Investing for the future

Socially responsible investors in Europe have, thus far, shown little interest in providing venture capital to fund the clean technology revolution. They risk failing to provide for the future, argues **Alexis Figeac**

Go to any conference on 'clean technology' (cleantech), and you will find a growing number of venture capitalists (VCs). They are eager to invest in emerging companies developing innovative, environmentally beneficial businesses, whether in renewable energy, energy or resource efficiency, advanced materials or waste management.

Cleantech is a field in which Europe has a clear technology and demand-driven lead. Whether as a result of political will, with mandates to increase renewable energy generation in the EU, high environmental awareness, or simply out of an economic necessity to become more resource-efficient, European researchers and entrepreneurs have demonstrated innovation in cleantech for a whole generation.

Yet VCs face an uphill battle in raising sufficient funds to back the innovations that could make Europe self-sufficient in energy in the medium-term, or transform manufacturing and services into models of sustainability. For every dedicated cleantech VC fund in Europe – of which at most half a dozen are open to institutional investors (ie, non-corporate or family-owned) – there are at least as many fund managers trying to raise new funds.

Why is fund raising so hard? The answer is threefold. First, institutional investors allocate a minute portion of their assets to venture capital. Alternative assets make up 5–10% of a typical portfolio, and VC has to compete with real estate, hedge funds and non-VC private equity (PE) for a slice of the action, resulting ultimately in 1 or 2% of all assets for VC). Secondly, unlike information technology or biotech, cleantech has not been circumscribed as an investment segment and thus has been hardly visible.

But thirdly, and most surprisingly, those institutional investors with a mandate to invest socially responsibly avoid VC funds as an asset class.

By and large, today's socially responsible investment (SRI) funds invest only in public companies, either on the basis of exclusionary criteria (cutting out environmentally or socially damaging sectors), or by choosing so-called 'best-in-class' companies in sectors that contribute to today's environmental problems. But, increasingly, if climate change is to be addressed, how businesses are likely to be affected by efforts to cut greenhouse gas emissions needs to become a major selection criterion.

In so doing, the current breadth of the SRI investment universe will shrink and they will need to seek new stocks with a low carbon risk or, better still, companies whose *raison d'être* is mitigating climate change. Yet many such companies are currently under private ownership, and therefore not within the investment scope of many SRI vehicles.

SRI is ideology not terminology – while some SRI funds have a self-imposed restriction preventing them from investing in non-quoted stocks, they should instead be adhering to an investment philosophy, irrespective of the asset class. Calvert's socially responsible funds in the US are a prime example of implementing a vision, as opposed to simply promoting a marketing whim.

Beyond broadening the pool of publicly listed SRI-fundable corporations in the medium term, channelling socially responsible capital into non-quoted cleantech via VC and PE funds responds to the original concerns of SRI: investing for returns without compromising the future, either environmentally or socially. Many pension fund contributors, whether specifically earmarking their contributions as SRI or not, will not retire for another 30 years and they are rightly concerned about climate change. Only by investing in innovative cleantech, as well as renewable power generation, can institutional investors do justice to their expectations.

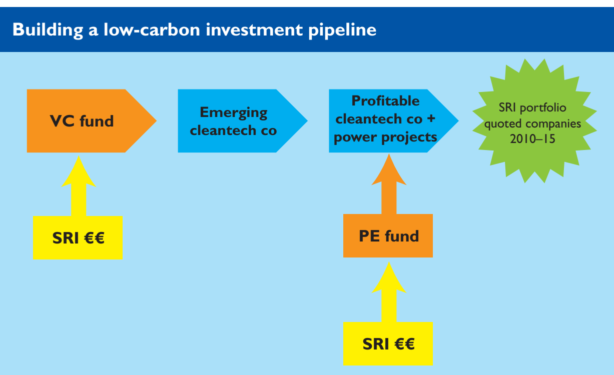
And the greatest innovations in cleantech do not take place in publicly quoted companies: they are to be found in laboratories, research institutes and small and medium-sized companies, where the savvy nurturing of venture capitalists assists in transforming them into robust and profitable business propositions.

The current trend towards listing on the London Stock Exchange's Alternative Investment Market, where many cleantech firms are going public before achieving stable economic activity, is symptomatic of the dearth of VC financing available. Passively waiting as a socially responsible investor for those businesses to stabilise is not the solution. SRI needs to become more active upstream: not by taking on the risk of directly investing in unquoted companies, but rather by investing in VC funds, and capitalising on their strengths in delivering risk diversification and adding value to their investee SMEs.

Such investments do not all share the high risk profile of venture capitalism. Whereas oil corporations and utilities are financing large wind and solar farms, small-scale power generation draws on private investment. Many farmers, for example, are becoming energy producers, either by tapping into the growing biomass market or erecting small-scale wind farms on their land. These investments are lower tech, and lower risk, but require private capital. There exist a number of PE funds focused on renewable energy generation. Therefore the SRI manager wishing to hedge some of the VC risk can move down the risk/reward curve, and also allocate funding to climate change mitigation via PE-financed renewable energy generation projects.

A further argument for the involvement of SRI capital in VC and PE funds is the pro-active role that they can play as investors. Such funds are typically "blind-pools", that is, funds are gathered from investors before investing begins. SRI asset managers can therefore lay down the rules from the outset, rather than typically only being able to react *ex-post* to the decisions of public companies. While SRI shareholder advocacy can react to corporate performance, its influence is at best limited. The equivalent investment in a VC fund provides a proactive framework – and a lot more (clean) bang for the SRI buck.

To summarise, then, investing in cleantech intrinsically corresponds to the underlying principles behind SRI. Cleantech is the growth industry of the 21st century, as it develops sustainability solutions across all industry sectors, and shapes the paradigm shift triggered by the end of the oil age. It is innovation-driven and therefore mostly found outside public markets – as seems to have been recognised by the giant US pension funds CalPERS and CalSTRS, which have pledged $1 billion to cleantech VC and PE. Socially responsible investors need to be investing now to ensure a sufficiently large pipeline of sustainability-oriented businesses for the future. They must get involved at all stages of the investment process, thus ensuring that their voices are heard and their values heeded.



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