

ESG Pulse Check: Getting the Basics Right for Start-ups and Venture Capital Firms

INSIGHT REPORT
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Introduction

Coined in 2005, ESG (environmental, social and governance)¹ is a term that is becoming nearly ubiquitous in boardrooms, quarterly earnings announcements and impact reports throughout the world. The shifting macroeconomic and geopolitical environment has only increased its importance, further enhanced by a regulatory push to increase scrutiny on how companies as well as investors address ESG. This mounting pressure is being felt across all asset classes, and venture capital is no exception.

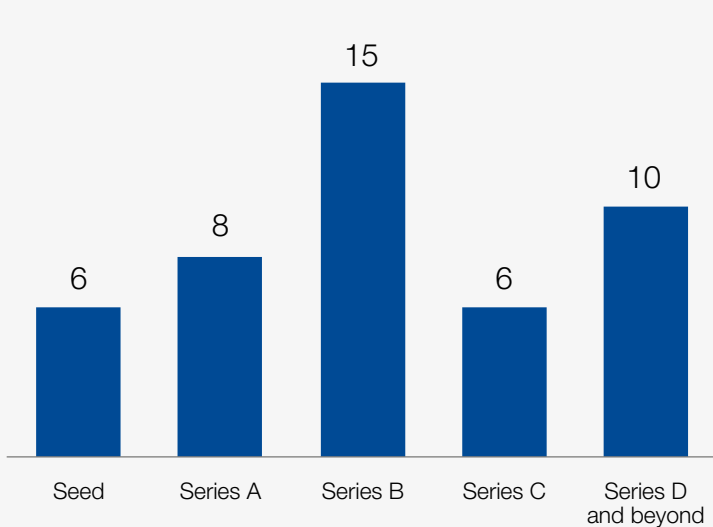
While venture capital firms are a critical force in shaping the future of people, planet and society as they invest in the leading start-ups and disruptive technologies of the future, the start-ups themselves have largely been left out of the conversation when it comes to ESG.

Through this briefing paper, the World Economic Forum aims to highlight what start-up and scale-up companies are thinking and doing on the ESG front, and the assistance they are seeking to ensure that they can avoid greenwashing and implement standards and strategies early on.

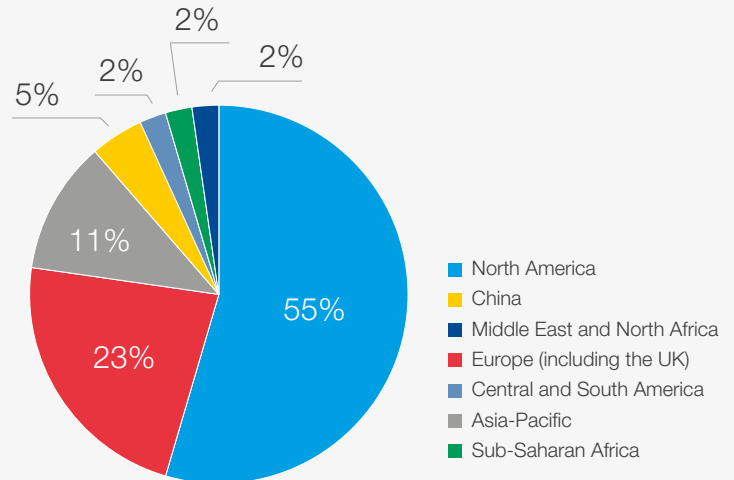
A wide-ranging group of 45 start-ups from the Forum's [Technology Pioneers](#) and [Global Innovator](#) communities, spanning different stages of funding, geographies and sector areas, have shared diverse perspectives on ESG through a survey as well as interviews with subject matter experts within many of these start-ups. Further, insights have also been gained from the session "The Next Startup: Competing in an ESG World" at the World Economic Forum's Global Technology Governance Retreat 2022.

FIGURE 1 Breakdown of survey participation

Funding stage of companies participated in the survey



Locations of companies participated in the survey



Source: World Economic Forum

An overwhelming number of survey and interview responses highlighted ESG factors as being a part of their core mission and business strategy, as demonstrated by the word cloud below. Founder commitment to ESG goals and the mounting pressure from consumers as well as employees is driving early-stage companies to build their

businesses with a consciousness towards their environmental impact, diversity and inclusion and ethics regarding the use of technology and data. Despite this, it is not yet evident that start-ups with more robust ESG strategies receive more funding or perform better.



It is important to note that this paper was conceptualized in February 2022, when macroeconomic conditions were more favourable and hence, fundraising could be considered as more plentiful for start-ups. Over the past few months, however, the fundraising environment has evolved due to heightened geopolitical tensions, supply chain disruptions and rising interest rates. Venture firms have, therefore, slowed dealmaking, especially at the early stage. While many founders may consider these shifts as an indication to de-prioritize ESG,

venture capital firms stockpiling cash right now might look to invest in early-stage companies that have a strong social license to operate as dealmaking picks up.

The following two sections highlight some of the key takeaways for start-ups interested in embedding ESG into their business strategies and venture capital investors looking to create a differentiated sustainability offering for their portfolio companies.

② Key takeaways for start-ups



1. Companies with robust ESG strategies tend to consider them from day one and build measurement and accountability into all facets of their business.

The overwhelming majority of start-ups that were surveyed (68%) integrated ESG into their business strategy since the genesis of their companies, before most even had a viable product, complete C-suite, or office space. While the companies surveyed likely skew towards being purpose-driven, which aligns to the Forum's mission to improve the state of the world, it is a significant number of companies nonetheless that had these considerations in mind from the beginning. With the chances of failure so high for start-up companies, there is pressure for economic survival, and ESG compliance or strategies is typically not something investors or customers are determining as mandatory. In a [study done by CB Insights](#) of seed-funded US companies, nearly 70% of companies

fail to raise further funding or successfully exit, most failing within 20 months of raising their seed rounds.

Rather than needing to balance the demands for economic survival (finding product-market fit, signing first customers, attracting talent and investors) with deploying ESG strategies, it is the companies that had ESG considerations in their mission, problem statement or business model from the beginning which continue to have the most mature ESG strategies as they scale. Many expressed their business has been built with ESG as one of their core values and founding principles and should never be considered as mere marketing collateral nor as additional corporate social responsibility (CSR) efforts.



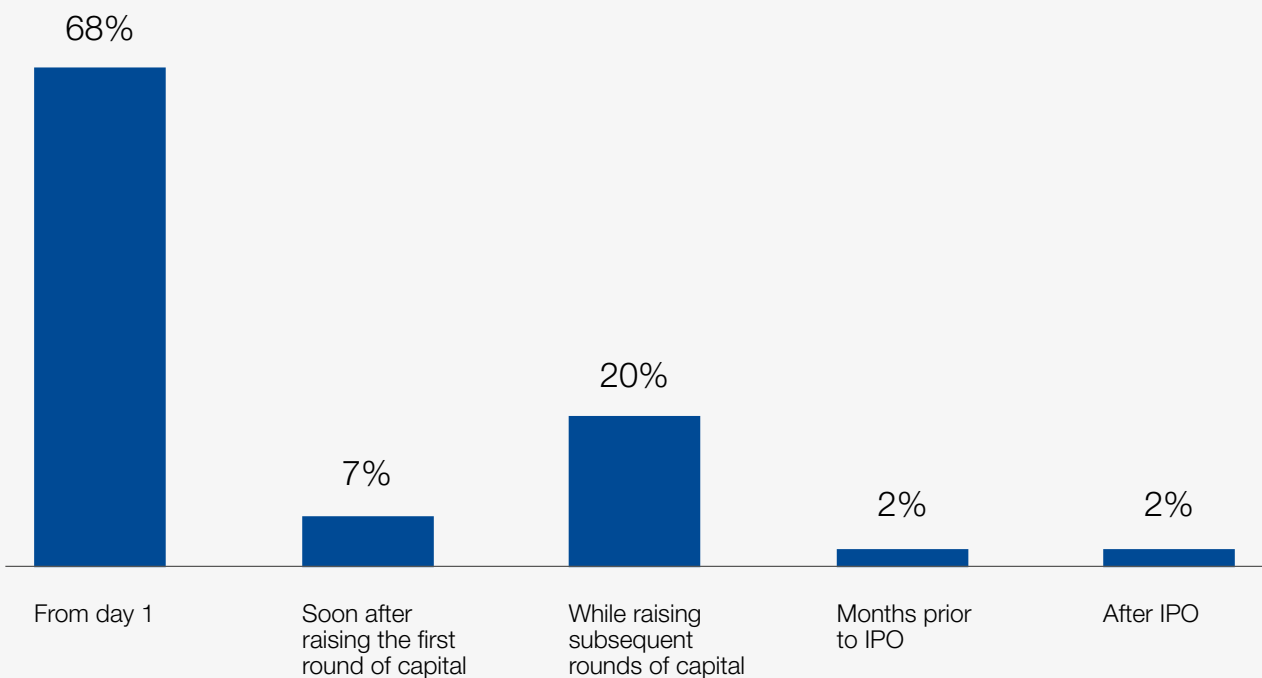
Companies are the catalyst to perform ESG and to create positive impacts beyond the immediate boundaries of corporations and industry verticals. For example, for companies that are committed to sustainable way of building, they should incorporate ESG as core of our businesses, not just an add-on, where measurable metrics are woven into the value chain for creating energy-efficient buildings and carbon-zero cities.

Fanyu Lin, Chief Executive Officer, Fluxus

The relative ease of early-stage ESG integration does not mean that later-stage companies should forgo ESG altogether. Rather, it suggests that the sooner a

company begins integrating ESG, the more effective this will be; it is never too late to get started.

FIGURE 2 Timing of ESG strategy integration



Source: World Economic Forum

As an organization working to prevent food waste through science and data-driven solutions, quantitative measures of impact and ESG reporting are integral to proving the viability of our plant-based protection and necessary for acceptance among various stakeholders.

Jessica Vieira, Vice-President, Sustainability, Apeel

Apeel Sciences is a California-based food system innovation company founded in 2012. It has developed a method of plant-based protection for fresh food providers that doubles the lifespan of harvested fruits and vegetables, helping to reduce food spoilage across the supply chain, which conserves water and energy, and preserves natural ecosystems.

In its first seven years, Apeel Sciences focused on research and product development and involved sustainability experts from the very beginning. Throughout the entire product development lifecycle, employees and experts together asked how sustainability was being factored into decision-making. Quantifiable metrics at the overall level and for individual products were built and tracked both manually and via such technology as smart utility meters, and the net environmental benefits were calculated using in-house lifecycle

assessment expertise. Products were thoroughly evaluated to determine their sustainability value propositions, ensuring that the products that were commercialized met the company's rigorous sustainability standards.

As Apeel has scaled to service retail customers throughout North America and Europe with products available in over 10,000 grocery stores, there is now a dedicated team focused on sustainability that is embedded in the finance department and maintains close alignment with the company's leadership. This team focuses on setting and maintaining sustainability metrics, overseeing all sustainability measurement technology, and twice a year reviewing overall performance with the leadership team and sharing updates with the board. Apeel plans to publish its first impact and ESG reports publicly in the fall of 2022.

For companies with sustainability, social equity, or better governance as their business model, ESG is inherently in the design of the product and company, and therefore tracking metrics internally like greenhouse gas emissions or pay equality is integral to them "walking the talk" with their own product offering. However, for companies whose product is not necessarily tied directly to a component of ESG, it is still possible to have robust ESG strategies, particularly if it is embedded in the culture from the beginning.

For example, the awareness and compliance of basic ESG principles is instilled in a company's people and processes and reinforced as the company scales. This can be done through a number of concrete actions:

- Tracking carbon related metrics (i.e. carbon emissions addressed through start-up offering, product-level carbon emissions)
- Offsetting airplane carbon emissions or incentivizing lower-carbon emitting transport options (i.e. commuting or traveling via train versus car or plane).

- Monitoring and reducing resource use in the office spaces – food waste, packaging and paper use, energy efficiency in the building
- Offering parental leave that extends beyond the minimum required by governmental policy and including extended leave for non-birthing parents
- Conducting annual pay equality and wage reviews
- Sharing diversity and inclusion metrics – the number of employees per employee group broken down by age group, gender, ethnicity, etc.
- Tracking and ensuring fair treatment and pay for employees, especially for start-ups employing gig workers
- Offering training on anti-corruption and ethical behaviour for all employees

Such visible actions typically driven by a start-up's leadership team are explicit ways to show stakeholders, including employees, customers, investors and partners, that the company not only deeply cares about the issues around ESG, but also puts practical efforts forward.

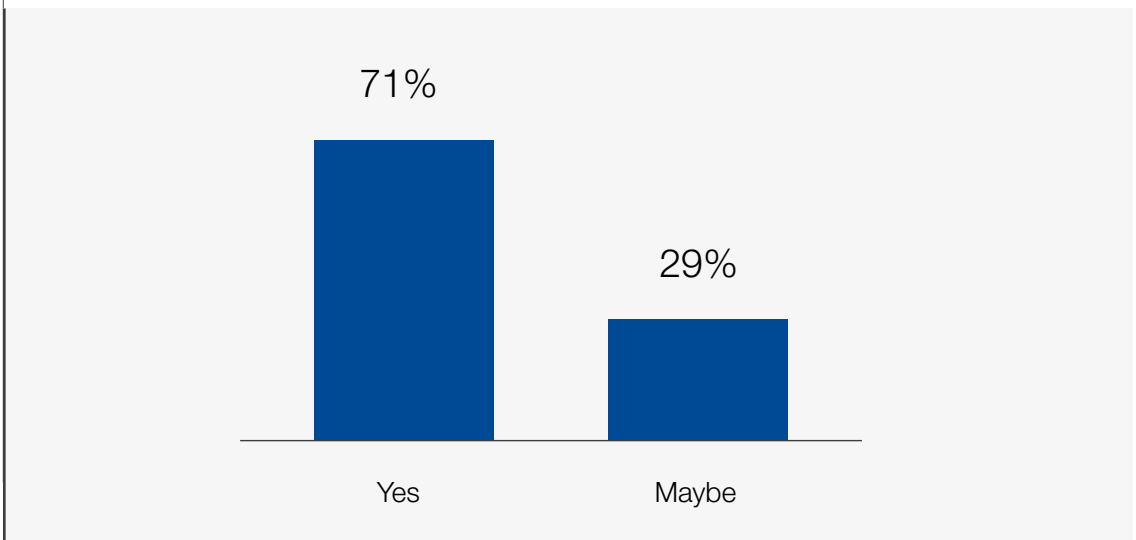
2. ESG metrics must be friendly towards start-ups and scale-ups.

When it comes to concretely measuring ESG performance, there is still a lack of methodologies as to how start-ups could practically approach ESG. The current standards in the market (such as SASB, GRI, etc.) are mainly focused on corporates that can dedicate resources into thoroughly tracking all required metrics. As often the highest priority for early start-ups is to survive and prove their products in the market, it can be seen as a luxury and burdensome for start-ups to follow such metrics. Collaborating with external consultants comes at a cost and often lacks buy-in from the management. Management teams often do not have enough bandwidth to think strategically on the matter or deploy the necessary resources for strict ESG measurement and compliance.

That said, start-ups positively viewed standard ESG frameworks that were tailored for venture-backed companies, currently being developed by certain industry communities, such as [VentureESG](#), [ESG_VC](#) and [UN-PRI](#). Many expressed that such metrics should not be designed as onerous for them to follow, measure and implement, but should be practical in nature.

The Forum's [Stakeholder Capitalism Metrics](#) is another example of universal and practical metrics that can be leveraged for a start-up's implementation. To help with measurement, start-ups can leverage technology to track and improve their environmental impact. When it comes to the S (societal) and G (governance) factors, existing guidelines and best practices highlighted in the above examples of metrics can be leveraged.

FIGURE 3 Usefulness of standard ESG frameworks for start-ups



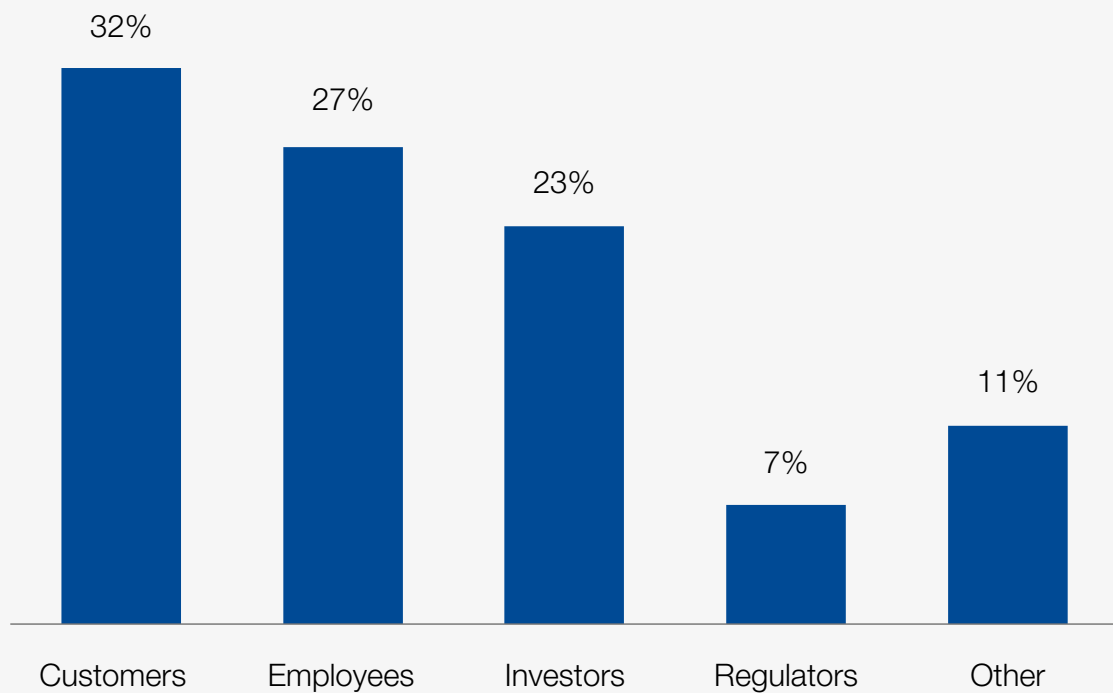
Source:
World Economic Forum

3. Customers and employees are the key stakeholders demanding ESG advancement from companies, while pressure from investors seems to be a forthcoming driver.

The majority of start-ups in the survey expressed the increasing importance of two key stakeholder groups when implementing their ESG strategies: customers

(32%) and employees (27%) were determined as the key drivers for implementing ESG strategies, followed by investors (23%) and regulators (7%).

FIGURE 4 Key stakeholders for ESG implementation



Source: World Economic Forum

Customers

A macro trend shows that consumers are increasingly demanding companies to take greater ESG responsibilities. In the [2021 Consumer Intelligence Series survey](#) on ESG, 83% of consumers think companies should be actively shaping ESG best practices. With symptoms of

climate change making headlines, about 69% of consumers worldwide have changed the products and services they use due to concern about climate change, according to a [survey](#) from IPSOS. This not only applies to B2C companies that are directly in relationship with consumers, but also with B2B companies with customers being organizations.



These days, customers not only require technology companies to provide products and services at competitive prices and quality, but are increasingly expecting them to improve their ESG performance.

Yinglian Xie, Chief Executive Officer, Datavisor

Employees

Millennials and Gen Z, which now make up a majority in the workforce, are a crucial component of start-ups shifting towards not only planning, but implementing ESG practices. These younger generations want to invest their resources in a way that leaves a positive mark on society and want to align their personal mission with that of an

employer. According to [Forbes](#), as social issues have become the mainstream in the global news, it is crucial for businesses to play their part by embracing ESG practices to satisfy Millennials and Gen Z, which essentially act as both employees and consumers. In the highly competitive market for talent, companies are able to differentiate themselves based on their principles and actions.



Young workforce recruitment is high and these individuals are more keen on ESG than investors.

David Garfield, Chief Executive Officer, Garrison

Investors

Although start-ups are traditionally backed financially by investors, it is not evident from the findings that robust ESG strategies are currently a significant factor when raising funds. While this may be a differentiating factor for later-stage and more established companies (Series C and beyond), for early-stage companies, a profitable and viable business model is considered the top priority.

However, a number of start-ups stated that venture capital funds are important partners for them to deepen their understanding of ESG, especially as the pressure to improve ESG in the venture capital asset class is mounting.

3

Start-up expectations for venture capital funds

As venture capital firms begin to scrutinize their own ESG strategies, there are some who are suggesting or even requiring start-ups to embed these considerations into their business activities.

Start-ups involved in this survey were asked to share their expectations of VC funds when it comes to ESG. Here are three insights:

1. Investors must demonstrate their commitment to ESG through successful case studies.

Start-up founders are increasingly looking for ESG-related value proofs from their investors before bringing them onto their cap table. While the funding environment for start-ups is tightening, with a funding drop of 23% in the second quarter of 2022,² start-ups are evaluating who they raise funds

from in a more nuanced manner, including aspects such as commitment to ESG and how they prioritize various factors within E, S and G separately. In the World Economic Forum Survey, 64% start-ups said that sustainability expertise of investors is a factor when they think about fundraising.

“

We are looking for investors with deep expertise and a demonstrable track record in investing and prioritizing ESG factors in their portfolio companies.

Charles Bark, Founder and Chief Executive Officer, HiNounou

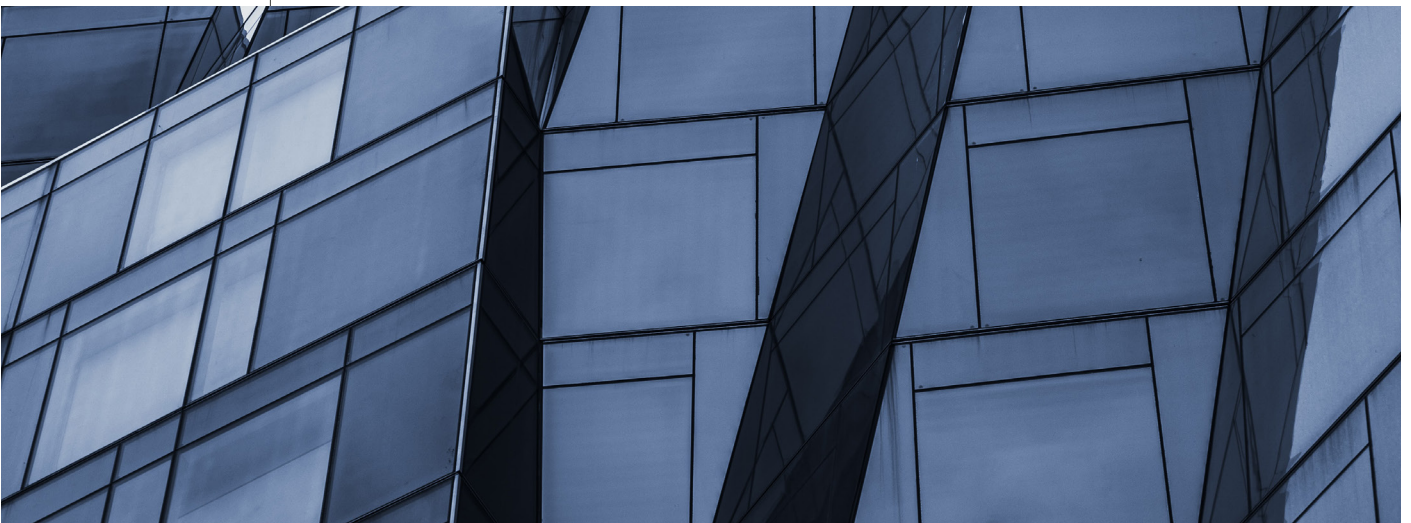
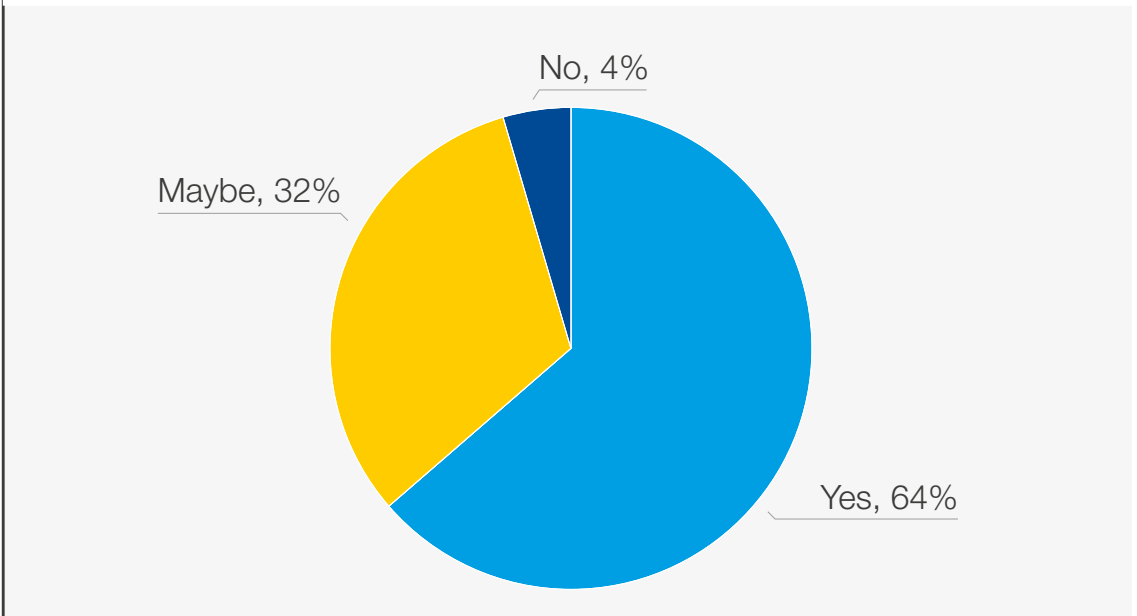


FIGURE 5 Sustainability expertise as a factor when choosing investors



Source:
World Economic Forum

“ It is imperative for VCs to show what they are doing while sharing how they are taking their responsibility of action forward. Further, start-ups must complement VC efforts by looking at ESG multi-dimensionally, so that it doesn't just become a marketing issue.

Katrina Donaghy, Co-Founder and Chief Executive Officer, Civic Ledger

2. Investors can provide differentiated value by meeting portfolio companies where they are in their journey and providing sustainability-as-a-service.

VCs can use the power of their networks and knowledge at an ecosystem level to identify key insights that help portfolio companies effectively embed and deploy ESG strategies. The topic of

education and capacity building was a recurring theme across survey responses, in-person workshop and interviews.

“ Investors should help founders by educating them on ESG topics and bringing their expertise to board meetings, just as they do on product and financial side.

Maria Carolina Fujihara, Founder and Chief Executive Officer, SINAI Technologies

In addition, it is imperative for VCs to meet start-ups where they are in their journey. Starting small, for instance by aligning on the one key ESG issue that the start-up has the potential to make a disproportionate impact in and building from there using the services that investors have to offer can add great value for both sides.

VCs can also collaborate with platforms such as the World Economic Forum, to aggregate best practices and build tools that help in implementation, especially the governance and social factors.

“ Investors can help start-ups structure their ESG and sustainability strategy and simplify upcoming regulations.

Lou Verschave, Impact Manager, Ynsect

3. Investors should be flexible and focus on tailored metrics for their portfolio companies.

Even though ESG integration in venture capital is still at a very nascent stage, increasing investor expectations on ESG is now extending to portfolio companies. While ESG metrics can be a helpful way to gauge and alleviate potential risks for start-ups, investors must recognize that there is a significant gap in the supporting ecosystem of ESG benchmarks, relevant indicators, measurement tools, etc. Levying onerous reporting requirements on start-ups can do more harm than good as these companies have limited resources to balance growth and sustainability.

During the survey and interviews, start-ups mentioned the need for investors to be flexible and work with the companies to identify a small, but material set of ESG metrics that fit with the company's strategic vision. Further, these metrics must be chosen in a way that enables the next set of investors to also find meaning in the ESG reporting.³ Many survey respondents also mentioned the benefit of VC firms sharing success stories of their portfolio companies to highlight qualitative insights about the progress of these start-ups.



Good news is a powerful thing. Investors can move the needle by sharing case studies that can clearly outline the tangible operational and tactical benefits of integrating ESG into their portfolio companies.

Aba Schubert, Co-Founder and Chief Executive Officer, Dorae

It is important to note that for VC investors, focusing on small sets of metrics that are material to each individual company can become quite onerous. The more bespoke the metrics, the more challenging it becomes to take a portfolio-level view of ESG.

Therefore, alignment between investors and start-ups on both value and values is key not only to balance bespoke metrics and portfolio-level metrics, but also to understand how can investors and startups scale and improve the business together.

Conclusion

Start-ups have largely been left out of the conversation when it comes to ESG until now. Considering the immense societal role that start-ups play in society today, it is crucial for each and

every company, no matter their size, to consider and define what ESG means for their organization and stakeholders they serve.

Key findings from the report include:

ESG should not be approached as a stand-alone topic but be embedded into key corporate strategies and decision-making, ideally from the beginning so that it scales with a company.

Having a practical and start-up friendly ESG framework or toolkit would be highly useful for companies and investors alike.

Support from the entire start-up ecosystem, especially investors, is helpful for start-ups as they plan, execute and measure their ESG strategies.

A strong ESG strategy alignment on a board level is critical, yet was not necessarily discussed as part of this paper. As Matthew Wallace, Chief Executive Officer of DXM, stated: “ESG must come from all stakeholders including the boardroom, CEO, investors, shareholders and employees in order to make it truly work and make the difference we all need it to.” He added that all stakeholders, including the board, should actively drive and advocate their own corporate ESG strategy. Additional insights on this topic will be investigated in the future research.

This briefing paper highlights the viewpoints of start-ups on the concept of ESG as well as areas of opportunities and challenges. Using the insights generated in the process as a foundation, the World Economic Forum aims to explore building a deeper toolkit and concrete corporate practices. This will be done through continuing to convene key start-ups as well as ecosystem players (e.g., venture capitals, regulators) across various geographies, industries and stages.

Contributors

Authors

Shrinal Sheth

Project Lead, Investing, World Economic Forum

Michelle Watt

Engagement Lead, Global Innovators, World Economic Forum

Saemoon Yoon

Community Lead, Technology Pioneers, World Economic Forum

World Economic Forum Global Innovators and Technology Pioneers

Charles Bark

Founder and Chief Executive Officer, HiNounou

Katrina Donaghy

Chief Executive Officer and Co-Founder, Civic Ledger

Misha Esipov

Co-Founder and Chief Executive Officer, Nova Credit

Fanyu Lin

Chief Executive Officer, Fluxus

Maria Fujihara

Founder and Chief Executive Officer, SINAI Technologies

David Garfield

Chief Executive Officer and Co-Founder, Garrison

Aba Schubert

Co-Founder and Chief Executive Officer, Dorae

Didier Toubia

Co-Founder and Chief Executive Officer, Aleph Farms

Lou Verschave

Impact Manager, Ynsect

Jessica Vieira

Vice-President, Sustainability, Apeel

Matthew Wallace

Chief Executive Officer, DXM

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Additional contributors

Leonardo Banchik

Partner, Global Founders Capital

Tracy Barba

Executive Director, Global Head of ESG, 500 Global

Angela Du

Partner, Softbank Investment Advisers (Vision Fund)

Subodh Gupta

Principal, Valo Ventures

Shu Dar Yao

Founder and Managing Partner, Lucid Capitalism

Endnotes

1. ESG: Environmental, social and governance factors that are material for a start-up to maintain its social license to operate.
2. Prakash, Prarthana, "Venture Capitalists Face a Reckoning as Funding and Deals Slow", Bloomberg, 13 July 2022, <https://www.bloomberg.com/news/articles/2022-07-13/venture-capitalists-face-a-reckoning-as-funding-and-deals-slow>.
3. Sheth, Shrinal, "ESG is coming to venture capital. Here's how startup founders can stay ahead of the curve", World Economic Forum Agenda, 5 January 2022, <https://www.weforum.org/agenda/2022/01/esg-is-coming-to-venture-capital-here-s-how-early-stage-startup-founders-can-stay-ahead-of-the-curve>.



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World Economic Forum
91–93 route de la Capite
CH-1223 Cologny/Geneva
Switzerland

Tel.: +41 (0) 22 869 1212
Fax: +41 (0) 22 786 2744
contact@weforum.org
www.weforum.org