How to capture value from sustainability opportunities after M&A

In pursuing mergers and acquisitions (M&A), an increasing number of dealmakers are taking environmental, social, and governance (ESG) factors into consideration when assessing value creation opportunities. The KPMG LLP 2023 US ESG Due Diligence Study revealed that 90 percent of investors with rigorous sustainability and ESG due diligence use their findings to guide an action plan after closing the deal.[1]

But how do you convert sustainability opportunities into improved financial performance and long-term growth? Given the time horizon needed to effect change, generating value at exit is more likely when you act fast using a comprehensive roadmap and implementation plan. Moreover, the earlier these are in place—preferably during due diligence or at the start of the hold period—the better.

01 Analyzing value creation opportunities for return on investment

Embedding sustainability and ESG assessments during due diligence can help identify sustainable sources of value creation,[2] but converting those insights into tangible business results during the hold period can be much more challenging. Unlike more traditional routes to value, sustainability opportunities can be slower to monetize, often because of a longer payback period or the inability to execute immediately. With time-to-value for sustainability initiatives taking as long as five years, achieving a return on investment before exit requires aggressive planning during due diligence and early in the hold period.

Private equity (PE) and corporate buyers can start by thoroughly analyzing the value creation opportunities at the acquired company. Prioritize the options that appear to offer the best return on investment: Environmental factors might include initiatives like product differentiation based on climate attributes, energy efficiency upgrades, renewable power purchases, and production method improvements. Next, quantify the opportunities using relevant financial analysis frameworks (Exhibit 1). This can help sequence actions by importance in the initial planning stage.

[1] "The sustainable advantage: Leveraging ESG due diligence to unlock value," KPMG LLP, 2023

[2] "How ESG due diligence can help PE firms create value," KPMG LLP, 2024

You'll also need to identify critical success factors, such as the ability to secure leadership buy-in, capital outlays, workforce training, and supplier collaboration. Failure to gain leadership buy-in, for example, could cause misalignment between sustainability and business goals or lead to resistance to change.

Exhibit 1. Use appropriate quantitative analyses to assess sustainability opportunities

Comprehensive sustainability analysis

A materiality and maturity assessment that helps the company understand where it stands in relation to peers and investor/customer expectations and what gaps need to be closed.

Environmental analysis

Analysis that can determine environmental value creation opportunities, such as emissions and decarbonization pathways; environment, health, and safety performance; and climate risk assessment.

Social analysis

Analysis of social factors that impact the business, such as customer sentiment assessments and employee sentiment and retention.

Governance analysis

Analysis that can help companies reduce the risk of governance violations by evaluating policies and incidents; it also assesses readiness for sustainability reporting regulations, such as the Corporate Sustainability Reporting Directive and Sustainable Finance Disclosure Regulation.

Getting a portfolio company ready for an accountable sustainability program

A PE firm that acquired a private chemicals and materials company wanted to report its sustainability metrics to investors and customers. Following the acquisition, KPMG helped the company assess its current state and analyze sustainability value, including greenhouse gas (GHG) emissions data. We also helped establish a streamlined, data-driven calculation process for measuring carbon footprint to be used as a metric for tracking progress toward key performance indicators (KPIs). After identifying gaps in its current sustainability programs and assessing them against its peers and investor expectations, we presented a sustainability strategy with a priority list of ESG topics and actions. In line with the client's ambition on sustainability goals, KPMG helped create an internal roadmap to execute the strategy and publish the progress in an external sustainability report.

02 Creating the roadmap

Both PE and corporate acquirers can maximize value creation opportunities faster by sketching out an initial plan at the end of the diligence process. That allows enough time to anticipate and remove roadblocks. This is crucial for sustainability opportunities because compared to traditional opportunities, sustainable value creation levers often have longer payback periods and it can be more difficult to realize value.

For example, some financially beneficial environmental projects require major capital spending such as changing manufacturing processes, retrofitting buildings, or connecting renewable energy on site. These projects often require long lead times for financing, planning, and execution. If the roadmap is not developed promptly there is a risk of not completing the project in time for exit of the investment, thus losing out on the value of the project. The acquired company may also not have the expertise to immediately capture the sustainability opportunity, and a roadmap can facilitate a timely process of finding, hiring, and training the right personnel.

When integrating priority sustainability practices, a detailed roadmap (Exhibit 2) can provide a clear plan of action. The roadmap will look different depending on the nature of the acquired business and the identified opportunities. But generally, it will identify the steps to take after the deal closes, the responsible party for each action, and the technology or upskilling required to carry out the tasks (such as training or gaining insights from industry organizations or publications). You can further define these actions in a 100-day plan contained within the roadmap that lays out the full scope of sustainability integration over two to three years (for PE firms, this is likely to correspond to the holding period).

Exhibit 2. A detailed roadmap can ensure a successful sustainability implementation

- Identify value creation opportunities
- Understand which sustainability value creation levers to prioritize and where to realize the best ROI

- Quantify and prioritize the opportunities, sequence actions to implement

- Draft a roadmap with actionable next steps to implement the levers
- Incorporate a 100-day plan to begin implementing the levers

- Implement the value creation opportunities
- Ensure a strong governance structure while upskilling teams

- Identify KPIs, metrics, and targets to track progress of levers and the value they are creating

- Demonstrate that the value creation levers have met targets

Next comes implementation of the value-creating E, S, and G factors. For a PE firm, this will mean engaging with the management of the portfolio company (PortCo) to ensure they are prepared to execute the 100-day plan (corporate acquirers will follow a similar path).

First, establish a budget and resources. Next, assess the current skills and capabilities of the PortCo personnel to identify gaps, and then provide training that will equip them to achieve a successful outcome. Corporates that lack in-house sustainability expertise will need to first secure advice from specialists with the right experience. Finally, assign responsibilities and determine the best way to enable cross-functional collaboration.

03 Addressing governance

To ensure that progress is timely and effective, both PE and corporate acquirers need to put in place a strong governance structure with clear roles and responsibilities. Without clear owners and accountability, necessary actions may not be done well or at all. These roles and responsibilities should outline who will own implementation, who will manage the individuals or companies involved, and which leader is accountable for completing work on time. It is crucial for management to consider climate-related expertise and resources, both at the management level and on the board.[3]

Another important task is measuring progress. Identify key KPIs and other relevant metrics—such as energy usage, GHGs, and employee diversity statistics—and track them to determine if the value creation process can deliver on its goals. Demonstrating that the sustainability integration plan has met pre-set targets and KPIs with hard data will help lock in the exit value of your asset.

How a roadmap can help raise the sustainability game

After it was purchased by a large global asset management firm, KPMG helped a US industrial staffing company create a sustainability strategy and roadmap focusing on climate reporting and diversity, equity, and inclusion (DEI). The client needed assistance working across its numerous business segments to clarify sustainability challenges and opportunities, increase internal stakeholders' understanding of ESG factors, and gain leadership buy-in. Our work included evaluating the client's current sustainability initiatives, understanding supplier priorities, and shaping a unique sustainability strategy. We crafted a practical roadmap for implementing priority actions around DEI and climate reporting, which included quick wins, next-step initiatives, KPIs, and other metrics. As a result, the client was able to successfully address investor, client, and employee demands for a more robust sustainability program.

Many deal makers today realize there's a lot of value to capture from sustainability opportunities. But to translate that ambition to reality, we believe they need to come up with a meticulous game plan at the start of the deal cycle. Armed with a strategic roadmap to help guide each stage of sustainability integration, organizations can create additional value from their operations.

[3] "Boardroom climate competence: Advancing the board-management conversation," KPMG LLP, 2023

How KPMG can help

KPMG helps PE firms, portfolio companies, and corporate organizations create value from sustainability in their investments. We bring a deep understanding of the factors that drive the success of an investment and incorporate these insights into sustainability due diligence, hold-period implementation programs, and exit due diligence and preparation.

Our client team members are comprised of data scientists, financial modelers, mathematicians, economists, M&A professionals, and climate strategists. We have assisted with a variety of sustainability engagements such as decarbonization strategies, decarbonization project implementation, social strategy development, prevailing wage assessment, operational transformation, supply chain management, marketing and brand management, sustainable finance, acquisitions and divestments, and fuel switching.

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