

BDO Deal & Valuation Advisory

Exploring the Impact of ESG on Valuation and Deal



Introduction

As environmental consequences become more apparent, social inequalities worsen, and sustainable laws are implemented, ESG (Environmental, Social, and Governance) factors are a new reality that all businesses must address. At the same time, pressure against the ESG movement is rising, especially in the US. **This raises the question: should corporations disregard ESG or embrace it?**

75% of company leaders view the ESG transition as an opportunity to create value rather than merely a compliance exercise with new regulations. *(Source: BDO & Mercuri Urval survey)*

In this paper, BDO Belgium's Deal & Valuation Advisory team aims to shed light on the **consequences of ESG on business valuation and deal-making activities**.

Valuation integrates various business aspects such as finance, strategy, and operations into a single metric that guides leaders, shareholders, and investors in their decision-making processes.

The first part of this paper aims to clarify the link between ESG and valuation by drawing on real-world experience, academic research, and insights from surveys and market reports.

We will examine how ESG considerations affect existing valuation methods and highlight what business leaders and shareholders must do to either create or preserve the value of their businesses.

Deals play an integral role in a business's life, as firms engage in them for a multitude of reasons: increasing market share, gaining control over the value chain, divesting certain assets, or having a desire to sell their shares.

The practical implications of ESG considerations on each step of the deal-making process will be explored in the second part of this paper.

We will provide recommendations on how business owners, corporate leaders, and private investors can incorporate ESG considerations into their buy-side and sell-side transactions.

Our observations indicate that ESG is not just a compliance exercise or an optional addition to a company's strategy, but an integral aspect of it. More precisely, companies that are proactive and strategic in their approach to ESG can enhance their value and facilitate their deal process. Those that overlook these critical dimensions risk a decrease in their value and shareholders may encounter challenges when attempting to sell their holdings or access funding.



ESG factors play a growing role in our valuations and M&A transactions, as they significantly influence buyer interests, financing terms, and ultimately the success of transactions. Thus, business leaders, shareholders, and investors must incorporate ESG factors into their decision-making processes to capitalise on opportunities and minimise risk exposure.

Alexandre Streel, Valuation Partner

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ESG is here to stay

Key takeaways

Sustainability and ESG have become integral aspects of the corporate landscape. Despite the recent opposition against ESG (particularly since the latest US elections), we believe that ESG is here to stay. This belief is supported by three trends that will have a profound long-term impact on business environment:

- ▶ As consequences of the climate crisis become tangible, companies and their leaders must take action to reduce and manage their exposure to environmental risks;
- ▶ Effects of sustainable laws that have been issued (and currently being reviewed) in Europe are becoming tangible for all companies;
- ▶ Social inequalities are becoming key issues within corporations that business leaders must address.

In addition, we believe that private companies, particularly those backed by private equity and family owners, are ideally positioned to lead the sustainability transition, leveraging their majority ownership, direct information access, and long-term perspectives.

For all these reasons, ESG has significant implications on valuation and deal.

- ▶ On the one hand, recent surveys indicate a positive sentiment between ESG and valuation: 79% of surveyed European dealmakers consider that higher ESG maturity leads to higher valuations⁵.
- ▶ On the other hand, ESG factors are increasingly integrated into the deal-making process, as a 2024 investor survey revealing that 60% of investors have turned down or would turn down a deal due to ESG concerns⁷.

Why does ESG matter in valuation and deal?

Business owners, corporate leaders, and M&A professionals can no longer overlook ESG considerations in valuation and transactions process.

Sustainability and ESG have emerged as pivotal buzzwords in the corporate world. But have you ever wondered about the origins of the term "ESG"? It was the UN report 'Who Cares Wins,' issued in 2004, that first introduced the acronym. This concept proposes assessing the sustainability of a firm based on three pillars: Environmental, Social, and Governance.¹

Although this paper primarily discusses private markets, it is important to note that **ESG first gained prominence in public financial markets**. The growth of sustainable funds has been truly remarkable, as illustrated by the inflows in 2022 and 2023 to European ESG funds compared to the outflows of traditional funds.² However, it is worth noting that the ESG movement (and consequently, flows to ESG funds) is currently facing significant turmoil, with pressure growing even more since the reelection of Trump. Additionally, the recent departure of major banks from the Net Zero Alliance highlights the current backlash against ESG initiatives. Despite all this, we argue (on the next page) that **ESG is here to stay given the environmental crisis, social inequalities, and regulatory frameworks in Europe**.

Shifting our attention back to private markets, **we believe that private companies, especially those family-owned or backed by private equity funds, are in a strong position to lead the sustainability transition**. On the one hand, private equity funds can rely on different leverages to implement their sustainability agenda such as their material ownership positions, direct access to information, and management control.³ On the other hand, family businesses are ideally positioned to include long-term ESG trends to ensure the preservation of their wealth and legacy over multiple generations.⁴ This has wide-ranging consequences, particularly in transactions.

Firstly, **valuation is influenced by ESG factors**. Recent surveys highlight a positive business sentiment between ESG and valuation:

79% of surveyed European Dealmakers believe that higher ESG maturity results in a higher valuation, with 32% reporting a premium of more than 5%.⁵

75% of company leaders consider the ESG transition as a value creation rather than a compliance exercise.⁶

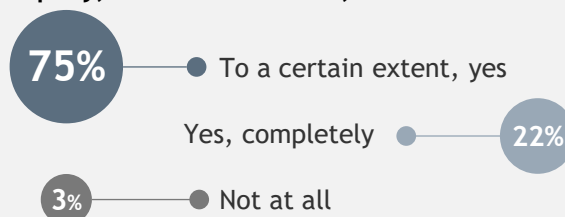
91% of private fund leaders state that ESG is important in the value creation of private market firms.⁷

Many academic studies have been conducted about the link between ESG and financial performance. Overall, findings are mixed, but the correlation tends to be positive or non-negative.^{8,9}

In addition, valuation professionals recognise that ESG considerations should be integrated into their analyses. For instance, the International Valuation Standards state that valuers must analyse and adjust for differences in ESG considerations.

Secondly, **corporate leaders have indicated that sustainability is going to affect business models and operations**, reshaping the considerations that play a role in the transaction process.

Do you think sustainability will reshape your company, its business model, and its activities?⁶



Therefore, **ESG factors are being increasingly integrated into the deal process** as reported by market participants :

60% of investors turned down a deal due to ESG concerns or would do so, a 2024 investor survey reveals.⁷

More than 80% of surveyed financial buyers active in Belgium have ESG considerations in their investment policies in 2024 (compared to less than 40% in 2022).¹⁰

20% of deals included an ESG due diligence, and 35% for deals larger than €100m.¹⁰

This underscores the increasing importance of ESG considerations in transactions. **ESG must be addressed in the deal process with the same level of scrutiny as financial, social, legal, or tax issues**.

In the following sections, we will explore the practical effects of ESG on valuation and its influence on the deal-making process. However, we will begin by examining three key drivers that reinforce our belief in the enduring relevance of ESG.

Three key drivers supporting ESG

European legislation, the impacts of the climate crisis, and the business relevance of social issues all support the long-term integration of ESG.

#1 The pressing condition of the climate crisis requires immediate and decisive action.

The scientific community is sounding the alarm on the environmental consequences of human actions. Did you know that we have already crossed six out of nine planetary boundaries?¹¹

As illustrated below, climate change is one of those. Its effects are becoming increasingly tangible, as evidenced by the devastating floods and fires that have recently swept across Europe. Nevertheless, environmental concerns should not be limited to climate change. Indeed, other crossed boundaries are of utmost importance, such as introduction of novel geological entities, biosphere integrity, freshwater and land-system changes, and biogeochemical flows.

#2 Social considerations are more and more relevant to businesses.

While more than 800 million people still live in extreme poverty¹², the 26 richest people account for 20,7% of global wealth.¹³ In recognition of these disparities, over 250 ultra-wealthy individuals penned a letter to global leaders at the 2024 Davos meeting, requesting fairer taxation.¹⁴

Corporations and their leaders are being held accountable for the growing economic, gender and racial inequalities, with society calling for action to address these issues.¹⁵ As a result, the focus of businesses on diversity, equity, and inclusion (DEI) has risen. Global spending on these initiatives were expected to double from \$7,5 billion in 2020 to \$15,4 billion in 2026.¹⁶ However, the new US administration has adopted a strong stance against DEI, with ramifications reaching also Europe. As a result, some companies have scaled back their DEI initiatives while others have even used this backlash. As a result, some companies have scaled back their DEI initiatives while others have even supported their commitments.

#3 Sustainable laws remain in place in major regions and cannot be ignored.

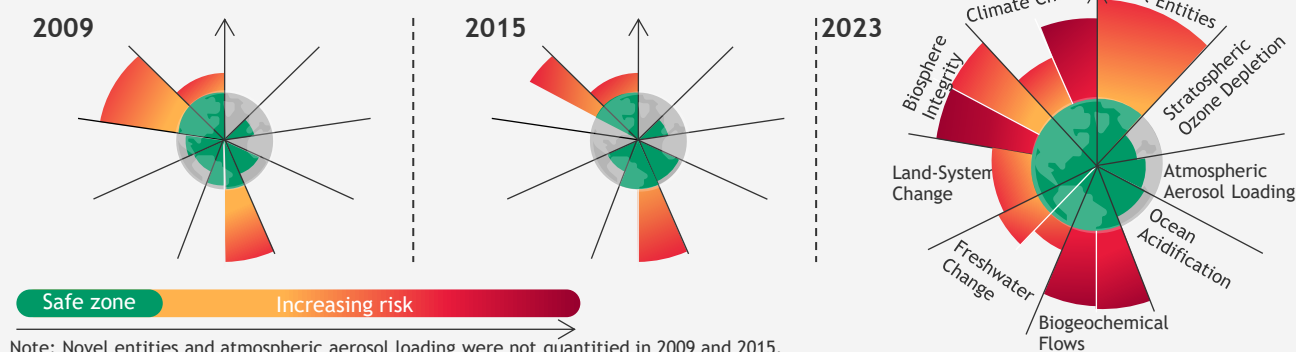
Governments and international institutions have begun to address sustainability issues, starting back in 2015 with the Paris Agreement and the UN Sustainable Development Goals. The European Commission is leading the way on sustainable regulation:

- ▶ Since 2021, the Sustainable Finance Disclosure Regulation (SFDR) imposes obligations on financial market participants to disclose how they integrate sustainability risks into their investment decisions and the impact of their products on sustainability.
- ▶ The Corporate Sustainability Reporting Directive (CSRD) has been a game changer for non-financial reporting. Initially affecting large firms from 2024 onwards, a snowball effect will impact smaller firm that collaborate with larger corporations.
- ▶ Moreover, the Corporate Sustainability Due Diligence Directive (CSDDD) is going to hold large companies accountable for their actions which will affect their relations with their small and large partners.

But these legal initiatives have been under a lot of scrutiny recently (partly due to US and EU politics although other regions as Asia progress on this). Consequently, the latter two directives are currently being revised to streamline administrative procedures while preserving their core content and intent, as part of the 'Omnibus Simplification proposal'. The timeline for implementation will also be delayed for certain companies. Nevertheless, the EU remains committed to sustainability, as illustrated by the Clean Industrial Deal launched in 2025.

As businesses navigate these challenges, an increasing number of corporate leaders recognise that sustainable practices are not just a reporting or a moral obligation but also a strategic necessity.

Planetary boundaries, 2009-2023¹¹



Implications of ESG on valuation

Key takeaways

75% of company leaders view ESG as a value creation exercise rather than merely a compliance one⁶. Additionally, academic research suggests a non-negative correlation between ESG and financial performance. Depending on the ESG maturity of a company and the materiality of ESG factors in its activities, we believe that ESG can lead to value creation, value preservation, or value reduction.

We have applied an income approach to understand the impact of ESG on value. Although there is neither consensus nor guidelines to integrate ESG in valuation, we stress that:

- ▶ Financial metrics (such as cash flows) must be adjusted for ESG considerations unique to the firm and measurable :
 - a. Growth of revenues, for example, due to shifts in customer preferences, technology or regulation;
 - b. Modifications in the cost structure related to measures such as employee wellbeing initiatives or circular business models;
 - c. Capital expenditures linked to sustainable investments such as renewable energy.
- ▶ The discount rate should reflect their exposure and management of ESG risks that are not specific to the firm. This can result in:
 - a. A lower or higher exposure to ESG risks and an improved management of those risks, resulting in lower cost of equity and cost of debt;
 - b. A reduced cost of debt as lenders increasingly adjust their rates for ESG factors;
 - c. A higher gearing if lenders continue to favour sustainable investments.

Similarly, the inputs of a market approach valuation (ex. EBITDA and multiple) should also be adjusted for ESG considerations when applicable.

However, the integration of ESG factors into valuation remains complex, due to among others: (1) the limited availability and reliability of ESG data in particular in private markets, (2) the unclear causal relationship between ESG and financial performance (“doing good by doing well” or “doing well by doing good”)?, (3) divergent views on value creation (is ESG an additional cost or a tool for creating value?), and (4) the limitations of valuation models that may fail to reflect exceptional and long-term ESG risks.

In practice, we recommend business leaders and investors to conduct an ESG materiality assessment to identify the material ESG factors that are likely to influence their operations and valuation drivers in the short and long term. Companies can then adapt their strategy and take actions to create or preserve value in line with their evolving ESG environment.

Will ESG enhance, preserve, or reduce business value?

To understand the link between ESG and valuation, we examine the influence of ESG factors on each valuation driver within the DCF method.

While valuation is not an exact science, we can rely on well-accepted methods to assess the impact of ESG on value. Rightfully, A. Edmans, finance professor at the London Business School, points out that “ESG is both extremely important and nothing special”¹⁷.

The impact of ESG on valuation can be assessed on the three main valuation approaches:

- **The income approach:** The value is the sum of discounted future cash flows (ex. DCF valuation);
- ↻ **The market approach:** The value is derived from the value of similar firms (ex. EV/EBITDA multiple valuations);
- ⬅ **The cost approach:** The value of a firm is the costs incurred by the owner to develop it (ex. adjusted net asset valuation).

We consider that the income approach is the most appropriate to assess the impact of ESG on valuation. This approach highlights valuation drivers that apply to all companies, namely growth, profitability, investment efficiency, and risks (see the valuation framework here below).

Although the market approach is popular in private markets, this method implicitly includes the different value drivers. This makes the investigation of the impact of ESG on value more difficult.

In addition, the cost approach is not suitable for companies with a going concern as future performance is the main factor influencing a firm's value.

We believe that the impact of ESG on a firm's value can fall under three different scenarios:

- ↻ **Value creation:** In a setting where ESG factors are important for stakeholders (e.g., employees and customers), companies leading on ESG can enhance their value by capturing larger market shares, increasing prices, reducing expenses, etc;
- ➔ **Value preservation:** Companies that operate in an environment with minimal ESG impact or with average ESG performance compared to their peers can maintain their value;
- ↻ **Value reduction:** Firms with poor ESG practices or whose activities are disrupted by ESG trends (e.g., the automotive industry) may face a decline in their value.

Valuation framework – Income approach with the Discounted Cash Flow (DCF) method

Adopting an income valuation approach, “only” two inputs are needed to estimate the value of a business: the expected future cash flows and the discount rate. The underlying formula of a DCF model is:

$$\text{Enterprise Value} = \frac{E(CF_1)}{(1 + WACC)^1} + \dots + \frac{E(CF_5)}{(1 + WACC)^5} + \frac{\text{Terminal Value}}{(1 + WACC)^5}$$

The following table presents each of the inputs and highlights the underlying valuation drivers:

Input	Definition	Key drivers
Expected future cash flows	▶ The expected future cash flows generated by the company from its operations after deducting investments. ▶ $CF = EBITDA - \text{Adjusted Tax} - \text{CapEx} \pm \Delta NWC$	▶ Growth ▶ Profitability ▶ Investment efficiency ▶ Working capital efficiency ▶ Tax rate
Discount rate	▶ The rate of return required by capital providers, e.g. the weighted average cost of capital (WACC). ▶ $WACC = \text{Cost of Equity} \times \text{Weight of Equity} + \text{Cost of Debt (net)} \times \text{Weight of Debt}$	▶ Market and economic risks ▶ Sector specific risks ▶ Company specific risks ▶ Financial structure

The link between value and ESG can be examined through each of the valuation drivers.

In the **multiple approach** (e.g. $EV = EBITDA \times \text{Multiple}$), most of the valuation drivers (growth, investment efficiencies, risks, financial structure etc.) are implicitly reflected in the multiple and the EBITDA.

Impact of ESG on expected cash flows

Revenue growth is influenced by customers' sustainable preferences and regulations, that all business leaders should take into account.

#1 The sustainability and growth of revenues are increasingly intertwined.

Revenues are the fuel of cash flows and are gradually influenced by sustainability concerns in consumer preferences and regulations. Specifically, business leaders indicate that customers are the stakeholders driving the demand for sustainable practices.⁶

Illustrations

- ▶ The transition to a net-zero economy, supported by new regulations and tax incentives, caused a rapid shift from fuel-based vehicles to electric ones. American and Chinese firms are leading this change, exerting pressure on established manufacturers and local dealerships across Europe.
- ▶ A McKinsey survey reports that 66% of consumers and 75% of millennials consider sustainability a crucial factor in their purchasing decisions¹⁸. This explains the success of brands like Patagonia or Veja, that promote ethical and sustainable fashion.



Case

Key sustainable practices:

- ▶ Pledged either 1% of sales or 10% of profits to environmental activism
 - ▶ 100% organic cotton use and recycled raw materials
 - ▶ Developed social-responsibility programs to ensure safe and fair working places that have a positive impact on workers and communities
- ▶ Multiple academic studies indicate that ESG initiatives enhance brand image and customer loyalty, which turn into a competitive advantage.^{19, 20, 21} A concrete example is DEI programs. Following Trump's return to the White House, pressure against such programs has mounted. However, Costco shareholders recently rejected a proposal to limit its DEI initiatives. Costco's board indicated that halting its DEI efforts would negatively impact its workforce and customers. This underscores the significance and effectiveness of DEI programs for many organizations.



The role of materiality analysis

An ESG materiality analysis helps the management in identifying and understanding future material ESG factors, forming the backbone of a firm's ESG strategy. It uncovers areas for improvement and acts as a risk management tool to reduce exposure to ESG-related risks.

What are the channels through which ESG materialises?

Value creation

A transition to ESG-friendly products can increase market share, enhance customer retention, enable product differentiation, and increase consumers' willingness to pay for ethical factors.

Value reduction

Companies that overlook ESG factors or engage in greenwashing risk losing market share to competitors who prioritise sustainability. But when ESG practices are not aligned with stakeholders' expectations, it can lead to a decrease in value. A prominent example of this is the recent boycott of Bud Light, which stemmed from a marketing campaign that was out of sync with consumer values. Although this initiative was well-intentioned, its flawed execution ultimately had a detrimental impact on the company.



Case

In April 2023, Bud Light partnered with transgender influencer Dylan Mulvaney for a promotional campaign, which led to significant backlash and a widespread boycott of the brand.

Results in figures:

- ▶ Lost potentially up to \$1,4 Bn in sales
- ▶ Declined in market share, dropping to the third position in the USA beer market

Overall, the integration of sustainability into business strategies is not merely a compliance or ethical issue but a foundational element driving long-term growth and resilience in the market.



Questions to business leaders

- ▶ Have you identified the ESG trends that will impact your sector over the next 5 to 10 years?
- ▶ How are you adapting your current offerings to meet future ESG needs from customers and requirements from regulators?
- ▶ What ESG initiatives are your competitors implementing and how could new sustainable entrants disrupt your market?
- ▶ Have you fairly integrated ESG into your marketing and strategic positioning in a way that resonates with your customers?

Impact of ESG on expected cash flows

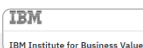
The shift to sustainable business models has a profound effect on a company's cost structure, ultimately transforming its profitability.

#2 ESG factors will have a significant impact on your cost structure and your profitability.

Once revenues are shielded from ESG trends, it is important to consider the impact on profit margins. Indeed, current ESG trends are transforming relationships with suppliers, employees, as well as and even more importantly, access to natural resources and raw materials, ultimately impacting the cost structure.

Illustrations

- ▶ Employees are crucial “assets” for any company. It is not surprising that a portfolio of firms ranked as the best places to work outperformed (with approximately 3% in the USA) the market, with similar trends in Europe (although mitigated by legal protection).^{22, 23, 24} A Swedish study indicates that workers accept lower wages (around 10%) to work for sustainable firms.²⁵ All this is explained by higher productivity, improved retention and attraction, and work satisfaction.



Research 2023

Companies with embedded sustainability in operations:

56% more likely to **outperform their peers on talent attraction.**

x2 more likely to **attribute great improvement in operating costs** to their sustainability efforts.

- ▶ As part of its circularity program, Schneider Electric implemented several practices: eco-design to minimise environmental impacts, waste reduction at production sites, maintenance enhancements to extend product life, repair and upgrade options, and take-back and buy-back services. These initiatives had an important impact on operations and cost structure of Schneider.



Case 2024

Danone Evian aimed to enhance the sustainability of its bottling operations for natural mineral water. To achieve this, Danone collaborated with Schneider Electric. The partnership led to significant improvements in operational efficiency and reduced environmental impact.

- ▶ Energy consumption reduced by 34% per bottle preforms.
- ▶ Savings estimated at 8 tons of material avoiding the equivalent of 70 tons of CO₂, and 700 m³ of water.

What are the channels through which ESG materialises?

Value creation

Enhanced efficiency or reduced expenses can lead to greater profitability. This might be achieved through improvements in production processes to reduce consumption of raw materials and energy or by investing in the wellbeing, safety, and training of the workforce.

Value reduction

Firms that are unable to secure access to critical resources and energy face significant exposure to market fluctuations and risk incurring higher costs, as illustrated by recent inflationary trends and the energy crisis. Additionally, regulatory measures can result in reporting costs or new taxes, such as carbon taxes.



Tax tracker

ESG-related taxes and initiatives in Belgium

As of June-24, not considering federal government agreement

Carbon pricing	Carbon tax	●
	CO ₂ pricing	●
	Waste tax & landfill tax	●
	Energy / Electricity tax	●
	Coal tax	n/a
Environmental taxes	Water tax & water usage fees	●
	Air passenger tax	●
	Tax on greenhouse gases	●
	Petroleum fuel tax	●
	Plastics tax	●
	Air pollution tax	n/a
	Vehicle tax exemptions / concessions	●
Incentives	Renewable energy (consumers)	●
	Sustainable energy (producers)	●
	Electric vehicles	●
	New innovative projects and environmentally friendly investments	●
	Green-powered and CHP / photovoltaic installations	●
		●

● Implemented

● Considered to implement

Questions to business leaders

- ▶ How could you include ESG factors in your operations (sourcing of material, production processes, HR management, etc.) to maintain or improve your profitability?
- ▶ Have you conducted a comprehensive review of your supply chain to ensure ESG compliance and identify risks that could result in additional costs?

Impact of ESG on expected cash flows

To prepare for the long term, ESG factors must be included into investment decisions. Neglecting to do so heightens the risk of holding obsolete assets.

#3 The long-term value of your investments is protected by including ESG criteria.

Alongside operating cash flows driven by growth and profitability, investment efficiency is a third critical avenue through which ESG can significantly influence cash flow generation and hence valuation. Investments are essential in maintaining long-term firm value, making it crucial to consider anticipated ESG trends in decisions.

Illustrations

- ▶ The Belgian government has facilitated the transition to electric vehicles (EV) through tax deductions for zero-emission cars and a revised mobility budget offering diverse green transportation options. Switching to a fleet of electric vehicles could entail a significant investment for companies. This transition to EVs will also have a tremendous effect on transportation companies.
- ▶ Facing changes in the automotive industry, D'leteren has diversified into slow mobility, focusing on electrification and renewable energy to significantly reduce its CO₂ emissions. The company is expanding its offering to include electric vehicle charging (EDI) and solar energy production (Go Solar, acquired in 2022). Additionally, D'leteren is growing its low-carbon solutions in cycling (Lucien, Joule), shared mobility (Poppy, Taxis Verts), and micromobility (Microlino) to provide versatile urban transport solutions. In FY23, 78% of D'leteren's capital expenditure (or €110m) were aligned with the EU taxonomy, reflecting its commitment to sustainable transportation.
- ▶ Colruyt significantly invested in renewable energy, equipping store rooftops with solar panels and developing wind farms. In 2023, 99% of its electricity consumption was sourced from renewables. The group aim is that by 2030 at least 60% of all the energy (incl. electricity and others energies) used is generated by renewable sources.

Regulation - EU Taxonomy

The EU Taxonomy requires large companies to disclose the % of revenues, opex and capex considered as sustainable (as per the regulation). This will help to compare performance across firms and sectors.

What are the channels through which ESG materialises?

Value creation

Early adopters of sustainable investments and of regenerative or circular models can secure competitive advantages and lower long-term costs, as well as enhance their independence. For instance, companies with less reliance on third parties experienced fewer disruptions during the recent COVID-19 and energy crises.

Value reduction

All companies face a greater risk that their current assets become obsolete as ecological crises materialise or new regulation force them to adopt greener technologies. For instance, fossil fuel companies are at risk of their assets becoming stranded as the world transitions towards net-zero emissions.

Questions to business leaders

- ▶ Which investments are necessary to transit to a zero / low carbon business model?
- ▶ Have you integrated key ESG factors such as green energy, health and safety, and cybersecurity into your investment strategies?
- ▶ Are you committed to preserving your natural capital by ensuring its continual maintenance (i.e., circularity)?
- ▶ Are any of your assets at risk of significant value reduction due to ESG factors?

The two remaining drivers of valuation are working capital and tax rate.

We believe that the influence of ESG on working capital will be minimal in most cases. However, ESG factors may reshape relationships with suppliers and clients. This is particularly relevant as larger firms may need to comply with regulations set by the EU and other regions, compelling firms to incorporate ESG into their supplier selection processes. However, we expect that this will have a limited effect on the working capital such as payment terms.

Regarding tax rates, if corporate income tax is not directly tied to ESG metrics, we do not foresee an impact from ESG factors. Nonetheless, it is important to acknowledge that governments might introduce new taxes related to ESG (e.g. carbon taxes) in response to increasing external pressure. Such taxes would reduce cash flows, which would need to be accounted for in valuation models.

Impact of ESG on cost of capital

In addition to impact on cash flows, ESG factors influence the discount rate through risk exposure, cost of debt, and access to leverage.

The discount rate used in a DCF model (WACC) is the required rate of return by both shareholders and lenders. Unlike factors such as size, liquidity premium, and credit risk, there are no widely used models to integrate ESG factors in the discount rate. However, we highlight three primary ways ESG influences WACC.

#1 ESG improves risk management and reduces risk exposure.

Both the cost of equity and the cost of debt mirror the risks assumed by capital providers. ESG initiatives can reduce a firm's overall risk exposure making it more future-proof. Additionally, the climate crisis introduces significant physical and transition risks. By taking environmental actions, a firm can minimise its exposure to these risks and therefore lower the rate of return required by investors.²⁸

On the equity side, research shows that firms with enhanced environmental risk management or engaging in corporate social responsibility (CSR) activities exhibit lower systematic risks.^{29, 30} Moreover, firms with robust ESG practices display increased resilience, thereby safeguarding against crisis risks.

On the debt side, S&P took 221 ESG-driven credit rating actions, out of which 166 were negative rating actions.²⁷ Additionally, studies suggest that climate risk exposure affects credit ratings and credit risks, thereby increasing the cost of debt.^{31, 32, 33}

#2 Access to debt funding is easier for ESG-friendly firms.

Firms demonstrating strong ESG practices are more likely to secure debt financing and obtain better lending terms.

This can be attributed to:

- ▶ **A demand-side effect:** Firms with lower operational risks (as noted above) can support higher optimal leverage ratios;
- ▶ **A supply-side effect:** Lenders are increasingly reluctant to extend credit to companies with significant social and environmental risks to reduce their own exposure. For example, Barclays announced its decision to cease financing the oil and gas industry in February 2024.

On the contrary, bankers are reluctant to finance projects that are not ESG-friendly. Those companies can have difficulties in accessing credits.

Improved access to debt financing leads to a higher proportion of debt in the capital structure, which in turn reduces the overall WACC since the cost of debt is lower than the cost of equity.

#3 Sustainable preferences of investors lower their required rate of return.

Research in sustainable finance suggests that investors expect lower returns from firms with better ESG performance.^{28, 34} Investors with a preference for sustainability increase their demand for high ESG firms, thereby reducing these firms' cost of capital. Conversely, a risk premium is often required for firms excluded on ESG grounds, such as the tobacco, defence, or alcohol industries.^{33, 35, 36} Historically overlooked by ESG-conscious investors, the defence sector is gaining attention due to recent geopolitical events. Many investors are now revising their policies to include defense companies in their portfolios, reflecting change in investors' preferences.

Furthermore, there is a growing trend in the debt market towards products that directly link interest rates to sustainable performance metrics, such as green/social bonds, or sustainability-linked bonds. The term 'greenium' describes the phenomenon where green bonds typically feature lower interest rates compared to conventional bonds.³⁷

But...what are the concrete implications?

The real estate market in Belgium offers a compelling parallel. Banks are now linking the capital provided and the interest rates to the PEB scores of buildings. Although ESG data reliability is still limited, we expect that similar trends will emerge in the corporate market: ESG will be increasingly integrated in lending and funding decisions.



Questions to business leaders

- ▶ What additional challenges might your company encounter due to the environmental transition? For instance, is your business situated in a region that is prone to environmental risks? Have you a plan to transition to green energy and/or reach net zero emissions?
- ▶ Are you active in sectors (such as oil & gas, tobacco, alcohol, and gambling) that might be excluded by banks or investors due to ESG concerns/preferences?
- ▶ Do your company's activities or value chain pose a high risk of environmental damage or negative social impacts?

Cash flows, discount rate, or both?

Measurable ESG factors unique to the firm should be incorporated into cash flows, while the discount rate should reflect ESG risks and debt implications.

Previous sections have shown that there are channels through which ESG affects cash flows and discount rates. In a nutshell, cash flows are influenced by sales growth, profitability, or investment efficiency, while discount rates (WACC) are affected by risk exposure, leverage, and investor preferences.

One could question whether valuers must adjust cash flows, discount rates, or both components.

According to a survey of financial executives, ESG is more often integrated by adjusting the discount rate rather than the cash flow.³⁸ The study also found that the cost of debt is more likely to be adjusted than the cost of equity, and the long-term growth rate may also be adjusted to account for the impact of ESG. According to the authors, integrating ESG into cash flows is more complex than adjusting the discount rate. However, analysts of RobecoSAM, an asset manager leading on ESG integration, report that cash flows are adjusted more frequently than capital costs in the value-driver adjustment approach.³⁹

In addition, some academics argue that ESG is company-specific and should only impact the cash flow, while the discount rate only reflects market risk and should not be adjusted for company characteristics (as it can be diversified away).⁴⁰ More precisely, expected cash flows should be adjusted for ESG factors and management actions on those factors.

In general, adjustments in the cash flows reflect that ESG is specific to the company whereas change in the discount rate reflects that ESG is more systematic / non-diversifiable.²⁸

Going further: extending valuation to non-monetary aspects

Up to now, our discussions have centered on the monetary valuation of businesses. However, it's important to recognise the growing initiatives that broaden valuations to include social and environmental factors, particularly within the impact investing sphere. These initiatives involve methodologies like Social Return on Investment (SROI), which quantifies the value created for stakeholders compared to investments. For more insights and resources on these approaches, organisations such as Impact Europe and Impact Finance Belgium are valuable references.

What about multiples?



The multiple valuation method is commonly employed in private markets. To derive the enterprise value, this approach relies on a financial metric such as sales or EBITDA, coupled with a multiple derived from comparable companies.

In fact, these market multiples reflect notably expected growth and risk. As in the DCF model, ESG considerations can be included in the multiple valuation process by:

- ▶ Ensuring that the peer companies used for comparison closely align with the evaluated company in terms of ESG. If discrepancies exist, modifications to the multiple should be corrected for these variances, similarly to how adjustments are made for differences in liquidity and other relevant factors. In other words, a premium or discount to the multiples reflects that the company outperforms or underperforms relative to its peers in terms of ESG;
- ▶ Adjusting financial parameters, such as sales or EBITDA, to reflect ESG effects, similarly to the cash flows corrections previously discussed. These adjustments enable the inclusion of firm-specific ESG impacts. Examples of normalisation could include revenue adjustments due to varying market conditions and preferences, cost reductions from enhanced efficiencies, or additional expenses from ESG commitments. It is furthermore essential to ensure that the EBITDA metrics of peer companies also account for ESG risks to maintain consistency in the implied multiples of the peer group.

If ESG factors positively impact value, then sustainability can lead to increased value through multiple arbitrage opportunities. Indeed, enhancing a firm's ESG performance can result in higher valuations through higher multiples, highlighting the financial benefits of strong sustainability practices.

The controversy of ESG in valuation

ESG integration into valuation is constrained by ESG data quality, differing views on value creation, unclear causality mechanisms and valuation model limitations.

#1 Measuring ESG is challenging.

Unlike traditional financial metrics, which are well-defined and universally accepted, ESG metrics are still evolving, with no generally agreed-upon standards. For instance, the correlation across ESG ratings (approx. 40%) is low compared to credit ratings, which could question their reliability.^{41, 42} A study has shown that the construction of ESG ratings is related to the social origins of the data vendor, which shapes its views on sustainability and materiality explaining the low correlation.⁴³

In private markets, access to reliable ESG information is even more challenging as firms are in general less mature in terms of ESG reporting.

The bundling of ESG pillars in a single score is also questionable.^{17, 26} In fact, the EU has issued a regulation that will oblige rating companies to disclose individual E, S and G scores and explain the bundling process.⁴⁴

Ultimately, the key question is whether ESG represents a subjective or objective assessment.

#2 When it comes to value creation, there exists conflicting views.

Profit has traditionally been considered as the primary objective of companies. Milton Friedman's argued that the only social responsibility of businesses is to increase profits within the rules of fair competition referred to as the 'shareholder theory'.⁴⁵

Numerous alternatives advocating the management of firms beyond profits have been proposed. The concept of Corporate Social Responsibility (CSR) highlights that businesses have a responsibility to society beyond profit-making. Similarly, the stakeholder theory supports the idea that all interested parties should be considered in decision-making.⁴⁶

A view growing in popularity is that the integration of stakeholders' interests will ultimately maximise shareholder value. Leading academics promote the idea that companies should have a purpose⁴⁷ and focus on growing the pie (being the economy) to ultimately increase their share of the pie.⁴⁸

#3 Correlation is not causality.

Although studies have reported a positive correlation between ESG and financial performance, the causality mechanism is not clear: is it 'doing well by doing good' or 'doing good by doing well'? For instance, one could argue that larger firms have more resources to be allocated to ESG activities and hence have high ESG performance regardless of their real impact.⁴⁹ Similarly, one might wonder whether the extra financial return of an ESG-leading company is due to an increase in intrinsic valuation or a shift in investor preferences.

Due to numerous transmission channels, the causality of ESG on financial performance and valuation remains an open debate.

#4 Short-term projections may fail to reflect long-term ESG changes.

The BDO-Urval survey⁶ reports that 97% of European companies believe sustainability will change their business model and activities, with 22% stating sustainability will completely reshape them.

However, valuations are generally based on relatively short-term cash flow forecasts from three-, five-, or seven-year business plans. Therefore, one could question if valuation models accurately incorporate expected impact on business models of trends such as climate change or actions needed for the company to become future proof.

Factors such as access to critical resources or cost-effective (renewable) energy are rarely or not fully accounted for in the projected cash flows unless investments are directed towards circularity and regenerative practices.

Besides, the terminal value (reflecting the cash flows after the projection period) account for a significant part of the value. But exceptional events occurring in the long term may not be captured in the terminal value or have a very low impact due to the discounting and the weak probability of occurrence. However, such events could have dramatic consequences on the future of the company. This is where scenario modelling can significantly enhance valuation estimates by exploring various cases and accounting for the probabilities of occurrence.

Implications of ESG on the deal process

Key takeaways

60% of investors turned down a deal due to ESG concerns or would do so according to a 2024 survey⁷. There are multiple ways through which ESG appears in the deal process:



Deal rationale



Valuation



Due diligence



Capex planning



Risk assessment



Management capabilities

However, implications of ESG widely differ from a buyer's and a seller's perspective. We emphasise that executive management teams play a crucial role in transactions. As such, they should assist in the gathering of ESG information and ensure that ESG considerations are correctly integrated in the deal process.

Seller

ESG is critical in the preparation phase to improve the likelihood of deal success and to ensure all ESG concerns are addressed early in the process. Among others, the seller can:

- ▶ Highlight ESG initiatives and gather data on ESG performance;
- ▶ Identify key ESG risks and opportunities and benchmark performance against industry peers;
- ▶ Mandate an advisor to perform ESG vendor due diligence.

Buyer

For buyers, ESG matters before and during the deal but plays an even larger role in the post-transaction phase. As ESG is here to stay, new shareholders must implement an ESG strategic plan that will drive value creation and/or avoid value reduction. Buyers, both financial and strategic, can:

- ▶ Include ESG in their deal rationale. This implies questioning the impact of ESG on the industry, the business model, and value creation;
- ▶ Ensure that valuation and the terms of the transaction correctly depict exposure to ESG factors and the ESG maturity of the target;
- ▶ Monitor that ESG objectives are met and contribute to value creation during the holding phase. This means that ESG factors must be part of the portfolio management and overall strategy of the portfolio company.

Why include ESG in deal processes?

Business owners, buyers, and deal professionals must incorporate ESG early in the transaction process to enhance the chances of a successful deal.

The previous section of the article highlighted the multiple ways through which ESG can affect valuation. In a transaction context, the valuation is subject to extensive negotiation between the parties, through which valuation turns into a price. However, ESG does not only impact valuation in the deal process.

Given the wide-range implications of a transaction, it comes as no surprise that integrating sustainable and stakeholder considerations improves the overall deal's success. A study published in a leading academic journal with over 1.500 citations reports that acquirers with high CSR scores have shorter deal completion times, lower risk of failure, and achieve greater long-term profitability.⁵⁰

Moreover, companies that proactively integrate ESG considerations into their M&A process gain a competitive edge by identifying value-creation opportunities or mitigating material risks that could affect post-deal performance.

Therefore, ESG can become a central point of negotiation, particularly in industries undergoing significant regulatory and technological shifts. More precisely, the exposure to ESG risks / opportunities and the maturity target can play a crucial role in determining its value and ensure deal's success:

- ▶ A seller must emphasise recent investments or high ESG maturity that have laid the groundwork for the future, thereby positioning these initiatives as a strategic advantage that warrants a premium.
- ▶ A buyer must assess the ESG maturity of the target and its exposure to ESG risks and opportunities. Discounts on valuation could be applied on targets with low ESG maturity or to reflect investments required to become ESG-compliant.

In this section, we will review the implication of ESG in the deal process, particularly during deal preparation, deal execution, deal integration, deal ownership, and exit.

Case

Differing views on value creation acted as a deal breaker in Kraft's \$143bn attempted takeover of Unilever (Harvard Business Case)⁵¹

In 2017, ESG considerations were not as prominent as they are today, yet they were instrumental in thwarting the \$143 billion takeover bid of Unilever by Kraft Heinz, which could have ranked among the largest deals in history at that time. The deal collapsed due to a stark contrast in value creation strategies between the two companies.

Unilever, known for its sustainability initiatives, focused on long-term value creation and integrating stakeholders' interests. Conversely, Kraft Heinz's investors (3G Capital and Berkshire Hathaway) aimed to deliver short-term shareholders' value by boosting Unilever's margins through cost-cutting measures, believing this justified their 18% premium offer. They viewed Unilever's approach as inefficient and ultimately detrimental to shareholders' value.

Faced with strong resistance from Unilever, Kraft Heinz retracted its proposal merely 48 hours after revealing its interest.



Impact on deal preparation

In the preparation phase, sellers should present their ESG performance and initiatives, while buyers must identify ESG factors likely to influence the deal.

#1 Deal preparation

For buyers, deal preparation starts with the formulation of a deal rationale. However, it differs for strategic acquirers (vertical or horizontal integration, diversification, technology access, etc.) and financial acquirers (LBO, growth, buy and build, distressed investing, etc.). Once the strategy is defined, counterparties are identified. Initial contacts, sharing of information, first rounds of negotiation follow. As the deal materialises, terms of the offers are settled in the Letter of Intent (LoI).

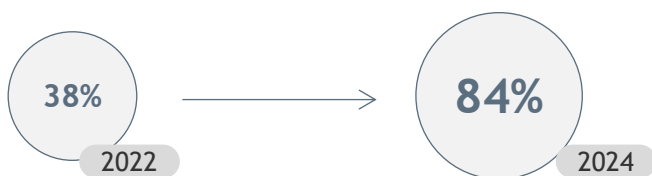
For sellers, motives are various but include, among others, the age of the shareholders, the desire to cash in, or the intention to divest a business segment. Preparation is crucial for sellers as it increases the chances of success and ensures that they obtain appropriate value from their deal.

How does ESG play a role?

- ▶ The risks and opportunities of material ESG factors can influence the decision to initiate a deal, such as divesting 'brown' / stranded assets, acquiring a green technology, controlling the value chain to secure access to raw materials, etc.

40% of deals in energy and natural resources are ESG motivated. ⁵²

- ▶ According to the M&A monitor, there has been significant growth in the proportion of Belgian financial buyers that include ESG in their investment policies. ¹⁰



Therefore, we believe that it is necessary to assess the ESG fit early in the deal to avoid surprises later in the deal process and integration.

Buyer perspective: what specific actions could be taken?

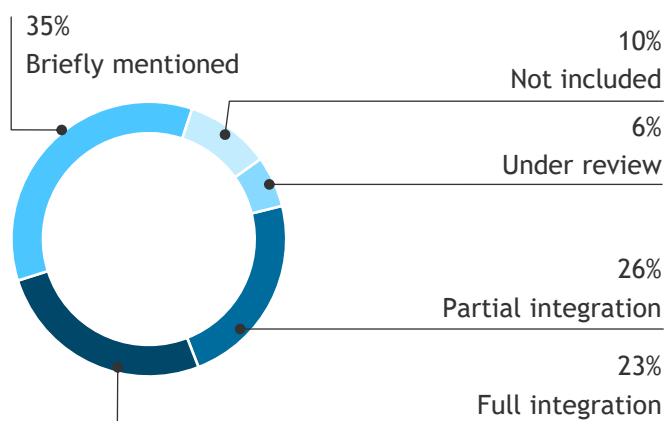
- ▶ Include ESG considerations in the investment policy and/or develop an M&A ESG strategy;
- ▶ Integrate ESG criteria in the screening process (e.g., sector / region exclusion, minimum requirement on labour rights, etc.);
- ▶ Identify material ESG trends (both risks and opportunities) in the target's industry and evaluate the ESG positioning of the target;
- ▶ Include ESG considerations in the Letter of Intent;
- ▶ Review the transaction perimeter, identify entities or assets exposed to ESG risks, and consider adjusting the transaction scope accordingly.

Seller perspective: what specific actions could be taken?

For sellers, ESG is primarily important in the preparation phase. They must ensure that material ESG issues are addressed before entering the deal execution phase. Failure to do so could lead to unsuccessful deal as well as a post-offer reduction in value. The seller can:

- ▶ Highlight ESG initiatives (that may not have been identified as such by the management) and gather data on ESG performance;
- ▶ Identify key ESG risks and opportunities and benchmark performance against industry peers;
- ▶ Mandate an advisor to perform ESG vendor due diligence.

ESG considerations in the investment policy of financial buyers



Impact on deal execution

ESG factors have become reasons to pursue or forgo a deal and therefore should be carefully considered in the due diligence process.

#2 Deal execution

The deal execution phase starts with due diligence – a comprehensive review of the target company. Typically, due diligence exercises scrutinise various aspects such as:



operations



commercial



financial



legal



fiscal matters

How does ESG play a role?

Given the wide-ranging implications of ESG, the due diligence process must include ESG perspectives as it brings in another perspective not necessarily addressed by the other due diligence streams".

On the one hand, the buyer will want to confirm its investment thesis and identify material ESG risks to eventually adapt its offer.

On the other hand, the seller will build on its preparation to ensure that the deal's success or value is not impaired by ESG factors. The lack of preparedness may signal to the buyer that the firm is not correctly integrating ESG factors, which could ultimately lead to a reduction in value.

Then, the buyer and seller engage in renegotiating the terms and the price of the deal.

The primary tasks involve creating the definitive agreement (Sales and Purchase Agreement, SPA) and eventually concluding the transaction.



What is ESG due diligence?

The objective of ESG due diligence is to provide the acquirer with:

- ▶ an overview of the target's material ESG risks and opportunities
- ▶ an evaluation of the target's ESG maturity

This will enable the acquirer to understand the key ESG trends affecting the company and assess its preparedness to address them.

The inclusion of an ESG stream in the due diligence process allows for the identification of risks and opportunities. The ESG due diligence also underscores potential challenges or opportunities for the integration phase. Finally, it prevents unexpected developments later in the transaction. For example, in one of our recent mandates, the deal terms had to be completely restructured just days before the closing date after the acquirer found that the building contained asbestos.

60% of investors turned down a deal due to ESG concerns or would do so, a 2024 investor survey reveals.⁷

ESG issues that have been identified can affect the decision to proceed with the deal, lead to changes in the deal's terms, price renegotiations, or request additional warranties. For instance, several banks have refused to finance a transaction due to involvement in the tobacco industry. Another example is the inclusion of potential investment related to the electrification of a bus fleet in the calculation of the net financial debt.

Buyer perspective: what specific actions could be taken?

- ▶ Issue ESG questionnaire and conduct interviews with the management of the target;
- ▶ Access third-party ESG database to assess the target;
- ▶ Mandate an advisor to conduct a buy-side ESG due diligence;
- ▶ Include ESG findings in the negotiation and SPA (value consideration or reps & warranties): earn-out with ESG related parameters, ESG related conditions precedent or ESG specific indemnities.

Seller perspective: what specific actions could be taken?

- ▶ Build on the preparation to answer the ESG requests of the buyer;
- ▶ Ensure that the buyer accesses the right information and addresses its ESG concerns.

Impact on integration and ownership

During integration, the value creation process should address material ESG factors and plan improvements in these areas.

#3 Integration and ownership

When ownership changes hands, it often triggers a period of shakedown within the acquired company. This can raise questions from employees, suppliers, and customers. The role of the seller is limited, although it can help to smooth the transition. It is now the responsibility of the new owner to outline its plans and vision for the target company, covering strategies, operations, and corporate culture.

How does ESG play a role?

Identification of ESG risks and opportunities

ESG analyses conducted in the (pre-)deal phase help to identify challenges for the target's integration. Management can then incorporate long-term ESG risks and opportunities into the integration plan. For instance, one of the findings of the ESG due diligence could be a lack of engagement of employees resulting in productivity losses and lower retention. Another example is the monitoring of the respect of human rights throughout the supply chain. It will require a thorough review of the contractual provisions in strategic contracts to include rights to audit, penalties, etc.

ESG performance monitoring

From acquisition day, management must monitor the ESG performance of the target and realign plans if necessary. With environmental regulations expected to become stricter in the future, acquirers must minimise their exposure to regulatory risks stemming from previous activities. A clear example of this is the decontamination and restoration of land previously used by industrial entities.

Buyer perspective: what specific actions could be taken?

- ▶ Create an ESG action plan linked to the value creation or risk management objectives;
- ▶ Set ESG targets and monitor the ESG performance with appropriate data and engagement with relevant internal and external stakeholders;
- ▶ Ensure that ESG responsibilities are given and taken, upskill management teams, if necessary.

Portfolio assessment



In addition to monitoring financial performance, fund managers can also track the ESG performance of their portfolio companies. The portfolio management process can incorporate several key components:

- ▶ Quick Scan, questionnaire, and interviews: through desk research, questionnaires, and interviews, perform a high-level (qualitative) baseline assessment focusing on two main dimensions: ESG management and impact;
- ▶ Benchmarking: evaluate the maturity of the firm by comparing it to 3-5 competitors or similar companies and business models. This assessment uses both publicly available data and internal information to gauge where the firm stands in relation to its peers;
- ▶ Trends and challenges: identify and analyse key sustainability trends and challenges within the sector to better understand the external factors impacting ESG performance.

Through these assessments, owners can gain a comprehensive overview of their companies, pinpointing material ESG topics, measuring ESG performance and its drivers, benchmarking against peers, and compiling a list of industry best practices.

Impact on exit

Building on the integration and ownership, establishing a strong ESG position by exit should streamline the selling process and ultimately lead to higher value.

#4 Exit

Especially relevant for financial buyers, the final step of the deal cycle is to realise the return on their investments by divesting the acquired company.

How does ESG play a role?

The ESG initiatives taken during the integration and ownership phase have changed the company and should be showcased. The seller should demonstrate how these actions have contributed to the value creation.

Buyer perspective: what specific actions could be taken?

As the deal progresses, the buyer has transitioned to the sell side. In alignment with the preparation phase, the following particular steps can be taken:

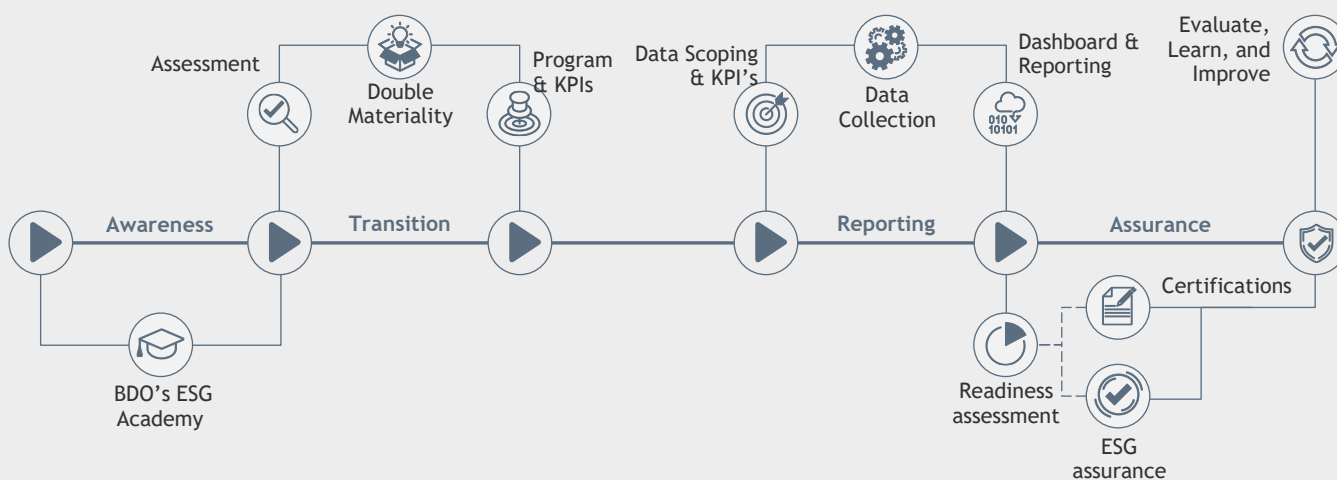
- ▶ Present the ESG plan that was initiated and demonstrate how it contributed to the value creation and made the company more future-proof;
- ▶ Summarise ESG exposure, ESG maturity and performance against industry peers.
- ▶ Mandate an advisor to perform ESG vendor due diligence.

A deal process to start an ESG journey

As it is necessary to include ESG factors in the M&A process, the post-deal phase is the right time for a company to start its sustainability journey. From the integration phase, this journey enables the company to establish a comprehensive roadmap.

This journey starts with building awareness of sustainability, with the upskilling of teams, for instance. The next step is to link business strategy with sustainability. It will point out opportunities and challenges that can transform processes, products, and services to become more sustainable. Once implemented through policies and identification of KPIs, transparent and credible reporting helps you build trust with stakeholders, such as customers, investors, and regulatory authorities. An external audit puts a layer of trust over your reporting and prevents (often unintended) greenwashing. This sustainability journey is a continuous improvement cycle.

BDO ESG Journey



Key takeaways

Key takeaways

Although being currently under pressure, we consider that ESG is here to stay due to: (a) regulations (in EU and other regions) forcing businesses to operate more sustainably, (b) the materialisation of climate crisis and difficult access to raw materials, and (c) the growing importance of inequalities, diversity, and inclusion in the corporate world. We argue that ESG is far more than a compliance exercise; it is a core strategic element that significantly influences value creation and deal-making. In particular, private equity funds and family-owned businesses are ideally positioned to drive the transition.

#1 ESG factors must be considered in valuation.

3 leaders out of 4 consider ESG as a value creation exercise rather than a compliance one⁶. Valuation professionals and academics reports that ESG factors should be considered in valuation. We believe that the impact of ESG on value depends the materiality of ESG factors on companies' activities and its ESG maturity:

- ▶ By adopting a proactive approach to ESG, companies can mitigate future risks and enhance their appeal to ESG friendly investors and lenders, thereby creating value by ensuring sustainable growth, controlling their cost structure and easing access to funding;
- ▶ Companies that neglect to act risk experiencing a decrease in value, resulting in challenges in accessing lending or finding buyers and struggling to maintain relationships with customers, suppliers or employees.

In practice, we have investigated the link between ESG and valuation through existing valuation models. In particular, we studied the impact of ESG on valuation drivers based on a DCF approach:

- ▶ **Sales growth:** pivoting towards sustainability can enhance revenues as consumer values and regulatory standards change customers preferences and behaviours;
- ▶ **Profitability:** transition to a sustainable business model can reduce the cost structure. A prime example is expenses on employee wellbeing to increase productivity and retention of talent. But it can also lead to new expenses, such as higher raw material costs or compliance expenses to environmental regulations;
- ▶ **Investment efficiency:** investments in sustainable assets (such as green energy sources) can significantly reduce long-term costs and become competitive advantage. In contrast, "brown" assets risk decline in value due to ESG factors.

- ▶ **Risk exposure:** the integration of ESG in management actions reduces the exposure to multiple risks, notably physical and transition risks caused by climate change.
- ▶ **Debt funding:** due to regulation and risk assessments, lenders offers lower rates and ease access to funding to ESG friendly firms.

Therefore, company leaders must identify ESG factors relevant to their firm through ESG materiality assessments. Management teams can then address these key ESG factors that contribute to value creation or prevent value reduction.

#2 ESG considerations are undoubtedly becoming more prominent in deal-making activities.

Recent surveys indicate that 60% of investors have stopped or would stop a deal on ESG grounds⁷, and that more than 80% of Belgian financial buyers include ESG considerations in their investment policies¹⁰. Therefore, we consider that ESG plays a role in each of the M&A processes:

Buyers

- ▶ Acquiring and investing in a company on ESG grounds, such as controlling the value chain or accessing green technology;
- ▶ Avoiding surprises later in the process and preparing for post-merger integration by assessing the ESG fit early;
- ▶ Identifying risks and opportunities, and tailoring the SPA with specific ESG safeguards (both in legal terms and value) through ESG due diligence;
- ▶ Incorporating ESG into post-merger integration plans supports risk management and value creation, e.g., reviewing strategic contracts in the supply chain to mitigate and manage ESG risks;
- ▶ Monitoring ESG performance and realigning plans if necessary helps achieve value creation.

Sellers

- ▶ Selling risky or 'brown' assets on ESG motives;
- ▶ Highlighting ESG initiatives to demonstrate value creation to potential buyers;
- ▶ Identifying material ESG risks and opportunities and benchmarking performance by conducting an ESG vendor due diligence.

In conclusion, it is important for business leaders, shareholders, and executive team to recognise the impact of ESG aspects on valuation and deals. Proactively incorporating these considerations is essential for accurately positioning their company in today's market.

Questions after reading this white paper?

Contact us for more information



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Would you like to explore other sustainability topics in more depth?



[Double Materiality Assessment \(DMA\) - Whitepaper](#)



[The ESG Imperative: Business Trends Among European Companies](#)



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