Global ESG due diligence+ study 2024

Moving from risk to value creation

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Foreword

This is the first global KPMG study on ESG due diligence[1] in M&A transactions. It builds on our 2022 industry-leading international study on ESG due diligence in the Europe, Middle East and Africa (EMA) region that showed clear evidence of the rising importance of ESG due diligence in transactions, the practical challenges faced by deal practitioners, as well as first glances at "what good looks like."[2] In 2023, our follow-up study in the US found similar developments, albeit slightly less pronounced than in the EMA region.[3]

Since conducting the previous studies, the world has changed. In many geographies, M&A markets have decelerated in the face of higher interest rates. Geopolitical and economic uncertainty has increased, shifting the priorities of many businesses. And, in some geographies, there is a vivid public debate about the merits and justification of including ESG factors in investment decisions.

In light of these developments, this study aims to achieve two main goals. First, it establishes a global baseline and creates comparability between the different regions of the world. To this end, we surveyed more than 600 dealmakers and conducted 50 in-depth client interviews globally on the topic in a consistent manner. Second, it sets out to re-examine the relevance of ESG due diligence in transactions.

As you will see on the following pages, the results clearly confirm previous findings. Not only is ESG due diligence still important, but in fact, a clear majority of respondents indicates that ESG in transactions has increased in priority in the past 12 to 18 months, despite the current headwinds. The motivations to conduct ESG due diligence and the challenges faced by practitioners were also in line with previous studies. While there are some nuanced regional differences, the 'direction of travel' appears to be comparable across the regions.

To avoid repetition, this report will reference trends explained in the earlier studies to make room to discuss interesting differences between the regions and dive deeper on key topics at the 'frontier' of current practice.

Specifically, we look at how leading financial investors are applying a value creation lens to ESG by combining a deep understanding of the commercial, operational, and financial risks and opportunities triggered by evolving ESG regulations and stakeholder behaviors with a disciplined focus on financial returns. We also share insights on how some of the prevalent challenges in ESG due diligence are being mitigated by leading investors and advisors.

We thank the over 600 active dealmakers who have shared their insights with us for this study and we hope, that like our initial publications, it provides valuable ideas and inspiration for practitioners to further advance their approach for ESG due diligence in 2024.

Florian Bornhauser
Director
KPMG Switzerland

Julie Vasadi
Partner
KPMG Australia

[1] Throughout this publication, "ESG Due Diligence" refers to the process of considering environmental ("E"), social ("S") and governance ("G")-related factors in the context of the pre-signing due diligence in an M&A transaction (buy-side or sell-side)

[2] KPMG 2022 EMA ESG Due Diligence Study, published November 2022: https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2022/11/ema-esg-due-diligence-report.pdf

[3] For example, the study of the US market showed that 74 percent of US investors have ESG on their M&A agenda (vs. 82 percent of investors in EMA) or that 27 percent of US investors expect to conduct ESG due diligence on >80 percent of their transactions going forward (vs. 48 percent of EMA investors). See KPMG LLP 2023 US ESG Due Diligence Study, published July 2023: https://kpmg.com/us/en/articles/2023/esg-due-diligence/us-esg-due-diligence-study.html

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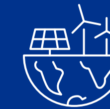
Global insights at a glance

ESG due diligence continues to rise in importance, despite headwinds. Dealmakers report an increased importance of ESG due diligence over the past 12 to 18 months, and expect further increases soon. This counters initial expectations of a decline in the importance of ESG factors due to softer M&A activity, economic uncertainty and an ESG backlash in some geographies.

Leading investors tie ESG to the investment thesis and drive financial value from it. They do this by combining a deep understanding of the commercial, operational, and financial risks and opportunities triggered by evolving ESG regulations and stakeholder expectations with a disciplined focus on financial returns during the holding period. They use tools like comprehensive baselining, integrated 100-day action plans, and a systemic scan for sources of financing to improve their investee's performance. Such performance improvements can materialize in the form of increasing revenues, decreasing costs, or de-risking of an investment, across various environmental and social and governance areas — at this moment, typically in connection with themes such as decarbonization, recycling and circularity and supply chain management.

Challenges in conducting ESG due diligence persist, but solutions are emerging. Investors struggle with selecting a meaningful, yet actionable scope with receiving quality data from target companies, and with quantifying potential findings. However, for each of these challenges, there are emerging solutions. On scoping, it is becoming increasingly clear which topics should indeed be part of an ESG due diligence workstream, with the focus moving from values to value. On data quality, we see a great opportunity for sellers and sell-side advisors to drive value from divestments by commissioning higher-quality ESG vendor documentation. And on quantification, the synergies between ESG due diligence teams and commercial and operational due diligence teams are becoming clearer.



ESG due diligence matters, but budgets don't match. Despite growing evidence of the importance and benefits of ESG due diligence, budgets remain low for ESG due diligence compared to other due diligence workstreams, such as financial, commercial or legal. This limits ESG specialists' ability to perform in-depth analysis across the many complex environmental, social and governance topics that investors seek.

KPMG professionals understand the challenges and complications of a client executing their ESG due diligence. They can identify and develop ESG-related deal strategies and processes that meet your unique needs and objectives. Read more on how KPMG can help.

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Contents

ESG due diligence continues to rise in importance, despite headwinds

- The importance of ESG considerations has increased further
- Investors expect to perform more ESG due diligence
- Belief in monetary value remains strong
- Stakeholder requirements, strategy updates, regulation and past learnings are driving adoption

Best practices from investors with mature ESG due diligence practices

- Financial investors (still) appear to be ahead on the maturity curve
- Financial investors are more likely to integrate ESG factors into their deal strategy
- Finding the link between ESG and financial value is key for the most mature investors
- A peek inside the ESG value creation playbook
- The big challenge for financial investors: The holding period
- Value over values

Challenges persist, but first solutions are emerging

- Prioritize material deal risk with impact on value
- Tapping into sell-side opportunities to drive divestment value
- Leverage synergies with commercial and operational due diligence teams
- Leverage leading advisors' expertise

If ESG due diligence matters, why don't budgets match?

- Those who perform ESG due diligence frequently find issues that can have a significant deal impact
- Yet, budgets for ESG due diligence remain low in comparison to other due diligence workstreams

How KPMG can help 43

Related publications 49

Contacts 51

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ESG due diligence continues to rise in importance, despite headwinds

Since our initial publication on ESG due diligence in 2022, the deal environment has changed significantly. Amid higher interest rates and economic uncertainty, global deal volumes reached a 10-year low in 2023.[4] Furthermore, there has been suggestion of an alleged 'ESG backlash' in investing in some geographies, centered around the question of whether incorporating environmental, social and governance-related considerations in investments has a potential negative impact on financial returns, along with the related political implications.[5]

Despite these developments, this study confirms the high and rapidly increasing importance of ESG in M&A transactions.

ESG in deal is rapidly maturing. The ESG lens is becoming increasingly important to investors and customers. The difficulty lies in the breadth of the topic, making it critical to know how to look at it in a focused manner. That's why we focus on value not values.”

Craig Mennie
Global Head of Transaction Services
KPMG Australia

[4] https://www.reuters.com/markets/deals/dealmakers-see-rebound-after-global-ma-volumes-hit-decade-low-2023-12-21/

[5] https://www.ft.com/content/a76c7feb-7fa5-43d6-8e20-b4e4967991e7

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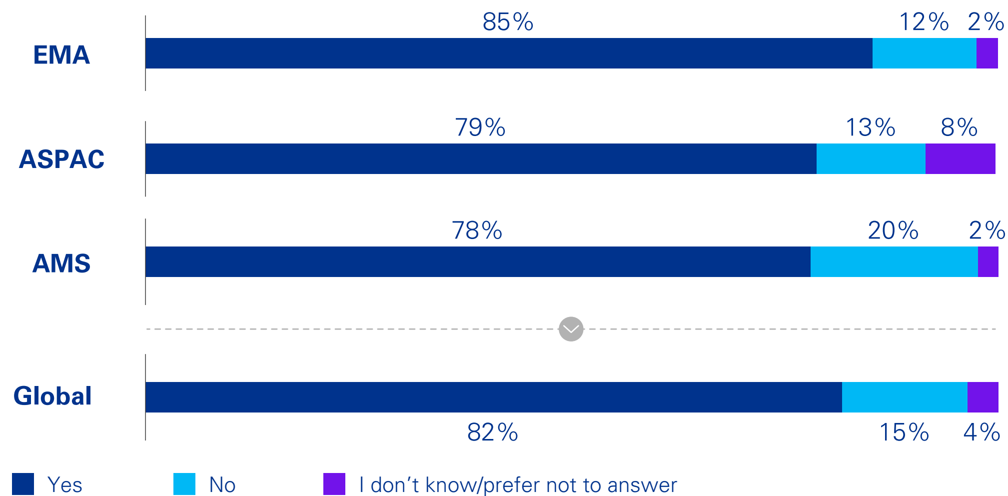
The importance of ESG considerations has increased further

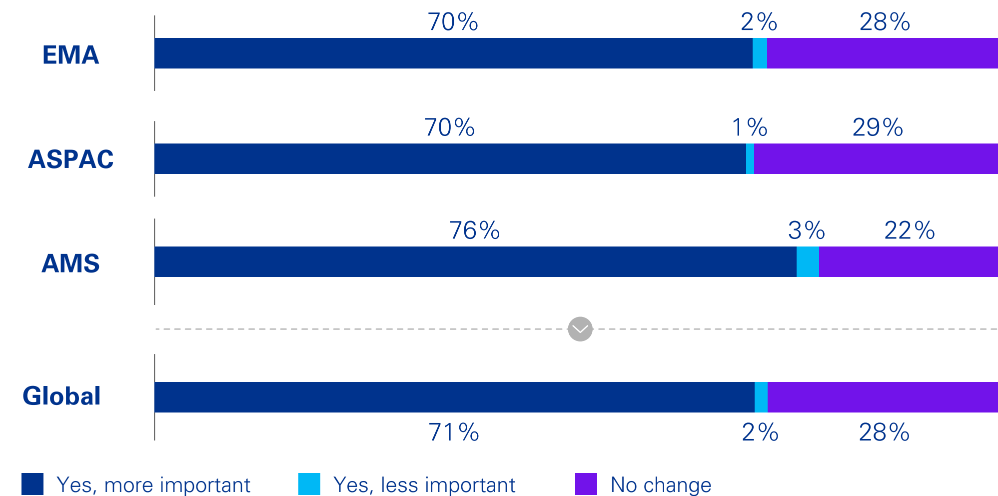
Similar to our initial 2022 study in the EMA region, four out of five dealmakers globally indicate that ESG considerations are on their M&A agenda, with little regional variation (see Figure 1). Even more explicitly, 71 percent of respondents report an increase in importance of ESG in transactions in the last 12 to 18 months (see Figure 2).

Figure 1. Are ESG considerations currently on your M&A agenda?



EMA = Europe, Middle East and Africa; ASPAC = Asia Pacific; AMS = Americas

Figure 2. Has the priority of ESG in transactions changed for you over the past 12 to 18 months?



Note: The statistics presented for the Americas are based on respondents in Canada, South America and the Caribbean Islands. See notes in the methodology section of this report.

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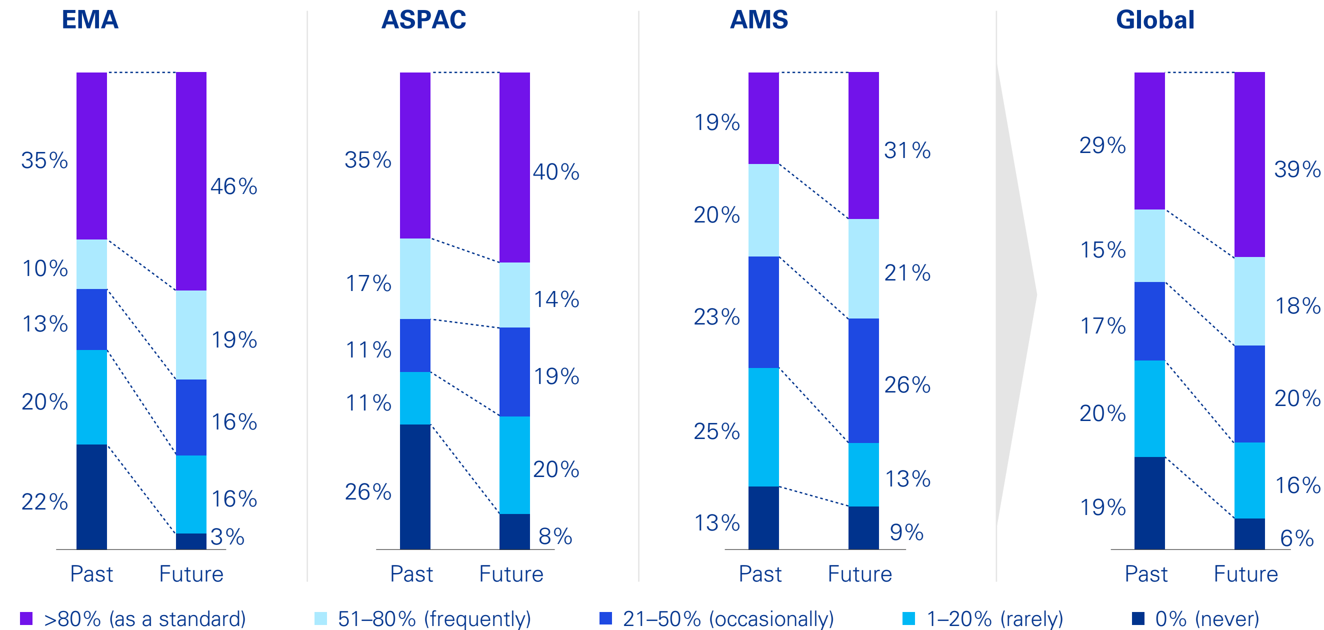
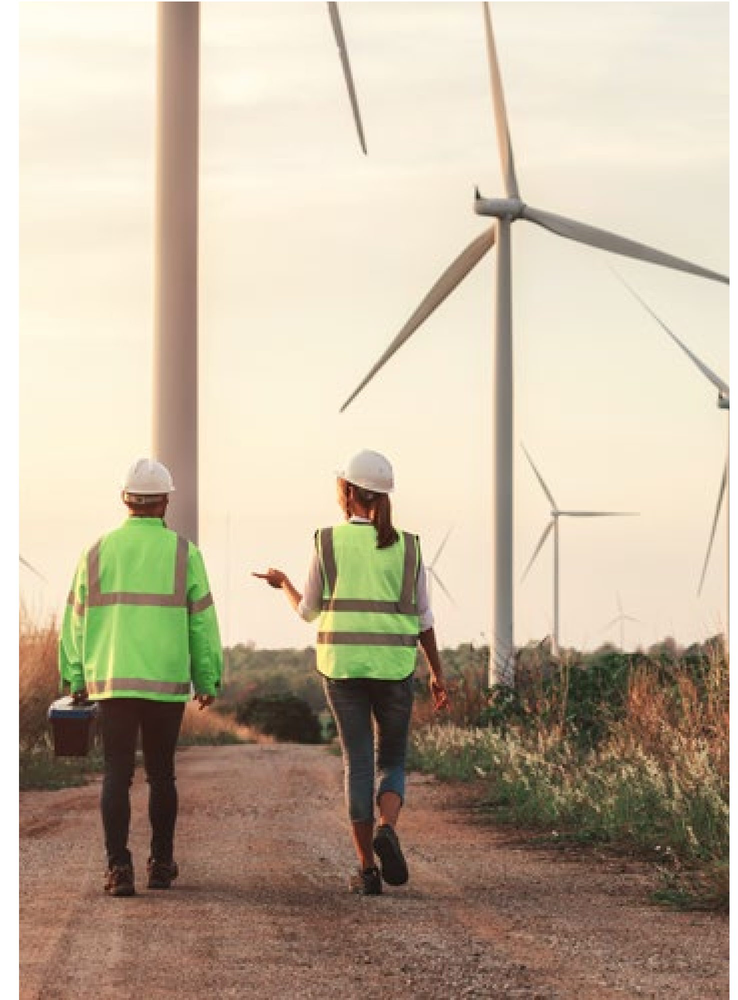
Investors expect to perform more ESG due diligence

What's more: The data clearly shows that investors expect the frequency of ESG due diligence on transactions to increase even further. Globally, 57 percent of respondents say they expect to perform ESG due diligence on most of their transactions over the next two years (up from 44 percent historically). On the opposite side of the scale, only 6 percent say they will continue not to conduct any ESG due diligence over the same time period (down from 19 percent historically) (see Figure 3).

Figure 3. Frequency of performing ESG due diligence on transactions (past 2 years vs. next 2 years)





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Belief in monetary value remains strong

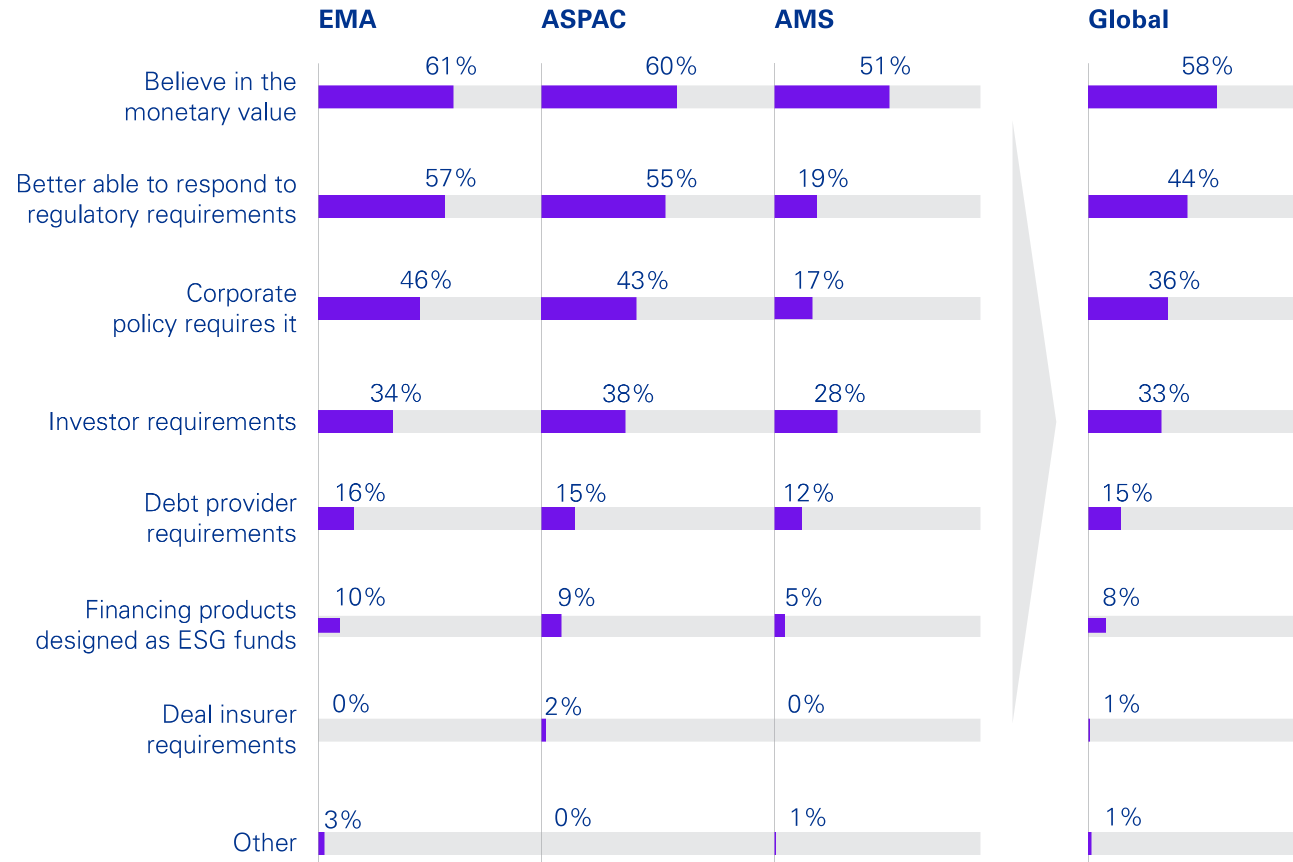
Dealmakers report conducting ESG due diligence primarily because they believe in the monetary value of identifying sustainability-related risks and opportunities early in the deal process. As one European investor shared: "It's important for us to understand the size of potential risks or opportunities at the pre-signing stage so that we can factor them into our valuation. Also, if we need to invest to bring a target up to speed, we need to know what this will cost us before we settle on a purchase price."

Investors are also motivated by the belief that ESG due diligence helps meet regulatory requirements, as noted by 44 percent of global respondents (see Figure 4). However, there are significant regional difference in this regard. EMA (57 percent) and Asia Pacific (ASPAC) (55 percent) rank regulation requirements much more prominently than in the Americas (AMS) region (19 percent).

Investors are also motivated by the belief that ESG due diligence increases monetary value, as noted by

58% of global respondents

Figure 4. Why have you conducted ESG due diligence on your past transactions or why do you plan to conduct ESG due diligence in the future (multiple choice)?



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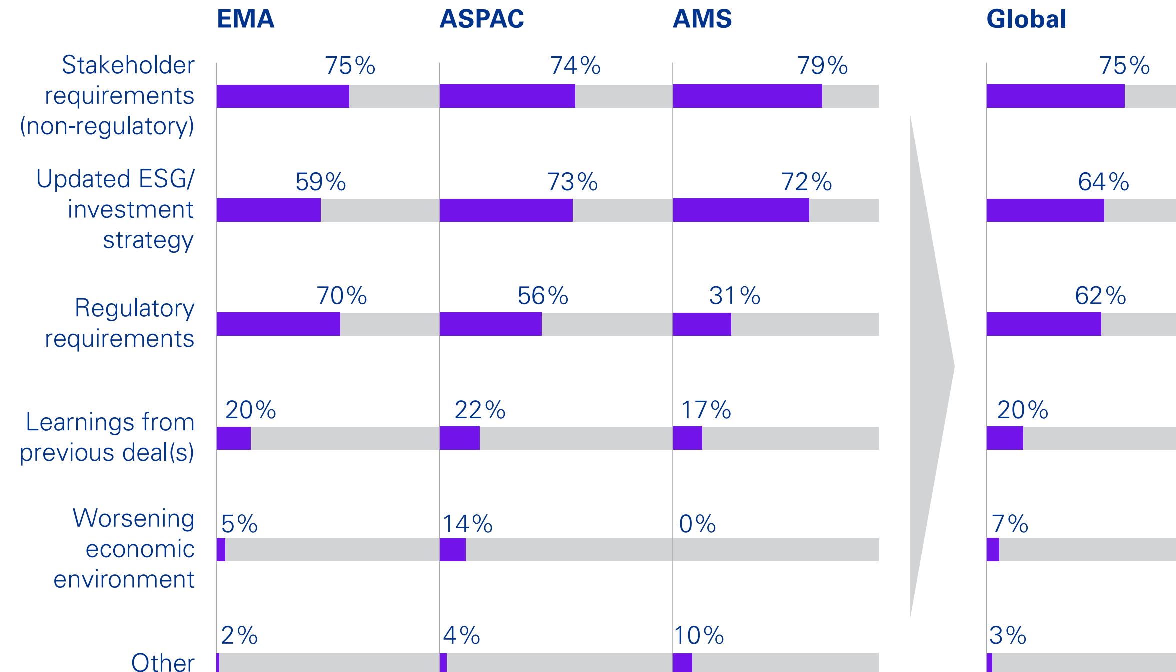
Similarly, there are regional differences in the factors driving the increased adoption of ESG due diligence in the last 12 to 18 months. In the EMA region, 70 percent of respondents say that regulatory requirements have made ESG due diligence more relevant, versus 31 percent in the Americas. ASPAC (56 percent) falls between the two regions (see Figure 5). According to a German financial investor: "In the EU, many new regulations have emerged that require transparency, comparability and reporting of ESG topics. They contain disclosure obligations, and they can have financial implications. This is a driving factor in the EU, specifically."

EU sustainability regulations may also be influencing investors in other regions of the world. Interviews with ASPAC investors found that investees in the region may soon be required to align with emerging European supply chain transparency laws, new carbon pricing rules (e.g., Carbon Border Adjustment Mechanisms (CBAM)) or general ESG data requests.[6] Whereas other investors are using EU regulations as the de facto gold standard in some areas (e.g., the SFDR for fund managers), and voluntarily aligning to them.

Stakeholder requirements, strategy updates, regulation and past learnings are driving adoption

Almost three in four respondents across the regions confirm they perceive ESG due diligence as more important because of changing stakeholder requirements. What this means, however, can vary from business to business. For example, for general partners of private equity funds, the requirements of their limited partners (LPs) play an important role.

Figure 5. Why did the importance of ESG in transactions change in the last 12 to 18 months (multiple choice)?



Note: The statistics presented for the Americas are based on North American respondents in Canada, South America and the Caribbean Islands. See notes in the methodology section of this report.

[6] CBAM is the EU's regulation to tax carbon-intensive goods upon import into the EU. See here: https://kpmg.com/xx/en/home/insights/2021/06/carbon-border-adjustment-mechanism-cbam.html

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As one participant in North America said: "Irrespective of whether you are skeptical about the value of ESG due diligence, if your LP thinks it is important, you will do it." It can also be hard to separate this effect from regulation. Take the example of a South American fund manager, who explained that their "investors are from Europe and North America. They want the fund to consider ESG more and more. So, we try to adapt our funds to the market-leading regulations and frameworks when they emerge to live up to these customer requirements."

Additionally, about two in three respondents indicate that ESG due diligence has become more relevant for them after a recent strategy update. One corporate investor from the Germany, Austria and Switzerland region, known as DACH, offered a good example: "We recently undertook an ESG strategy refresh and developed our first double-materiality assessment. This led to the recognition that greenhouse gas emissions are a much more material topic for us than we previously thought, which now has an impact on how we go about ESG due diligence in transactions. We will do more of it, and we will focus it more on climate than we used to."

KPMG practitioners working in this space see this story playing out for many corporate dealmakers at the moment, especially in regions where local disclosure regulations (e.g., the EU Corporate Sustainability Reporting Director (CSRD)) require much tighter materiality assessments.

Finally, about one in five dealmakers report that learnings from a recent deal experience led them to perceive ESG due diligence as more important. Consider the example of a corporate investor in the DACH region. The investor had committed to emission reduction targets based on the Science Based Targets initiative (SBTi), which are now in jeopardy of being met because they did not conduct proper due diligence on climate-related matters on a sizeable acquisition at the pre-signing stage. Upon integration of the target, the investor realized the carbon footprint of the acquired company was far greater than their own. Going forward, the investor plans to pay more attention to such matters at the pre-signing stage.

We recently undertook an ESG strategy refresh and developed our first double-materiality assessment. This led to the recognition that greenhouse gas emissions are a much more material topic for us than we previously thought, which now has an impact on how we go about ESG due diligence in transactions. We will do more of it, and we will focus it more on climate than we used to.”

Corporate investor
EMA region

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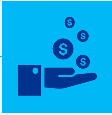

Best practices from investors with mature ESG due diligence practices

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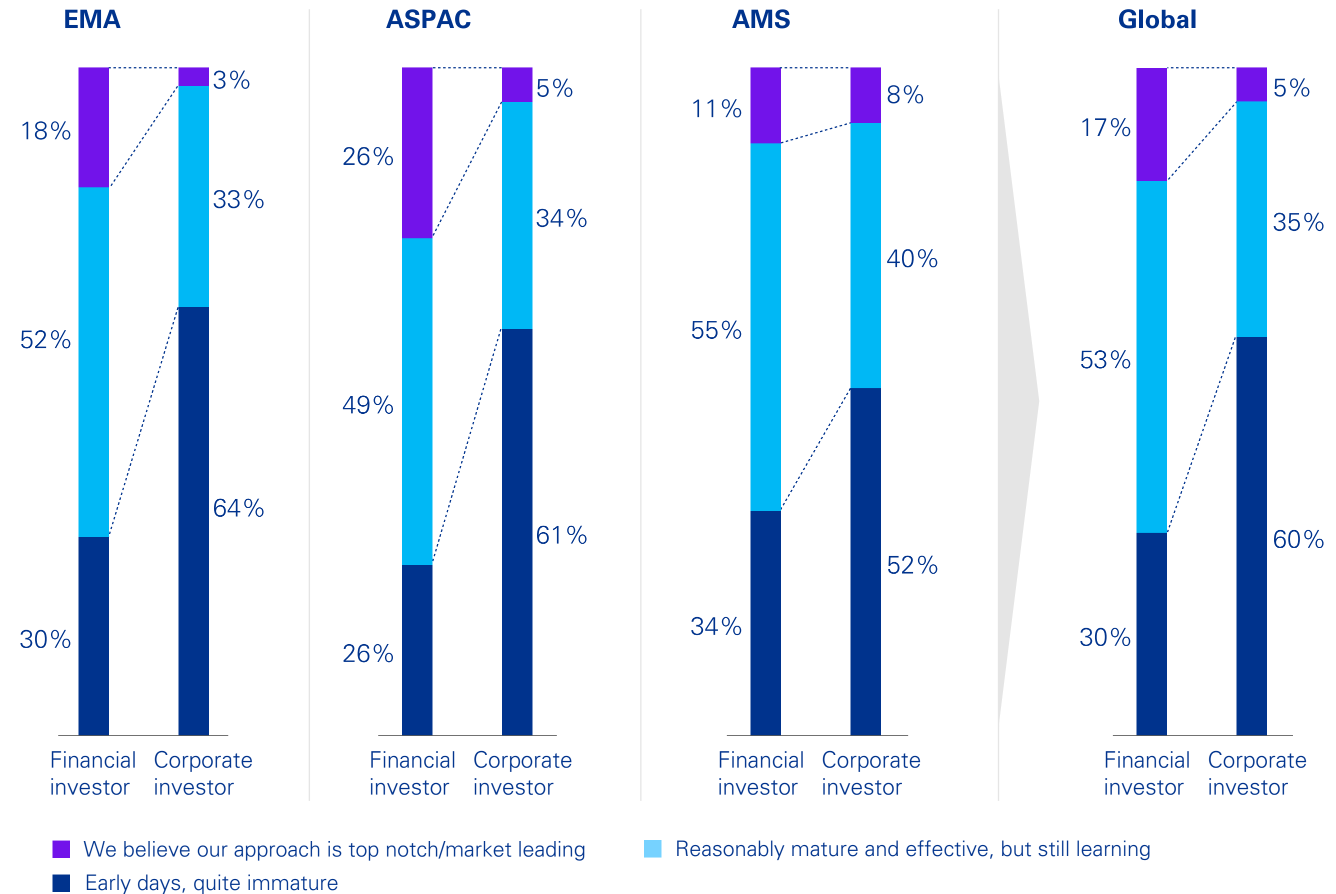
Financial investors (still) appear to be ahead on the maturity curve

Across all major regions, financial investors tend to be ahead on the ESG due diligence maturity curve, confirming earlier findings in the 2022 EMA study.[7] On average, financial investors self-assess their ESG due diligence approach as more mature than corporate investors (see Figure 6). They also report a stronger link between their ESG due diligence approach and their ESG strategy, a stronger focus on ESG value creation as opposed to pure risk mitigation, and a stronger link between pre-signing due diligence findings and post-closing action plans (see Figures 7-9). According to ESG due diligence practitioners at KPMG firms around the globe, these are the hallmarks of a leading approach in executing ESG due diligence.

> Leading investors report a stronger link between their ESG due diligence approach and their ESG strategy and post-closing actions and a stronger focus on value creation.

Figure 6. Overall, how mature would you describe your ESG due diligence approach?



[7] KPMG EMA ESG Due Diligence Study 2022

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Figure 7. How well-connected is your pre-signing ESG due diligence approach to your ESG strategy?

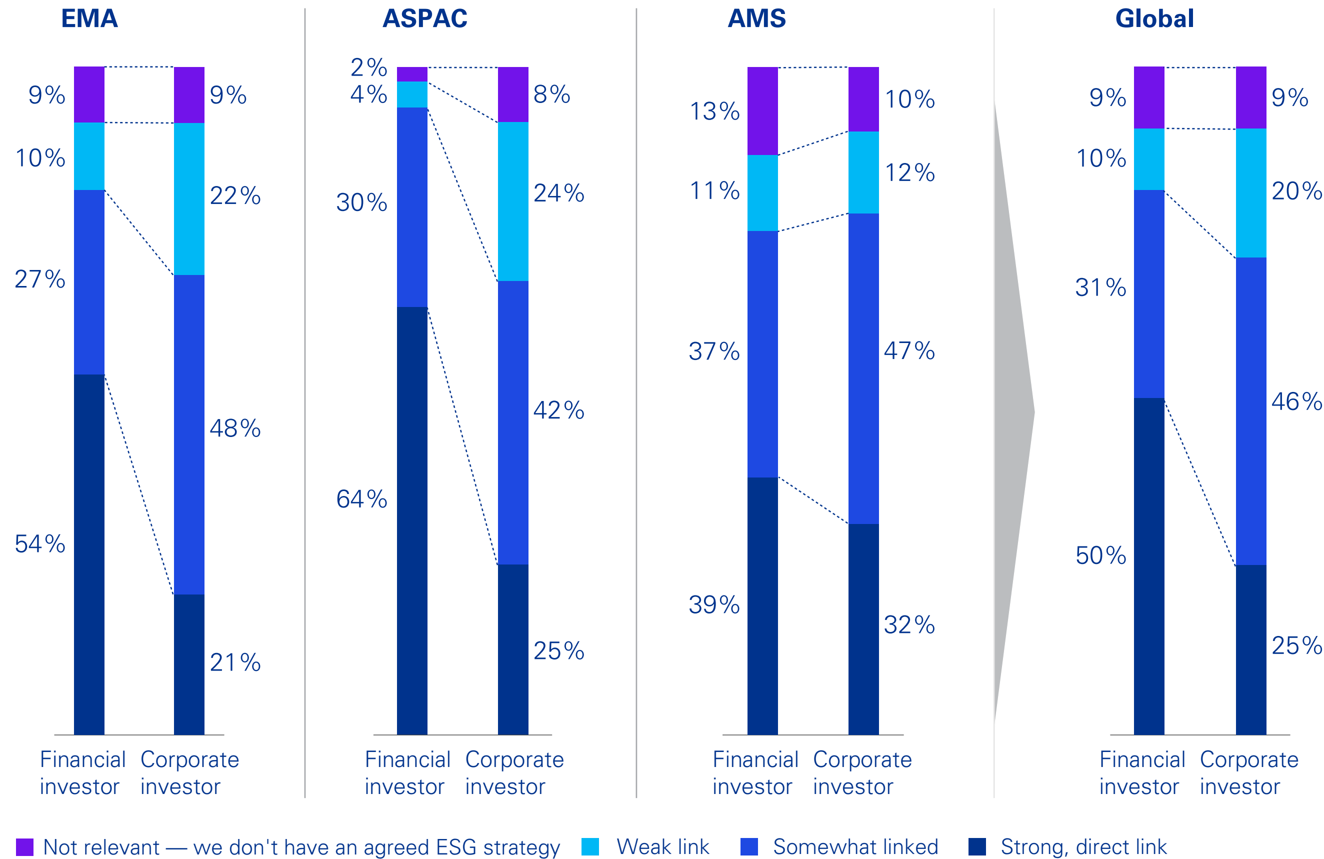

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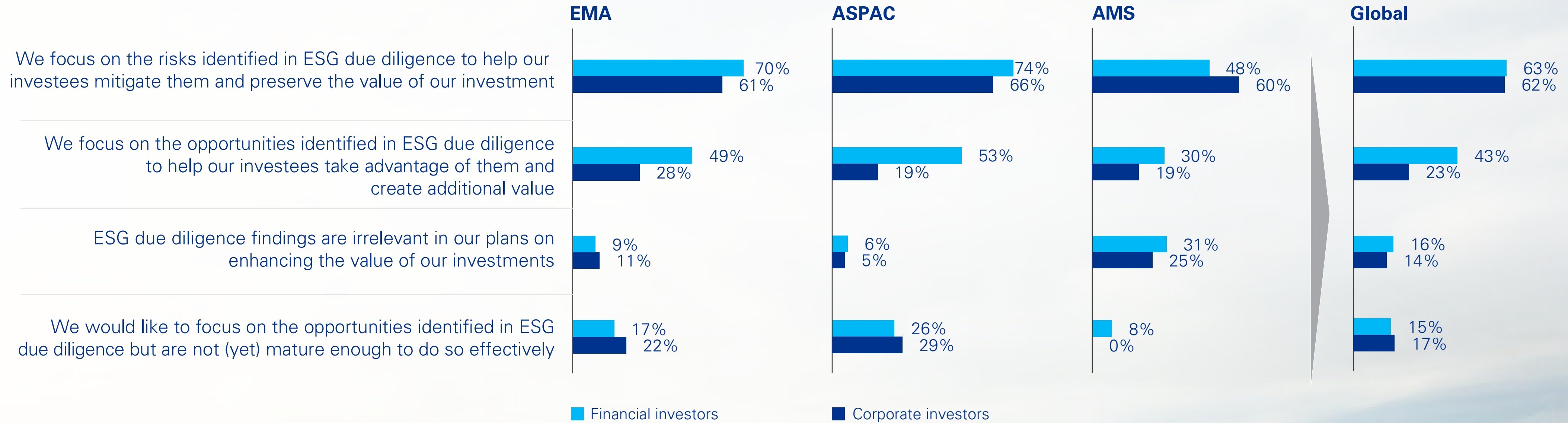
Figure 8. To what extent are the findings of ESG due diligence relevant in your value creation plans of your investments?



It is becoming increasingly clear that considering ESG on transactions primarily means understanding the commercial implications that could have a significant deal value impact. ”

Florian Bornhauser
Director, Deal Advisory,
Co-Head of Strategy Group in Switzerland
KPMG Switzerland

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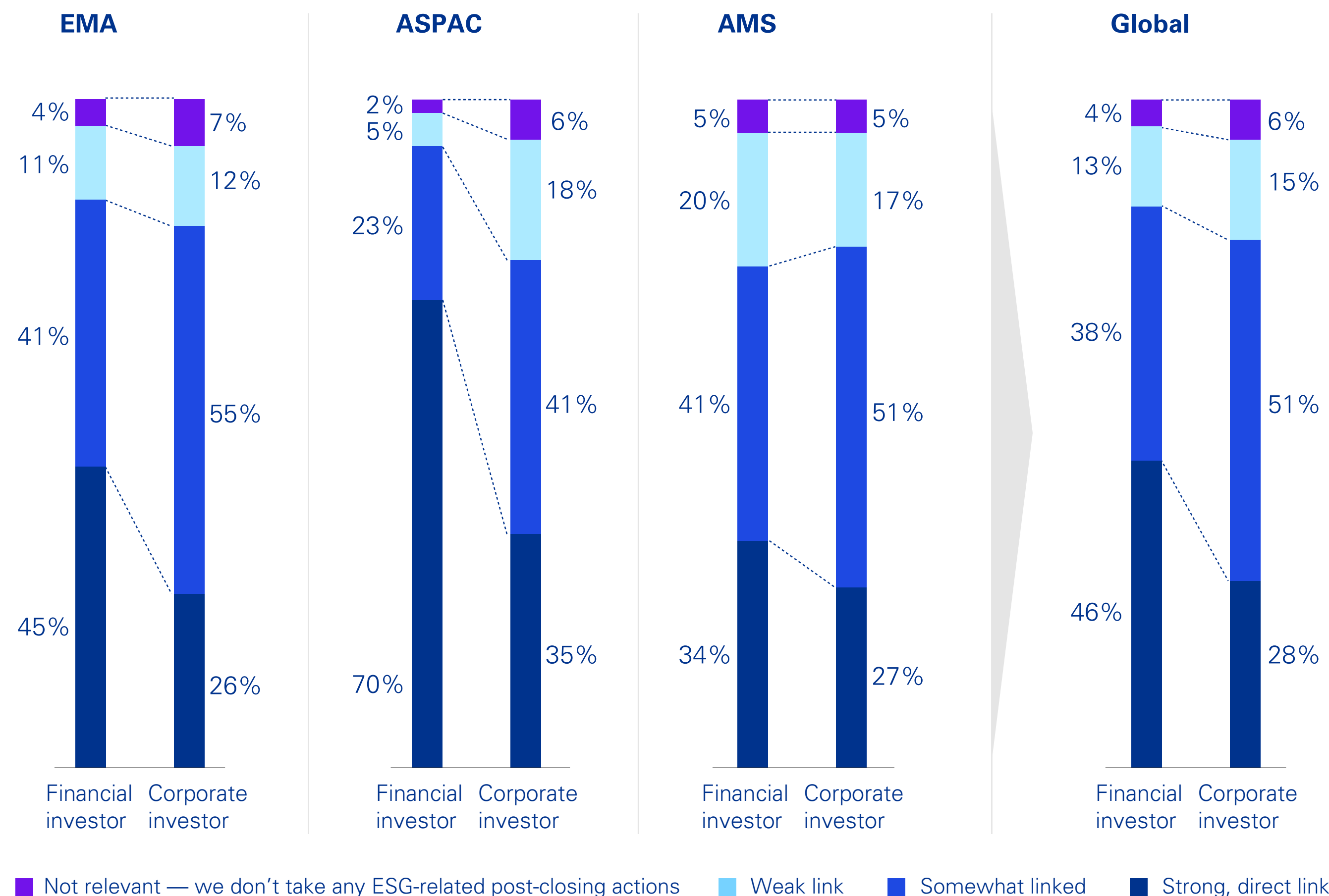
Figure 9. How well do you make use of findings of your ESG due diligence reports to establish a post-closing action plan?



Financial investors are more likely to integrate ESG factors into their deal strategy

Beyond ESG due diligence execution, there appear to be differences in how ESG factors impact deal strategy for corporate investors versus financial investors. Financial investors are almost twice as likely than corporate investors to proactively seek target companies that will benefit commercially from superior ESG positioning. This often means looking for target companies that are becoming more commercially attractive due to evolving regulatory factors or customer expectations. Review the example of a European private equity investor who systematically uses evolving ESG regulations in the following case study.

> Financial investors are almost twice as likely to proactively seek target companies that will benefit commercially from superior ESG positioning than corporate investors.

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Case in point

The ESG regulatory landscape is rapidly changing in many geographies. Some investors are using these regulatory shifts as an investment theme.

For example, a KPMG firm in Europe was called upon by a private equity investor to collect and analyze current and anticipated ESG regulations across various geographies.

This analysis identified specific geography-sector combinations where new regulations could alter competitive dynamics and winning business models. Within these target sectors, KPMG professionals helped the investor pinpoint potential target companies poised to benefit from these changes due to superior technology or business models.

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Similarly, financial investors are more likely than corporate investors to invest in companies that have the potential for an ESG transformation, even if these targets have been ESG underperformers so far. In the words of an Australian institutional investor: “Specifically in the mid-market, you can find many companies that lack a proper sustainability strategy or governance. But that means that there are opportunities to improve ESG performance, which we think reduces risk or improves performance.”

Conversely, corporate investors report being more likely to divest an asset due to sub-par ESG performance (24 percent of corporates vs. 11 percent of financial investors). Almost half of corporate investors report that ESG factors do not impact their deal strategy (47 percent of corporates vs. 23 percent of financial investors) (see Figure 10).

These findings suggest that financial investors are more deliberately integrating ESG into M&A decisions compared to corporates, on average.

Finding the link between ESG and financial value is key for the most mature investors

Financial investors are not all the same, especially when it comes to integrating ESG in dealmaking.

On one end of the spectrum, there are impact funds where the main goal is achieving positive ESG impacts through investments (as opposed to chasing maximum financial returns, although certain minimum return criteria typically must be met, too) — for example, by acquiring ‘brown’ assets and making them ‘greener’.

Figure 10. How do ESG considerations impact your deal strategy?

	Financial investor	Corporate investor
We have acquired/are looking to acquire targets that have potential for an “ESG transformation” (even in the face of low current ESG performance)	61%	28%
We have acquired/are looking to acquire targets due to their (superior) ESG performance or potential future return profile in connection with their ESG positioning	45%	24%
ESG factors do not impact my deal strategy	23%	47%
We have divested/we are considering divesting assets due to their (sub-par) ESG performance or expectation of future sub-par ESG positioning	11%	24%

Note: The statistics presented for the Americas are based on North American respondents in Canada, South America and the Caribbean Islands. See notes in the methodology section of this report.

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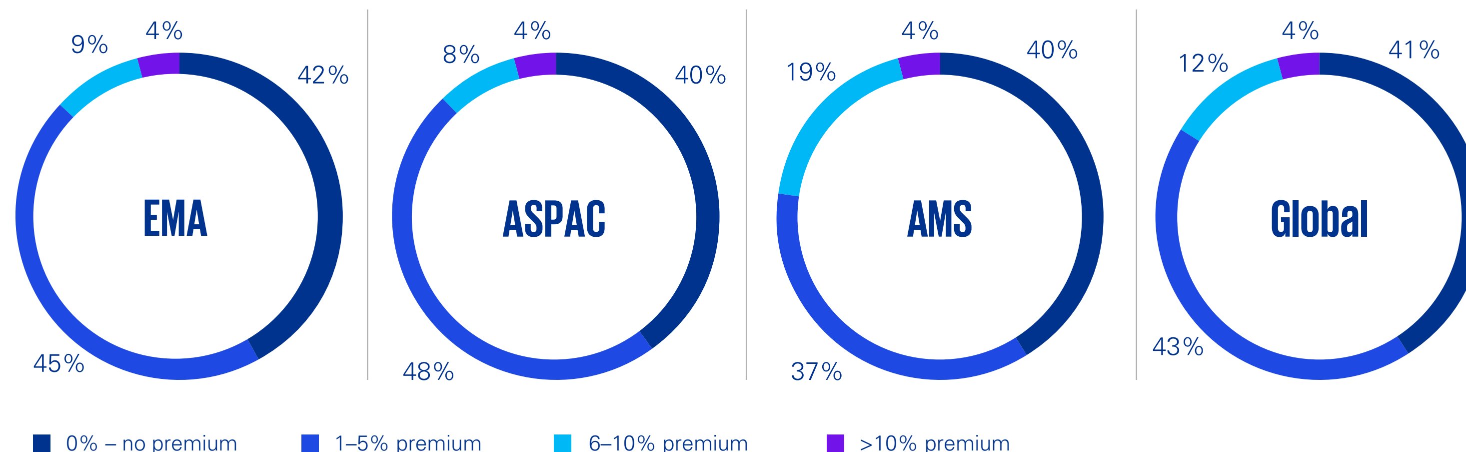
Then, there are funds that are primarily focused on maximizing risk-adjusted financial returns. In our experience, these funds are open to ESG-driven opportunities for financial gain, just like any other value driver. However, they do not invest in ESG performance unless the business case is proven. As one Nordic private equity investor told us: "We emphasize growth potential in general. ESG can be one angle or key driver of growth potential. In that case, we are interested."

For most investors, except the most ESG-focused or philanthropic, the value of ESG lies in finding areas where ESG improvements also promise adequate financial returns. In fact, finding such sources of ESG value creation is considered the holy grail that many sustainability practitioners and investors are trying to capture.

Although many studies report a positive correlation between ESG performance and financial performance, establishing a causal link remains difficult due to methodological challenges.[8,9] That said, around two-thirds of survey respondents are willing to pay a premium for assets with high ESG maturity, with minimal variation across the regions (see Figure 11). This suggests that a majority of investors believe in the financial value of positive ESG performance.

Figure 11. As a buyer, how much would you be willing to pay more for a target that demonstrates a high level of ESG maturity in line with your ESG priorities?

All respondent groups, by geography



Considering ESG in investment decisions has become non-negotiable for many investors. The extent and depth to which ESG-related risks and opportunities are being considered has increased significantly over the past 12 months, and leading investors are driving value from it. ”

Julie Vasadi
Head of ESG Due Diligence, Transaction Services
KPMG Australia

59% of global respondents are willing to pay a premium for a target that demonstrated a high level of ESG maturity in line with their ESG priorities.

[8] Whelan, Atz, van Holt and Clark (2021), "ESG and Financial Performance: Uncovering the relationship by aggregating evidence from 1,000 plus studies published between 2015-2020"

[9] E.g. due to different measurement methodologies for ESG performance, low data quality, the difficulty of aggregating very different environmental, social and governance topics into "ESG", etc.

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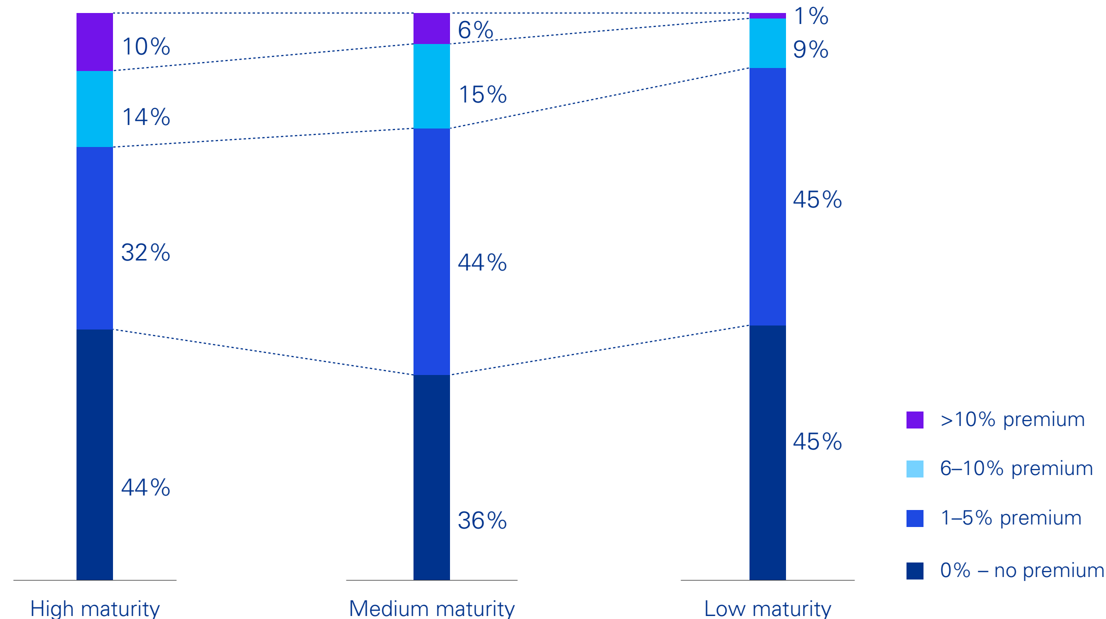
Interestingly, more mature investors show a higher willingness to pay a premium. Specifically, the share of investors who are willing to pay a premium over 5 percent was more than twice as high among those who self-reported having a medium or high degree of maturity compared to beginners on the topic (see Figure 12).

Figure 12. As a buyer, how much would you be willing to pay more for a target that demonstrates a high level of ESG maturity in line with your ESG priorities?

All respondent groups, by self-reported ESG maturity



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In the view of the authors, this suggests that, despite the challenge in proving a causal link between financial and ESG performance, there may indeed be specific, ESG-related value levers that the more mature investors may be better able to unlock. In the following subchapter, we aim to reveal their methods.

A peek inside the ESG value creation playbook

To identify the most promising ESG value creation levers, we interviewed 50 investors, including some of the world's most advanced practitioners, from all major geographies.

These interviews revealed that many investors still see ESG as a broad, fast-evolving field without a single authoritative handbook. As a German investor put it: "It is not possible to say in general terms how value can be created through ESG. In our experience, this is very sector and company specific."

However, we regularly see certain approaches come up in many advanced investors' ESG value creation strategies. There are process-related best practices — such as linking ESG to the investment thesis, conducting comprehensive ESG performance baselining, embedding post-closing actions into post-closing transformation plans, and leveraging financing expertise. There are also three overarching ESG value lever categories: those that increase revenue, decrease costs or de-risk an investment. Such levers are usually unlocked in themes around environmental issues like decarbonization, recycling and circularity, and social themes such as employee engagement, conflict minerals or labor standards.

Here we discuss the four most prominent tools and the three value levers we encountered, with specific examples of their practical application across different ESG areas. A key theme is decarbonization, which many interviewees find more tangible than other ESG topics. Estimating emissions, especially for Scope 1 and 2, is relatively straightforward, and there are international agreements (e.g. The Paris Agreement), policy commitments and standards (e.g. SBTi-based targets) to help guide progress and enable accurate cost-benefit quantification.

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Tool
#1

Explicit link to investment thesis

Mature investors willing to pay a premium for assets with a high ESG maturity don't see ESG as a mere 'hygiene item.' Instead, they actively seek potential links to their overall investment thesis.

For example, some investors recognize large commercial opportunities in the global energy transition. Target companies that produce cleaner energy or more energy-efficient processes are attractive because the energy transition drives demand for their products and services. This trend is often accelerated by major subsidy programs like the US Inflation Reduction Act (IRA) or the EU Green Deal.

These considerations are primarily commercial, driven by policy changes or shifts in customer demands, rather than a desire to create positive ESG impact. As one private equity investor in Southeast Asia noted: "We are seeing strategic opportunities linked to the green transformation. The types of deals we do are increasingly addressing that need because — to be a bit cynical about it — that is where the money is going."

To illustrate, a North American investor involved in constructing a new gas pipeline based their investment on the expectation that natural gas demand would grow over the coming decade as it serves a transition away from coal and oil. Yet, this investment can raise ESG concerns of its own, such as the contribution of natural gas to global warming, potential leaks during operation, and disturbances of natural habitat during construction. This example underscores that the link to the investment thesis is often a commercial consideration that requires an understanding of regulation shifts and stakeholder demands triggered by ESG factors.

Consequently, some mature investors see increasing synergies between commercial due diligence and ESG due diligence. They seek deal teams knowledgeable in various ESG subjects (e.g. policy changes, stakeholder behavior) who can integrate this knowledge with commercial thinking and tie it into the deal rationale.

As a global private equity investor stated: "ESG can really drive value when it links to the investment thesis. For example, if you invest in e-mobility in a geography that has a zero-emission transport target and a decarbonized grid, it's easy to link it to the investment thesis. Conversely, we've seen other investors that may not know how to spot these angles and tie it to the investment thesis. In that case, it doesn't add value, but primarily causes noise."

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Tool #2

Comprehensive baselining

Mature investors also recognize the importance of comprehensive baselining. During the pre-signing stage of a deal, they perform thorough ESG due diligence to gain transparency on a target company's true ESG performance.

A financial investor from the DACH region shared: "There can be many potential ESG transformation paths, depending on the company. We systematize the identification of what is possible by making ESG part of every due diligence. We look for company-specific risks and opportunities, which might include commercial and operational opportunities. Then, we try to execute them during the holding period." Another investor agreed: "If we didn't look at ESG, we would lose a lot of potential value, and we'd be more vulnerable to risks. It is important to uncover where and what the risks are, so that we can take targeted action."

Figure 13 shows that this is a common pattern among mature investors: 75 percent of those with high ESG maturity conduct ESG due diligence as a standard pre-signing practice, compared to only 6 percent of those with low ESG maturity.

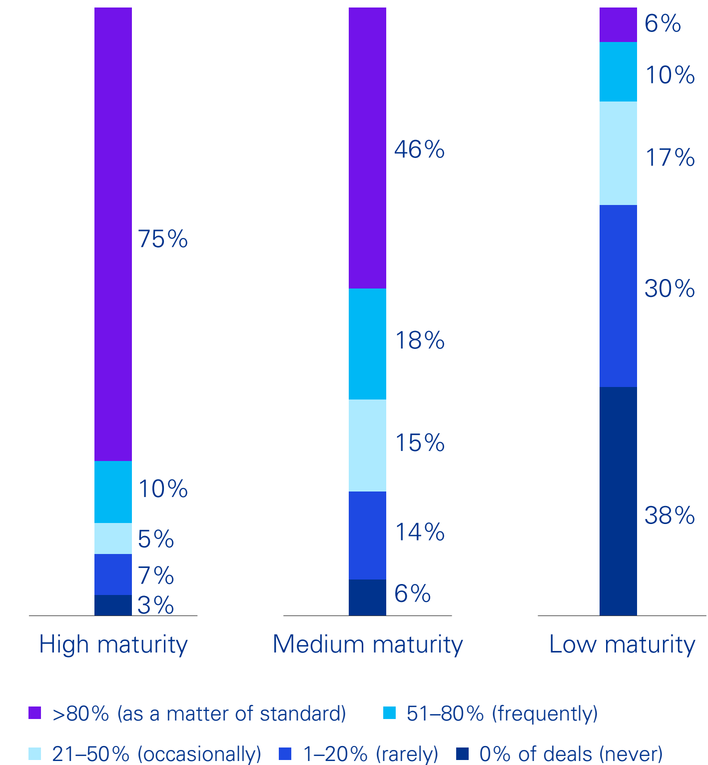
Baselining usually starts during due diligence but isn't always completed pre-closing. Often, due diligence reveals that a target lacks a dependable quantitative baseline for its ESG performance. As a German corporate investor noted: "With ESG data, we are going through a process that took society several decades for financial data. Nowadays, we all have the same understanding of EBITDA and CAPEX, but this took time." No surprise that ESG data is not as mature yet in many companies.

Creating a solid baseline often features high on the post-closing action plan for investors aiming to improve ESG performance. "Even post-signing, we work hard to set a dependable baseline," said one investor focused on ESG transformation during the hold period. This strongly aligns with KPMG practitioners' experience, who generally find that a more comprehensive baseline improves the ability to establish clearer causal links between ESG performance and value creation.

> With ESG data, we are going through a process that took society several decades for financial data. Nowadays, we all have the same understanding of EBITDA and CAPEX, but this took time. ”
>
> **Corporate investor**
> EMA region

Figure 13. Historically (in the past 2 years), for what share of deals did you involve an ESG due diligence?

All respondent groups, global, by self-reported ESG maturity



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Tool #3 Integrating post-closing actions in transformation plans

After identifying ESG risks and opportunities during the pre-signing stage, the next step is to execute improvements post-closing. Our survey data shows that investors with high ESG maturity are much more likely to link their post-closing action plan directly to pre-signing ESG due diligence findings (see Figure 14).

Several of the leading investors we spoke to often use 100-day plans to drive ESG improvements, with priorities drafted before closing based on the pre-signing ESG due diligence. An ESG-experienced private equity investor in the Nordics stated: "We've been most successful in ESG value creation when clear 100-day plans are embedded in the overall transformation agenda for the business."

While such 100-day plans are frequently drafted before closing, some investors emphasize aligning them with the target's management post-closing to obtain buy-in. Integrating ESG transformation into the overall business strategy and transformation agenda is crucial. "We don't want the sustainability strategy to be standalone. It will not have much impact, unless you make it part of the overall business strategy," said a financial sponsor who regularly addresses ESG value creation opportunities in their portfolio companies.

Tool #4 Leveraging financing expertise

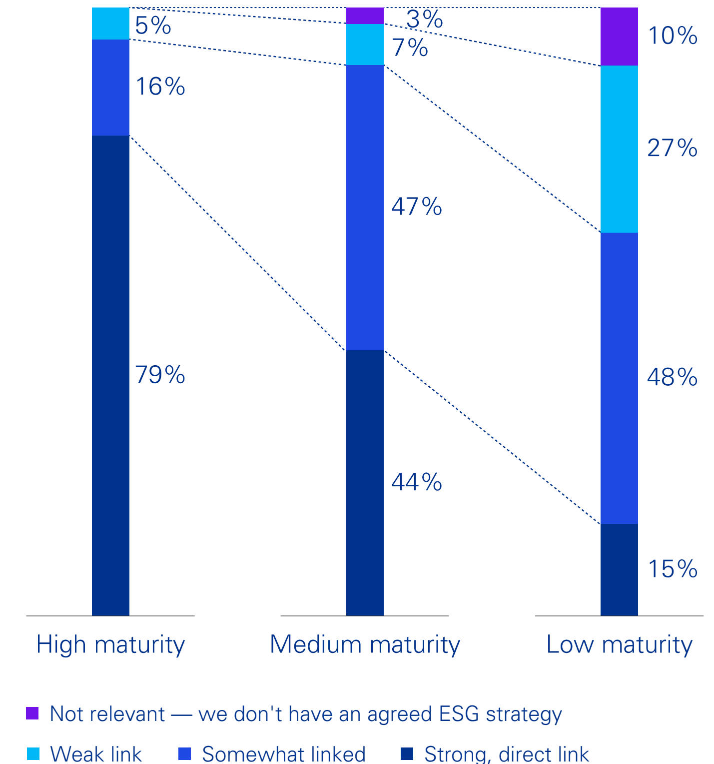
Some financial investors leverage their financing capabilities to drive ESG transformation. A European private equity practitioner noted: "Efforts like decarbonization require big investments. We think a financial sponsor can add value, if a target company couldn't make such investments without us, assuming there is a monetization angle, of course."

In addition to supporting capital expenditures (CAPEX) investments, some financial owners systematically leverage government incentive programs for ESG value creation. For example, programs like the EU Green Deal and the US Inflation Reduction Act (IRA) offer tax incentives and grants for companies that contribute to some desired economic policy goal, often in energy transition and decarbonization.[10,11]

Some KPMG practitioners help leading investors by collating and analyzing available funding mechanisms across different geographies, sectors and government levels (see page 16). When portfolio companies may lack the resources for such analysis, investors typically make such information available and encourage them to pursue the funding mechanisms faster than their competitors.

Figure 14. How well do you make use of findings of your ESG due diligence reports to establish a post-closing action plan?

Global, all respondent categories, by self-reported ESG maturity



[10] https://kpmg.com/ie/en/home/insights/2023/05/plugged-in-cge-eut/inflation-reduction-act-changes-the-game-for-energy-transformation-cge-eut.html

[11] https://kpmg.com/xx/en/home/insights/2021/08/delivering-the-european-green-deal-and-fit-for-55-package.html

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Value lever #1: De-risking an investment

Financial value can be created by increasing revenues, decreasing costs or de-risking investments. According to many interviewees for this study, the "de-risking" aspect through ESG management is an important part of the ESG value creation playbook of most advanced investors.

This strategy is frequently pursued in areas such as climate risks (e.g. both physical and transition), regulatory risks of fines triggered by breaches of environmental or social laws, or reputational risks from issues like human rights violations in the supply chain, or diversity, equity and inclusion.

Among these risk categories, climate-related risks were mentioned most frequently by the interviewees. De-risking from a climate perspective involves two main approaches: physical risk and transition risk. Reducing physical risks means minimizing exposure and increasing resilience to extreme weather events. This can help lower expected losses from asset write-downs and business interruptions. Addressing transition risks can involve aggressively investing in decarbonization. For example, a 1.5°C climate scenario would require widespread adoption of carbon taxes, including significantly higher prices per ton of CO_2 emitted. As a Nordic private equity investor shared: "We think that an increase in carbon pricing will hit high-emitting sectors significantly unless a good decarb plan is in place."

In other words, decarbonization is viewed as a risk management measure that will enhance competitiveness as carbon emissions are internalized. Even without higher carbon pricing, decarbonization could remain vital as high emitters confront increased scrutiny and potential loss of their license to operate in the face of rising public awareness of climate change.

From a valuation perspective, reducing the exposure to or the resilience against risks in areas like the above can either be reflected by a lower discount rate (via a decreased Beta factor) or higher valuation multiples, indicating a lower-risk investment. However, according to KPMG valuation professionals adjusting the Beta factor or multiple is still debated due to the lack of robust market data on ESG impact. A more transparent approach involves probability-weighted cash flow scenarios.[12]

When it comes to the value lever of de-risking an investment during the due diligence phase, the focus is on identifying these risks and determining if they warrant a purchase price reduction, contractual protection or to abort the deal. During the holding period, the focus shifts to reducing exposures to these risks through adaptation measures (e.g. making properties resilient to extreme weather), and mitigating actions (e.g. implementing a decarbonization roadmap, developing better internal controls, improving supplier audits, or investing in employee engagement).

Among these risk categories, climate-related risks were mentioned most frequently by the interviewees. De-risking from a climate perspective involves two main approaches: physical risk and transition risk. Reducing physical risks means minimizing exposure and increasing resilience to extreme weather events. This can help lower expected losses from asset write-downs and business interruptions.

[12] https://kpmg.com/ch/en/home/services/advisory/deal-advisory/valuation.html (e.g. Q1/2021)

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Value lever #2: Increasing revenue

Beyond de-risking operations, some investors are looking to sustainability-related themes to drive revenue growth, for example by developing products with lower carbon footprints.

A financial investor from the DACH region explained, that emerging customer demand drives this opportunity in some sectors: "An increasingly important area where we see value is decarbonization. In our portfolio companies, we see that more and more customers are asking for it. It is also starting to be required in public tenders. So, we look at how CO_2 can be reduced, what the reductions cost, and what financial benefits they can bring."

Similarly, a private equity investor in the ASPAC region invested in detailed lifecycle assessments (LCAs) of one of its portfolio companies' products, and in reducing their environmental footprint during the holding period. This strategy aims to enhance the products' competitiveness in a market where customers increasingly value sustainability.

In other words, some investors see sustainability-related performance improvements as a growth driver and a way to differentiate from the competition.

Value lever #3: Decreasing costs

Similarly, some investors pursue cost reduction opportunities through active management of ESG-related topics. Decarbonization was once again a common theme, offering multiple cost reductions avenues. For example, reducing energy consumption directly cuts energy costs. Similarly, certain ways of decarbonizing (e.g. own on-site renewable generation and long-term power purchasing agreements with renewable producers) may reduce exposure to peak electricity prices during fluctuations in the spot market, also resulting in expected savings on energy costs. In geographies with carbon taxes, reducing emissions can help save costs on purchasing carbon certificates, provided the marginal abatement cost is lower than the current market price for emission rights.[13] And finally, credible decarbonization efforts can also be rewarded by lenders in the form of lower borrowing costs through green bonds or sustainability-linked loans.

Looking beyond decarbonization, some investors are looking at cost reductions through waste reduction and circularity. Of course, the minimization of waste has always been a hallmark of operational excellence, especially in manufacturing. Designing products with fewer materials or reducing scrap rates during production have long been financially beneficial, irrespective of any ESG considerations. However, the financial value of reducing material usage of certain materials is increasing due to changing ESG regulations at various levels. For example, consider the adoption of plastic taxes or the carbon border tax in Europe, both of which are aimed at internalizing the environmental costs of the use of certain materials.[14,15] These developments create additional value creation opportunities, as companies that excel at reducing material usage and waste will gain competitiveness and stand to benefit financially.

Furthermore, some regulations under discussion could boost the financial viability of circular business and operating models.[16] Traditionally, circular business models have struggled to be successful at scale, as evidenced by the share of secondary materials consumed by the global economy standing at only 7 percent (and falling).[17] However, regulatory efforts, such as the EU's 'right to repair' rules for consumer products, or local, sector-specific laws that mandate the re-use and recycling of materials, like in France's construction sector, could drive the adoption of circular models.[18,19]

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13 This is a point that may also be considered as a 'de-risking' value lever rather than a direct cost saving, specifically in cases where the decarbonization effect of an investment today will only materialize many years into the future, in which case there can be significant uncertainty around the scope of carbon taxation and pricing of emission certificates. In such scenarios, the relevant comparison metric for the margin abatement cost becomes the expected future cost of emissions.

14 https://kpmg.com/xx/en/home/insights/2021/09/plastic-tax.html

15 https://kpmg.com/xx/en/home/insights/2021/06/carbon-border-adjustment-mechanism-cbam.html

16 This could have an effect on both revenue and costs, depending on the detailed design of the respective circular business and operating models. For readability purposes, the opportunity is only described once in the text above.

17 https://www.circularity-gap.world/2024#download

18 https://www.europarl.europa.eu/news/en/press-room/20240419IPR20590/right-to-repair-making-repair-easier-and-more-appealing-to-consumers

19 See here for a discussion of how concerted, ESG-driven policy action is changing a sector in France and how this could be a precursor for other European countries that are observing the outcome of this intervention: https://www.bcg.com/publications/2024/green-building-regulations-disturb-french-construction

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The big challenge for financial investors: The holding period

Many leading financial investors use a combination of the tools discussed above to drive ESG value creation, pushing the frontier of integrating ESG factors into deal strategies, developing leading ESG due diligence approaches, and unlocking value in their investees. However, financial sponsors (as opposed to corporate investors) face a key challenge: the holding period.

A private equity investor in the ASPAC region explained, "The five-year hold period is a real limitation in investing in transformation from an ESG perspective. Even if we believe that some ESG transformation elements might pay off eventually, we won't be able to realize their benefits over the short holding period." A Nordic private equity investor agreed: "In private equity, the long games are harder."

While many investors believe ESG investments will be valued by the next buyer upon exit, the holding period constraints can sometimes hold back investments that could improve ESG performance and yield a positive return in the mid-term. For example, a European private equity investor admitted they might avoid buying solar panels in the last year of the holding period as it would have a negative impact on financial returns.

Value over values

In summary, the most advanced investors excel at identifying ESG-related risks and opportunities that could materially impact the financial success of a transaction. They do this by combining a deep understanding of the commercial, operational and financial risks and opportunities triggered by evolving ESG regulations and stakeholder demands with a disciplined focus on financial returns during the holding period. As one leading private equity investor shared, "A good investment remains a good investment." A large North American private asset manager echoed this sentiment: "We invest for value, not for values."

Encouragingly, the preceding analysis suggests that the principles of a 'good investment' increasingly align with positive ESG impact, most notably around the theme of decarbonization.

A good investment remains a good investment; we invest for value, not for values.

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Challenges persist, but first solutions are emerging

Even for the most advanced investors, some aspects of integrating ESG into transactions remain a major challenge. This year's data confirm virtually all of the key challenges first identified in our initial 2022 EMA ESG due diligence study, across all major geographies.

Nearly half of respondents struggle with the three most pressing issues: selecting a meaningful, yet manageable scope (considering the breadth of ESG), quantifying potential findings, and the lack of robust data or written ESG policies at the target (see Figure 15).

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Figure 15. What are the key challenges you encountered/are expecting to encounter in conducting ESG due diligence (multiple choice)?

	EMA	ASPAC	AMS	Global
Selecting a meaningful, yet manageable scope, considering the breadth of ESG	51%	41%	51%	49%
Difficult to quantifying potential findings	48%	52%	45%	48%
Lack of robust data or written policies of allegedly followed practices at the target	45%	32%	53%	45%
Lack of common understanding of what "ESG due diligence means" between us, the target, and/or other parties in the process (e.g., advisers, banks, lawyers)	14%	14%	46%	24%
Don't know how to approach ESG due diligence (no framework, limited experience available in-house)	15%	21%	13%	15%
Issues identified from a ESG due diligence are not calibrated against investment materiality	15%	21%	8%	14%
Difficult to find relevant benchmark	16%	11%	5%	12%
Difficult to find a knowledgeable adviser	10%	11%	9%	10%
Low level of knowledge/training/common terminology in our own organization	10%	5%	7%	8%
Encountered no serious challenges	6%	12%	6%	7%
Other	7%	7%	3%	6%

A full debrief of these findings can be reviewed in our initial study. Here, we review solutions KPMG global practitioners have used to help clients mitigate these challenges.

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Prioritize material deal risk with impact on value

In the experience of KPMG professionals, there is a fundamental difference between material ESG business risk and material ESG deal risk. The former considers risks related to ESG topics relevant to the stakeholders of the business, which will need to be appropriately managed post-deal. The latter prioritizes the ESG risks that have the potential to make or break a deal, and impact value.

In this context, the breadth of the term ESG presents a particular challenge. As we wrote in our initial 2022 EMA study, the term ESG "co-mingles a multitude of distinct topics under each of the respective letters that are quite different in their nature". Or, as one investor interviewed for this study remarked: "The topics within 'E', 'S' and 'G' are separate. Why are they still grouped together? This is causing us lots of trouble."

This year's data confirms that selecting a meaningful, yet manageable scope remains the number one challenge ESG due diligence practitioners face globally (see Figure 15).

Like in the initial 2022 EMA study, survey participants were asked to rate a set of 20 potential ESG due diligence scope topics according to: Whether they consider them important at all; and if so, whether they should be included in an ESG due diligence workstream or in another workstream, such as environmental due diligence, HR due diligence, tax due diligence, legal due diligence, commercial due diligence, operational due diligence, or technical due diligence. Most potential scope items gathered only up to 40 percent to 50 percent consensus among respondents, indicating that there is no market standard of which environmental, social and governance scope items should feature in a typical ESG due diligence scope (see Figure 16).

There is a fundamental difference between material ESG business risk and material ESG deal risk. The former considers risks related to ESG topics relevant to the stakeholders of the business, which will need to be appropriately managed post-deal. The latter prioritizes the ESG risks that have the potential to make or break a deal, and impact value.

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Figure 16. How important are each of the following potential ESG due diligence scope items on your transactions?

Sub-question	2024			
	Important and should be part of ESG due diligence	Important, but should be part of another due diligence work stream	Unimportant in the context of my deals	Don't know
Biodiversity — A target's understanding of its impact and dependency on biodiversity, related targets and action plans	47%	17%	31%	5%
Certifications and ratings — Degree to which the target has obtained well-recognized sustainability certifications and ratings	45%	31%	22%	3%
Climate — A target's understanding of its carbon footprint, science-based decarbonization targets and a credible decarbonization plan	67%	15%	15%	2%
Climate — A target's understanding of its exposure to climate change-related risks	66%	14%	18%	3%
Community and stakeholder engagement	50%	25%	20%	5%
Compliance — Degree to which a target has mature compliance processes and a strong compliance record	45%	47%	4%	3%
Contamination — Risks from soil or groundwater contamination	57%	28%	12%	3%
Corruption — Strength of a target's anti-corruption policies and processes	46%	45%	7%	2%
Cybersecurity — Strength of a target's cybersecurity policies and track record	29%	63%	7%	2%
Data and systems — Maturity of a target's ESG data, systems, and processes	41%	40%	16%	2%
Diversity and inclusion — Strength of a targets diversity and inclusion policies and performance, incl. equal pay	50%	30%	18%	2%
EHS — Strength of a target's employee health and safety records and policies	53%	36%	9%	2%
Environmental or social product features (e.g. eco-design, circularity)	63%	19%	15%	4%
ESG controversy screening — Whether the target has had any controversy that may impact their ESG performance and wider reputation	60%	25%	11%	4%
Governance — A target's sustainability-related governance structures (e.g. management roles and responsibilities, link to executive pay, etc.)	56%	32%	10%	2%
Labor practices — Strength of a target's labor policies and practices (e.g. human rights, living wages, modern slavery, child labor)	60%	32%	7%	1%
Link to business strategy — Degree to which ESG considerations are embedded in a target's strategy and business model (e.g. whether to play in a certain product category, geography, etc.)	47%	35%	14%	4%
Materiality — Whether a target has a robust understanding of its material areas	48%	33%	14%	5%
Product safety — Strength of a target's product safety records and policies	45%	42%	10%	3%
Regulation — A target's understanding of existing or emerging sustainability-related regulation relevant to its business	57%	34%	7%	2%
Tax transparency — Degree to which organization makes use of aggressive tax planning; risks of tax avoidance/evasion; non-regulatory disclosure of tax-related information	28%	62%	6%	3%
Waste and resource efficiency — Maturity of a target's waste and resource management practices	59%	23%	15%	3%
Water stewardship — Target's assessment on water usage efficiency, pollution prevention policies, water quality monitoring, etc.	57%	20%	19%	4%

0–20% 21–40% 41–60% 61–80%

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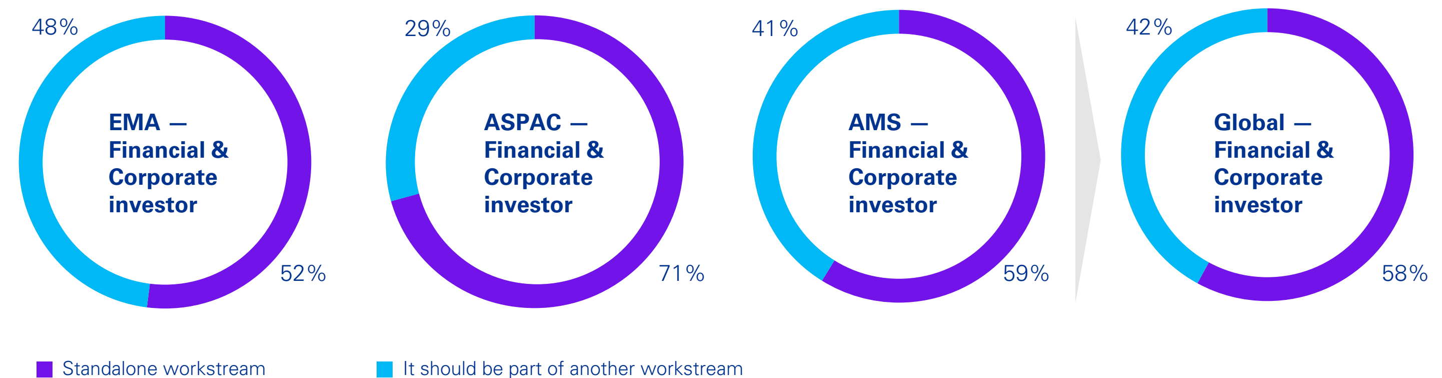
Nonetheless, the experience of KPMG practitioners suggests that there are some helpful guiding principles to cut through the complexity. Below, we offer two practical learnings to help scope a meaningful ESG due diligence.

Learning #1: Commission a dedicated workstream, but keep it focused

The experience of KPMG firms suggests it is generally recommended to commission a dedicated ESG (or climate) due diligence workstream, but to keep these efforts focused. This could differ depending on the individual situation, but there are some guiding principles that are helping KPMG practitioners cut through the noise.

1. **Climate-related inquiries** are highly relevant in many transactions, and as they are not traditionally covered elsewhere, it is valid to have a dedicated ESG due diligence workstream. In fact, of all scope items presented, climate gathered the most consensus by respondents for being an important part of an ESG due diligence (see Figure 16). A majority of respondents, especially in the ASPAC region (71 percent), favor a standalone climate due diligence workstream (see Figure 17).
2. **Regulatory readiness is increasingly material in many transactions** and traditional financial, legal or tax due diligence workstreams often do not have the capabilities to cover new regulations. An investor explained: "We need to understand if a target requires a lot of development to become compliant with new regulations, be it the CSRD, the EU Taxonomy or the CBAM, for example. If a lot needs to be done, that's an investment we need to factor into our business plan."
3. **Analyzing a target's ESG maturity can be a valuable first step**, especially when detailed data is lacking. This involves reviewing the quality of a target's materiality assessment, the role of its sustainability team, ESG systems and data quality, and the degree to which ESG is integrated into business strategy and governance. Such an assessment can help set post-closing priorities.
4. **Some potential 'E', 'S' and 'G' topics may be important, but could also be best placed in other workstreams.** Some ESG topics, such as cybersecurity or tax transparency, might be better placed in other due diligence workstreams. Other topics may not fit so neatly. The decision depends on the sector and the organization. For example, in agriculture, environmental topics are closely linked with commercial and operational topics

Figure 17. Should climate be a standalone workstream or part of another workstream?[20]



[20] This question was not asked to US-based respondents, as the question was only contained in the Wave 2 questionnaire (see methodological notes at the end of this study). The statistics presented for the Americas in Figure 2 are based on respondents in Canada, South America and the Caribbean Islands.

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and disentangling ESG due diligence from commercial or operational due diligence may be challenging. In other sectors, the same cut can be very clear. Overall, in the experience of KPMG practitioners, the decision of which topic to place inside or outside an ESG due diligence workstream is secondary — as long as the relevant ESG topics are identified and covered by a team that has the required technical, commercial, operational and financial skillset to analyze the topic in depth and to articulate the 'so what' in the deal context.

5. **Don't be afraid of not including some topics:** KPMG professionals recommend focusing on what is material to the deal. For example, while scientists agree biodiversity is critical to human life and while the topic is becoming mandatory in ESG disclosure regulations, it may not be relevant to many transactions yet (see Figure 16). The interviews led for this study suggest that this is because the topic is perceived as being less tangible and that it does not yet directly translate into financial impact. As one Nordic investor said, "We don't understand biodiversity yet. There are no agreed metrics, and we don't know how to evaluate it. It will probably become more important over time, but right now, we really don't see how this should have an impact on our deals." Whether it is biodiversity, or another topic, experience shows that ESG due diligence should focus on investment materiality and have a meaningful approach to tackle these topics during due diligence.

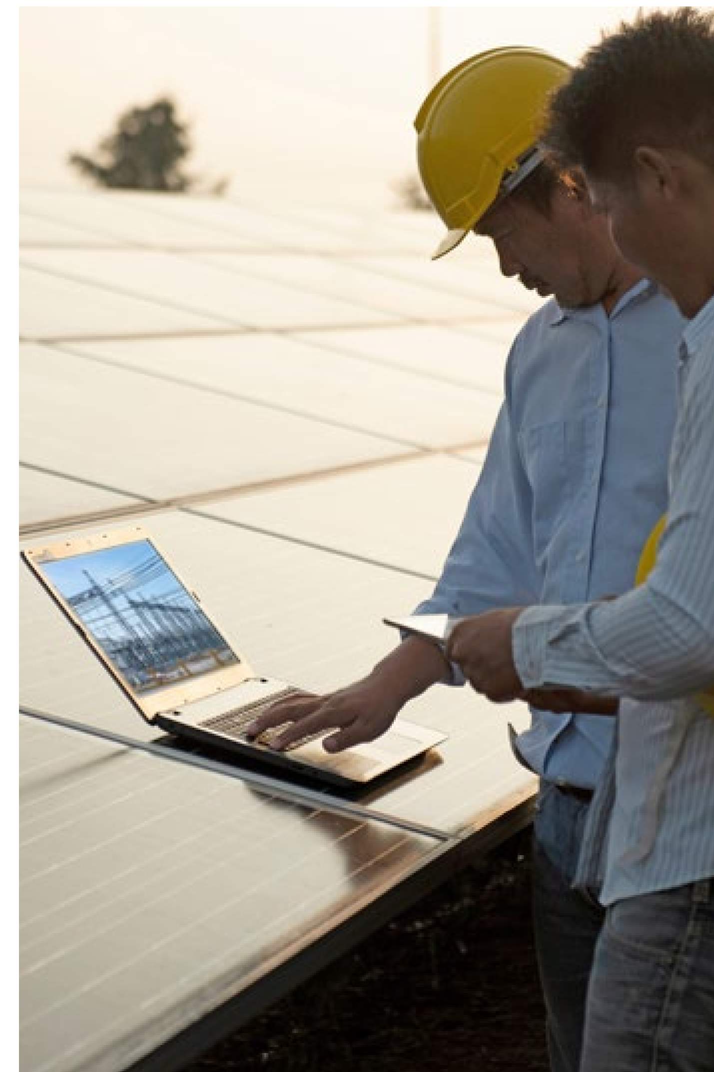
Learning #2: Climate due diligence should include both physical risks and transition considerations (e.g. decarbonization)

Until recently, climate due diligence primarily focused on physical climate risks, such as exposure to floods and droughts, and climate adaptation to increase resilience. Now, as discussed in a previous chapter, some investors recognize the tangible financial risks and opportunities associated with transitioning to a low-carbon economy — what are called transition risks or opportunities. These include regulatory changes, technological shifts and market dynamics, which are driving many investors to pursue decarbonization.

Therefore, a comprehensive climate due diligence scope should address both climate adaptation (physical risks) and climate mitigation (transition risks and opportunities). In fact, many leading regulatory disclosure frameworks also emphasize this dual approach.[21]

A German private equity investor explained: "We focus on both climate protection and climate adaptation. For physical and transition risks, we look at the 1.5°C and 2°C scenarios and the potential problems that may arise from them in areas like supply chain disruption stemming from work stoppages due to heat, for example."

KPMG member firms have developed innovative tools and alliances to analyze physical risks and transition effects, such as Climate IQ and a strategic collaboration with Zurich Resilience Solutions (see page 33 for more details). These tools are increasingly used in deal contexts to assess climate exposures during the pre-signing phase.



[21] For example: TCFD, CSRD/ESRS

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The KPMG approach to climate risk

Assessing climate risks holistically requires understanding both physical risks as well as transition risks and opportunities.

KPMG Climate IQ is a proprietary risk management tool that can identify and assess the climate change-related risks for a specific company under multiple scenarios. It uses a proprietary computable general equilibrium model to simulate the price developments of key macroeconomic variables under different climate scenarios, considering a coherent set of policy actions on a sectorial basis.

Moreover, in September 2023, KPMG formed a strategic alliance with Zurich Resilience Solutions, the commercial risk advisory unit of Zurich Insurance Group. The alliance combines Zurich Resilience Solutions' expertise in physical and operational risk with KPMG professionals' capabilities in assessing business-related risks and opportunities from the transition to a low-carbon economy. Initially available in Switzerland, the alliance is currently expanding to other geographies across the globe.

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Tapping into sell-side opportunities to drive divestment value

Almost two in three investors surveyed for this study are willing to pay a premium for a target company with superior ESG performance (see Figure 11). And although the premium is still moderate (for most respondents: 1 percent to 5 percent), mature buyers are ready to pay a higher premium than less mature ones (see Figure 12), suggesting that ESG premia will grow as more dealmakers advance in their maturity.

> Mature investors are willing to pay higher premiums than less mature investors. As investors continue to mature their ESG investment approaches, the ESG premia will also grow.

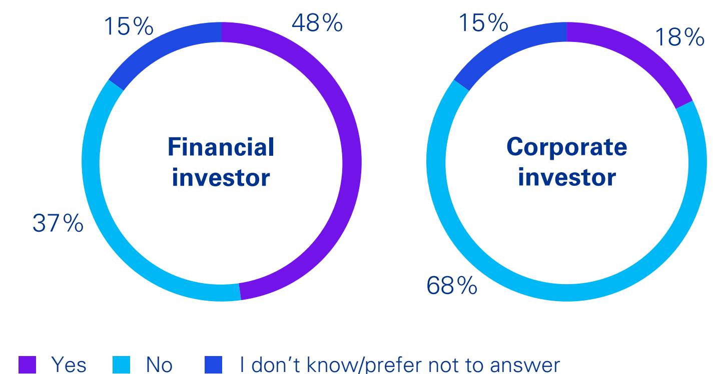
However, almost half of respondents identified the "lack of robust data or written policies of a target" as a key challenge in conducting ESG due diligence (see Figure 15). This indicates that sellers are not yet preparing divestment targets adequately from an ESG perspective. Indeed, less than half of financial sponsors and less than one in five corporate investors use formal sell-side ESG reports (see Figure 18).

This opens the door to a real opportunity for sellers to improve divestment value by incorporating ESG aspects into the divestment equity story and supporting it with reliable, evidence-based ESG documentation. In areas like financial, commercial, operational and legal, sellers typically prepare months ahead of a potential transaction, often with the support of external advisors. This often takes the form of vendor assistance services whereby advisors work with the leadership of a seller and the target to identify the key issues of risk or opportunity that buyers will focus on during due diligence, and summarize these issues in a defendable, yet seller-friendly, manner to take control of the narrative before a buyer can. In some geographies, sellers go even further and commission formal vendor due diligence reports that summarize the relevant aspects of a business in a comprehensive and factual manner, which can include granting reliance to buyers.[22] The underlying data and analysis is frequently made available in a virtual data room and it is standard practice for management to grant expert sessions to discuss these topics so that buyers can get comfortable with the forthcoming investment. In the experience of KPMG ESG practitioners in many geographies, it is still the exception rather than the norm for such documentation and access to be readily available at the beginning of a transaction. This limits the extent to which high-quality due diligence procedures can be performed on ESG matters.

Encouragingly, some KPMG firms report having observed an increase in the use of sell-side ESG reports, as well as an increasing desire for higher-quality evidence-based reports and independent assessments in recent months. For instance, KPMG firms in some European and ASPAC geographies report growing requests from professional financial investors for ESG sell-side assistance, including formal ESG vendor due diligence reports with reliance instead of ESG factbooks.

This trend presents a specific opportunity for private equity funds, which hold over US$3 trillion in unexited assets.[23] While a major ESG transformation may not be feasible for all portfolio companies before private equity dealmaking resumes, creating basic transparency on ESG maturity and performance, and highlighting unrealized ESG value creation potential, is feasible in the two to three months ahead of a transaction.[24]

Figure 18. As part of your divestment process, did you prepare specific ESG documentation (e.g., ESG Factbook, ESG Vendor Due Diligence, etc.)?



Note: This question was not asked to US-based respondents. See methodology section of this report.

[22] Allows a third party (in this case the buyer) to rely (to a certain degree) upon the accuracy of the report even though it was initially prepared for someone else, in this case the seller
[23] https://www.bain.com/insights/topics/global-private-equity-report/
[24] https://www.bain.com/insights/topics/global-private-equity-report/

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Given the willingness of many buyers to pay a premium for an asset with higher ESG performance, proper sell-side preparation and documentation on ESG matters offers sellers an opportunity to secure additional value.

Leverage synergies with commercial and operational due diligence teams

Similar to our initial 2022 EMA ESG due diligence study, nearly half of dealmakers globally find quantifying ESG due diligence findings challenging (see Figure 15).

The main issue is determining how ESG due diligence findings will impact financial value. Some cases are straightforward, like modeling future carbon tax costs using Scope 1 emissions and expected emission rights prices. However, modeling the financial impact of issues like diversity, equity and inclusion, or biodiversity is much more complex.

Recent KPMG practitioners' experience suggests that it is becoming clear that there are synergies between ESG due diligence and commercial or operational due diligence teams in some areas, especially when it comes to quantification.

For example, environmental product features are increasingly included in ESG due diligence reports, but too often, these reports do not make a direct link to deal value. Conversely, commercial due diligence teams have always analyzed product competitiveness, key purchasing criteria and customer willingness to pay. Analyzing the true environmental product features often requires a sustainability professional's experience and technical skillset. Quantifying the 'so what' in terms of addressable market and an ability to command a premium price in the market is a question best addressed with a commercial due diligence practitioner's toolbox. In this area, the authors have seen the best results when commercial due diligence teams were complemented with the deep sustainability expertise of ESG due diligence practitioners, as this allows for solid environmental product assessments viewed through a disciplined commercial lens, to jointly articulate the quantitative 'so what' for the respective transaction.

Similarly, consider ESG risks in the supply chain — be they potential human rights violations, corruption, business interruption, or others. While ESG due diligence teams tend to be highly qualified to assess aspects like the relevant standards, policy requirements or governance and control frameworks, operational due diligence teams — especially those with international supply chain management backgrounds — tend to bring a valuable set of real-world experiences (e.g. best practices of supplier audits, power dynamics between suppliers and customers). By combining these skillsets, meaningful analysis, including potential risk quantification, becomes more feasible.

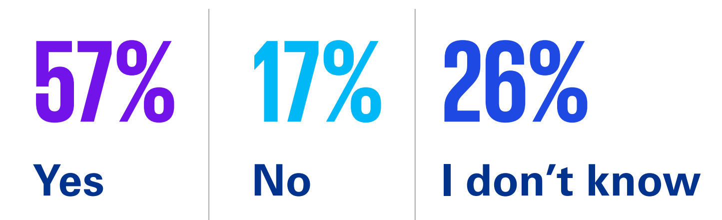
The main challenge to realize these synergies in practice is finding 'hybrid profiles' — that is, people skilled in both ESG and commercial or operational aspects. To address this, many investors included in this study are upskilling their deal teams on ESG and enhancing connectivity between their corporate sustainability and deal teams.

At KPMG, we actively pursue these synergies through our Diligence+ approach, integrating both risks and opportunities into due diligence, and using sector-specific value driver trees and integrated deal teams, including but not limited to, ESG.[25]

Leverage leading advisors' expertise

About one in four investors report struggling with a "lack of shared understanding of what ESG due diligence means between us and other parties on a deal." Additionally, 15 percent of respondents do not have a clear framework to approach an ESG due diligence (see Figure 15). Perhaps in response to these challenges, almost two-thirds plan to seek external advisor support for future transactions, primarily from Big 4 accounting firms, pure-play sustainability specialists or strategy consultants (see Figures 19-20).

Figure 19. Going forward, do you plan to work with external advisors for ESG due diligence?



[25] See here for more information: https://kpmg.com/xx/en/home/insights/2023/08/the-future-of-due-diligence.html

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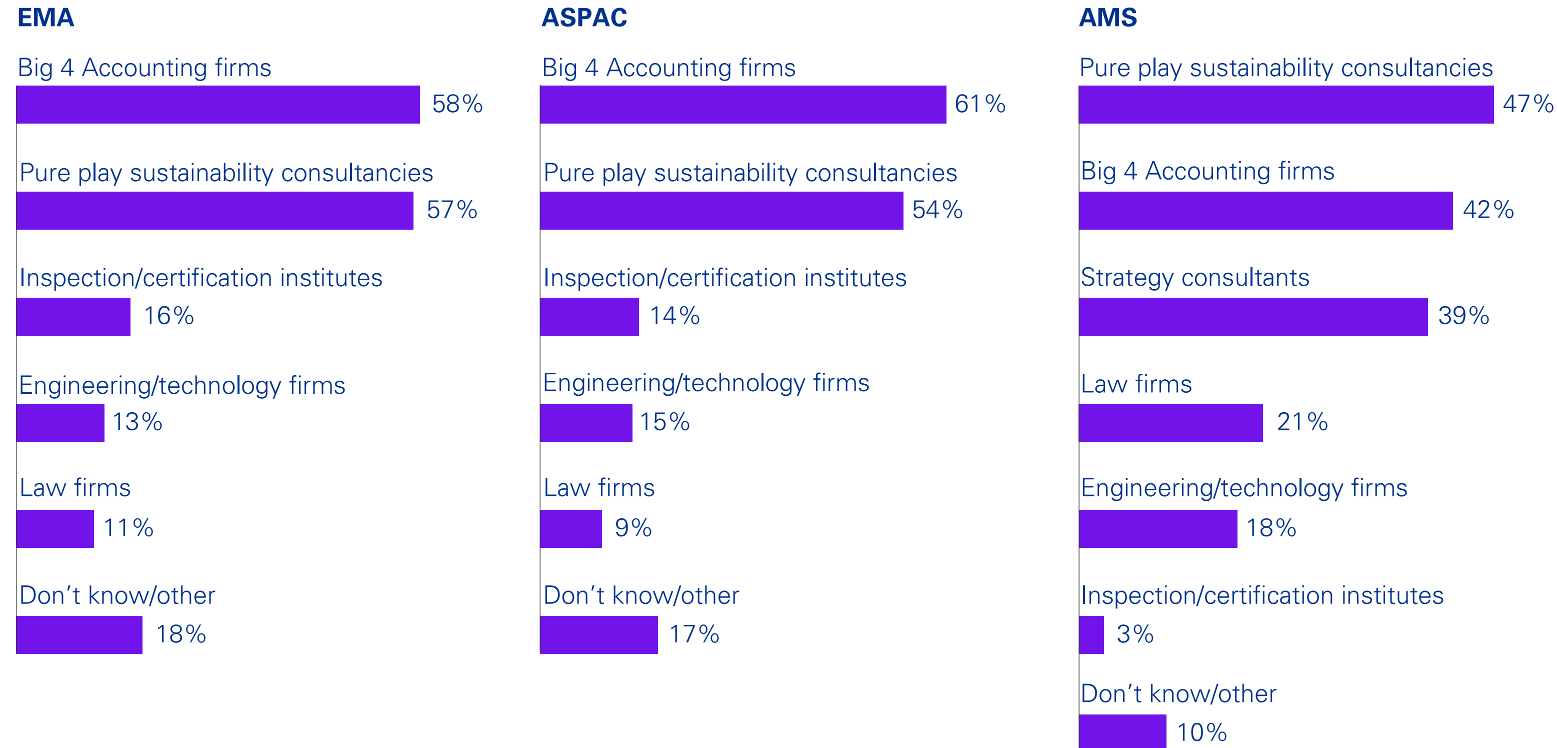
Figure 20. Which types of external advisors do you consider leading in the field of ESG due diligence (multiple choice)?



Note: "Strategy consultant" was available as an option to US-based respondents only. All others would have selected "Other" for this option.

This diverse landscape of service providers reflects the absence of market consensus on good ESG due diligence service. Different provider types have different strengths, which may be more or less important, depending on the transaction context, available in-house capabilities, sector and motivation for conducting ESG due diligence. For example, an ASPAC private equity investor said: "For us, it is important to commission ESG due diligence reports by a Big 4 because it helps convince our limited partners to co-invest on a deal."

In some situations, KPMG professionals have observed benefits in using a single advisor as a one-stop-shop, minimizing friction between multiple players and providing a holistic overview of findings from multiple workstreams. Conversely, working with multiple advisors can leverage specific strengths, such as combining a Big 4 firm's deal expertise with an engineering firm's technical prowess for soil samples or emissions measurements. Ultimately, the ideal advisory setup for an ESG project depends on the specific deal context.

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If ESG due diligence matters, why don't budgets match?

While many investors plan to hire external advisors for ESG due diligence, available budgets for such work remain low, despite its proven value. This raises a question: why?

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Those who perform ESG due diligence frequently find issues that can have a significant deal impact

This study has found clear evidence that ESG due diligence matters. Respondents who regularly conduct ESG due diligence are more likely to find issues with material deal implications (Figure 21). The consequences of such findings can be serious: globally, more than half of surveyed investors indicate encountering a 'deal stopper,' and over a third report that ESG findings led to additional contractual protection, changes in post-signing priorities, or purchase price reductions (see Figure 22).

Figure 21. Have you ever had a material finding in an ESG due diligence that has had a significant deal implication?

Region	Answer	Respondents who do ESG rarely (0–20%)	Respondents who do ESG occasionally (20–50%)	Respondents who do ESG very frequently (50–80%)	Respondents who do ESG very frequently (>80%)
EMA	Yes	6%	14%	19%	61%
EMA	No	37%	17%	9%	38%
EMA	I don't know	35%	25%	15%	25%
ASPAC	Yes	2%	13%	20%	65%
ASPAC	No	32%	14%	29%	25%
ASPAC	I don't know	23%	23%	23%	31%
AMS	Yes	20%	24%	29%	27%
AMS	No	41%	32%	12%	15%
AMS	I don't know	20%	20%	40%	20%
Global	Yes	13%	19%	24%	45%
Global	No	38%	22%	13%	27%
Global	I don't know	29%	24%	21%	26%

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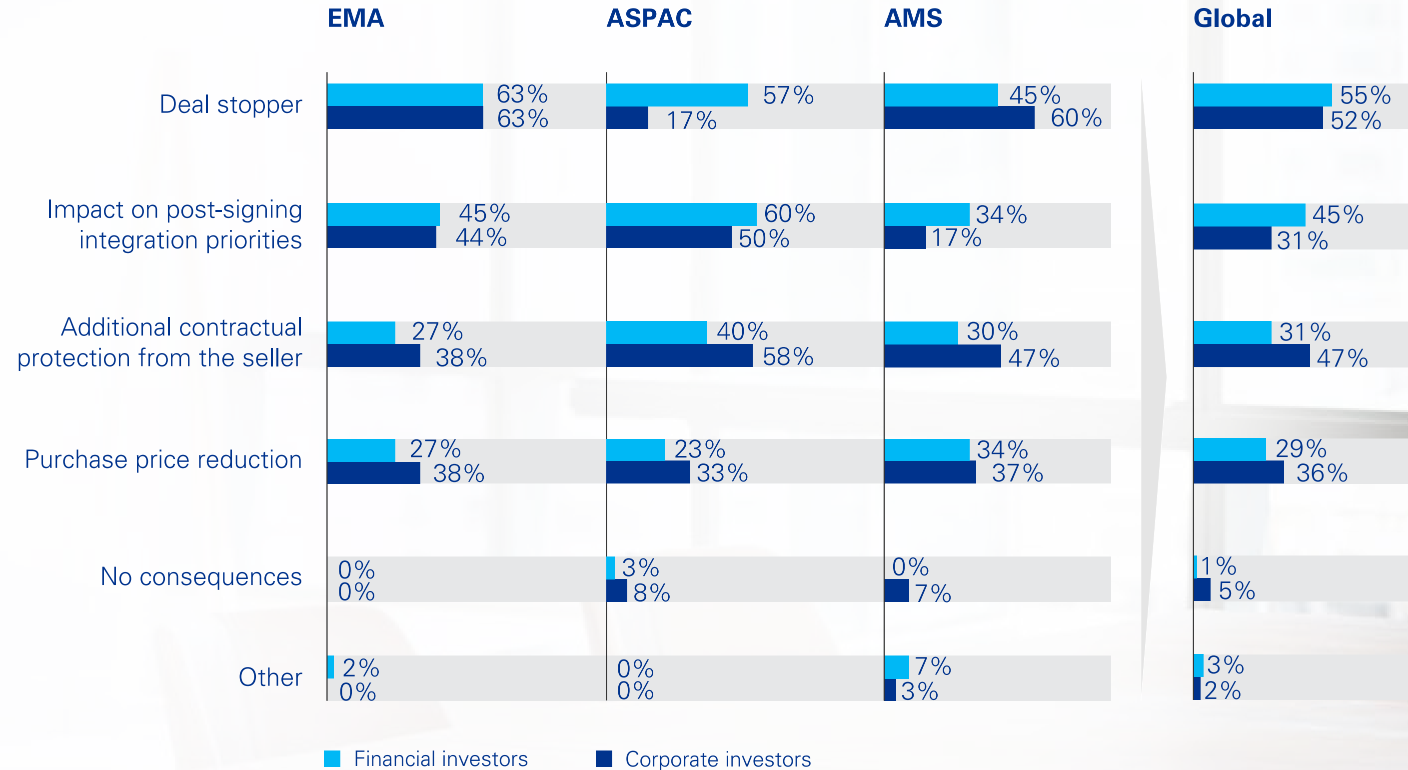
Figure 22. What was the consequence of the material finding on the deal?



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Yet, budgets for ESG due diligence remain low in comparison to other due diligence workstreams

Despite evidence of the value of ESG due diligence and the majority of investors seeking external support, budgets for this work remain low. Globally, approximately 60 percent of corporate investors and nearly 80 percent of financial investors consider a reasonable ESG due diligence budget to be below US$50,000 per project (see figure 23). This contrasts sharply with the significantly higher budgets available for other due diligence work, such as financial, commercial, operational and legal.

One reason for this disparity could be the perceived importance of ESG due diligence compared to other workstreams. As shown in Figure 24, only 44 percent of respondents globally consider ESG due diligence to be 'very important' or 'absolutely critical,' compared to 94 percent for financial due diligence, 91 percent for legal due diligence and 85 percent for commercial due diligence.

> Globally, approximately 60 percent of corporate investors and nearly 80 percent of financial investors consider a reasonable ESG due diligence budget to be below
>
> **US$50,000 per project**

Figure 23. What do you consider a reasonable adviser budget for an ESG due diligence, assuming a deal of your typical deal size and complexity?

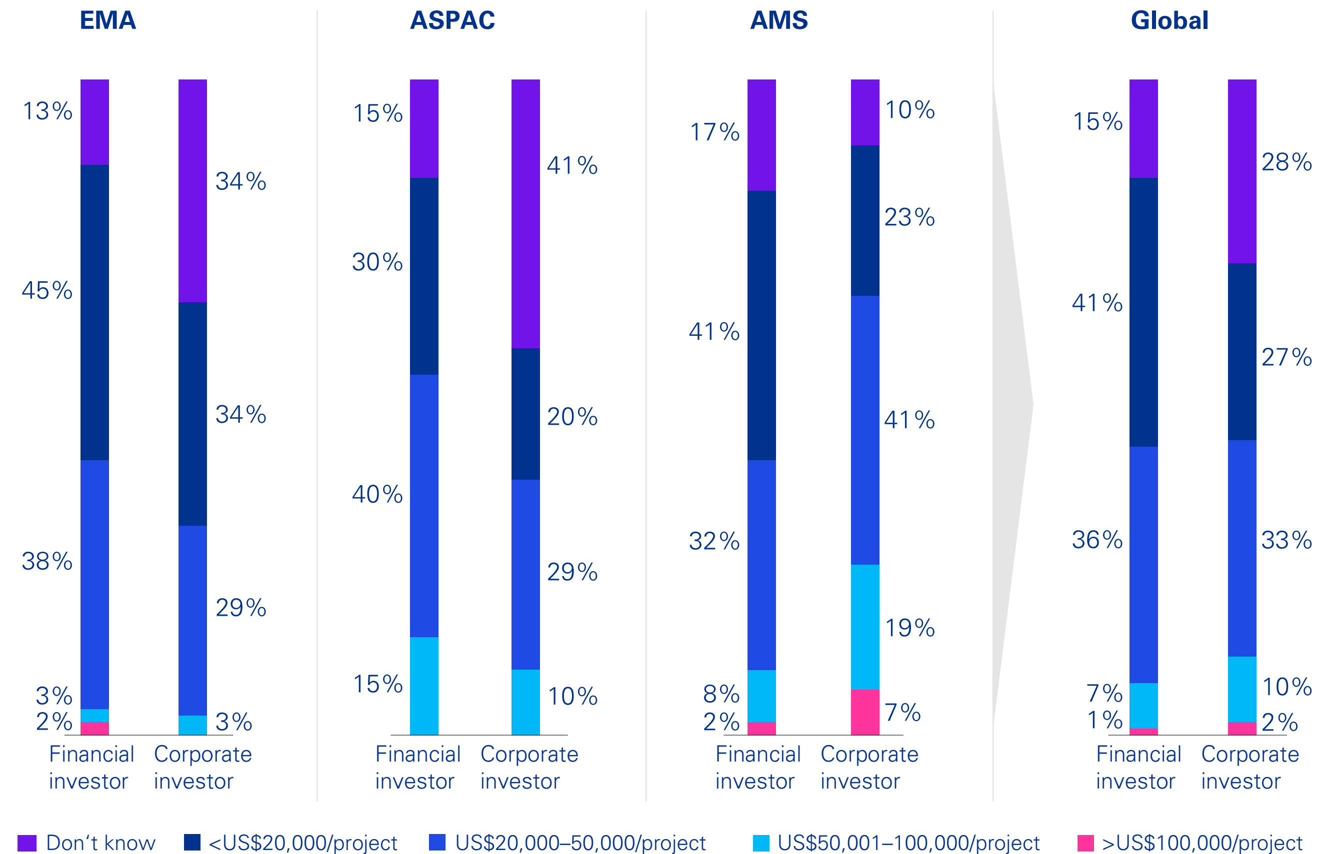

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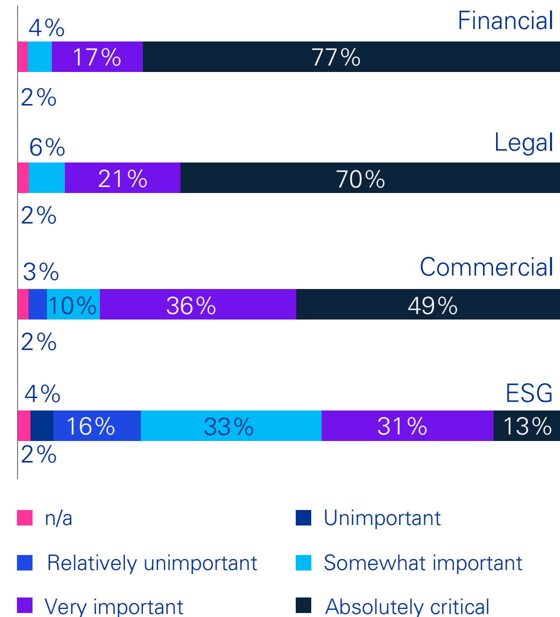
Figure 24. Please indicate the importance of each of the following due diligence workstreams on your transactions.



Another potential explanation for low ESG due diligence budgets is the perceived quality and inconsistency of many ESG due diligence products in the market. A large global private equity investor noted: "We haven't seen much consistency in the market. Some people are just taking a list and trying to check a box. Other people's thinking is advanced. For us, it's important to understand the mindset of the person doing the due diligence rather than the firm behind it." Similarly, a large financial investor in the ASPAC region said, "The quality of advisors varies a lot. There are still many that aren't able to articulate the 'so what' for the deal. We are looking to see the real ESG value drivers, not a superficial assessment."

This is a clear call to action for ESG due diligence advisors to enhance their insights, innovate their approaches, and drive consistency in their deliverables. At KPMG, ESG due diligence practitioners have spent the last two years improving the insights and consistency of our approach across our global network. Moreover, we hope our insights of this study help other practitioners on the frontier of ESG due diligence.

At the same time, investors also need to appreciate the need for appropriate budgets to conduct high-quality work. Some investors are still cutting corners. For example, we heard from some fund managers that their limited partner base may expect an ESG due diligence to be conducted, but they "don't dig down exactly on what the ESG due diligence is, so it can well just be a checklist of 30 boxes to tick." However, such approaches are increasingly insufficient. As one large pension fund — in their role as a limited partner to multiple private equity firms — explained: "It is not uncommon that we receive an ESG due diligence from a fund manager that is a low-quality, tick-the-box exercise. When that happens, they are doing themselves a disservice, because we end up asking more questions anyway. In many cases, it would probably have been better to do it properly from the beginning."

General partners, in particular, face potentially more serious implications if their ESG due diligence doesn't meet rising limited partners' expectations. One limited partner warned: "We may let our general partners get away with a low-quality due diligence or two. But if this happens repeatedly, we may consider to what extent we should continue to allocate capital to them when there are others with a more rigorous approach to diligence."

> "The quality of advisors varies a lot. There are still many that aren't able to articulate the 'so what' for the deal. We are looking to see the real ESG value drivers, not a superficial assessment."
>
> **Financial investor**
> ASPAC region

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KPMG firms' global ESG due diligence methodology

Since the launch of the landmark KPMG ESG due diligence study in the EMA region in 2022, the state of adoption and prevailing challenges faced by investors have been clear.

In response, KPMG ESG due diligence solution leaders worldwide have developed a market-leading, client-informed ESG due diligence methodology that quantifies ESG risks and value creation opportunities, calibrating them against investment materiality. It combines the experiences of the leading practitioners across the global KPMG organization, making them accessible and consistent to our teams globally.

The KPMG methodology leverages internationally recognized ESG standards and frameworks, as well as industry-specific regulations. It is scalable, enabling tailored scoping for respective targets and sectors, and covers a wide array of ESG topics with input from various subject matter specialists across the global KPMG organization. The methodology is also tech-enabled, drawing on vast public and proprietary ESG benchmarks and data sources globally. Importantly, ESG due diligence findings are calibrated with financial materiality and value drivers, articulated in terms of their strategic business and deal implications.

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How KPMG can help

As some of the world's leading deal advisory and sustainability service providers, KPMG member firms are at the nexus of the intersection between M&A and ESG. Through their daily work, KPMG professionals are at the forefront of the developments taking place in this rapidly evolving field. They are working with many of the leading corporate and financial investors to identify and develop ESG-related deal strategies and processes that meet their unique needs and objectives.

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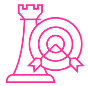
Leading investors and dealmakers around the world look to KPMG firms to help them



Develop the corporate sustainability strategy:

For investors who do not have a sufficiently sharp corporate sustainability strategy in place, KPMG professionals can help review, develop and sharpen your corporate sustainability strategy. They can help identify which areas should be considered material. They can help align ambition with the strategic context of your sector and overall business strategy. And they can help articulate pathways toward achieving your ambition. Read more in our Anchoring ESG in governance report

Link the M&A strategy to corporate strategy:

For investors who have a sharp corporate sustainability strategy in place, but who have not yet explicitly linked it to their M&A strategy, KPMG professionals can help ensure your M&A strategy reflects and aligns to your corporate sustainability strategy. They can help make the linkage stronger. They can help assess acquisitions or divestitures based on sustainability-related criteria. And they can assist investors to articulate the material areas that should be reflected in the deal process.

Enhance your responsible investment strategy:

KPMG responsible investment specialists guide investors in crafting a strategy tailored to your unique operating environment and the needs of your asset owners, while aligning with international best practice. Strategy components can include integration of ESG information into existing investment decision-making processes, responsible stewardship through engagement with investee companies on ESG topics, and issuance of reports on responsible investing activities.

Strengthen responsible investment policies and practices:

KPMG professionals can help draft policies to bring your responsible investment strategy to life, including creating screening and rating mechanisms to assess ESG components of a prospective investment, creating a playbook on how to address issues and opportunities identified in the due diligence stage, and stewardship policies for supporting and incentivizing investee companies to improve their ESG performance and disclosure.

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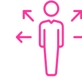
Develop an ESG due diligence framework:

KPMG professionals can help investors develop their ESG due diligence framework. For those seeking to include standard ESG due diligence approaches going forward, KPMG professionals can help identify areas that should be considered material in all transactions and those that will be material on a case-by-case basis. And they can help you consider what operational approach would be most effective for your organization.

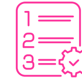
Perform ESG due diligence procedures:

KPMG professionals can help investors execute against their framework on live transactions. They can help perform not only ESG due diligence procedures, but a wide range of different due diligence workstreams. And they can help enable a seamless integration across the due diligence environment to enhance value.



Identify and quantify ESG-related value creation opportunities linked to value drivers:

Both on transactions as well as during the holding period, KPMG professionals can help create a robust ESG performance baseline, identify ESG-related value potential opportunities, translate them into quantitative estimates of financial value and help realize such value creation opportunities.



Implement post-deal priorities:

Making an acquisition is just the start. The pre-signing ESG due diligence findings provide the starting point for post-closing action plans. Building on a strong heritage of post-deal integration advisory, KPMG professionals can help establish post-closing action plans and can help drive their implementation alongside the investors’ in-house teams.

How can KPMG help your organization? To find out, please contact your local member firm or any of the authors listed at the back of this publication.

About this study

This report is based on three main sources:

- A global online survey with over 600 active dealmakers across 35 geographies
- An interview series with 50 interviewees
- Complementary market observations from KPMG solution leaders across our global organization

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With regard to the online survey, a total of 617 valid responses were collected. Respondents to the online survey were distributed as follows:

Respondents by geography

	Absolute	% of total
EMA		
DACH	77	12%
Eastern Europe	52	8%
Scandinavia	31	5%
UK and Ireland	23	4%
Benelux	17	3%
Italy and Malta	16	3%
Iberia	16	3%
France	15	2%
Africa	7	1%
Middle East	4	1%
Subtotal EMA	**258**	**42%**

	Absolute	% of total
ASPAC		
Australia	25	4%
China (incl. HK)	22	4%
Japan	19	3%
Southeast Asia	18	3%
Taiwan	16	3%
India	15	2%
Central Asia	3	0%
Subtotal ASPAC	**118**	**19%**

	Absolute	% of total
AMS		
North America	218	35%
South America	19	3%
Caribbean Islands	4	1%
Subtotal AMS	**241**	**39%**

Total | Absolute 617 | Percent of total 100%

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Respondents by ownership status

	Absolute	% of total
Publicly traded	209	34%
Privately held	378	61%
Government-owned	30	5%
Total	**617**	**100%**

Respondents by investor type

	Absolute	% of total
Corporate investor	241	39%
Financial investor	273	44%
Others	103	17%
Total	**617**	**100%**

Note: "Others" includes debt-provider, independent board members and advisors, and M&A insurance provider.

Respondents by role in organization

n= 617	Corporate investor	Financial investor	Others
ESG/Sustainability team	58 (9%)	100 (16%)	11 (2%)
Final deal decision-maker	-	76 (12%)	-
Deal captain/principal with key operational deal responsibility	-	65 (11%)	-
Head of M&A	53 (9%)	-	-
M&A debt financing professional with lending decision responsibility	-	-	48 (8%)
Strategy/business development team	41 (7%)	-	-
CFO	37 (6%)	-	-
Other	21 (3%)	15 (2%)	12 (2%)
M&A debt financing professional with lending decision responsibility	-	-	25 (4%)
Portfolio management/Value creation team	-	17 (3%)	-
CEO	15 (2%)	-	-
M&A team	13 (2%)	-	-
Board member in one of more corporates	-	-	6 (1%)
Other position with deal-making responsibilities	3 (0%)	-	1 (0%)
Total	**241 (39%)**	**273 (44%)**	**103 (17%)**

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Respondents by deal number

n=617	Corporate investor	Financial investor	Others
<1	18 (3%)	6 (1%)	11 (2%)
1–3	94 (15%)	68 (11%)	35 (6%)
4–5	49 (8%)	50 (8%)	22 (4%)
6–10	34 (6%)	60 (10%)	10 (2%)
>10	44 (7%)	85 (14%)	25 (4%)
None/Not applicable	1 (0%)	2 (0%)	-
Don't know or prefer not to answer	1 (0%)	2 (0%)	-
Total	**241 (39%)**	**273 (44%)**	**103 (17%)**

Respondents by deal size

n= 483*	Corporate investor	Financial investor	Others
US$ <10m	33 (7%)	47 (10%)	11 (2%)
US$ 10m–50m	57 (12%)	95 (20%)	7 (1%)
US$ 51–100m	33 (7%)	66 (14%)	8 (2%)
US$ 101–500m	37 (8%)	46 (10%)	5 (1%)
US$ 501–1bn	8 (2%)	16 (3%)	2 (0%)
US$ >1bn	5 (1%)	3 (1%)	4 (1%)
Total	**173 (36%)**	**273 (57%)**	**37 (8%)**

To find out more about the survey sample — or to view further breakdowns of the results — please view the interactive dashboard online.

The responses to the online survey were collected in two rounds. The first was performed by KPMG LLP in US in 2023 and the local US results of that survey were discussed by KPMG LLP in a related publication. The second round was conducted in all other geographies in Q1 2024. The questionnaires used in the two rounds were the same, except for a small number of additional questions added to the Q1 2024 version. Consequently, these questions were only answered by respondents outside of the US. Where this is the case, a note was made in the main text.

The interview series with investors was conducted after the collection of the online survey results. It took place in the form of semi-structured interviews, building on the key findings of the quantitative survey as they were relevant to the respective interviewee.

Market observations were collected from 34 KPMG member firms across the globe listed in the Contacts page of this report.

*Note: US corporate investors and 'others' were excluded from these respondents.

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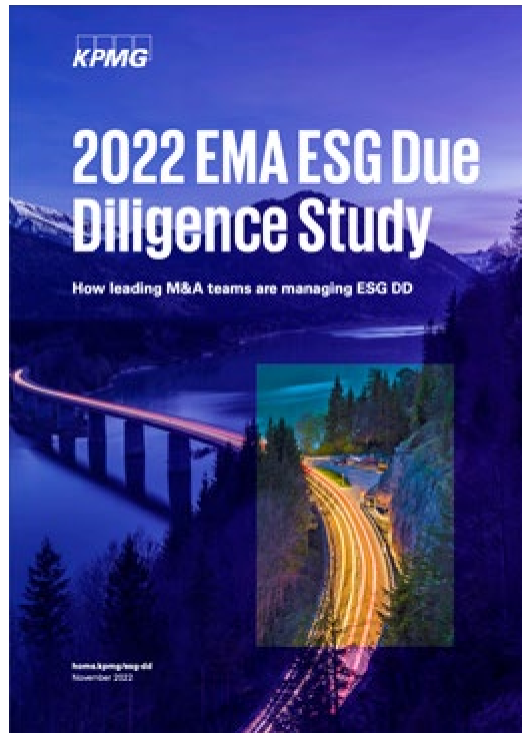

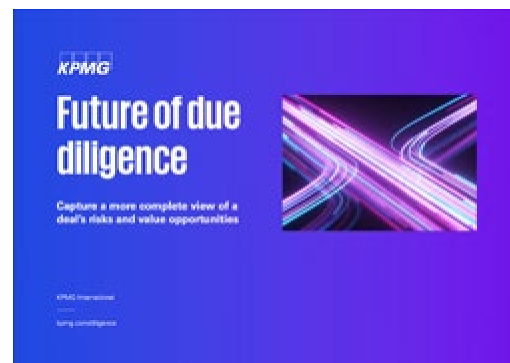

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Florian co-leads our Swiss Deal Advisory Strategy team, which is part of KPMG's Global Strategy Group (GSG). GSG supports companies in the development of strategic courses of action up to the successful implementation of holistic transformations, organic growth paths, M&A strategies as well as necessary operational changes.

Florian supports clients in both the design and execution of strategy projects, primarily in the context of M&A transactions (commercial due diligence, integration/separation, ESG due diligence), growth plans and sustainability-driven transformations.

Florian was the lead author of KPMG's first international thought leadership report on ESG Due Diligence in the EMA region in 2022, which identified the state of the art of integrating ESG factors into due diligence in M&A transactions.

Julie Vasadi
Partner, Head of ESG Transaction Services, Deal Advisory
KPMG Australia

Julie leads KPMG Australia's ESG Transaction Services practice and supports clients to integrate ESG into their investment, financing and lending decisions across the full investment life cycle. She provides her clients with critical insights on ESG risks and value creation opportunities leveraging her extensive experience from more than 15 years advising on ESG strategy, reporting and deals across a wide range of sectors in Australia and internationally.

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