SUSTAINABILITY IN TRANSACTIONS
A SUMMARY

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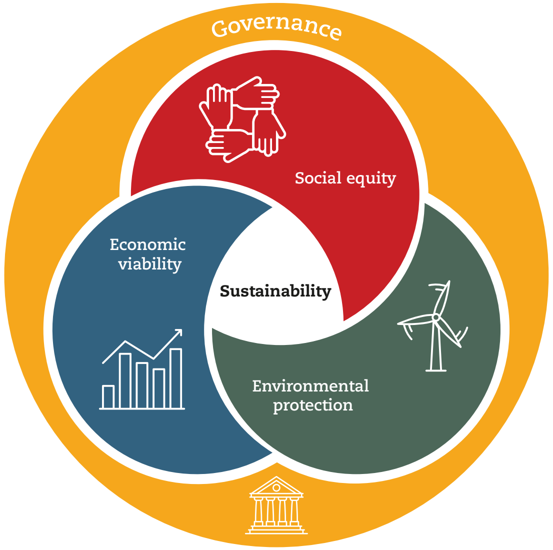
The transaction cycle of buying, investing and selling organisations is part of the on-going economic cycle. Should an acquirer or somebody being acquired overlay the issues of sustainability-related issues in this process? If so, to what extent and what are the implications. Using the insights of nearly 50 finance and accounting professionals from across the globe, this report considers this question and its implications.

Three key messages

- Sustainability-related opportunities and risks cannot be ignored in a transaction: they now form a fundamental part of the strategic intent of the transaction and the valuation of an entity.
- The assessment of these risks and opportunities must be comprehensively considered as part of the due diligence process, both as a specific workflow and as an integral part of other forms of due diligence.
- Organisations need to ensure that they have an appropriate level of expertise across the transaction workflow and in relation to the target's operations, assets and liabilities.

FIGURE 1: The three dimensions of a sustainable organisation



Do sustainability-related issues matter in a transaction?

In short, sustainability-related issues and opportunities do matter in a transaction. What is mean by 'sustainability', however. Sustainability in this context itself can be thought of as the longer-term survivability of an organisation considering the need to transition to a more sustainable operating model which addresses environmental, social and economic viability in combination (Figure 1).

Organisations need to address not only the actions that support the achievement of limiting global warming to 1.5°C above pre-industrial levels in line with the Paris Climate accords, but in so doing to manage the social and economic impacts of doing so such that no one is left behind.

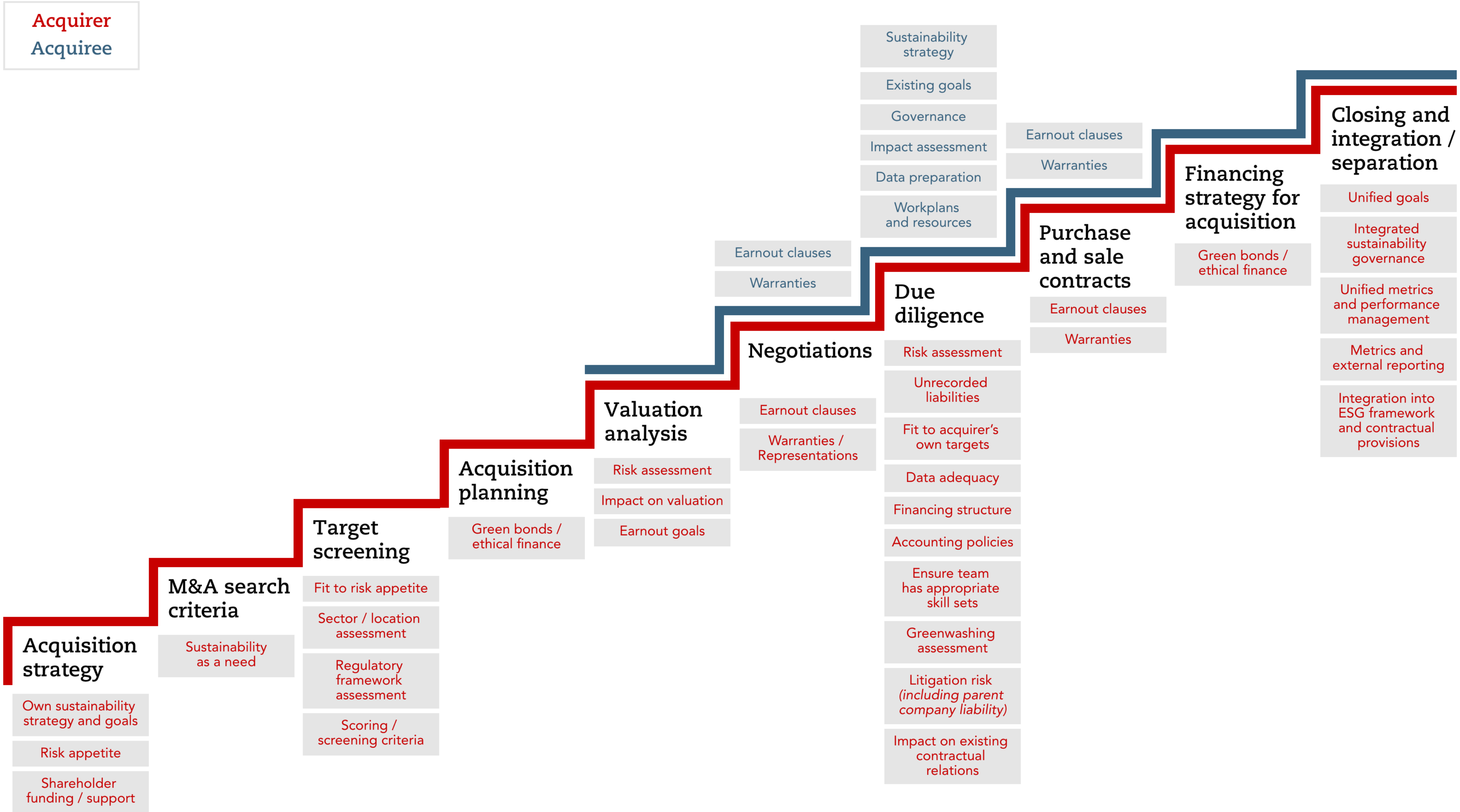
This can represent a significant change in the operating model but also in the culture of the organisation.

As a simple example, whether an organisation requires investment to meet these obligations will impact the future cash flows and hence the valuation of the organisation. There could potentially be historic liabilities which any acquirer would assume upon acquisition. Assessing the risks that arise from sustainability-related issues and opportunities both from the perspective of the acquirer and the acquired and how this aligns to the existing appetite is an important first step in the transaction workflow. Having appropriately skilled staff at all levels is essential. Ensuring that sustainability is factored into the valuation model and that the sensitivity analysis which is conducted upon it also reflects the relevant risks.

The implications for the transaction workflow

The consideration of sustainability-related issues and opportunities is important in all phases of the transaction workflow for both parties (Figure 2). Each phase may require specific expertise either from an operational or a financial perspective. Whilst this may be presented as a linear model, in many transactions' phases may be reprised as information is discovered and evaluated. For example, discoveries in due diligence can impact the valuation and negotiations.

FIGURE 2: Sustainability-related risks and opportunities in the transaction workflow



Issues to consider in due diligence

Due diligence forms a key part of the transaction workflow. It is the process that involves a risk and compliance check, investigating, reviewing, or auditing to verify facts and information about a particular subject. There are several forms of due diligence that an acquirer may choose to undertake, one of which may be sustainability due diligence. However, sustainability-related issues should also be a consideration in other forms of due diligence including financial, commercial, legal and operational. Whether it is conducted as a standalone activity or interwoven with the other forms there are several considerations that should be considered when defining the scope. Some examples of these are shown in Figure 3.

Not all these considerations will apply in equal measure to all organisations. In defining the scope, it is also worthwhile considering the implications of appropriate reporting standards and available industry guidance.

The output of the due diligence process should be evaluated against the risks and opportunities of the transaction. All transactions are undertaken to enhance or create value. Sustainability-related considerations do not only present risks, but they can also present opportunities. Those who evaluate the transaction must ensure that they have access to appropriate skills such that they can make an informed decision.

FIGURE 3: Sustainability-related considerations in due diligence

Conclusion

There are six observations related to sustainability-related issues to consider in the transaction cycle (Figure 4).

The starting point has to depend on the **strategic** objectives of both the acquirer and acquiree. Alignment of sustainability objectives is an important factor and also needs a **risk-based** approach.

Sustainability-related due diligence needs to be **integrated** into the overall approach to the transaction, whether it is a standalone aspect or an integral aspect of other due diligence aspects. It is not a standalone business issue: it is integral to the future of the organisation. It also needs to be reflected in the valuation.

There must be **operational rigour** in commoditising the assets of the organisation in relation to the achievement of sustainability objectives, recognising that this is both an opportunity and a risk.

There is a need to recognise that the sustainability agenda is **agile and flexible** as our level of understanding of the issues develops and the regulatory environment evolves. Sustainability-related concerns will continue to be integrated into the operating model.

Sustainability-related issues are technical issues and attaining these therefore needs **relevant expertise** but this needs to be incorporated into the overall assessment so those leading the work across all phases need to have a detailed appreciation of the issues such that they can analyse and interpret the information presented to them in an appropriate manner.

Any issues identified need to be framed as **actionable observations**. Transactions may fail not because of sustainability issues themselves, but rather from a lack of understanding of their implications and how their risks can be addressed in a post-closure process.

FIGURE 4: Six sustainability-related observations in the transaction cycle

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