VC IS COLLABORATING TO TACKLE ESG

ESG initiatives in venture capital (VC) are still 'version 1.0', but they are unrecognisable from 18 months ago thanks to efforts from industry leaders, writes journalist **Paul Bryant**

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C was behind the curve when the environmental, social and governance (ESG) trend dramatically accelerated in public markets in 2019.

When **VentureESG**, a non-profit organisation promoting ESG uptake in VC, was being planned in early 2020, there was little activity in the sector. "We were speaking to funds and coming away with the impression that some had an 'exclusions' list (to avoid totally unpalatable investments), but that was it," says Hannah Leach, Co-founder of VentureESG and Partner at **Houghton Street Ventures**. "It was also common to field questions such as 'What is ESG?' and 'Why does it matter to VC?'."

That's changed. Ian Connatty, Managing Director at **British Patient Capital**, a venture limited partner (LP) and subsidiary of British Business Bank, says most VC firms he talks to today have a more formal framework to think about and implement ESG, although many of these are still 'version 1.0'.

> "A factor in the rise of ESG within VC has been the rapid scaling up of collaboration"

Collaboration ramps up

A factor in the rise of ESG within VC has been the rapid scaling up of collaboration. VentureESG, for example, has grown into a community of 157 funds and just under 50 LPs.

It focuses on providing funds with guidance, resources, knowledge and access to expertise and community. This is delivered through mechanisms such as a Notion page (where resources such as measurement frameworks can be shared), an active WhatsApp group to discuss bite-sized problems, and regular member calls for deep-dive education or knowledge sharing.

Another collaborative initiative making an impact is **ESG_VC**, which approaches the challenge from a different angle – by helping portfolio companies to advance their ESG journey. ESG_VC also started in 2020 and already has around 100 participating VC funds.

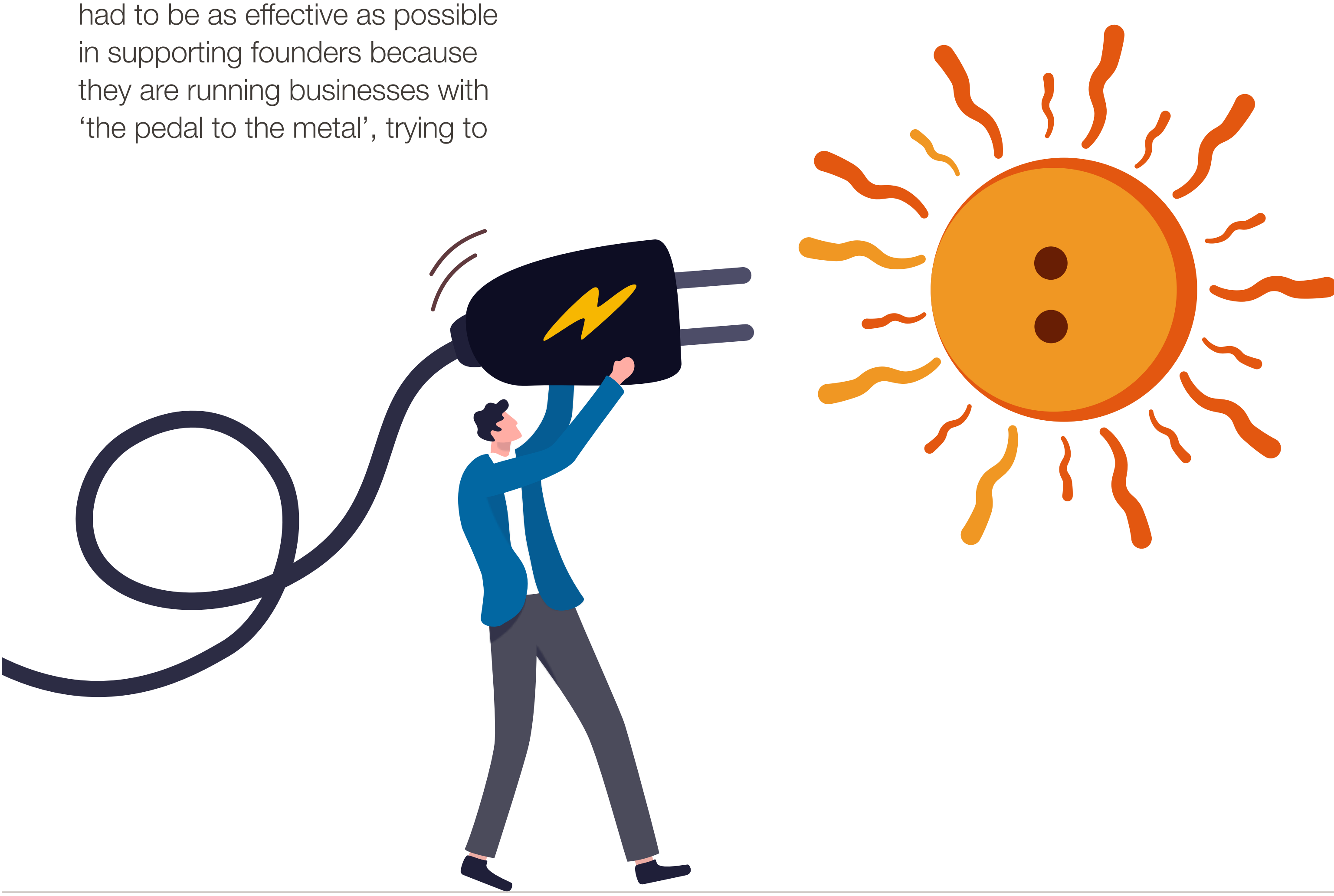
The initiative offers practical help with common problems faced by founders looking to address ESG. It does this by providing a measurement framework designed specifically for VC-backed businesses, a training and events programme for start-ups, and a bank of resources, such as policies and implementation guidelines to help companies maximise their impact.

Henry Philipson, Director of Marketing and Communications at VC firm **Beringea**, a founding member of ESG_VC, says: "Beringea was grappling with a number of issues that would fit under the ESG banner (such as diversity and inclusion) and also fielding a lot of questions from portfolio companies, such as: 'I want to understand how to measure my carbon footprint', or 'I know unconscious bias is a problem within my recruitment process but I have no idea how to solve that problem'."

Beringea realised that investors had to be as effective as possible in supporting founders because they are running businesses with 'the pedal to the metal', trying to tackle many issues with relatively few resources. Being effective meant an initiative at sector level.

> "We don't want to burden portfolio companies with a myriad of frameworks"

Philipson says many venture funds agreed that it did not make sense to approach ESG with a competitive mindset. The most common attitude among VCs was: "We're all facing the same issues, we all have to do this, and some degree of standardisation makes sense, so we don't want to burden portfolio companies with a myriad of frameworks and reporting structures. Collaboration and pooling VC resources just makes sense."

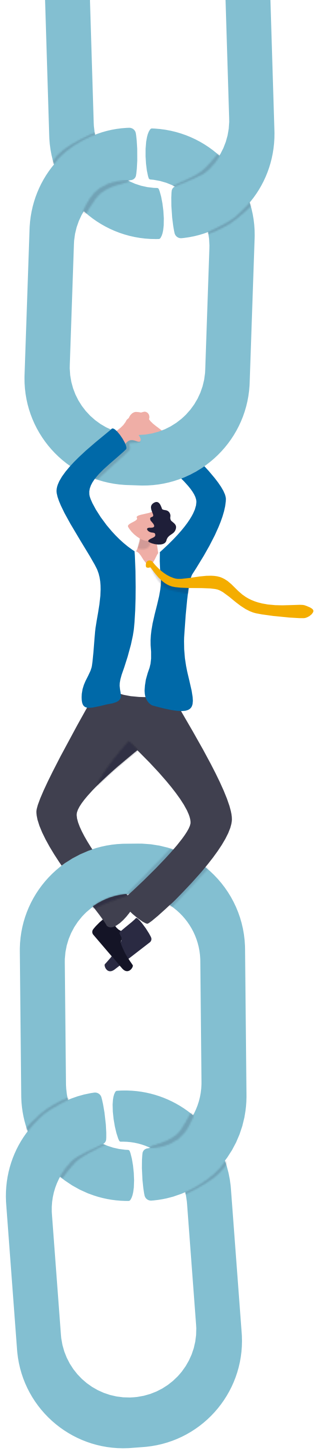


Early-stage hurdles

One of the most important challenges to tackle was capacity: "ESG reporting for start-ups is really difficult. Some of the frameworks available for larger companies are asking companies to report on 150-200 metrics. An early-stage company simply doesn't have that bank of information or the resources to complete it," explains Philipson.

So the ESG_VC framework was whittled down to 48 metrics (14 environmental, 17 social and 18 governance) and positioned to founders as a starting point, helping them understand the journey they should be taking with reporting. Philipson says the response has been excellent.

Leach at VentureESG found an issue with the language of ESG among some start-ups. She recalls instances where founders have bristled at the term ESG because it implied a box-ticking exercise to them. Some VC firms have adapted their terminology accordingly: Atomico has a 'conscious scaling framework', and Balderton has a 'sustainable future goals' framework, which, she says, are more in line with founders' language and thinking.



Version 2.0

These collaborative initiatives have brought the industry on a long way in a short period of time, but this is still the start of the journey. How VC approaches ESG will iterate over the years. From an LP perspective, Shanika Amarasekara, Chief Impact Officer at **British Business Bank**, thinks it will be important to prioritise some ESG factors over others.

"We've prioritised climate change, diversity and inclusion, regional inequalities and access to finance. Others will have different priorities and that's OK. But you want investors and their portfolio companies to be really focused and aligned on their priorities," says Amarasekara. "The danger is that if you try to cover all ESG factors you'll find decision-making really difficult and end up not having any obvious measurable impact in any area because you are measuring and focusing on too many things."

For general partners (GPs) in particular, Leach thinks a key next step is to build an industry-wide accountability mechanism. "We are working towards playing a big role in this," she says. "We want to see some sort of pledge rolled out where funds commit to specifics, such as minimum training commitments, publicising ESG policies and putting timelines to their reporting and impact delivery. Right now, we are not sure who is implementing what."

And for ESG_VC and portfolio companies, Philipson says the immediate next steps are to provide more assistance with ESG implementation. "We are already building a 12-month programme of events for portfolio companies which is focused on implementation in common priority areas – carbon offsetting is one of these. So, we are speaking to some of these providers and helping with guidance on how companies go about this process and select the best offsetting partner."

Scaling ESG

Over the longer term, thought needs to be given to what happens as companies transition out of VC. Companies undergoing an initial public offering, for example, will be exposed to ESG frameworks designed for much larger, more mature businesses.

"One of the things we have started doing is mapping our framework to some of those that exist outside of VC so that we can assess how useful our frameworks will be as companies transition," says Leach. "We need to talk to NASDAQ, LSE etc, who are promoting ESG very strongly and make sure it won't be a big leap to get aligned with other frameworks."

> "A key next step is to build an industry-wide accountability mechanism"

VC may have been a little slow getting the ball rolling on ESG, but it is taking strides now. If the industry continues to collaborate in the way it has over the past 18 months, VC can have a big impact on the wider economy.

It can put ESG at the centre of tomorrow's big companies, defining their culture and reporting standards. It can also bring a degree of much-needed consistency to how companies approach ESG, making the lives of later-stage investors that bit easier.

Tips for tailoring ESG to VC

1. **Use dedicated early-stage frameworks**
   Common public market measurement frameworks are proving unsuitable: data requirements are impractical and insufficient emphasis is placed on prominent early-stage ESG issues (such as technology-bias).

2. **Put emphasis on assistance (not just measurement)**
   Founders need assistance with 'how to improve', not just 'how we are doing'.

3. **Prioritise certain elements of ESG**
   Covering the entire ESG spectrum risks diluting impact across the board, and can be too resource-intensive for early-stage businesses.

4. **Think about the language you use**
   Some founders are dedicated to the principle of ESG, but are put off by the terminology, associating it with box-ticking exercises.