More and more entrepreneurs are interested in starting and growing businesses that succeed along several dimensions: economic, environmental and social. These sustainable entrepreneurs can seek capital from the traditional sources; however, they should be prepared to tap into the resources available from sustainable investors.

This Guide provides an introduction to the values and business model characteristics that sustainable investors look for in entrepreneurs and companies, thus providing sustainable investors with a useful checklist of how they should be organizing their businesses.
Introduction to Investment Criteria of Sustainable Investors

Sustainable investors are concerned not only with what companies are striving to accomplish, but also with the way in which those companies intend to operate and the values and methods that will be used by the principals of the companies.

Specifically, sustainable investors look for individuals and companies that value and exhibit transparency and honesty and candor in communications among stakeholders; define economic success by social and ecological impact, not just financial results; have an entrepreneurial spirit and culture that encourages and fosters innovation and continuous improvement; and which are truly pioneers in their areas interested in building the fields in which they operate through collaboration and “open sourcing” of methods and ideas.

Sustainable investors also tend to be particularly interested in developing and maintaining close, long-term relationships with their investees and providing them with appropriate support and resources throughout the investment period.

One way this is accomplished is by matching entrepreneurs with local investors from the same community to develop a sense of shared responsibility and facilitate face-to-face interaction.

What Sustainable Investors Look For

Enterprises seeking financing from social venture capital funds and other sustainable investors need to understand the criteria that these types of investors use when evaluating potential portfolio companies.

A modest survey of the published investment criteria of various investors indicates that are looking for companies that:

- Have a primary, clear objective to achieve significant social change and a business model in which generating social impact is an essential and necessary part.

- Provide goods and services that meet human needs and have significant social impact (e.g., food, medicine, clothing, housing, heat and light, transportation, communication, recreation, renewable energy, and “green” products and services).
• These goods or services must be based on core technology that is economically better or create greater social impact than what is available currently through the market, aid, or charitable distribution. Sustainable investors prefer and expect evidence of customer feedback on the utility of the proposed goods or services.

• Have a clear business plan and model that demonstrates the potential for financial viability and sustainability within a five to seven year period, including the ability to cover operating expenses with operating revenues and generate a fair return for investors.

• Have a strong and experienced management team with the skills, will, and vision to execute the business plan, an unwavering commitment to achieving the desired social impact in an ethical manner.

• Demonstrate a clear path to scale for the number of end users over the anticipated investment period, and be positioned as one of the leaders in the market.

• Provide positive leadership in the areas of business operations and overall activities that are material to improving societal outcomes, including those that will affect future generations.

• Balance the needs of financial and nonfinancial stakeholders and demonstrate a commitment to the global commons as well as to the rights of individuals and communities.

• Advance environmental sustainability and resource efficiency by reducing the negative impact of business operations on the environment, managing water scarcity and ensuring efficient and equitable access to clean sources, mitigating impact on all types of natural capital, diminishing climate-related risks and reducing carbon emissions, and driving sustainability innovation and resource efficiency through business operations and products and services. Red flags for sustainable investors would include a record of poor environmental performance and failure to comply with applicable laws and regulations, activities that contribute significantly to local or global environmental problems, and/or risks related to the operation of nuclear power facilities.

• Establish an environmental management system with objectives and procedures for evaluating progress, minimizing negative impacts, training personnel and transferring best practices to customers, suppliers and other participants in the marketplace through trade associations and other collaborations.

• Contribute to the quality of human and animal life. Sustainable investors will not invest in companies that abuse animals, cause unnecessary suffering and death of animals, or whose operations involve the exploitation or mistreatment of animals.
• Contribute to the community through charitable giving, encouraging employee volunteering in the community, making products and services available free or at cost to community groups and supporting local suppliers and striving to hire locally.

• Respect consumers by marketing products and services in a fair and ethical manner, maintaining integrity in customer relations and ensuring the security of sensitive consumer data.

• Respect human rights, respect culture and tradition in local communities and economies and respect Indigenous Peoples’ Rights. Sustainable investors will not invest in companies that have exhibited a pattern and practice of human rights violations or have been directly complicit in human rights violations committed by governments or security forces.

• Promote diversity and gender equity across workplaces, marketplaces and communities. Sustainable investors look for diversity throughout the organization, beginning with the board and senior management team, and will not invest in companies that discriminate on the basis of race, age, ethnicity, religion, gender, sexual orientation or perceived disability or support the discriminatory activities of others in their workplaces, marketplaces or communities. Red flags include a record of consistent violations of workplace-related laws and regulations and failure to adopt and enforce explicit policies against discrimination in hiring, salary, promotion, training or termination of employment.

• Demonstrate a commitment to employees by ensuring development, communication, appropriate economic opportunity and decent workplace standards. Sustainable investors will not invest in companies that have been singled out for serious labor-related actions or penalties by regulatory agencies or that have demonstrated a pattern of employing forced, compulsory or child labor. Sustainable investors seek confirmation that companies have implemented and follow personnel policies that promote the welfare of their employees, adhere to internationally recognized labor standards, value employee welfare and safety, pay a living wage to its employees and maintain a reasonable ratio of CEO earnings to average employee earnings, maintain cordial and professional relations with labor unions and bargain fairly with their employees, and follow sustainable employment practices.

• Save lives by guaranteeing product safety while promoting public health. Concerns for safety and public health caused sustainable investors to reject proposals from companies engaged in certain “prohibited business activities” such as the manufacture and/or sale of tobacco products; the manufacture of alcoholic beverages or gambling operations; the manufacture and/or sale firearms and/or ammunition; or the manufacture, design or sale of weapons or the critical components of weapons that violate international humanitarian law.

• Provide responsible stewardship of capital in shareholders’ best interests.
Investment Criteria of Sustainable Investors

- Exhibit accountable governance and develop effective boards that reflect expertise and diversity of perspective and provide oversight of sustainability risk and opportunity. Sustainable investors will shun companies that have demonstrated poor governance, including failure to practice transparency in disclosures to shareholders or respond to shareholder communications or proposals, or engaged in harmful or unethical business practices.

- Commit to an external code or standard or a set of business principles that provides a framework to measure the company’s progress on environmental and social issues.

- Integrate environmental and social risks, impacts and performance in their material financial disclosures in order to inform shareholders, benefit stakeholders and seek their ideas and views and contribute to company strategy.

- Lift ethical standards in all operations, including in dealings with customers, regulators and business partners. Sustainable investors require that the companies in which they invest adopt and rigorously follow codes of conduct that are based on recognized global best practices to guide their policies, programs and operations.

- Demonstrate transparency and accountability in addressing adverse events and controversies while minimizing risks and building trust.

Preferences for Domains and Geographic Areas

Sustainable investors often focus their activities on companies engaged in addressing needs, problems and challenges in a specific societal domain and/or geographic area.

Popular target societal domains include agriculture, education, safety, demography, community, poverty, environment, health and well-being, housing, and ethical goods and services.

Geographic areas that have attracted substantial interest from sustainable investors include East Africa, West Africa, India, Pakistan and Latin America.

Given the nature of some of the requirements described above, it is not surprising that many sustainable investors are not interested in pure “startups” and are looking for companies that have advanced to the “early stage” of development and have identified a stable business model that has already achieved some minimum level of revenues.
Exclusionary Criteria

Many sustainable investors have developed “exclusionary criteria” that list activities and other characteristics that will disqualify companies from investment consideration. For example, a sustainable investor is quite likely to rule out funding companies that:

- Are involved in the extraction of carbon based resources, such as coal, petroleum, and natural gas, for the production of fossil fuels;
- Are primarily involved in producing or distributing alcohol or tobacco products;
- Develop, manufacture or profit from weapons, including conventional, chemical, biological, and nuclear weapons;
- Generate nuclear power;
- Genetically modify seeds or living organisms (although such activities may be allowed with a showing of countervailing social benefits such as demonstrating leadership in promoting safety, protection of Indigenous Peoples’ Rights, the interests of organic farmers and the interests of developing countries generally);
- Are involved in the gambling, gaming or adult entertainment industries;
- Have primary business practices that involve the inhumane treatment of animals; or
- Have profited from conspicuous consumption, land speculation, predatory financial practices, or privatized detention facilities.

This startup guide is intended to contain general information as to some of the legal matters that a client may encounter during a financing. It is not intended to be comprehensive or otherwise constitute legal advice or opinion. Please contact us if you have any questions.

Reprinted from Business Transactions Solution with permission of Thomson Reuters. For more information about this publication please visit www.legalsolutions.thomsonreuters.com