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# Looking behind the curtain -
## Exploring the role and content of ESG in M&A Due Diligence

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# Abstract

Issues surrounding the climate crisis are becoming more visible in society, and as a result, topics concerning sustainability and social responsibility increase in importance. At the same time, global Merger and Acquisition (M&A) activity is increasing. Hence, since the opportunities to include sustainability and social responsibility are a part of the world today, they are a part of M&A. Therefore, these aspects need to be considered, and investors are doing so by measuring them with the concept of ESG (Environmental Social Governance). Therefore, ESG criteria are investigated during the Due Diligence process in an M&A. The scientific research within this area is limited.

This indicative study was conducted to explore the content and role of ESG in a Due Diligence process in an M&A. The empirical data was collected through a qualitative, multiple-case study investigating Due Diligence cases. Nine semi-structured interviews with investment professionals who participated in 21 Due Diligence cease were carried out and analyzed in three aggregated dimensions of ESG: Environmental, Social and Governance.

This study uncovered twelve themes that created a greater understanding of the content of ESG. Investigating ESG in Due Diligence can help to assess risk, identify sources of value, productive capabilities, and support the achievement of long-term objectives. Furthermore, ESG in Due Diligence plays a major role on different levels. Besides enhancing the informative value, ESG adds complexity and cost to the Due Diligence process.



**Keywords**: Sustainability, M&A, ESG, Due Diligence, Environmental, Social, Governance.

**Wordcount:** 17653

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# 1. Introduction

The climate crisis and its consequences have become more important than ever in the eyes of the public, with the growing social movements like “Fridays for Future,” and the growth of natural disasters like the bushfires in Australia. Every year, the importance and influence of topics regarding sustainability and social responsibility have increased (Cone communications, 2015; Camilleri, 2017; Brooks, Craig & Bichard, 2020). Furthermore, politics and governmental institutions are increasingly incorporating sustainability issues into their decision process. The United Nations issued the 2030 Agenda for Sustainable Development, which is an action plan that aims to strengthen people, planet, and prosperity by the year 2030 (United Nations, 2019). Additionally, the EU is putting a focus on sustainable development and better social conditions in the European 2020 Strategy to create sustainable and inclusive growth. This strategy has been undertaken to “*improve Europe's competitiveness and productivity and underpin a sustainable social market economy”* (European Commision, 2019, p.3). An example of this growing trend for sustainable development driven by politics is the Swedish National Pension Fund, which has an ethical board that considers sustainability concerns in the fund’s investments and even holds a veto right in all decisions (AP, 2020)

At the same time, mergers and acquisition (M&A) activities have increased worldwide and this trend is predicted to increase even further (Caiazza & Ferrara, 2016). By definition, an M&A activity entails that one company acquires another company by purchasing it or merging it into the existing company (Christensen et al., 2011). According to a report by UNCTAD (2019), the total global net value of M&A deals has increased from 290 billion dollars in 2018 to 816 billion dollars in 2019. In the same period, the volume of M&A deals has increased from 4,200 to 6,821, an increase of over 62 percent (UNCTAD, 2019). However, it is unclear how sustainability issues related to protecting the environment and improving social conditions are accounted for in M&A processes.

The value-enhancing capabilities of firms’ social and environmental activities are widely acknowledged in the academic literature (Malik, 2015). The corporate social performance (CSP) of any particular company's operations can be quantified in an ESG rating (Reich, 2018). ESG stands for Environmental, Social, and Governance, which are three main factors when it comes to describing sustainable development and social impact of a company or entity (Nielsen & Noergaard, 2011). The available ESG literature focuses on the implication of ESG for investments and financial performance (Friede, 2019). The link between ESG issues and

financial performance is well supported by empirical research (Eccles, Ioannou & Serafeim, 2014; Khan, Serafeim & Yoon, 2016). However, research connected to ESGs underlying dimensions: Social, Environmental and Governance are far less explored. Despite the popularity of ESG in research and amongst practitioners, there is no consensus on what ESG actually means and how it should be tackled. In fact, there is yet no universally accepted definition of ESG metrics and methodology (Eccles, Lee & Stroehle, 2019).

There has been an ongoing debate in the literature regarding the ability of a company to increase its value by incorporating sustainability into their operations and organization since the 1990s (Eccles & Vivier, 2011; Malik, 2015). Since 2005, the role of ESG has been highlighted as a part of an approach to sustainability (Eccles & Vivier, 2011). Incorporating ESG has been said to strengthen the organization's legitimacy, which is an area that is highly important for an organization's ability to attract investors and customers (Suchman, 1995; Eccles & Vivier, 2011). Additionally, capital markets have witnessed a rise in their investment decisions that are incorporated with ESG (Sherwood & Pollard, 2018). Earlier studies have found a strong positive correlation between high ESG propositions and equity returns (Friede, 2019). In 2005, ESG was promoted by establishing the Principles for Responsible Investment (PRI) which is a collaboration between the investment community and United Nations in partnership with the UN Environment Programme Finance Initiative (UNEP FI) (Reich, 2018). Similarly, Blackrock, the world's largest asset manager, is integrating ESG factors into their investment decisions (Blackrock, 2019). Also, other experienced investors with capabilities to rate the potential investments with ESG scores are using ESG to evaluate their investment decision. This indicates a clear commitment of the financial market to incorporate ESG into investment decisions (Auer & Schuhmacher, 2016; Friede, Busch & Bassen, 2015). These ESG scores are calculated internally by investors or third-party agencies which provide individual ESG scores for companies, similar to what a credit rating agency would do for the creditworthiness of a firm (Schäfer, 2005; Escrig-Olmedo, Muñoz-Torres & Fernandez-Izquierdo, 2010).

Based on the relevance for society and attractiveness to investors, companies could be incentivized to strengthen their ESG activities to increase firm value. The financial positive impact of ESG on investments is empirically well grounded (Friede, 2019). Knecht and Reich (2014) argue that ESG is a critical factor for the value chain and should be integrated by the management. Besides the recent increase in M&A activity, M&As has been considered an important topic by both practitioners and researchers within strategic management for over a century (Cartwright, 2005). After all, aside from joint ventures and strategic alliances, M&A

is a strategic source for external growth and corporate development (Bauer & Matzler, 2014). The amount of research conducted in the M&A field has increased tremendously during the last 50 years and studies have been conducted from several different theoretical angels (Birkinshaw, Bresman & Hakanson, 2000; Barkema & Schijven, 2008). Different schools of thought have evolved around the financial, strategic, organizational, and process-related implications of M&A (Bauer & Matzler, 2014). The impact of M&A transactions on both the bidder and target performance is well researched (Fatemi, Glaum & Kaiser, 2018). Recent research sees the importance of ESG growing when it comes to M&A (Franklin, 2019). However, what ESG entails with regard to M&As, is much less explored.

The description of the M&A process in literature changes slightly depending on which scholar is followed. The M&A process defined in the literature can consist of two to five phases (Appelbaum et al, 2000; Picot, 2002; Weber, 2013). However, independent of how an M&A process is conducted, it generally consists of one phase which includes an investigating aspect (Galpin & Herndon, 2000). The investigating aspect is the moment where the M&A transaction begins to be measured and valued (Lynch & Lind, 2002; Cartwright & Schoenberg, 2006). This investigation is called Due Diligence and is depending on the layout of the M&A, this is part of the first stage of a transaction (Howson, 2018). The phase which contains Due Diligence is regarded as one of the most important phases in M&A, as costs are balanced and potential risks are identified (Savovic & Pokrajcic, 2013). The Due Diligence covers different aspects of a company to support the value proposition of the acquirer (Howson, 2018). Further, Due Diligence has been declared as essential for the decision about whether the initiated M&A process will proceed or will be terminated (Puranam, 2006). In general, Due Diligence is divided into three different parts: Commercial, Legal and Financial Due Diligence (Reich, 2018). Moreover, the Due Diligence process as such can be applied to any topic that the acquirer deems important (Howson, 2018). The assessment in a Due Diligence for non-financial criteria, as such ESG, has increased over the past decade. (Knecht & Reich, 2014)

Since the 1980s, there has been a lot of research conducted concerning Due Diligence, but most of the research has covered the financial and economic aspects. Standard guidelines, statistical methods and practices related to Due Diligence have been subjected to empirical studies (Ayers, 2008; Bhagwan, Grobbelaar & Bam, 2018). The number of factors that are addressed in Due Diligence are rising continuously (ibid.). For example, the research by Knecht and Primdal (2005) describes a method to identify, measure and describe environmental and social performance. As mentioned before, the importance of the Due Diligence for the M&A process

is rooted in the aspect that risks which are not identified can lead to a failure and the decision of undertaking the transaction is based on the findings in the Due Diligence. In the past years, companies have not viewed ESG issues to be significant except if they had any implications for legal compliance (Dowse, 2009). In recent years, ESG is becoming more important as a part of the Due Diligence process. This is either included in the commercial Due Diligence, or as a standalone part conducted parallel to the traditional commercial, legal and financial Due Diligence (Sharma & Prashar, 2015). This is because companies see the connection between ESG and its potential impact on the company's intangible assets like brand, reputation, network, and the quality of the capability of its workforce (Stuebs & Sun, 2010). However, there is little research regarding the content of ESG in general, even less about ESG in Due Diligence as a part of the M&A process. Hence, there exists a research gap of what ESG in a Due Diligence entails. Given the increased M&A activity in combination with the increasing importance of ESG, this is an area that is predestined for further research. This study will contribute to the ESG and Due Diligence field and help to close the research gap. In order to study the content and the role of ESG in a Due Diligence process, this paper tries to answer the following two research questions:

- ***What is the content of ESG when part of a Due Diligence in an M&A process?***

- ***What is the role of ESG in Due Diligence in an M&A process?***

The purpose of this study is to explore the content and role of ESG within settings where M&A is conducted and in the relevance to Due Diligence. The empirical strategy will consist of data that is collected through investigating from different Due Diligence cases of M&A. The collected data that will be gathered through semi-structured interviews from respondents who work as investment professionals in the financial industry and are involved in a Due Diligence process. The conducted data will be used to explore the research questions and provide answers to them. The theme of ESG is shown to be rather complex and consisted of several different dimensions. In this study, ESG will be analyzed and unpacked into the underlying dimensions: Environmental, Social and Governance. This will be done to get an in-depth understanding of the content of ESG in a Due Diligence process of an M&A process. Furthermore, by unpacking ESG and looking at it through different scopes provided by the collected data we will be able to analyze the role of ESG in a Due Diligence process of an M&A. As the respondents during the interviews requested for anonymity, they will simply be referred to as respondents in the study.

# 2. Theoretical Framework

## 2.1 Merger and acquisitions

The concept of M&A is the process of combining two or more separate existing companies into one. This is done through companies merging together] or one company buying another one, meaning one being the acquirer and another being the acquired (Meglio & Risberg, 2011). For over a century M&As have been used by companies and organizations to gain growth and increase value (Lynch & Lind, 2002; Cartwright & Schoenberg, 2006). Additionally, M&As have been explained as a strategic choice to strengthen the firm's competitiveness, increase market share and to diversify operations (Salvi, Petruzzella & Giakoumelou, 2018). Several researchers agree that when it comes to the background of value creation, M&A is the most considered action when doing so (Larsson & Finkelstein, 1999; Parvinen & Tikkanen, 2007; Calipha, Tarba & Brock, 2010). Further, M&A is also a popular way to increase the profitability of an organization. Brakman, Gerretsen and Van Marrewijk (2006) argue that motives behind performing M&As is a widespread tool to increase a company's profitability. This can be done by merging or acquiring other companies and by controlling a larger part of a value chain, creating the possibility of increasing a company's efficiency (Brakman, Garretsen & Van Marrewijk, 2006).

However, despite all the possibilities for growth, increasing value and strategic moves, there is still a large number of failed M&A transactions (Young, 1981; Schweiger & Lippert, 2005; Christensen et al., 2011). The failure rate of M&A has been widely debated and results showing everything between a 50 percent chance of failure (Weber et al., 1996; Adams & Neely, 2000; Perry & Herd, 2004) up to as much as 70-90 percent (Christensen et al., 2011). This means that a large amount of the executed M&A deals have not yielded the results it was supposed to do or succeeded in the way it was intended. (Young, 1981; Perry & Herd, 2004; Schweiger & Lippert, 2005; Christensen et al., 2011). Reasons for frequent M&A failures include cultural differences, integration issues, external factors, negotiation error**s,** misevaluation among other things (Straub, 2007).

The studies of M&A have been argued for being placed in the management business strategy segment (Jovanovic & Rousseau, 2002; Gaughan, 2010; Kim, Halebliam & Finkelstein, 2011). A segment that can be quite a wide-ranging segment to look at (ibid.). Thus, it is reasonable to believe that M&A as a phenomenon have been studied both broadly and in length. Furthermore,

the phenomenon has generated a broad base of theories as well as procedures of how to use M&A in practice. The procedure of an M&A process is slightly different depending on which literature is explored. One example is that an M&A process consists of three phases:, planning, implementation and integration (Picot, 2002). The three phases range from an initial strategic decision with preliminary work such as the reasoning to perform an M&A. The implementation is where the M&A is being evaluated, which includes the financial investigations as well as a Due Diligence aspect. The third and final phase, the integration phase, is where the integration of the acquired company with the acquiring company is executed (Picot, 2002).

Another example of the M&A process is The Watson Wyatt Deal by Galpin and Herndon (2000) which is a process focusing on five stages. These five stages are: formulate, locate, investigate, negotiate and integrate. This is similar to the method described by Picot (2002) except for the larger focus on different transaction stages as a way to describe the M&A process rather than just separating it into three different ones. The first of the five stages are about formulating a strategy and criterions for the M&A, followed by the second which is locating possible organization targets. The third is about investigating the chosen target with Due Diligence amongst others. This is then followed by the fourth, negotiating the deal. Last, the fifth stage is the integration process of the organization regarding both cultural as well as financial aspects (Galpin & Herndon, 2000).

Further on, the M&A process can be seen as a start-to-end process that manages a transaction throughout the entire deal (Galpin & Herndon, 2014) and not only certain solitary sections within the progression. This suggests that an M&A is more than one action, it is a flow. Moreover, the execution of the different stages in an M&A process can also overlap each other, it is not something to be adamant (Galpin & Herndon, 2000; Picot, 2002). An M&A is an entire transaction phase and not just different sections (ibid.).

## 2.2 Due Diligence

As previously mentioned, the M&A process can consist of several different phases (Galpin & Herndon, 2000; Picot, 2002). However, a principle of the M&A process is that it includes a phase which incorporates an investigating part. The company that is about to be merged or acquired needs to be measured for the value of the deal (Lynch & Lind, 2002; Cartwright & Schoenberg, 2006). This measurement is called Due Diligence and is an analysis of financial and nonfinancial objectives of a company to support the value proposition of the acquirer

(ibid.). Further, Due Diligence is essential for the decision about whether the initiated M&A process will proceed as planned or be terminated (McIntyre, 2004; Venema, 2012).

Moreover, Due Diligence has been expressed as a very important aspect to an M&A transaction (Angwin, 2001). Considering it gathers all important information that is needed to make an assessment of the company (ibid.). The purpose of this action is to make sure that the value that is being paid in the M&A is in proportion to what the acquirer gets (Howson, 2018). In addition, several authors have argued that a Due Diligence is a key factor to avoid a failure in M&As (Jeffery & Herd, 2004; De Florian, 2007; Morrison, Kinley & Ficery, 2008). Non identified issues have shown that they may lead to failures in an M&A integration or post-M&A stage (Savovic, 2012). According to Jemison and Sitkin (1986) there is always substantial ambiguity at the start of an M&A process and the Due Diligence in successful M&A is seen as the part which resolves most of this ambiguity.

Furthermore, Due Diligence is only one part of M&A, but it has been expressed to be one of the most crucial parts for it to be successful with value creation as a result (Savovic & Pokrajcic, 2013). There are different ways to look at the Due Diligence in an M&A. There are some M&A processes that use a three-, four- or five-way process (Galpin & Herndon, 2000; Picot, 2002; Howson, 2003). The decision if there will be a three-, four- or five-way process depends on what kind of M&A that is planned, what sort of companies or organizations that are involved as well as what kind of process the people performing the M&A prefer (ibid.).

Conducting a Due Diligence may require a variety of resources, due to the nature of the process (Marks & Mirvis, 2000). Depending on the industry and complexity of the target company, Due Diligence often requires deep knowledge in different areas like industry, accounting, corporate culture, business operations, legal issues and financial performance. A consultant or a consulting company can support management during the Due Diligence as well as in the integration process (ibid.). Even though many large companies have departments with skills in the respective areas of Due Diligence, the use of external advisors can be more efficient when companies do not have all the needed knowledge internally (Marks & Mirvis, 2010). Furthermore, the use of external advisory can give the whole M&A process increased legitimacy (Angwin, 2001). The increased legitimacy can be beneficial towards capital providers like banks and investors that sometimes demand the use of a third party to conduct the Due Diligence as a requirement (ibid.).

Due Diligence has been expressed to be both narrow and broad at the same time (Godfrey, 2009). This could indicate that there is both depth as well as a need for a bigger picture with the gathering of information in a Due Diligence (ibid.). As previously mentioned, there are several different ways to measure Due Diligence. Depending on which industry is utilizing it, some measurements are more frequently used than others (Howson, 2018). However, it has been argued that the most frequent means of conducting a Due Diligence is to split the process into a Financial Due Diligence, Legal Due Diligence and Commercial Due Diligence (ibid.).

The Financial Due Diligence consists of historical data of the financial aspects such as profit, earnings and cost, these numbers typically act as a base for Due Diligence. The Legal Due Diligence focuses among others on agreements between the acquirer and the acquired company, possible existing contracts as well as stock transfers or possible existing conflicts. Commercial Due Diligence is mainly with topics such as evaluating competition, assessing the chances for possible future earning as well as combining the organizations strategies for a combined business (Howson, 2018).

Last, there are several other areas within Due Diligence such as HR, cultural, management, pension, insurance, tax, environmental, IT, technical and intellectual property to mention a few. However, several of these are combined during a Due Diligence and can be seen gathered under the same areas such as pension, tax and insurance could all be gathered under the Financial Due Diligence. Environmental, intellectual property and human resources can be part of the Legal Due Diligence and the management and technical could both be grouped under the Commercial Due Diligence (Howson, 2003).

## 2.3 ESG

The term ESG (Environmental Social Governance) was firstly used in a United Nations (UN) report in 2004 for the influence of financial markets on sustainable development (United Nations, 2004). Although the research regarding ESG is limited, researchers have discussed the role of ESG in related topics (Eccles & Vivier, 2011). Furthermore, one important underlying concept of ESG is sustainability. The use of the term sustainability has over the last decades increased within research (Kohtala, (2015). Since the inception of the term sustainability, there has been an ongoing debate between academics about the use and the concept of the term “Sustainability” (Stavins, Wagner & Wagner, 2003) The term is used in relation to among others environmentally friendly production, pollution prevention, pollution control and

minimization of resource usage (Gluckmanan & Socrates 2007). The frequent use of the term sustainability in different sources and different contexts is often misleading. In the context of this study, sustainability is defined and analyzed from a corporate view. Sustainability is well established within a corporate context (Campbell, 2007; Mittal, Sinha & Singh, 2008). Most business operations connected to the sustainability area are conducted under different labels, with "corporate sustainability" (CS), being one of the most used ones (Steurer et al., 2005). The public and investors are increasingly demanding sustainable operations from companies (Ahi & Searcy, 2014). Furthermore, sustainability is said to create several advantages such as strengthening an organization's legitimacy. Legitimacy is an area that is highly important for an organization's ability to attract investors and customers (Suchman, 1995). Corporate sustainability may also increase an organization's financial advantage (Martinuzzi & Krumay, 2013). Conversely, some researchers identified a negative correlation between corporate sustainability and financial performance (Smith, Yahya & Amiruddin, 2007; Crisóstomo, de Souza Freire & de Vasconcellos, 2011). Financial advantages are something that are perceived to be of high importance, as if there is no profitability in an organization, it has the risk of going bankrupt (Carroll, 1991; Carrol, 2016). Due to the high importance of profitability, it is important to highlight the research which says that organizations that do not work for a financial profit cannot work for sustainability (ibid.).

It has been discussed that sustainability is a concept that needs a positive value to be created in all social, environmental and economic aspects (Lankoski 2006; Lankoski 2016). This statement has been agreed on by other researchers (Carroll, 1991; Carrol, 2016) and has in some cases been called Corporate Social Responsibility (CSR). Despite the vast research done on M&A transactions, there is not much research about how the new shift towards more environmentally friendly and sustainable operations is affecting the M&A process (Lin & Wei, 2006; Eisenbach et al., 2011; Chan & Walter, 2014). Although, studies by Aktas, De Bodt and Cousin (2011) and Deng, Kang and Low (2013) concluded that there is a positive impact on shareholder value when taking the acquirers and targets CSR performance as independent variables. Further, Salvi, Petruzzella and Giakoumelou (2018) points out that acquiring companies could gain growth benefits by targeting sustainable firms under a long-term perspective.

Beyond meeting a financial objective, organizations are also faced with a growing pressure of increasing their performance in Environmental, Social and Governance (ESG) aspects (Hart & Zingales, 2017; Bénabou & Tirole, 2010). The importance of the ESG topic for the performance

of the company is widely recognized in the literature (De Zwaan, Brimble, & Stewart, 2015; Fernandez & Elfner, 2015). Public and private investors use ESG ratings to support their investment decisions (Friede, Busch & Bassen, 2015). There exists no definitive list and methodology on ESG measures and issues due to the constant change in technology, market environment, industry as well as the different cultural and social preferences can vary between regions and countries (Inderst, Kaminker, & Stewart, 2012). Environmental and social issues can be a high risk for companies and the integration of ESG into investment and operational decisions can possibly lead to better risk adjustment (Eccles, Kastrapeli & Potter, 2017). The ESG framework measures the operational impact of a company beyond the accounting dimension (Holland, 2011). The ESG scores when not conducted internally within an organization, are provided by specialized third rating agencies (Schäfer, 2005; Escrig-Olmedo, Muñoz-Torres & Fernandez-Izquierdo, 2010). The ESG rating agencies are functioning as a link between stakeholders and companies (Schäfer, 2005). As mentioned above, the use of ESG by organizations can be a positive means for engagement in sustainability responsibilities as well as increasing competitiveness (Franklin, 2019). The ESG framework can be interpreted as a tool to measure the often not so quantifiable CSR activities (Arouri, Gomes, & Pukthuanthong, 2019). Even though ESG can offer a competitive advantage, the use of ESG for investment decisions is often still ignored by companies (Greenwald, 2010). According to Malik (2015), a strong ESG performance is a key measure to attract investors.

The ESG literature focuses on the implication of ESG for investments and financial performance (Friede, Busch & Bassen, 2015). The link between ESG issues and financial performance is well supported by empirical research (Eccles, Ioannou & Serafeim, 2014; Khan, Serafeim & Yoon, 2016). However, there is a research gap as to what ESG entails, especially for companies. Furthermore, there is little research about ESG's underlying dimensions: Environmental, Social and Governance. In fact, there is yet no universally accepted definition of ESG metrics and methodology (Eccles, Lee & Stroehle, 2019).

### 2.3.1 Environmental

The environmental criteria of the ESG framework are directed to deal with potential risk that business activities can have for ecosystems (Indahl & Jacobsen, 2019). This includes potential risk assessment for air, water and human health. The environmental criteria include resource management, waste management, energy consumption, animal welfare and disclosing information about environmental policies (Markopoulos et al., 2020). The management of

environmental factors is important for industrial companies which have high demand and usage of natural resources and energy.

Furthermore, climate change policies are affecting most companies and industries (Bui & Villiers, 2017). Environmental management and sound use of resources can lead to growth and higher margins (Babiak & Trendafilova, 2011). Nonetheless, environmentally sustainable operations lead to competitive advantage (Esty & Porter, 1998).

### 2.3.2 Social

The social criteria of the ESG framework is connected to employees, society and communities which are affected by the operations of the company. Social criteria looks at the social values of the company and the impact it has on the stakeholder. Social criteria include policies related to diversity and to ensure a discrimination free workplace. Furthermore, labor standards are part of the social criteria to ensure the health and wellbeing of employees, not only internally, but also along the whole value and supply chain.

The reporting of what companies are doing in the social area to shareholders and local communities is important to ensure that companies can get licenses and support for their operations without pressure from society (Orlitzky, Siegel & Waldman, 2011). The study of Garriga and Mele (2004) shows that social responsibility can lead to higher financial performance of the company. This is supported by Saeidi et al. (2015), which pointed out that the social reputation of a company has a positive influence on financial performance. Furthermore, Stuebs and Sun (2010), point out that companies can use reputation to improve efficiencies and specifically labor efficiencies.

### 2.3.3 Governance

The Governance criteria focus on corporate policies and the governance of companies. Governance supports managing the expectations, rights and responsibility of stakeholders. The Governance criteria include tax strategy, executive compensation, donations and lobbying, disclosure of information, board structure and corporate risk management.

Corporate governance is important to align expectations and interests of the different stakeholders in order to achieve long term strategy goals (Ward, Brown & Rodriguez, 2009). Furthermore, corporate governance is seen as important to avoid unexpected financial outflows and can also lead to a better social acceptance due to wealth being more fairly distributed

(Hawley & Williams, 2005). Additionally, governance provides transparency of the processes and this provides accountability which is important to investors and shareholders to prevent financial crime and scandals (Borgia, 2005). Nonetheless, previous research identified a positive correlation between corporate governance and firm financial performance (Zabri, Ahmad & Wah, 2016; Reddy, Locke & Scrimgeour, 2010).

## 2.4 ESG in Due Diligence

According to Galpin and Herndon (2014), Due Diligence is an action that should be performed to prevent surprises in the future after the M&A process is done. With the threat of climate change, social concerns such as human rights and the importance of governance in organizational structure, it is important to highlight the potential risks of these elements to prevent or prepare for said possible future surprises. Hence, it is essential to go beyond the standard Due Diligence of financial, legal, and commercial (Galpin & Herndon, 2014). With that premise, ESG Due Diligence accounts for factors that are in the division of Environmental, Social and Governance, thus giving the Due Diligence a high degree of importance in an M&A (Franklin, 2019).

ESG factors are of high importance to organizations' marketing and regulatory work and therefore also a part of Due Diligence (Franklin, 2019). According to Corino (2000), environmental topics in Due Diligence are becoming more important. Since environmental topics are becoming a bigger part of Due Diligence, there may be other factors that have not been accounted for in other Due Diligences within M&A, such as financial, legal or commercial ones. Hence, aspects connected to ESG may have been wrongly evaluated or missed. The ESG Due Diligence is similar to other areas covered in a Due Diligence process, in that it is a matter of risk management and if the valuation of the deal will be correct or not (Dowse, 2009).

To adhere with previous research, to conduct a Due Diligence investigation can be very resource consuming (Marks & Mirvis, 2000) and hence there is an aim to have it as effective as possible with the restrictions that's tied to it such as time limits and costs (Howson, 2003). Particularly with the strong connection to failures of M&A that is connected to insufficient Due Diligence (Jeffery & Herd, 2004; De Florian, 2007; Morrison, Kinley & Ficery, 2008). In today's markets many investors use ESG to evaluate their investment decisions, and if the investors do not conduct the assessment themselves, there are agencies that can provide these ESG scores (In et al., 2019). For the investors, these ESG evaluations can be seen as a natural

part of the full Due Diligence process. Hence, the positive approach towards using ESG factors in the evaluating process for investors could show the importance of Environmental, Social and Governance in Due Diligence. However, there is a limited amount of studies on the impact of ESG factors in the Due Diligence process in an M&A.

## 2.5 Analytical framework

M&A as a strategic tool used by the company for creating growth and increasing value is well established (Lynch & Lind, 2002; Cartwright & Schoenberg, 2006). The motives for an M&A are rooted in enhancing the value of a company and can be directed to growth, profitability or strategic motives (Salvi, Petruzzella & Giakoumelou, 2018). An M&A process consists of several stages and one of them is Due Diligence (Lynch & Lind, 2002; Cartwright & Schoenberg, 2006). The Due Diligence phase is considered as one of the most critical phases of the M&A process. In the Due Diligence stage, the target company of an M&A is investigated to confirm the information which the buyer has on the target and screen the company for potential risks and opportunities.

Sustainability and ethical topics are becoming more important for companies and an opportunity to increase the value of the company (Suchman, 1995; Ahi & Searcy, 2013). The ESG measures and represents the sustainability and ethical impact of a company and stands for the three pillars: Environmental, Social and Governance. The literature review showcased the importance of ESG not only for the operations of companies but also for investors and stakeholders (Suchman, 1995). The connection between financial performance and ESG is well established in empirical research (Eccles, Ioannou & Serafeim, 2014; Khan, Serafeim & Yoon, 2016). Investors have been seen to use ESG criteria to evaluate their investment decision (Friede, Busch & Bassen, 2015). Furthermore, ESG is starting to play a bigger role in M&A (Franklin, 2019).

The ESG ratings are mostly done by third party agencies. However, there is no universally accepted framework and methodology of evaluating ESG factors. Nonetheless, the research about ESG in M&A is still underrepresented. ESG is rooted in the company's operation and is becoming a more important part of the Due Diligence (Franklin, 2019). By using the theoretical background of the three pillars of ESG: Environmental, Social and Governance this paper will explore the content of ESG what the role of ESG entails in a Due Diligence of an M&A process. As described in Figure 1 this study will explore the content and role of ESG in the boundaries

in a Due Diligence of an M&A. However, the aim of this study is not to explore the Due Diligence or the M&A process and its motives, these topics have been examined in several waves during the last decades (Caiazza & Volpe, 2015). Moreover, as presented in the figure below the Due Diligence of an M&A serves as the framework in which this study explores the content and role of ESG. This approach in the study also works to distinguish how the data collecting should be framed.

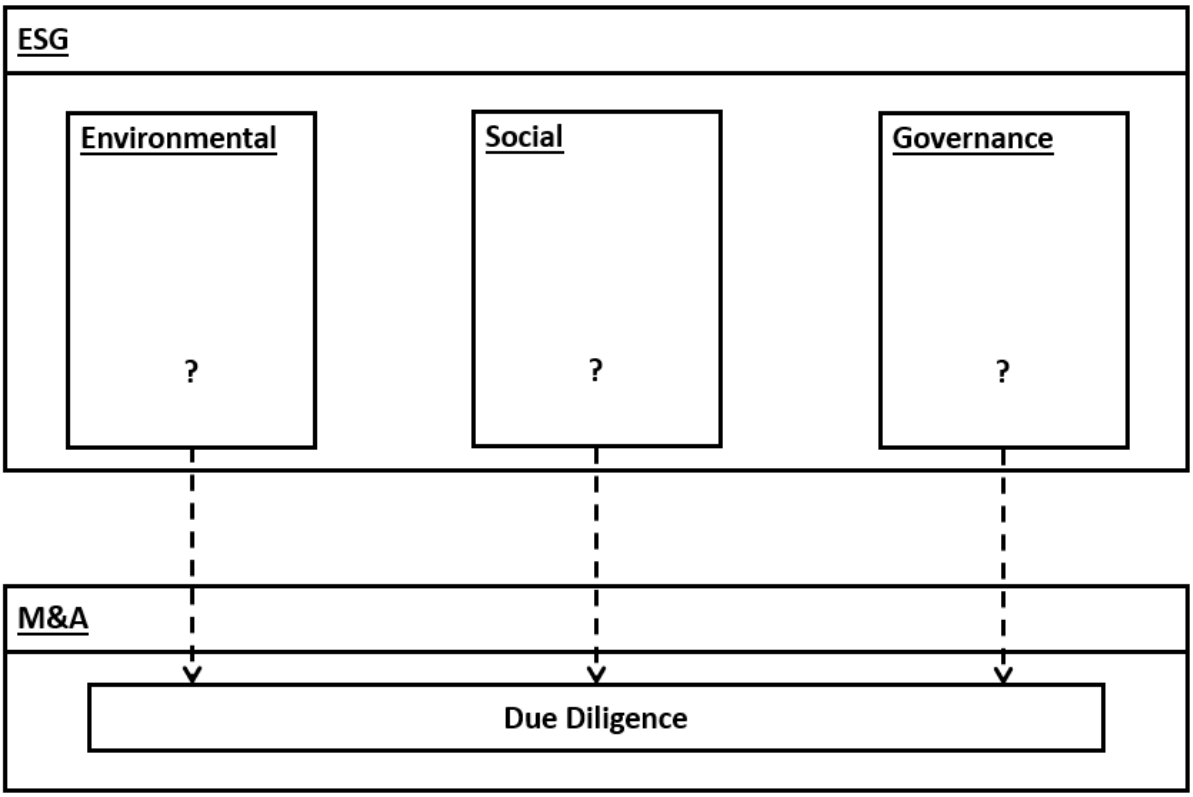


**Figure 1. Summary of the theoretical dimensions.**

When answering the research questions of "*What is the content of ESG when part of a Due Diligence in an M&A process?"* and "*What is the role of ESG in Due Diligence in an M&A process?"* As illustrated in Figure 1, the study will look at the content within ESG and what it consists of by entangling it and thus making it less complex. As seen in the figure the three different pillars of ESG, Environmental, Social and Governance are part of it. However, what these three pillars contain is still a conundrum. Moreover, there are connections towards Due Diligence and M&A, as the literature has pointed out (Caiazza & Volpe, 2015). Nonetheless, which role ESG plays in those connections are not revealed. Further, this is an exploratory study and the current literature regarding ESG can be seen as a point of departure to something very few studies have investigated.

# 3. Method

## 3.1 Research approach and design

The purpose of this study is to further exploratively investigate the content of ESG and contribute to the understanding of the role ESG have in the Due Diligence in an M&A. Previous research has been done on Due Diligence as part of M&A. However, within the same frame of research, ESG factors have only partly been studied, or not at all. Thus, there is a gap to close in this particular research field.

To further investigate and gain a deeper understanding of the topic, a qualitative and inductive exploratory research was conducted (Miles & Huberman, 1994; Azungah, 2018). Inductive research involves conclusions to be drawn from observations (Wright, 2017). Moreover, the selected approach also aims to identify meanings from collected data (Saunders, Lewis & Thornhill, 2012). As shown in the previous chapter, the topic of ESG and ESG in regards to the Due Diligence of an M&A in particular, is characterized by a clear research gap. The purpose of choosing a qualitative research approach is that it is seen as a preferable research method to answer research questions of an explorative type. Due to the limited research, an inductive approach is suitable for answering the outlined research questions. The selected method with a qualitative research approach allows us to investigate in-depth areas that are broad and complex and hence contribute to the research within the research area (Drumwright 1996; Eisenhardt 1989; Fischer, 2006). Using an explorative approach makes it possible to observe underlying dynamics and get an understanding of the decisions and meanings of how ESG is being used.

The theme of ESG was shown to be rather complex and consisted of several different dimensions. This study therefore had to unpack these dimensions individually to fully comprehend this theme. To provide a deeper understanding of the role that ESG has in Due Diligence of an M&A process, this study was carried out using a multiple-case study approach. The study was conducted as a case study not only due to the complexity that Due Diligence involves, but also since it has been suggested to contribute to a foundation for a generalization of the analytics (Yin, 2009). The objective was to first get information from several cases from each of the respondents. From there, go more in depth in the interviews. As a result, both general information about ESG and more depth knowledge related to different cases can be obtained (Eisenhardth, 1989; Yin, 2009).

Moreover, due to the choice of a qualitative exploratory study, there is a need for a literature review (Brown & Sauter, 2012). As shown in chapter two the field of ESG in Due Diligence of an M&A consists of a small amount of literature (Eccles, Lee & Stroehle, 2019). Therefore a literature review was performed to screen earlier published reports, articles, and journals within the theme of ESG in Due Diligence and M&A. The information gathered throughout the literature review helped foremost to gain a broader understanding of the concepts used in the study such as the content of ESG. But also, an extensive understanding in the field of Due Diligence and M&A. Moreover, this would also grant information to portray what research previously had been done. Hence, confirming that the contribution that is aimed for is accurate. Furthermore, the literature review enabled the study to have the research questions formulated in a correct way towards what was being explored (Brown & Sauter, 2012).

## 3.2 Setting and selections

### 3.2.1 Industry setting

To be able to answer the research questions stated in the study, the correct scope when it comes to which industry the study should look further into was necessary. Worldwide there has been an increasing trend of M&A as well as growing assessments for Due Diligence recently (Knecht & Reich, 2014; Caiazza & Ferrara, 2016; UNCTAD, 2019). Moreover, studies show a trend of ESG being included in the Due Diligence phase as an important matter. Furthermore, it incentivizes companies to enhance their ESG activities, giving the opportunity to increase their value (Friede, Busch & Bassen, 2015; Reich, 2018). Hence, the industry that the study focused on had to be part of the business of M&A and Due Diligence.

The chosen respondents are investment professionals in the financial industry. Part of the financial industry are consultants who are supporting in the Due Diligence process, strategic buyers, private equity companies as well as other actors involved in transaction services with relations to M&A and Due Diligence. The reason for selecting respondents within these industries are that they are involved in the process of Due Diligences within M&A and therefore their involvements would contribute to answering our research questions (Marks & Mirvis, 2000; Howson, 2018).

### 3.2.2 Criteria and selection of respondents

The chosen companies were selected purposefully to be investment professionals in the financial industry. Several criteria were set for the respondents with the aim to be able to answer and contribute to the research. These criteria needed to be fulfilled in order to be a part of the research as well as to increase the reliability in the study. This is in line with the process of theoretical sampling approach by Eisenhardt (1989). The reasoning behind this, was that they had to be knowledgeable enough to take part in the interviews and bring expertise and substance.

Moreover, the criteria were set up to ensure that the different participants had information that was relevant for our area of research. These measures could have been something that was selected merely for this study. However, it was unavoidable that the participants had certain knowledge gathered, in order for them to be able to supply the information needed (Ghauri & Grønhaug, 2010). Participants involved in this study had to fulfill two criteria. The first criterion was that they had to have experience from working with Due Diligence as part of an M&A transaction. This was chosen to investigate the possible role of ESG factors in the Due Diligence phase of an M&A. The first criteria is therefore that '*the participants should have experience of working with Due Diligence in the context of M&A*'. The second criteria was that the participant needed to have been involved with Due Diligence in an M&A in the last two years. This is because ESG is in some cases seen as a new phenomenon (Sherwood & Pollard, 2018). Hence, the participants who had not been involved in Due Diligence in an M&A the last years could therefore have been excluded in the development of ESG, creating bias. Thus, the second criteria is '*the participant should have at least two years of experience working with Due Diligence in the context of an M&A*".

There has been mentioned that anonymity in qualitative research may compromise the quality of the data (Parry & Mauthner, 2004). However, at the same time it was opposed that exchange of confidential information between respondent and researcher could also impact the quality of the data in a productive way (ibid.). Moreover, anonymity has been practiced to promote respondents to speak more freely and contribute ideas more openly (Wilson & Jessup, 1995). However, Tilley and Woodthorpe (2011) stress that it is the responsibility of the researcher to protect respondents through anonymity. Hence, all the respondents contributing in the interviews have been promised to be kept anonymous. According to Lancaster (2017) promising anonymity is something that could increase the respondents' trust during the

interviews and hence encourage respondents to speak more freely and honestly. This is found evident since several of the respondents have disclosed confidential information regarding cases they have been involved with and the company they are working in. Therefore, names, exact positions within the company, as well as the company names are under disclosure. The year of the acquisitions as well as the deal values that were involved have also been hidden, due to the specific regions and industries that we present people don't want to be identified. However, all cases were conducted from 2017 and forward.

The interviews were of a semi-structured format, meaning amongst others that there were questions prepared before the meeting in the form of an interview guide (see Appendix 1). The semi-structured approach was done to be able to give the respondents follow up questions or ask them to elaborate further on their responses. Bryman and Bell (2015) express that a semi-structured interview is an appropriate way to gather data in a qualitative and explorative study such as this. Additionally, it makes it possible to increase the understanding of a complex research question with that structure (ibid.). Moreover, it has been said that a semi-structured format for interviews are suitable for this kind of qualitative data collection, which gives the respondents flexibility with the answers while still following an interview structure related to our stated theme (Yin, 2009; Azungah, 2018).

The first contact with the respondents were conducted by phone, email and LinkedIn. In the cases where contact was done through email and LinkedIn, a standardized letter was written (see Appendix 2) which explained our intentions with the interview and gave some information regarding the topic. The respondents that answered and expressed their interest, as well as fulfilled the two criteria, were then contacted again to set up the interview. The interviews were conducted with Skype and Zoom-meetings as well as over the phone. In the section below (see Table 1) information regarding the respondents are shown. The information shows the number of cases the respondent was involved in and disclosed in the interview, the role within the company, type of industry they are present in, which country they are positioned in, their working experience within Due Diligence as well as the lengths of the interviews.

**Table 1**
*Interviews and respondent information*

| Respondent | Number of DD cases | Role within the company | Company | Location | Work Experience | Interview length |
|---|---|---|---|---|---|---|
| A | 3 | Associate Transaction Services | Consultancy | Sweden | 3 years | 34 min |
| B | 1 | Associate Deal Advisory | Consultancy | Sweden | 2 years | 28 min |
| C | 2 | Investment Professional | Private Equity | Sweden | 10 years | 36 min |
| D | 2 | M&A Strategy Manager | Consultancy | Sweden | 5 years | 43 min |
| E | 3 | Investment Associate | Private Equity | Germany | 4 years | 40 min |
| F | 4 | Project Manager | Consulting | Germany | 6 years | 46 min |
| G | 1 | CEO | Retail | Germany | 15 years | 28 min |
| H | 2 | Corporate Strategy Analyst | Telecommunication | Germany | 4 years | 44 min |
| I | 3 | Associate M&A Advisory | Consulting | Germany | 4 years | 45 min |

***Table 1. Interviews and respondent information.*** *Shows information of different kinds related to the respondents.*

This study was conducted with nine participants who were connected to 21 different cases. Information regarding which respondent was involved in which case, which region the acquisition took place in as well as in which industry can be seen in Table 2. The nine respondents were each involved in 1 to 4 different individual cases each out of the 21 in total. More, the interviews were recorded and transcribed after the interviews had been done. This is a method that has been expressed as having the potential for higher quality and better structure in the study (Ghauri & Grønhaug, 2010). The chosen language for all interviews was English, considering the interviewers and the respondents speak different native languages. This was not a major issue as all respondents use English as an active language within their companies. Moreover, using the same language during interviews has been found to create better validity for qualitative studies (Squires, 2009).

**Table 2**
*Project information*

| Project | Responded | Region | Type of industry |
|---|---|---|---|
| 1 | A | Scandinavia | Chemical |
| 2 | A | Scandinavia | Mining |
| 3 | A | Scandinavia | Maritime Infrastructure |
| 4 | B | Scandinavia | IT services |
| 5 | C | Central Europe | Health and MedTech |
| 6 | C | Scandinavia | Consumer goods |
| 7 | D | Baltics | Energy |
| 8 | D | Central Europe | Automotive |
| 9 | E | Europe | Aerospace/Defense |
| 10 | E | Europe | Consumer goods |
| 11 | E | Central Europe | Beverages |
| 12 | F | Europe | Vehicles |
| 13 | F | Europe | Construction |
| 14 | F | Central Europe | Ship |
| 15 | F | Central Europe | Construction |
| 16 | G | Europe | Retail |
| 17 | H | Central Europe | Telecommunication |
| 18 | H | Baltics | Media |
| 19 | I | Central Europe | Consumer goods |
| 20 | I | Central Europe | Consumer goods |
| 21 | I | Europe | Retail |

***Table 2. Case information.*** *Shows information related to the different cases brought in the empirical gatherings.*

## 3.3 Interview guide

During the interviews, the respondents could ask questions for clarifications to make sure they did understand the questions correctly and the interviewers did ask accompanying follow up questions within the guiding lines of the interview guide (see Appendix 1). The questions were aimed towards talking more about concrete cases where Due Diligence was being used rather than just Due Diligence in general. The material gathered from these interviews were then used as the main source (data) to try to develop a solution and answers to help answer the research questions.

In order to be consistent with the questions aimed towards the respondents being interviewed and to make sure that everyone got the same questions, an interview guide was developed (Mason, 2011). The aim of the interview guide in this study was to gather empirical data which will help answer the research questions "*What is the content of ESG when part of a Due Diligence in an M&A process*?" and "*What is the role of ESG in Due Diligence in an M&A process*?". The interview questions were directed towards respondents of our study who have experience in the field of Due Diligence and M&A. The interview guide was developed with support of the analytical framework, thus making the questions have an explorative way while also connecting to the foundation of ESG, Environmental, Social and Governance.

The interview guide was constructed that it would be divided into three different sections. First, the respondents were asked some more general questions about themselves, the company in which they work in as well as their experience within M&A and Due Diligence. This was done to get a more general understanding of where the respondents come from, their background as well as their experience. Secondly, this was followed by more specific questions regarding M&A and Due Diligence in different cases that the respondents had been involved in and contributed to. The reasoning behind this was to have the respondents share information regarding information from different cases they had taken part of. Third, the last section in the interview guide contained questions more directly towards ESG and the different aspects that surround it such as environmental, social and governance. This was done in order to get a deeper understanding of what the content in the study of what ESG is as well as which role ESG plays in Due Diligence (Brown & Sauter, 2012)

Moreover, if the case were that the respondent had no experience in the field of ESG, the questions would change direction after the second part to try and understand possible reasons why ESG was not part of the Due Diligence. This gave the respondents the option to first summarize information regarding the respondent as well as recent cases and the involvement and experience towards M&A and Due Diligence. As suggested by Drogendijk (2008) the questions in the interview guide were discussed together with the supervisor of this study to ensure a higher internal validity but also that the questions would be relevant to the studied theme.

As preparation before the actual interviews, pilot interviews were conducted. This was done to test the approach of our interview guide. These pilot interviews were used to test the questions to see if they were clear or if there were a possibility to simplify them even more. Moreover, it was decided to send the interview guides beforehand to our respondents to give them the opportunity to prepare. It has been acknowledged that sending out the questions beforehand can lead to bias (Bryman & Bell, 2015). Nonetheless, the respondents could reflect over the question beforehand and then give more in-depth answers. In addition, the test pilots did experience that receiving the interview guide before gave the chance to recall information better thus giving more length and precision in the answers.

## 3.4 Data processing and coding

To be able to process and structure the data gathered through the interviews in a sound manner, we used a framework that was inspired by Corley and Gioia (2004). This is a framework that has been used regularly in inductive and qualitative research, to structure and present different dimensions that disclose from the gathered data (Gioia, Corley & Hamilton, 2013). More, this kind of presentation of data has been said to increase transparency and therefore also the credibility of the study (Patton, 1999; Gioia, Corley & Hamilton, 2013). Presenting data in a clear, composed and understandable way increases the replicability of the study (Patton, 1999). Hence, if the study was replicated by other researchers, it would show similar results (ibid.). Further, the framework by Corley and Gioia (2004) have been shown to provide a good display of the coding process from the raw data into clear and understandable results.

Additionally, the process to develop and present rigor in qualitative research has been expressed as something essential to enhance the quality of the work (Alvesson & Sköldberg, 2009). In order to display rigor, it is crucial for the study to have a stance of reflexivity (Patton, 1999). Also, to demonstrate said reflexivity within the study the decisions made in the process need to be open and transparent. A way of doing so is using a structured framework approach (Patton, 1999; Gioia, Corley & Hamilton, 2013).

As introduced above the model for coding is inspired by the data structure by Corley and Gioia (2004) which consists of three different steps (Figure 2). The different steps presented below are modified versions to apply better towards the purpose of this study.

**First order concepts: differentiating concepts from data**

The first step was to develop first order concepts, which include different quotes from our produced interviews which then were transcribed. Each of the transcribed interviews were searched individually for concepts and statements related to factors that could be related to ESG and Due Diligence and thus help to answer the research questions. Moreover, these concepts and statements were marked accordingly in the transcriptions and later compared between the two readers for possible similarities. The identified similarities between the two authors were seen as valuable. As a result, the findings were added as a part of the data structure and transferred to be a first order concept. In the cases where one word or sentence was marked by only one author, it was brought up with the other author to see if the author who noticed it

misinterpreted it or the other author may have missed it. This was followed by a dialog in between and then a conclusion if it was to be included or not.

**Second-order themes: structuring the first order concepts**

Furthermore, once all data had been examined and the first order concepts were differentiated, it was followed by the second-order theme phase. The structure of this phase contains quotes organized in the first order concepts which were put together and arranged into different compatible themes. These themes can be observed as ways to connect the quotes and detect relations between them. This progress was conducted for each and all the first order concept, which resulted in 12 second-order themes (see Figure 2). Additionally, the second-order themes that are presented are the ones which were found to be the most prominent ones. There might be others as well in the data, but what was found is what was reported and showed in the study

**Aggregated dimensions: organizing second-order themes and conclusion drawing**

Moreover, the first order concepts and second-order themes were put in their positions. The themes were structured into groups of similarities. Thus, the third step, the aggregated dimensions, emerged from the underlying factors of second-order themes. These emerged aggregated dimensions consist of Environmental, Social and Governance.

After the coding was completed, the last step after the emerged aggregated dimensions is conclusion drawing, which was done upon the aggregated dimensions that were extracted from the second-order themes. This was done to create an understanding of the different contents they consist of, as well as which roles the findings have (Gioia, Corley & Hamilton, 2012). The authors guarantee that all the different steps of the data process and coding were executed in the same way throughout the development. The results will be presented later in the empirical findings section.

The figure below (Figure 2) is presented as a clarification of the systematic approach that was conducted in this study (Corley & Gioia, 2004). The purpose of this presentation is to give a clear understanding of the systematic approach that the study used during the data processing and coding of the empirical data gathered in the interviews. This therefore displays both reflexive and transparent results (Alvesson & Sköldberg, 2009). Central parts of the results are presented further in chapter 4.

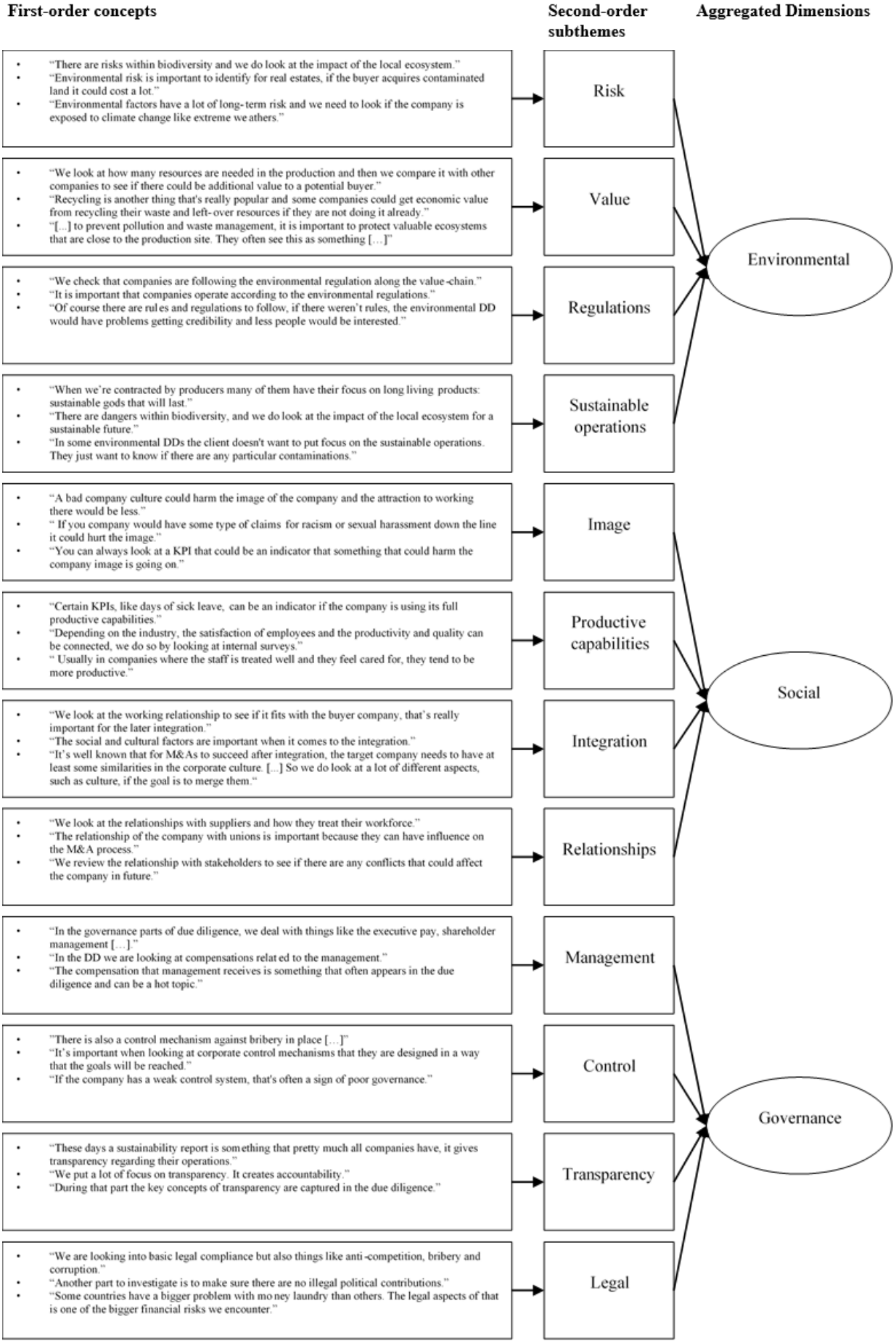


**Figure 2. Data Structure.**

# 4. Empirical Findings

The empirical gatherings from the interviews show several interesting points when it comes to the relevance of ESG in Due Diligence and M&A. Additionally, the gathered empirics describe what the respondents answered to the questions outlined in the interview guide (see Appendix 1). Considering the explorative character of this study, the data from these semi-structured interviews with open-ended questions defined the second order themes of the aggregated dimensions Environmental, Social and Governance. Following in this section will be the empirical sections of second order themes. But first more general observation towards ESG in Due Diligence.

According to our data, 86 % of the Due Diligence conducted by our respondents had a separate "ESG Due Diligence" part. Although no explicit "ESG Due Diligence" was conducted in 14 % of the transactions, parts of the ESG criteria was investigated during the Financial Due Diligence, Commercial Due Diligence or Legal Due Diligence

According to one of our respondents:

> *"The majority (of companies) are doing some kind of ESG Due Diligence. At least that are using us as their service provider. The investors who already have ESG as a core part of their company and are about to acquire usually have their own experts in-house that can look at the ESG Due Diligence."* (Respondent B, 2020)

Another respondent concurred with this. Even though some concerns regarding the popularity were expressed as well.

> *"The coin has two sides. On one side where the capital market is, ESG is seen as something very attractive and a high valuation regarding ESG means a high financial value for a company. For the private equity firms, it's a lot calmer, they approach it with a more traditional financial view.*" (Respondent D, 2020)

However, not all respondents recognized the recognition of ESG within Due Diligence. Even if they had the capability within the company, it was not seen as something that happens often.

> *"Our clients come to us, typically private equity firms who are about to buy another company and they need transaction services. Specifically, financial Due Diligence. We*

*are usually not asked to do other Due Diligences even though we have that capacity."* (Respondent I, 2020)

## 4.1 Environmental

The aggregated dimension of Environmental was frequently discussed by the respondents. The Environmental dimension entailed the second order themes: *Risk*, *Value*, *Regulations* and *Sustainable operations*. See, table 3 for different frequencies.

### 4.1.1 Risk

The second-order theme *Risk* was mentioned by every participant. There was a common understanding that environmental factors entail risk for the company and its operations. The theme *Risk* emerged mainly from the use of scarce resources, waste management pollution and carbon dioxide. The possibility of polluting the environment due to the operation was seen as a major risk investigated by our respondents.

> *"We managed to identify both potential land contamination as well as risks that could be connected to faulty wastewater management."* (Respondent F, 2020)

> *"There are risks within biodiversity and we do look at the impact of the local ecosystem."* (Respondent B, 2020)

> *"We had this Due Diligence for a chemical company and we found a major risk regarding pollution and how they currently manage their waste water."* (Respondent A, 2020)

Furthermore, it was mentioned that *Risk* is connected to potential financial costs that can arise out of these environmental factors. The financial risk was connected to the sourcing of scarce resources or due to pollution in the ground of real estate assets.

> *"Environmental risk is important to identify for real estates, if the buyer acquires contaminated land it could cost a lot."* (Respondent D, 2020)

> *"We look for possible scarce resources used in the value chain to see if there is a risk for the company. If the supply of resources would diminish it could lead to higher costs."* (Respondent E, 2020)

In addition, the *Risk* was not always related to the current state of being but a possibility in the future. Moreover, one participant talked about possible future exposure to extreme weather

conditions due to climate change. Another participant saw a risk in the future development of carbon dioxide prices.

> *"We try to see where environmental factors can be a financial risk in the future. For example, we don't know how the price for carbon dioxide will develop."* (Respondent C, 2020)

> *"Environmental factors have a lot of long-term risk and we need to look if the company is exposed to climate change like extreme weathers."* (Respondent F, 2020)

### 4.1.2 Value

The second-order theme *Value* was mentioned by some of the respondents. An environmental friendly production with little waste of resources and a good ecological footprint was identified during the interviews as a possibility to create value for the acquirer of the company. One participant expressed that low energy consumption in comparison with industry peers can be an indicator for advanced technology and therefore create value for the acquirer. Furthermore, another participant mentioned that if a company does not use recycling already it could be a source for value creation. Additionally, products which are produced with a low ecological footprint was indicated to be a value add for the product portfolio of the acquiring company.

> "*[...] products with a low ecological footprint in the production could create additional value for the product portfolio of the company."* (Respondent E, 2020)

> *"If the energy consumption of production facilities is low in comparison with industry peers, it could be a sign of advanced technology advantages, but also as a source to create value for the buyer."* (Respondent D, 2020)

> *"We look at how many resources are needed in the production and then we compare it with other companies to see if there could be additional value to a potential buyer."* (Respondent I, 2020)

> *"Recycling is another thing that's really popular and some companies could get economic value from recycling their waste and left-over resources if they are not doing it already."* (Respondent I, 2020)

Beside the economic profit one participant mentioned that waste management helps to conserve valuable natural capital and suggested that the local community could possibly profit from that.

> "*[...] to prevent pollution and waste management it is important to protect valuable ecosystems that are close to the production site. They often see this as something positive since it can increase the image of the company in the local community*." (Respondent F, 2020)

### 4.1.3 Regulations

The second-order theme of *Regulations* was a theme that the respondents were consistent with in their expressions. All of the respondents did mention it sometime during the interviews and many times it was formulated as an essential part of the environmental factors in Due Diligence. The central component that was communicated in the empirical gathering was that *Regulations* are to be followed. It was sort of a consensus indicating that the regulations were created to help staying within the borders, rather than just point towards a prerequisite. The empirics below show the previously mentioned statement, that the respondents want to be certain that regulations are upheld.

> "*We check that companies are following the environmental regulation along the value-chain.*" (Respondent F, 2020)

> "*It is important that companies operate according to the environmental regulations.*" (Respondent G, 2020)

> "*If we look at an industrial company for example, we look closer to see if they are following the regulations with pollution and waste management.*" (Respondent C, 2020)

> "*Depending on the industry, we review different things, but that the company is following current regulations is a must.*" (Respondent E, 2020)

In general, the respondents communicated a similar view at the theme of *Regulations*. There were none of them who disclosed that the regulations are not something to be followed and the overall expression was that they found it to be helpful as guidelines during Due Diligence. Moreover, one respondent did express quite clearly that regulations are in place and needs to be complied to, when asked if there are certain laws or rules to adhere to.

> "*Of course there are rules and regulations to follow, if there weren't rules, the environmental DD would have problems getting credibility and less people would be interested.*" (Respondent A, 2020)

### 4.1.4 Sustainable operations

*Sustainable operations* such as sustainable development are factors that adhere to incorporating environmental sustainability. Moreover, it is also the second-order theme of the Environmental dimension. Sustainability was from the respondent disclosed as something that's sustainable over a longer period of time. This included connections towards long lasting products as one

respondent articulated and an interpretation that the ambitions of sustainability from the clients are growing.

> "*When we're contracted by producers many of them have their focus on long living products: sustainable gods that will last.*" (Respondent D, 2020)

> "*Earlier sorting the trash could be seen as a sustainable act, these days the clients want a thorough investigation, they want to plan for the future.*" (Respondent I, 2020)

Further, the presence of scarcity in resources around the world was expressed to be important as a sustainable operation for another respondent. This was communicated in the context of a frightening future of the environment.

> "*There are dangers within biodiversity and we do look at the impact of the local ecosystem for a sustainable future.*" (Respondent G, 2020)

Moreover, there was one respondent that perceived that clients want a bare minimum when it comes to sustainable operations. In this case the respondent felt somewhat disgruntled that the client was not susceptible to a full analysis.

> "*In some environmental DDs the client doesn't want to put focus on the sustainable operations. They just want to know if there are any particular contaminations*." (Respondent D, 2020)

### 4.1.5 Environmental influencing Due Diligence

The addressed respondents that mentioned that the Due Diligence of environmental factors were used as part of their Due Diligence composed a large majority. Hence, the environmental contributions discussed in the Environmental area of ESG should not be ignored. According to respondents, environmental topics have become a bigger part of Due Diligence. With this comes an increasing demand for services connected to environmental factors.

Moreover, respondents are expressing that the Due Diligence of environmental factors increased the scope of the Due Diligence Process. Hence, the process becomes more expensive. The respondents further reasoned that the increased complexity of environmental factors demands a higher expertise. Thus, another argument for it to become far more costly.

> "*When environmental parts become a larger factor in Due Diligence, we need to put more time on it, this results in bigger cost for the client*." (Respondent B, 2020)

> "*The majority (of companies) is doing some kind of Due Diligence with environmental factors. At least that are using us as their service provider. The investors who already have ESG as a core part of their company and are about to acquire, usually have their own experts in-house that can look at the ESG Due Diligence.*" (Respondent F, 2020)

> *"You need more experts. If we look for possible pollution we hire and institute to do it and then it takes some time till we have the results"* (Respondent E, 2020)

> "*We have noticed that the increasing challenges with environmental risks are also affecting the demand for environmental parts in DD.*" (Respondent B, 2020)

> "*Well, there's a bigger knowledge requirement in DD with environmental components. I think that's one of the reasons it cost more.*" (Respondent G, 2020)

Moreover, respondents have expressed that since there is an increased focus on ESG they are looking for more relevant environmental topics during the commercial Due Diligence to provide information towards the environmental factors in Due Diligence. Hence, the environmental factors in Due Diligence were disclosed to enhance the results regarding sustainability goals for the clients.

> "*Depending on which industry we look at, we could possibly overlap other DDs such as the commercial one with the environmental. From an environmental perspective there is a lot of information to merge that in the end could gain the company.*" (Respondent C, 2020)

## 4.2 Social

The social aspect of ESG is something that has been discussed broadly and was something that many of the respondents did perceive as an important section in the Due Diligence, and therefore expressed frequently. The aggregated dimension Social is grounded in four different second order themes. The four themes that were identified were as follows. *Image, Productive capabilities*, *Integrations* and *Relationships*.

### 4.2.1 Image

Issues regarding damage to company reputation due to not adhering to human rights standards or rules regarding social behavior, such as racism or sexual harassment, were connected to

*Image*. Further, the second order theme *Image* was highlighted by nearly all the respondents. This is depicted in the quotes below:

> "*A bad company culture could harm the image of the company and the attraction to working there would be less*." (Respondent H, 2020)

> "*We look into the supply chain to see if the supplier are involved with child labor or human rights violation which could have a negative impact*." (Respondent G, 2020)

> "*If your company would have some type of claims for racism or sexual harassment down the line it could hurt the image.*" (Respondent I, 2020)

Moreover, it was disclosed during interviews with a respondent that the theme *Image* was also noticed during a conversation connected with Key Performance Indicators (KPIs). In this case the respondent did evaluate KPI to be a useful tool in measuring the current standing. See below.

> "*You can always look at KPIs, that could be an indicator that something that could harm the company image is going on."* (Respondent H, 2020)

### 4.2.2 Productive capabilities

The second order theme of *Productive capabilities* was something that were acknowledged by the majority of the respondents. *Productive capabilities* were expressed from the respondents to be factors in the context of sick leave, competence growth to increase productivity, certain labor risks and other productivity related aspects in the social aspects of Due Diligence. It was indicated that KPIs, if used to measure sick leave, could indicate capacity flaws.

> "*Certain KPIs, like days of sick leave, can be an indicator if the company is using its full productive capabilities.*" (Respondent A, 2020)

In the empirics there were also communications from the respondents to look further into unsafe working environments, handling of conflicts as well as the amenity of employees. Moreover, the empirics do foretell that even if they collect the information with different approaches such arranging records and surveys, it was still indicated that they reach for similar comparable goals.

> "*We look at the record of accidents because work and health safety issues are not only important to protect the employees but an unsafe workplace could also affect productivity and quality*." (Respondent C, 2020)

> "*During the Due Diligence, I try to see if there are any conflicts at the workplace which could affect productivity.*" (Respondent E, 2020)

> "*Depending on the industry, the satisfaction of employees and the productivity and quality can be connected, we do that by looking at internal surveys.*" (Respondent I, 2020)

The general expression the respondents gave during the empiric gathering was a coherent attitude of agreement that social factors in Due Diligence was important. Further, it was pointed out that measuring acts of wellbeing could be complicated but also rewarding.

> "*Usually in companies where the staff is treated well and they feel cared for, they tend to be more productive.*" (Respondent A, 2020)

### 4.2.3 Integration

*Integration* emerged as a second order theme to the aggregated dimension Social. It was communicated quite similarly by the respondents and many of them reasoned around that theme. Relationships and communications in both the target company as well as the client's company during a Due Diligence were factors that were brought up. This was considered in the context of corporate culture, which several of the respondents allude to and expressed the importance of. The later following integration seems to be crucial for several of the respondents when they talked about relationships. Hence, the reason they are portraying it with strong contentions.

> "*We look at the working relationship to see if it fits with the buyer company, that's really important for the later integration.*" (Respondent F, 2020)

> "*It's important for the post-merger integration that the corporate culture of the two merging companies are matching."* (Respondent I, 2020)

> "*The social and cultural factors are important when it comes to the integration.*" (Respondent C, 2020)

Furthermore, one respondent did mention that internal factors as the corporate culture could possibly be one of the most important social factors in Due Diligence. Since the thrive after a successful corporate integration was important. It was expressed as influencing the approach to the target company.

> "*It's well known that for M&As to succeed after integration, the target company needs to have at least some similarities in the corporate culture. [...] So we do look at a lot of different aspects, such as culture, if the goal is to merge them.*" (Respondent E, 2020)

### 4.2.4 Relationships

The second order theme of *Relationships* developed from respondents expressing relations in different contexts. *Relationships* was a theme that was communicated relatively similarly amongst all the respondents. The different relations disclosed during the empirical gtherings originated from the respondents, which brought forward that the relationship itself was consisting not only of stakeholders such as suppliers and company unions, but also the local community.

> "*We look at the relationships with suppliers and how they treat their workforce*." (Respondent A, 2020)

> "*The relationship of the company with unions is important because that could influence the M&A process*." (Respondent F, 2020)

> "*There could be local social campaigns and initiatives. That's often a sign that the company has a good relation to its local community.*" (Respondent C, 2020)

Furthermore, there was also indications from respondents that investigations were done to discover possible frictions or hostilities. It was mentioned that conflicts can cause difficulties for the company in the future, see quotes below.

> "*We review the relationship with different stakeholders to see if there are any conflicts that could affect the company in future.*" (Respondent H, 2020)

> "*As a way to avoid future internal competitions between different departments, there need to be good relationships between them.*" (Respondent G, 2020)

### 4.2.5 Social influence on Due Diligence

The aggregated dimension of Social adheres to the social factors in a Due Diligence. Each of the respondents discussed these Social factors assorted into different contexts. One was expressing the cultural importance in social factors that have adhere to the ESG Due Diligence. While other respondents brought up social violations and human rights as factors that often directly abort the Due Diligence or increase awareness. Both were communicated as quite strong issues which have throughout the social factors have affected the process of Due Diligence.

> "*If we see that the culture does not match in a company that we want to merge with, we see that as a red flag and usually terminate the DD process."* (Respondent C, 2020)

> "*Social violation against human rights for example, will often end the process right away, there is really no space for negotiation […]*" (Respondent G, 2020)

> "*These days we look more on things like human rights and potential child labour, because of ESG this has become a lot more important.*" (Respondent H, 2020)

Further, in the context of social factors in Due Diligence one respondent expressed that there was higher awareness in the value chains to see if suppliers are following the same social values. Hence, making the process much more complex with more people involved in the process.

> "*We have to talk with more people and gather more Information than we did earlier when examining suppliers since we're now checking how the organizations are incorporating social values in the value chain as well.*" (Respondent A, 2020)

Moreover, one respondent disclosed information regarding social factors in the sense of the hardship with protection of customer data and the related rules to follow. It was expressed that on one side they have to investigate more with the social factors in Due Diligence then previously. Which on the other side is harder due to stricter restraints.

> "*It's hard with privacy laws and that other companies can't share everything with us anymore because of the protection of customers data and the compliance with privacy laws.*" (Respondent H, 2020)

## 4.3 Governance

The Governance aspect of ESG is something that has been discussed less broadly compared to Social and Environmental. The aggregated dimension Governance is grounded in four different second order themes. The four themes that were identified were as follows. *Management*, *Control*, *Transparency* and *Legal*. See presentations below.

### 4.3.1 Management

The second order theme of *Management* is a theme that was developed during interviews with the respondents in the context of governance and Due Diligence. The emerged theme of *Management* was perceived by the respondents as an essential part of Due Diligence and hence it was frequently noticed in the meetings. The empirics foretell that important settings surrounding the *Management* theme were shareholders and compensation.

"*In the governance part of Due Diligence, we deal with things like the executive pay, shareholder management […].*" (Respondent D, 2020)

"*During the DD we're looking at compensations related to the management*." (Respondent I, 2020)

"*Further investigations could contain material about the structure of board members or management, but also to see if they are following the current compliances like avoiding unnecessary conflict of interest, etcetera.*" (Respondent F, 2020)

"*The compensation that management receives is often something that appears in the Due Diligence and that can be a hot topic.*" (Respondent E, 2020)

### 4.3.2 Control

The second order theme *Control* was mentioned from several different respondents during our interviews. *Control* was connected to the corporate governance mechanism incorporated by the company. Furthermore, respondents expressed that they are looking if whistleblowers, in addition to grievance and anti-bribery mechanisms are in place. The respondents mentioned money laundering as a topic with significance when talking about *Control*. Additionally, it was mentioned that the mechanism should be designed in a way that they could reach their objectives.

"*In the Due Diligence we also look for a proper whistle-blowing, as well as grievance mechanisms as a part of the governance control in the company.*" (Respondent C, 2020)

"*There should be a control mechanism against bribery in place […]*" (Respondent H, 2020)

"*It's important when looking at corporate control mechanisms that they are designed in a way that the goals can be reached.*" (Respondent E, 2020)

Moreover, the theme *Control* was also connected to Governance in the sense of good or bad quality. According to one participant, poor governance could include weak control systems. Furthermore, the corporate governance systems were also expressed that it should be included in the management.

"*If the company has a weak control system, that's often a sign of poor governance.*" (Respondent F, 2020)

"*We ensure that good corporate governance is in place through internal control systems, that also includes the management.*" (Respondent H, 2020)

### 4.3.3 Transparency

The second order theme of *Transparency* was disclosed as an important matter for many of the respondents. Transparency was expressed as acts in the context of accountability of the company to its Stakeholders. These stakeholders include board members, communities and other public and none public establishments. The arguments behind transparency were changes in the guidelines such as a demand for sustainability reports. Moreover, the respondents also expressed the importance of diversity in connection with *Transparency*.

> "*These days a sustainability report is something that pretty much all companies have, it gives transparency regarding their operations.*" (Respondent A, 2020)

> "*We put a lot of focus on transparency. It creates accountability.*" (Respondent C, 2020)

> "*We look into Corporate governance reports to see what they disclose and how transparent that is.*" (Respondent B, 2020)

The general expressions from the respondents was that *Transparency* is important. Further on, *Transparency* is also suggested to provide long term benefits such as that of financial character and law abiding.

> "*[...] good implemented corporate governance could lead to transparency and prevents financial scandals in the long run*." (Respondent I, 2020)

### 4.3.4 Legal

The second order theme *Legal* was mentioned at some point by all respondents and thus given a high importance. The respondents mentioned the legal theme in combination with compliance to bribery, corruption and lobbying. But also, in the context of risk connection towards the *Legal* theme.

> "*We are looking into basic legal compliance but also things like anti-competition, bribery and corruption.*" (Respondent A, 2020)

> "*Another part to investigate is to make sure there are no illegal political contributions.*" (Respondent D, 2020)

> "*During the Due Diligence we look at the organization's lobbying record to make sure it was kept legal, we also check for things like potential political donations […]"* (Respondent F, 2020)

The respondents also mentioned *Legal* in combination with financial risks and exposures. Money laundering is seen as a topic that can lead to high financial risk depending on which country the company operates in. The respondents did communicate the importance of this during the interviews.

> "*Some countries have a bigger problem with money-laundry than others. The legal aspects of that is one of the bigger financial risks we encounter.*" (Respondent C, 2020)

Overall, the view indicated by the respondents was that *Legal* is an essential part of the aggregated dimension Governance. However, there were also indications that it could possibly impact other parts of Due Diligence as well such as Legal Due Diligence. Controverly, there was no concession of agreement in that field.

### 4.3.5 Governance influence on Due Diligence

The Governance dimension was expressed by several of the respondents as a part of Due Diligence. Furthermore, the respondents reflected on subjects regarding a growing world market with higher demands and increased transparency as substantial changes. Factors of governance were disclosed by one respondent that mentioned the context of the increased legal risks in the world market. Which requested for a broader competence as well as a higher expertise as a continuance.

> "*We often need to hire external experts to help us with the governance part of DD.*" (Respondent H, 2020)

> "*In the past, the demand for transparency with reports and such, were not so important. But now the governance is far more demanding, and the Due Diligence requires a thorough analysis.*" (Respondent F, 2020)

Moreover, one respondent expressed the matter of work against money laundering and corruption to be increasing in demand. The communication was disclosed by informing the influence governance factors had on legal Due Diligence.

"*But we also look into governance when doing the clients ESG DD […] that consist of a lot of details that previously was mostly looked at in the Legal DD.*" (Respondent C, 2020)

## 4.4 Empiric summary and cross-case comparison

The empirical gatherings of the cases that the respondents were involved with are summarized in the table below (see Table 3). The table is built upon the occurrence of the different second order themes.

When examining the frequencies of the second-order themes of the aggregated dimension, there were some themes showing a larger impact than others. Hence, expressing a higher influence to ESG then others. The second-order themes of *Risk, Value, Regulations, Image, Relationships*, *Management* and *Transparency* were the one who were perceived as the most influencing ones on the respective aggregated dimensions. The themes with the highest impact on creating a better understanding related to the research questions, hence also expressed the most by the respondents were *Risk*. The least frequency from second-order themes were *Control* and *Legal*, with an emphasis on *Control* due to *Legal* being not high in expressions amongst the respondents, but the respondents expressing it did it recurrently. Further, the most expressed second-order themes were found in the aggregated dimension of Environmental, second in order was Social and last were Governance placed.

As shown in Table 3 all the second order themes and the aggregated dimension are presented there in an order to show the frequency of them in the interviews. This was done in order to display possible cross-case comparisons in between cases. This allows for the chance to see differences and similarities within cases in the occurrences expressed from respondents regarding different second-order themes.

As seen in the table “A” stands for the highest occurrences, meaning an occurrence of second-order themes more than 3 times during the interviews. “a" stands for low occurrence, showing for an occurrence of less than 3 times. “0” stands for no occurrence of the second-order themes from the respondents. When looking at the table, something that surprised us was that there seemed to be no difference between how the different aggregated dimensions were viewed between the cases. Overall, in most cases the results were quite similar. However, when investigating similarities between the second-order themes, there were some findings.

The second-order theme of *Risk* and *Regulations* showed several similarities within the different cases. However, in comparison to *Regulations, Risk* was mentioned to a larger degree by the respondents.

The table also shows similarities with the themes *Sustainable operations* and *Productive capabilities* when compared with each other. The displayed similarities were that when *Sustainable operations* was brought up by the respondents, the same respondents seemed to disclose information connected to *Productive capabilities*.

Further, the second-order theme of *Management* is perceived to show a high degree of similarities with the theme *Control*. With 13 out of the 21 cases showing the same occurrence of frequencies by the respondents.

The presented patterns and similarities shown in the table do not necessarily have to be the only ones, there might be more. Nonetheless, these are the recognized ones found within this cross-case analysis. The next chapter will continue with a more thorough analysis of the empirics.

**Table 3**
*Distributions of second-order themes*

| **First order code frequency per Due Diligence** | | | | | | | | | | | | | | | | | | | | | **Second-order themes** | **Number of codes** | **Aggregated Dimensions** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *1* | *2* | *3* | *4* | *5* | *6* | *7* | *8* | *9* | *10* | *11* | *12* | *13* | *14* | *15* | *16* | 17 | 18 | 19 | 20 | 21 | | | |
| a | A | A | a | A | A | A | A | a | a | A | A | A | a | A | A | A | a | a | A | A | Risk | 65 (197) | Environment |
| A | A | A | A | A | A | 0 | A | a | a | A | a | A | A | A | a | 0 | A | a | A | A | Value | 52 | |
| A | A | a | a | A | a | A | A | A | A | a | a | A | 0 | a | A | A | A | A | A | a | Regulations | 46 | |
| a | A | A | 0 | A | A | A | A | 0 | a | A | A | A | 0 | A | A | a | 0 | 0 | A | A | Sustainable operations | 34 | |
| A | a | a | 0 | a | A | a | a | A | A | 0 | A | a | 0 | a | a | A | A | a | A | A | Image | 48 (168) | Social |
| a | a | A | 0 | a | a | A | A | a | a | a | a | A | a | a | A | a | 0 | 0 | A | a | Productive capabilities | 37 | |
| 0 | a | 0 | a | a | 0 | a | a | 0 | a | a | A | a | A | a | a | 0 | a | a | A | 0 | Integration | 39 | |
| a | A | a | A | a | a | A | 0 | A | 0 | A | a | A | a | a | A | A | A | A | 0 | A | Relationships | 44 | |
| A | A | a | a | A | 0 | a | a | A | 0 | a | A | a | a | a | 0 | A | a | A | a | A | Management | 38 (129) | Governance |
| a | A | a | A | A | a | A | a | A | 0 | a | a | 0 | a | a | a | A | a | a | a | A | Control | 29 | |
| a | A | a | A | a | a | 0 | a | A | 0 | a | 0 | A | a | A | a | A | a | A | A | a | Transparency | 37 | |
| A | a | 0 | 0 | 0 | a | A | a | 0 | a | 0 | 0 | a | a | a | a | a | 0 | a | a | 0 | Legal | 25 | |

***Table 3. Distribution of second-order themes.*** *The table shows the frequency of second-order themes given by respondents in interviews. "A" shows the highest occurrence, "a" shows a low occurrence and "0" shows that there were no occurrences by the respondents.*

# 5. Discussion

## 5.1 The content of Environmental and its influence on Due Diligence

From the empirical findings, it is clear that Environmental has an important role in Due Diligence for ESG. All respondents mentioned the presence of Environmental factors in their performed Due Diligences. This is aligned with Environmental topics in Due Diligence views stated by Corino (2000), as well as the rise in popularity within this field (Franklin, 2019).

The empirical data shows that Environmental factors that were investigated include resource and waste management, environmental policies, as well as potential risks assessments for air, water and human health, which are also mentioned in literature (Indahl & Jacobsen, 2019; Markopoulos et al., 2020). According to the empirical findings, ESG entails the following themes when it comes to Environmental issues in Due Diligence in an M&A: '*Risk', 'Value', 'Regulations'* and '*Sustainable Operations'*. These findings contribute to the ESG literature and give a more detailed view on the content of Environmental issues in a Due Diligence process.

From our results, it is clear that *Risk* is something all participants identified when dealing with Environmental factors in a Due Diligence. These findings are directly in line with the research of Eccles and Kastrapeli (2017), which also put emphasis on the potential risk that environmental issues can have for a company. An important part of the Due Diligence is to assess risk, since unidentified issues can lead to a failure of the whole M&A process (Savovic, 2012). In this regard, our findings show that the assessment of the Environmental factors is important to identify potential risks and therefore should be assessed in the Due Diligence process. The investigated environmental risks were in some cases seen as a financial risk. This result ties well with previous studies, which sees a positive correlation between companies with high ESG scores and financial performance (Friede, Busch & Bassen, 2015; Khan 2016). A company with large environmental related financial risk is more likely to get a low ESG score whereas a company with less environmental risk will tend to have a higher ESG score. However, there are apparent limitations to this indication, due to the fact that the ESG score consists also of Social and Governance criteria, which also have to be examined to make a clear statement.

Nevertheless, the empirical data demonstrated that the environmental factors investigated in a Due Diligence can be identified as a potential source for value creation. These findings are in line with the research of Babiak and Trendafilova (2011), who see the sound use of

environmental resources as a way to increase growth and margins that lead to a higher value of the company. However, the objective of the Due Diligence is to investigate the value proposition of an M&A (Lynch & Lind, 2002; Cartwright & Schoenberg, 2006). In the case where potential value is detected or confirmed by investigating environmental factors, it supports the M&A case. After all, according to the literature one of the major motives for an M&A is to create value for the company (Calipha, Tarba & Brock, 2010).

Furthermore, the gathered data revealed that *Regulations* for environmental factors play a significant role. On one hand, this can be seen as a way to identify risk as when the companies are following the regulations and are preparing for upcoming regulations. As mentioned before, Due Diligence should identify possible risks for the acquirer (Savovic, 2012). On the other hand, this could also be a way to ensure that value is created, which as stated before, is a reason to undertake an M&A (Calipha, Tarba & Brock, 2010).

Following the empirical findings, companies that follow environmental regulations can also be seen operating in a more environmentally sustainable way. According to Ahi and Searcy (2014), operating sustainably attracts investors and this can create value for potential acquirers. Ahi and Searcy (2014) is applicable for the second-order theme *Sustainable Operations*. When analyzing the empirics it can be concluded that *Sustainable Operations* plays a major role in connection with environmental factors. According to the data, sustainable operations are important to secure that the business lasts in the future and leads to a competitive advantage. This is supported by literature regarding environmentally sustainable operations (Esty & Porter, 1998). Nonetheless, sustainable operations can have a positive impact on the ESG scores (Malik (2015), and therefore a competitive advantage.

## 5.2 The content of Social and its influence on Due Diligence

The collected data shows that Due Diligence on Social factors is mentioned frequently thus can be seen as an important part when it comes to investigating ESG criteria (Table 3). The empirics state that social criteria in Due Diligence are connected to image, work conditions, and social values, both internal and external in organizations. Overall, these findings following findings reported by Orlitzky, Siegel and Waldman (2011) when looking both inside a company, as well as to external connections, such as value and supply chains. This analysis of the empirics isolated four second-order themes for social criteria in Due Diligence: *Image*, *Productive*

*Capabilities*, *Integration*, and *Relationships*. These findings are extended to the ESG literature when looking at the content of Social criteria.

The results indicate that there is a connection between the image of the company and how employees are treated. The image of what the company has, among its employees, has an impact on the operations. This is supported by the findings of Stuebs and Sun (2010), which indicate that a better reputation increases labor productivity. According to Saeidi et al. (2015), there is a positive correlation between the image of the company and the financial performance. This is also in line with Orlitzky, Siegel and Waldman (2011), if a company acts socially responsible it will get more support for its operations. This can lead to better operational performance and as a consequence to better financial performance. This can be connected to the motive of a company to undertake an M&A to increase profitability (Brakman, Garretsen & Van Marrewijk, 2006). However, reputation alone will probably not lead to better performance by itself, and other factors need to be taken into account. Some researchers identified even a negative connection between social responsibility and financial performance (Smith, Yahya & Amiruddin, 2007; Crisóstomo, de Souza Freire & de Vasconcellos, 2011).

Another finding is that the social factors are connected to *Productive Capabilities*. The data showed that there is a perceived connection between labours risk, job satisfaction, health safety at the work and productivity. It can be argued that higher productivity when compared with peers is a competitive advantage. According to Cartwright (2005), M&A is seen as a strategic move to gain competitive advantages. The Empirical data shows that social factors can influence the productivity of a company. This supports the proposition that companies with improved social conditions, and therefore a higher ESG rating, perform better (Eccles, Kastrapeli & Potter, 2017).

The research indicates that social criteria was often connected to *Integration*. According to our findings, the corporate culture which is influenced by social factors plays a major role when it comes to the post-merger integration. That can be seen as a factor of high significance, because if an integration fails, the whole M&A can be seen as failed (Straub, 2007). The cultural mismatch between two companies explored in Due Diligence was seen as a red flag, which would terminate the M&A process. Considering the high failure rate of an M&A, which exceeds in most literature more than 50% (Weber, Schenkar & Raveh, 1996; Adams & Neely, 2000; Perry & Herd, 2004), The investigated emphasis on cultural factors in the Due Diligence of social ESG criteria can be explained.

Derived from the empirical data, it became clear that *Relationships* is a focus area of social criteria in Due Diligence. According to the data, potential conflicts between the stakeholder insight or outside the company can be harmful for the operations. However, good relations with stakeholders can lead to a good reputation. Therefore, it leads to increased productivity. These findings are consistent with research showing that a good reputation increases labor productivity as well as quality of work (Stuebs & Sun, 2010).

## 5.3 The content of Governance and its influence on Due Diligence

Governance, as the third pillar of ESG in Due Diligence, was also discussed but seemed to be less frequent than social or environmental factors. The empirical findings in this topic lead to the identified second-order themes: *Management, Control, Transparency* and *Legal*. The empirical data in the governance dimension indicates that the issues investigated are related to tax strategy accounting standards, executive compensations, donations, and lobbying, as well as board structure and compensation. These findings are directly in line with previous findings that see corporate governance as a measurement to align the different interests of stakeholders to archive strategic long-term goals (Ward, Brown & Rodriguez, 2009).

It is clear from empirical data that the theme *Transparency* is linked to Due Diligence of the governance dimension. The data shows that *Transparency* is connected to the accountability of operations and management to its stakeholders. Furthermore, transparency is seen as a way to minimize the risk of unexpected and non-legitimate financial outflows, as well as enabling clear information sharing with stakeholders. Overall, these findings are in accordance with findings reported by Borgia (2005), who concludes that corporate governance provides accountability and lowers the risk of future financial crime. Searching for risk has been expressed as a main objective of Due Diligence (Galpin & Herndon, 2014). Additionally, previous research reinforces this statement and declares that ESG criteria included in Due Diligence uphold risk identification (Eccles & Kastrapeli, 2017). Hence, it can be argued for that the empirics strengthen investigating Governance criteria in ESG to support Due Diligence in the evaluation of the object.

The data suggest that the analyzed second order theme *Management* is connected to compliance, compensation and structure of the management. Furthermore, the *Management* theme is closely connected to the second-order theme *Control,* which deals with mechanisms for whistleblowers, against bribery and money laundry. The connection of Management and

Control could be that the management is made accountable by these control systems, but also responsible that these control systems are in place. Hence, it can be argued that governance criteria provides accountability for the Management (Borgia, 2005). This is important when it comes to archiving long term goals

The *Legal* second-order theme was also related to the topic's money laundry and bribery but it broadened the dimension of law into the analyses of ESG. That was a surprising finding as according to the theory legal aspects are investigated during the Legal Due Diligence (Howson, 2018). However, an explanation for that could be that the professionals who were dealing with the ESG Due Diligence were not a part of the Legal Due Diligence and to cover all aspects of the governance criteria, they also investigated the legal implication of these topics. Nonetheless, looking at the implied topics it can be concluded that all three second-order Governance themes are dealing with measures that need to be addressed to achieve long term goals. This is in line with the study of Ward, Brown and Rodriguez (2009). Furthermore, the mentioned governance criteria deals with topics that could lead if not addressed to financial outflow. This can be connected to the literature that states companies who integrate ESG criteria improve their financial performance (De Zwaan, Brimble, & Stewart, 2015; Fernandez & Elfner, 2015).

## 5.4 The role of ESG in Due Diligence in an M&A

The results highlight that most of the Due Diligences have an ESG DD part. This is in line with the literature which emphasizes the increased importance of ESG (Bénabou & Tirole, 2010; Hart & Zingales, 2017). However, the conducted data indicates that when investigating the ESG topics as part of the Due Diligence process, on the hand the process gets more complex and costly, but on the other hand, it also enhances the informative value of the process.

The extension of the Due Diligence process by the dimension ESG topics was perceived as an increase in complexity and costs also partly due to the need for external experts. Assessing Environmental criteria and legal topics connected to governance criteria can sometimes only be done by external experts as most of the companies do not have the required expertise in-house. Therefore, experts need to be hired and that leads to additional costs and complexity of the process. Furthermore, it was found that the assessment of social criteria leads to increased complexity and higher costs as a result of the additional effort when investigating working conditions and the social values of suppliers. This supports previous findings in the literature which see Due Diligence as a resource consuming process (Marks & Mirvis, 2000).

However, the screening for ESG criteria and its content enhances the result of Due Diligence as it gives a deeper understanding and therefore increases the informative value of the process. The investigation of ESG gives a more elaborated picture of the company. This supports the proposition of a Due Diligence which is to decrease the ambiguity and confirm the value proposition of the acquirer (Jemison & Sitkin, 1986; Cartwright & Schoenberg, 2006). As proposed by the literature a more informative Due Diligence process leads to a better basis for decision-makers regarding how the M&A process should be proceeded (Cartwright & Schoenberg, 2006). Therefore, the assessment for ESG enhances the Due Diligence process. The role of the ESG in Due Diligence is graphically presented in the evolved analytical framework below (Figure 3). The results highlight that most of the Due Diligences have an ESG DD part. This is in line with the literature which emphasizes the increased importance of ESG (Hart & Zingales, 2017; Bénabou and Tirole, 2010). One the one hand, the conducted data indicates that when investigating the ESG topics as part of the Due Diligence process, the process gets more complex and costly. On the other hand, it enhances the informative value of the process.

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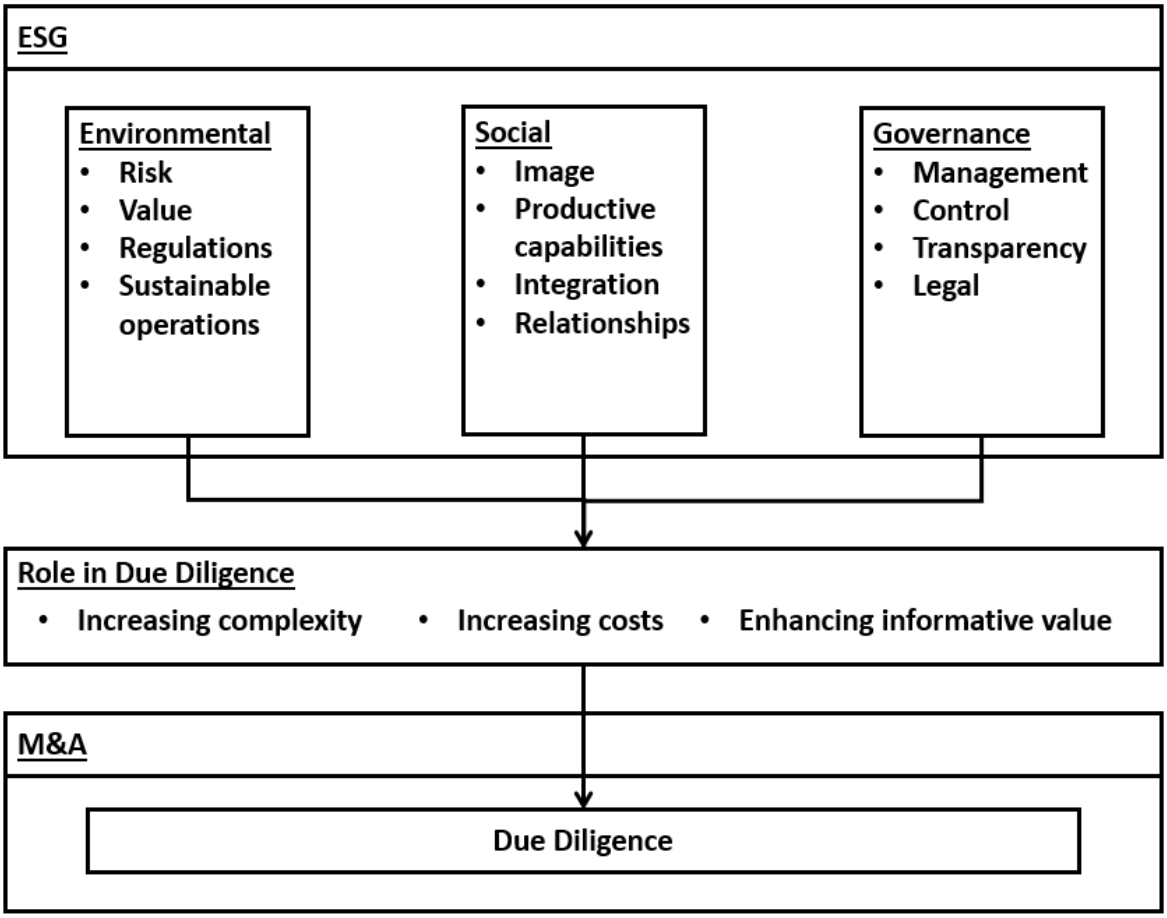


***Figure 3. Evolved analytical framework.*** *This is an evolved analytical framework of the one portrayed in chapter 2 (see Figure 1). The dotted lines represent the 'role' which ESG have in connection with Due Diligence in an M&A. This figure also shows the content found within Environmental, Social and Governance*

.

# 6. Conclusions

This explorative study sought to investigate the content of ESG in the setting of a Due Diligence process in an M&A. It also aimed to address what role ESG plays in a Due Diligence process in an M&A.

This study uncovered twelve themes that opened up for a greater understanding of the content of ESG. This resulted in unpacking ESG in general, which added understanding to the specific dimension of Environmental, Social and Governance, respectively. Furthermore, our results indicate that ESG in a Due Diligence process of an M&A plays an important role as it enhances the informative value of the process. Nonetheless, assessing ESG as part of a Due Diligence adds complexity as well as cost to the process.

According to our data, the Environmental dimension was the most frequently mentioned one. Environmental criteria are important factors when assessing operational and financial risk in Due Diligence. Furthermore, incorporating environmental regulations into the Due Diligence can identify potential future risk. Additionally, investigating environmental factors can be a source for increasing the firm's value and laying the ground for competitive advantage.

The empirical data showed that the Social dimension was mentioned second most frequently. Further, the Social dimension in a Due Diligence is important when it comes to assessing the productive capabilities of a company. Additionally, social criteria play a major role when assessing the possible integration capabilities of two companies. Incompatible corporate cultures can raise a red flag, which can terminate the whole M&A process. Social criteria in a Due Diligence process helps to assess the internal and external relationships, and consequently, identify potential risk.

The analysis suggested that the Governance criteria in a Due Diligence process support the assessment of transparency in the company. This is particularly important to access future risk associated with crime and financial scandals. Further, control mechanisms which were also connected to management are an important theme in the Governance dimension. The data suggested that governance criteria in Due Diligence helps to improve the potential of a company to achieve long term goals.

## 6.1 Contributions

This explorative study was conducted to lessen an identified gap in the literature regarding ESG and its implications within the Due Diligence process of an M&A. The concept of ESG was shown to be rather complex and the content consists of several different layers. During the study we have revealed and unpacked the content of the ESG dimensions Environmental, Social, and Governance. This study has generated a practical contribution in the form of indications for practitioners when conducting ESG Due Diligence. This was established based on the aggregated content and role of ESG conducted from 21 cases involving Due Diligence of an M&A. Furthermore, this study also provides insights into the aspects which comprise ESG, and the possible underlying implications this could have for practical use Additionally, this study helps to broaden the current perspective and give insight into ways companies could benefit from using ESG as part of their Due Diligence.

This study contributes to developing theoretical discussion and confirming the importance of ESG in Due Diligence. It has also contributed to the theory field within ESG in Due Diligence of an M&A process, increasing the understanding of this subject. The study has enlightened both the challenges, as well as the fundamental scopes that the ESG concept is built on. In addition, the identified content of ESG contributes further to the already existing literature. Moreover, this research has theoretical implications of ESG in a Due Diligence process. This process provides valuable knowledge regarding said ESG in an area where there is very little previous research composed, yet substantial growth.

## 6.2 Limitations

Throughout the study, the aim was always directed towards conducting a study of high quality. However, there are some limitations that need to be contemplated and considered. First of all, the scope of the results can be limited, due to the fact that the empirical data for each case is coming from one respondent. Generally, there is more than one actor involved in a Due Diligence process and therefore, there is the possibility that relevant information was missed by only considering one perspective per case. This could limit the general applicability of this research.

Secondly, there is limitation in this study in terms of the methodological approach. Semi-structured interviews were planned to be held in person, however due to Covid-19 and the distance that had to be taken to our respondents, the interviews were conducted over Skype,

Zoom and Microsoft Teams. Although we could see the respondents and have eye contact during the interviews, it was not always possible to analyze differences in their body language when answering the interview questions. As a consequence of this physical absence, we could have misinterpreted answers and missed opportunities to ask follow up questions to get a more detailed picture.

Finally, the respondents of the study were located in Germany and Sweden. Therefore, this study could be biased, and the results may not be entirely transferable to other parts of the world, since there were some remarks and indications that Europe has a far more encouraging approach towards the use of ESG, both in general, but also in the context of Due Diligence of an M&A process. This could possibly limit the ability to generalize our findings, the practical and theoretical application of this research.

## 6.3 Future Studies

The interview respondents indicated that different geographical regions experience different aspects of ESG. As mentioned before, there were some remarks that ESG is more established in Europe than in other regions. This could be both in general and in the context of Due Diligence of an M&A. This has not yet been fully analyzed, but we believe it could be a potential area for future research. This could possibly be conducted in a cross-study method of doing comparisons between, for example, Europe and North America. Further, a comparison such as this could also display potential interesting differences, which include other underlying themes than the one presented in this study.

Moreover, another possible future study could be to use the identified themes as a survey to reach a larger community, and consequently scale up the research. If there would be multiple sources with different perspectives per case, this could possibly increase the reliability, and probably lead to more detailed findings. The results could be interpreted in a quantitative approach, and it could possibly give other kinds of insight due to the larger size of the sample. This could thereafter be used to compare previous research within this field, such as ours, with the new research to confirm or deny possible established conclusions.

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# 8. Appendix

## 8.1 Appendix 1: Interview guide

**Beginning questions of more general character:**

Q1: What is your name and in which company do you currently work? (The answer will be anonymized but is needed to separate the different interviews)

Q2: What is your position in the company?

Q3: For how long have you been working for this company?

Q4: What country are you currently positioned in?

Q5: What kind of experience do you have regarding DD/M&A?

**Questions with relevance towards case with DD in M&A:**

Q6: Could you describe the DD phase briefly for your company?

Q7: Was the DD in the M&A conducted internally or externally? (Was it done by you/your company or did you take in someone else for that part)

Q8: Could you explain (briefly) what the most recent case with DD/M&A you worked on?

Q9: How involved were you in the M&A and/or DD processes?

Q10: What was the main purpose or intention of this acquisition?

Q11: What kind of analysis do you usually perform before an acquisition like this?

Q12: Was this acquisition different compared to others?

Q13: If it was different, in what way?

Q14: What were the expectations with the acquisition?

Q15: Did the expectations get fulfilled?

Q16: Were ESG factors (environmental, social and governance) part of this M&A/DD?

**Questions connected towards ESG:**

<u>If ESG factors were a part of your M&A/DD case:</u>

Q17: What is your experience with ESG factors?

Q18: How did you perceive the attitude of the acquired firm/firms to ESG factors?

Q19: How did you investigate ESG factors in this M&A?

Q20: Were there particular Environmental factors? If so, which ones?

Q21: Were there particular Social factors? If so, which ones?

Q22: Were there particular Governance factors? If so, which ones?

Q23: Would you say this is how you usually use ESG in an M&A/DD?

Q24: What would you say the role of ESG had in the M&A/DD?

Q25: From your experience, are you using it during DD?

Q26: If not, do you think that you should?

Q27: Is there something else that you want to add that we haven't asked you about?

<u>If ESG factors not part of recent M&A/DD:</u>

Q28: Was it a reason why was ESG not used during this M&A/DD?

Q29: If you have information about this, would you say that ESG usually is a part of M&A/DD?

Q30: Is there something else that you want to add that we haven't asked you about?

## 8.2 Appendix 2: Invitation Letter to interview respondents

**Interview invitation**

Hi [Name],

My name is [The name of the author sending it] and I am currently writing my master thesis with [the name of the other author involved in the thesis], as part of the International Business (Business and Management) Master's Programme at Uppsala University. Our study is looking at the role of ESG (Environmental, Social and Governance) factors in Due Diligence in M&A, how companies are facing that, and how they handle it.

We are conducting interviews as part of a research study to increase our understanding of the challenges companies face during Due Diligence of an M&A. Since you are working for a leading company when it comes to offering services within M&A, you are in an ideal position to give us first hand information from your perspective. We intend to conduct short (less than an 1 hour) interviews over the next two weeks.

Due to the current Covid-19 situation, we will conduct all interviews over Skype, or a similar video call technology. The interview and responses to the questions will be kept strictly confidential. A numerical code will be assigned to each interview to ensure that personal identifiers are not revealed during our analysis or the write up of our findings. Similarly, all individuals and companies mentioned will be anonymized alphabetically, for example: "Person A", "Company 5".

Your participation would be a valuable addition to our research and the findings could lead to a greater academic and managerial understanding of ESG in a Due Diligence of an M&A. If you are willing to participate we would be very grateful, please suggest a day and time that suits you and we will get back as soon as we can.

Please do not hesitate to email and ask if you have any questions.

We are looking forward to your answer!

Kind regards,

Alexander Leucht and Arvid Rydell