



ESG Due Diligence

A Strategic Imperative in Mergers & Acquisitions

Unlocking Value and Mitigating Risks Through ESG
Integration in M&A Transactions

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Overview

In today's business landscape, ESG (Environmental, Social, and Governance) factors are becoming critical to the success of businesses across sectors. Customers, employees, shareholders, investors, rating agencies, and regulators are increasingly focused on how companies conduct their business, its impact on the world, and their contribution to society.

- **Climatic Change:** Carbon emissions, energy efficiency
- **Natural Resource Use:** Water stress, biodiversity, land use
- **Waste Management:** Toxic emissions, electronic waste
- **Environmental Initiatives:** Renewables, clean tech, green building



- **Human Capital:** Labor management, health & safety, supply chain, employee well-being
- **Product Safety:** Chemical safety, financial product safety, privacy & data security
- **Social Opportunities:** Nutrition & health, access to communication, health & finance

- **Corporate Governance:** Practices & Policies, Disclosures
- **Business Ethics:** Corruption & Instability, Ethics & Fraud, Anti-competitive Practices
- **Government & Public Policy:** Financial System Instability

What is ESG Due Diligence?

Traditional due diligence focuses on deal-specific risks and opportunities, historical and projected earnings, the quality of assets, commitments, and contingencies. In addition, ESG Due Diligence (DD) offers a comprehensive assessment of material ESG risks, liabilities, and opportunities for a target, which may be a portfolio company or transactional target. It helps identify and mitigate potential risks around reputation, regulatory challenges, and financial impacts.

ESG Due Diligence serves multiple functions in a business environment, such as:

ESG DD in Investment Decision



- Strategic and financial investors with long-term value creation scout for companies with ethical, sustainable, and well-governed policies.
- Organizations with strong ESG metrics/ratings attract favorable investment terms.

ESG DD in Supply Chain



- Validating vendors and business partners on their ESG strategies helps mitigate long-term risks to the organization.
- To avoid reputation damage, ESG Due Diligence should be applied to validate existing suppliers and in onboarding new suppliers.



Why is ESG Due Diligence Critical?



Key measure for investors

Access to capital is increasingly focused on areas of sustainability performance, social responsibility, and governance, making ESG Due Diligence a key step in securing additional funding for the enterprise.

Advantages of ESG DD for both investor and the company



Price negotiation, premium for favourable ESG factors



Value enhancement opportunities



Quantification of post acquisition cost in M&A



Better return, compensation expected



Mitigation of Key risks

Reputation Risk

ESG covers key stakeholders such as clients, shareholders, investors, lenders, and employees. Satisfaction of key stakeholders helps mitigate the reputation risk

Regulatory Risk

Major regulatory bodies have now put stern measures on ESG, as sustainability is the key topic trending worldwide. ESG DD helps mitigate regulatory consequences

Financial Risk

ESG compliant organizations helps save on major outflow towards regulatory fines for non-compliance and helps garner major investor funds

Strategic Risk

ESG compliant organizations helps developing long term strategic partnerships which aids in achieve rapid inorganic growth



Competitive Advantage and Improved Stakeholder Relations

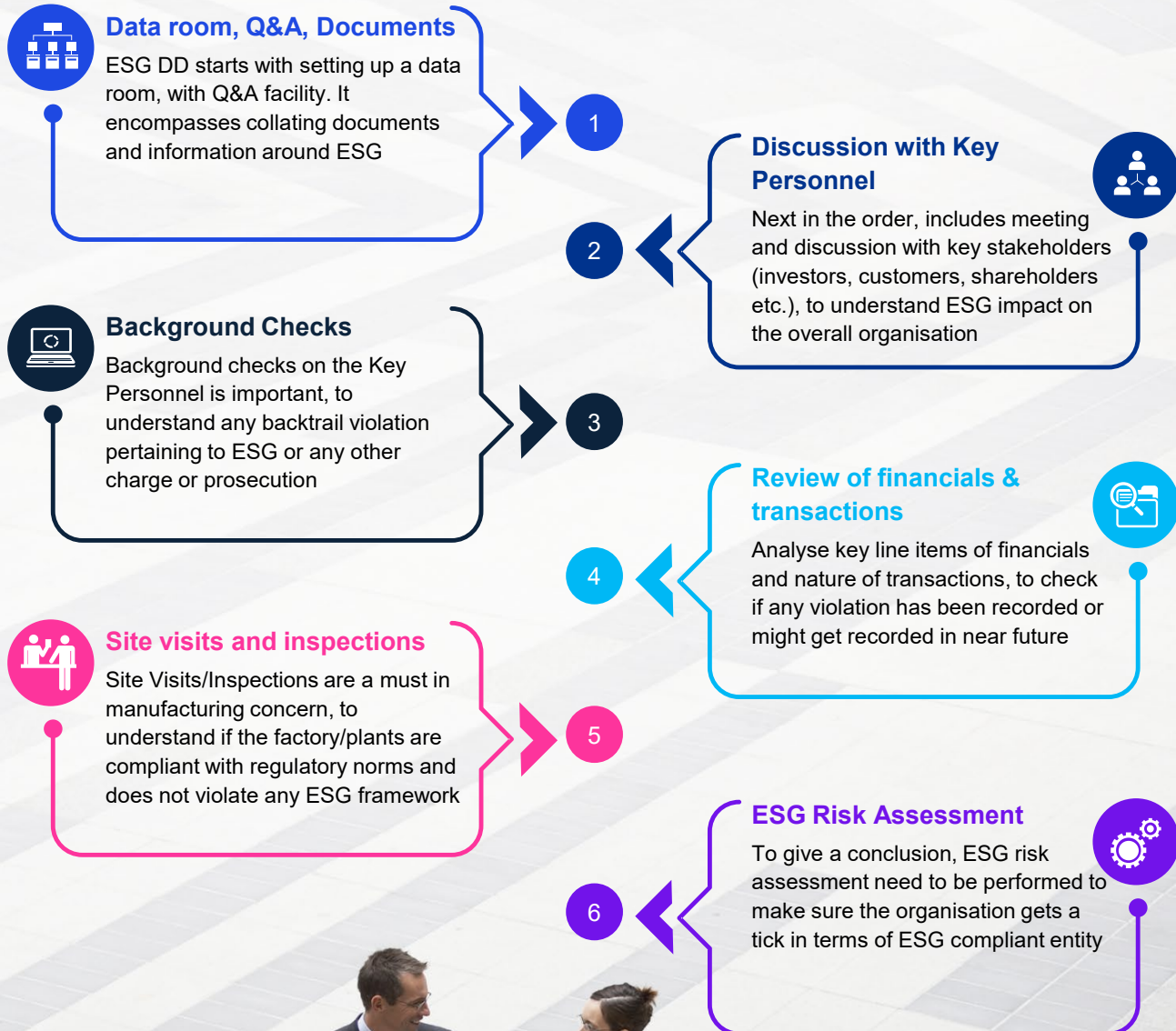
Incorporating ESG into the business culture provides a competitive edge over peers, resulting in market share enhancement, customer retention and loyalty, and increased investor interest. It also helps in building strong relationships among shareholders, customers, investors, lenders, and employees.



Sustainability Goals

Prioritizing ESG due diligence helps achieve the United Nations' Sustainable Development Goals (SDGs), which also offer the added benefit of gaining recognition and attracting new customers and investors.

What are the key steps?



Non-Exhaustive checklist



Environment

- Does the organization have an internal policy that captures key issues such as climate change, sustainability, waste management etc
- Writeup on the waste management process, detailing the steps taken to recycle/discard the waste produced during manufacturing process
- Is there any specific team that looks after Environment component of ESG? It is headed by whom? and who looks after routine aspects of the mentioned segment
- In case of manufacturing concern, are there checks and measure to track whether the raw material used are not detrimental to the environment
- Confirmation that the organization has received all the regulatory permits, licences and clearances in relation to environment segment
- Were there any regulatory breaches that have harmed the environment? If yes, then what were the mitigatory steps taken to curtail the same in future



Social

- Any survey conducted among employees regarding their satisfaction, complaints etc.? How frequently is the survey conducted
- What are the systems in place to secure data integrity? Were there any data breaches in the past? What were the steps taken to resolve the same
- Please confirm if the organisation adheres to the minimum wage and other regulatory requirements
- Does the organization have an internal health and safety policy and how often does it get renewed
- Has the gender and cultural equality maintained in the organisation.
- Does regular inspection take place regarding product quality and health. Any instances incurred regarding product deterioration



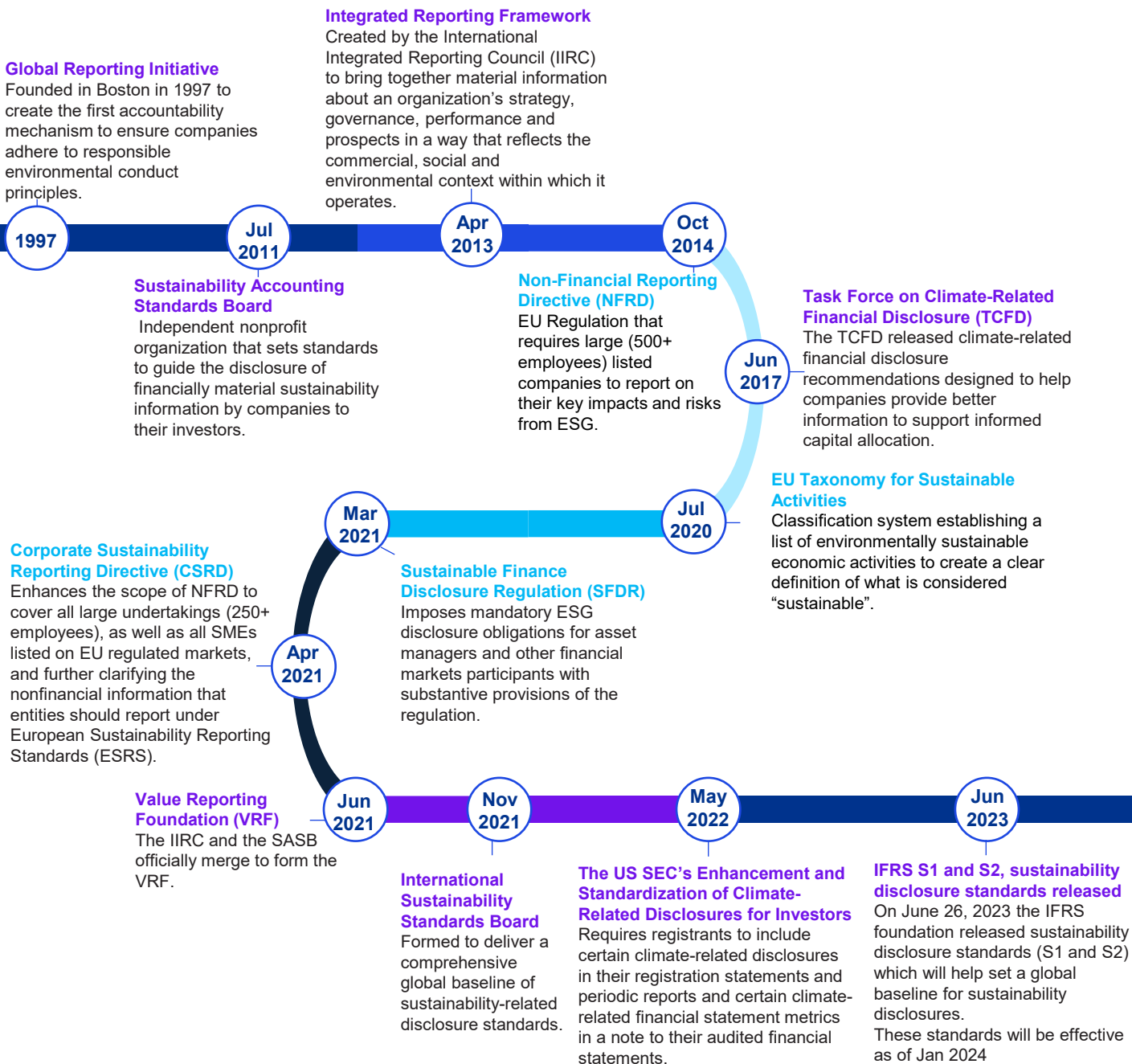
Governance

- What are the corporate governance policies in place? Were there any violations in implementing the same
- Has there been any corruption, bribery or any other fraudulent charge been imposed in the past or any ongoing litigation regarding the same
- What is the composition of board currently, are there any dedicated members from the board who looks after ESG matters
- Has any training session been conducted to educate the employees on corporate governance and anti-corruption/fraud policies

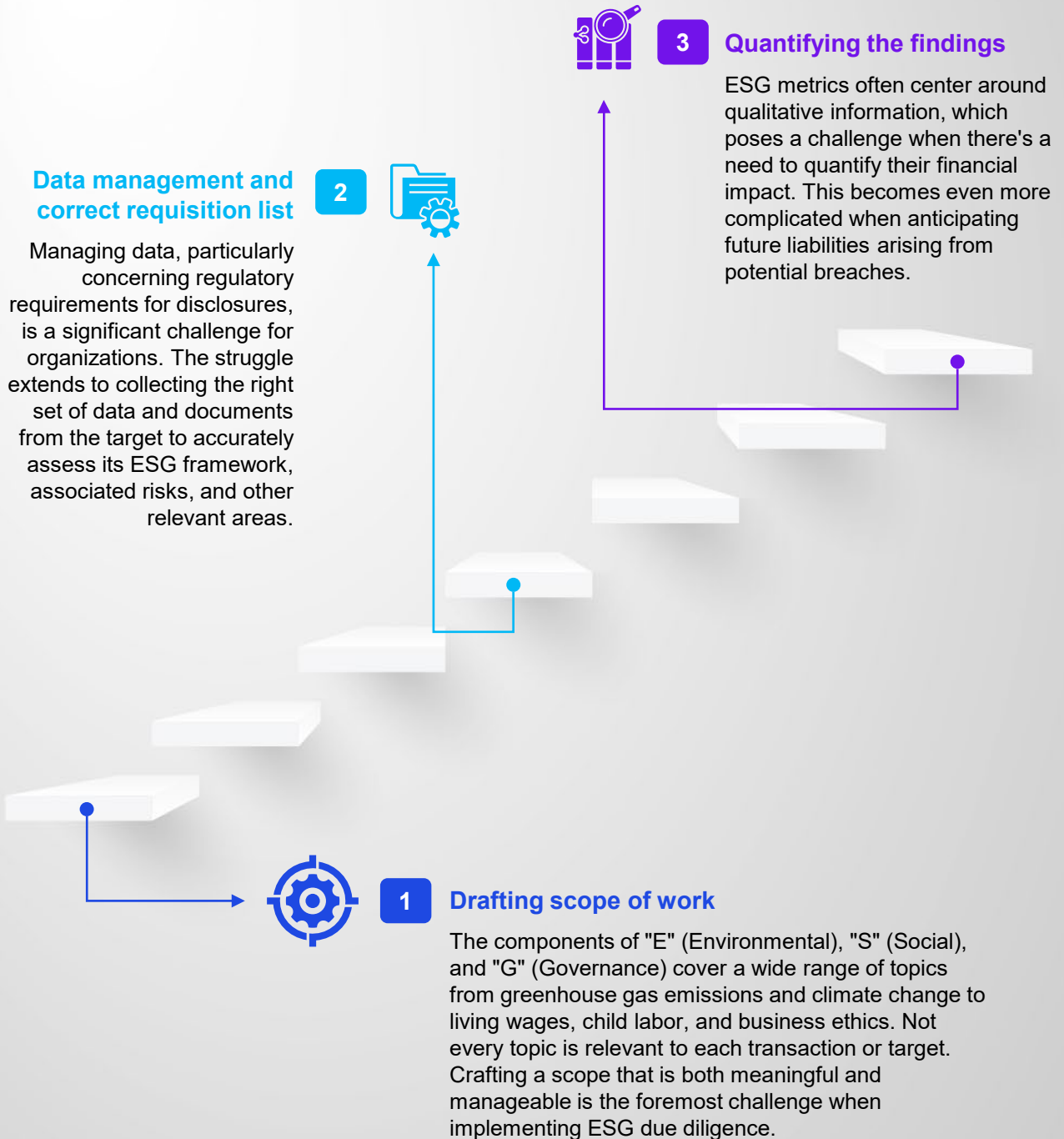
Regulatory developments are giving a big push to ESG DD

A variety of regulatory and nonregulatory bodies release guidance and standards on ESG reporting. These initiatives promote transparency and consistency in corporate disclosures. It aims to set up common frameworks and provide better information to assess the risks and opportunities related to ESG factors.

In the meantime, companies are adapting their disclosures and, in some instances, developing their own tools in order to meet the regulatory requirements and stakeholders' expectations. These disclosures help investors make informed decisions and encourage the incorporation of ESG factors in company valuations.



Challenges in implementing ESG DD



How KPMG can support – ESG Advisory

Developing responsible and sustainable strategies, business models, operations, and investments, KPMG ESG Advisory's solutions are both holistic and practical. They can guide you to drive sustainable innovation across your business and help in gaining a competitive edge.

By leveraging our industry-leading experience, data-driven technology, and global alliances, we can transform insights into actionable opportunities for your business, stakeholders, and the planet.

The ESG team comprises transformation, measurement, and reporting specialists. They can help you with:



**Assess and design
ESG strategy**



**ESG DD for
investments and M&A**



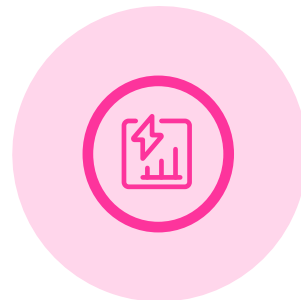
**Financial impact in
case of ESG breach**



**ESG Risk assessment
and its impact**



**ESG regulatory compliance
& disclosures**



**Measure progress and
tell your ESG story**

Our Due Diligence specialists can support you with the diligence of your company, your target, or your investments, through an ESG lens. Together we can help you solve complex due diligence problems to facilitate strategic decision-making. We will work closely with you, while remaining objective and independent in our approach.



Contact us

We hope that you find this thought leadership of interest and value. In case you wish to seek any further information or desire to evaluate the value of your business, please do not hesitate to contact the authors mentioned below.



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