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Mergermarket

Chain reaction

How supply chain considerations and sustainability are shaping M&A in Europe

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Foreword

No business is an island – all are bound by deals, supply chains and rules. Our exclusive survey reveals European dealmakers' attitudes to the current M&A environment, the growing stringency in sustainable legislation and its effect on global supply chains.

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Supply chains are the connective tissue of the global economy. Despite recent geopolitically motivated protectionism, decades of globalisation have created sprawling, deeply integrated networks spanning countless jurisdictions and touching every aspect of our lives. In light of European policymakers' regulatory push towards greater supply chain sustainability, the importance of understanding often-overlooked risks has never been more apparent.

The following report sheds light on how corporates and financial investors are adapting to this uncharted regulatory environment and what it means for M&A in the near term.

We open by reviewing the overall European M&A picture and the sectors poised for growth. This is followed by a look at the growing importance of sustainability in M&A due diligence, driven by EU legislation such as the forthcoming Corporate Sustainability Due Diligence Directive (CSDDD) and the now live Corporate Sustainability Reporting Directive (CSRD).

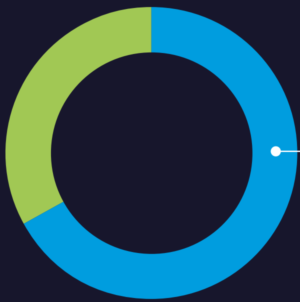
In the third part, we examine these regulatory changes and their potential impact on the deal process, while the fourth section focuses on the critical issue of supply chain due diligence. Finally, we consider the outlook for European M&A over the next 12 months and beyond.

With this report, the Forensic Investigations & Intelligence business line at RSM Italy aims to equip readers with the insights and strategies needed to thrive in this new era of responsible dealmaking. As investors and corporate leaders seek to balance growth with compliance and societal impact, we believe that understanding the forces shaping M&A and due diligence priorities will be key to unlocking value, mitigating risk and seizing opportunities in the years ahead.

Methodology
In Q2 2024, Mergermarket surveyed 60 senior executives to gain insights into the M&A strategies of European corporates, private equity (PE) and hedge funds. This included questions about how sustainability considerations and supply chains impact M&A activities. The 60 respondents were comprised of 25 from corporates, 25 from PE firms and 10 from hedge funds. Fifteen respondent companies/funds are headquartered in each of Italy, Spain, Germany and Greece. Respondent firms have a minimum global net turnover/AUM of EUR 150 million. All responses are anonymous and results are presented in aggregate.

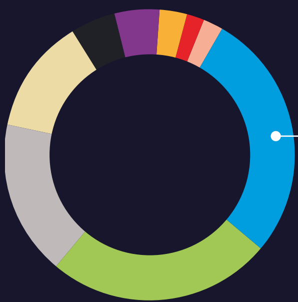
Key findings

M&A on the up



67% plan to undertake between one and three M&A transactions

Two thirds of respondents (67%) are planning to undertake between one and three M&A transactions over the next 12 months, up from 63% who completed this number of deals over the past year. Germany is tipped to see the most growth in M&A activity, with 28% of respondents highlighting it as the key deal market, while the Iberian nations (Spain and Portugal) come in second with 25% of respondents.



28% of German respondents highlight M&A growth as the key deal market

CSDDD under the spotlight

The forthcoming CSDDD is set to make European companies more attractive acquisition targets, according to 92% of respondents with German executives being particularly optimistic. B Corp certification is also considered by 83% of respondents (93% in Germany) as increasing the appeal of prospective deal targets.

Supply chain due diligence to rise

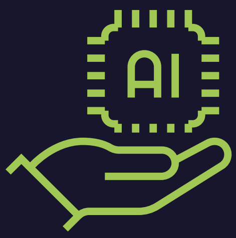
Nearly half of respondents (47%) have always conducted due diligence on a target company's global supply chains as part of the dealmaking process in the past two years. This is set to rise to 68% who expect to always undertake this over the next two years. German respondents are ahead of the curve, with 60% having always done this over the past two years, growing to 73% who expect to always do this over the next two years.

47% Conducted supply chain due diligence in the last two years

68% Expect to conduct supply chain due diligence over the next two years

AI adoption in sustainability due diligence

More than half of respondents (55%) anticipate using AI tools for sustainability due diligence over the next two years for some or all deals they pursue, a significant increase from the 32% who have used AI for this purpose to date. German respondents are leading the charge, with 60% having already used AI and 66% expecting to do so over the next two years.



Ask the experts

Investors are placing more emphasis on external specialists to understand supply chain risks. While 63% of respondents have used such specialists already, an overwhelming 91% plan to use them to conduct due diligence on the supply chains of target companies with respect to sustainability matters over the next two years.

63% Respondents have used external specialists already

91% Respondents plan to use external specialists for supply chain due diligence over the next two years

Part 1: M&A in Europe

After sluggish M&A activity in 2023, the European market has picked up this year, particularly in value terms. And dealmakers are optimistic about the months ahead.

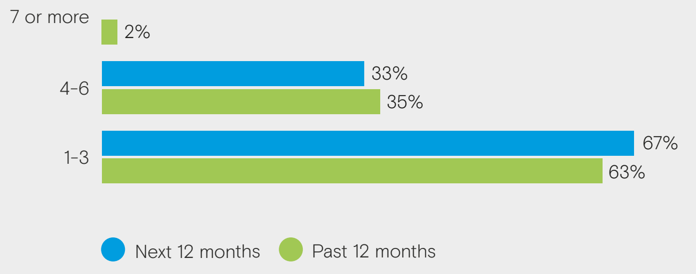
European M&A started this year on a firm footing, with total deal value reaching impressive levels, even as the number of completed transactions declined compared to the previous year. In the first quarter, the total value of transactions hit a noteworthy EURO 178bn, representing a substantial 43% year-on-year gain.

However, the number of deals completed in Q1 2024 fell 6% year-on-year, with 3,938 transactions recorded. Despite this decrease in overall numbers, the current volume of European M&A activity remains well above pre-pandemic levels.

This suggests that, while there has been a slowdown in the number of deals, there is robust appetite for high-value transactions, particularly among strategic buyers. Building on this momentum, preliminary figures for Q2 2024 indicate that the European M&A market continues to thrive. In Western Europe alone, EURO 253bn worth of deals were completed in the first half of 2024, surpassing the total value achieved in the entire first quarter.

As for intentions for the remainder of the year, acquirers are optimistic. More than two thirds of respondents (67%) are planning to undertake between one and three M&A deals over the next 12 months, up from 63% who completed this number of deals over the past year.

Approximately how many M&A deals did your organisation undertake in Europe over the past 12 months? How many M&A deals do you expect to undertake in Europe over the next two years? (Select one)



German M&A rebound?

Germany and the Iberian nations are predicted to see the most growth in M&A over the next 12 months, with 28% and 25% of respondents respectively tipping these markets. Despite the upbeat sentiment, Germany's economy is currently experiencing a period of stagnation following a recession in 2023. Economic growth is projected to be minimal in 2024, with real GDP expected to increase by only 0.1%, due to high energy prices, slower export markets and persistent high financing costs.

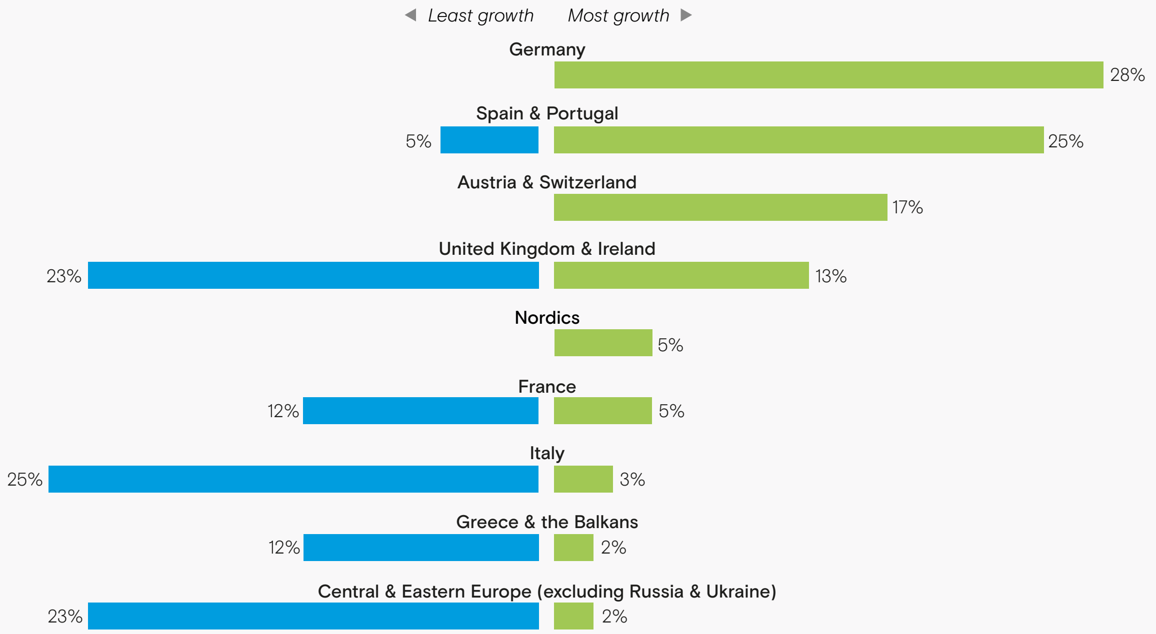
However, our survey reveals several trends that could play into both Germany's current strengths and even its weaknesses. First, the sector tipped for the most growth in European M&A activity over the next year is industrials and chemicals, including automotive-related deals. With Germany boasting the largest and most advanced industrial base in Europe, the country is well-positioned to benefit. As companies in these sectors seek to consolidate, streamline operations and pursue strategic acquisitions to navigate through the challenging economic environment, Germany's depth of industrial assets could deliver sizeable deal flows.

With 22% each, the consumer and leisure, and energy, mining and utilities industries are expected to see the second highest rates of M&A growth. Meanwhile, at the other end of the scale, 17% of respondents see the pharmaceuticals, medical and biotech sector as delivering the least growth in deal activity.

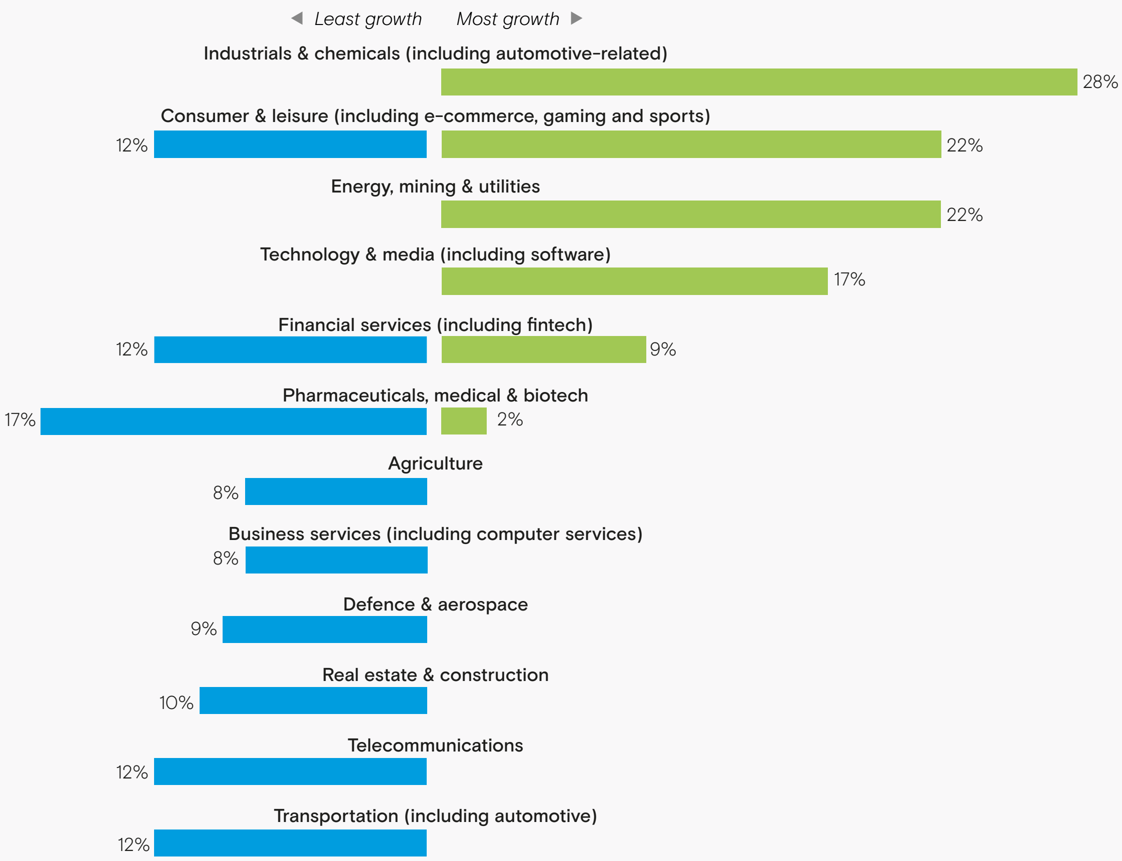
In further evidence of Germany's potential for strong future M&A growth, capturing synergies between businesses is seen as the key driver for dealmaking activity. Almost three quarters (72%) of respondents say that such synergies will influence their deal plans in some way and 22% report this will be the number one factor.

This emphasis is particularly pronounced among German respondents, with 87% recognising its importance. As companies navigate the challenges

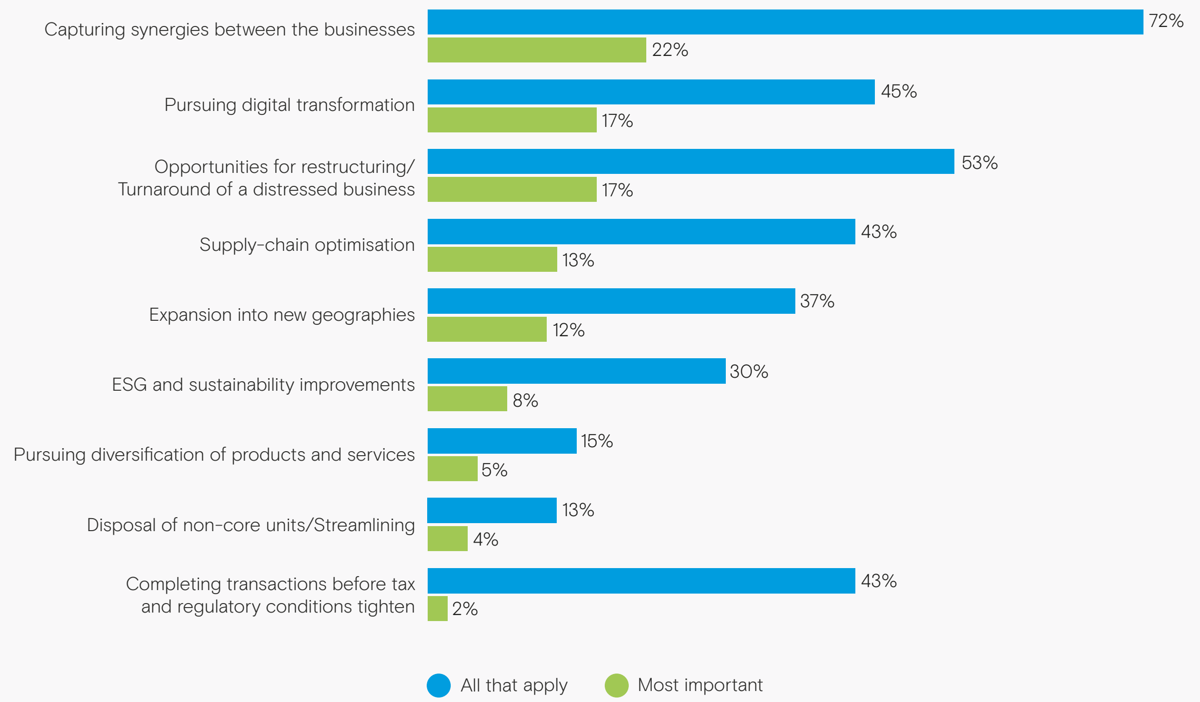
Over the next 12 months, which parts of Europe do you believe will see the most and least growth in M&A activity? (Select one sector for 'Most growth' and one for 'Least growth')



Over the next 12 months, which sectors do you believe will see the most and least growth in M&A activity in Europe? (Select one sector for 'Most growth' and one for 'Least growth')



Over the next 12 months, what will be the main points of emphasis for your organisation in its M&A strategy? (Select all that apply)

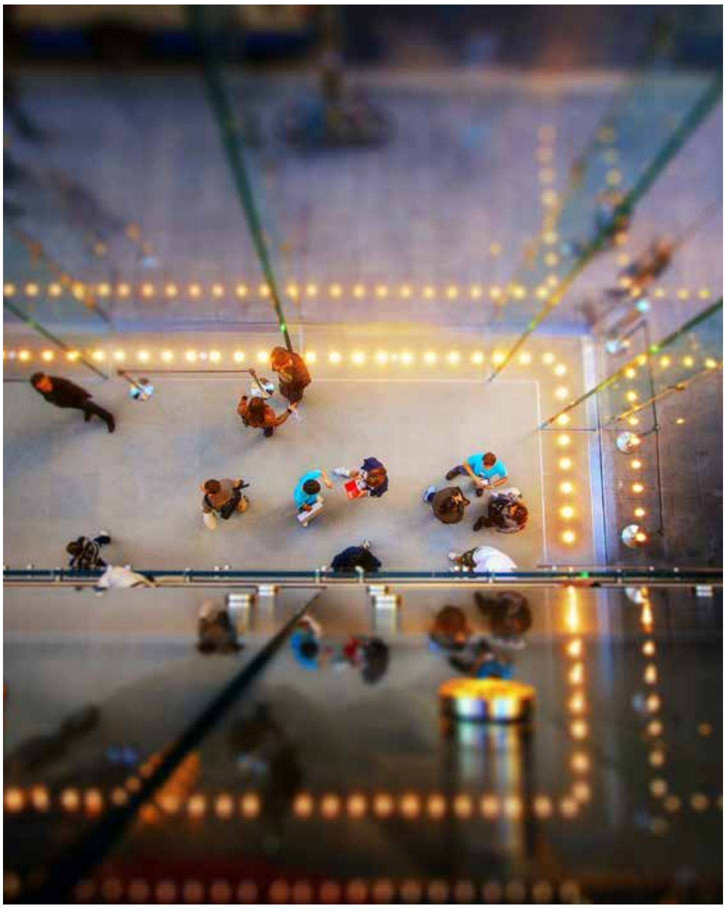


posed by the economic slowdown, identifying and capturing synergies via dealmaking has become a strategic priority. Combining operations and bringing down long-term costs is especially salient at a time when profit margins are under pressure.

More than half of respondents (53%) highlight restructuring and the turnaround of distressed businesses as a significant driver of activity, with 17% considering it a key factor. In a sluggish economy, distressed businesses may present attractive targets for well-capitalised buyers seeking to acquire strategically covetable assets at favourable valuations.

The survey also reveals that pursuing digital transformation is considered the single most important driver for deals by 17% of respondents. Businesses across industries urgently need to adapt to an ever-changing digital landscape and M&A offers a route to gaining valuable technologies, talent and knowledge. In a challenging economic environment, investing in digital transformation through dealmaking can help companies sharpen their competitive edge.

“There is a great need for digitisation within Germany and many other of Europe’s economies and investment in technology will continue as companies look for ways to automate processes,” says Andrejs Klisans, Senior Manager at RSM Italy. “It is a reality that a lot of corporates are identifying and so a lot of investment is going into software companies.”



Conflicted interests

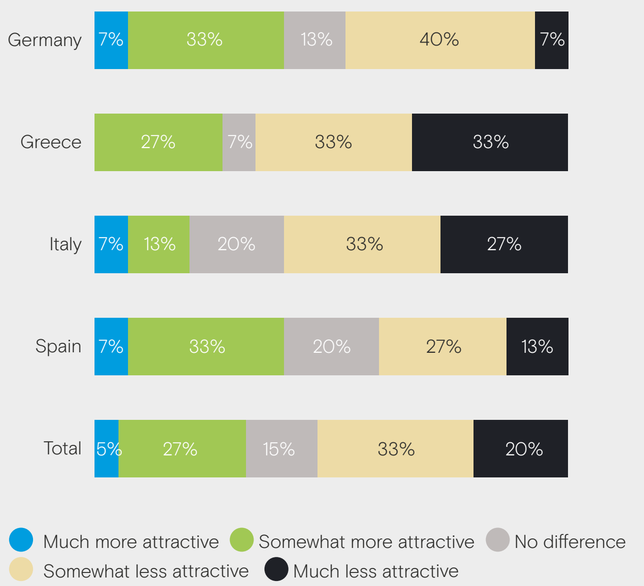
The ongoing war between Russia and Ukraine has cast a shadow over Europe's attractiveness for M&A over the coming year. A slight majority of respondents (53%) believe the conflict will make the region less appealing for dealmaking over the next 12 months. This sentiment is particularly strong among Greek and Italian respondents, with 66% and 60% respectively expressing concerns, while only 40% of Spanish respondents share the same view. Undoubtedly, closer proximity to the conflict, including exposure to supply chain disruptions, presents higher risk for dealmakers, at least with regard to the majority of industries.

Furthermore, Europe is witnessing a rise in political risk as government cohesion weakens. There has been a notable shift towards the right of the political spectrum, with far-right parties currently holding power or supporting governments in several European countries, including Italy, Hungary, Finland, Slovakia and Sweden. This is also reflected in the European Parliament. While the centrist grand coalition retained a majority following the European Union (EU) elections in June, the far-right Identity and Democracy party emerged as the fifth-largest bloc, gaining 49 seats. Similarly, the right-leaning European Conservatives and Reformists group increased its presence with 69 seats.

The growing influence of Eurosceptic parties indicates a diminishing cohesion between Member States, which could lead to significant changes in key policy areas such as immigration, climate change and the overall legislative agenda of the EU.

Moreover, the polarisation of the political structure may contribute to more radical policymaking, impacting the attractiveness of Europe as a cross-border M&A destination either positively or negatively. Acquirers will need to pay close attention to how political risk develops in target markets and how these might benefit or undermine their future deals.

To what extent do you believe Europe will become more or less attractive as a destination for M&A over the next 12 months in the light of the ongoing war between Russia and Ukraine? (Select one)



> There is a great need for digitisation within Germany and many other of Europe's economies and investment in technology will continue as companies look for ways to automate processes.

Andrejs Klisans, Senior Manager, RSM Italy

M&A risk in focus

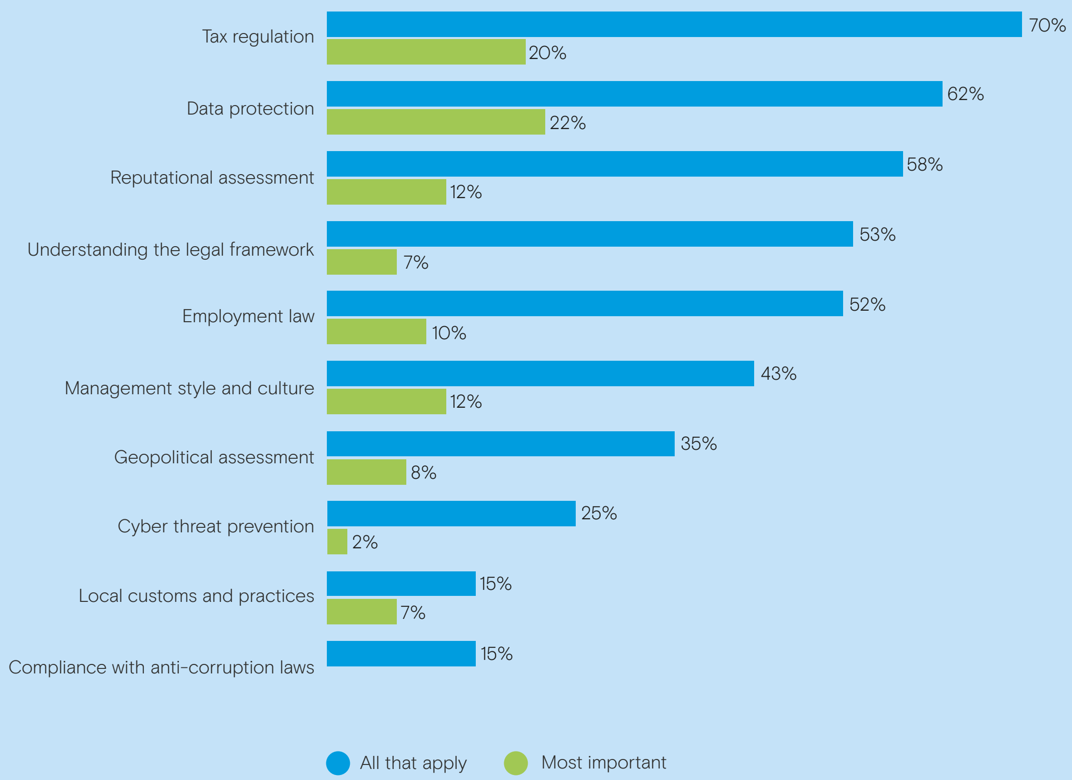
Risk is inherent in all deals, but assessing which threats are most urgent is a complex science – and can make or break a transaction.

Risk assessments are the cornerstone of successful M&A deals. Without them, acquirers may unknowingly inherit liabilities or face compliance issues that can significantly impact the value and success of the transaction. Our survey reveals that tax regulations, data protection and reputational considerations are the primary elements when it comes to assessing risks in a deal.

Tax can significantly impact the financial outcomes and legal standing of transactions. As the managing director of a German private equity firm notes: "Tax risk assessments are fundamental. It's essential for teams to scrutinise tax laws as there have been recent changes that apply to both domestic and foreign advisers. These can cut into returns over time." Indeed, 70% of respondents prioritise tax in their risk assessments, with 20% identifying this as the most important factor.

In today's exponentially digitalising world, data protection is also at the forefront. With 62% of respondents highlighting its importance and 22% flagging it as critical, effective data protection measures are essential to prevent breaches and maintain customer trust. And given the more stringent regulation surrounding data protection, it is vital that companies dedicate adequate resource to the task, be that internal or external.

What are the most important elements when carrying out risk assessments in an M&A deal? (Select all that apply and the most important)



As the managing partner of a German PE firm says: "Data protection rules are stricter today than ever. Identifying the data protection standards at a [target] company is a priority. If dealmakers are not equipped with necessary resources, they need to bring in external personnel to investigate and recognise systemic flaws."

For more on the advantages of using external experts and advisers, see External expertise makes all the difference, page 21.

Evaluating the public perception and market standing of a target company is also crucial for long-term success. Reputational assessments therefore play a vital role when vetting targets, with 58% of dealmakers considering them among the most important elements of risk assessments and 12% viewing them as a top priority.

Whether an acquirer is taking a full share or making a stake investment, the need for reputational due diligence is paramount, according to the head of group strategy at a German corporate. He says, "It's very important to conduct a thorough assessment of the reputational value of the target company. Even if we are considering minority share investments, knowing their reputation in local and global markets is essential."

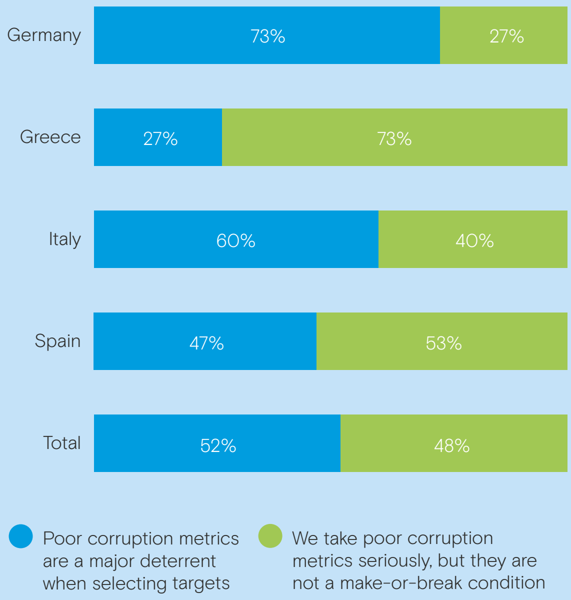
Countering corruption

The shadow of corruption looms large over the dealmaking landscape. Just over half of respondents (52%) view a country's poor corruption reputation as a major deal deterrent, while 48% might overlook such concerns for a strategically advantageous purchase. This divide highlights the differing risk appetites for dealmakers. Among German (73%) and Italian (60%) respondents, corruption metrics are more likely to represent a major deterrent to doing M&A in a country. However, while Greek and Spanish dealmakers take corruption metrics seriously, the majority (73% and 53% respectively) do not see them as a make-or-break consideration.

Dealmakers need to be aware of adapting their due diligence strategies when engaging in markets with higher corruption risks, which can be achieved by partnering with specialist providers who are adept at uncovering hidden dangers and conducting thorough investigations.

"Many countries do not provide access to information on past criminal proceedings, therefore you are not able to determine whether a company or its management has had a problem. So, reputation inquiries and field investigations can go a long way," says Marianna Vintiadis, Partner and Head of Forensic Investigations & Intelligence at RSM Italy. "Although a record may not be publicly available, the reference market will know if a company has had trouble in the past and they will tell you! So, there are ways to mitigate this risk."

To what extent does a country's reputation for corruption, such as poor performance in Transparency International's Corruption Perceptions Index, impact your decision on whether to do an M&A deal in that country? (Select one)



> Data protection rules are stricter today than ever. Identifying the data protection standards at a [target] company is a priority. If dealmakers are not equipped with necessary resources, they need to bring in external personnel to investigate and recognise systemic flaws.

Managing partner, Germany-based PE firm

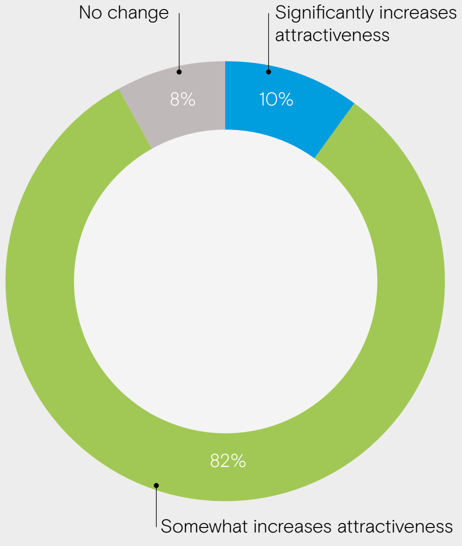
Part 2: Sustainability and M&A due diligence

Regulations around sustainability are ramping up across Europe and this will change the way M&A is conducted. Dealmakers need to be ready.

The clock is ticking on the introduction of the EU's CSDDD. The European Council gave its final approval to the regulation on 24 May and Member States have a two-year implementation period, starting in 2026, to incorporate the directive into national law. Once in place, the CSDDD will require companies to integrate due diligence into their policies and management systems to identify, prevent, mitigate and account for actual and potential adverse human rights and environmental impacts in their own operations, subsidiaries and value chains.

With clear regulatory expectations in place, companies will be more likely to prioritise sustainability initiatives and better promote transparency, making them more appealing to potential acquirers who value responsible business practices.

How do the requirements of the upcoming Corporate Sustainability Due Diligence Directive (CSDDD) impact the attractiveness of acquiring European companies?



Recognising the positive impact of the forthcoming legislation, our survey reveals that almost all respondents (92%) believe the CSDDD is set to make European companies more appealing acquisition targets, including 10% who believe it will significantly increase their attractiveness. German respondents are particularly optimistic, with 20% stating that the CSDDD will significantly enhance the allure of European companies.

As one managing director from a German PE firm explains: "There will be more structure to the overall corporate responsibility approach. Earlier, corporate responsibility was widely based on the views of leadership teams. Now that there are stricter regulatory expectations, sustainability opportunities will be pursued strongly."

German respondents are also more likely to view their own country's regulatory bodies as adopting an effective approach to environmental and sustainability regulation, with 93% holding this belief compared to the overall average of 43%. This perception is exemplified by a head of group strategy from a German industrials and chemicals company, who says: "The regulatory bodies have adopted an effective approach. The extent of liabilities is well-known to acquirers. The regulations are straightforward and do not have any uncertain elements."

Other countries are less certain about their regulatory bodies. In particular, respondents in Greece – where 93% felt that these administrators took only a somewhat effective approach to environmental and sustainability regulation. Overall, the Southern European states felt their regulatory bodies were far less effective than their German peers.

This coincides with the fact that Germany has been at the forefront of progress. The German Supply Chain Due Diligence Act (LkSG), which came into force on 1 January 2023, has positioned the country as a leader in mandating corporate responsibility for human rights and environmental risks throughout global supply chains. The law requires large German companies to identify, prevent and mitigate these risks, and non-compliance can result in substantial fines.

Given Germany's head start, it stands to reason that the country's respondents express greater optimism about the positive impact of the upcoming EU-wide CSDDD on acquisition targets, as well as viewing their country's regulatory approach more favourably compared with respondents from other markets.

"Every country within the EU is looking at Germany very closely to understand the challenges that they are facing because they will need to address these same issues," says RSM Italy's Klisans. "Once the European legislation kicks in, Germany will be more prepared and other countries will have to very quickly follow suit."

B Corp status

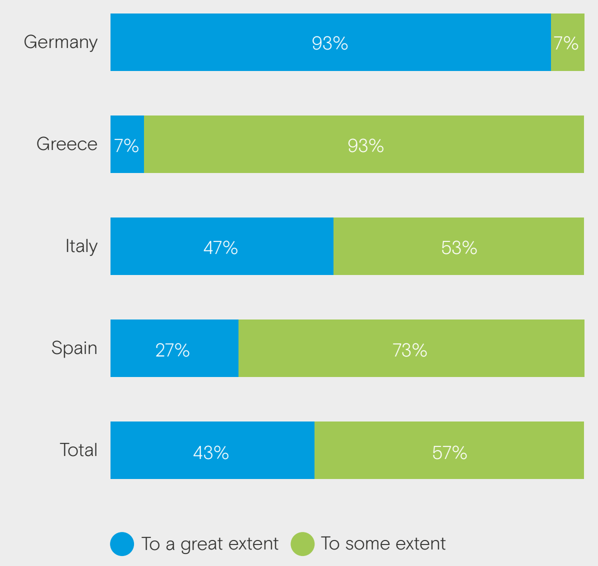
Third-party validation of a company's sustainability efforts is also a valuable asset in the eyes of potential acquirers. Specifically, 83% of respondents believe that B Corp certification increases the appeal of prospective deal targets.

B Corp certification is awarded by the non-profit organisation B Lab to companies that meet rigorous standards of social and environmental performance, public transparency and legal accountability to balance profit and purpose. To achieve certification, companies must demonstrate high levels of performance across five key impact areas: governance, workers, community, environment and customers.

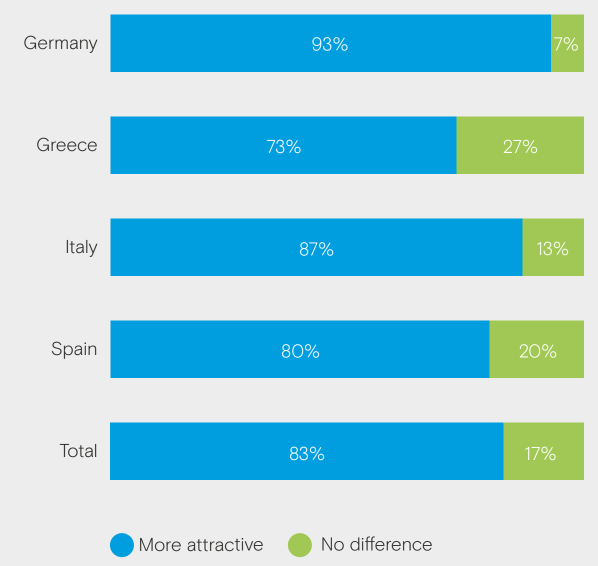
This certification provides a comprehensive, objective assessment of a company's practices, signalling to potential acquirers that a business has a genuine commitment to sustainability and is well-positioned to meet the rising expectations of regulators and other stakeholders.

> The regulatory bodies have adopted an effective approach. The extent of liabilities is well-known to acquirers.
>
> Head of group strategy, Germany-based industrials and chemicals company

Do the regulatory bodies in your country adopt an effective approach to environmental/sustainability regulation?



From a target perspective, do you believe that a company that has attained B Corp certification is more attractive than a company that has not?



Diligence is due

Given the legislative changes that are being imposed on European companies, it is little wonder that acquirers are already adapting their sustainability due diligence practices and prioritising different areas for most scrutiny.

For instance, while 38% of respondents note that they scrutinised the environmental impact of a company's operations most rigorously in the past, only 20% plan to do so in the coming years. By contrast, 28% intend to submit targets' global supply chains to most scrutiny over the next two years, up from 17% who did so previously. Meanwhile, a quarter of respondents note that human rights due diligence will receive most scrutiny over the next 24 months (second only to global supply chains).

Companies and their shareholders are growing increasingly conscious of the reputational risks associated with human rights violations. And respondents note that EU legislation will have a significant impact on human rights due diligence in the coming years.

This is emphasised by the chief strategy officer of an Italian corporate who says: "We will scrutinise human rights violations more closely, in line with the latest EU directive. It is vital to determine whether a company has lowered its standards on human rights, as this is an issue that can cause serious reputational damage."

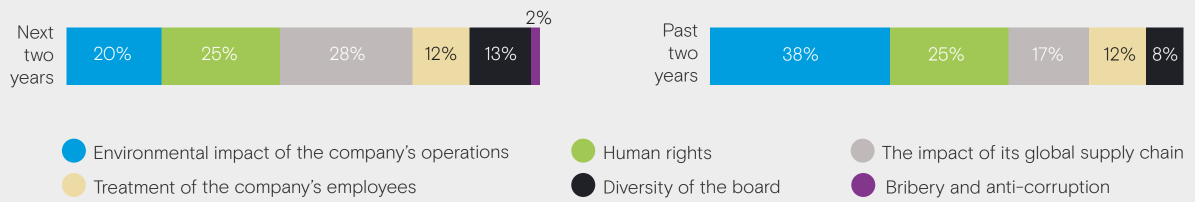
Room for improvement

However, undertaking sustainability due diligence can present a series of challenges. The treatment of employees and human rights-related information are each highlighted by 25% of respondents as areas where the scope and quality of information provided by target companies could be improved. Similarly, 22% point to the environmental impact of a company's operations as an area for improvement.

The lack of standardisation in sustainability reporting, the voluntary nature of disclosures for smaller companies, and the complexity of data collection all contribute to the difficulty in obtaining reliable and comprehensive environmental, social and governance (ESG) information. Moreover, the absence of external assurance for ESG data, unlike audited financial statements, can raise concerns about the accuracy and reliability of reported information. This can make it difficult for acquirers to evaluate and compare the sustainability performance of potential targets.

With expectations increasing and Europe-wide regulations emerging, companies should already be focused on improving the transparency and quality of their ESG reporting. This can be achieved by adopting widely recognised reporting frameworks such as the Global Reporting Initiative (GRI) or the Sustainability Accounting Standards Board (SASB) to improve consistency and comparability. Acquirers would be wise to seek out companies that are proactively taking these steps, as it not only demonstrates a commitment to sustainability but also showcases their ability to adapt to evolving regulatory requirements and stakeholder expectations.

Which of the following types of due diligence on EU-based target companies have your company scrutinised most over the past two years? And which will receive the most scrutiny over the next two years?



The scope and quality of which types of information provided by target companies in the EU could be most improved? (Select top choice)

Part 3: Spotlight on forthcoming EU legislation

The CSDDD and CSRD are likely to change the way in which dealmakers conduct transactions with greater resource and preparation needing to be applied to sustainability due diligence.

The EU is taking a multi-pronged approach to addressing corporate sustainability governance and practices. The looming CSDDD builds upon the progress already made with the introduction of the CSRD, which officially entered into force on 5 January 2023 and started being phased in from the beginning of the 2024 financial year.

The CSRD strengthens the existing disclosure requirements set out in the Non-Financial Reporting Directive (NFRD), extending the scope of mandatory ESG reporting to all large companies and listed SMEs, covering approximately 50,000 companies in the EU. The directive introduces more detailed mandatory reporting requirements.

The CSDDD and CSRD are complementary but serve different functions within the EU's sustainability framework. The CSDDD focuses on due diligence processes to prevent and address adverse human rights and environmental impacts, with a strong emphasis on supply chain management. In contrast, the CSRD aims to enhance transparency and provide stakeholders with detailed, standardised sustainability information through comprehensive reporting. Together, these directives aim to improve corporate accountability and transparency.

Contractual obligations

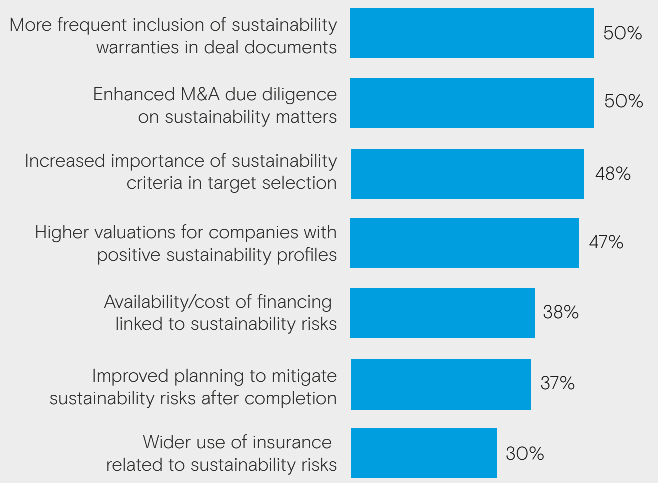
Respondents foresee these greater regulatory obligations as directly influencing the details of M&A contracts. The impact of compliance is likely to be felt in more frequent inclusion of sustainability warranties in deal documents, according to 50% of respondents.

Typical clauses in sustainability warranties include assurances that the target company complies with all relevant environmental, human rights and sustainability laws and regulations. The company must provide accurate and complete sustainability reports and disclosures in line with CSRD requirements. Additionally, there should be no known violations or pending investigations related to sustainability laws. The company is also expected to follow best practices in environmental management, labour standards and human rights. If a warranty is breached, the acquirer can seek remedies such as indemnification for any losses incurred. This may involve financial compensation or other corrective actions to address the breach.

"Sustainability warranties in deal documents would ensure that parties are held accountable for their actions when they were responsible for processes. Due diligence will include extensive investigations of sustainability actions," says the managing partner of a hedge fund in Greece.

Half of respondents also believe that tighter regulations will lead to enhanced due diligence on sustainability matters. It follows therefore that 70% of respondents also expect the level of resources they will devote to sustainability due diligence on EU-based target companies to increase after implementation of the CSRD, including 23% who expect resourcing levels

How do you expect compliance with new EU legislation (e.g. the Corporate Sustainability Reporting Directive (CSRD) and Corporate Sustainability Due Diligence Directive (CSDDD)) will impact your dealmaking in the future? (Select all that apply)



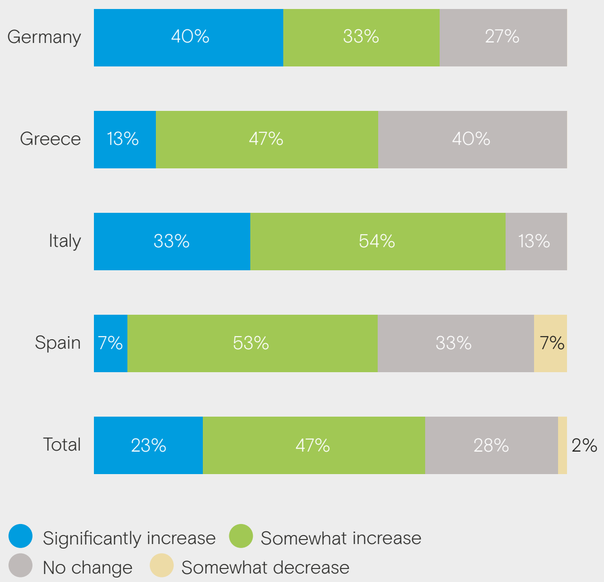
to increase significantly. Of these, 40% of German respondents expect to significantly increase the level of resources they devote to this, once again demonstrating that acquirers in Germany are ahead of the curve. Italy is not far behind, with 33% of companies noting that they would significantly increase resources, with a further 54% saying that these would be increased to some extent.

Data with destiny

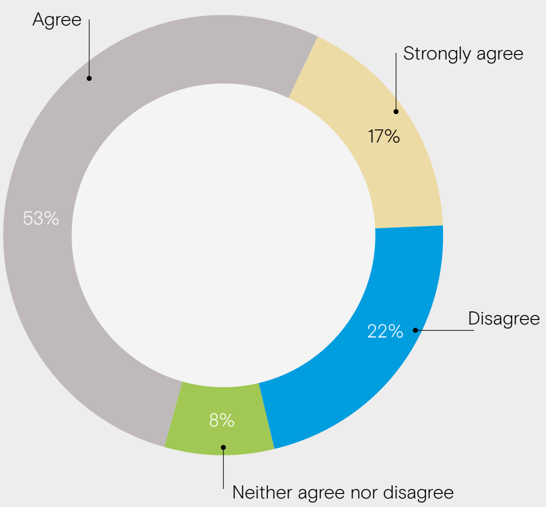
Organisations like the GRI and the UN Global Compact often show that while many companies report on sustainability, there is significant variation in the quality and reliability of the data. Common issues include inconsistent metrics, lack of standardised reporting frameworks and limited third-party assurance. However, 70% of respondents have a high degree of confidence in the accuracy of reported corporate sustainability data, with just 22% saying they are not fully confident in its accuracy.

"Everything is heading in the right direction, towards more harmonisation and standardisation," says Klisans. "Making sure that accurate and reliable data is being collected is crucial, which is naturally more complicated when factoring in suppliers, transparency issues and inconsistent reporting standards. But there is still more work that needs to be done on that front."

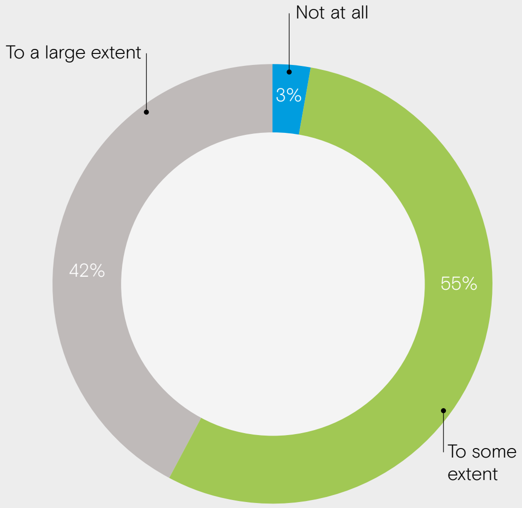
How do you expect the level of resources that your company devotes to sustainability due diligence on EU-based target companies to change after the Corporate Sustainability Reporting Directive (CSRD) has been fully implemented?



To what extent do you agree or disagree with the following statement: "I generally have a high degree of confidence in the accuracy of reported corporate sustainability data"?



Do you expect companies to which the Corporate Sustainability Reporting Directive (CSRD) does not apply to adopt CSRD reporting standards in practice?



Which of the following measures have already been taken within your company with a view to complying with the corporate due diligence duty under the proposed Corporate Sustainability Due Diligence Directive (CSDDD)? (Select all that apply)

While the CSRD is estimated to capture around 50,000 European companies within its scope, an overwhelming 97% majority of respondents expect that even companies that fall outside CSRD will adopt the reporting practice. Aligning with the standards can enhance a company's reputation, demonstrating a commitment to transparency and sustainability that resonates with consumers, investors and other stakeholders. Additionally, using these standardised frameworks can improve internal processes and decision-making, as comprehensive sustainability reporting often leads to better identification and management of risks and opportunities.

Furthermore, as the global market increasingly prioritises sustainability, non-EU companies that fall below the regulatory threshold but aim to compete internationally or partner with EU-based firms may find it advantageous to adhere to these standards. Proactive alignment will also prepare companies for potential future regulatory changes, ensuring they remain one step ahead of their peers.

Prep work

With the CSDDD on the horizon, businesses are already gearing up to meet its requirements. Most respondent companies have prepared a communication strategy (58%) and set up a working group (52%). Half have also conducted an audit, and half have identified relevant internal and external stakeholders.

Further steps that businesses can take include mapping out risks in their value chain by conducting thorough assessments to identify potential human rights abuses and environmental impacts, from top-level sourcing of raw materials through to end-product delivery. Tracking and monitoring ESG due diligence outcomes by establishing robust systems with key performance indicators (KPIs) will help companies make data-driven decisions, regularly reviewing progress to ensure compliance and advancement towards sustainability goals.

Drafting and integrating comprehensive policies and clear communications will also help to ensure that all stakeholders, including employees and suppliers, understand and adhere to codified sustainability commitments. Transparent communication about these policies and their implementation will build trust and accountability both within the company and externally. Taking steps today in preparation for the directive's implementation into national law will minimise disruptions and better position companies for this sweeping transition.

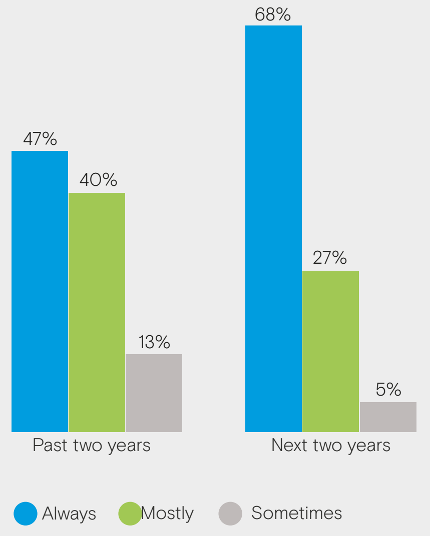
Part 4: Focus on supply chain due diligence

Impending EU regulations mean that stringent due diligence on every link in a supply chain is vital for dealmakers. While this may increase costs and complexities, it could also deliver competitive advantages.

The European Commission (EC) first proposed the CSDDD in February 2022, capturing the attention of investors and prompting a re-evaluation of M&A due diligence approaches. Nearly half of respondents (47%) report that they have already been consistently conducting diligence on target companies' global supply chains over the past two years.

Germany, a legislative forerunner on this front, introduced its groundbreaking supply chain sustainability law in June 2021, giving it an eight-month lead over the EC and motivating investors in the country to steal a march on their peers in other European markets. This is evidenced by the fact that 60% of German respondents have conducted due diligence on target companies' value chains over the past two years – 13 percentage points above the number of total respondents. Moreover, 73% expect to apply diligence to this area over the next two years, versus 68% who say the same across our wider respondent group.

How frequently have you conducted due diligence on target companies' global supply chains as part of the M&A process?



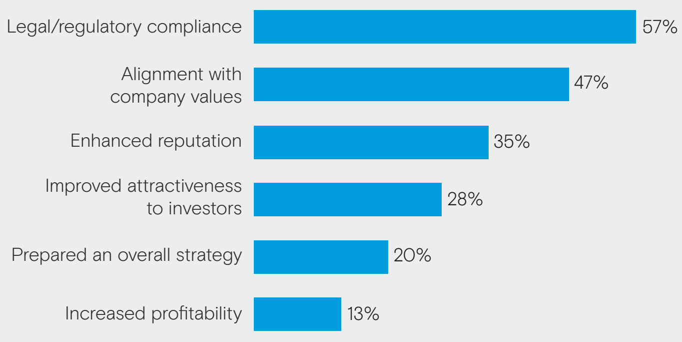
There are numerous advantages to ensuring that target companies' supply chains are sustainable, chief among them the obligation to fall on the right side of regulations. We find that 57% of respondents cite legal and regulatory compliance as the most important benefit, alignment with company values emerges as the second most important factor, with 47% of respondents emphasising its significance.

To a slightly lesser extent, investors also recognise the commercial and reputational imperatives of prioritising supply chain sustainability as part of their M&A activities. A managing partner of a hedge fund in Greece notes: "Increased profitability is one of the key benefits. Companies working sustainably have become attractive to end users as well. Customers want to purchase products and services from these businesses."

Meanwhile, a managing director of a hedge fund in Germany explains: "Ensuring that the targets work sustainably adds to their reputation and ours. As investors, it will increase the appeal of these targets. They would fit into the sustainability goals of our company."

Of course, these benefits are not mutually exclusive, rather they are complementary and self-reinforcing. A company with a stronger reputation among

What are the most important benefits of ensuring that the supply chains of target companies are sustainable? (Select top two)



customers is more likely to grow its revenues and earnings over the long term, thereby becoming more attractive to investors.

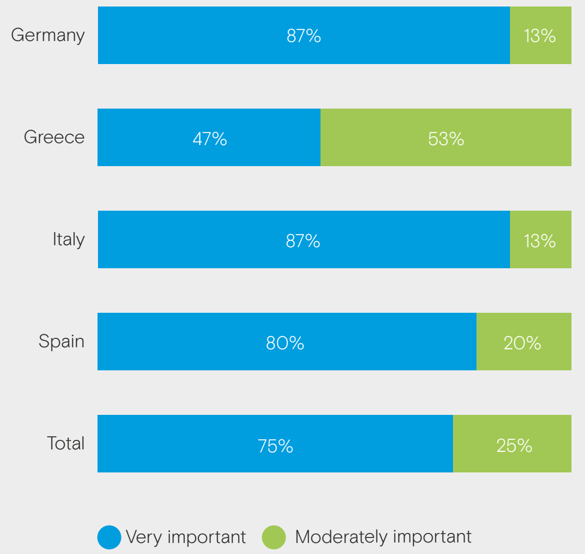
Cost of compliance

However, there is a trade-off at play here. All respondents in the survey acknowledge that maintaining sustainable supply chains is crucial for gaining a competitive advantage, with 75% emphasising its high importance. This sentiment is particularly strong among German and Italian respondents, with 87% from each country considering it very important. In contrast, only 47% of Greek respondents share this view.

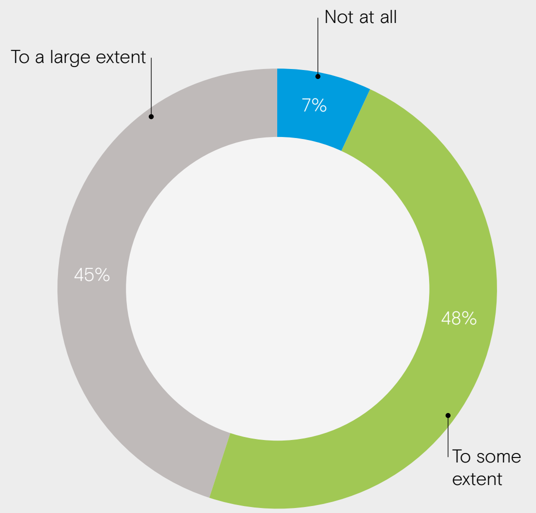
The potential conflict arises as companies manage the balance between input costs with sustainability goals. Choosing to source cheap goods and labour typically comes at the expense of increasing exposure to human rights risks and vice versa. When asked about the extent of the trade-off between supply chain sustainability and commercial imperatives, 45% of respondents say there is a large conflict, while 48% believe it exists to some extent, illustrating the constant push and pull of financial considerations versus sustainability obligations.

As far as the challenges of undertaking supply chain due diligence are concerned, investors face several hurdles. A lack of transparency emerges as the most prominent challenge, with 55% of respondents ranking it among the top two concerns. This is closely followed by the lack of standardisation, which 43% of respondents consider a major impediment, and technological limitations, which 40% of respondents identify as a key obstacle.

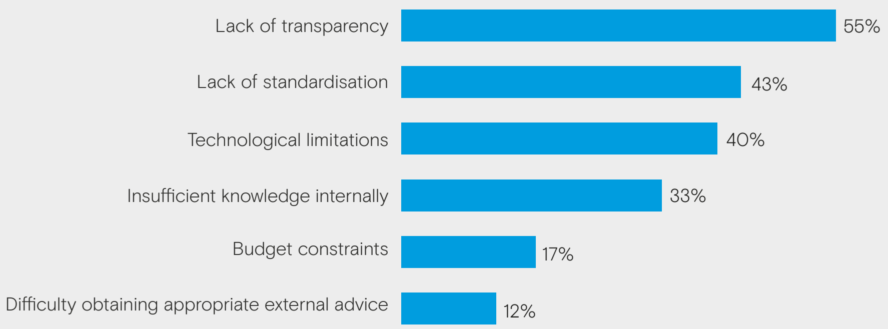
How important is maintaining sustainable supply chains as a competitive advantage? (Select one)



To what extent is there a conflict between maintaining sustainable supply chain practices and commercial imperatives? (Select one)



What are the key challenges in undertaking due diligence on the supply chains of target companies as part of the M&A process? (Select top two)



The complexity of global supply networks, the reluctance of some suppliers to share sensitive information, the absence of globally harmonised reporting and disclosure frameworks all contribute to disclosure limitations.

The power of AI
Given these limitations, dealmakers are turning toward technology to find solutions – in particular Artificial Intelligence (AI). This burgeoning technology holds immense promise for sustainability due diligence, particularly as it relates to sprawling global supply chains.

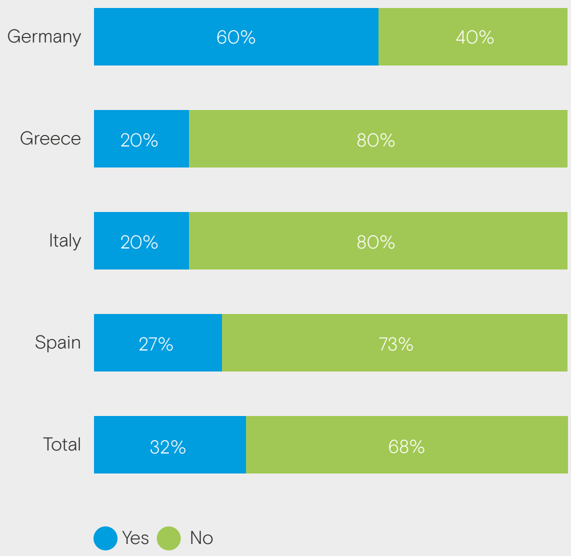
"AI can be an extremely powerful mitigation tool when dealing with large volumes of reputational analyses. In the past, these analyses were elective, but now some level of screening is required for everyone," says Vintiadis. "With consistent, ongoing analysis, structured data will accumulate, allowing AI to spot patterns, identify new parameters and immediately highlight anomalies that humans might miss among a large number of contractors or suppliers."

To date, 32% of respondents have used AI for sustainability due diligence in M&A, rising to as high as 60% among German respondents. Looking ahead, more than half of respondents across Europe (55%) anticipate using AI tools for sustainability due diligence in the next two years for some or all deals they pursue, with 66% and 60% of respondents in Germany and Italy respectively sharing these expectations. It's clear that AI is viewed as becoming an indispensable tool for understanding supply chain risk by uncovering data relationships and patterns that might otherwise fly under the radar.

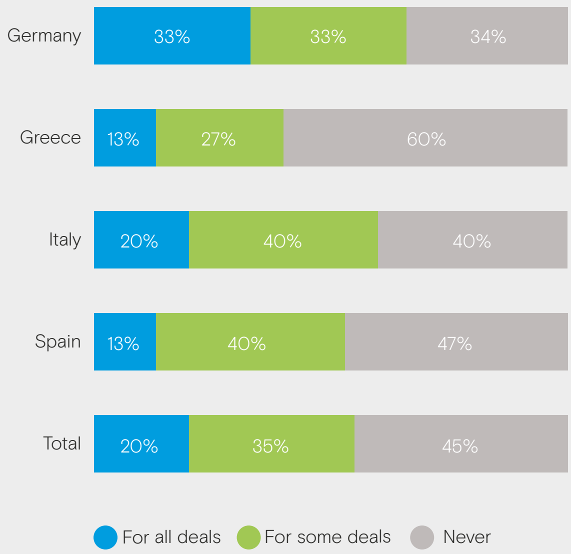
With consistent, ongoing analysis, structured data will accumulate, allowing AI to spot patterns, identify new parameters and immediately highlight anomalies that humans might miss among a large number of contractors or suppliers.

Marianna Vintiadis, Partner and Head of Forensic Investigations & Intelligence, RSM Italy

Has your company used artificial intelligence (AI) tools for sustainability due diligence in M&A?



In the next two years, do you expect to use AI tools for sustainability due diligence in M&A?



External expertise makes all the difference

While technology, and in particular AI, can be invaluable for supply chain due diligence, tech is just a tool, and no substitute for external specialists and their experience and expertise.

Technology in isolation cannot solve supply chain sustainability issues, and there are inherent limitations to how it can capture ethical and social nuances, driving home the need for human insight and judgement.

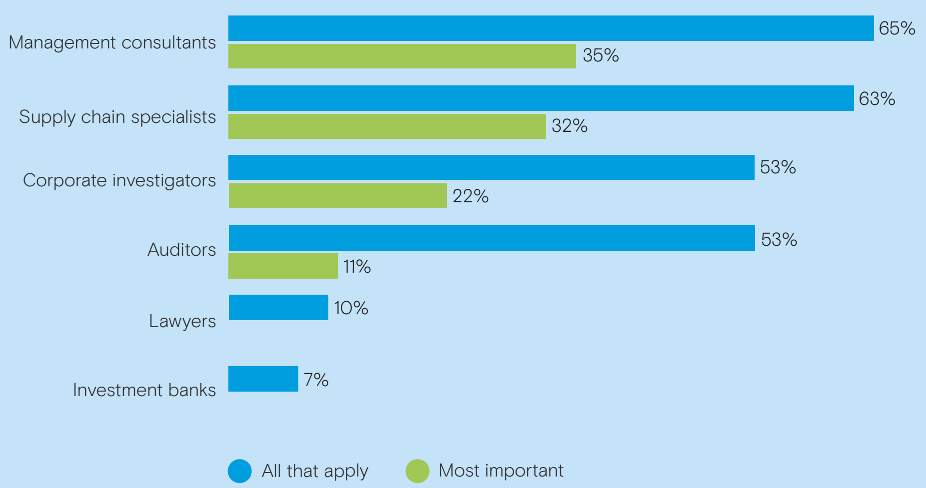
As a managing director of a private equity firm in Germany explains: "There are ethical and sustainability aspects that cannot be tested using technology assets. We have to identify risks manually."

The complexity and global nature of modern supply chains means acquirers must go beyond automated screening tools and engage in more in-depth, qualitative assessments of supply chain practices. However, the manual nature of identifying and assessing sustainability risks can be time-consuming, resource-intensive and prone to human error. As a result, many investors are turning to external specialists with a deep understanding of industry-specific issues, local contexts and cultural nuances to conduct in-depth supply chain due diligence. These experts are able to engage with a wide range of stakeholders, including suppliers and local references, enabling them to uncover hidden risks and provide actionable insights.

One of the key advantages of engaging external specialists is their ability to collect and verify information on suppliers at the very end of a target company's supply chain. Specialists have the resources, expertise and networks to gather data from even the most remote and opaque parts of a supply chain, ensuring a comprehensive assessment of sustainability risks.

Management consultants are a popular choice, with 65% of respondents having used this class of advisors to date and 35% considering them the most important category of external support. That said, dedicated specialists are on an almost equal footing, with 63% having used supply chain experts already and 32% ranking them as key for due diligence on target companies' supply chains.

In the past two years, which types of external specialists have you used to assist with due diligence on target companies' global supply chains as part of the M&A process? (Select all that apply and most important)



External specialists bring a wealth of knowledge and experience to the due diligence process, allowing them to uncover issues that may not be immediately apparent. This deeper level of scrutiny is essential for identifying and mitigating sustainability risks in supply chains.

However, not all external specialists contribute to the due diligence process in the same manner, as RSM Italy's Klisans explains.

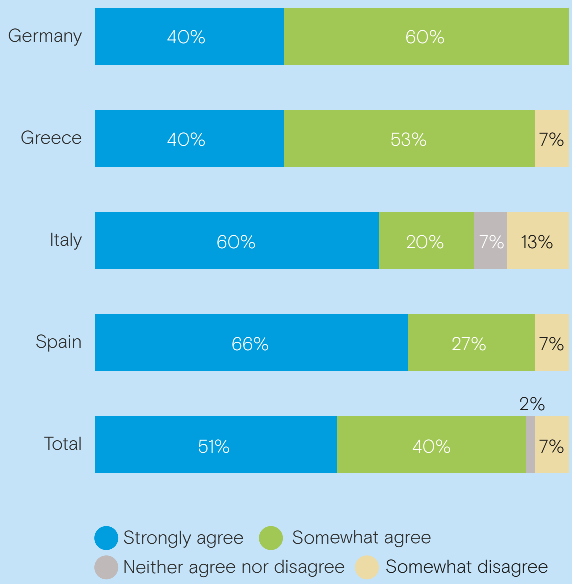
"Management consultants draft the various processes themselves, whereas external specialists dig right down into whether processes that companies have in place are being adhered to," he says. "And if they are not being followed, specialists will take a closer look, conducting an investigation into where things went wrong and help companies to understand that so it can be corrected."

This depth of actionable analysis will become ever more critical as companies and acquirers adapt to the compliance requirements of the CSDDD and seek to gauge the sustainability risks in their existing operations and those of target companies. This explains why an overwhelming 91% majority of respondents are planning to use external specialists to conduct supply chain due diligence over the next two years as the new regulatory obligations start to be phased in. This is especially true of Southern European respondents. Two thirds of Spanish (66%) and almost as many of their Italian counterparts (60%) strongly agree that their companies are likely to use external specialists to conduct due diligence on the supply chains of target companies.

The CEO of a healthcare company in Spain shares their experience, saying: "An external team is hired to test the resilience of the entire supply chain. We have relied on their expertise in the past, and we will continue to do so. It is impractical to handle this aspect in-house."

The stakes are simply too high not to lean on the expertise of specialists to build a comprehensive risk profile of value chains, no matter how complex they may be.

Do you agree or disagree with the following statement: "My company is likely to make use of external specialists to conduct due diligence on the supply chains of target companies in respect of sustainability matters over the next two years."



Management consultants draft the various processes themselves, whereas external specialists dig right down into whether processes that companies have in place are being adhered to.

Andrejs Klisans, Senior Manager, RSM Italy

Outlook

M&A in Europe is set to climb over the next 12 months. But dealmakers will have to be laser focused on sustainability and supply chains if they are to get the most out of their transactions.

Europe's M&A market is poised for growth, with most dealmakers planning to undertake between one and three transactions over the coming year. In June, the ECB made its first rate cut since 2019 and any further loosening will go a long way to making deals more viable, especially for debt-dependent financial sponsors. However, the ongoing conflict in Ukraine could dampen the attractiveness of the European market for some investors, who may look to other regions for growth acquisitions.

As the sustainability agenda takes centre stage, EU directives such as the CSDDD and CSRD are already impacting upon dealmaking approaches. Enhanced due diligence, more frequent inclusion of sustainability warranties and increased resources allocated to sustainability matters will become the norm. Compliance with these regulations and the attainment of B Corp certification are expected to make European companies more attractive targets.

Forward-thinking dealmakers are already preparing for this new era by focusing on supply chain sustainability. Comprehensive due diligence on target companies' global value chains, aided by AI tools and external specialists, will be crucial in identifying risks and ensuring alignment with company values. Despite the challenges posed by a lack of transparency and standardisation, maintaining sustainable supply chains can confer important competitive advantages.

As the European M&A market navigates these changes, companies that prioritise sustainability throughout their operations and supply chains will emerge as the most sought-after targets in this new era of responsible dealmaking.

About RSM Italy

The Forensic Investigations & Intelligence business line is part of RSM Italy Corporate Finance S.r.l., a member of the RSM International network. We provide unparalleled standards of work in corporate intelligence, investigations and forensic services. We operate globally, with a keen focus on Southern Europe and the DACH region. Our methodology disrupts the currently prevailing intelligence model by integrating traditional investigative strategies and human intelligence with cutting-edge technology. We produce client-centric reports which tell the story. Our tech factor is key to our effectiveness and efficiency while our highly qualified personnel interpret the digital and human swarm of information. We think things through.

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