How Purpose Is Changing the Board M&A Oversight Role: What Directors Are Saying

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INTRODUCTION

While the past two years have been defined and dominated by the global spread of COVID-19, the world has also witnessed a renewed reckoning with racial, economic, and environmental issues. Progress in the economy and success in business has taken place against a backdrop of protests in the streets, splintered politics, and an ever-more-worrying climate outlook.

These are powerful forces. Companies can feel the urgency, and the need to respond in constructive ways, as consumers and workers demand that businesses generate positive social impact. Society is asking how companies can produce solutions, not problems. Corporate boards, in their oversight role, have an opportunity to respond to this growing demand from diverse stakeholders seeking better outcomes.

Taken together, these concerns put a premium on corporate purpose—the ability of a company to align around a set of principles that define how it contributes to the greater good. Purpose can permeate the organization and extend into everything the company does, including mergers and acquisitions (M&A).

The organizations that will thrive today and in the future will be those that define their purpose broadly, addressing a broad range of stakeholders. They will be the companies that acknowledge, as the Business Roundtable articulated in its 2019 redefinition of corporate purpose, a responsibility to their customers, employees, and communities, while also generating long-term value to investors. Businesses have a moment right now where they can engage the stakeholders who they may have failed to fully recognize in the past.

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Defining purpose

Purpose is bigger than the environmental, social, and governance (ESG) objectives that are a focus for a growing number of investors. It is broader than the diversity, equity, and inclusion goals that corporate managements have begun to address, and it goes beyond the environmental, health, and safety programs or corporate social responsibility initiatives companies may already have in place.

Deloitte views purpose from the perspective of inclusive prosperity—defined as the effort to drive value through a focus on greater inclusion and shared prosperity. This is about what companies can do to make the world more equitable, accessible, safe, and sustainable for all stakeholders. This is about value creation seen through the lens of what a business can do to improve the community or society in which it operates.

Executives and directors may have a range of definitions in mind as they discuss purpose. Some may be referring to a longstanding set of values the company brings to its decision making. Others may think of purpose as how the company responds to demands from customers, employees, or the community for better efforts on diversity or faster action on carbon emissions. Some leaders may see purpose mostly in terms of the company's brand, products, and reputation.

And yet, the purpose conversation, however it's defined, is reordering priorities for executives and directors. Bringing these new priorities to the table will be increasingly important as companies plan M&A strategy and pursue deals.

To assess how companies are using purpose as a lens for M&A strategy, target evaluation, and deal execution, we interviewed a select group of corporate directors across a variety of industries. We asked what role purpose plays in dealmaking today, where it comes into play, and how it affects decisions. We asked how they see this changing in coming years. This report is based on their responses, along with the experiences of Deloitte professionals who advise on thousands of transactions each year.

KEY PROJECTIONS

1. **Purpose doesn't set M&A strategy yet—but that may change.**

   Successful companies approach their M&A decisions with financial rigor, making sure that they know how a given deal will help to meet growth goals or fill competitive gaps. Revenue, margin, and earnings per share (EPS) are paramount. According to our interviewees, ESG considerations mostly don't yet reach the board level as M&A strategy is formed or potential deals weighed.

   ESG is interesting, but EPS is still more important, according to one interviewee who serves on the boards of several global companies. This may be changing, however, especially as the pandemic and other recent events have boosted debate on a range of issues. Purpose is demonstrated when a company acts in accordance with its values, and few boards are going to be willing to go out and acquire a company whose values are not in line with their own, this director argues.

   Indeed, as purpose permeates business strategy and planning, the impact on M&A strategy may become inevitable. A cosmetics maker building its brand around environmentally responsible product packaging may want to acquire a packaging company that uses recycled materials innovatively. An apparel company that's committed to better treatment of workers might pursue a vertical supply chain integration to gain control over factory conditions.

David Meador, vice chair of DTE Energy, says a company such as his that pursues environmental leadership as part of its mission could well see purpose affect its M&A strategy. It might target a renewable energy technology company, for example. He adds that corporate purpose can also affect divestitures. In a recent spin-off, DTE Energy took steps to ensure that the carved out entity would have adequate resources to continue to pursue the environmental, social, and community objectives that the parent company established.

2. **Corporate purpose increasingly defines what acquisition targets are viable.**
That a company would seek to avoid headline risk in the acquisitions it pursues is hardly a new idea. Still, the increasing focus on corporate purpose raises the stakes around what might be considered an acceptable deal.

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For example, a buyer may not be interested in acquiring a company that has a history of racist policies or a track record as a polluter, according to Jim Hinrichs, a director at several life sciences companies. A potential buyer may want to avoid doing a transaction with a business that has a reputation for treating its employees unfairly. A growing focus on a company's purpose may reinforce such thinking.

Consider a life sciences company that discovers a business it intends to buy has significant unaddressed quality-control issues. This might be something that can be fixed, or it might be a reason to walk away. Insofar as the purpose of a life sciences company is to bring effective and safe products to patients, Hinrichs suggests, such decisions have tight links with corporate purpose.

There are businesses forming around ESG concepts. To cite one example, an investment trust saw potential value in ecologically sound resorts. They began by developing a product and service concept, and then they used this to identify acquisition targets. Their wish list for a potential purchase included: an ecologically viable water source, access to clean energy, a population that could benefit from a new source of employment, and a government that treats local populations fairly. Eventually, M&A diligence will include many of these points to identify value and incremental investment.

New concerns relevant to M&A activity may emerge as companies more carefully define their purpose, weighing how their actions affect a broader group of stakeholders. Even away from the bigger issues that might have raised red flags in the past, diligence is changing and may come to include an ESG scorecard right alongside assessments of financial control systems, HR competencies, or technology infrastructure.

3. **Purpose is playing a bigger role in integration planning and execution.**
   If corporate purpose has growing importance for the financial success of every company and an expanding influence on its M&A activities, it follows that purpose will also be relevant to the integration planning and execution that comes with every deal.

   Companies are beginning to ask how completion of a merger is going to impact various ESG efforts. Will the combined workforce be more or less diverse? Will planned workforce reductions adversely impact a particular community? Will the combined company have a better or worse carbon emissions profile? These issues are being pushed to the fore, and they come into play during divestitures too. When the right questions are on the table, the integration planning process can be adjusted to mitigate impacts and improve outcomes.

   To be sure, value can be created in the process of addressing problems or shortcomings during an M&A transaction. When a company might be able to improve the diversity efforts of an acquisition target, or put better environmental policies in place, there may be much to gain from the deal, not just for the acquirer, but for society as a whole.

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4. **Purpose-driven investment funds are driving purpose in M&A.**
   In a trend that has been building for many years—and one that accelerated during the pandemic—investors have come to believe more strongly that their money can be put to work in ways that produce prosperity in a more inclusive manner. This can be seen playing out in the explosion of retail stock investment funds with ESG parameters and in the recent growth of private equity and venture capital funds with specific themes, such as renewable energy or Black entrepreneurship.

   In some respects, a greater attention to and broader definition of corporate purpose can actually come full circle. If investors want companies to address the impact that they have on a broader set of stakeholders, then the purpose-driven company that is mindful of broad stakeholder impacts will in fact be paying heed to what investors and shareholders want. This is going to play out in the context of M&A and in other activities.

BOARD IMPLICATIONS

1. **Board members should be actively engaged in the purpose discussion.**
   Board oversight responsibilities should extend to what management is doing to shape and pursue the company's purpose. This requires formal inclusion of defined topics on the board agenda. Reports to the board on progress toward diversity goals might be appropriate, for example, or regular presentations on community economic development efforts. Some of these will undoubtedly become part of a company's regulatory reporting, if they haven't already.

When reporting around purpose-related objectives is on equal footing with other topics such as growth goals or financial milestones, and when it begins to inform M&A strategy and decisions, it indicates that management and the board are giving proper weight to corporate purpose. At DTE Energy, senior executives some years ago created a force-for-good committee that reports to the board on a regular cadence. Meador explains, “That was a tipping point.”

It also matters that the discussion around purpose is honest—that it’s not just for appearances. It must be focused on real, important societal concerns that the company and its people feel compelled to address, Meador says. When that’s the case, it will pay dividends in areas such as employee and community engagement and ultimately will improve financial performance.

2. **Boards need a clear definition of purpose—and a way to measure progress.**
   Directors, working with management, should be able to articulate a company’s purpose and clearly define the objectives that support it. They need metrics that make it possible to track progress toward these goals. Increasingly, such metrics will be necessary whenever an M&A transaction is contemplated.

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In the Deloitte M&A Trends survey, conducted in October, corporate and private equity executives reported that ESG considerations now play a prominent role in their dealmaking. More than three-quarters of respondents (77%) said they incorporate ESG metrics in setting valuations and assessing risks, and 75 percent said they have reevaluated their business portfolio for acquisitions or divestitures using an ESG lens.

Kelsey Lynn Skinner, a technology venture capital investor at IP Group in London, who serves on public and private company boards, says that in a recent deal she was involved with, a large European company wanted metrics on diversity and carbon emissions for a business it was acquiring. These metrics were part of the discussion process, even if the financial numbers were still going to define the transaction.

There are few standards so far that address what ESG issues a company should track or how metrics should be reported, though European companies have reporting requirements related to climate change and some other issues.

Companies are just beginning to grapple with this challenge. “Across my experience as a director, I see how management is still having difficulty with purpose and ESG in determining what they should measure, how they should measure it, and how they can be consistent in their approach,” Skinner says.

Indeed, some 72 percent of respondents in the M&A Trends research said ESG is a challenge for their organization. And yet, these issues also cannot be ignored: in the survey 72 percent of respondents said the environmental or social behaviors of acquisitions or portfolio companies had caused significant unrest among stakeholders and investors.

"Sometimes it's better to start with something instead of nothing—rather than waiting for the perfect approach—and be willing to have it evolve as you go," Skinner suggested. For precisely these reasons, board oversight and involvement in this effort may be particularly relevant right now.

3. **Boards should consider how M&A can be an engine to achieve a company's purpose.**

Boards today are looking for all the possible touchpoints where they can exert influence or find leverage to support the greater purpose of the company. M&A activity is one of those touchpoints. This may not be the first place where purpose or ESG concerns garner attention, but because M&A presents important opportunities to shape a company's future, it will also be an engine for shaping its purpose.

A company's purpose may be more or less directly related to its business mission. Elisha Finney, who serves on boards of companies in the technology and health-care industries, says that when an organization is in the business of making medical products, for example, that may clearly define its greater purpose. However, a company that sells entertainment or markets clothes or appliances also has a larger purpose as well. In either case, the setting of M&A strategy or the pursuit of specific deals will present significant opportunities to drive or change the organization's purpose—and boards should be alert to such opportunities.

BOARD OVERSIGHT QUESTIONS

- Has purpose been defined and clearly built into our corporate strategy?
- Has the M&A strategy or the screening process for potential deals been reviewed to assess how well it supports our company's purpose?
- Is the board examining M&A activity as an opportunity to help reshape or reinforce the company's purpose?
- Are defined topics related to the company's purpose being reported to the board on a regular basis?
- Does the board know what ESG metrics are being included in regulatory reports, or which metrics and topics related to purpose might need to be added to such reporting?
- In integration or divestiture execution planning, does our company examine how different racial or ethnic groups in our workforce may be disproportionately affected?
- Does the organization, in its M&A diligence, specifically examine a target company's ESG goals (including metrics around diversity, environmental compliance, and so on) and assess how they complement or conflict with the company's purpose?


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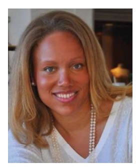
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