Startups – What is your ESG score? And why should you care?

Have you measured your ESG score lately? Should you care? Well, if you are startup or a scaleup, your ESG score, such as your product or service's adherence to the UN's Sustainable Development Goals (SDGs), is likely to impact your business's ability to fundraise and grow.

Whether your business is purpose driven or not, according to *new research* by my team at *NGP Capital*, your business's perceived commitment to environmental, social and governance could be the difference between your business surviving or thriving, as the major economies of World race or accelerate towards net zero and balance gender inequality, and investors follow suit.

Our latest research demonstrates how environmental, social, and governance (ESG) is shaping the future of global fundraising and that a startups' purpose and impact matters to investors, employees, and customers now more than ever.

The SDG data for NGP Capital's report was sourced from Dealroom.co. The global fundraising data was sourced by NGP Capital's own data and analytics platform, Q, which scans and combines data from hundreds of different data sources. With $1.6Bn under management, NGP Capital is a global venture capital firm founded in 2005 investing in Europe, the U.S., and China that specializes in growth-stage venture investing and beyond.

Earlier this month, we analysed 2,292 startups from across Europe, the USA and Israel, which were founded no earlier than 2015 and had raised at least one equity funding round. We measured those startups' relevance to the UN's Sustainable Development Goals (SDGs), as we believe SDGs offer an ESG framework that can be applied and adhered to globally.

Our analysis revealed the following key insights into global startup and scaleup investment trends:

SDG relevant start-ups are less likely to fail. 5% of non-SDG focused startups founded since 2015 have ceased operations. By comparison, only 2.6% of SDG relevant, purpose-driven startups have closed shop. Startups focused on Climate Action, Consumption and Production, and Affordable and Clean Energy are especially robust.

SDG startups (36.6%) are more likely to raise Series A or growth funding rounds than their counterparts without an ESG focus (26.1%).

SDG relevant startups do not have a similar edge on exits. With 7.3% non-SDG relevant startups founded in or after 2015 having exited in the last 7 years, compared to 5.5% SDG relevant startups.

SDG relevant startups raise 2-3 times more than their non-purpose-driven counterparts. Typically, the average venture round size of SDG relevant startups is larger than those of non-SDG relevant companies. Zero Hunger, Affordable and Clean Energy, and Life on Land stand out as categories which raise the most growth stage funding

Even in the current investment market, our analysis shows that climate change and other global issues are getting the attention of the world's entrepreneurs and investors, and SDG relevant startups are proving that they have the potential to reshape the world's economy in the next decade and offer investors robust investment opportunities in the current economic climate.

Interestingly, our research also reveals:

Europe is leading the way. In terms of share of total funding, European SDG startups are raising more funding than their American counterparts. Reaching 14.7 % in 2021, compared with 6.2 % in the US. However, overall investment in SDG relevant startups in both markets is increasing year on year.

Funding for SDG relevant startups has doubled since 2020 and, in absolute terms, SDG relevant startups founded on, or after 2015 raised $24.2 billion in venture funding last year (2021).

Between 2015 and 2021, SDG relevant startups' share of total global funding has increased from 1.4 % to 8.4%.

Both the share of SDG relevant funding and the actuals have increased every year in the period, with a massive increase between 2020 and 2021 (from $10.5B to $24.2B), aligned with a general increase in VC funding in parallel.

- Sweden is currently the best place to setup an SDG relevant startup and access investment. SDG relevant startups in Sweden ($3.6 B)[i], the United Kingdom ($2.4 B) and Germany ($2.1 B) have received the most funding.
  While SDG relevant startups in Israel ($0.7 B, 11% of total) and France ($0.6 B, 8% of total) have attracted less-than-average amounts of funding.

- Just under 3000 SDG relevant startups have been founded in the USA, Europe, and Israel in the last 7 years (since 2015).
  Climate Action (SDG #13) is the most common cause or function amongst SDG relevant startups (881 businesses). Responsible Consumption and Production (SDG #12) is the next most popular issue (465).

- Climate Action and Clean Energy focused startups receive the most funding.
  Comparing funding levels, startups focused on Climate Action (SDG #13) have raised the most funding $13.1 B since 2015.

  Affordable and Clean Energy (SDG#7) startups raised $10.7 B.

  Industry, Innovation, and Infrastructure (SDG #9) startups raised $4.9 B.

It is clear that investors are starting to care; and with *ESG reporting* likely to become mandatory as early as 2023, in sectors not covered by the current *SFDR*, it’s a good idea to get up to speed or get involved/informed. Startups may not be required to report by any regulatory agency, but their investors are starting to ask. Longer term, suppliers to larger companies are likely to find this type of non-financial reporting becomes part of winning new business, so successfully managing relationships with larger customers (who are subject to reporting requirements) will also become increasingly more important.

If that wasn’t reason enough to adopt or operationalise an ESG focus, future external audits are likely to be based on publicly available ESG information too, so simply putting this information on your website will not be enough. S&P Global’s ESG Scores, for example, are uniquely informed by a combination of verified company disclosures, media and stakeholder analysis, and in-depth company engagement. With analysts validating disclosures for both accuracy and relevance. This sort of approach will further drive proactive disclosure and raise the bar for sustainability standards over time.

It's clear that ESG can't be tackled with a well-intentioned policy statement that's copied and pasted. So, start-ups need to take measurable actions to improve the impact of their operations. It isn't enough to just say it. The good news is that what many startups are already doing more than they might realise that could be grouped under the ESG umbrella. It may be that you have not consolidated this information or put it out there yet. Startups integrating ESG deeper into the performance and personality of both their services to clients and the internal workings of their business will, consequently, increase their ESG score – although admittedly the pace varies.

And it's not just prospective clients asking these questions in RFPs. We're hearing more and more how existing clients and employees are equally concerned with a startups' ESG intentions. This is driving startups to take decisive steps to show the world they're sustainable and responsible businesses, mainly because if they don't, they may be prevented from winning key business opportunities in the future.

Businesses should expect to be asked about their gender pay gap, their inclusive and diverse culture, employee wellbeing agenda, along with their carbon reduction strategy on a regular basis – we're living in an era where businesses acting on ESG commitments are likely to outperform their less sustainably minded rivals. ESG needs to be integral to your business. It needs to be woven in the fabric of the organisation, central to the brand narrative, linked to company purpose/culture/behaviours, until it becomes 'the way we do things around here'.

Climate change has become a global political priority and an everyday reality for us all. At the same time, there is a recognition that sustainable change and the interconnected crises of climate change, COVID-19, conflict, poverty, and inequality will not be solved, unless governments, businesses, NGOs, civil society, innovators, and investors work together in a coherent way.

As a result, climate change and other global issues are getting the attention of the world's investors, and investment in companies who identify with one or more of the UN's Sustainable Development Goals (SDGs), has more than doubled over the last two years.

That rise is being seen across the world's major markets and extends far beyond impact investors – as new partnerships between the world's investors and a new generation of entrepreneurs create new and innovative solutions to the world's problems, and large institutional investors require their investment partners to report on ESG and add SDG-relevant measures to their investment activities.

At NGP Capital, we believe that the era of binary differentiation between impact and non-impact is coming to an end for investors and entrepreneurs alike. As seen in the data within this report, SDG-relevant startups offer investors a robust, long-term option and hope for the future.

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