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Sustainable venture capital – catalyst for sustainable start-up success?

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ABSTRACT

To address global sustainability challenges, major investments are required in sustainable businesses that deliver triple bottom line results. Although interest in sustainable businesses is on the rise, these businesses are not yet widespread. Venture capital investment has a key role to play in the development of sustainable start-ups. The research area of 'sustainable' venture capital is still emerging. More research is required to understand how venture capital can support the development of sustainable businesses. This paper provides insight into how venture capitalists can contribute to sustainable business success, by investigating their role, motivations, investment theses, and barriers and enablers to success of sustainable ventures. The following question is investigated: How can sustainable venture capitalists contribute to the success of sustainable start-ups? Interviews were conducted with an expert sample of leading sustainable venture capitalists and other key stakeholders in sustainable entrepreneurship. It was found that next to financial support, venture capitalists provide triple bottom line business advice and network support. Key success factors include business model innovation, collaborations and a strong business case, whereas failure factors include a lack of suitable investors, a strong incumbent industry and a short-term investor mind-set. Sustainable start-ups should focus on triple bottom line business model innovation, find opportunity in new technology and funding platforms and develop multiple business cases to create success beyond the 'green customer base'. Sustainable venture capitalists can help prove the success of sustainable business formats, mitigate financial risk through co-investments and exercise patience by balancing financial with social and environmental returns.

1. Background

Entrepreneurship has been recognized as a major conduit for sustainable products and processes, and new ventures are viewed as an answer to many social and environmental problems (Hall et al., 2010; Pacheco et al., 2010). Venture capital has a key role in nurturing entrepreneurship and new ventures. As such, venture capital may be viewed as an important catalyst to develop sustainable businesses (Bürer and Wüstenhagen, 2008) – those that contribute positively to the environment and society while generating a profit. Already in 2003, the Journal of Cleaner Production dedicated a Special Issue on "Financing Cleaner Production" (Huhtala, 2003) emphasising the importance of the role of finance in promoting cleaner production and sustainability in businesses more broadly. One of the common misconceptions has been that "sustainability costs money" and it is a capital cost without return (Huhtala, 2003). In this paper, the focus is on gaining insight on the role of venture capitalists as supporters and promoters of sustainable businesses and the potential barriers and opportunities associated with this.

A growing population, paired with changing consumption patterns creates significant pressures on health, wellbeing and the natural environment (Royal Society, 2012). To create a sustainable global society, the development of billions of people needs to be addressed; the cost of externalities need to be internalised; agricultural output will need to be doubled without increasing resource use; deforestation need to be halted while increasing yields; and carbon emissions need to be halved worldwide while delivering a tenfold improvement in resource use (WBCSD, 2013). The UN World Commission on Environment and Development chaired by Gro Brundtland (WECD, 1987) already advocated the need for sustainable development: to meet the needs of current generations without

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compromising future generations' ability to satisfy their needs. It created a global agenda for change, proposed long-term strategies for sustainable development, encouraged cooperation and achievement of joint objectives and advocated the need for international action. This shows that the challenges to business are significant: across industries, businesses are increasingly confronted with environmental and social challenges while stakeholders expect firms to meet a triple-bottom line of economic, environmental and social value creation (Elkington, 1997), rather than mere short-term profit requirements (Hockerts and Wüstenhagen, 2010).

Current incremental solutions largely allow businesses to operate in a less unsustainable way, but the increasing severity and pressure of global challenges requires a different approach (Ehrenfeld, 2008). A fundamental change of businesses and business models is required. Business models, through the value proposition (product/service offering), creation and delivery (e.g. partners and activities), and value capture (cost and revenue streams), will need to include a wide range of stakeholder concerns, and the environment and society need to be regarded as important stakeholders to tackle our key global issues (Bocken et al., 2013). According to Russo (2003), those companies that seek to protect and enhance their supply of natural (and social) capital will gain a competitive advantage in the coming decades. Hence, 'sustainability' can also be viewed as a business opportunity. A survey by MIT Sloan Management Review and The Boston Consulting Group (2013) amongst more than 2600 executives, managers and thought-leaders across the world, showed that the portion of respondents reporting to profit from sustainability went up to 37% and nearly 50% of companies have changed their business models as a result of sustainability opportunities.

Venture capitalists are key in the emergence of businesses: they can make start-ups grow faster, create more value and generate more employment and innovation (Keuschnigg, 2004). Venture capitalists may be viewed as the 'gate keeper' to the emergence of new businesses, as their role is to select venture ideas presented to them by entrepreneurs (Marcus et al., 2013). They influence entrepreneurship by acting as 'scouts', identifying and selecting future potential and as 'coaches' who can help realise that potential (Baum and Silverman, 2004). The venture capitalist's investment thesis includes the ventures that fit the investment portfolio, and therefore, the rationales for making investments (Kaplan and Strömberg, 2001). Venture capitalists typically invest in 'riskier' businesses and support start-ups financially through their expertise and networks, typically after angel investors or 'friends and family' have made their initial investment in the business and before banks or private equity, which might find investment too risky (Fig. 1). The hope is to make a profitable deal through mergers and acquisitions or initial public offerings (IPO), where the venture capitalist typically sells its shares in a venture (Gompers and Lerner, 2001). The relationship between venture capital and entrepreneurs is long-term and therefore important. Marcus et al. (2013) refer to timelines of up to 10 years between raising money and exiting (i.e. selling the business) whereas 'clean' or sustainable investments are often stretched beyond this.

This research investigates the role of the specific niche of sustainable venture capital investors in encouraging sustainable entrepreneurship. These investors deliberately invest in sustainable businesses, because they are aware of the opportunity and necessity of creating business with triple bottom line returns. This paper investigates the following question: *How can sustainable venture capitalists contribute to the success of sustainable start-ups?*

2. Literature review

Although literature has emphasised corporate sustainability practices in large businesses, the area of sustainable start-ups and entrepreneurship has received increasing interest with contributions

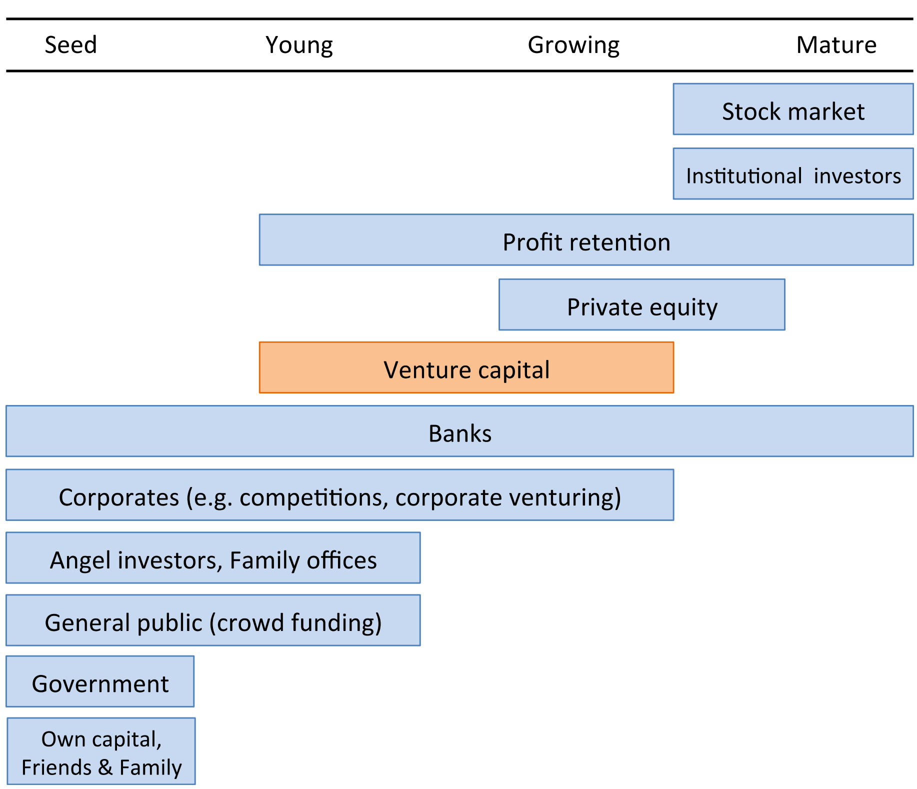

Fig. 1. The role of venture capital and emerging roles of other actors in growing businesses.
Adapted from Marcus et al. (2013).

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