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# The Impact of ESG on IPO Valuations



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Environmental, Social, and Governance (ESG) factors have been key components of business strategies over the past decade. Once a corporate buzzword, ESG influences investor perceptions, market valuations, and regulatory frameworks. ESG can drive market success for companies preparing for an Initial Public Offering (IPO).





A [McKinsey](#) survey shows that 57% of investment professionals believe ESG programs create shareholder value. As sustainable practices increasingly influence global investments, companies with strong ESG credentials attract capital and achieve higher returns.

This white paper explores the impact of ESG on IPO valuations and why companies should consider incorporating ESG principles into their business models from an early stage.



## Importance of IPOs for Businesses

An IPO allows businesses to raise capital and allows investors to own a stake in the company. It has manifold advantages for the business such as:

-  **Access to Capital**  
Companies raise funds to expand operations, invest in research, or pay off debt.
-  **Increased Visibility and Credibility**  
Boosts a company's profile, attracting investors, customers, and partners, leading to better business opportunities.
-  **Liquidity for Shareholders**  
Shareholders, including founders and early investors, can sell their shares on the public market.
-  **Employee Benefits**  
Companies can offer stock options in employee compensation to attract and retain talent.

The number of IPOs in a market depends on its economic conditions. During strong economic growth, IPOs increase as investors feel optimistic. On the other hand, economic downturns, high inflation, or instability reduce investor confidence and IPO activity.

## What is ESG?

ESG measures the sustainability and societal impact of a company's operations based on the changes it brings about on the planet, society, and governance. The three factors are:



### Environmental factors

assess a company's commitment to sustainability, including its ability to cut carbon emissions, manage waste, conserve resources, and address risks.



### Social factors

include stakeholder engagement, employee treatment, diversity, inclusion, community involvement, and societal impact.

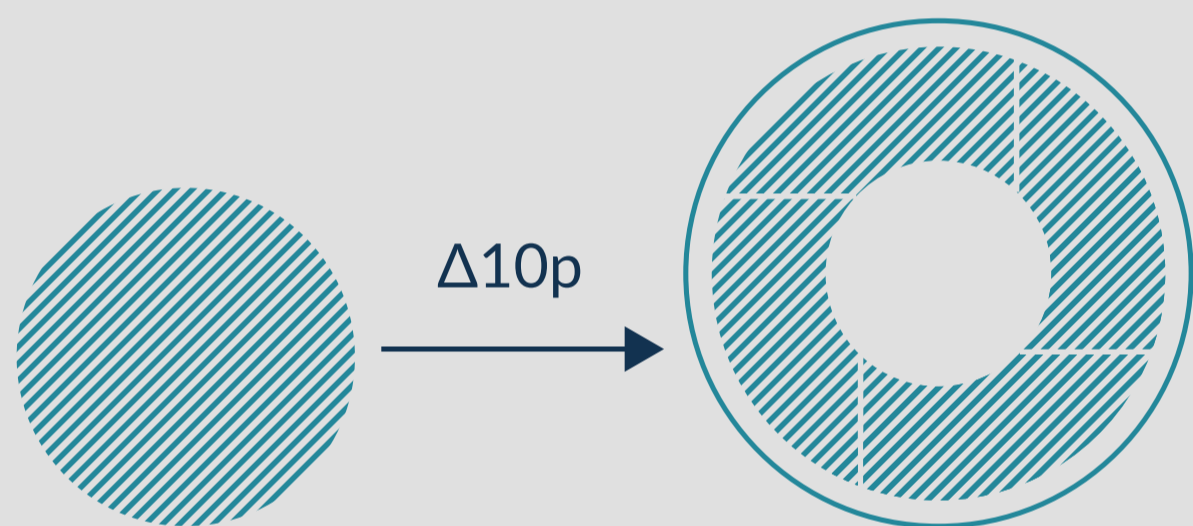


### Governance factors

focus on transparency, accountability, and ethical practices, including board structure, executive pay, and shareholder rights.

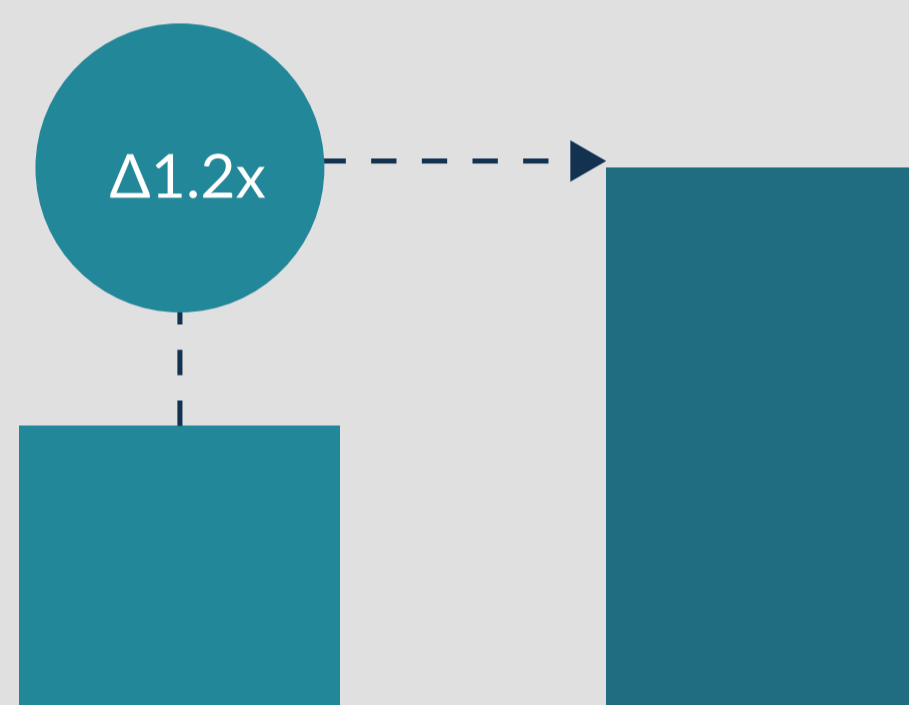
### Isolated effect of ESG score

The Higher the ESG score  
at a point in time...



[Source](#)

the higher is the EV/EBITDA



## The Growing Importance of ESG

The significance of ESG in business strategies and investment decisions has surged for several reasons.



### Better Performance

Integrating ESG improves risk management and protects against losses during instability. According to [McKinsey](#), companies with strong ESG commitments create more shareholder value while outperforming peers in growth and profitability.



### Enhanced Investor Confidence

Investors are drawn to companies with strong ESG credentials, linking them to lower risk and future-ready practices. These firms attract long-term capital and enjoy higher valuations.



### Regulatory Requirements

Governments worldwide are implementing policies that encourage businesses to adopt sustainable practices. Companies without proper ESG programs risk facing penalties or being excluded from certain markets.

## The Financial Case for ESG

Investments in ESG initiatives are often seen as a financial cost tied to risk management and compliance rather than a way to create value. However, [Deloitte](#) research shows that improved ESG performance has measurable financial benefits:

- A 10-point improvement in a company's ESG score correlates with a 1.2X higher EV/EBITDA multiple.
- Companies that improve their ESG score by 10 points while meeting stakeholder expectations see a 1.8X increase in their EV/EBITDA multiple.

The research outcomes strengthen the view that ESG is no longer merely an ethical checkbox. It is a driver of business value for companies considering an IPO.

## ESG's Role in Attracting Investors

[Bloomberg Intelligence](#) estimates global ESG assets to reach \$40 trillion by 2030. Regulators worldwide are increasingly focusing on ESG disclosures for IPOs. In Europe, new rules now require companies to outline sustainability risks and impacts in their prospectus. The trend is expected to continue as governments across the globe focus on addressing climate change and promoting sustainability. ESG compliance reduces risks and focuses on long-term value for investors in volatile markets.

[Morgan Stanley](#) reports that sustainable funds delivered median returns of 12.6%, significantly outperforming traditional funds (8.6%) in early 2023. The integration of ESG into the IPO process is driven by growing demand for socially responsible investing. Millennial investors prioritize environmental and social impact, so companies must commit to ESG principles to attract this market. They favor companies with strong records, and those falling short risk valuation drops or rejection by ESG-focused investors.



## Key ESG metrics that influence IPO valuations



### Environmental Factors

Investors are paying closer attention to companies' environmental commitments. Initiatives to reduce climate risk, achieve carbon goals, measures to prevent depletion of resources, and support for net zero by 2050 can greatly enhance a company's appeal during its IPO.



### Social Factors

Social metrics like diversity, equity, inclusion (DEI), ethical supply chains, and community engagement are becoming key drivers of valuation. Workplace policies on health and safety, employee engagement scores, and customer data protection measures show a company's ability to build positive, sustainable stakeholder relationships.



### Governance Factors

Strong corporate governance ensures transparency, ethical leadership, and reduced risks. Board diversity, performance-based executive pay, transparent bookkeeping practices, upholding shareholder rights, and strong governance frameworks are key to building investor trust.

## Incorporating ESG into IPO Planning

When preparing for an IPO, companies should adopt ESG principles to boost their market value.

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#### Align Business Strategy with ESG

Integrate ESG factors into business models and clearly communicate with investors through sustainability reports and disclosures.

#### Involve Stakeholders

Engage stakeholders early in IPO planning to align company values with shareholders and reduce future conflicts.

#### Assess Risks and Opportunities

A thorough ESG risk assessment identifies risks and opportunities, helping companies reduce negative impacts on valuations and highlight growth areas.

#### Consider Impact Investing

Attract socially responsible investors by highlighting how your products or services benefit society and the environment. It will boost your company's reputation too.

# Impact of ESG on Valuations

ESG clubs non-financial factors in a company's business model to impact its IPO valuations. A company with a high ESG score often sees an increase in valuation compared to its peers with weaker ESG scores.

ESG factors impact IPO valuations in the following ways:

## Higher Valuations

Companies that prioritize sustainability have better financial performance and higher market valuations. For example, [Rivian Automotive](#), a California-based electric vehicle (EV) maker, went public on November 10, 2021, with a sustainability-focused business model appealing to investors. It was the largest IPO of the year and one of the biggest in U.S. history. Shares were priced at \$78, giving Rivian an initial valuation of \$93 billion, which quickly rose above \$100 billion.

## Improved Investor Perception

Incorporating ESG principles helps companies attract investors focused on sustainability, boosting demand and IPO valuations. For example, [Instacart](#), a San Francisco-based grocery startup, went public on September 19, 2023, pricing shares at \$30 each to raise about \$660 million, reaching a market valuation of nearly \$10 billion. From optimizing delivery routes to workforce diversity and supporting local communities by providing essentials, Instacart highlighted its commitment to social responsibility and sustainability. These initiatives resonated with retail investors seeking a socially responsible tech business. The IPO saw strong demand and investor enthusiasm for Instacart's potential, with shares opening at \$42.

## Reduced Risk of Negative Publicity

Weak ESG practices impact the company's reputation among customers and investors during IPO valuations. Addressing ESG concerns early on helps maintain a positive public image. For example, WeWork's IPO in 2019 failed after serious governance issues were highlighted. It included CEO Adam Neumann's conflicts of interest, questionable financial disclosures, and lack of transparency. These problems, combined with no clear focus on sustainability or social responsibility, shook investor confidence. Initially seeking a \$47 billion valuation, [WeWork](#) faced scrutiny over its governance and business model, leading to a plummeting valuation and the withdrawal of its IPO.





## Implementing ESG at an Early Stage

A proactive approach helps integrate ESG into a company's operations and culture at an early stage, bringing significant benefits.



### Competitive Advantage

Adopting eco-friendly practices, utilizing sustainable materials, and committing to transparent governance helps companies stand out from competitors.

[BusinessDasher](#) states that 92% of consumers trust brands that are socially responsible or environmentally friendly.



### Better Risk Management

Early disclosure of environmental and social initiatives helps companies avoid losses and disruptions. [Taylor & Francis's](#) study shows companies with strong ESG frameworks are better equipped to handle disruptions and avoid losses.



### Positive Public Perception

As consumers become more eco-conscious, strong ESG credentials can help create the buzz to enhance brand image and drive sales. [McKinsey](#) reports that products with ESG claims saw 28% cumulative growth in five years, compared to 20% for those without.



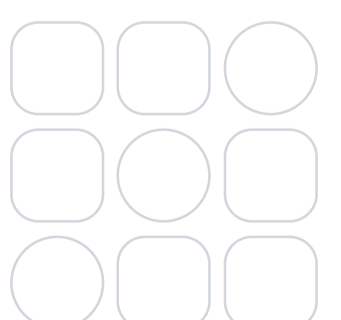
### Lower Capital Costs

Strong ESG commitments help companies attract capital at lower costs and diverse funding sources. [McKinsey](#) survey results reveal that 60% of consumers would pay more for sustainable product packaging.



### Customer Loyalty

Companies that prioritize ESG build stronger connections with customers, which drives repeat business. [McKinsey's](#) study of NielsenIQ's data shows brands making ESG claims for half of their products see 32 to 34% repeat rates.



# Success Story

## ESG-Led IPO Transformation for an Energy Company

### Overview & Challenge

A rapidly growing energy startup was preparing for its initial public offering (IPO). Despite strong financials, early feedback from potential investors indicated concerns about the company's long-term sustainability strategy. They had solid environmental initiatives but lacked a cohesive ESG framework that addressed social and governance factors—critical elements increasingly demanded by the market.

### The Practus Approach

A comprehensive ESG assessment was conducted, aligning organization's sustainability efforts with clear and measurable objectives. This involved:



#### ESG Roadmap & Strategy

We created an integrated ESG strategy that highlighted the company's carbon footprint reduction initiatives, employee engagement programs, and transparent governance practices.



#### Risk & Compliance Management

Leveraging our ESG risk assessment model, we helped the client identify and mitigate potential pitfalls in their supply chain and data protection processes.



#### Stakeholder Engagement

We facilitated sessions with investors, employees, and community leaders to clarify expectations and incorporate feedback into the company's long-term vision.



#### Narrative & Disclosure

We guided the client in crafting a compelling ESG story that showcased their environmental impact, social commitments (like DEI and fair labor practices), and strong board governance. Detailed ESG metrics and progress updates were featured prominently in their IPO prospectus.

### The Practus Impact



#### Higher Valuation Multiple

Post-implementation, the internal ESG score improved significantly, boosting investor confidence. Their pre-IPO valuation rose by nearly 25%, aligning with research showing strong ESG performance can command higher EV/EBITDA multiples.

#### Stronger Market Reputation

By proactively communicating their ESG commitments, the client differentiated itself from competitors. This led to favorable media coverage and a heightened brand image as a forward-thinking, responsible enterprise.





## Conclusion

Sustainability and ethics are now key for investors and companies prioritizing ESG initiatives, which appear more forward-thinking and responsible. A [Deloitte](#) survey shows nearly 75% of organizations say investors rate their ESG performance. Addressing ESG factors early, like reducing environmental impact, improving governance, and championing social responsibility, appeals to investors and stakeholders.

Incorporating ESG principles into IPO planning boosts valuations by building investor trust. It helps attract capital, reduce risk, and stand out from competitors. A strong ESG foundation supports long-term value, helping businesses manage operations, meet regulations, and stay resilient in a changing economy.

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## About the Author

Abhinav Kumar is a seasoned management consultant with over 12 years of experience leading large-scale transformation programs for global clients across the UK, North America, Europe, the Middle East, and APAC. Specializing in Strategy & Operations, he excels as a trusted advisor to C-suite executives, blending strategic insight with operational excellence.

