PRIMER

BSR

Key Considerations in Managing ESG through a Merger

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Introduction

We are living through a time of tremendous external disruption, technological innovation, and increased political, social, and climate risk. As a result of this ongoing disruption, we are seeing significantly increased mergers and acquisitions (M&A) activity as companies seek to buy into the latest innovation or disrupt the competition—or seek to prevent being disrupted by the competition. According to the EY report *Global Capital Confidence Barometer*, 59 percent of respondents expect to pursue M&A activity in the next 12 months, noting that "in an age of transformation, buying rather than building can unlock future value creation at speed."

These mergers or acquisitions can have a huge impact on the state of environmental, social, and governance (ESG) affairs for the companies involved. M&A activity creates substantial ESG opportunities and risks for the companies involved: opportunities to create more ambitious and resilient sustainability strategies, but risks that ESG objectives will be sidelined by overwhelming pressures to create short-term value. As leadership will likely emphasize legal and financial due diligence in the lead-up to the merger, ESG considerations risk becoming an afterthought during the merger processes. However, there is an opportunity to develop a due diligence process that more effectively considers ESG issues, thereby mitigating the reputational and financial risk associated with potential ESG crises and positioning the company to build competitive advantage through better integration of its sustainability strengths.

Many companies have achieved differentiation through their ESG performance and won't want to risk losing that competitive edge with customers, consumers, employees, or investors. A successful merger requires integration of culture, strategy, and processes—and a company with a resilient sustainability strategy will be better positioned to integrate ESG elements across that culture, strategy, and processes as well. There is a range of scenarios that might occur:

- Company A bids to acquire Company B, but it is rejected by the Company B's board due to a lack of commitment to ESG or sustainability[1]. How can Company A avoid this in the future?
- One company has nascent sustainability efforts while the other has a robust sustainability program—how can the merger create an opportunity to bring the newly formed company up to the higher standards?

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[1] We will use the terms ESG and sustainability interchangeably throughout the document. In essence, environmental, social, and governance policies within an organization contribute to the company's overall sustainability.

- A smaller, sustainably oriented brand is bought by a larger company—how can the executives ensure that the sustainability commitments, credibility, and progress will continue?

- A larger company intentionally buys a sustainable brand to incubate more sustainable processes or products—how can they replicate those learnings across other parts of the business?

- Two companies with significant investments in ESG merge—how can they combine their efforts, teams, and data in a meaningful way?

It is also important to note that sustainability is managed by different functions in different businesses, so it will be essential to identify and engage all the functions that have an impact on ESG issues, including a formal sustainability team, communications, marketing, legal, compliance, risk, public affairs, procurement, environment, health and safety (EHS), and human resources (HR).

An organization's Chief Sustainability Officer (CSO) as well as leaders across all business units and departments who value ESG performance have a role to play in ensuring that ESG remains a priority throughout the M&A process. M&A decisions are driven by boards and executive management, and these involve a variety of strategic, financial, and governance decisions. Ideally, boards and executives would include ESG considerations in those decisions. This primer, however, focuses on actions that sustainability teams can take. It provides a guide on what questions to ask in such scenarios and how to manage ESG through the lifecycle of the deal and integration.

Managing ESG through a Merger

Mergers and acquisitions are a common occurrence in the business world causing a period of transition, uncertainty, and restructuring, which can pose a significant threat or opportunity to an ESG program. The below steps illustrate the governance measures that can help you keep your ESG program intact through a merger or acquisition.

PRIOR TO MERGER

- **KEY CONSIDERATIONS:**
    - **Integrate due diligence:** Regulatory and reputational due diligence is an essential process prior to a merger or acquisition. Work with the business leaders within your company to integrate ESG considerations into the process. What are the ESG risks or opportunities affiliated with the company that yours will be merging with? What are their salient human rights issues and material climate change risks, and how are they addressed?
    - **Understand the context:** Evaluate the sustainability state of play in the other company involved in the merger as well as their organizational capabilities. Is there a sustainability team and/or program in place? How would it complement yours? Are there redundancies? What internal systems and expertise do they have in place?
    - **Build the business case:** Assess your ESG program in the context of the impending merger and determine which drivers will best resonate with different internal stakeholders: ethical, legal, operational, reputational, political pressure, investor pressure, customer pressure, peer company action, brand enhancement, other stakeholder pressure. This, along with an understanding of the organizational culture, will help you build buy-in and position ESG successfully in transition conversations.

» **QUESTIONS TO ASK:**

- What are the ESG risks or opportunities presented by this potential merger?
- What are the strengths and expertise that the new company brings with regards to ESG? How can you bring the best of both sustainability programs into the new company?
- What is the value proposition for your ESG program? How might you articulate it differently for different internal stakeholders?

DURING AND IMMEDIATELY FOLLOWING MERGER

» **KEY CONSIDERATIONS:**

- **Assess the business context:** A merger or acquisition may mean that your new company is very different from the previous one in significant ways, including the industry, key risks or issues, and relevant regulations. For example, a U.S.-based company may acquire a Brazilian company to expand into Latin America and face an entirely new business context. Alternatively, a consumer packaged goods company may buy a company that produces its own raw materials and thus have to shift to thinking about agriculture as part of its core business, rather than as part of its external supply chain.
- **Evaluate material risks and opportunities:** It is essential to understand and disclose the material risks and opportunities of the newly merged company. The other company involved in the merger may have a very different risk profile that you will inherit once the merger is complete. What risks and opportunities do they face that your current company does not? What systems do they have in place to address these risks?
- **Understand the internal landscape:** Map the internal landscape at the new (combined) company, including priorities, policies, processes, and decision makers. As you consider the new company's approach to ESG issues, identify best practices in both companies' sustainability programs. While there will inevitably be changes to the newly integrated approach to account for differences in goals, priorities, and risk profiles, there is also potential to leverage best practices to develop and strengthen the new company's ESG program.
- **Integrate into new organizational structure:** Within the new company, provide briefings for functional teams across key geographies. There is value in being humble and open to learning from ESG and sustainability counterparts from the company that yours has merged with. Develop a steering committee to engage the newly combined key functions in the strategy and oversight of the ESG priorities.
- **Use external stakeholders:** Allies can also be external stakeholders who promote your program and reinforce the risk of falling behind. Oftentimes, outside pressure or interest from civil society and government regulators can have a big impact on corporate behavior.
- **Manage expectations:** You will face roadblocks and not everything will be achieved in the first year. Sketch out an ambitious yet realistic schedule, with tiers of strategies/actions based on priority level (must-do's, nice-to-do's) so your plan can be scaled depending on budget and executive appetite.

» **QUESTIONS TO ASK:**

- How has our overall business profile changed and what are the most material risks and opportunities of the new company?
- What best practices can be leveraged from each of the existing programs? How will you navigate roadblocks to building or maintaining an ESG program? Roadblocks could include no budget, delayed approvals, or key staff layoffs.
- How will you build trust and culture among the new team?

ONGOING MANAGEMENT

» **KEY CONSIDERATIONS:**

- **Prepare for a fluid environment:** Expect ongoing changes in terms of operations, management, etc. Integration takes months at a minimum, and in many cases years.
- **Continue to monitor material issues:** Depending on the nature of the changes to your business, your material ESG issues may have also shifted. Reassess whether your most recent materiality assessment needs to be updated for your next sustainability reporting cycle, and consider the implications this may have for your overall governance and communications. For example, an apparel company that has acquired a wearables company may now be facing new issues around data privacy and will need to be sure to include that issue in its materiality assessment, as well as transparently communicate how it's addressing this new issue in its management practices, goals and commitments.
- **Update your ESG governance structures:** Examine your existing sustainability governance structures and consider which new colleagues should be added to relevant committees, etc. Are there new data providers for key metrics? Check in with them well before your sustainability reporting cycle if possible, to make sure you are aligned on systems, measurement, and timelines.
- **Fill internal information gaps:** Are there new employees who may not be aware of how sustainability relates to their jobs? Are there new executives who should be made aware of your programs and policies? Consider how best to educate your new peers about your approach to these issues and create a plan of action.
- **Revisit technical aspects on reporting:** Does your current approach to reporting, including your use of the Global Reporting Initiative (GRI) or Sustainability Accounting Standards Board (SASB) standards, meet the needs of the new company? Are there new rankings or ratings that are applicable to the new company, or are there aspects of the new company's business model that these groups should be made aware of in order to accurately assess it? How do the reporting timelines of the two companies align or differ, and how can reporting data be streamlined in a way that promotes accuracy, integrity, and efficiency?

» **QUESTIONS TO ASK:**

- Are your existing governance structures well-suited for the management of these issues?
- How do you plan to report on ESG data for the new company? Have you connected with the right colleagues to make this possible?
- It is likely there will be ongoing change after the merger closes. Integration is not a one-time activity. How will you prepare for this fluidity and navigate it?

Conclusion

Pursuing mergers and acquisitions is a strategic business decision that can allow companies to expand their technical capabilities, talent pool, and geographic reach, among others. However, the process brings with it uncertainty for departments across both organizations, including those responsible for ESG performance. As such, M&A activity carries both risks and opportunities for the sustainability team.

While ESG priorities may be swept aside if management focuses solely on legal and financial due diligence, business leaders who understand the value of resilient sustainability strategies can and should act to ensure ESG programs continue in the newly-formed company.

We understand that there is a plethora of ways two companies can merge: a smaller company being acquired by a much larger one, or two conglomerates with multiple business units combining into an even larger company. The guidance in this primer may not fit every variation of M&A, and for those in need of advice for their particular situation, BSR is available to connect.

CONTACT

If you're interested in learning more about BSR's work in helping companies manage ESG and sustainability issues, please don't hesitate to get in touch. We look forward to connecting with you.

ABOUT BSR

BSR is a global nonprofit organization that works with its network of more than 250 member companies and other partners to build a just and sustainable world. From its offices in Asia, Europe, and North America, BSR develops sustainable business strategies and solutions through consulting, research, and cross-sector collaboration. Visit www.bsr.org for more information about BSR's 25 years of leadership in sustainability.