the two.
- Evaluate whether the target has received ESG-focused shareholder proposals.

What are the main benefits of conducting ESG due diligence of an M&A target?

The main benefit of an ESG due diligence inquiry is that an acquirer is able to gain a more comprehensive understanding of the risk-adjusted value of a business or an asset.

- In a recent global survey of private equity general partners, 54% had a reduced bid price after conducting ESG due diligence and 32% had an increased price following ESG due diligence.
  - In a recent deal involving a Chinese acquirer of a European manufacturer of tableware, an ESG due diligence team from KPMG uncovered many ESG risks including environmental liability, poor working conditions, potential for labor disputes, and unsound Board processes in the target which led to reducing the deal price by $10 million dollars.
  - When a private equity firm sought to acquire a South American marine equipment manufacturer, ESG due diligence revealed that the target failed to secure a number of mandatory environmental licenses and permits for its business operations. This discovery resulted in a reduction in deal price and allowed the parties to address the risk in the transactions terms.

How does ESG due diligence for joint ventures differ?

Companies often thoroughly investigate potential joint venture partners because these relationships are typically long-term. Though the framework for approaching ESG due diligence does not differ much from the M&A context presented above, the power dynamics of these transactions change the tenor of negotiations.

- These arrangements work best when joint venture partners have similar sustainability policies and standards.
- Due diligence for joint ventures varies in scope depending on the percentage ownership in the joint venture.
  - **Majority**
    If a company is the operator of the project or holds a majority stake in the project, more extensive due diligence efforts are usually undertaken because the bulk of the activities and liability associated with the project are shouldered by that party.
  - **Minority**
    In situations where companies are minority stakeholders or have little leverage, due diligence activities are often significantly scaled back in scope.
  - **State-owned**
    In some instances, there is little to no choice in joint venture partners because some governments require that oil and gas companies partner with the state-owned national oil company as a condition to operating the joint venture in that territory. In these cases, even though there is no choice in partners, due diligence into sustainability risk is still important to accurately value the partnership.
- If ESG due diligence reveals potential liability, the parties should evaluate if mitigating the risk is possible. If mitigation efforts are costly or not possible, the parties may decide to stop negotiations and consider other partners or other strategic alternatives.

Sustainability Toolkit

Explore the topics	Defining Sustainability	Public Policy: Climate Change	Public Policy: COVID-19	Public Policy: Environmental Justice	Public Policy: UN Sustainable Development Goals
Engaging and Advising BODs	Investor Expectations	Corporate Disclosure: The Basics	Corporate Disclosure: Standards and Initiatives	Setting Corporate Goals	M&A and JV Transactions
Green Bonds and SLLs	Carbon Markets	Marketing Claims	Crisis Management	Insurance Implications	Sustainability NGOs