LEADING POINT

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3 Reasons Why All Startups Should Embrace ESG

And how they can seize the opportunity

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Environmental, Social & Governance (ESG) issues are firmly on the board agendas of large, publicly-listed companies. 2021 marks the year in which VC-backed startups need to follow suit. What is the best way to achieve this change?

Some smaller companies have already made the move. A recent survey of pre-seed and series A startups[1] found that almost two thirds already had some ESG policies in place. Of those who didn't, over half were now seriously considering them.

1. 500 Startups (2020) Survey results: The Impact of Covid-19 on the Early-Stage Investment Climate

Why All Startups Should Embrace ESG

1. Increase investment
2. Attract top talent
3. Mitigate risk

1. Increase investment

Over the last five years there has been an explosion in VC funds focusing on startups in the ESG space. One such fund is DBL Partners. They are currently looking to raise $450m for their fourth fund. Their mission involves investing in companies which provide capital returns while also enabling environmental and social benefits.

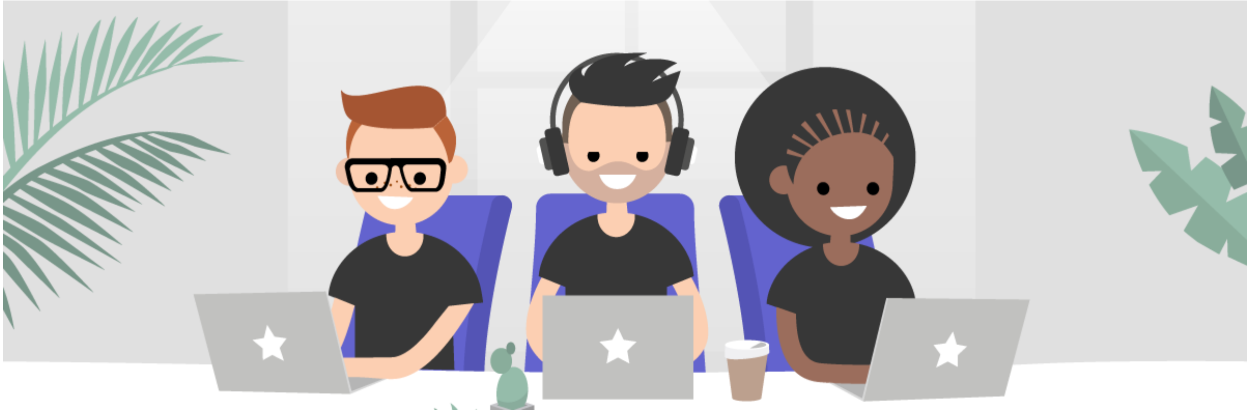
More recently, an increasing number of non-ESG focused VC firms are embedding ESG values into the companies they invest in. For example, Christine Tsai, CEO of 500 Startups, one of the most active global early stage venture capital firms whose "unicorn investments" include Credit Karma, Canva, Grab and Talkdesk, said that startups should implement ESG early on[2].

If startups want to stand out, they should embed ESG policies into their business model, principles and culture at the beginning rather than trying to "retro-fit" policies later under the pressure of investors or others.

2. Venture Capital Journal (June 2020) 500 Startups makes ESG top of mind going forward

2. Attract & retain top talent

Startups with ESG values embedded are more attractive to the best talent. This gives them a tangible competitive advantage.



Millennials currently make up 50% of the global workforce[3]. A recent study[4] found that more than 40% said they had joined a firm because they performed better on sustainability. The same study showed that they are 70% more likely to stay longer if they feel the company has a strong sustainability plan.

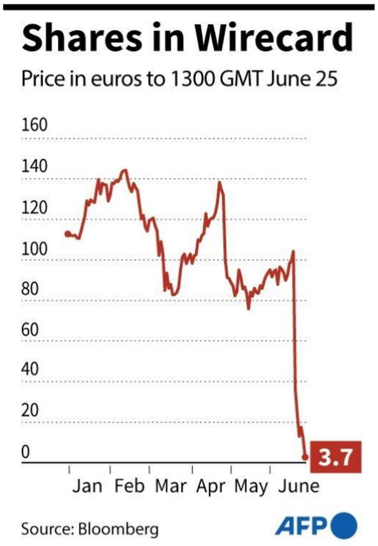
However, relying on ESG policies and reporting (internally and externally) alone is not enough to benefit. Startups need to embrace a culture of openness at the core of their business. They must be honest to their stakeholders about their ESG weaknesses as well as their strengths. Only then will their ESG communications be authentic and have real impact on talent attraction and, more importantly, retention.

3. KPMG (2017): Meet the millennials
4. Fast Company (Feb 2019) Most millennials would take a pay cut to work at a environmentally responsible company

3. Mitigate risk

ESG policies can de-risk young companies as policy adoption becomes more difficult as they grow. A recent white paper[5] argued that startups are even more vulnerable to negative reputational impacts compared to more established firms, given their relatively small size and high growth characteristics.

For example, German fintech success story Wirecard shook the financial world earlier this year as it became clear that over $2bn was missing from their balance sheet[6]. Also, in late 2019, it was reported that the CEO and founder of luggage startup AWAY, which had raised over $31 million, openly bullied and belittled her employees[7]. This led to a media backlash against the company which greatly impacted their growth and market position.



With stronger governance policies and procedures, these scandals may have been avoidable. Startups which embed strong governance policies early on are much less likely to run into such issues.

5. CDC investment works & FMO Entrepreneurial Investment Bank (Jan 2020) Responsible venture capital Integrating environmental and social approaches in early-stage investing
6. Markets Insider (Jun 2020) How $2 billion vanished from the balance sheet of Wirecard, according to a forensic financial expert
7. The Verge (Dec 2019) Away's founders sold a vision of travel and inclusion, but former employees say it masked a toxic work environment

How to integrate ESG into a VC-backed startup

- Map your current ESG strengths
- Develop your goals and measure your progress
- Communicate your position

ESG action plans should follow a staged approach, with a roadmap assessed and realigned at each funding round

1. Map your current ESG strengths

Work out what you are already doing right, supported by resources such as the Sustainable Accounting Standards Board Materiality Map[8] to work out which ESG policies and metrics are relevant for your industry. Also, map out the ecosystem of the different stakeholders your company interacts with, including customers, suppliers, regulators and employees.

2. Develop your goals and measure your progress

Collect the relevant data to work out your current baseline and decide goals for the short, medium and long term, building a dashboard incorporating relevant Key Performance Indicators (KPIs) to track progress. ESG standards are complex and can need a multitude of different data points depending on the type of industry.

3. Communicate your position

Regularly collect and communicate your ESG data to relevant stakeholders including investors, employees, regulators, consumers and the media. Publish your ESG successes and milestones on your social media channels and your recruitment page. You might also want to consider inviting in third party auditors to validate your ESG data and methods of collecting it, and even look into external certification e.g., B-corp[9] status.

8. SASB (2020) The SASB Materiality Map®
9. Bcorperation (2020) About B Corps

> ESG action plans should follow a staged approach, with a roadmap assessed and realigned at each funding round. Only then can startups fully benefit from the opportunities ESG has to offer.
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Client propositions and products in data-driven transformation in ESG and Sustainable Investing.

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This is the fourth in a series of blogs which explored the ESG world: its growth, its potential opportunities and the constraints that are holding it back. We explored the increasing importance of ESG and how it affects business leaders, investors, asset managers, regulatory actors and more.

ESG: The Future Pillars of Investing
In the first part of our Environmental, Social and Governance (ESG) blog series, Ale and Anya explore the ESG market and the opportunities for business and investors.

Artificial Intelligence: the Solution to the ESG Data Gap?
In the second part of our Environmental, Social and Governance (ESG) blog series, Anya explores the potential opportunities surrounding Artificial Intelligence and responsible investing.

Riding the ESG Regulatory Wave
In the third part of our Environmental, Social and Governance (ESG) blog series, Alejandra explores the implementation challenges of ESG regulations hitting EU Asset Managers and Financial Institutions.

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