
Is there a Market Demand for Green Due Diligence?

- A study of the Swedish Acquisition Market and its view on sustainability

Berntsson, H. and Svensson, L.
Lund University, Faculty of Engineering, Sweden

Abstract

During 2011, ÅF launched a service called Green Business Screening (GBS) that provides a situation analysis of the overall environmental performance of a company. The model measures a company's external and internal environmental integration and evaluates sustainability work through Ten Green Fields - ten categories within a company where the focus changes from internal categories to external categories. During the marketing and sales of GBS, a new potential market was discovered - the possibility to perform screenings in acquisition processes. Through literature studies, investigations of the Swedish acquisition market and transaction services, and interviews with experts on the market and ÅF employees, the demand for an environmental evaluation service prior to acquisitions, so called Green Due Diligence, was investigated in general and if the GBS can be adjusted to meet the demand in particular. The results showed that there is little or no request for sustainability investigations when acquiring companies. The reputational and legal risks associated with sustainability are already covered by other evaluation services. In accordance, GBS in its current form has no potential as a transaction service on the Swedish acquisition market. However, sustainability evaluation services are useful when developing sustainability strategies.

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Introduction

During 2011, ÅF launched a service called Green Business Screening (GBS) that provides a situation analysis of the overall environmental performance of a company. The model measures a company's external and internal environmental integration and evaluates sustainability work through Ten Green Fields - ten categories within a company where the focus changes from internal categories to external categories. GBS is a generic economic-

environmental evaluation service that analyzes a company's current environmental performance and ability to handle future environmental challenges. During the marketing and sales of GBS, a new potential market has been discovered that ÅF wants to examine further - the possibility to perform screenings in acquisition processes. The purpose was to investigate whether there is a market demand for a Green Due Diligence. And more specifically GBS can be adapted from serving as a generic

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environmental-economic evaluation service to also be used as an analytical tool in acquisition processes.

Since the ultimate purpose of this study is to investigate whether the GBS model has a potential as a transaction service, a Green Due Diligence is in this thesis defined as an evaluation service that investigates the overall environmental performance of a company and to what degree the environmental work is integrated into the organization.

This was achieved through three objectives:

- Compilation of up to date research reviewing the relationship between sustainability strategies and financial value.
- Mapping of the Swedish acquisition market and transaction services.
- Evaluation of the market potential for a Green Due Diligence.

Green Business Screening

The GBS model evaluates to what extent environmental work is integrated in a company. The company is evaluated using ten categories – Ten Green Fields. The categories are indexed from a company's internal perspective to an external perspective and presented in Figure 1. Companies that would benefit the most from a GBS are companies with no structured environmental work or appointed environmental manager, product development in-house and preferably between 50 and 5000 employees.

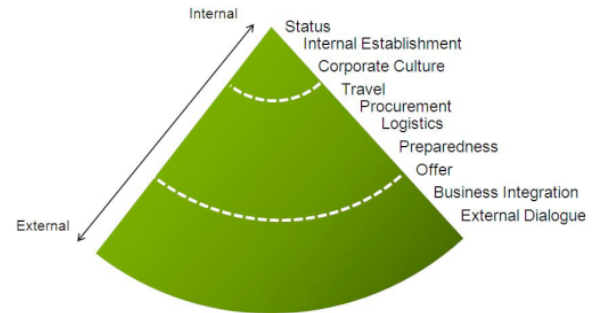


Figure 1 - Green Business Screening (Månsson & Thormark, 2011)

Methodology

The study aimed at being normative, providing a recommendation regarding whether ÅF should proceed with GBS as a transaction service. It was performed included mapping of research and the acquisition market, and a case-study of the GBS service and company-specific factors. The study started with literature studies of the acquisition process and related transaction services. Also, a review of recent research regarding the correlation between environmental performance and financial value growth was conducted to find sales arguments for GBS and a Green Due Diligence. After the literature study, potential customer target groups and interview groups were identified. The potential target groups that acquire companies suitable for a GBS are large corporations and buyout companies. The interviewees selected for the study were Investment managers at buyout firms, M&A managers at large corporations, Commercial Due Diligence Consultants, Operational Due Diligence Consultants and Post-Merger Integration Consultants. Also employees at ÅF working with the GBS, environmental services and corporate finance were selected. A series of in-depth interviews were conducted to obtain detailed knowledge of the acquisition process, understanding of how sustainability work is viewed in the process, the demand for a new

sustainability evaluation service, and assessments of the GBS model. The ÅF employees were interviewed regarding the internal resources and competences at ÅF and their views and ideas of how to proceed with GBS. The results of the interviews and literature studies were compiled and analyzed and recommendations were provided.

Analysis and Results

Research Reviewing the Relationship between Environmental Performance and Financial Value Growth

According to frameworks regarding CSR, sustainability strategies should be developed simultaneously and be aligned with the company's overall strategy. (Porter & Kramer, 2006) However, many studies fail to find an actual relationship between environmental performance and value creation. A positive relationship has been found in most studies even if the causal relationship hasn't been proved due to the complexity of the problem. Studies coincide that the difference in interests between companies and the society cause conflicts. Markets work well when corporate and social interests are aligned; i.e. when companies' social and private costs are the same. On the contrary, markets are not working if the costs are differing. The researches show that CSR is a possible solution when social goals and company profits are differing since companies with CSR strategies tend to work proactively to avoid environmental conflicts with stakeholders.

Since it is hard to find generalizable studies that prove that environmental performance affect the bottom line, it is also hard to use it in the marketing of the service. The purpose of green

initiatives such as access to new markets or increased brand equity are often achieved after a considerable amount of time, often years, and it is hard to separate the green efforts from other factors that contribute to a company's success. However, no research is needed to conclude that investment in energy-efficient equipment will be good for the environment, and save money which directly affect the bottom-line. Unfortunately investments of that kind are often not viewed as environmental investments since they are based on traditional investment calculations and simply save costs for the company. The writers believe that it is important to emphasize that environmental initiatives doesn't have to be associated with expensive and unprofitable investments, but that investments such as the one mentioned above can be profitable and used in a company's external communication.

Mapping of the Swedish Acquisition Market and Offered Services

There are two main categories of investors and acquirers of unlisted companies in Sweden, and they are large corporations and private equity firms. (Gedeon, 2012) The main motive for large corporations to acquire smaller companies is to create synergies with existing businesses. The private equity companies can be grouped into subsets of companies with similar attributes. These are angel investors who invest their own capital in startups, venture capital firms investing in startups and new technology, and buyout firms investing in mature companies through a fund structure. (SVCA, n.d.)

Large corporations and buyout firms are the main customers for transaction services. Offered Due Diligence services cover past, current and future threats, opportunities and liabilities that the target company can face, or

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have faced. (Kersby 1997/1998, p.144) Neither investment managers at buyout companies nor M&A managers at large corporations see environmental policies and sustainability work as a deal breaker in acquisition processes. Nevertheless, buyout firms' investors, which first and foremost are pension funds, have started to raise demands regarding responsible investments and environmental and social policies. The buyout companies have therefore started to look into how they can create a structured approach to sustainability work in their portfolio companies. (Willén, 2012) Transaction services are performed within a couple of weeks and the results are always related to risk and return. The companies performing Due Diligence services are first and foremost audit bureaus, management consulting firms, and law firms. Target companies' environmental work or sustainability strategies are not thoroughly investigated in any Due Diligence service, and the reason is that sustainability isn't a deal breaker in acquisitions. Illegal contamination or litter dumping are however deal breakers, but they are also violations of the law and are therefore investigated in Environmental Due Diligences. Operational Due Diligences investigate whether target companies' operations comply with environmental standards. Further, none of the interviewees in the study had heard of a service like GBS in acquisition processes, some of them however mentioned that management consulting firms offer sustainability strategy services.

Evaluation of the market potential for a Green Due Diligence

When investigating the potential market for a Green Due Diligence, the first task consisted of identifying the customers. The potential customers found were large corporations, where managers of M&A are responsible for the

acquisitions and purchasing of transaction services, and private equity firms where the subgroup buyout firms are the most suitable target group. When examining the motives for purchasing transaction services, all evaluations performed are risk-related, hence pushing sustainability issues down the list of prioritized investigations. Business cycles and access to capital are factors affecting investments and acquisition activity, and as an entailment also the demand for transaction services.

Unfortunately, the competition is strong. Most well-established management consulting firms offer both environmental strategy services as well as transaction services. Some sort of environmental screening is often the base for developing a strategy, and taking existing services from one market into another existing market is not a big step. Also, audit bureaus such as the Big 4 (Ernst & Young, Deloitte, KPMG and PwC) have strong positions on the transaction service market and can easily acquire the competence needed to perform services similar to GBS.

All Due Diligences investigate factors related to risk and return, and no generalizable relationship between sustainability performance and business success has been found. Therefore a service evaluating the sustainability performance of a company is not interesting in the acquisition process. The sustainability factors that are interesting in the acquisition process are already covered by other existing services. Therefore, the state of the market today is that there is no demand for a Green Due Diligence.

Can the GBS Model be used in Acquisition Processes?

The ultimate purpose of this Master's thesis was to investigate whether the GBS model

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could be adapted from serving as a generic environmental-economic evaluation service to also be used as an analytical tool in acquisition processes. Since the findings from the conducted research show that there isn't a

market demand for a Green Due Diligence, there is no point in trying to transform GBS into such a service. This doesn't exclude that this service can be interesting in other contexts, such as being the foundation for developing environmental and sustainability services.

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