CIO believes entrepreneurs who are ESG leaders in their sector may have the greatest appeal to sustainability-conscious strategic buyers. (UBS)

Business Owners

Sustainability transparency and your business exit

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Many business owners believe sustainability regulations raise both costs and risks of doing business. But we think regulations like the EU Taxonomy, may unlock new opportunities operationally, and also whether you decide to seek an eventual business exit. We consider 3 categories in which sustainable buyers may place your company, what each implies for your business, and how to position yourself:

1. ESG leadership

What is it?

In sustainable investing, an ESG leader strategy invests in the equities or the bonds of companies that are best positioned to manage ESG topics. These companies are more successful than their peers in recognizing ESG implications, minimizing risks, and unlocking the opportunities that arise from them.

Empirical evidence suggests that listed firms managing ESG risks well may benefit financially—and that ESG leader strategies do not lag conventional investment approaches. A 2015 metanalysis by Friede and others of more than 2,000 empirical studies discovered a non-negative relationship between ESG and corporate financial performance.

How can it affect your exit plan?

It is possible that ESG leadership will increasingly lead to more optimal deal conditions—in terms of price paid or time to completion, for example—compared to the exit price for a non-ESG or non-sustainable business.

We believe entrepreneurs who are ESG leaders in their sector may have the greatest appeal to sustainability-conscious strategic buyers. Greater ESG transparency and EU Taxonomy alignment will be pivotal for private equity or other large asset owners running Article 8 funds (those that promote environmental or social characteristics) or Article 9 funds (funds

with an explicit sustainable or impact investment objective) according to the EU's Sustainable Finance Disclosure Regulation (SFDR).

2. Scope for ESG improvement

What is it?

In sustainable investing, an ESG improvement strategy seeks to buy equities of companies that demonstrate progress in ESG transparency. These companies minimize ESG risks or seize ESG opportunities, and demonstrate their improvement path is gaining momentum.

ESG transparency does not have to be perfect. There is potential for value creation in improving ESG data availability and performance.

In some ways, ESG improvement strategies mirror the way private equity houses buy an "imperfect" asset with untapped potential, use financial and non-financial capital to transform a business, and then seek a buyer willing to pay a premium to the original price for the transformed asset.

How can it affect your exit plan?

ESG improving companies may not necessarily secure the highest possible exit price, as strategic buyers may discount the investments they need to make before a company can be included in their sustainable or impact fund.

Nevertheless, ESG improvement has the potential to improve your company profitability and the overall valuation of your firm. This approach may attract external acumen in sustainability and beyond. And finding a financial partner focused on ESG improvement could also help you to acquire a long-term financial partner that helps you and your company preserve an enduring sustainability culture aligned with your and your family's values.

3. Your business is well-placed for ESG engagement to make a measurable positive change

What is it?

In sustainable investing, an ESG engagement strategy involves buying equities (or high yield debt) of companies that would benefit from specific ESG improvements, and where the investor actively engages with the company to drive intentional, material, and measurable change.

An engagement strategy is different from an improvement strategy. First, engagement strategies are to public markets what impact investing is to private markets. An engagement strategy has intentionality—the investor intends to improve ESG performance specifically, not as a by-product of other transformations. An engagement strategy has additionality; the ESG changes must be shown not to have been possible without the additional investment. And an engagement strategy must be measurable and verifiable—with the objectives of measuring and corroborating improved financial and societal impact equally.

How can it affect your exit plan?

It may help you if you're looking for both a capital injection (or full exit) and active investor involvement in the firm's day-to-day and strategic decision-making.

An engagement strategy will not suit all business owners. It will necessarily involve you giving up some control. An external investor may identify ESG improvement points that are different from yours, opening the door for potential disagreement or conflict. And there may be competing priorities if you and the investor have different time horizons for when changes should be affected and financial gains realized. On the other hand, if you have specific social or environmental objectives that you believe your business can help to achieve, then finding a strategic buyer who is on the same page as you are may create an opportunity.

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Read the full report Three ways sustainability transparency can affect your business exit 11 February 2022.

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