Start with why

Practical considerations for approaching ESG due diligence in a private M&A transaction

From a buyer's perspective:

Scope

Buyers should consider broadening the scope of ESG due diligence from a focus on the customary liability areas (such as environmental and health and safety compliance for example) to include an evaluation of the target's ESG capabilities and readiness. This might involve an assessment of any ESG governance structure or ESG objectives set, of the extent to which the target already collects and monitors relevant ESG data points (e.g. a baseline of its GHG emissions) and of any ESG policies, plans or processes in place, including any net zero transition plan, any supply chain due diligence process and any steps taken to increase diversity. This will help to identify additional ESG-related risks that need to be dealt with in the transaction documentation, that may impact on the valuation of the target or, for the biggest issues, may cause the buyer to walk away from the deal.

Timing

Early identification of such ESG risks will maximise the buyer's time in terms of assessing their impact - both in terms of negotiating the allocation of such a risk with the seller but also the impact of such a risk in terms of integrating the target into the buyer's group while keeping the timetable of the transaction on track.

Expertise

Where a buyer has developed skills and expertise in ESG policies and initiatives internally, this knowhow can be harnessed when evaluating the impact of an acquisition on the buyer. Where no such internal knowhow exists, buyers should ensure that they are working with advisors who are alive to these issues and can co-ordinate an ESG due diligence exercise working with ESG specialist consultants where appropriate.

Impact

In addition to the early identification and evaluation of any risks to the target and buyer's group, a broader ESG due diligence evaluation will also, crucially, enable a buyer to spot ESG-related opportunities which could impact upon business plans and targets set with the management team.

From a seller's perspective:

Credentials

At the same time as it is getting its house in order with a view to selling the target, sellers should consider strengthening a target's ESG credentials by, for example, reviewing or streamlining the target's operating model with a view to reducing the use of resources and waste or putting in place an appropriate ESG governance structure. Even if the sale does not proceed according to plan, this will stand the target in good stead for any future sale and benefit the business in the meantime.

Preparation

Working with its advisors prior to the start of a sale process to pre-empt likely areas of enquiry from a prospective buyer by performing its own ESG due diligence exercise will put a seller on the front foot when the sale process begins. This will also help a seller to identify any ESG risks and opportunities in the target that can be remedied (or at least understood and quantified) or exploited as appropriate in advance of the sale process commencing.