



## Grounding Your Investment Diligence: ESG in Agriculture

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### Key Takeaways

- ESG due diligence assists agricultural investors in developing value creation and risk mitigation strategies
- Climate change introduces new urgency for innovative products and services to support crop production
- Key agriculture industry ESG strategies include sustainability certificates, water reclamation projects, and regenerative agriculture production initiatives
- Malk advises both traditional and impact investors and their portfolio companies on ESG management in agriculture, helping maximize the value potential of agricultural investments and mitigate risks

### Background

As the agriculture industry faces an aging and shrinking farming population, supply chains struggle amid labor shortages, and climate change impacts food production by region and crop, the industry finds itself immensely strained to support the livelihoods of small- and mid- sized farmers and adopt agriculture practices that will adapt to climate change while also mitigating its own impact. In 2022, [1.3 billion people](#), a 10% increase from 2021, were defined as food insecure, placing additional demands on farmers to produce nutritious and affordable food even in the face of global geopolitical instability and rising inflation rates.

The agriculture industry must also adhere to evolving regulations and shifting production requirements. Notably, the [Farm to Fork Strategy](#) introduced by the European Green Deal will require farmers (those operating in the EU and exporting goods to the EU) to abide by sustainability guidelines, and in Japan, the [Green Food System Strategy](#) has set targets to reduce chemical pesticides and fertilizers by 2030. Meanwhile, in the US, the [Inflation Reduction Act](#) provides new funding for the United States Department of Agriculture to support climate-smart farming advancements.

Additionally, advocacy groups are already lobbying for sustainability provisions in the 2023 US Farm Bill; it is anticipated there will be more groups urging for the adoption of sustainable agriculture provisions than in previous farm bills, a trend partially driven by farmers' crops experiencing greater climate resiliency due to regenerative agricultural techniques. New regulatory requirements intensify the demand for novel services that will assist agriculturists with the transition to adopt sustainable practices in alignment with regulatory compliance and to capitalize on new government incentives.

A majority of the agriculture industry's current products and services are largely controlled by a select group of players. Bayer, BASF, Corteva, and Chem-China, typically referred to as "The Big Four," control [67% of seed sales](#); three of which also comprise of 70% of the agrochemical industry. These companies have been subject to significant public scrutiny around a range of social and environmental issues, from pollution of waterways and loss of topsoil from fertilizers and monocultures to farmworkers' [diagnoses of cancer due to pesticide exposure](#). Many of these environmental and social consequences can be linked to the inherent conflict of interest of these

large agri-businesses, in which a customer may buy seeds from one business only to realize the crop will only be successful with the application of fertilizer produced by the same company.

Given the critical role of the agriculture industry in global food production, there is a need for both continuous scaling and sustainable innovation in the sector—something private equity investors are well positioned to provide via sustainable investing strategies and sound ESG management. New products and services, developed responsibly with ESG risk controls in-place, can support the agricultural sector as it scales food production amid challenges related to climate change, resource depletion, and access to labor.

### **Environmental, Social, and Governance (ESG) in the Agriculture Industry**

The multi-faceted nature of the agriculture industry does not allow for a one-size-fits-all approach to ESG. Rather, business models dictate ESG materiality. For example, climate change will be of utmost importance to farmers trying to manage the effects of extreme weather events while producing high crop yields. Whereas topics related to sustainable branding and environmental management will take priority for a co-packaging company interested in exploring more environmentally friendly packaging options. By staying abreast of trends and regulatory sentiment and implementing ESG best practices, investors can mitigate risks and increase the value of their agricultural assets. Both impact and traditional investors in the agriculture industry are increasingly considering ESG as a critical risk mitigation and value creation lever. Malk collaborates with our clients to incorporate ESG at all stages of the investment lifecycle, from the investment thesis to diligence to ongoing portfolio stewardship.

#### *Environmental*

The agriculture sector must withstand extreme weather events associated with climate change to continue producing high crop yields. Climate scenario analyses help agriculture investors identify exposure to climate risks in their portfolio (e.g., sea level rise, hurricanes, temperature rise) and appropriate mitigation strategies. Furthermore, as the global agriculture industry contributes to [18% of greenhouse gas \(GHG\) emissions](#), it is becoming increasingly expected for businesses to track Scope 1, 2, and 3 emissions and set GHG emission reduction goals. To meet reduction goals, investors are deploying crop rotation strategies, grazing management systems, and delivery route optimization. From an environmental management perspective, companies often have the opportunity to improve resource efficiency, including implementing effective food waste diversion strategies, exploring water reclamation opportunities, and introducing sustainable packaging alternatives. Depending on where they sit in the production value chain, companies can also engage with their suppliers to address these topics. This can manifest in developing a Supplier Code of Conduct and standardizing an approach to reviewing vendors of certain agricultural inputs (e.g., fertilizer, pesticide, equipment) for environmental and social practices.

#### *Social*

To drive value within the employee workforce and decrease costs associated with turnover, agricultural businesses should consider topics related to social labor conditions, worker health and safety, and diversity, equity, and inclusion throughout the supply chain and internally. Employees in the agriculture industry operate under physically taxing conditions to provide the greater population with the products necessary to sustain everyday life, yet this workforce remains greatly underappreciated and underpaid. Responsible investors can shift the paradigm towards creating more ethical labor standards and instituting fair wages. While not always a straightforward task, investing in labor and ethical working conditions can attract talent in a competitive labor market, reduce costs associated with training new talent, and improve overall efficiency of the workforce.

#### *Governance*

Sound governance in the agriculture sector is critical in addressing business ethics, product stewardship, data privacy and security, food safety, and sustainable branding. In 2022, [the global sustainable labels market was](#)

[valued at \\$15.6 billion](#) with strong projected growth through the next decade. With hundreds of certification options (e.g., GLOBAL Good Agricultural Practices, Fair Trade), it is important for investors to consider reputational value, stringency of audit standards, and product/service fit associated with each option for their portfolio companies. While a sustainability certification can help heighten brand awareness and appeal to consumers, failing to meet associated requirements or selecting a certification that is too general for a given product, can drive reputational scrutiny and consumer backlash. In building governance mechanisms, it is also important for companies to consider any communities impacted by their operations. Companies can foster relationships with neighboring communities through community liaisons, town halls, grievance hotlines, periodic community newsletters, and event sponsorships. Those involved directly in crop production have a particularly unique opportunity to drive community engagement by addressing local food insecurity challenges (e.g., through partnerships with food pantries).

Data governance and ethical AI are becoming increasingly relevant topics for the agriculture industry. Precision agricultural technology now frequently uses AI to provide resource allocation (e.g., fertilizer, pesticide) guidance for crop production. For companies producing or using this technology, it is imperative to maintain strong ethical review and data audit controls. Such controls help ensure AI-enabled recommendations are accurate and manage any potential conflicts of interest, such as those inherent in a fertilizer manufacturer also providing technology that estimates ideal fertilizer application for a given crop.

### **Opportunity in the Agriculture Industry**

The agriculture industry presents an opportunity for private equity investors to diversify portfolios and generate returns while investing in products and services designed to help farmers withstand climate change-driven resource constraints and other emerging challenges. Private equity firms investing in the agriculture industry have historically allocated capital to food production inputs, infrastructure to support agriculture in emerging markets, clean energy, and AgTech. The market is now moving toward more tech-enabled product and services. In 2021, [\\$5 billion was invested in VC agricultural technologies](#), a 50% increase from the year before. Capital supported a range of climate-smart agricultural pursuits, including regenerative agriculture, vertical farming, and agricultural robotic applications. This presents a unique opportunity for impact investors in particular, as they look to drive environmental and social outcomes commensurate with financial returns. In overcoming challenges imposed by climate change and resource depletion, companies are developing innovative solutions to help farmers meet food demands while also building responsible and regenerative agricultural systems.

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### **About Malk Partners**

Malk Partners is the preeminent advisor to private market investors for creating and protecting value through environmental, social, and governance (“ESG”) management and impact investing. Founded in 2009, Malk Partners advises many of the world’s leading alternatives managers investing across private equity, growth equity, venture capital, and private credit by helping them define ESG goals, achieve ESG results, and guide their portfolio companies in driving value creation and mitigating risks. The firm is headquartered in La Jolla,

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