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Sustainable investment strategies for a venture capitalist: the issues of implementation

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Sustainable finance refers to the process of taking due account of environmental and social considerations (e.g., inclusiveness, labour protection, investment in human capital and local communities, addressing inequality) when making investment decisions leading to increased investment in longer-term and sustainable activities [1, p. 2]. Integrating social and environmental goals into the capital flows and investment is recognized as an essential step towards more sustainable economies, as reflected in the UN Principles of Responsible Investors and the 2030 Agenda for Sustainable Development.

The use of financial products, introduced in view of sustainability (impact investing, green and social bonds, etc.) have increased in recent years. However, they are still characterized by a limited range of investment tools and are primary aimed at ecological companies, which restricts their use in capital market [2, p. 10]. In this respect, effective and extensive sustainable investing is infeasible without respective adaptation of the common investing and commercial mechanisms.

Venture capital, appeared from the combination of risk management and business expertise over sole financing, could contribute significantly to scale the sustainable businesses in both emerging markets and advanced economies [2, p. 11].

Common sustainable investment strategies could still be used by venture investors, for example, negative screening and portfolio diversification, shareholder and management activism; targeted use of funds, disclosure and reporting requirements. Conversely, their integration by venture investors could be at the same time considered impractical and unnecessary due to a focus on the early stages companies, limited influence over decision-making and quick exit.

First, venture capitalists typically invest at early and growing stages, when a startup either seeks the first sales and profit or expands its presence on the market. Imposition of social or environmental requirements along with set commercial indications could appear overburdening for a CEO and team, distract from business priorities and incur the additional costs, especially for hardware startups.

On the contrary, product modification and development of market strategies takes place both on early and growing stages of a startup. Inclusion of environmental and social focus could enhance competitiveness of a startup and give a selective advantage over the competitors through meeting the demands of sustainability-oriented consumers [3, p. 16]. Moreover, well-built corporate sustainability management leads to cost reduction [4, p. 288].

Secondly, the influence of a venture investor over the startup corporate management may be restricted based on the involvement of other investors, including in the next funding rounds. Correspondingly, the role of venture investor in corporate structure may range from minority shareholder to member of the board of directors.

Thus, a venture investor may obtain the reliant management tool, allowing or not to shape a business-model of a startup, and anyway shall coordinate his / her vision with other shareholders who, it their turn, may pursue solely commercial goals.

Thirdly, venture investors are guided by the principle ‘invest to exit’, meaning that a venture capital investor seeks a successful exit and not a permanent stake in the startup so that to maximize the financial gain and find money for further investment activities. This principle also constitutes an integral part of risks management for venture investors.

Exit for venture investors could be relatively quick and typically starts after 2-3 years. This prevents the investor from insisting on long-term sustainable strategies, especially when such strategies result in bearing additional costs while the economic benefits for a company may appear much later.

Nonetheless, successful exit from the startup requires active planning and preparation on behalf on the investor so that to conduct IPO or sale with a remarkable return on the investment. Well-performed management and operation of the investee’s company could be listed among factors, which ensure that the investor could construct a good exit strategy. Company, effectively addressing sustainable issues, enhances its reputation, contributes to legitimizing the business and meets the compliance requirements. As a result, such a company contributes to mitigating related risks and optimizing costs, which makes it more attractive for a further buyer.

Market competitiveness also matters in this context, especially for startups aimed at solving environmental and social problems. This emerging market with multiple innovations is characterized by the increased financial risks, which primarily could be handled only by venture investors. The absence of early investments and integration of corporate sustainability may lead to a failure of a startup and the whole emerging market.

Hence, although venture investing provides the ample and actual opportunities to support social impact startups, the investor faces the number of obstacles and additional risks while integrating sustainable strategies to exclusively commercial startups. These risks could overburden an already high-risk market of venture investments. The described specifics shall be considered by governments, while determining the policy towards venture capital market.

Imposing specific legally binding corporate social responsibility either on venture investors or startups is not adequate from our point of view. Venture capital market, associated with the high risks and drastically growing competition, shall be supported by flexibility and discretion of the actors so that they can exercise effective risk-management.

The mechanisms to compensate the increased costs to the investors shall be implemented to stimulate sustainable investing, for example, subsidies to cover additional expenses arising from ensuring sustainability of investee companies; proportionate preferences for income or capital gains taxation.

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