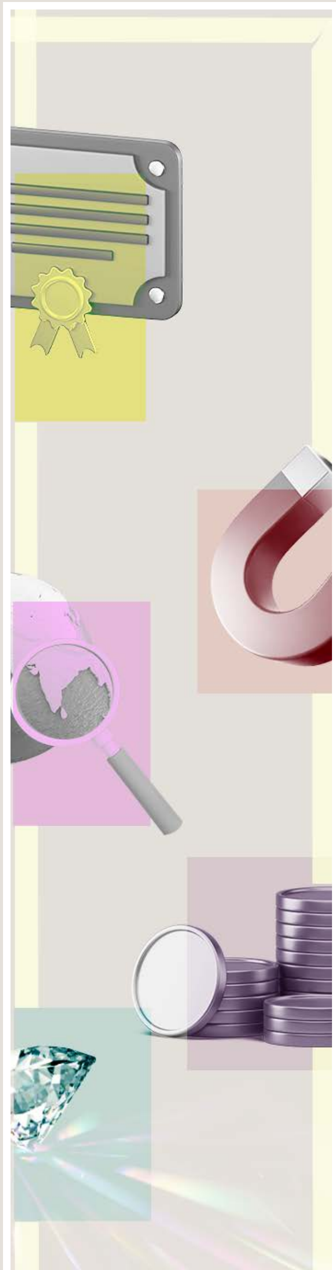
Deloitte.

Sustainable synergies:
The evolution of Environmental, Social and Governance landscape in Mergers & Acquisitions

June 2024

Table of contents

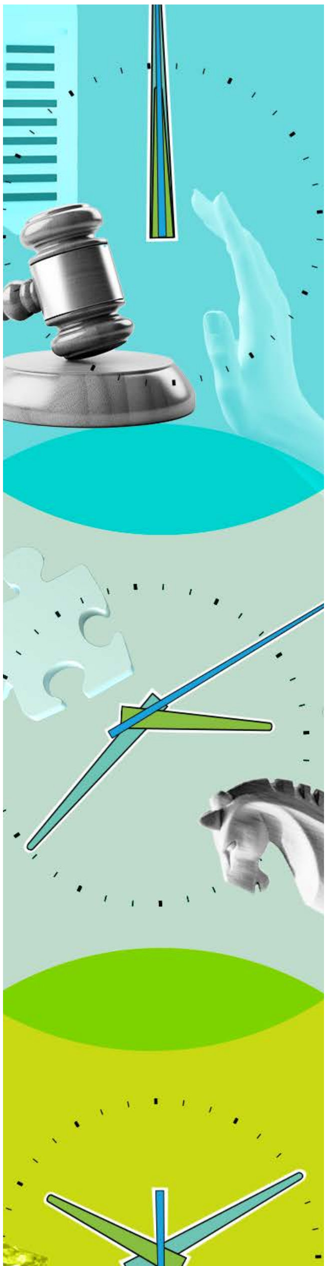


The expanding stakeholder universe has permanently integrated ESG into the transaction cycle

13

ESG value framework

15



No strict boundaries separating ESG principles

17

The ESG evolution in India

The commitments and policies adopted by Indian regulators over the past few years indicate that India has made a conscious move towards sustainability, by nudging as well as motivating market players to adopt sustainable ways of doing business.

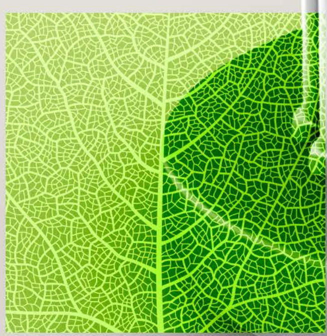
At CoP 26, India's prime minister pledged to achieve **net-zero carbon emissions by 2070.**[1] The SEBI amended the Business Responsibility Report (BRR) to introduce Business Responsibility And Sustainability Reporting **(BRSR) framework**[2] that mandates top 1,000 listed companies, by market capitalisation, to annually provide Environmental, Social and Governance (ESG) related disclosures.

In its Union Budget 2023–2024, the government announced various initiatives to move towards a sustainable future:

Green growth[3]
From green credits to green energy, from green mobility to green farming all these constituted the seven main priorities.

INR 35,000 crore[4]
sanctioned for priority capital investments towards energy transition and net-zero objectives.

Ecomark scheme[3]
It provides accreditation and labelling for household and consumer products that meet specific environmental criteria while maintaining quality standards per Indian norms.



Further legislation and clarifications regarding ESG are expected. The Indian government has increasingly emphasised on ESG issues, which can be seen in India's active role in global climate forums. At the recently concluded, **CoP 28**, India announced **Green Credit Program[3] (GCP)**, a market-based mechanism designed to incentivise voluntary environmental actions across diverse sectors by various stakeholders.

The regulatory environment for ESG in India is constantly evolving. While it lags a bit behind its Western counterparts, significant efforts are being made to achieve the net-zero emission goal.

Until 2019

Before 2019, the regulatory framework in India governing ESG issues was scattered and did not direct any mandates about a broader set of companies.

This period witnessed the start of ESG-related investing instruments, however in a limited capacity.

- The ESG factors are **scattered into various legislations**[5], such as the Factories Act, 1948; the Air (Prevention and Control of Pollution) Act, 1981; the Environment Protection Act, 1986; the Prevention of Corruption Act, 1988; the Prevention of Money Laundering Act, 2002; the Companies Act, 2013.
- **2011**
  The Ministry of Corporate Affairs published **National Voluntary Guidelines**[6] on social, environmental, and economic responsibilities of business.
- **2012**
  The SEBI introduced BRR[7] that mandated largest 100 listed companies to publish an annual business responsibility report (extended to 500 companies in 2015).
- **2013**
  Nifty 100 ESG index[8] launched to reflect the performance of companies within NIFTY 100 index based on their ESG score.
- **2014**
  First green bond was issued by **YES bank**[9]; and India signed the **Paris Climate agreement.**

2020-2023

The period witnessed an uptick in both the growing need for ESG compliance and investor focus, leading to higher investments and deals focused on ESG.

The Business Responsibility and Sustainability Reporting (BRSR) framework was implemented with basic principles that align with broader global ESG reporting frameworks.

- **2021**
  The SEBI introduced **BRSR framework** that mandates the top 1,000 listed companies, by market capitalisation, to annually disclose ESG-related information from the financial year 2022–23 onwards.
- **2022**
  The National Green Tribunal imposed an **INR 52 crore penalty**[10] on a power and utilities company for violating environmental laws and polluting its surroundings.

  Growth in ESG fund size[11] to INR 12,447 crore in 2022, up from INR 2,268 crore in 2019.

  ESG-aligned investments[12] increased to 13 percent in 2022 of total PE investments from 5 percent in 2018.
- **2023**
  In FY 2022-2023, ESG disclosure was provided by **more than 50 percent** of the top listed companies in India.

  The Government of India launched its **first sovereign green bond**[13] amounting to **INR 16,000 crore.**

  National Green Hydrogen Mission[14] was launched with an outlay of **INR 19,744 crores** and a target of 5 MMT production capacity per annum by 2030.

The way ahead

In the future, organisations may incorporate ESG in their business and growth strategies. This may lead to higher shareholder value creation due to increasing focus on sustainable investments by stakeholders.

Further, it is expected that there will be increased scrutiny of ESG factors and enhanced clarity on regulatory disclosures.

- **2024 and beyond**
  Indian companies could **lose more than INR 7,000 billion due to climate-related risks**[15] in the next five years if they do not prioritise building robust ESG frameworks.

  The emphasis on ESG is expected to grow, which will result in **stringent scrutiny and the development of reporting KPIs.**

  The focus is shifting **towards ESG being a value creation lever,** whilst compliance was historically the primary driver.

  The incorporation of additional clarifications into **ESG reporting and assessments** will help Indian companies **benchmark against global standards.**

Shedding the myopic view of ESG in M&A

The Indian ESG regulatory momentum has been building due to heightened awareness of ESG risks and opportunities amongst investors, and increased focus on corporate sustainability. Indian companies are recognising the significance and inevitability of complying with ESG principles. This shift is an enduring change rather than an investor trend.

As investors' awareness grows, businesses are recognising the importance of ESG considerations in their M&A strategies. ESG considerations play a crucial role in evaluating strategic fit, influencing both acquirers and targets as they seek to use synergies arising from aligned ESG profiles. ESG is no longer just a check in the box, but is considered a contributor to long-term value creation by boosting growth, reducing costs, mitigating legal and regulatory interventions, enhancing employee productivity, and optimising investments. Companies that integrate a long-term ESG view within their M&A strategies are bound to have better investment performance, stronger brand reputation, improved valuations, reduced risk profile, and smoother integration.

> *As ESG continues to gain importance in M&A transactions, both buyers and sellers realise that ESG is no longer a source of risk mitigation but rather an enabler of long-term value creation.*
>
> *Nearly 70 percent organisations surveyed by Deloitte, consider ESG to be strategically important in M&A.*[16]

In the past, an overseas sovereign wealth fund excluded some of India’s largest companies in the Energy and Consumer space from its portfolio citing potential risk to the environment and human rights violations as the primary reasons.[17]

While ESG-centric M&A is on the rise, evaluating companies on ESG risks can be tough due to informational asymmetry, lack of quantifiable data, voluntary disclosures, greenwashing effect, and lack of ESG reporting standardisation. As a result, provisioning for optimal risk coverage for ESG-related concerns may pose a challenge.

However, investors can take active steps to safeguard themselves from any legal and financial complications arising from ESG-related risks. They can conduct materiality assessments to identify ESG-related risks and may seek flexibility to alter valuations based on these material risks. These assessments help companies understand the impact of the seller's business activities on the environment, society, and economy.
In addition, buyers now seek the inclusion of extensive ESG action plans, policies, and robust default provisions in transaction documents in case of breach of ESG commitments undertaken by the target. They insist on including ESG-specific disclosures, representations, and warranties that focus on compliance with generally required ISO standards or codes, operational practices, and overall ESG-specific implications.

On the seller's end, failure to disclose environmental and social issues, or observing a disconnect between ESG commitment and action can create a post-transaction risk of litigation.

Key drivers of ESG in M&A

Rise of circular economy

- Businesses working on proactive ESG improvements aim to incorporate circular solutions into their M&A plans. This approach enhances resource efficiency, meets consumer expectations for sustainability, and supports regulatory compliance.
- The Indian market witnessed the growth of innovative startups working on circular solutions that aim to create significant environmental and social impact. Large corporations are acquiring or funding these smaller organisations, gaining access to innovative sustainable solutions and accelerating the adoption of circular practices within their operations.
- A leading Indian energy exchange acquired a minority stake in an environment-focused circular solution startup, to promote a circular economy and gain a leading edge on self-decarbonisation and sustainability commitments. The collaboration will catalyse solutions for compliant waste management, including segregation, processing, recycling, tracking, tracing, and valorisation of waste materials.

The Indian eco-awakening: A shift towards sustainability

- The markets are witnessing changes in consumer awareness, spending patterns, employee expectations, regulatory frameworks, and industry perception, which are caused by ESG-related factors. According to a Deloitte analysis[18], companies that increase their ESG score by 10 points experience an increase of approximately 1.8 times in its EV/EBITDA multiple. Such factors have nudged investors to take a more ESG-driven approach to their investments.

Correlation of ESG and risk management

- Investors are recognising the direct correlation between strong ESG practices and commercial risks and opportunities in deals. This recognition has spurred Private Equity funds and corporations to use ESG-driven considerations when assessing the business feasibility of potential investment targets and the possibility of potential sustainable value creation.

According to a global consumer life study[19], two in three urban Indian consumers surveyed consider environmentally responsible actions (eco-friendly materials, reduced carbon footprints, and sustainable practices) undertaken by businesses for their purchase decisions.

Indian circular economy space[20] attracted investments of more than US$1.8 billion from 2016 to 2021 and has the potential to reach US$45 billion by 2030.

An APAC-based Private Equity fund focused on financing growth opportunities in climate tech for circularity has invested US$19 million[21] in four circular waste management and recycling companies in India.

ESG considerations in deal planning and execution

ESG

The significance of ESG is steadily increasing for both buyers' and sellers' considerations.

Buy-side

Utilise ESG as a catalyst to drive deal success

Build strong ESG credentials

Set criteria for target selection to fuel self-ESG goals and improve sustainability efforts.

Ecosystem analysis

- Better transparency and evaluation of both financial (forensics, etc.) and non-financial factors (environmental policies, labour practices, board structure, etc.) affect business during ESG-focused due diligence.
- Safeguard the acquirer against potential future litigations and penalties.
- Get a ground view on the target's supply chain, customers, group companies, affiliates, and related party concerns.

Long-term stakeholder value

Deliver stakeholder value by establishing efficient operating models, retaining talent, and embedding a sustainability-conscious culture in the merged entity.

Sell-side

Boost economic value through ESG-focused asset building

Attractiveness to prospects

- Investors look for businesses that act towards ESG mechanisms.
- ESG data helps investors get a better understanding of a business and its associated opportunities and risks.

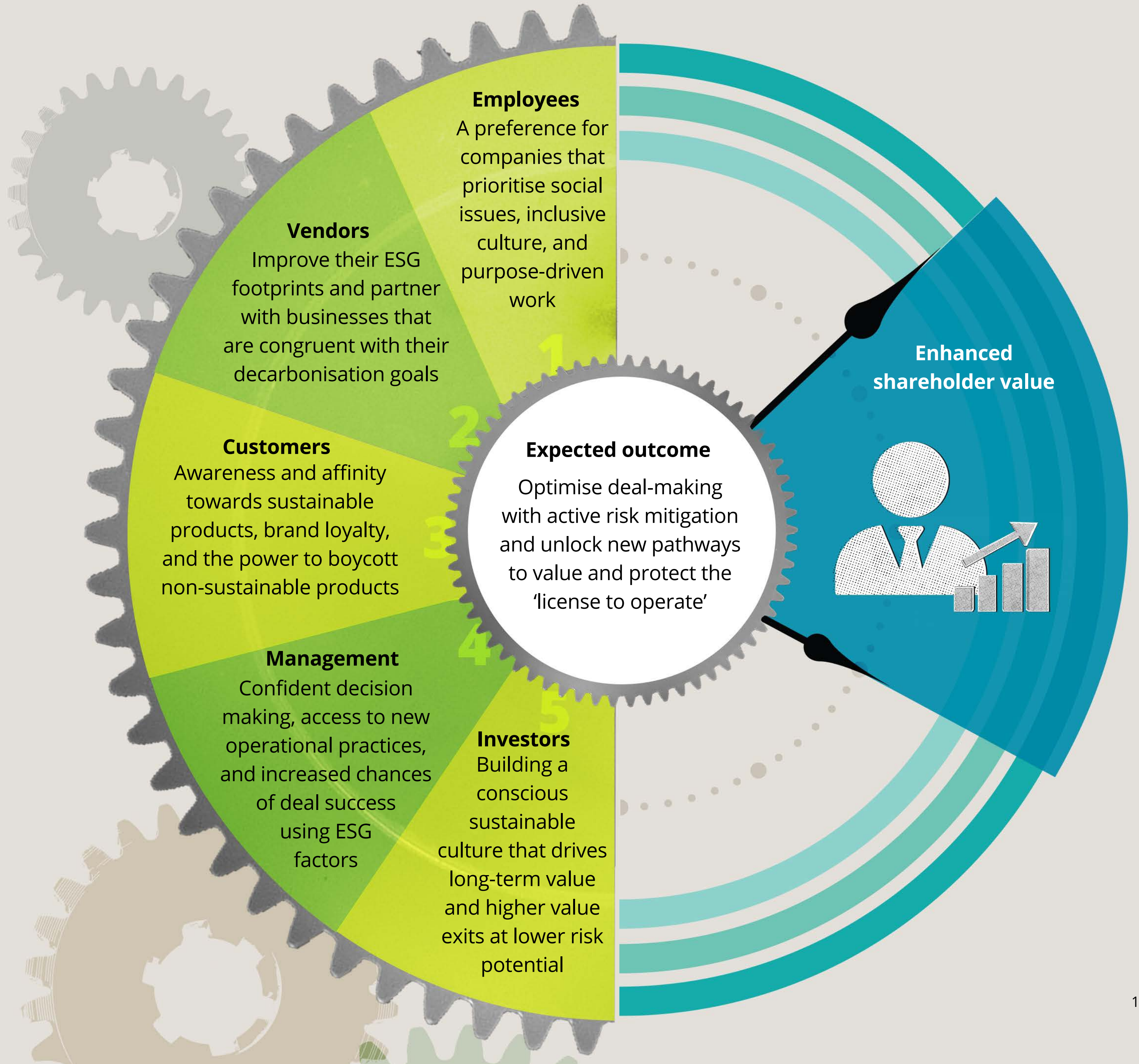
High-value exits

- Sellers with ESG focus, climate changes commitment and actions, attract an 'ESG premium' resulting in higher value exits.
- One of the largest Japanese PE firm-backed Indian renewable energy companies was sold to an Indian conglomerate at a premium enterprise valuation due to its best-in-class governance, operations, and maintenance practices.

According to a Deloitte survey[22], 75 percent of Indian CXOs said, they were assessed on ESG performance before finalising a deal.

The expanding stakeholder universe has permanently integrated ESG into the transaction cycle

Factors that strengthen implementation of ESG-related strategy for M&A

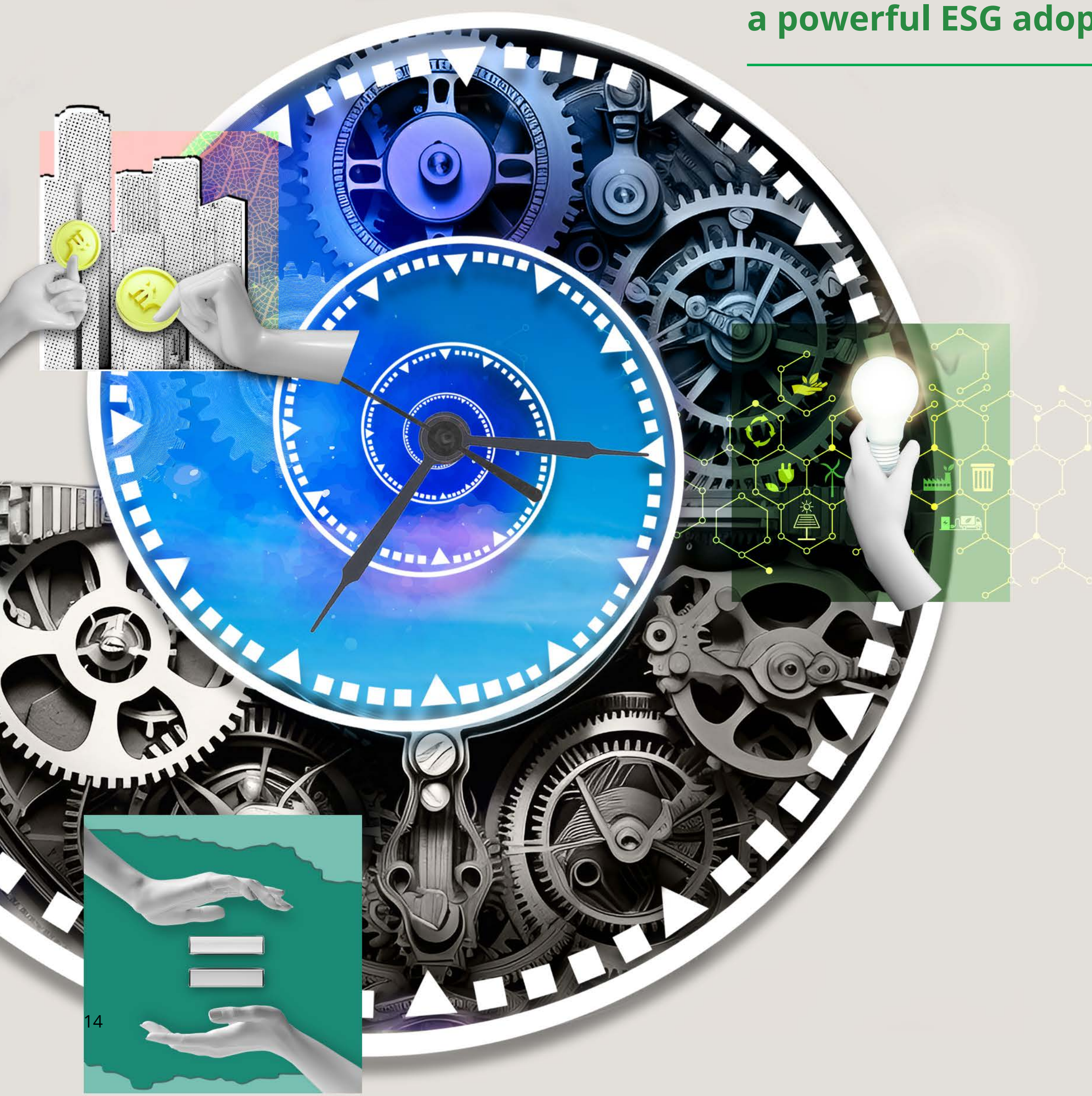


In the past, pressure from regulators was often the key driver of ESG action. Now, pressure from stakeholders—customers, employees, suppliers, and investors is strong enough to lead to value destruction in an enterprise.

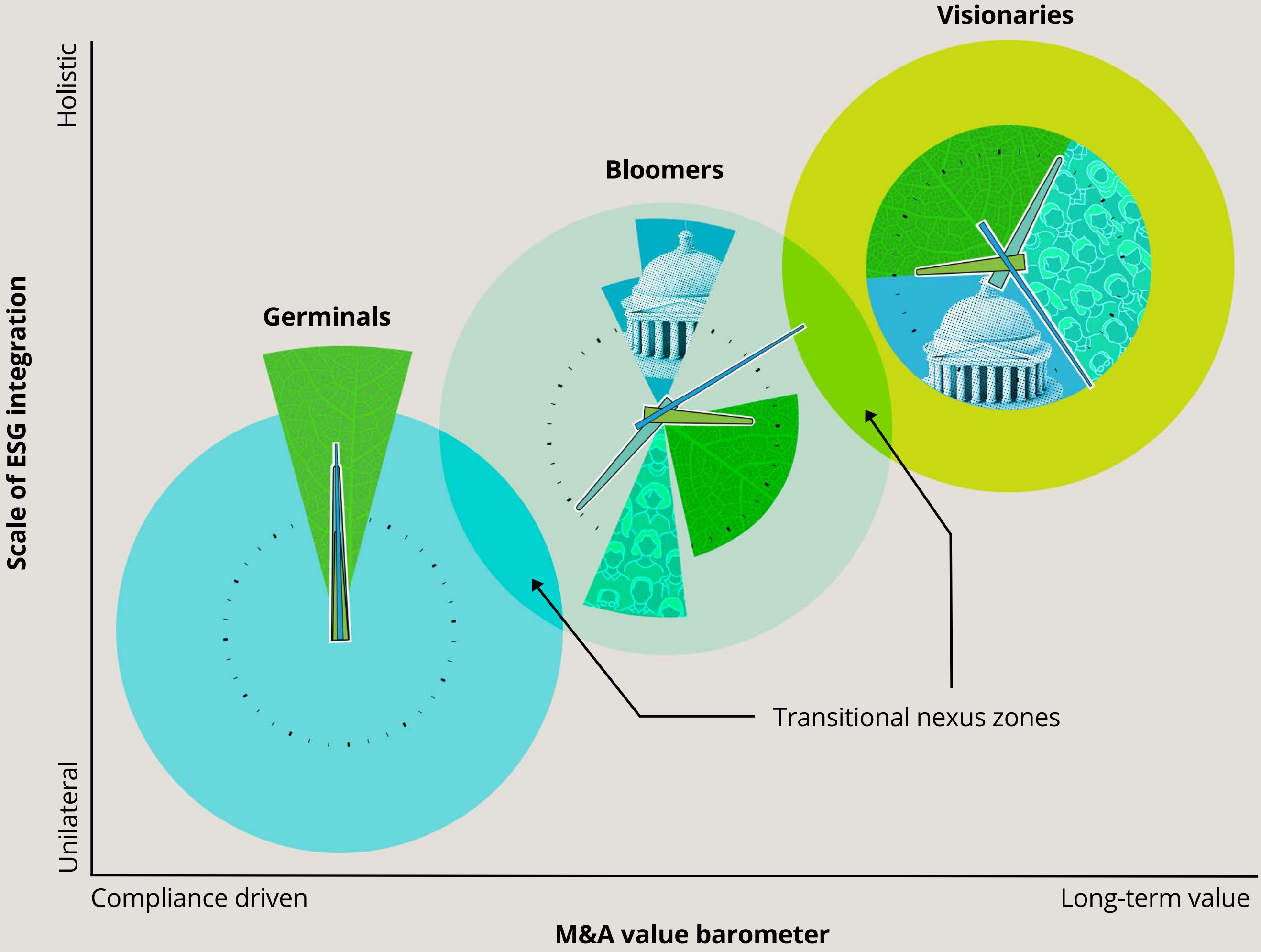
As ESG concepts gain recognition across the business value chain, we are witnessing a shift in stakeholder attitudes. Employees are now demanding purposeful work. They want their company to take a strong position on social issues and make an impact that matters. Customers are making choices in the marketplace based on purpose and sustainability. Millennials and Gen Z inherently focus on sustainable businesses and base their purchase and investment decisions based on an ESG rationale. With the growing regulatory pressures, vendors and suppliers are also looking to improve their ESG footprints and partner with businesses that are congruent with their decarbonisation goals. Investors are resorting to green financing to attract higher returns, build a conscious sustainable culture, and focus on long-term value.

Companies are increasingly concerned that risks arising from the value chains of acquired companies will challenge their license to operate. Hence, ESG is now seen as a strategic imperative for M&A. In addition, board rooms are incorporating ESG strategies across their transaction cycle, to stay competitive and derive multiplied value from these deals.

According to a DBS and Bloomberg Media studios survey, 92 percent of Indian SMEs agree that the influence of the global value chain, including vendors, suppliers, and customers is a powerful ESG adoption driver.



ESG value framework



Evaluation metrics

The scale of ESG integration
The nature of ESG integration is often limited to only one or maybe two ESG components during a transaction, leading to a narrow view of the ESG palette. However, few companies pay equitable attention to all three components of ESG, both in terms of breadth and depth of integration, which is a desirable element in M&A transactions.

Value barometer
Realising the tangible value of ESG integration in the deal lifecycle depends on companies' commitment. Some may view it from a compliance lens, while others have a genuine inclination to build a sustainable community. The former results in a short-sighted perspective, which focuses on avoiding fines. The long-term planning focusses on investing in a well-rounded ESG strategy.

Transitional nexus zones denotes the overlap where organisations in the preceding maturity are progressing partially towards the next level.

Germinals

For these organisations, commitment to ESG components in M&A deals aims to fulfill immediate regulatory obligations, with a focus almost exclusively on environmental goals. This selective compliance is motivated by a desire to avoid penalties whilst meeting obligatory responsibilities. As a result, such short-sighted M&A transactions mostly fail to foster long-term sustainable growth and value creation, ethical business practices, or meaningful societal contributions.

Bloomers

Organisations in this category have articulated the benefits of investing in all ESG aspects, including M&A transactions. This has positioned them well to generate significant long-term value as their implementation efforts yield results. However, they lack a comprehensive strategy for all three components and tend to approach ESG principles in a siloed manner.

Visionaries

At the most mature end of the framework, the visionaries are well positioned with a strong emphasis on ESG goals when evaluating and executing deals. They invest in their people, processes, and profits to ensure sustainable long-term value creation. They adhere to the needs of their investors, employees, shareholders, board, and extended enterprise while maintaining a responsible brand image within the community.

According to a Deloitte global capital allocation and resilient portfolio survey, 65 percent of businesses believe that ESG boosts enterprise value, while 40 percent see it as a competitive advantage with the potential to create value.

No strict boundaries separating ESG principles

Visionary organisations and investors understand that there exist no firewalls between E, S, and G. As the industry responds to global climate change and given the measurable impact of climate factors, most pledges, international commitments, and governmental policies focus on environmental issues. However, this creates a ripple effect on the organisations' social culture, which can subsequently lead to improved governance.

All the three factors–E, S, and G–are interlinked. We cannot draw a clear demarcation amongst them. ESG collectively functions as a core strategic driver to help future-proof organisations and deliver meaningful impact over the long term.

As the dynamics of business deals transform, the emphasis on ESG is expected to grow–**96 percent of corporate and Private Equity investors anticipate increased ESG scrutiny in deals over the next three years.**[23]

ESG planning appears to be falling behind in comparison to the increasing awareness. However, teams overseeing M&A strategy and deal-making are now acknowledging the growing importance of ESG.

Indian companies must understand that **ESG in M&A isn't "easy come easy go."**

- Integrating ESG in M&A can be tricky due to the lack of knowledge and credible qualitative ESG data for basing investment decisions.
- The operational practices associated with ESG evaluation increase the overall transaction costs.
- Companies often tend to have a short-sighted view on the value that ESG curtails for the stakeholders.
- Various departments within a company prioritise ESG differently, leading to integration of ESG considerations in deal making taking a secondary role.

In the end, businesses must recognise that ESG is not merely a compliance metric, but a crucial value creation lever that can drive value for the stakeholder, business, and society.

Our recommendation

Create a cross-functional ESG team of legal, finance, operations executives and the chief sustainability officer to emphasise that ESG is a collective responsibility and shared commitment throughout the enterprise.[24]

References

[1] https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1961797

[2] https://www.sebi.gov.in/legal/circulars/may-2021/business-responsibility-and-sustainability-reporting-by-listed-entities_50096.html

[3] https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1967476

[4] https://www.pib.gov.in/PressReleasePage.aspx?PRID=1907698

[5] https://iclg.com/practice-areas/environmental-social-and-governance-law/india

[6] https://www.pib.gov.in/Pressreleaseshare.aspx?PRID=1568750

[7] https://www.bseindia.com/downloads1/BRR_FAQs%2010052013.pdf

[8] https://www.nseindia.com/products/content/equities/indices/Factsheet_NIFTY100_ESG_Index.pdf#:~:text=Launch%20Date,March%2027%2C%202018

[9] https://archives.nseindia.com/corporate/YESBANK_30042021171209_GreenBondsdisclosureFinal.pdf

[10] https://www.deccanherald.com/business/ngt-orders-adani-thermal-plant-to-pay-rs-52-crore-for-damaging-environment-1114415.html

[11] https://www.business-standard.com/article/markets/assets-of-esg-funds-rise-5x-in-four-years-to-rs-12-450-crore-shows-data-122042400997_1.html

[12] https://www.bain.com/about/media-center/press-releases/2023/2022-indian-pe-vc-investments-surpass-$60-billion-for-the-third-consecutive-year-amid-global-headwinds/

[13] https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1896724

[14] https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1897043

[15] https://www.cdp.net/en/articles/media/indian-companies-see-7-138-billion-us100-billion-financial-impact-due-to-climate-risks-in-the-next-five-years-corporate-commitments-to-the-science-based-targets-initiative-sbti-substantially-increase

[16] https://www2.deloitte.com/content/dam/Deloitte/us/Documents/mergers-acqisitions/us-four-ways-esg-is-reshaping-m-a.pdf

[17] https://timesofindia.indiatimes.com/business/india-business/norway-sovereign-wealth-fund-excludes-bhel-from-portfolio/articleshow/58543498.cms#:~:text=New%20Delhi%2C%20May%205%20%28%29%20Norway%20%27s%20sovereign,based%20on%20its%20assessment%20of%20risk%20to%20environment.

[18] https://www2.deloitte.com/ch/en/pages/financial-advisory/articles/does-a-company-ESG-score-have-a-measurable-impact-on-its-market-value.html

[19] https://www.gfk.com/insights/indian-consumers-evolving-priorities-towards-environment-sustainability

[20] https://kalaari.com/wp-content/uploads/2022/04/Circular-Economy-Report-2022.pdf

[21] https://economictimes.indiatimes.com/industry/banking/finance/circulate-capital-commits-usd-19-mn-investment-in-4-waste-management-cos-in-india/articleshow/79661163.cms

[22] https://www.vccircle.com/thegrowing-significance-of-environmental-social-and-governance-in-m-a

[23] https://www.aon.com/en/insights/articles/esg-factors-are-carrying-increasing-importance-in-mergers-and-acquisitions-dealmaking#:~:text=According%20to%20Aon%27s%20M%26A%20Risk,expecting%20it%20to%20increase%20significantly.

[24] https://www.deloitte.com/global/en/services/tax/perspectives/tax-aspects-of-esg-in-m-and-a.html

Connect with us

Rohit Mahajan
Partner, One M&A Leader,
Deloitte South Asia
rmahajan@deloitte.com

Bimal Modi
Partner, Deloitte India
bimalmodi@deloitte.com

Anil Talreja
Partner, Deloitte India
atalreja@deloitte.com

Vishal Jain
Partner, Deloitte India
jainvishal@deloitte.com

Abhijit Agarwal
Partner, Deloitte India
aagarwal1@deloitte.com

Sumeet Salwan
Partner, Deloitte India
sumeetsalwan@deloitte.com

Acknowledgements

Ankita Vaiude

Manasi Kajabaje

Rebecca Dsouza

Sanchi Gabrani