ESG CHANGING THE M&A LANDSCAPE.

ESG has become a key agenda in the M&A space, - One of the reports from Bloomberg suggests that ESG assets under management are set to reach over $50 trillion by 2025—more than a third of the $140.5 trillion projected total under management—some of the most recent mergers and acquisitions (M&A) have carried a distinct ESG tone.

ESG factors can be expected to increasingly influence how companies select potential targets and business partners. Certain key ESG risks—notably, risks related to corrupt business practices, privacy and data security, climate change, greenhouse gas emissions, diversity, and labour practices—are already being evaluated in the context of M&A due diligence, as is the more general consideration of the potential impact of an acquisition on the culture and integration of the combined company. Similarly, quantifying the business value and adjusting for the associated risks and overall weighted average cost of capital (WACC) involved due to poor or good ESG scores is also being increasingly factored in M&A valuations and specifically in earn-outs or incentive linked pay outs for promoters.

The days when strategic buyers would have used ESG compliances as a tool to clamp down on the valuations are over. The buyers are now highly conscious of the role of ESG and its long-term impact on their reputation and the businesses which they buy, hence an ESG due diligence is most preferred choice to evaluate the price which they are paying and any future liability or capital expenditure that may come up due to non- compliance. Any underperformance in the ESG score can directly impact the targets business value, hence a haircut on part of the sellers. On the other end of the spectrum, sellers need to focus on the making their business ESG compliant with establishing industry best practices from various perspective including energy consumption and dissipation, corporate governance, efficient treatment of discharged effluents, empathetically understanding and fostering all stakeholders relationships, comply with all regulatory and statutory norms.

Earlier, the findings from ESG due diligence were brushed aside as one of the ticks in the boxes while planning a post-merger integration, however, now we see that in many M&A transactions much of those findings are being discussed and being integrated with conditions precedent (CP's). Even in case of the SPAs (share purchase agreement), while specific risk attributed to false ESG claims may not be covered under representation and warranties, but we are witnessing an increasing trend where customized warranties are being included in the transaction documents.

ESG has become an important component in valuing the overall business for certain industries, however its impact is set to be witnessed across all the industries with a direct impact on the betterment of the environment, corporate governance and all the stakeholders of the business. This is a long-term trend that is likely to continu for many years to come…

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