eban The European Trade Association for Business Angels, Seed Funds, and other Early Stage Market Players

EUROPEAN EARLY STAGE IMPACT INVESTING

EBAN White Paper June 2011

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EBAN is delighted to be publishing this white paper to encourage more early stage investors to invest in triple bottom line, People, Planet, Profit entrepreneurs. This is vital for the sustainable development of our economies and to address major social and environment challenges we face. On a personal basis I invest in Impact start-ups and enjoy doing well while doing good "

Brigitte Baumann, President, EBAN

EXECUTIVE SUMMARY

Early stage impact investing is investing in for profit businesses that have the specific objective of creating positive social and environmental impact, in the way the business is conducted and/or the products are realised.

The market is very young and is still in a diverse and nascent stage, which makes measurement of its size difficult. Eurosif, which has been collecting data on this market since 2007, predicts that the share of impact investing of high net worth individuals' portfolio will grow from 11% to 15% by 2013. EBAN will publish its first data on this sector in 2011.

EBAN believes that early stage Impact Investing should and is poised for growth since:

- There is growing evidence that investors can do well and do good at the same time. This is attracting the interest of younger generations of investors, women and family offices. This will grow the business angel investing sector as a whole.
- There is an increasing need for sustainable business and consumer behaviour. This is creating new opportunities for impact entrepreneurs which will require financing, especially from the private sector as government support diminishes.
- Other public and private players in the ecosystem are becoming active in this area, creating opportunities and needs for collaboration.

Early stage impact investing is not significantly different from traditional investing. However, three aspects that do differ are: measurement parameters, diversity of co-investors, and exit opportunities.

To facilitate the successful growth and integration of impact investing in the early stage investment asset class, EBAN will integrate its specificity in its five strategic pillars of activity:

- Professional standards
- Benchmarking (research and events)
- Capacity building
- Lobbying
- Support to cross-border collaboration including co-investment.

WHAT IS EARLY STAGE IMPACT INVESTING?

Impact investing: investing in for-profit businesses that have the specific objective of creating positive social and environmental impact.

Key characteristics:

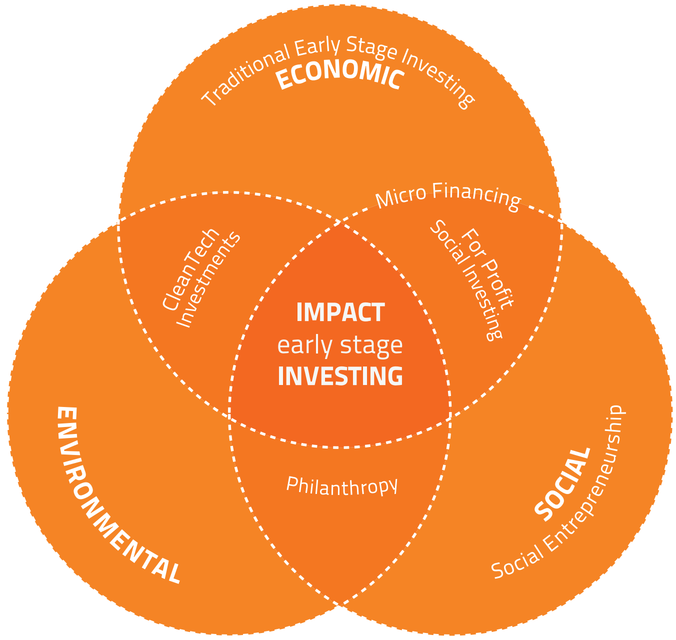
- Capital may take the form of equity, convertible debt or debt.
- Impact may be delivered through HOW the business is run, for example in terms of governance, operations and processes employed, and/or WHAT the business does, for example the target population served, the products and services produced.
- Return of impact investments can range from producing a return of principal capital to offering market-rate or even market-beating financial returns[1].

What are the potential impacts?

- Economic
- Environmental
- Products and Services
- Product Responsibility
- Governance
- Labor Practices
- Human Rights
- Societal[2]

1 Based on Impact Investments an emerging asset class, JPMorgan Global Research, 2010
2 Based on Sustainability Reporting Guidelines, GRI, 2010

How does impact investing differ from other forms of investing:



Glossary of terms and references:

Traditional early stage investing: The key difference between traditional early stage investing and early stage impact investing is that the former essentially focuses on shareholder & financial return while the latter takes a stakeholder and triple bottom line – People, Planet, Profit perspective. Further differences are detailed later in this document.

Social responsible investing (SRI): Investing in companies, typically through publicly-traded securities, that favor strong environmental and social governance ('ESG') policies and avoid investments in businesses involved in industries such as alcohol, tobacco, gambling and weapons, although there can be exemptions to this in some cases of defense industries. Impact investing and socially responsible investing contrast in two points: SRI does 'negative screening' of projects and includes investments in publicly traded companies, whereas early stage impact investors proactively create impact and invest in private unquoted startups.

CleanTech investing: CleanTech companies seek to provide an environmental impact but unlike impact investing, do not necessarily make sure that they create an end-to-end positive impact. In other words, they may solve a problem in one area but create one in another area like food or waste.

Social investing: Social investments focus around an impact on the social line and do not necessarily consider environmental impact. Although they are becoming profit oriented, unlike impact investing, many are not geared to give above market or even market returns.

Philanthropy: Philanthropy has traditionally focused on gifts made by individuals and organisations to benefit society and the environment. Impact investing, with its requirement of a minimum return of principal, is distinct from grant making or subsidy activities.

Micro financing: Micro financing is a part of impact investing; however early stage impact investing usually involves larger amounts of investment compared to microcredit's, investment is in start-ups rather than projects, and usually equity based rather than debt based.

*Please note that the spectrum of these definitions is subject to change in the long term, since the concepts are emerging.

Who are the early stage impact investors?

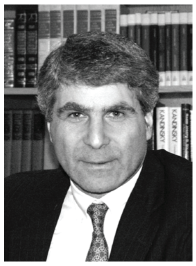
They can be classified into three key categories:

- Financial first investors: seeking to optimise financial return with an attention to social or environmental impact.
- Impact first investors: seek to optimise social or environmental impact with a view to make a financial return.
- Ying-Yang deals: Deals that combine impact first and financial first investors, and sometimes philanthropic investors as well[1].

The following types of investors have been identified as active in the impact investment sector.

What is the current European market situation? Is early stage impact investing a growing trend?

Currently, the impact investing market is still in its building phase, which means that centres of specialised activity and interest are beginning to develop and infrastructure is being built around the sector. Yet it is still in a diverse and nascent stage, which makes the precise measurement of the size of the market difficult.



We are delighted that EBAN is publishing this White Paper at this crucial juncture. We at ClearlySo are one of Europe's largest social business angel networks (with over 2,000 social entrepreneurs and 200 investors), and we can testify that interest in this sector is surging. Not only are the number of interested angel investors growing but the demand from social entrepreneurs for capital is also booming. This is partly due to the fact that across Europe, privately funded social enterprises are needing to fill the gap in delivering positive social impact as fiscally constrained governments retrench. This was the perfect time for EBAN to use its clout and credibility to put its views forward—it is high time for the EU to respond to the possibilities from this sector. "

Rodney Schwartz, CEO, ClearlySo (London, UK)

← **Early Stage Investors** | **Later Stage Investors** →

High Net Worth Individuals	Development Finance Institutions	Foundations	Values and Faith Based Investment Networks/ Funds	Retail Investors	Large Corporations/ Financial Institutions	Public Institutional Investors
Apply business principles to philanthropic pursuits.	Aim to achieve results without sacrificing financial sustainability	Aim high social impact with the order of an investment. May forego return for sustainability	Have diversified portfolio of investments consistent with social values	View investment as a cover to a donation	Support corporate social responsibility programs	Deploy percentage of capital in socially responsible manner

← **Higher Risk/Return Expectation** | **Lower Risk/Return Expectation** →

Source: More than Money, Center for Global Development, 2010

1 Based on Investing for Social & Environmental Impact, Monitor Institute, 2009

We at EBAN have been collecting data on the business angel market since 1999 and have started to collect data on this sector this year. We will publish our first findings in our 2011 Statistics Compendium. Other organisations, such as Eurosif, collect European data on impact investment and EVCA on private equity and venture capital investments in the CleanTech sector. In the US, the Kaufmann foundation and GIIRS collect industry data. Support to market research on European early stage impact investing would greatly contribute to increasing the awareness and information for potential investors.

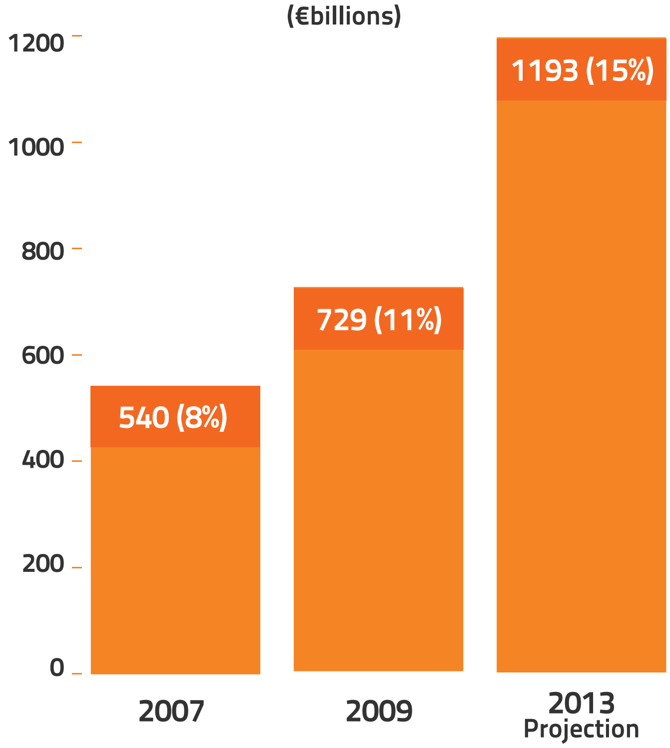
The EBAN white paper provides business angels facts, trends, and analysis about the emerging field of impact investment. We all love investing in a good business model; when it's a good business model also doing good in the world, that is impact. "

Frank van Beuningen, founder, PYMWYMIC (Put Your Money Where Your Mouth Is Company)

Although EBAN does not yet monitor early stage impact investments, according to our annual survey of activities undertaken by members of business angel networks in 2009, 13% of deals done and 14% of the amount invested concerned the energy/environment and healthcare sectors, which can be considered close to impact investments. EBAN estimates that early stage impact investments will account for around 5% of early-stage investments in the near future.

Eurosif has been conducting research on Sustainable investments since 2007. They have found that, even though total European high net worth individuals (HNWI) financial wealth decreased since 2007, the share of sustainable investment is growing. Eurosif predicts that the share of sustainable investments in European HNWI's portfolios will grow from 11% to 15% by 2013, just below €1.2 trillion.

European HNWI Sustainable Investment Market (€billions)



HNWI Sustainable Investment Segment

Source: High Net Worth Individuals & Sustainable Investment, EUROSIF Report 2010

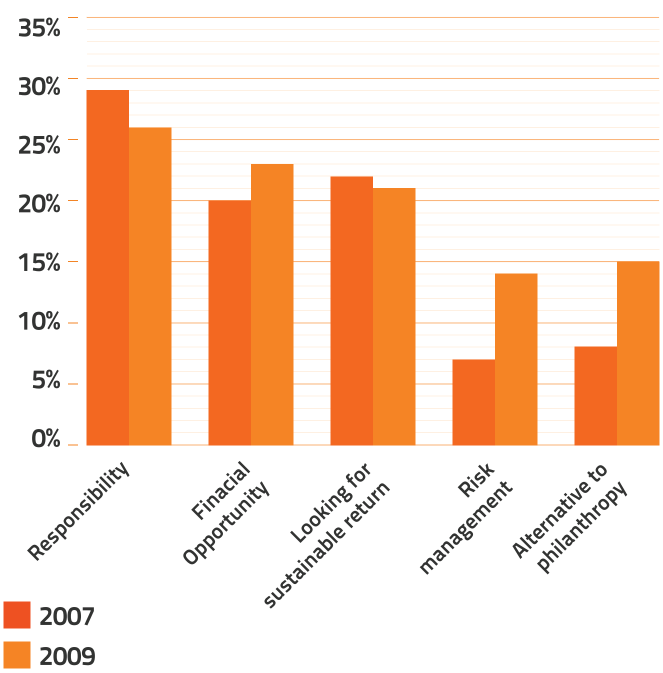
WHY IS EARLY STAGE IMPACT INVESTING POISED FOR GROWTH?

- There is growing evidence that **investors can make money and 'do good' at the same time.** While some of the 'do good' elements of start-ups may increase costs vs. traditional way of doing business, they can also have a net positive economic impact, such as customer loyalty, employee recruitment, etc. There are more and more success stories in various sectors and seasoned entrepreneurs in this space. The loss of confidence in traditional financial markets continues to increase interest in investing in businesses that have a purpose beyond just making money.
- Established **world needs**: People have become aware that the planet cannot survive under current business and consumer behavior. Entrepreneurs are the key and critical players to kick-start and drive the changes the world needs and require financial support.
- Impact investing is attracting the interest of a certain typology of business angels – the ones that could grow the business angel-investing sector. Eurosif's study on HNWI and sustainable investment shows that younger generations of wealth managers are more tempted to invest in sustainable sectors. At the same time, women as key decision-makers, play a significant role in introducing and supporting sustainable investing in their ecosystem. These could be new groups of investors and new entrants to the early stage investment market.

What are the other drivers of this sector?

- Government regulation in most EU27 countries currently encourages investment that serves other gains besides financial, especially further to the economic and financial crisis of 2008.
- Several private banks are developing impact-investment products for their HNWI clients, including fund-of-funds models.
- Technologies are being developed to mitigate many of the world challenges particularly for less developed markets.
- Foundations and investment consultancies show interest in the market (e.g. the Kelloggs, Gates, Rockefellers, and Cambridge Associates Mission Investing Unit).
- Universities are offering concentrations in social entrepreneurship and establishing centres dedicated to the topic (e.g. Duke University, Columbia University, Harvard, Said Business School, Skoll, INSEAD, ISEA, Heidelberg, Erasmus).
- Major corporations have begun to explore whether investment should be one option for their corporate social responsibility programs. (e.g. The Shell Foundation, ChevronTexaco).

Drivers for Sustainable Investment Demand Over Time



Source: High Net Worth Individuals & Sustainable Investment, EUROSIF Report 2010

In this chart the most significant conclusion is that in 2008, over 20% of HNWIs were still motivated by philanthropic considerations when choosing sustainable investments. In 2010, less than 10% of

HNWIs believe they are filling a philanthropic need when investing sustainably. This is a good sign for the impact investing market since it shows that HNWIs distinguish between the social or environmental returns and the financial return, thus they do not see impact investing as an alternative to philanthropy. People increasingly believe that philanthropy cannot reach the scale that impact investing could reach in providing solutions to environmental and/or social challenges.

Early stage investors more and more often look at a triple bottom line (People, Planet, Profit) combining financial sustainability with social and environmental impact. EBAN's efforts to clearly define and monitor this new investment sector is critical in establishing consistent industry standards and to support building the ecosystem. This is an important milestone in the creation of a common language among investors, entrepreneurs and regulatory bodies.

Anna Czekaj, Early stage impact investor, Go Beyond

What are the challenges for early stage impact investors?

- Impact investing is a sector with little data and metrics i.e. low transparency and clarity of action to ensure return. There is a danger for this sector to be perceived as a trend or a bubble, or to be damaged by a few visible investments with little impact.
- Pursuing social/environmental return objectives and financial objectives at the same time.
- Possible mismatch between the expectations of investors in the same investment, between the weight they put on financial vs. people/planet impact. This could put unnecessary pressure on the entrepreneur and divert attention away from building the business.
- Finding follow-on investors and acquirers who will equally value the triple bottom line aspects of the startup as much as the early stage investors and continue the momentum.
- Investing in start-ups whose target markets are developing countries without the knowledge of key success factors in those markets and without local like-minded co-investors. Current early stage investors have limited experience in doing this.

HOW DO EARLY STAGE INVESTORS ENGAGE?

To engage in early stage impact investing, here are some of the differences in deal flow sourcing, due diligence, negotiation, investment management and exit:

cf. Table 1 (page 13)

A major difference amongst the two investment processes lies in the key evaluation criteria of an investment option, expected progression over time (milestones) and ways to measure/benchmark:

cf. Table 2 (page 14)

Examples of Early Stage Impact Investing – Case studies

Eko-Logic: Winner of Impact Investing of the year award at 6th Annual EBAN Awards Competition[1]
The idea of Eko-Logic's business model is to encourage compliance with the Kyoto Protocol while allowing individual investors to enter into sectors hitherto reserved for corporations. New regulations enabled the technology using dispersed generation to be implemented. This improves the efficiency of the system, provides higher quality energy to the costumer, increases the reliability of the power supply, and plays a part in the environment policy. Regarding the impact; first and foremost, the business model implemented by Eko-Logic, enables the provision of electricity to the inhabitants of the so-called 'last mile'. Thus, for many people in remote villages on Polish territory, it becomes possible to start a business - which in the absence of sufficient power was not possible. Second, the major customer is Czerneckich Educational Foundation, for which Eko-Logic performs close to 200 MW (100 turbines). All profits from wind farms will be allocated to the statutory objectives of the Foundation. The Foundation aims to help gifted students to develop their passions and interests, regardless of their distance from the main centers of science, and to give them better future prospects. It is important to break the barrier separating the students from rural areas and show them the possibilities, unfortunately, they usually do not have access to.

Ashberg Multi Family Office is delighted to be associated with EBAN who are leading the data consolidation and scene setting of early stage impact investing.
The EBAN White Paper is an excellent reference tool and provides clear signposting to investors wanting to make a positive social and environmental impact. It also covers investor motivations and challenges as well as detailing the investment process and highlighting successful case studies. This in turn serves to ensure clarity and common understanding amongst interested parties.
We are keen to recommend that other organisations support the growth of early stage investing through EBAN. "

Susan Dark, Director Ashberg MFO

IKAWA
Over 2.25 billion cups of coffee are consumed in the world every day, the majority of these by drinkers in industrialised economies. In contrast, some 25 million small holders in developing countries grow over 90% of the world's coffee. IKAWA is serving an alternative approach to the coffee trade that is more equitable and tastes better. The IKAWA approach enables a coffee supply chain where growers are able to supply drinkers directly with unroasted coffee beans. By simplifying the supply chain the IKAWA allows farmers to capture more

1 Case is directly taken from the pitches the companies have provided for the competition.

of the money paid by coffee drinkers. For coffee drinkers, IKAWA has designed an experience that allows them to turn un-roasted coffee beans into coffee they can drink. This experience offers better tasting coffee and increased sense of connection with the grower.

Prakti Design

Today half the world's population relies on biomass for their cooking needs. The biomass stoves or fires they cook on produce toxic fumes that kill almost 2 million people a year. These fires also consume over twice the necessary fuel and contribute to global warming and deforestation. Prakti Design is a for-profit company that designs and disseminates fuel-efficient, clean-burning cookstoves for the base of the pyramid. They advocate a human-centered design tailored to regional cooking practices and received good feedback to date. The whole community is impacted by a wide range of stoves, micro-financing schemes, and distribution (both by existing networks and trained salespersons), thus promoting local economic development. Following successful pilots that have improved the lives of 25,000 people in South India and Nepal, Prakti plans its first full-commercial distribution to roll-out from this July in India.

Table 1

To engage in early stage impact investing, here are some of the differences in deal flow sourcing, due diligence, negotiation, investment management and exit:

	General Early Stage Investment Process	**Early Stage Impact Investment Process**
Deal origination: The investor becomes aware of the opportunity	Mainstream methods: business angel networks, incubators, universities, intermediaries, referral from business associates or other individuals or organisations in their network, or personal search.	Follow the traditional methods via specialised sources including not-for-profit organisations such as Ashoka for social entrepreneurs.
Due diligence	Key decision criteria: • Team • Potential for financial return • Potential to achieve scale • Market need and innovation • Personal investment criteria	Key decision criteria: • Team • Potential for significant social and/or environmental impact • Potential for financial return • Potential to achieve scale • Market need and innovation • Personal investment criteria
Negotiation and execution: Negotiations with the entrepreneur over valuation & deal terms	Main factors are valuation, deal terms, follow-on investors and exit opportunities.	Define people/planet impact goals and how they will be measured. Negotiate valuation, terms including governance with 'sustainable' approach.
Manage investment and follow-on rounds	Investor is likely to become involved with the business, including through advice and mentoring, networking, functional input and member of board.	Importance of mentoring and advising is more significant in early stage impact investing since the market is still developing; there is a shortage of available best practices, impact tracking & benchmarks.
Exit investment	Investors often exit from successful investments by means of a trade sale.	Exit strategy options and best practices are being developed.

Table 2

A major difference amongst the two investment processes lies in the key evaluation criteria of an investment option, expected progression over time (milestones) and ways to measure/benchmark:

	General Early Stage Investment Process	Early Stage Impact Investment Process
Business plan	Potential for financial sustainability	Potential for financial sustainability Potential for significant social and/or environmental impact
Processes: core business activities, value chain	Economic Product Responsibility	Environment Human Rights Labor Society
Adhering to specific standards	ISO SA	ISO SA GRI
Management	Superior management with a proven track record, entrepreneurial team and/or capacity to take on board advice Reputation	Superior management with a proven track record, entrepreneurial team and/or capacity to take on board advice Management team with positive ethics Reputation
Governance	Relationship between shareholders, management and the Board of Directors	Relationship between shareholders, management, the Board of Directors and the other stakeholders

RECOMMENDATIONS AND CONCLUSIONS

What are EBAN's recommendations as a European trade association to stimulate this sector?

- The market needs to recognise that this is a full-fledged sector of early stage investing.
- All aspects of the ecosystem need to be encouraged and developed in a coordinated way in order to ensure sustainable growth of the market.
- The EU should continue to include social and impact innovation as part of its discussions on access to finance and the development of entrepreneurship across Europe.

To facilitate the successful growth of early stage impact investing, for Business Angel Networks (BAN), seed funds and national BAN Federations, EBAN will integrate the following actions into its five strategic pillars:

Professional standards
- Integrate impact investment aspects in our professional standards strategy, which could include certifying impact measurement tools.

Benchmarking
- Continue to refine the definitions of early stage impact investing. Measure and report on the estimated size of the early stage impact investing market.
- Facilitate impact investing seed funds to network and collaborate with BANs whose members do early stage impact investments.

Capacity building
- Support the building of the early stage impact investing ecosystem.
- Support the capacity building of business angel network fund managers in this sector by providing training through its EBAN Institute.

Lobbying
- Build awareness for this sector, in collaboration with the EU.
- Lobby with the EU for securities regulations, which are suited for the specificities of seed funds including (especially) for those doing early stage impact investing.

Support cross-border collaboration
- Extend the EBAN Shared Deals programme to impact investments.

These actions will increase the number of European early stage impact investors/BANs/funds, who will in turn provide valuable assistance to the entrepreneurs and ensure this sector grows rapidly and successfully thus contributing to the development of a sustainable world. EBAN will proactively reach out to players in this sector to integrate them into the EBAN membership.

Conclusions

The impact investing market is in its nascent stage and is growing.

However, a clear ecosystem is not yet defined and therefore there is room for new entrants and new practices.

In our view, impact values will and should be integrated over time into all early stage investments, therefore EBAN as the trade association for early stage investors will support its growth, formalisation and integration into this asset class.

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www.eban.org

EBAN is the European Trade Association for business angels, seed funds and other early stage market players.

Our mission is to support the growth and professionalisation of the early stage investing sector, from a 3 billion Euros to a 10 billion Euros asset class in the near future, up from 1 billion Euros 5 years ago.

The full and updated list of EBAN members can be found at :
www.eban.org/membership/directory

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