



# Venture Capital for Sustainability | 2007



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# VENTURE CAPITAL FOR SUSTAINABILITY

2007

## FOREWORD

Over the past five years, Eurosif, in its mission to **Address Sustainability through Financial Markets**, has focused primarily on the public financial markets. Yet in the same period of time, we have been witness to a phenomenal growth curve of Private Equity/Venture Capital, which in 2006 hit record levels of financing in both Europe and the U.S. In fact, last year, one third of the value of all acquisitions in the U.S. involved private equity firms, up from 5% just five years ago.<sup>1</sup>

This is not to say that private equity will replace public markets – far from it. Nevertheless, private equity's ability to shape them is growing. So what does all this have to do with Sustainability? A lot. If private equity is increasingly playing a role in the development and practices of companies, there is a growing role for sustainability factors to play an important part in the criteria of these investors.

Five years ago, a European study in this area was not really possible – there were not enough players in Europe that had Venture Capital funds linked to Sustainability issues. Today, that is no longer the case. This burgeoning sector encompasses funds specialised in renewable energy but also includes funds that are focused on the bridging of economic divides. Eurosif calls this emerging space Venture Capital for Sustainability (VC4S).

What you will find in this initial study on the VC4S market are the early results from a fast-growing, new segment within the much larger private equity sector. You will learn about success stories as well as the obstacles being faced by these pioneers. We have included case studies and examples of companies that have received investment from VC4S funds. Whether you are an investor, asset manager, policy maker, or entrepreneur, this study should leave you excited about the future. VC4S is yielding some of the most interesting opportunities at the present time to make profits and positively contribute to sustainability issues.

Eurosif would not have been able to lead this work without the help of many people. Our Advisory Board was instrumental in helping us to learn about the space, reach out to other players in this area, and gather useful data. We would also like to thank the Member Affiliates and the European Commission for the continued support of Eurosif's mission in Addressing Sustainability through Financial Markets. Finally, please accept our thanks to the individuals who responded to our questionnaire without whom this study would not have been possible.

Happy reading and sustainable investing,



**Robin Edme**  
*President*  
Eurosif



**Matt Christensen**  
*Executive Director*  
Eurosif

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## EXECUTIVE SUMMARY

Venture Capital and Sustainability are increasingly being linked together as investors see that financial returns can also coincide with societal benefits. Eurosif defines this growing sector as **Venture Capital for Sustainability (VC4S)**, a specific area within Venture Capital where profit objectives are supplemented by a mission which has direct impacts on sustainability.

A venture capital fund's "mission" can be categorised by the following three areas:

- **Products** that the portfolio company offers which may change the nature of the industry by increasing its sustainability.
- **Targeted Economic Impact** of the portfolio company (when it is located in depressed areas for instance).
- **Processes/Internal Operations** utilised by the company with regards to sustainable management.

According to our study, **€1.25 billion** of committed capital has been raised by European VC4S as of 2006. The size of VC4S investments tends to be in the **€1 to €5 million** range, and their focus is on the earlier phase of company development, which distinguishes them from mainstream VC. At the same time, a majority of the surveyed VC4S investors still look towards traditional VC returns (20-25%) in their sustainable investments.

The greatest obstacle the sector currently faces is the under funding of the VC4S funds themselves. As a result, the portfolio companies operating in the sustainable space could be under funded as well. In fact, one of the key factors restraining growth of the sector is the lack of capital being allocated to VC4S from institutional investors. Presently, VC4S is often led by smaller investors, in the form of family offices and/or High Net Worth Individuals (HNWI).

Thus, to develop this exciting but still fragile VC4S market at a European level, Eurosif suggests two courses of action: First, pension funds and foundations should direct more of their portfolio allocations to Venture Capital funds that have sustainability as a part of their missions. This approach would be consistent with the long term orientation of pension funds and foundations. Second, EU policy makers should review how EU-wide incentives can better foster a healthy European private equity market, and VC4S specifically. Studies increasingly show that private equity can be a powerful means to unlock job growth. VC4S, with its focus on sustainability issues and company creation, could greatly help the EU meet its Lisbon Agenda goals.

There is no doubt that the VC4S segment is growing. The issues being covered in this sector are attracting more attention over time, ranging from climate change to economic divides. Eurosif hopes this study is a first step towards better understanding and growing the European VC4S market.





# 1. CONTEXT

## WHY RESEARCH VENTURE CAPITAL?

'Sustainability' is a notion that has been growing steadily in the financial services sector for the past twenty years. It has most often been associated with either asset management (large-cap equity investing) or government lending (project or micro-finance). Nevertheless, the increasing role of public and private sources of capital in Europe as a tool for economic growth, innovation and job creation, means that all parts of the financial system warrant further reflection around sustainability issues.

Up to now, Eurosif's research focus has been centred on the linkage between sustainability issues and listed stock markets. However, most companies do not list their stock in public markets. **Companies are indeed created, owned, and traded, privately and increasingly so.** Because of the private sector's important role in the economy, it is relevant to investigate the private equity, or non-listed stock, side of the market.

Moreover, in many ways, Venture Capital helps answer some of the issues faced by the SRI (Socially Responsible Investment) community when investing in listed stock markets. Venture Capitalists' stake in the companies where they invest is significant and visible, making it much easier to engage with the management of the company and deal with governance issues (they usually sit on the Board of Directors). Additionally, their personal involvement is also high, due to their own financial stakes in the companies in which they invest.<sup>2</sup>

This idea is made more relevant by the fact that **sustainability is often the fruit of innovation, both in technological terms and in social terms, and innovation is often driven by the creativity and energy of young entrepreneurs and companies.** In our modern economy, Venture Capital can play a crucial role in helping these innovative companies come to life, become profitable and reach

"market" size. There are a number of different models of sustainable Venture Capital developing across Europe and it seems likely that this trend is going to grow.

Venture Capital (VC) can therefore be an important lever for the development of sustainable technologies and practices in the economy.

## THE GOALS OF THIS STUDY

The aim of this study is to shed light on the advancing field of Venture Capital which contributes to Sustainability. This is an emerging area and at the present time, there is no commonly accepted name for this sector. In fact, one of Eurosif's goals with this study is to create more clarity around Venture Capital for Sustainability (VC4S).<sup>3</sup> Thus, this study should be read as a working document that synthesises some of the developments in VC4S as of today and suggests some future steps that may enable it to grow in the future.

The research includes quantitative analysis, profiles of the types of activities being undertaken, and case study examples. Some of our ultimate goals are that:

- The research will encourage asset owners to consider investing in this area in the context of their fiduciary duties,
- It will encourage authorities and regulators to develop incentives for this sector,
- It will encourage other Venture Capitalists to look at approaches to sustainability.

Finally, where appropriate, we have drawn comparisons of VC4S to mainstream European VC within the document.

<sup>2</sup> AGF Private Equity Study, October, 2004.

<sup>3</sup> After having consulted with many practitioners, this is the term that Eurosif will use to define this space.

## 2. METHODOLOGY AND SCOPE OF RESEARCH



### SCOPE OF RESEARCH

There are many activities related to VC4S which pursue sustainability goals or indirectly contribute to it. In this first attempt at examining the market, it is therefore important to limit the scope of our study. To this effect, we have chosen to focus on:

1. Finance in the form of equity investments (as opposed to, for example, existing debt instruments),
2. Investments that are clearly profitability-oriented,
3. Investments by funds/partnerships, rather than by individuals such as business angels,
4. European based Venture Capitalists (since Venture Capital is largely proximity-based).

### THE STUDY DOES NOT INCLUDE

**"Corporate" Venture Capitalists:** frequently, innovative ventures are supported by corporations that provide capital and some resources. This configuration occurs for example when large corporations want to support the development of ideas or technologies in a context that provides more entrepreneurial freedom than typically found within their own walls. Corporate Venture Capital plays an important role in sustainability, particularly with regards to Clean technologies. However, because their access to capital is different from that of traditional Venture Capital, they have been left out of our scope.

**Social ventures or venture philanthropy:** an increasing number of non-profit charities, philanthropic entities or 'social businesses' use the techniques of Venture Capitalists (i.e. providing capital, closely accompanying the development of the business model, providing various types of support, setting reporting requirements) in order to optimise management and use of resources by their ventures. However rich and interesting, we are leaving this area out because it is not profit oriented.

For a cutting-edge example of what is happening in this field, see the Community Action Network (CAN) at [www.can-online.org.uk](http://www.can-online.org.uk) or visit the European Venture Philanthropy Association ([www.evpa.eu.com](http://www.evpa.eu.com)).

**Micro-equity or Micro-credit:** Micro-credit is an essential part of modern economic development, providing capital through financial tools to the neediest populations on earth. Micro-equity, its lesser-known cousin, is often used as a tool for local development. Both micro-credit and micro-equity are technically investments directed towards non-listed companies or individuals. However, they are not practiced by Venture Capital investors and are really a specialty of their own. We have therefore chosen to leave them out of our current scope.

### METHODOLOGY

The project was structured with the help of an expert Advisory Group, which met in May 2006 in order to outline the direction of the project. The Advisory Group was composed of people known for their expertise in Venture Capital and sustainability and included mostly Venture Capital practitioners.

A research questionnaire was then created and distributed online to the target population of European-based VC funds. The database of contacts was populated through assistance from the Advisory Group as well as through Eurosif's network.<sup>4</sup>

The questionnaire was sent to 46 target institutions and we received 23 responses (50%). A few follow up meetings or phone interviews were set up for clarifications and research for case studies. The results of the research are presented here.

<sup>4</sup> This approach, while not allowing for a reach of the entire European VC community, was deemed more time and cost effective and believed to cover 80% of the existing European VC4S market.



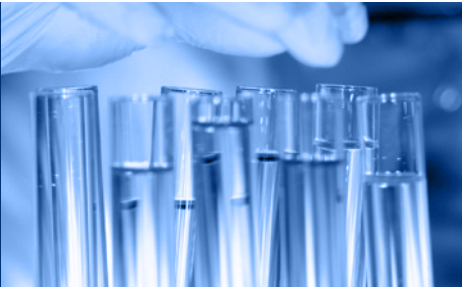
## DEFINITION OF VENTURE CAPITAL FOR SUSTAINABILITY (VC4S)

We define Venture Capital for Sustainability (VC4S) as a specific area within Venture Capital where profit objectives are supplemented by a mission which has direct impacts on sustainability.

VC4S is not synonymous with 'Clean tech' investing. Although many of the survey respondents are involved with the growing clean or green tech movement, VC4S is understood to encompass a wider remit which is explained through the different categories in section 4 of this study.

In general, Venture Capital is, strictly speaking, a subset of private equity and refers to equity investments made for the launch, early development, or expansion of a business.<sup>5</sup> VC4S, as discussed in this report, falls primarily within this subset of private equity.

5 The other subset of private equity is 'Buyout', a transaction in which a business or company is acquired from the current shareholders.



### 3. MARKET SIZE AND GROWTH

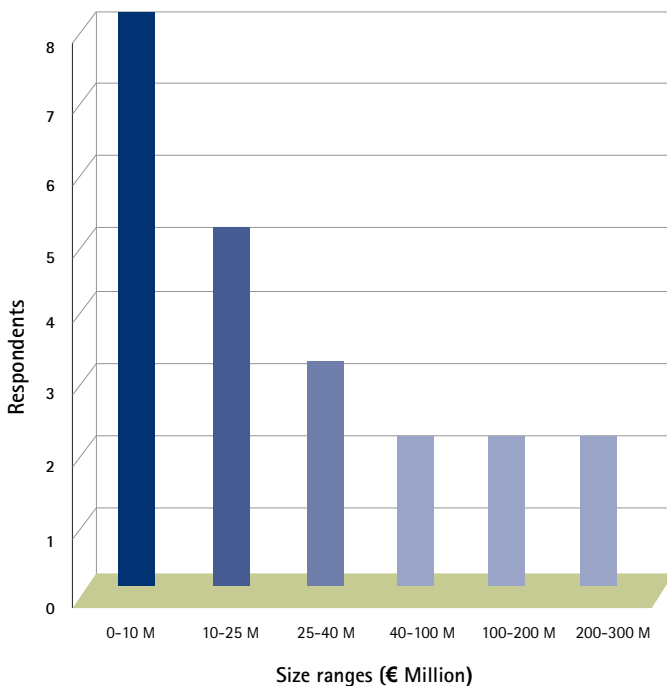
#### MARKET SIZE

Our research suggests that **€1.25 billion of committed capital has been raised by European VC4S, as of 2006.** By way of comparison, €72 billion was raised by mainstream VC and Buyout management companies located in Europe in 2005, of which about 30% (or €20 billion) was dedicated solely to VC.<sup>6</sup> Roughly, that means that VC4S could represent about 2% of the total European Private Equity market or 6% of the Venture Capital-only market. While these figures are modest, what is notable is that five years ago, the VC4S market was almost non-existent, so the upward growth curve has been fairly steep.

Out of our 23 respondents, we find a great variety in terms of amounts of committed capital under management for VC4S. They range from €0 to €250 million as illustrated in Figure 1. Keeping in mind that 'respondent' is synonymous with VC funds, 57% of the respondents have between €0 to €25 million in their funds as committed capital.<sup>7</sup> Nevertheless, Figure 1 also points out that the majority of the funds are on the smaller side; this fact has implications that will become clear through the supplementary findings in this report.

Related to the recent growth of the committed capital, one of the areas Eurosif has tried to understand are the 'draw down' levels of the funds. While we were not successful in collecting a meaningful amount of data to measure the progression of fund allocations, the surveyed VC4S investors said that they had largely found adequate deal opportunities where to place their capital. This is an area that Eurosif would like to revisit in the years to come to gauge whether the growth of available capital has resulted in too few deals where to place it.

**FIGURE 1**  
VC4S committed capital under management per respondent



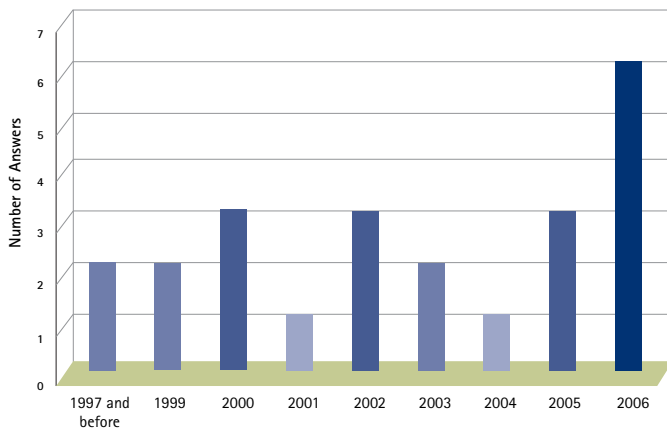
Source: Eurosif

6 Although the 'Buyout' phase represents the majority of the funds raised for Private Equity, the VC phase accounts for the majority in terms of numbers of investments. Source : Estimated from figures in EVCA's 'Employment contribution of Private Equity and Venture Capital in Europe Research Paper', November 2005.  
 7 Respondents could manage more than one fund so the actual committed capital per fund could be smaller.

## EVOLUTION AND GROWTH

As illustrated by Figure 2, our research suggests that **VC4S is a recent phenomenon**, as only two funds began their activity pre-1997. There has been a steady stream of fund launches since, with a boom happening in 2006. This space is continuing to grow with new entrants, and this trend should continue.

**FIGURE 2**  
What year did your company begin investing in VC4S?



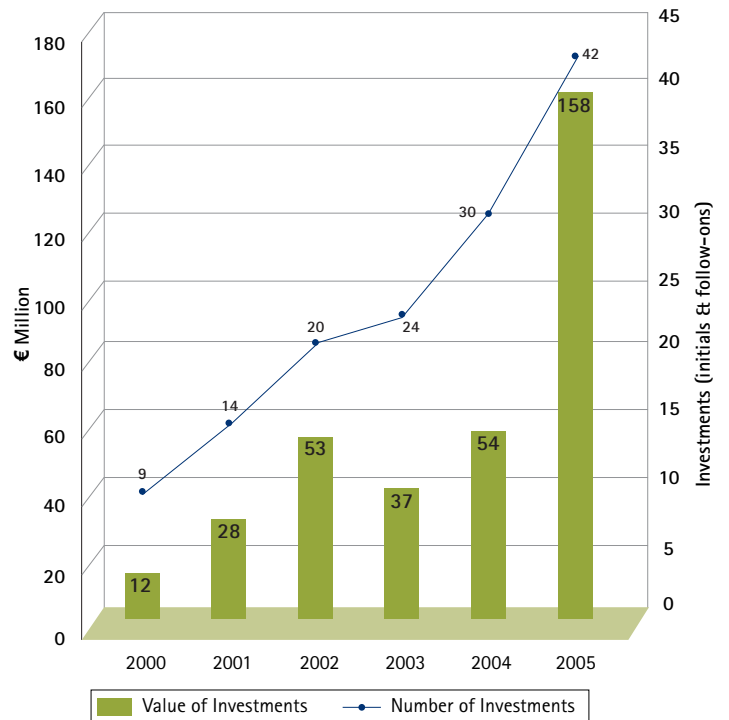
Source: Eurosif

The recent growth of this market also explains why VC4S represents only 7% of the total capital that is managed by our surveyed population. This also suggests that VC4S 'pure plays' are usually of relatively smaller size than traditional VC players.

When looking at deal flow (Figure 3), our research shows that the value of VC4S investments has been fluctuating since 2000. Nevertheless, **the number of investments (initial and follow-on) has grown steadily**, and the average amount per investment is also increasing over time.

All the same, if we look at 2005 numbers, we derive an average investment size of €3.8 million per investment for VC4S. This is a smaller amount than in mainstream European VC, suggesting that VC4S may be under funded.<sup>8</sup>

**FIGURE 3**  
Growth of yearly VC4S investments 2000 - 2005



Source: Eurosif

8 As a comparison, in 2005, there were 10,915 Private Equity investments made in Europe for a total of €47 billion. Source: EVCA.

## 4. SUSTAINABLE APPROACHES OF THE FUNDS



As mentioned earlier in our definition of VC4S, our research looked closely at how the mission of fund has direct impacts on sustainability. This mission is reflected in the activity of the companies the VC4S invests in, and perhaps also in the relationship between VC4S and the company (such as for reporting). The mission may be economic, social or environmental.

**We have defined three categories that the fund's mission may be linked to:**

### Products

A VC4S mission can focus on an industry, where the products the start-up company offers (such as Clean technologies) may change the nature of the industry by increasing its sustainability.

For some VC funds, the current boom for sustainable technologies, such as renewable energies, represents a compelling opportunity for returns on investment. In this case, their interest in sustainability per se may be indirect. These funds may be viewed as a significant subset of VC4S.

New Energy Finance advocates this field and produces helpful research (see [www.nef.org](http://www.nef.org)).

➡ *See the case study on SAM Private Equity (p17).*

### Targeted economic impact

The mission of the fund could also be linked to the targeted economic impact of the company, such as when it is located in depressed areas or when it grants access to certain products to heretofore deprived categories of the population (medicine in the developing world). Some VC4S funds consider that they can play a significant role as drivers

of economic development in underprivileged communities, which, while not being bereft of entrepreneurial talent, are excluded from more traditional financial channels.

➡ *See the case study on Bridges Community Ventures (p18).*

### Processes / Internal Operations

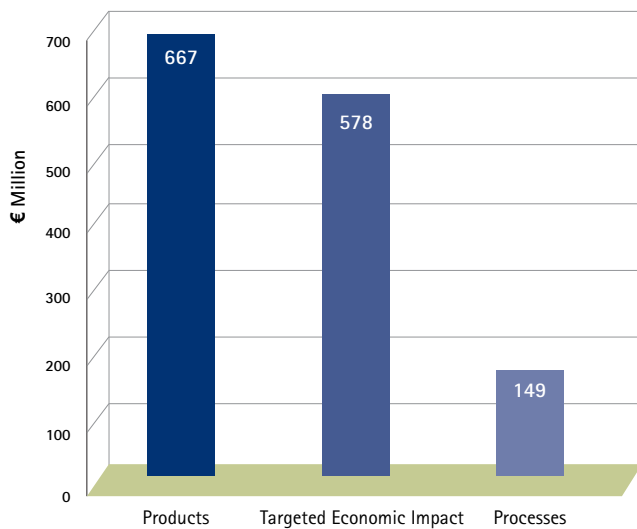
The mission of the VC4S fund could be linked to the internal operations and processes which the company employs with regards to sustainable management, and/or to the personal ethics of the entrepreneur, who may have strong beliefs relative to sustainable management.

For some, the notion of incorporating sustainability criteria is inherent to the long-term success of business. As such, implementing sustainable business practices early on, such as good HR, clear governance standards, or good environmental resource management, are important profitability and success factors.

➡ *See the case study on BonVenture (p19).*

Among our respondents, products (54%) and targeted economic impact (42%) were the most popular approaches of VC4S investors. The weight of these can also be broken down into the amount of capital that is available to put into VC4S projects, as illustrated in Figure 4. Available capital again reflects the dominance of "Products" and "Targeted Economic Impacts" as fields of activity. (Capital may have been counted twice if Venture Capitalists were active in more than one category as multiple answers were possible).

**FIGURE 4**  
Managed VC4S capital available for (€ Million, 2005)

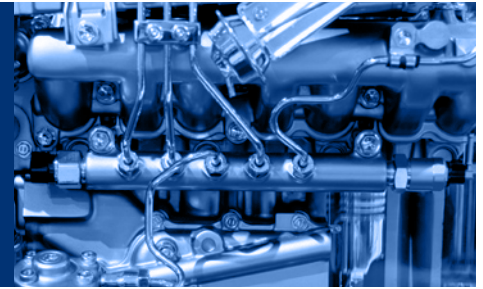


Source: Eurosif

## MISSIONS OF THE FUNDS

Some examples of the stated mission of the funds surveyed are:

- High return in Clean technologies.
- The financing of innovation and technology which has a positive environmental impact.
- The harnessing of the entrepreneurial spirit in under-invested communities to stimulate economic growth and create jobs, wealth and role models of business success.
- Investing in high-potential, established UK and European social enterprises to help them address financial and management challenges, and scale up their impact.
- Expansion of the financial sector in the Balkans to better serve the micro, small and medium sized enterprises (MSME and SME) that drive economic development.
- Focus on businesses which provide resource efficiency offerings to their customers.

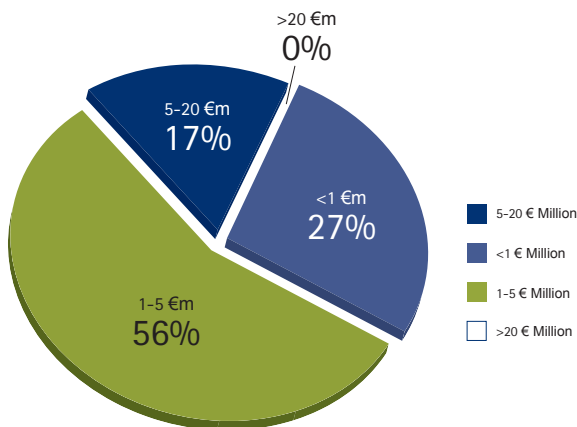


## 5. CHARACTERISTICS OF VC4S INVESTMENTS

### SIZE OF INVESTMENTS

As illustrated below, the size of VC4S investments being placed in companies tends to range from €1 to €5 million. As a comparison, the mainstream European VC average financing per company was €6.5 million in 2005.<sup>9</sup> This suggests that the companies operating in the sustainable space may be under funded. As touched upon earlier, one of the main reasons for this could be that the VC4S funds are too small.

FIGURE 5  
Breakdown of investments by size



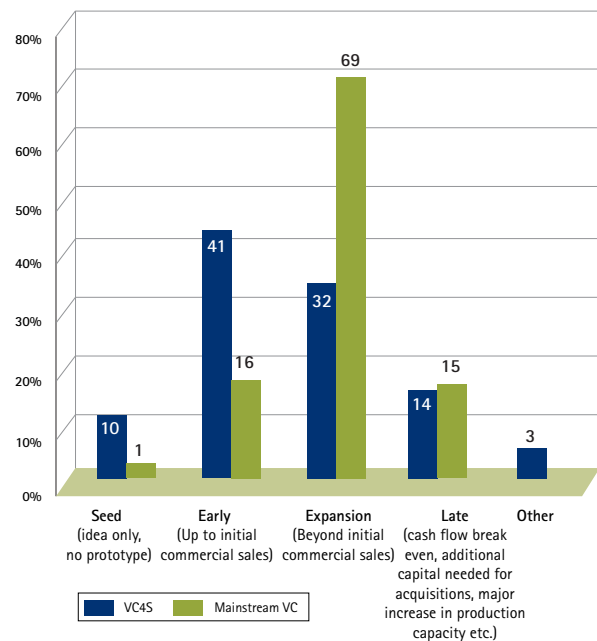
Source: Eurosif

### INVESTMENT STAGES

We can also glean from the numbers in Figure 6 that the focus of VC4S is on the earlier phase of company development. In fact, a notable difference between VC4S and mainstream VC is seen in the early and expansion stages. 41% of VC4S funding takes place in the early phase of a company's life cycle compared to only 16% in mainstream VC. This is quite a contrast to the expansion stage where mainstream VC represents more than double the amount of fund placement than VC4S.<sup>10</sup>

This tendency for the VC4S investor to fund early growth businesses is interesting and open to interpretation. For example, it could be that the VC4S investors do not have enough money to keep funding the companies through expansion; thus their relative exposure to the early stage investment rounds is higher. On the other hand, the data could mean that VC4S investors lean more towards the earlier stages of company development because they have a greater interest in the sustainable aspect of the investments and not only in the standard financial parameters. Eurosif suggests that both reasons may be at play.

FIGURE 6  
Percentage of amount invested by stages



Sources: Eurosif and EVCA

9 Source: EVCA

10 Source: EVCA, excluding the Buyout numbers (part of PE but not VC)

Institutional investors willing to make sustainable investments should consider that bypassing VC4S to invest only in traditional VC may result in neglecting sustainability entrepreneurship. On this point, one survey respondent said, *"If institutional investors think that by making investments in traditional VC, they also make investments in sustainability, they will still find that the VC4S sector is limping along in the early stages in the years to come."*

### INDUSTRY SECTORS

VC4S invests in various industry sectors, but remains mostly linked to environmental issues (particularly energy/Clean technologies with nine mentions, water, waste management and agriculture). The social enterprise/services sector was mentioned twice.

In mainstream VC, the top three industry sectors receiving investments are consumer related (28%), communications (15%) and industrial products and services (9%). The energy sector represented only 2% of the mainstream VC investments in 2005.<sup>11</sup> This shows that VC4S has its own specificity in terms of industry sectors receiving investments.

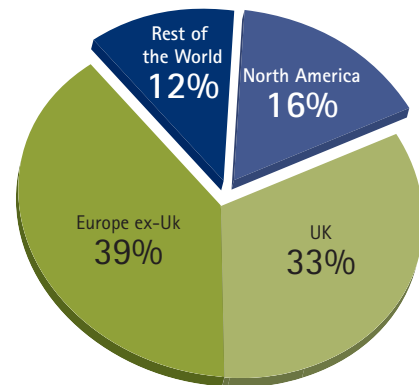
### GEOGRAPHIC FOCUS OF INVESTMENTS

The destination of investments is broad, as it includes non-European and non-American regions, such as the CIS (Former Soviet Union), Africa and Australia. This is an important facet of VC4S, in that investors in this space specifically search for opportunities in developing economies that may be overlooked by more mainstream players.

For the European countries, and in line with the national origins of the investors, the UK appears to be the bigger market for VC4S investments. This is not surprising as the greater portion of VC4S investments in the UK reflects the longer tradition of mainstream VC investing in the UK over

that of Continental Europe. As stated earlier, VC investing favours companies based within close proximity to funders. Thus, the more developed VC market in the UK results in more investments occurring there. In fact, even now, cross-border VC investments within Europe still only account for 10% of total investments.<sup>12</sup>

FIGURE 7  
Destination of investments (aggregated)

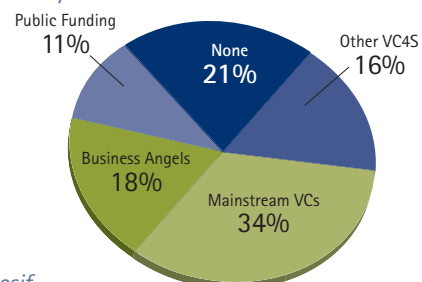


Source: Eurosif

### THE CO-INVESTORS

In general, co-investing plays a significant role in the VC sector. VC4S is no exception as illustrated by Figure 8, where our surveyed venture capitalists are most likely to co-invest with mainstream VC, followed by business angels or other VC4S players.<sup>13</sup>

FIGURE 8  
With whom do you co-invest?



Source: Eurosif

11 Source: EVCA

12 Source: EVCA

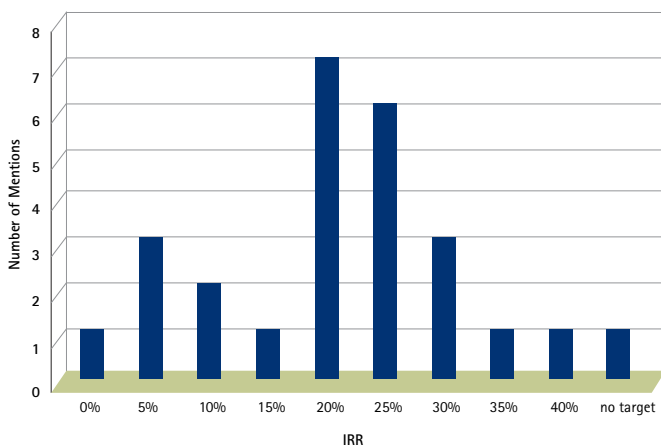
13 It is also possible that co-investment is a means to secure funding for later rounds.

The fact that only roughly 20% of the VC4S investments is done without some sort of co-investor (be it public or private) reveals the importance in sharing the risks (including financial risks) with other investors. Further, VC4S has a greater portion of co-investors stemming from public funding and business angels than found in mainstream VC, reflecting the earlier stage of investing taking place.

### THE FINANCIAL EXPECTATIONS

Here, the population is quite diverse. **Many of our surveyed Venture Capitalists look for traditional VC returns in their sustainable investments** as the majority were targeting gross IRR's (internal rate of return) of 20%-30%. Some, however, accept to discount their returns or trade a bit of profit for a bit of sustainability. Perhaps, this would account for some of the players in the VC4S sector placing more stringent sustainable requirements at an earlier stage than others. Some of the non-financial goals that could help explain this are described in chapter 7.

**FIGURE 9**  
Target gross IRR



Source: Eurosif

### EXITS

The preferred exit from an investment varied, with equal preference for trade sale (38%) or IPO (Initial Public Offering) (37%). The preferred time frame for exits ranged from 1 to 8 years, with a majority in the 3 to 5 year range (about 60%).

The actual exits are still scarce given the young age of most of the VC4S investments, so limited hard data exists to reflect actual experiences in the VC4S space.

However, there is data from a subset of the Clean tech space which may serve us as a proxy in our study. In 2006, the European Clean Energy Venture Returns Analysis (ECEVRA) looked at a sample of 19 investors who had invested in 57 companies in the energy technology sector since 1999 and drew some of the following conclusions:<sup>14</sup>

Overall, the portfolio companies showed an average annualised return of 86.7% per annum.

- Of the 57 portfolio companies sampled, five had completed an IPO and three had been sold to a trade buyer. This group of companies had produced an average annualised return of 476% for their investors.<sup>15</sup>
- A further 9 had undergone a second or subsequent venture investment round at a higher valuation, yielding an average annual return (on paper) of 14.9%.
- Six companies had been liquidated, with the majority of the money invested being lost.
- The remaining 34 portfolios companies had not undergone any subsequent investment round, and so were valued for the purpose of the study at the same value as the time of the initial investment.

One of the findings of the study is critical for consideration in the context of VC4S. Namely, that it is at the larger fund sizes that the IRR of the fund really showed marked success. Funds that had attracted more than €100 million of capital earned IRRs more than ten times those of funds that were under €100 million.

Again, if we use the ECEVRA research as a proxy for the VC4S sector, it becomes increasingly clear that **high IRR is determined by larger fund sizes. This points to the need for VC4S investors to be properly backed with ample capital**, which leads us to the quandary reflected on in chapter 6.

14 Source: New Energy Finance

15 One company was particularly successful in its IPO, but even when excluding it from the portfolio, the results of the study showed the attractiveness of the Clean tech space.





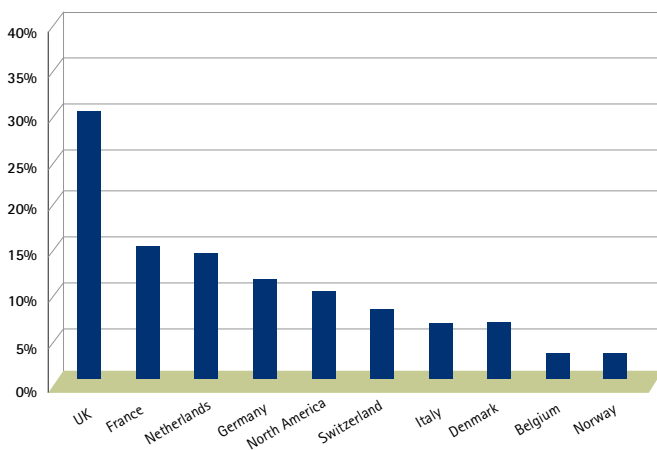
## 6. INVESTORS

What is the background of the ultimate investors that are interested in allocating their capital into VC4S funds? We assess their geographic origins and then follow by closely looking at the type of ultimate investor.

### WHERE ARE THEY FROM?

In terms of national origin, the leading countries for investors are the UK, followed by France, the Netherlands and Germany. This somewhat reflects the mainstream VC European market where the UK accounted for more than 60% of the funds raised in 2005, followed by France (16%), and Germany (4%).<sup>16</sup>

**FIGURE 10**  
National origin of investors

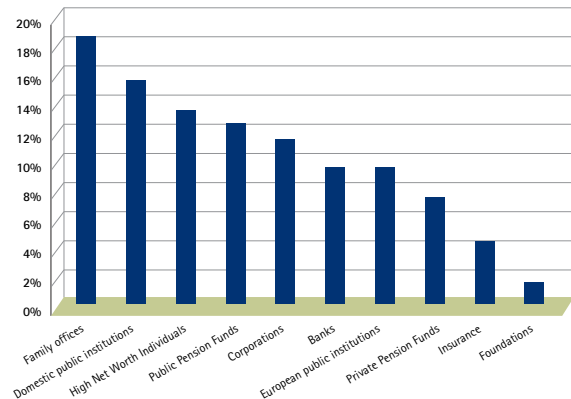


Source: Eurosif

### WHO ARE THEY?

Our research suggests there are a great variety of investors in VC4S (see Figure 11). Most prominent are family offices (18%) while among institutional investors, public pension funds (12%) are more present than banks (9%), private pension funds (7%), or insurance companies (4%).

**FIGURE 11**  
Who invests in VC4S funds? (weighted by actual investments)



Source: Eurosif

The data in this chart is quite revealing. Family offices make up for the largest proportion of money being placed in VC4S funds. While this financial support is laudable (and even critical at this phase of growth of the sector), family offices will never possess the deep pockets that can be found at either pension funds or foundations.

In fact, Eurosif would argue that **the dearth of capital being allocated to VC4S from European pension funds and foundations is one of the key factors restraining growth of the sector.** Pension funds account for 25% of the capital received by mainstream VC,<sup>17</sup> significantly more than the amount currently being allocated to VC4S. But perhaps the most glaring omission is found with foundations, which currently only account for 1% of the funds collected in VC4S. Unfortunately, many foundations separate the missions of their grant giving from their endowments, and it would appear that this is certainly the case in VC4S. In the years to come, foundations have a tremendous opportunity to connect their missions to their endowments by supporting VC4S funds.

In summary, Figure 11 highlights the difficulties that VC4S investors have in raising funds from European institutional investors at the present time.

16 Source: EVCA  
17 Source: EVCA

## 7. SUSTAINABLE TOOLS



Eurosif found that the sustainability tools are still quite new and in a state of rapid development. As stated earlier, VC4S funds choose to be involved in sustainability related businesses in different ways, and that also means that some place more emphasis on their sustainable dimension than others. **The vast majority appear not to have formalised their use of tools related to sustainability issues. The one exception to this would be at the highest level, where many VC4S investors have set out non-financial objectives.**

Here is a summary of the responses:

	YES	NO	No answer
Do you set (non-financial) objectives?	6	1	16
Do you refer to specific codes/standards?	4	5	14
Do you require specific Human Resources Management systems?	2	10	11
Do you require specific Environmental Management systems?	1	11	11
Do you require specific Sustainability Management systems?	3	10	10
Have you set up tools for impact assessment?	6	9	8
Do you involve third parties in your impact assessment?	5	10	8
Do you benchmark your performance with regards to other traditional companies?	2	13	8

As you can see, many of the respondents preferred not to answer, implying that VC4S has not created formalised tools. Delving further into some of the data, some of the non-financial objectives set by the VC4S funds include:

- High Social Impact, measured by selected Triple Bottom Line criteria.
- Social and Environmental Guidelines set at Board and Management level.
- Stakeholder engagement (Suppliers, Community, Employees).
- Specific criteria created under a 'Responsible Entrepreneurship' agenda.

Eurosif found some VC4S funds were using Balanced Scorecard Principles modified and tailored for 'sustainable' enterprises. Almost all respondents stated that the sustainable tools had to be customised to fit the specific goals of the investment. This included variables such as sector or industry, but equally whether the emphasis was more social or environmental.

In summary, VC4S investors do not wish to burden their portfolio companies with a number of heavy compliance-oriented tasks since resources in these early stages of a company's growth are at a premium. For this reason, there were many cases where less formal criteria were being used – many stated that they were creating overarching sustainable goals with detailed objectives to be filled in over time.

Nevertheless, Eurosif would argue there is still an opportunity for VC4S investors to create simple tools and metrics that can be used early on by companies without creating an unreasonable drain on management. Work on this is indeed happening in other networks, including some of the initiatives at the Skoll Foundation as well as through the yearly Global Social Venture Capital Competition (GSVC) held collectively in different MBA programs.<sup>18</sup>

<sup>18</sup> For example, the GSVC site, [socialvc.net](http://socialvc.net), has created tools to help VCs and others determine social impacts of new companies.



## 8. OBSTACLES AND OPPORTUNITIES

### CHALLENGES FACED BY VC4S

Certainly, one of the key areas highlighted in the survey was the challenge in raising funds for VC4S investments. This space is still often led by smaller investors, in the form of family offices and/or HNWIs rather than institutional investors. To some degree, this reflects the fact that VC4S has only started to gain prominence within the past two years. In the same way that ten to fifteen years ago, mainstream venture capital was trying to convince institutional investors of the relevance of VC as an asset class, VC4S investors are trying to convince those same investors of their own relevance now.

Even today, public pension funds in Europe are more conservative in their asset allocations to mainstream VC than their North American counterparts, where institutional investors typically allocate 2% to 3% of their portfolios to venture capital and where Clean tech is estimated to represent as much as 10% of the entire US VC market.<sup>19</sup>

Further, not only do European institutional investors invest little in VC, but the situation is even more challenging for VC4S. As a result, raising funds for VC4S takes a long time and the funds remain relatively small, which means that the amounts invested in the portfolio companies remain relatively small as well.<sup>20</sup>

### WHAT CAN HELP DEVELOP VC4S AT A EUROPEAN LEVEL?

Given a challenging institutional investor environment, one place to look for encouragement would be through public policy incentives. In fact, when asked what EU initiatives could help develop their VC4S activity, 58% of the respondents picked tax breaks, 38% co-investment programmes, and 21% a specific legal status for VC4S.

EuroSif points out four examples that may serve EU policy makers, one from the US, two from the UK and a fourth one which is based on a current EU initiative:

#### SBIC

In 1958, the US Congress created the Small Business Investment Company (SBIC) programme to fill the gap between the availability of venture capital and the needs of small businesses in start-up and growth situations. SBICs are privately owned and managed investment firms that use their own capital, plus funds borrowed at favorable rates with a guarantee from the US Small Business Administration (SBA), to make venture capital investments in small businesses. The SBIC programme has provided over \$46 billion in financing to almost 100,000 small US companies since the programme was started. SBICs fill the gap for companies that require financing in the critical \$250,000 to \$5 million range that is generally not available through banks or non-SBIC private equity firms.

#### EIS and ECF

The UK's EIS (Enterprise Investment Scheme) creates incentives for individuals (essentially, angel investors). The EIS provides individuals with an income tax break on an EIS-qualified investment of 20% on investments of up to £400,000 with a holding period requirement of three years. The ECF (Enterprise Capital Funds) is a UK government initiative that commits significant public sector funding to be invested alongside capital from private sector investors. The funds target businesses seeking between £250,000 and £2m of equity. One of the first ECF funds focused on sustainable technologies.

<sup>19</sup> Source: National Venture Capital Association (NVCA), *Clean tech Venture Capital Report, 2006*.

<sup>20</sup> This is due to the 10% limit of the fund invested per company, which most funds apply. For instance, a company needs €20m to reach cash flow break-even. A €50m VC4S fund would be limited to €5m. Further, to be conservative, the management company of the fund calculates that it can only provide €3m in total. This VC4S fund could therefore need as many as 6 other funds to participate, if they are of similar size, in a syndicated deal.

## JEREMIE

Lastly, JEREMIE (Joint European Resources for Micro to Medium Enterprises) is a joint initiative launched by the European Commission (DG REGIO), the European Investment Bank (EIB) and the European Investment Fund (EIF) to improve SMEs' access to finance in the framework of European Regions. The initiative enables European Member States and Regions to use part of their structural funds to obtain a set of financial instruments that are specifically designed to support micro, small and medium enterprises. These financial instruments include 1) Advisory and technical assistance 2) Equity and venture capital 3) Guarantees (both for microcredit loans and SME loans). This programme is in its early stages, but its mission is to support small business start-ups, however there is no specific support for sustainability.

All of these above listed initiatives could be employed in various means towards the VC4S sector:

- A policy such as the SBIC programme could act as a means to increase institutional investing in the VC4S space through favourable rates and a system of guarantees.
- An EIS-like policy across the EU might be beneficial as private investors are still a key source of VC4S funding in the EU. Currently, there are still limited incentives available (e.g. Tax Breaks, Subordinated Investors).
- An EU version of the ECF programme could increase governmental support while guaranteeing private investment.
- Finally, an EU initiative similar to JEREMIE dedicated to VC4S would be consistent with the EU's Lisbon Agenda whose primary goal is to "make Europe, by 2010, the most competitive and dynamic economy in the world, with stronger growth, creating jobs and favouring social and environmental policies leading to sustainable development and greater social cohesion".

Some form of these policies would also serve the goals of the SRI community, ensuring the creation and growth of businesses that are both sustainability-oriented on the outside (sector / products) and on the inside (processes). Such companies could then become suitable investment targets once publicly listed.

## WHAT EXPECTATIONS CAN WE SET FOR THE FUTURE?

"Green" is quite popular today as witnessed by media coverage, public policy discussion, and corporate investments. But the reality is that VC4S is still in its early stages. **A key driver of growth will be the increase in institutional investors' allocating capital to this space and helping VC4S to successfully grow as a component of the overall venture capital market.**

Here, we may take a lesson from the asset management field of SRI (Socially Responsible Investment) focused on public capital markets. SRI funds have attracted increasing institutional investor money<sup>21</sup> over the past few years due to the business case becoming clearer, track records that equal or beat conventional funds, and positive media attention. It is possible that within the next two to three years, VC4S funds will have more liquidity events that will in turn attract media coverage, drawing further investor attention and pools of capital.

This does not obviate the need for incentives however, and so **public policy will be another driver of growth** in this space. The EU has already been placing capital into the European Investment Fund (EIF) to foster a thriving European venture capital market since 1997. The EIF is the largest fund of fund in the EU investing in Venture Capital. Recently, in order to fulfill specific mandates from some of the EU member states, the EIF has been placing a stronger emphasis on seeking Venture Capitalists focused on Clean tech. To date, the EIF has backed one pure Clean tech fund. It is hoped that the initial support from the EU specifically for VC4S will continue and grow over time.

Part of what we may see over time from the SRI community may be SRI funds with new investment statutes allowing them to invest in non-listed securities with a sustainability orientation. Such investments are best done via a fund and not through direct investments (a different skill set is required).

Finally, other initiatives could be developed as well, such as the creation of a European prize for sustainable innovation for Venture Capitalists around sustainability issues. Specific instruments for each of the different categories of VC4S (especially for the Targeted Economic Impact and Processes / Internal Operations categories) could be developed as a part of this process.

21 SRI now accounts for as much as 10% of the European equity investing, having more than doubled within three years.

## LAST THOUGHTS

Although European governments have been supportive of sustainable initiatives, they have been slow to use venture capital as a tool towards these goals. Europe will need to move quickly, in order to maintain and capitalise on its early lead in sustainability. It is possible that in the upcoming years, European VC4S players could face a significant challenge from the North American (and principally, the US) market.

It is no secret why VC4S has started to take off in the US. In 2004, pension funds began to allocate funds and create mandates in this area. For example, since California state pension funds CalPERS and CalSTRS announced major allocations to Clean tech, the Silicon Valley funds have followed suit and made significant inroads in the VC4S space in the past 18 months.

Mainstream VC players such as Kleiner Perkins reveal their recent approach in this area by having:

- Created a Prize for Green Innovation to create incentives for entrepreneurs;
- Sponsored legislation to benefit alternative energy investing;
- Pooled resources into the local Universities for further research that may yield future products and future entrepreneurs.

To conclude, Europe is in a strong position to capitalise on the accumulated learning of prior initiatives in areas such as renewable energy and sustainable agriculture. VC4S is a natural evolution as Europe increasingly utilises private equity as primary generators –and funders– of economic growth. **There is no doubt that VC4S can become a significant means to fulfil the EU's goals of creating 20 million jobs in the 27 Member States.** Just from 2000 to 2004, one million new jobs were created through mainstream European Venture Capital alone.<sup>22</sup> Eurosif hopes that this study will help EU policy makers, investors and the public better understand that VC4S is positioned to be an excellent source of financial returns and sustainable job growth if provided with the appropriate backing.

# CASE STUDY

## PRODUCTS STRATEGY

### *SAM Private Equity*



Launched in 2000, SAM Private Equity today manages three funds as well as two mandates all focusing on venture capital in the Clean tech sectors, namely, energy, materials, water, and agricultural technologies.

SAM Private Equity is a pure VC4S player and has €248 million under management. €110 million have been invested in VC4S since 2000, with a total of 33 investments being made (average size of €3.4 million).

#### Mission

Sustainability-related trends are increasingly becoming the most important challenges of global industries. These fundamental and long-lasting challenges are shifting industry boundaries and will provide substantial growth opportunities to small, innovative companies that develop and deliver breakthrough technologies.

Outstanding investment opportunities currently exist for investors who have the resources and ability to assess next-generation technologies on a global basis, demonstrate exceptional transaction know-how, and deliver value-adding support to build portfolio companies.

#### Investors

SAM's Limited Partners include leading corporations, financial institutions (public pension funds, insurance), domestic and European public institutions and high net worth individuals. The investors are drawn from North America, Europe, and Asia.

#### The sustainability angle: investments focus on Clean technologies

SAM Private Equity has identified attractive industry sectors affected by global trends and regulations and are therefore facing the necessity to change and to seek innovative solutions and efficiency gains: energy, materials, water, and agricultural technologies.

The funds invest in early and expansion-stage businesses, primarily in North America and Europe.

#### Investment criteria

SAM Private Equity only invests in outstanding companies and applies strict investment criteria:

- Management team with sufficient technical and executive capacity to execute its business plan;
- Projected market growth of at least 15-20% per annum;

- Demonstrated competitive advantage in technical solution on a global basis that are superior from an economic and sustainability point of view, and ideally have multiple potential applications;
- Offer a technology that has a clear path to commercialisation and isn't dependent on other technologies which have yet to be developed;
- Robust intellectual property and IP protection;
- Technology offers an opportunity to transform an industry, thus creating opportunities for strategic partnership with major industry partners;
- Clear exit strategy to be implemented within 3-5 years and alignment of interests with other stakeholders.

#### Challenges

Fund raising for VC4S; not only for SAM fund but for the pure play co-investors upon whom SAM is dependent as well.

#### Example of an exit

Schmack Biogas AG is a leading German full-service provider of biogas plants. The company specialises in anaerobic digestion of biomass, a natural microbial process that converts organic material into a methane rich gas.

SAM participated in the last private equity financing round in May 2005 to provide growth capital and strategic advice to the company. As one of the largest shareholders, SAM is represented in the supervisory board.

In May 2006, SAM partially liquidated their investment in Schmack Biogas AG following the company's IPO at the Prime Standard in Frankfurt, Germany. The IPO was oversubscribed several times and the placement volume amounted to €71.3 million. The offer price was set at €31, representing a company value of €153 million. SAM realized a return beyond 10 times on the position it has exited.

*More information: [www.sam-group.com](http://www.sam-group.com)*



## CASE STUDY

### TARGETED ECONOMIC IMPACT STRATEGY

#### *Bridges Community Ventures*

Bridges Community Ventures (Bridges) defines itself as a mission driven venture investor that aims to make investments that have the potential to deliver financial returns and make a positive social or environmental impact.

The first fund raised by Bridges was a Community Development Venture fund. The idea for community development venture funds in the UK arose from the Social Investment Task Force that reported to the Chancellor of the Exchequer in October 2000. Bridges was set up to manage the first of such funds and began investing in 2002. Based on a promising track record with the first fund, Bridges is raising a second fund, Bridges CDV Fund II.

About €100 million of committed capital is under management, of which €18 million have been invested since 2002, with a total of 24 investments being made as of September 30, 2006.

#### Mission

To harness the entrepreneurial spirit in under invested communities to stimulate economic growth and create jobs, wealth and role models of business success.

#### Investment strategy

Bridges is looking for businesses with the following attributes: clear business objectives, a strong management team, a compelling business proposition and the potential to deliver attractive returns.

Bridges is a generalist investor, investing in a range of industry sectors and stages. Investment stages go from early stage to management buy-outs and property backed businesses. All sectors are considered with an emphasis on manufacturing, services, media, retail, leisure, education, environmental and healthcare.

The investors in the funds are mainly banks and UK public institutions, followed by family offices and public pension funds, most coming from the UK.

#### The sustainability angle

Bridges invests in ambitious businesses that are located in deprived areas in the UK (as defined by the UK government according to the "Index of Multiple Deprivation") and connected with the local economy by employment, market or supply chain.

To demonstrate economic links with the target areas, a company should have at least one of the following three linkages:

1. Employees: at least 35% of current employees or employees who will be recruited as an immediate result of the investment must live in Bridges' target areas.
2. Markets: the core target market for products and/or services, as identified in the business plan, are local people who reside within the target areas.
3. Suppliers: at least 50% of non-salary expenditure goes to local businesses, defined as having at least 50% of staff located in the target areas.

#### Challenges

Attracting large pension funds and funds of funds. The greatest obstacle is that these investors tend to invest in minimum lot sizes of 20 million plus. Small funds such as those currently raised by Bridges cannot make a meaningful impact on the returns of these large investors. Unless the large pension funds feel they have a strong mandate to make a positive social impact as well as strong financial returns, it is not worth their while investing in these smaller funds.

#### Example of an exit

SimplySwitch (a price comparison service for household utilities and financial services) was one of Bridges's earliest investments and a start-up at the time of the initial commitment of £125K. Bridges later followed its investment to a total of £345k and has worked closely with the SimplySwitch management team to grow the company from an energy focused telephone based service to a highly successful multi-channel multi-product company. Bridges exit from SimplySwitch in August 2006 will return c.£7.5m which represents a money multiple of c.22 x and IRR of c.165% to investors in Bridges's funds.

SimplySwitch has also made a valuable social impact. As a result of Bridges's investment, the company located itself in one of Bridges's target areas where the company has created over 80 jobs. SimplySwitch has raised over £500k for charities with whom they have established affinity relationships and who offer the service to their supporters and receive a share in the revenue. It was also the first service of its kind to be accessible by telephone as well as the web, making it easier for those who lack the resources or know-how to go online to save money on their household bills.

More information: [www.bridgesventures.com](http://www.bridgesventures.com)

## CASE STUDY PROCESSES CATEGORY *BonVenture Management GmbH*



*Note: BonVenture is an interesting example of the processes approach. While the fund is open to institutional investors, currently its investors are High Net Worth Individuals. It is also at times willing to compromise on IRR.*

### Missions

To tackle social and ecological problems and to contribute to their reduction, to improve the efficiency and transparency in the social and/or ecological sector and to set an example for sustainable, social and ecological investments by combining humanity and economic efficiency.

BonVenture's main objective is to reduce social and ecological problems in German-speaking countries and to promote social responsibility in a time when existing systems often fail to perform their tasks due to a lack of financial resources and innovation.

About €5.5 million of committed capital is under management, of which approx €1 million have been invested since 2003, with a total of 8 investments (4 for-profit/4 non-profit) being made (average size of €300,000 per for-profit investment).

### Investment strategy

A main criteria for a commitment from BonVenture is the existence of a Social Entrepreneur who initiated the project and is accelerating it. For BonVenture, Social Entrepreneurs are individuals who think and act as entrepreneurs to lead their social or ecological project. They use their energy, personal commitment and high level of motivation to achieve sustainable positive change in the social or ecological field. BonVenture will act as a partner to bring Social Entrepreneurs and investors together.

BonVenture sets financial and in particular social/ecological objectives as benchmarks for success (Triple-bottom-line approach):

- The primary objective is to reach a high social impact.
- The financial objective is capital preservation in real terms.

### Investors

The present investors of BonVenture are all High Net Worth individuals, from Germany with a sustainability mandate. Social and environmental impact is their main target; they expect however financial returns of 6 % in average (capital preservation in real terms).

### The sustainability angle

BonVenture will invest in projects that provide solutions and services for the following areas:

- Children and teenagers, disabled or elderly people as well as socially disadvantaged individuals,
- Unemployment and education,
- Medical care,
- Innovative social services,
- Food and water quality,
- Solar and regenerative energy,
- Environmental protection and recycling,
- Protection of nature and species,
- Other ecological technologies.

### Challenges

Raise more funds (also 'sidefunds') and build more capacity as financial intermediary for the social and ecological sector.

*More information: [www.bonventure.de](http://www.bonventure.de)*



**EXAMPLES OF PORTFOLIO INVESTMENTS**

Venture Capitalist	Company	Business Activity	Type of Investment	Stage of Investment	Amount invested	Revenue of the company
Ludgate Investments Ltd	<b>Azur Dynamics - Canada, US, UK</b> www.azurdynamics.com Listed on TSX (Canada) & AIM (London)	Developer of hybrid electric and electric powertrains for commercial and military vehicles	Clean tech	Pre-IPO (AIM)	£245,000	\$4.6m (2005)
Ludgate Investments Ltd	<b>Ceres Power - UK</b> www.cerespower.com Listed on AIM (London)	Solid oxid fuel cell technologies	Clean tech	Early stage	£312,000	£1.4m (year ended 06/2006)
InSpire Management	<b>OptiNose - Norway / UK</b> www.optinose.no	Innovative devices for nasal delivery of vaccines and drugs (liquid and powder)	Drug Delivery Devices	Seed capital	NOK 4m (£ 340,000)	Presales (In clinical trials)
WHEB Ventures	<b>Exosect - UK</b> www.exosect.com	Pesticide free or very low dose pesticide methods of insect control	Agriculture	Expansion	a £2.7m investment round with two other VC funds + follow-ons	Pre-revenue (1st product launched in 2006)
WHEB Ventures	<b>RecovCo - UK</b> www.recovco.com	Rotary Tilting Furnace (RTF) technology for the recycling of Aluminium	Clean tech / Recycling	Expansion	£2m	Not disclosed
Demeter Partners	<b>Aérowatt - France</b> www.aerowatt.com Listed on Marché libre Euronext, Paris, 11/06	Develops and operates wind turbine power plants in France mainland and overseas territories	Wind power	Expansion	€6m	€4.5m (2006)
Demeter Partners	<b>Vergnet - France</b> www.vergnet.fr	Rural water supply and wind power	Wind power Water treatment	Expansion	€4m	€38m (2006)
Bridges Community Ventures	<b>Chill Factor - UK</b>	First indoor real snow Alpine village in North West England	Economic development	Early	£3m	Pre-revenue
Bridges Community Ventures	<b>School Stickers - UK</b>	Motivational tools for school children	Economic development/ Education	Early	£1.4m	£1.6m
Bridges Community Ventures	<b>Insurance Dialogue Limited - UK</b>	An insurance broker which offers tailored insurance products to the over 50s market	Economic development	Early	£1m	£1m

**EXAMPLES OF PORTFOLIO INVESTMENTS**

Venture Capitalist	Company	Business Activity	Type of Investment	Stage of Investment	Amount invested	Revenue of the company
BonVenture	<b>Institut für Vermittlungscoaching / DVC GmbH</b> - Germany www.vermittlungcoach.de	Employment coaching consultancy	Economic development (employment)	Early	Not disclosed	Not disclosed
SAM Private Equity	<b>Evergreen Solar Inc.</b> - USA www.evergreensolar.com quoted NASDAQ	Developer and manufacturer of photovoltaic (solar electric) modules with proprietary silicon technology known as String Ribbon	Renewable energy	2 rounds: pre-IPO (pre-commercial revenue) and the PIPE	€5m	Product revenue: \$43.6m (2005)
SAM Private Equity	<b>Inge AG</b> - Germany www.inge.ag	Water purification company: innovative ultrafiltration membranes for the treatment of drinking, industrial and waste water	Water treatment	Early commercial revenue	€3.2m	Not disclosed
SAM Private Equity	<b>Pemeas</b> - Germany www.pemeas.com	Supplier of key components and subsystems to the emerging fuel cell industry	Cleaner energy	Pre-revenue	€4.3m	Not disclosed
BankInvest New Energy solutions	<b>BioGasol</b> - Denmark www.biogasol.dk	Developed a process to extract ethanol from agricultural residue such as straw and bellows	Renewable energy	Early	€2m	Pre-revenue
BankInvest New Energy solutions	<b>Cellex Power Products Inc</b> - Canada www.cellexpower.com	Developed an electric motor based on fuel cells	Clean tech	Early	€3.5m	€256 000
BankInvest New Energy solutions	<b>Marine Current Turbines Ltd.</b> - UK www.marineturbines.com	Tidal under water turbine and generators	Renewable energy	Early	€3.7m	€4.4m
Foursome Investment Limited	<b>Hydrodec Group PLC</b> - Australia, UK www.hydrodec.com Quoted AIM London	Supplier of advanced recycling technologies enabling the re-conditioning of specialty oils	Waste management	Growth	>£1m	£0.6m
Foursome Investment Limited	<b>Inetec Ltd</b> - UK www.inetec.co.uk	Supplier of industrial organic waste treatment technology	Waste management	Growth	<£1m	£0.8m
Rabo Private Equity	<b>De Leckere</b>	Organic micro-brewery	Agriculture	Expansion	Not disclosed	Not disclosed
Rabo Private Equity	<b>FluXXion</b>	High technology supplier of special micro filtration membrane assemblies and cleaning concepts, characterised by their cost effectiveness and unsurpassed benefit to the environment	Clean tech	Start up	Not disclosed	Not disclosed

**VC4S Advisory Group**

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