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ESG considerations in Venture Capital and Business Angel investment decisions:

Evidence from two pan-European surveys

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Executive summary[1]

This EIF Working Paper provides the first ever testimony on the integration of ESG considerations and impact investing in the areas of venture capital (VC) and business angel (BA) investing. The results are survey-based and are derived from the respective questions in the *EIF VC Survey 2019* and the *EIF Business Angels (BA) Survey 2019*. Both surveys were conducted before the coronavirus outbreak and therefore the results do not capture the impact (if any) of the current crisis on ESG considerations. Despite any short-term tweaks, however, we expect ESG criteria to remain highly relevant in the long-run. If anything, as discussed in greater detail towards the end of this paper, preliminary evidence suggests that the exceptional circumstances caused by the Covid-19 pandemic may even heighten investors' attention to ESG issues and broaden their focus to include factors that had been relatively understated so far.

The *EIF VC Survey 2019* is a survey among VC general partner (GP)/management companies headquartered in the EU27, the UK and other European countries. The surveyed population includes both companies in which the EIF has invested as well as companies in which the EIF has not (or not yet) invested. It is the largest survey to date on the VC market.

The *EIF BA Survey 2019* is a survey among Business Angels (BAs) supported under the European Angels Fund (EAF), an initiative that is advised by the EIF and provides equity to BAs for the financing of innovative companies in the form of co-investments.

The current paper discusses the combined findings from both surveys in relation to the respondents' human capital characteristics and ESG considerations. The ESG-related results are clustered around six main themes:

- What is the level of ESG engagement in VC and BA investing?
- What motivates VCs' and BAs' ESG engagement (and what deters them from doing so)?
- What are the most common ESG investment strategies?
- How do VC firms implement ESG criteria in terms of policies and procedures?
- How do VCs and BAs perceive the relation between ESG considerations and investment returns?
- What lies ahead for ESG investing?

Respondents' profile

- Both surveys allow to track the human capital in VC and BA investing and map the profile of participating VC GPs and BAs in terms of age, education and relevant work experience.
- Most VCs and BAs are **between 45 and 54 years old** (with the age distribution of BAs being more skewed towards the older age groups).

[1] We would like to thank the anonymous respondents to the surveys. Without their support and valuable replies, this project would not have been possible. This paper benefited from comments and inputs by many EIF colleagues, for which we are very grateful; we would like to express particular thanks to Oscar Farres, Cyril Gouiffes, Uli Grabenwarter, Patric Gresko, Silvia Manca and Paula Ruiz Martín. We would also like to thank colleagues from Invest Europe and from the Trier University for their support. All errors are of the authors.

- The vast majority of the respondents are **highly educated**, holding a **PhD, MBA or other master qualification**, mainly in **business/economics or STEM**.
- **Millennial investors** are much more likely to have specialised in business/economics as part of their formal education, while investors in more senior age groups tend to have a science-based educational focus.
- Senior age groups appear to complement their formal education with an MBA more often than **millennial investors**, while at the same time, it is much less common for millennial investors to pursue an advanced degree at doctoral level.
- Aside from VC/BA investing, most respondents have gained **prior industry experience in a technology/engineering-focused firm** or have a **finance/investment banking background**.
- 9 in 10 BAs have **created their own venture** in the past, compared to almost 7 in 10 VCs.
- **Millennial investors** (particularly millennial VC GPs) are much less likely, compared to more senior age groups, to have gained prior work experience in a technology-based firm and also less likely to have been former entrepreneurs.
- On average, surveyed BAs have **12 years of experience in BA investing** and have invested in **19 companies in total**.
- On average, surveyed VCs have **11 years of experience in VC investing** and have raised **4 VC funds**.
- **Female and male VC GPs** exhibit almost identical profiles in terms of the level and field of education as well as in terms of the average years of experience in VC investing.
- **Female VC fund managers** appear to have greater prior exposure to the finance/investment banking industry, but less prior entrepreneurial experience compared to their male counterparts.
- **Younger VC firms**, i.e. those founded in the last three years, have the highest percentages of prior entrepreneurs and of millennials among their investment teams, as well as the highest participation of female GPs.
- Both VC GPs and BAs target more prominently **investee companies in the ICT sector**, followed by life sciences.
- **Investments in the life sciences sector** increase with the respondents' age and among respondents with a STEM-oriented education. GPs in more established VC firms (in terms of years of operation) also seem to tilt the portfolio mix towards more life science investments.
- BAs tend to **invest in younger companies** compared to VC fund managers.
- Millennial VC investors tend to focus more on **seed-stage investments**. GPs in younger VC firms also seem to target more prominently seed-stage investments, shifting to more mature investment stages the more established their firm becomes.

ESG survey results

ESG: level of engagement, drivers and strategies

- ESG investing appears to be **accelerating into the investment mainstream**, as approximately 7 in 10 VCs and 6 in 10 BAs incorporate ESG criteria into their investment decision process.

- **Ethical or social responsibility considerations** are the most widely cited motive for ESG engagement.
- The **desire to encourage change** towards responsible business practices at investee companies as well as ESG integration as **part of the formal investment policy** complete the top three of ESG drivers.
- **Ethical or strategic motives are in general more important** than the financial materiality of ESG criteria (as reflected in the relevance of ESG criteria for investment performance or for risk mitigation).
- However, the **financial relevance of ESG criteria** is a stronger motive for ESG engagement in the case of VC investors relatively to BAs, who are more highly motivated by the will to have a positive footprint in society.
- For VC fund managers, external factors such as the **positive reputational signal** associated with ESG investing and the **growing pressure from Limited Partners** are also powerful determinants of ESG adoption.
- For both VCs and BAs who do consider ESG criteria, the use of **ESG information predominantly serves as a portfolio screening tool**.
- VCs apply ESG screening particularly on an exclusionary basis at due diligence ('**negative screening**'), whereas the vast majority of BAs explicitly target firms that perform well in terms of selected ESG criteria ('**positive screening**').
- **Negative screening** appears to be mainly driven by the mitigation of ESG-related risks or as a response to growing demand from LPs for ESG consideration, as it is considered a relatively easier way for the GPs to become ESG-compliant.
- By contrast, **positive screening** is seen more like an opportunity for value creation, as it is prominently pursued among VC fund managers who consider ESG criteria due to their relevance for investment performance or as part of their firm's investment policy.
- ESG strategies that generally entail either a greater involvement on the part of the General Partners (e.g., '**active ownership**' in the form of direct engagement with and provision of ESG expertise to investee companies in order to improve their ESG performance) or a more formalised approach to ESG incorporation (e.g., an **ESG 'factor' integrated into valuation**) are much less frequently adopted.
- In the case of BAs, '**impact investing**' (i.e. seeking to generate a positive social and/or environmental impact alongside a financial return) ranks second among all ESG investment strategies.[2]

The role of age, education and prior experience

- Both surveys show that the respondents' human capital characteristics can influence both the level of ESG engagement and the type of ESG strategy adopted.
- Contrary to common belief, the **evidence on ESG adoption is not driven by Millenial investors alone**, but is instead rooted across all age ranges.

[2] For the purpose of this paper, impact investing has been incorporated into the broad ESG spectrum as part of the widespread responsible finance movement and as an investment strategy seeking to address social and environmental issues at scale, through entrepreneurial solutions.

- Neither of the two surveys provides strong support for the hypothesis that the higher the level of education, the greater an individual's ability to process complex decision criteria, such as the identification and interpretation of material ESG factors.
- There is no strong evidence either for a hypothesis often cited in the academic literature that business school education is characterised by a "profits-first" mentality which may undermine moral or social responsibility considerations in investment decisions. The survey findings reflect instead the reality that **responsible and ethical leadership is nowadays becoming a critical issue in business school education**, as more and more graduates seek higher 'purpose' rather than exclusive financial benefits.
- BAs who have gained **prior experience in a technology/engineering-based firm** are significantly more likely to engage in positive screening and impact investing, unlike BAs with a finance/investment banking background who overwhelmingly rely on ESG exclusion criteria.
- VC fund managers with **prior entrepreneurial or start-up experience** also show higher level of ESG engagement, and generally adopt ESG strategies that require greater effort (in terms of information needs and level of commitment) on the part of the GPs.

ESG considerations and VC firm characteristics

- A range of VC firm characteristics, such as location, investment stage focus, size (proxied by assets under management) and gender diversity in the management team, appear to be significant determinants of ESG considerations by the GPs.
- Investment activities incorporating ESG criteria are particularly **prominent in the Nordic countries, in the UK & Ireland and in France**, while VC GPs in DACH and the CESEE region report considering ESG criteria to a lesser extent.
- The more matured the **investment stage (seed vs. early vs. growth)** the higher the degree of ESG integration. This may reflect the fact that there is more information available for later/growth-stage companies, including on ESG issues, which facilitates the processing and integration of ESG criteria into the investment decisions.
- Fund managers from **bigger (in terms of assets under management) VC firms** generally report a higher degree of ESG consideration, along with a higher propensity to engage in ESG investing as a result of growing demand from their LPs.
- The VC survey results point in the direction of a positive correlation (but not necessarily causality) between the extent of gender diversity in the VC firm's management team and the degree of ESG consideration.

ESG policies and procedures

- 1 in 2 VC fund managers state that there is an **explicit ESG policy already in place** in their respective VC firms.
- But half of the surveyed VCs report not having an **ESG expert** in their investment team.
- Almost 40% lack formal monitoring of the performance of their portfolio companies in terms of **ESG metrics**.

- **Bigger firms are better equipped**, in terms of the resources and personnel expertise, to develop formal ESG procedures and to deal with the challenges of ESG integration and reporting.
- The **development of an explicit ESG policy is a focal point** in the ESG implementation process that helps streamline other ESG-related procedures.
- Two **'internal' factors** (i.e. considering ESG criteria as part of the VC firm's investment policy and the perceived positive impact of ESG considerations on investment performance) and two **'external' factors** (i.e. regulation and growing demand from LPs) appear to be the most important in shaping the ESG policies and procedures.

ESG considerations and investment returns

- Both surveys contribute to the discussion about whether ESG considerations can materialise into superior investment returns.
- The general consensus is clear: **ESG considerations and investment performance are not mutually exclusive**.
- Different ESG investment strategies have **varying degrees of positive impact** on investment returns.
- Based on the VC fund managers' experience from the implementation of each ESG strategy, **active ownership and impact investing are considered as the two most beneficial strategies** in terms of investment returns, while negative screening (despite being the most widely used strategy) ranks last. Indeed, as also discussed earlier, the adoption of negative screening is more driven by risk-mitigation purposes rather than by its importance for investment performance.
- The evidence from the VC survey that ESG considerations are not incompatible with investment performance is generally also echoed in the case of BAs.
- The results are particularly impressive for impact investing: they show that **impact investors can pursue a 'noble' cause and still 'do well by doing good'**, and that the return ambition of impact investors is neither deliberately non-return maximising nor return-compromising.

ESG considerations: looking forward

- Both surveys indicate that **the importance of all ESG strategies is expected to further grow in the next five years**.
- Even more so in the direction of direct engagement with portfolio companies on ESG issues as well as with regard to explicitly factoring ESG into the valuation of investment opportunities.
- Despite the promising evidence, however, **ESG investing is still at a nascent phase**.
- Not only because a formalised ESG implementation in terms of concrete policies and procedures in place might have a long way to go; but also because **ESG considerations still rank very low in the hierarchy of VCs' and BAs' investment selection criteria**.
- Regarding the **key barriers to ESG investing**, the survey respondents highlight the **limited resources and expertise** on ESG issues as well as data-related concerns, such as the **difficulties in quantifying ESG** information and the **lack of adequate ESG disclosures** from companies.

- Therefore, greater emphasis should be placed at **'educating' VC and BA investors** on how to identify material ESG-related risks and opportunities.
- Most importantly, coming up with a **commonly accepted framework and methodology** to measure ESG performance would facilitate both the development of ESG-related Key Performance Indicators (KPIs) as well as the assessment and comparison of these disclosures across firms.

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1 Introduction

Venture capital (VC) and Business Angel (BA) financing are essential sources for start-up and young companies to achieve growth and create value through innovation. The relevance of this type of financing, not only for young and innovative companies but also for the economy as a whole, is very high.

The core mission of the European Investment Fund (EIF) is to reduce barriers for small and medium-sized enterprises (SMEs) that wish to access financing. By developing and offering targeted products to a number of different financial intermediaries, the EIF enhances SMEs' access to finance in Europe. To achieve this, the EIF partners with entities such as banks, guarantee and leasing companies, micro-credit providers, diversified debt funds, crowdfunding platforms, VC / private equity funds, BAs, etc.

The EIF is a leading institution in the area of VC- and BA-financing, focusing on the establishment of a sustainable equity financing ecosystem in Europe in order to support innovation and entrepreneurship. The EIF concentrates on incentivising private sector financing to address market gaps.

The EIF works with VC funds and BAs, which act as intermediaries and invest into innovative high-tech SMEs in their early and growth phases. The particular focus is on disruptive early-stage technology enterprises that typically face financing challenges but also provide outstanding investment opportunities.

EIF's Research & Market Analysis (RMA) supports EIF's strategic decision-making, product development and mandate management processes through applied research, market analyses and impact assessments. In order to facilitate EIF's activities in European VC- and BA-financing, and to provide additional benefit for market participants, RMA aims at gathering and providing relevant information that can shed more light on this important but still relatively opaque part of the SME financing market.

In recent years, investors' attention to Environmental (e.g., carbon footprint, renewable energy/energy efficiency, waste management), Social (e.g., diversity and inclusion, labour standards, community engagement) and Governance (e.g., board structure, anticorruption, political lobbying) data has soared, as market participants are increasingly interested not only in *what* profit a company made, but also in *how* this profit was made. Arguably, in recent months, the focus of the investment community has shifted to dealing with the unprecedented challenges brought about by the coronavirus pandemic. However, as discussed in greater detail towards the end of this paper, despite any short-term tweaks caused by the current crisis, we expect ESG considerations to remain highly relevant in the long-run.

According to the latest Global Sustainable Investment Review,[3] at the start of 2018, global sustainable investment assets reached USD 30.7 trillion, a 34 per cent increase from 2016, with Europe accounting for the largest pool of sustainable investment assets (USD 14.1 trillion in assets under management). Furthermore, according to the most recent data, the number of signatories to

3 See "Global Sustainable Investment Alliance (GSIA): 2018 Global Sustainable Investment Review".

the United Nations' Principles for Responsible Investment (UN PRI) exceeded 3000 globally, representing over USD 89 trillion in assets under management.[4]

For the EIF, the consideration of ESG (Environmental, Social and Governance) criteria is highly relevant[5] and therefore, as an intermediated business model is applied, it is as well important to generate knowledge about business partners' perception and use of such criteria. Building on its ESG principles, the EIF has further stepped up its efforts and has embedded a specific questionnaire on ESG policies and practices in its core due diligence processes, addressed to financial intermediaries across all business lines. Furthermore, in the context of impact investing, the EIF has established thought leadership in Europe and has implemented a methodology for impact metrics and accountability that has become market standard in the risk capital markets for impact businesses over the past five years (see Box 1 and Box 2).

Box 1: Impact investing – Methodological considerations

As also discussed later in this paper, impact investing has been incorporated into the broad ESG spectrum as part of the widespread responsible finance movement. Impact investing is an investment strategy seeking to address social and environmental issues at scale, through entrepreneurial solutions. Hence, even if an overlap between ESG considerations and impact investing does exist (this is the basis for our approach in the current paper, also to enable comparability with other ESG surveys), the two concepts are different.

In order to shed more light on our understanding of impact investing, it is useful to introduce the EIF approach towards impact investing in EIF's venture capital activities. The EIF runs several dedicated investment programmes on impact investment and supports impact investing through funds, accelerators or payment-by-results schemes (see Box 2 for more information on some these programmes). In addition to financial value creation, impact funds also generate positive social and/or environmental impact from their portfolio companies as a result of their investment activity. Impact in a company's theory of change refers to the positive net change induced by an investment through the business activity of a company. Impact is not the result of a positive externality, but an intentional positive change triggered by a company's business model. Social/Environmental impact must be quantifiable, measurable, and a direct result of the enterprise's business activity.

Hence, while integrating ESG considerations in investing reflects the investors' mindfulness of the externalities of their investment and is intended to mitigate negative impact, it does not necessarily translate into proactively pursuing positive impact. In other words, ESG considerations in the investment process do not necessarily mean impact investing and could even be applied without necessarily achieving a measureable social/environmental impact in the sense of impact investing as per the approach presented above. Similarly, impact investing typically goes far beyond the integration of ESG considerations in investing and can even be performed without necessarily considering the entire spectrum of ESG criteria (e.g., in case an impact investor would not apply any considerations related to the "G" component of ESG). It should however be emphasised that the VC survey results suggest that impact fund managers are more geared towards ESG considerations than mainstream VC GPs. Indeed, while on the basis of the average industry results, only 8% of VCs rank

4 See "UN PRI Update Q2 2020".

5 For EIF's ESG Principles, see https://www.eif.org/what_we_do/institutional-asset-management/esg-principles-13112017.pdf.

ESG considerations in the top three of their investment selection criteria, this percentage rises to 19% for impact fund managers, and even higher, to 26%, for EIF-supported impact GPs.

When looking at our survey results, the reader should also have in mind that the respondent category "impact investors" does not only comprise respondents who are supported under EIF-managed programmes. Moreover, impact investors in our survey are fund managers who self-declared to follow an impact investing strategy rather than being identified by a third party (e.g., by the EIF) as "impact investors". Even if some of those fund managers may be supported by the EIF, they are not necessarily supported as an impact investor under EIF-managed impact mandates, but rather under more general VC programmes and might therefore not underlie the EIF criteria for impact investing.

In a forthcoming paper, based on the results of the EIF surveys performed in 2020, we will more deeply analyse impact investing, e.g. in terms of the main challenges faced by impact investors and their return expectations, the performance drivers of impact funds, and the most prominent sectors in impact investing. Hence, it will be easier to perform the necessary distinction between ESG and impact investing in the analysis and presentation of the results.

Box 2: The Social Impact Accelerator (SIA)

The Social Impact Accelerator (SIA) is the first pan-European public-private partnership addressing the growing need for availability of equity finance to support social enterprises. SIA operates as a fund-of-funds managed by the EIF (vintage 2013) and invests in social impact funds which strategically target social enterprises across Europe. In the context of the SIA, a social enterprise shall be an SME whose business model serves to achieve a social impact. It shall provide an entrepreneurial solution to a societal issue based on a scalable approach, and shall generate a measurable impact next to financial value creation.

To measure social impact, the EIF has developed a new framework for quantifying and reporting on impact metrics at all levels of the SIA investment chain (companies, funds and fund-of-funds). Social impact funds financed by the SIA are asked to define between 1 and 5 social impact indicators per portfolio company and set pre-investment quantifiable objectives for each of the indicators. Over time, the EIF and its co-investors in a social impact fund will monitor portfolio companies' progress towards achieving their social impact objectives. The fund manager will be held accountable for the social performance of the portfolio companies, since this performance will partly affect the distribution of carried interest to the management team. EIF approaches impact measurement as an alignment-of-interest tool for investments' stakeholders, rather than as a reporting tool.

The SIA also ensures that knowledge-sharing between private sector actors committed to social impact investing and the EIF becomes a core part of the initiative from the outset. To this end, Crédit Coopératif, Deutsche Bank, SITRA and the Bulgarian Development Bank have joined the EIB Group as investors and as part of an undertaking to pioneer strong public-private partnership in the sector. The SIA investment period ended in July 2019 and impact investing has now become a full-fledged investment strategy within the EIF's venture capital department, relying on a variety of mandates available and raised on an ongoing basis. With close to EUR 250m invested in impact funds, the EIF has backed to date more than 20 impact funds, and counting.

See https://www.eif.org/what_we_do/equity/sia/index.htm for more information about the SIA.

The current paper provides the first ever testimony on the integration of ESG considerations and impact investing in the areas of VC and BA investing. The results are survey-based and are derived from the respective questions in the *EIF VC Survey 2019* and the *EIF Business Angels (BA) Survey 2019*.

The *EIF VC Survey 2019* (a survey among VC general partner (GP)/management companies headquartered in the EU27, the UK and other European countries) consisted of questions covering five main topics:

- The *VC market sentiment,*
- *Policy recommendations regarding regulatory and tax-related issues in VC business*,
- *The human capital in VC,*
- *ESG (Environmental, Social, Governance) considerations in VC investment decisions, as well as*
- *EIF's product and mandate development*.

The *EIF BA Survey 2019* (a survey among BAs supported under the European Angels Fund[6]) also covered five main topics:

- The *main characteristics of the BAs,* in terms of *human capital and investment activities*
- The *market sentiment* of BAs*,*
- The *role of the public sector*,
- The *added value of EIF activities under the European Angels Fund (EAF)*, as well as
- *ESG (Environmental, Social, Governance) considerations in BA investment decisions.*

This EIF Working Paper discusses the combined findings from both surveys in relation to the respondents' human capital characteristics and ESG considerations.[7] The ESG-related results are clustered around six main themes:

- What is the level of ESG engagement in VC and BA investing?
- What motivates VCs' and BAs' ESG engagement (and what deters them from doing so)?
- What are the most common ESG investment strategies?
- How do VC firms implement ESG criteria in terms of policies and procedures?

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[6] The European Angels Fund (EAF) is an initiative advised by the EIF, which provides equity to BAs in Europe for the financing of innovative companies in the form of co-investments. EAF works hand-in-hand with BAs and helps them to double their investment capacity by co-investing into innovative companies in the seed, early or growth stage. The activity of the EAF is adapted to the BAs' investment style by granting the highest degree of freedom in terms of decision-making and management of investments. Since the launch of the German compartment in 2012, the EAF has expanded to nine European countries and includes a new pan-European compartment for cross-border strategies with total assets under management of c. EUR 700m. The EAF is proactively connecting its community of BAs from different ecosystems in Europe in order to share best practices and investment opportunities through an on-line platform and dedicated events. See https://www.eif.org/what_we_do/equity/eaf/index.htm for more information about the EAF.

[7] The results on the other topics covered in the *EIF VC Survey 2019* and the *EIF Business Angels Survey 2019* were published in two separate EIF Working Papers, namely "EIF VC Survey 2019: Fund managers' market sentiment and policy recommendations" and "EIF Business Angels Survey 2019: Market sentiment, public intervention and EIF's value added"; both available at http://www.eif.org/news_centre/research/index.htm.

- How do VCs and BAs perceive the relation between ESG considerations and investment returns?
- What lies ahead for ESG investing?

The subsequent Chapters discuss the answers to these questions.

It is envisaged to repeat both the *EIF VC Survey* and the *EIF BA Survey* on (at least) an annual basis in order to improve the availability of information about these important market segments. The insights from the *EIF Surveys* will help to further improve the EIF's product offer and the European VC and BA ecosystems in line with markets' needs. Moreover, the *EIF Surveys* form part of the EIF's work to assess the impact of its activities and complement the recent and ongoing quantitative analyses of the economic effects of the EIF's VC and BA operations. In 2020, the EIF also conducted for the first time a survey in the area of mid-market private equity.

All three surveys (re)examine the ESG topic and look in greater detail into the implementation aspects of ESG criteria, particularly in relation to the specific frameworks that shape investors' approach to ESG integration and the metrics used to monitor ESG performance. The analysis also covers more extensively impact investing in terms of the main challenges faced by impact investors and their return expectations, the performance drivers of impact funds, and the most prominent sectors in impact investing. The ESG and impact investing results of the 2020 *EIF Surveys* will be presented in a future EIF Working Paper.

2 Sample overview and respondents' profile

The results presented in this working paper are based on two pan-European surveys: the *2019 EIF VC Survey* and the *2019 EIF Business Angels (BA) Survey*. For the purpose of the VC survey, EIF internal data and PitchBook were used to derive the contact details of the GPs[8] who are active in the European VC market – our target population.[9] The survey questionnaire was received via e-mail by 4,367 individuals, representing 2,095 distinct VC firms headquartered in the EU27, the UK and other European countries (mainly Norway, Switzerland and Turkey). We received, on an anonymous basis, 774 completed responses from 538 VC firms in Europe, making this, to the best of our knowledge, the largest survey on VC to date. This also translated into high response rates, 17.7% at individual revel and 25.7% at firm level. We targeted and we indeed received responses mainly from senior people within the VC firms (CEOs, CFOs, COOs, managing/investment directors, (managing/general) partners, etc.), meaning that these responses reflect the views of the decision-makers within the respective VC firms.

For the purpose of the BA survey, the target population consisted of the BAs who benefited from the European Angels Fund (EAF), i.e. an initiative that is advised by the EIF and provides equity to BAs for the financing of innovative companies in the form of co-investments.[10] The e-mail invitation to participate in the online survey was therefore sent to the 93 BAs[11] supported under the EAF compartments for Austria, Denmark, Finland, Germany, Ireland, the Netherlands and Spain.[12] We received, on an anonymous basis, 60 completed responses, which translates into a high response rate of 65% and a good coverage of the EAF population.

Both surveys allow to track the human capital in VC and BA investing, and map the profile of participating VC GPs and BAs in terms of age, education and relevant work experience. Most VCs (a combined 37%) lie in the age range between 45 and 54 years old (Figure 1), with the average age being 48 years old. The corresponding percentage for BAs is notably higher, namely at 46%, reflecting the more general pattern that the age distribution of BAs is more skewed towards the older age groups. As Gvetadze et al. (2020) note, accumulating the experience and capital needed to become successful as a BA investor takes time. As a result, the so-called "millennial" investors make up 18% of the VC sample, compared to only 10% in the case of BAs. Conversely, age-wise, a significant proportion of BAs (1 in 3) fall in the "baby boomers" generation, compared to only 1 in 5 VCs.

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[8] The terms "GPs", "VC managers", "VC investors", "fund managers", "VCs" and "respondents" are used interchangeably throughout the report.

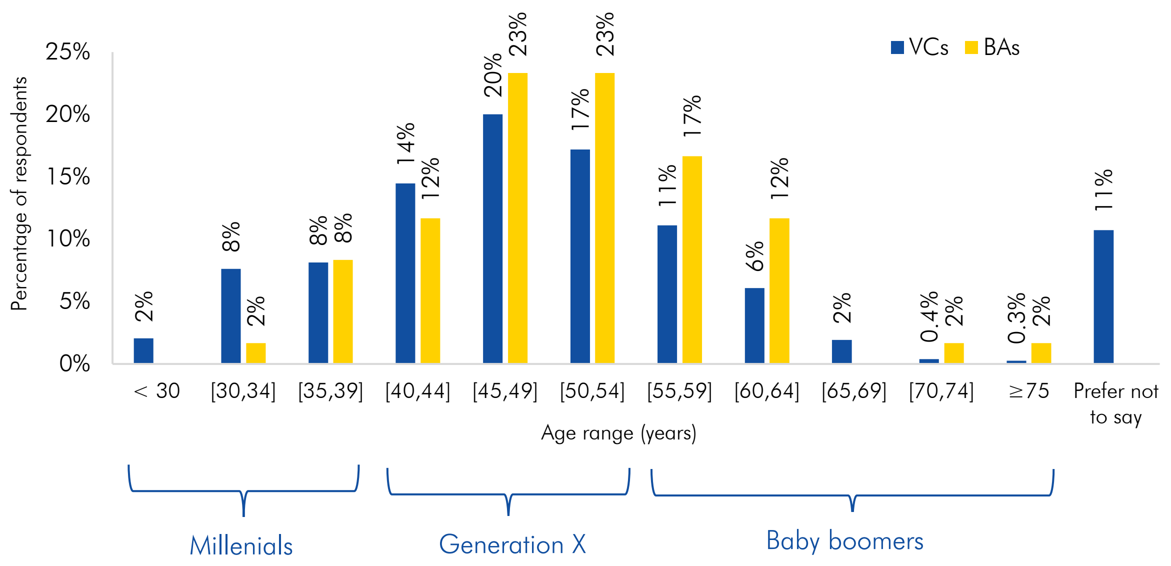
[9] The surveyed population includes both companies in which the EIF has invested as well as companies in which the EIF has not (or not yet) invested.

[10] Due to the EAF eligibility criteria and the EIF's selection process, the survey population represents a specific sub-segment, mostly composed of experienced BAs who invest higher amounts per funding round than reported industry averages. We therefore refrain from claiming that the survey population represents the overall BA market in Europe.

[11] At the time the survey was conducted.

[12] Apart from the aforementioned EAF compartments, an EAF compartment also exists for Italy and, since recently, for the Belgian region of Flanders. A pan-European compartment was set up at the end of 2018. At the time the survey was conducted, the EAF was not active in Italy and Flanders, and no BA was supported under the pan-European compartment. Hence, this study does not cover BAs supported under these three compartments.

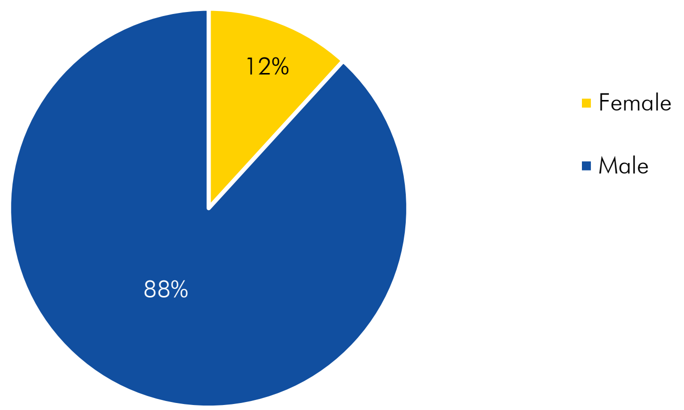
Figure 1: Respondents' age distribution[13]



Q. What is your age?

Regarding the gender diversity of the respondents (Figure 2),[14] almost 9 in 10 surveyed VC GPs are male. In addition, results not presented here for the sake of brevity show that female partners represent, on average, 15% of all partners in the VC firms that participated in the survey, with 6 in 10 surveyed GPs reporting no female partners at all in their respective VC firm. Indeed, as shown in Figure 3, the vast majority of the VC respondents indicate a male-dominated management team in their respective VC firm.

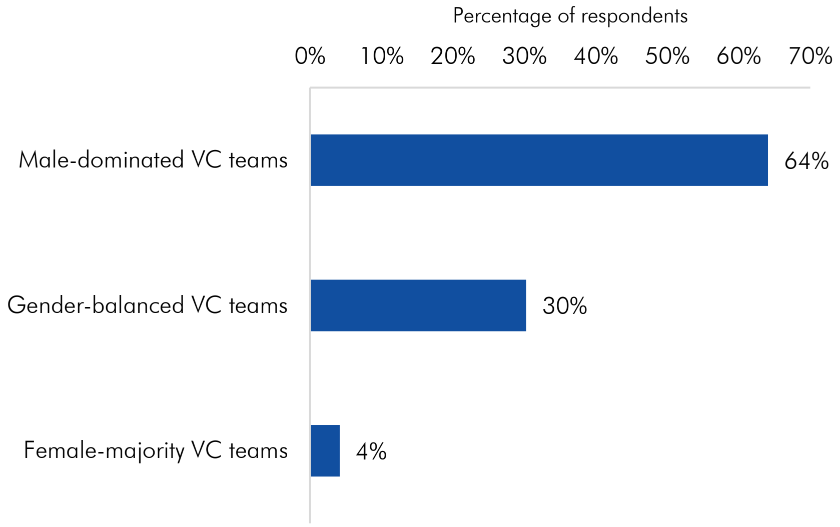
Figure 2: VC GPs' gender distribution



Q. What is your gender?

[13] Percentages may not always add up to 100% due to rounding.
[14] A gender-related question was included only in the context of the *EIF VC Survey*. Due to the small number of female BAs that have received support under the EAF initiative, a similar question in the context of the *EIF BA Survey* would have compromised the anonymous nature of the survey.

Figure 3: Gender diversity in the management team of the respondents' VC firms



Note:

Male-dominated VC teams: % of female partners less than 20%

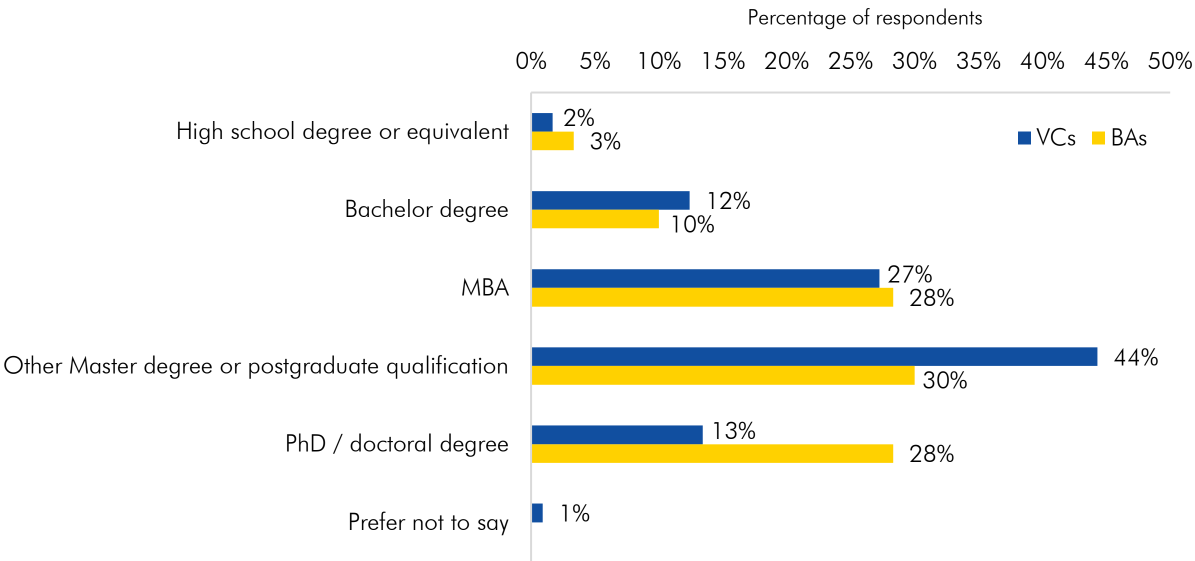
Gender-balanced VC teams: % of female partners between 20% and 50%

Female-majority VC teams: % of female partners in excess of 50%

Q. How many *female* partners/senior managers are there in your firm? / How many partners/senior managers are there in your firm?

Both VCs and BAs are highly educated, see Figure 4. Almost 7 in 10 VCs and 6 in 10 BAs hold a master's degree (including a very similar proportion of VCs and BAs, 27% and 28% respectively, who are MBA holders). It is also worth noting that the percentage of BAs who have been educated at doctoral level (28%) is more than twice the corresponding figure for VCs (13%) – contradicting the notion that BAs are rarely educated at the master level or above (Ramadani, 2009).

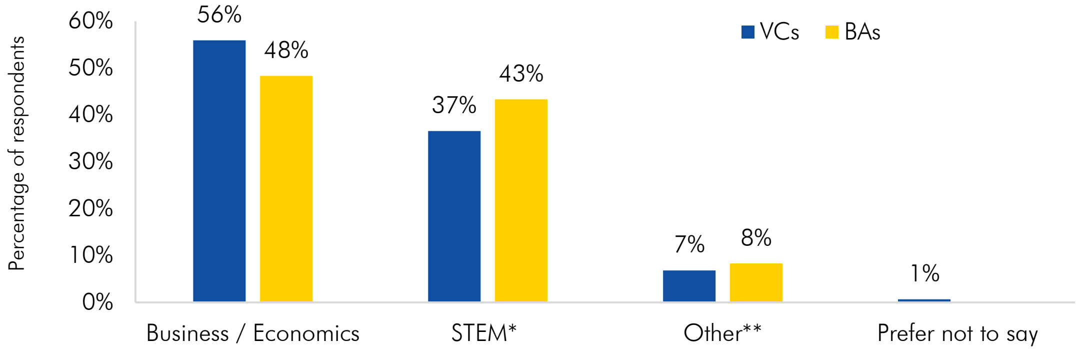
Figure 4: Respondents' level of education



Q. What is your highest degree of education?

Figure 5 illustrates the distribution of fields in relation to the respondents' educational focus. The majority of VCs (56%) have obtained some formal education in Business/Economics, while a significant percentage (37%) has pursued a STEM-related education. In this respect, the results echo prior research (e.g., Dimov and Shepherd, 2005; Zarutskie, 2010) reporting these two educational backgrounds as the most common ones for VCs. In the case of BAs, we note a more balanced split between BAs with a business-focused degree (48%) and those coming from a mainly science-oriented educational background (43%).

Figure 5: Respondents' field of education

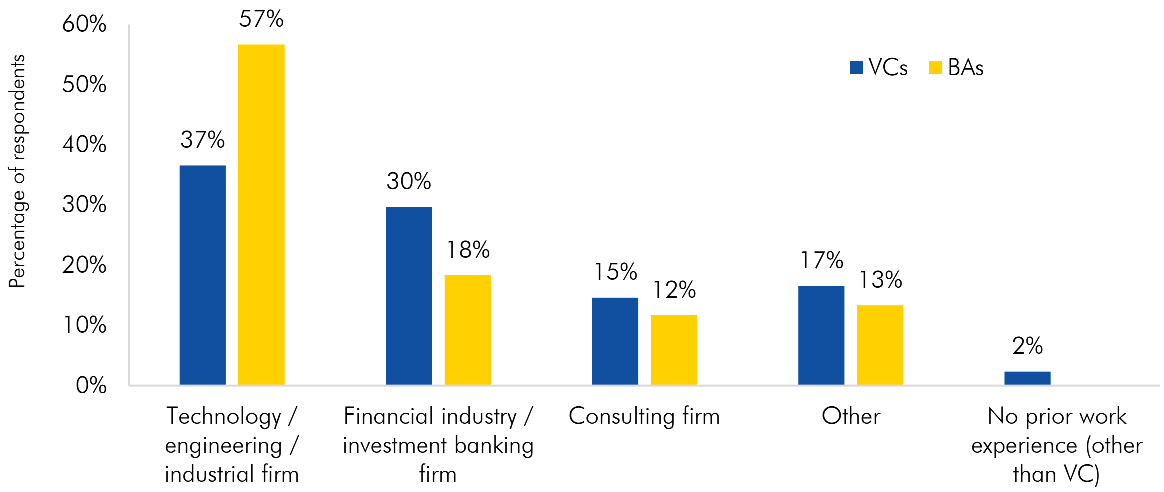


*STEM: Science, Technology, Engineering, Mathematics
**Other include: Humanities, Law, Social Sciences

Q. What was the main focus/field in your education?

Aside from their current role as BA investors, more than half of the BAs (57%) have gained prior industry experience in a technology/engineering-focused firm (Figure 6). By contrast, in the case of VCs, there is a relatively more even distribution between those with a technology-focused background (37%) and those coming from the finance/investment banking industry (30%).

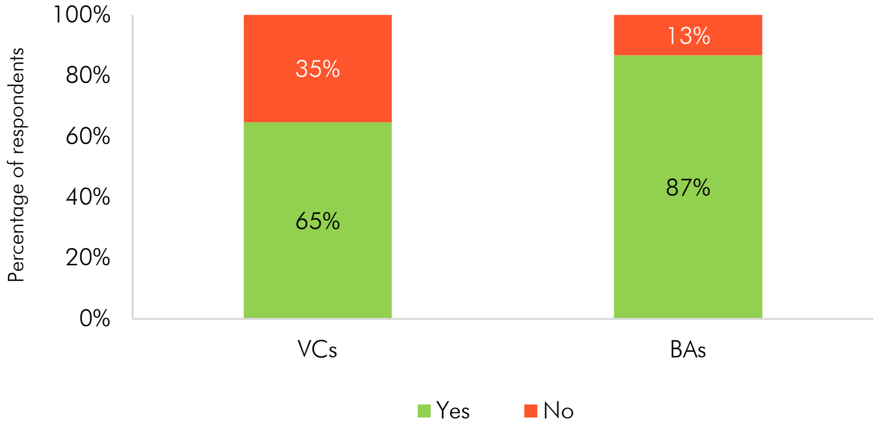
Figure 6: Respondents' prior work experience (aside from VC/BA investing)



Q. Which of the following would best describe your type of prior work experience (aside from VC/BA investing)?

Compared to VCs, BAs have to a greater extent prior entrepreneurial experience (Figure 7). Almost 9 in 10 BAs report having created their own venture in the past, compared to 65% of the VCs. At the same time, 4 in 10 BAs report being currently entrepreneurs/owners (either in a start-up or in an established company) in parallel with their BA activities.

Figure 7: Respondents' prior entrepreneurial experience

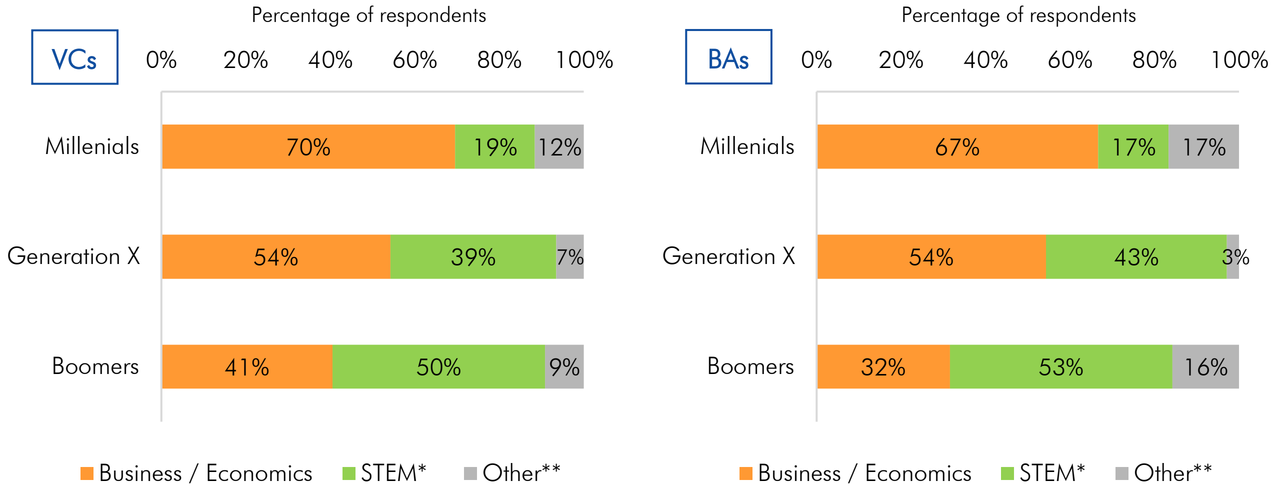


Q. Have you ever created your own venture?

Both surveyed VCs and BAs are highly experienced investors. On average, VC GPs have 11 years of experience in VC investing and have raised 4 VC funds. As for BAs, on average, they have 12 years of experience in BA investing and have invested in 19 companies – implying an average investment rate of approximately two investees per year.

Interacting the human capital characteristics analysed earlier leads to further insights regarding the profile of surveyed VCs and BAs. For example, in both groups of respondents, millennial investors are much more likely to have specialised in Business/Economics as part of their formal education (Figure 8), while investors in more senior age groups tend to have a science-based educational focus.

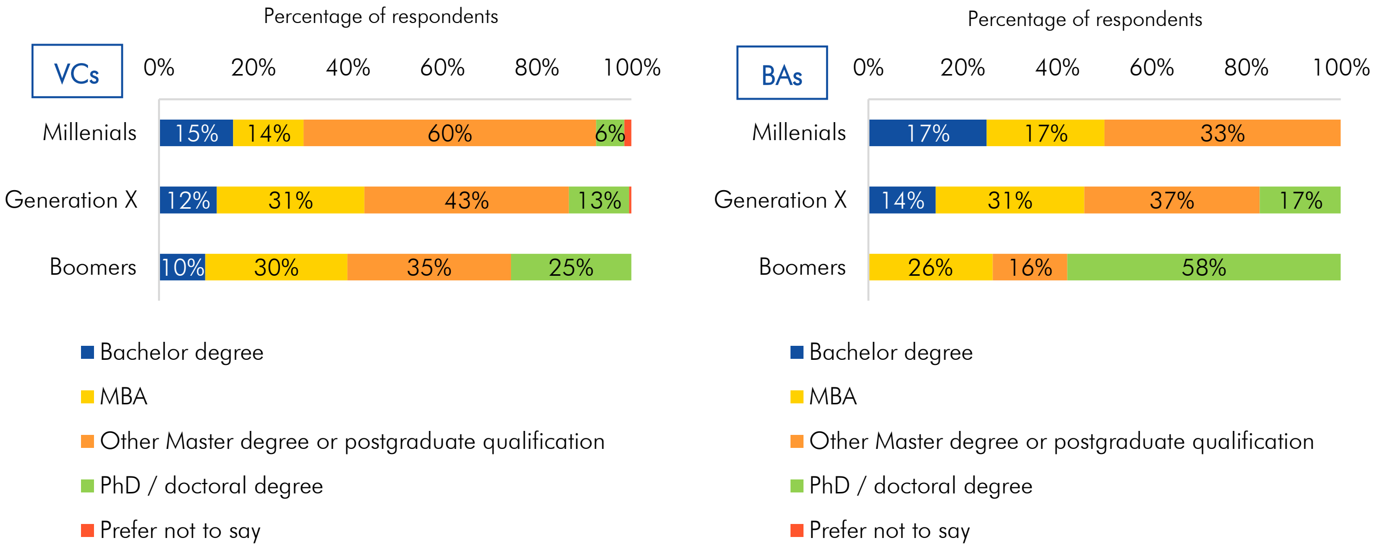
Figure 8: Respondents field of education – by age group



*STEM: Science, Technology, Engineering, Mathematics
**Other include: Humanities, Law, Social Sciences

Related to the above point is the fact that senior age groups appear to complement their formal education with an MBA more often than millennial investors (Figure 9), while at the same time, it is much less common for millennial investors to pursue an advanced degree at doctoral level.

Figure 9: Respondents' level of education – by age group



Note: High school education has been omitted from the above Figures due to the very low percentages of surveyed VCs and BAs belonging to this specific education group (see Figure 4).

The differences in educational focus across age groups are also reflected in the respondents' type of prior work experience. As such, millennial investors (particularly millennial VC GPs) are much less likely, compared to more senior age groups, to have gained prior work experience in a technology-based firm (Figure 10) and also less likely to have been former entrepreneurs (Figure 11). The latter finding is consistent with theories in which key entrepreneurial resources (such as human capital, financial capital, and social capital) accumulate with age; and with recent evidence (for the US) whereby the highest success rates in entrepreneurship come from founders in middle age and beyond (Azoulay et al., 2018).

Figure 10: Respondents' prior work experience – by age group

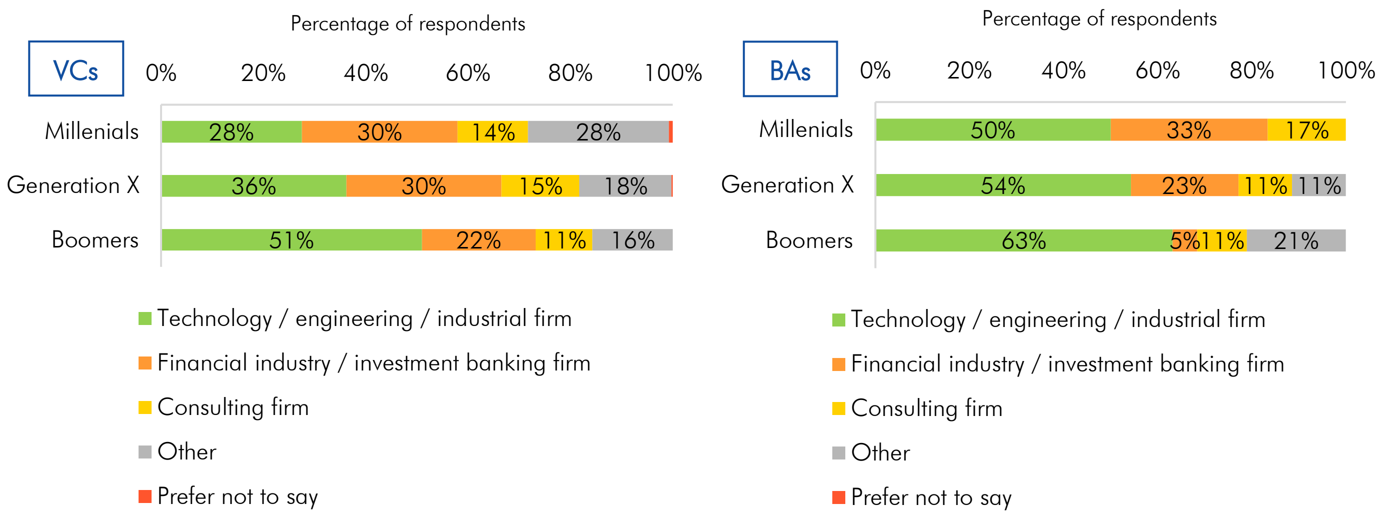
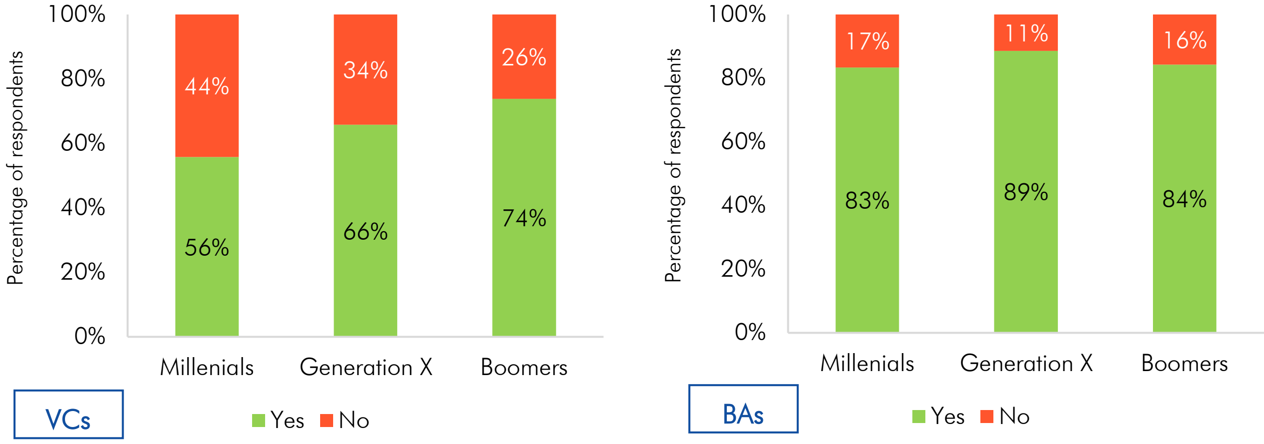


Figure 11: Respondents' entrepreneurial experience – by age group



When gender is taken into consideration, female and male VC GPs exhibit almost identical profiles in terms of the level and field of education as well as in terms of the average years of experience in VC investing, in line with the results presented earlier (see Figure 4 and Figure 5) for the overall VC sample. However, female VC fund managers appear to have greater prior exposure to the finance/investment banking industry (Figure 12), but less prior entrepreneurial experience (Figure 13) than their male counterparts.

Figure 12: VC respondents' prior work experience – by gender

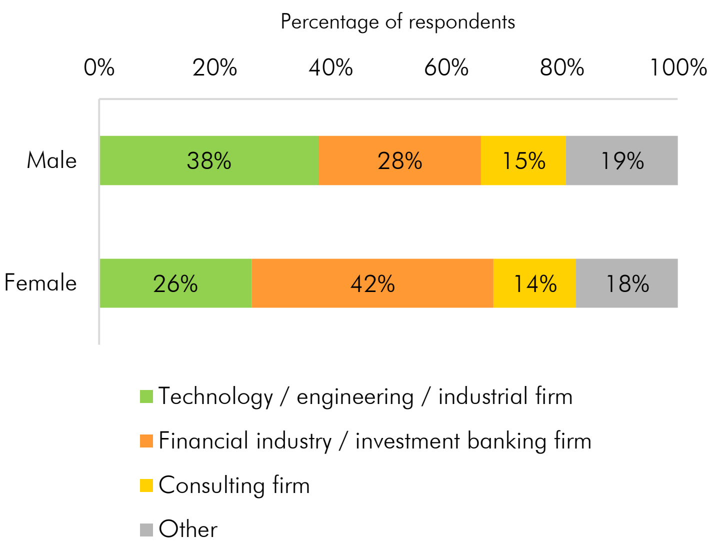
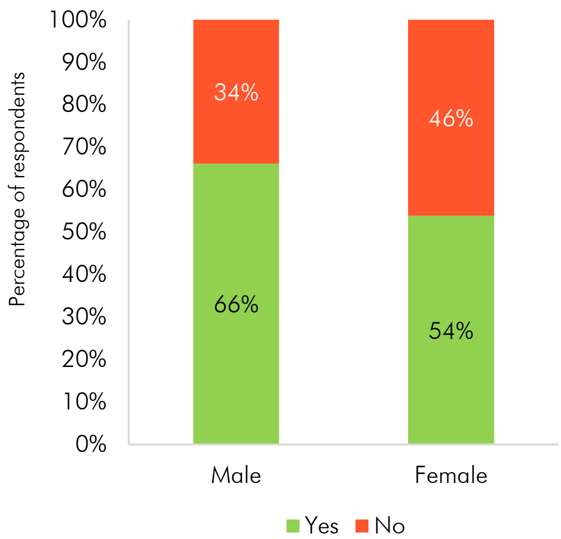
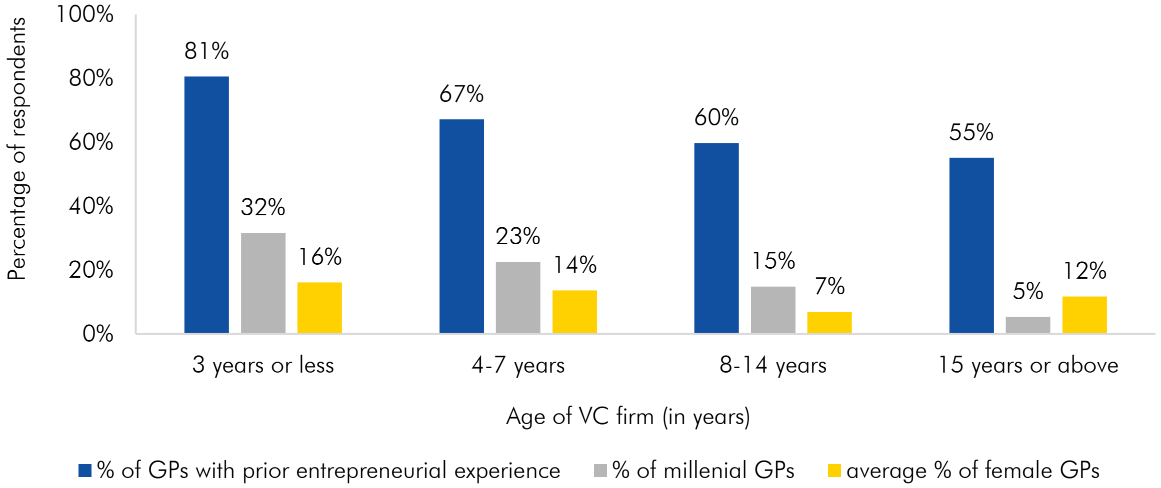


Figure 13: VC respondents' entrepreneurial experience – by gender



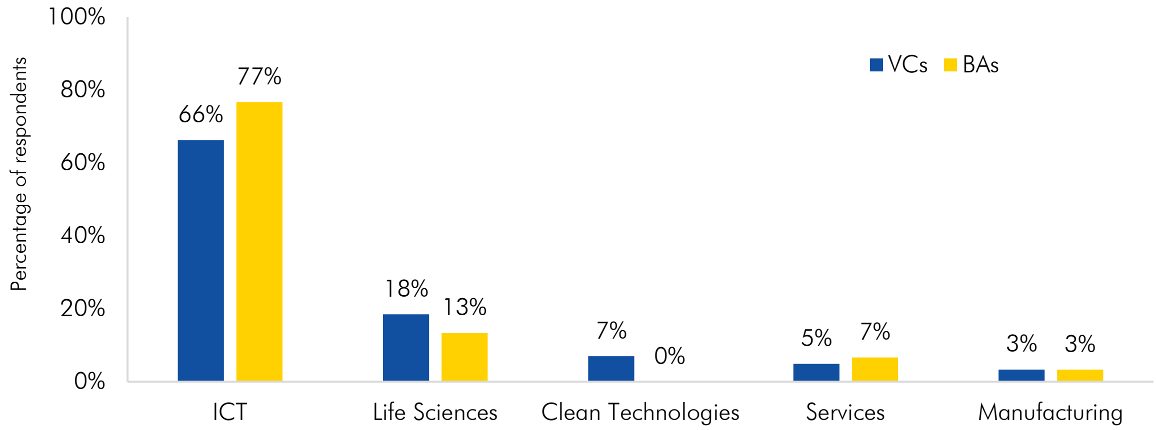
It is also interesting to see how the human capital characteristics vary according to certain features of the respondents' VC firms, such as firm age. The majority of the VC firms that participated in the survey (approximately 60%) have been founded over the last decade, with the average (median) firm age in the sample being 11 (8) years. The survey results show (Figure 14) that it is the younger VC firms in the sample, i.e. those founded in the last three years, which have the highest percentages of prior entrepreneurs and of millennials among their investment teams, as well as the highest participation of female GPs.

Figure 14: Human capital characteristics and VC firm age



Going back to the comparison between VC GPs and BAs, both groups of respondents appear to target more prominently investee companies in the ICT sector, followed by life sciences (Figure 15). However, for both VCs and BAs, investments in the life sciences sector increase with the respondents' age (Figure 16 shows that life science investments feature less prominently among millenials compared to more senior age groups) and among respondents with a STEM-oriented education (Figure 17 indeed confirms that personal expertise and educational background influence investment choices, with STEM graduates investing almost twice as frequently in life sciences compared to Business/Economics graduates). GPs in more established VC firms (in terms of years of operation) also seem to tilt the portfolio mix towards more life science investments (Figure 18).

Figure 15: Respondents' most important target industry for VC/BA investments



Q. Select up to three of the most important industries in which you/your firm invest/s.

Note: The above percentages reflect the respondents who indicated the respective industry as their No1 most important target industry for VC/BA investments.

Figure 16: Most important target industry – by age group

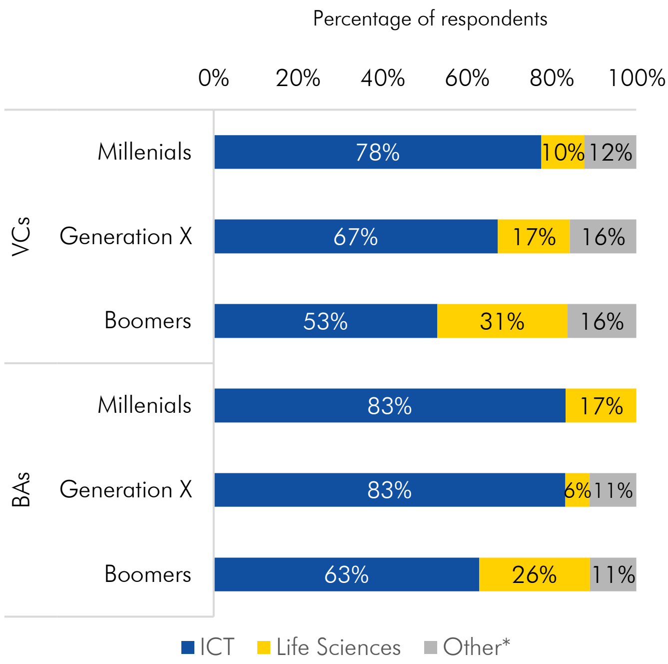
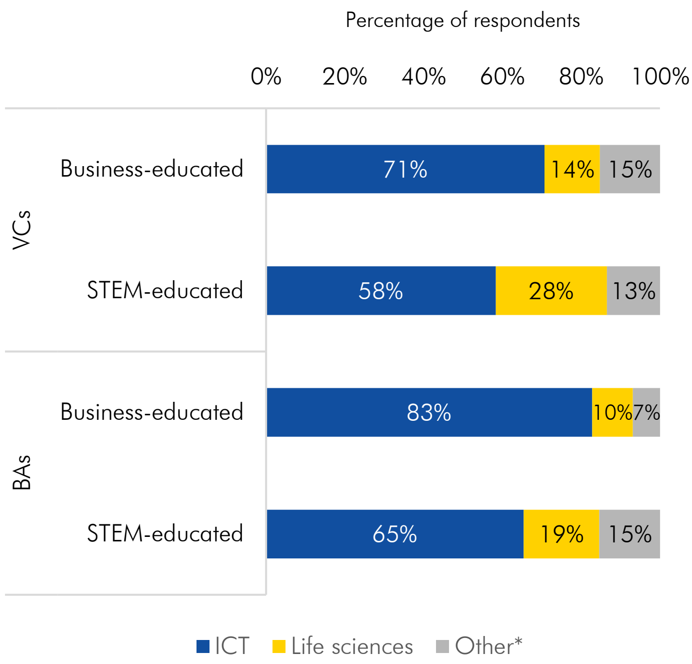
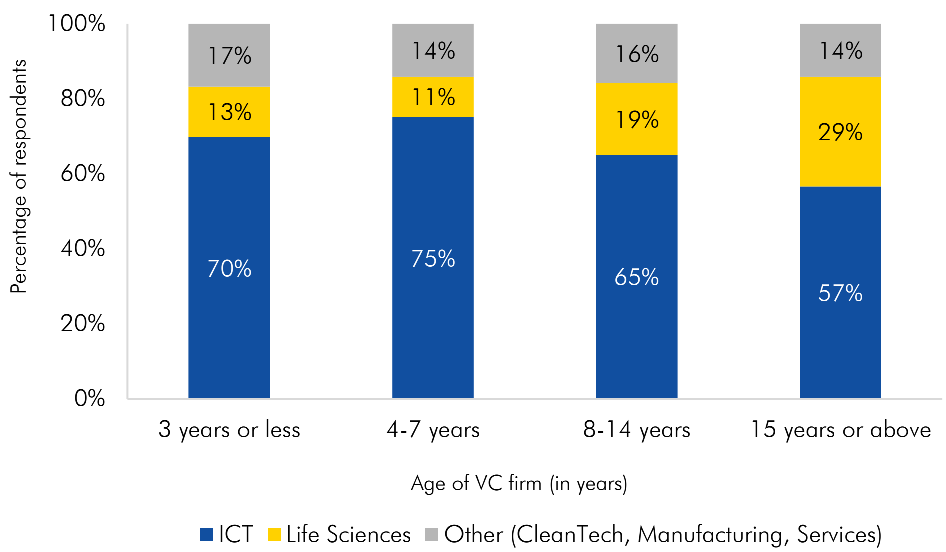


Figure 17: Most important target industry – by field of education



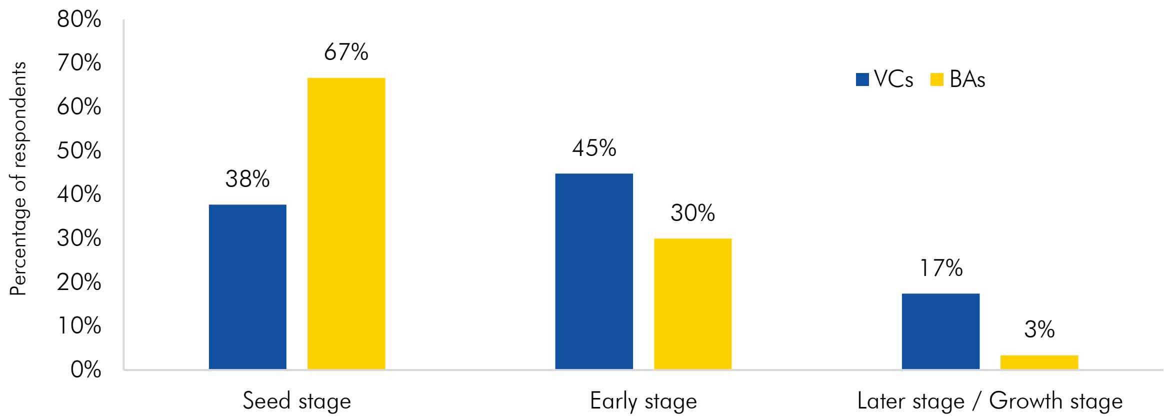
*Other include: Clean Technologies, Services, Manufacturing

Figure 18: Most important target industry – by VC firm age



As for the investment stage focus (Figure 19), the results echo prior research findings that BAs tend to invest in younger companies compared to VC fund managers – almost 7 in 10 BAs invest in seed-stage companies compared to only 4 in 10 VC GPs. As Gvetadze et al. (2020) note, BAs' personal approach to investing allows them to better mitigate the information asymmetries, implying they are better able to evaluate business opportunities even at a very early stage.

Figure 19: Respondents' most important investment stage



Q. What is (are) the most important stage(s) in which you/your firm invest/s.

Note: The above percentages reflect the respondents who indicated the respective investment stage as their No1 most important stage for VC/BA investments.

In the case of VC fund managers, it is worth noting that millennial investors (Figure 20) tend to focus more on seed-stage investments – 48% of millennial VCs invest in seed-stage companies, compared to 38% for the overall VC sample. Furthermore, GPs in younger VC firms (Figure 21) also seem to target more prominently seed-stage investments, shifting to more mature investment stages the more established their firm becomes.

Figure 20: VCs' investment stage focus – by age group

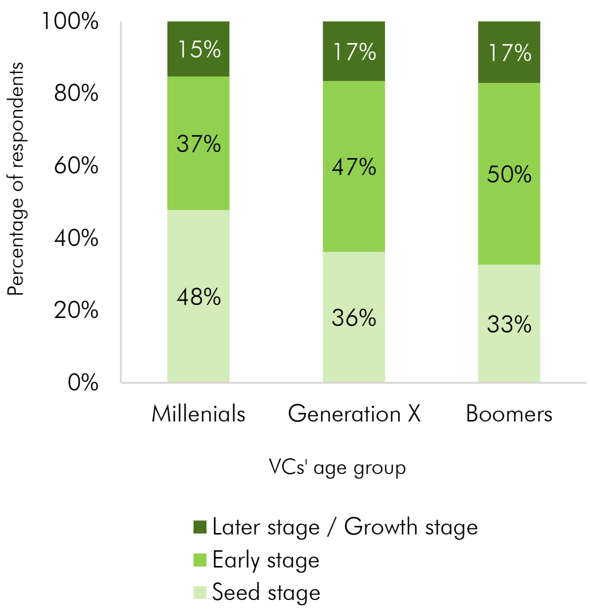
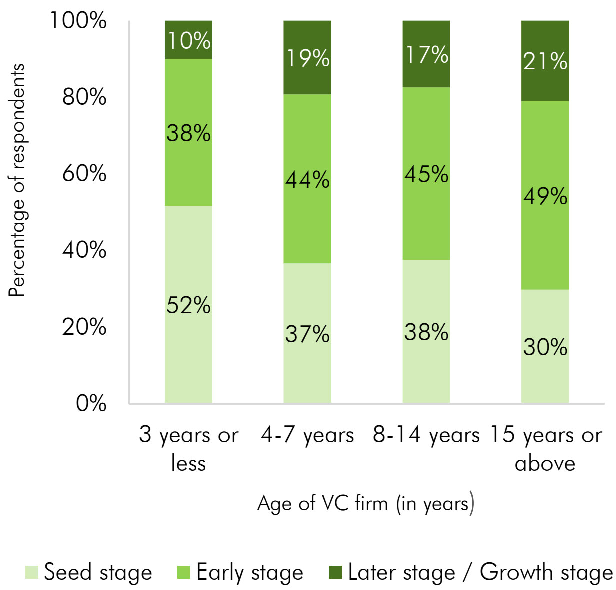
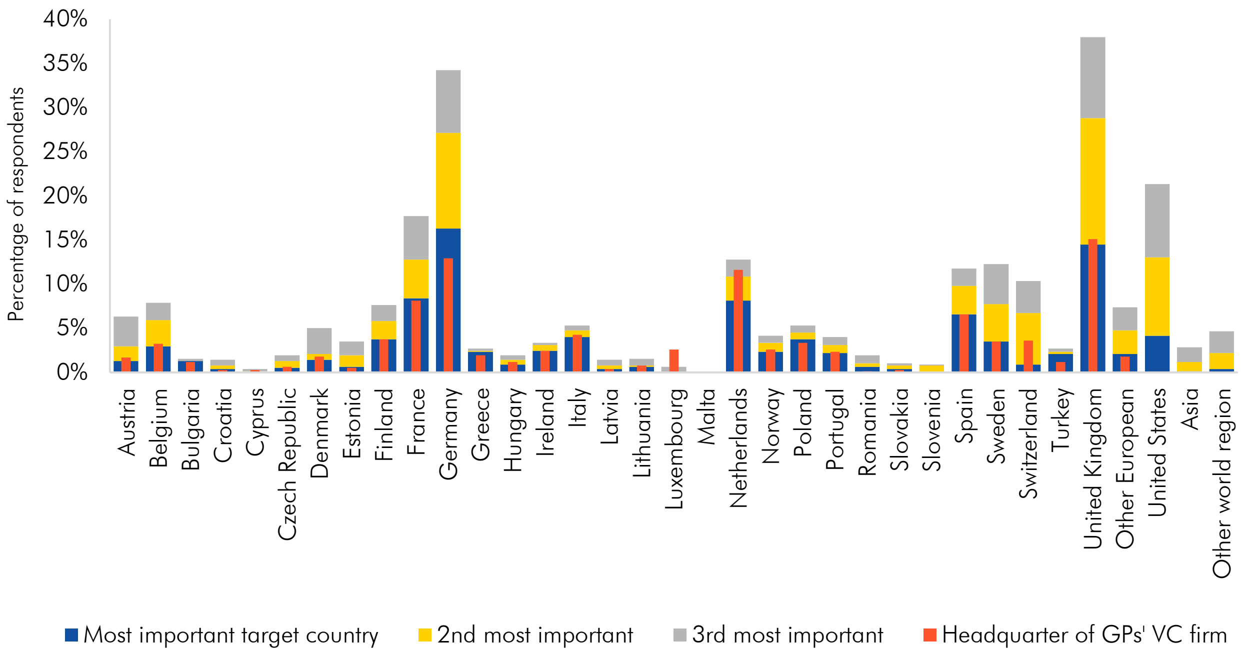


Figure 21: VCs' investment stage focus – by VC firm age



A final note in this section is with regard to the respondents' geographical distribution and their capital under management. In the case of VC fund managers (Figure 22), nearly half of the respondents state the UK, Germany, the Netherlands and France as the headquarter location of their VC firm, while these four countries also constitute the most frequently mentioned target countries for VC investments. Outside the EU, the US also feature high in the rank. The average (median) assets under management of the 538 VC firms represented in the survey is EUR 204m (EUR 70m), with the total value of AUM for all firms exceeding EUR 100bn.

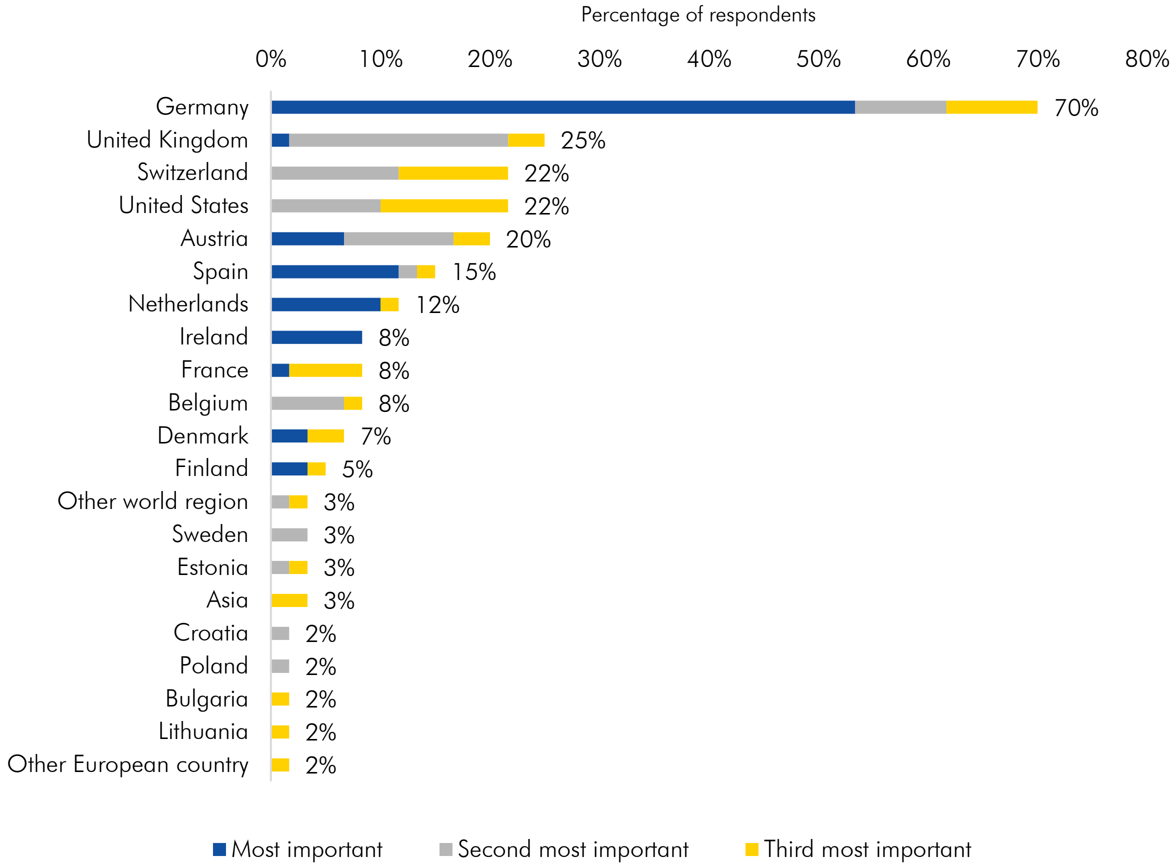
Figure 22: GPs' most important target countries for VC investments



Q. Select up to three of the most important countries in which your firm invests in venture, in order of importance.

In the case of BAs (Figure 23), the countries mentioned as the most important target countries for BA investments reflect the EAF compartments under which the BAs have been supported, hence Germany being largely ahead, followed by Spain. When also taking into account each BA's second and third most important investment target country, geographies outside the existing EAF compartments rank high as well, in particular the UK, Switzerland and the US. With regard to the volume of the BA activities, the total amounts invested mostly range between EUR 1m and EUR 8m, with the majority of the BAs typically contributing up to EUR 3m of their own personal wealth.

Figure 23: Most important target countries for BA investments



Q. Select up to three of the most important countries in which you invest as a BA, in order of importance.

3 ESG survey results

The ESG-related questions in the *EIF VC Survey 2019* and the *EIF Business Angels Survey 2019* can be clustered around six main themes:

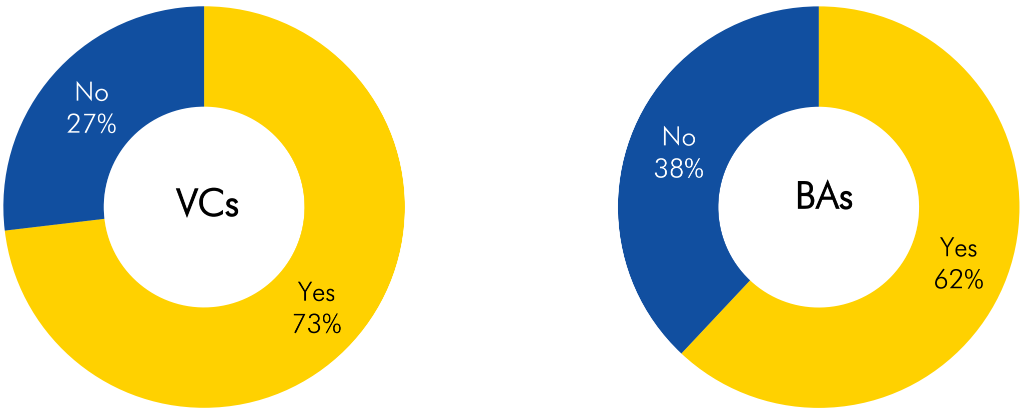
- What is the level of ESG engagement in VC and BA investing?
- What motivates VCs' and BAs' ESG engagement (and what deters them from doing so)?
- What are the most common ESG investment strategies?
- How do VC firms implement ESG criteria in terms of policies and procedures?
- How do VCs and BAs perceive the relation between ESG considerations and investment returns?
- What lies ahead for ESG investing?

The subsequent sections in this Chapter discuss the answers to the above questions.

3.1 ESG: level of engagement, drivers and strategies

The evidence from the two surveys confirms the anecdotal evidence and general market perception that ESG investing indeed accelerates into the investment mainstream, as approximately 7 in 10 VCs and 6 in 10 BAs incorporate ESG criteria into their investment decision process (Figure 24).

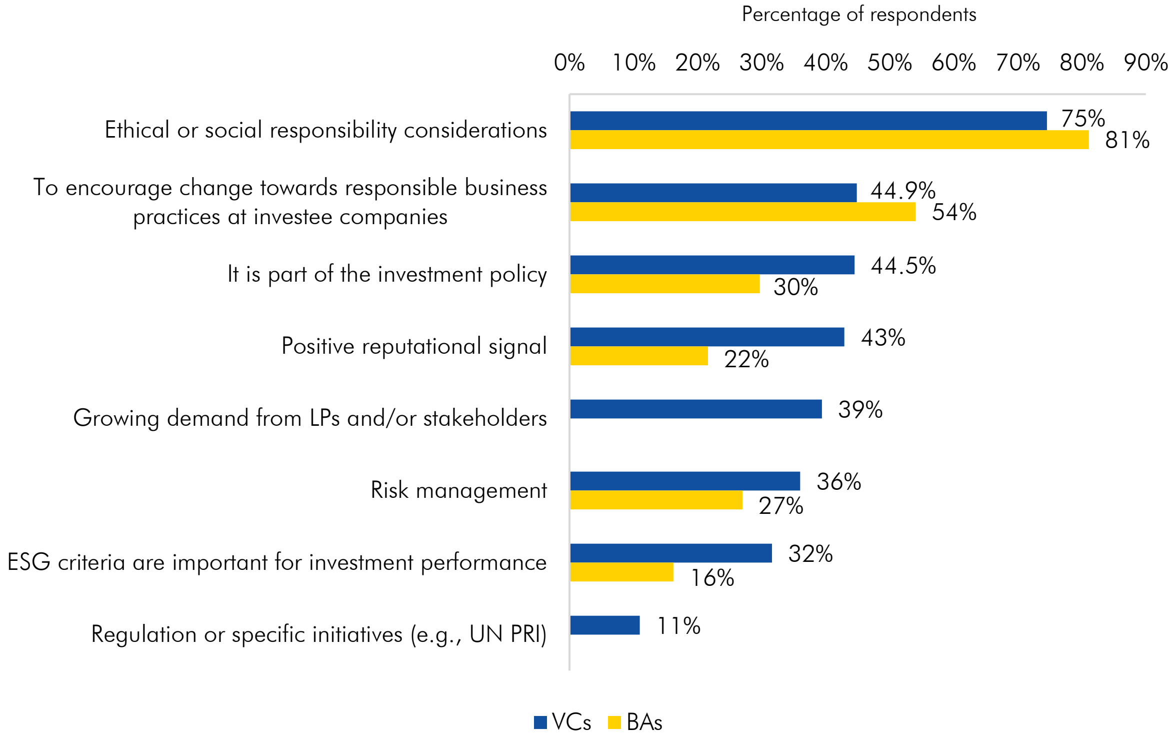
Figure 24: ESG considerations in investment decisions



Q. Are ESG considerations part of your investment decision process?

For both VCs and BAs, ethical or social responsibility considerations are the most widely cited motive for ESG engagement (Figure 25). The desire to encourage change towards responsible business practices at investee companies as well as ESG integration as part of the formal investment policy complete the top three of ESG drivers. At the same time, it seems that for BAs the will to have a positive footprint in society is relatively more important than for VC fund managers, for which external factors such as the positive reputational signal associated with ESG investing and the growing pressure from Limited Partners are also powerful determinants of ESG adoption. Another pattern that emerges from Figure 25 is that ethical or strategic motives are in general more important than the financial materiality of ESG criteria (as reflected in the relevance of ESG criteria for investment performance or for risk mitigation). Then, in turn, the financial relevance of ESG criteria is a stronger motive for ESG engagement in the case of VC investors relatively to BAs. Interestingly, only 1 in 10 VCs and none of the BAs mention regulatory initiatives as a key ESG driver. The European Council recently adopted a regulation setting out an EU-wide classification system ("taxonomy"[15]) of sustainable finance as well as the sustainability-related disclosures in the financial services sector.[16] It would therefore be interesting to monitor in the future whether and how having these specific sustainability regulations in place impacts investors' approach to ESG integration.

Figure 25: Motivation for ESG engagement



Q. What are your motives for considering ESG information when making investment decisions? *(multiple selection possible)*

Surveyed VCs and BAs were further asked to indicate the way in which they integrate ESG information into their investment process. They were specifically asked to select among the following ESG strategies:

Full integration of ESG criteria into the evaluation of investment opportunities: incorporating an explicit ESG factor into a valuation model (e.g., as input to cash flow forecasts)

Positive screening of companies: investing in companies that perform well in terms of selected ESG criteria

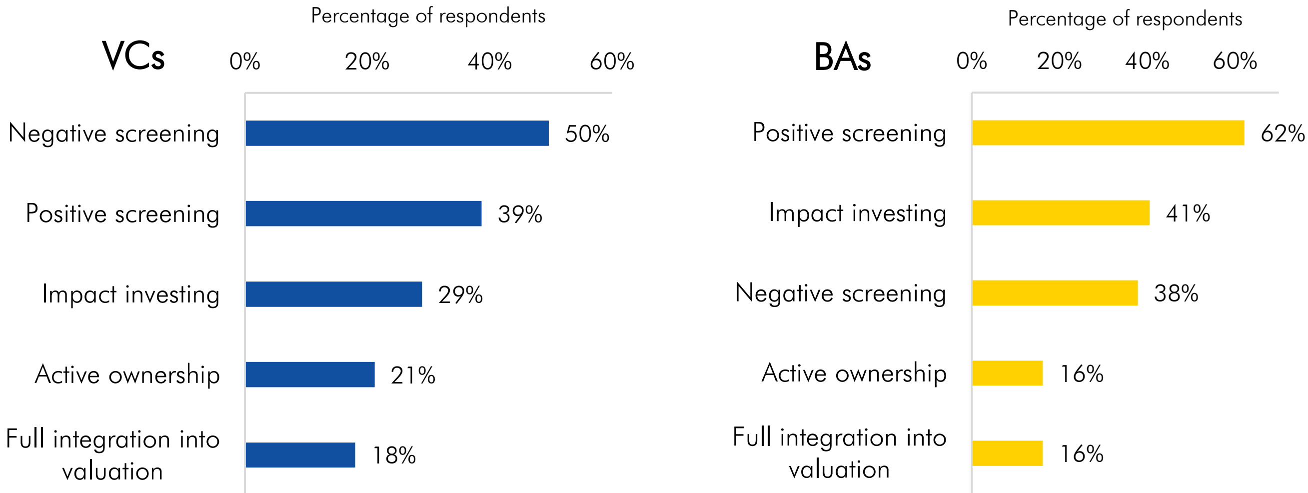
[15] See "EU Taxonomy: Final report of the Technical Expert Group on Sustainable Finance", March 2020.
[16] See "Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector", Official Journal of the European Union, Vol. 62, 9 December 2019, L317.

Negative screening (filtering-out) of companies: eliminating from the investment universe companies that fail to meet specific ESG criteria

Impact investing: investing in companies generating a positive social and/or environmental impact alongside a financial return[17]

Active ownership / Direct engagement with investee companies on ESG issues: support and value-adding service to the investee companies (e.g., through the provision of ESG expertise) to improve their ESG performance

Figure 26: ESG strategies



Q. How do you integrate ESG information into your investment process? *(multiple selection possible)*

As shown in Figure 26, for both VCs and BAs who do consider ESG criteria, the use of ESG information predominantly serves as a portfolio screening tool. The main difference between the two surveyed populations lies in the fact that VCs apply ESG screening particularly on an exclusionary basis at due diligence ('negative screening'), whereas the vast majority of BAs explicitly target firms that perform well in terms of selected ESG criteria ('positive screening'). ESG strategies that generally entail either a greater involvement on the part of the General Partners (e.g., 'direct engagement' with and provision of ESG expertise to investee companies in order to improve their ESG performance) or a more formalised approach to ESG incorporation (e.g., an ESG 'factor' integrated into valuation) are much less frequently adopted. In the case of BAs, however, we note that 'impact investing' features much more prominently – ranks second among all ESG investment strategies.

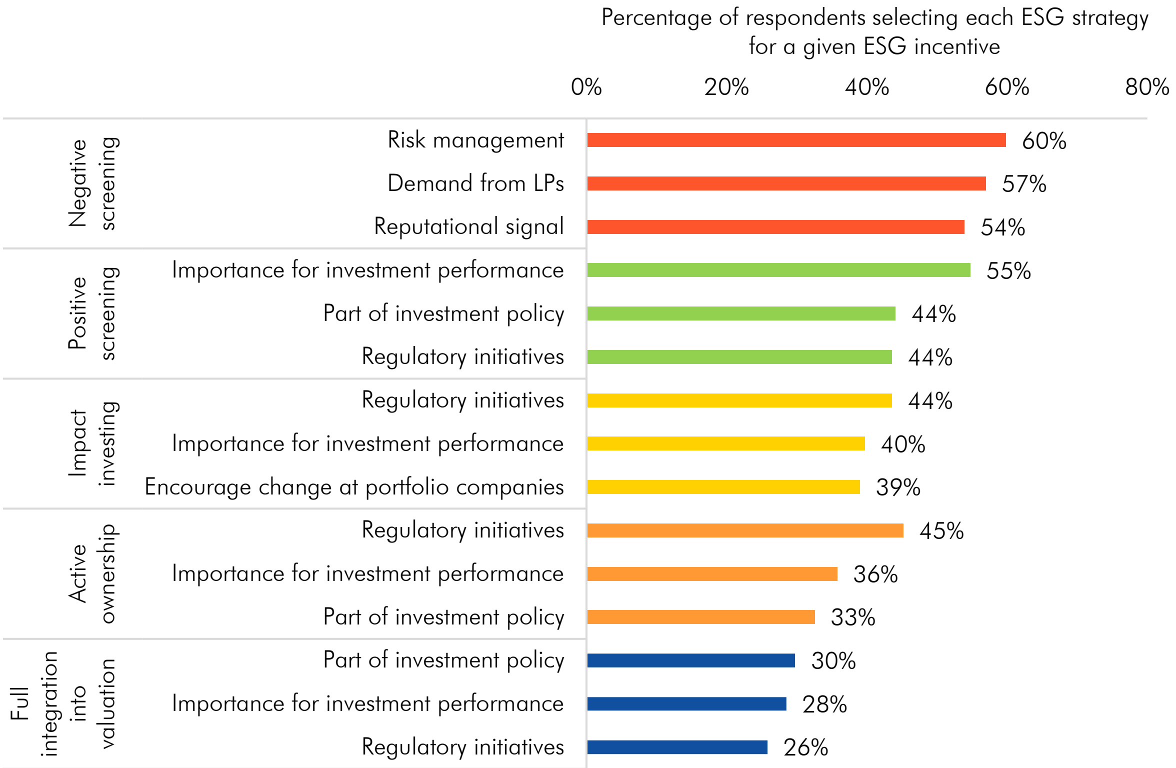
We further report on the interaction between the motivation for ESG engagement and the specific ESG strategy pursued.[18] More specifically, we look into how frequently a particular ESG investment strategy is adopted among respondents who indicate each respective reason for ESG engagement (Figure 27). Negative screening appears to be mainly driven by the mitigation of ESG-related risks or as a response to growing demand from LPs for ESG consideration. In this respect, negative

[17] As discussed in the Introduction of this paper (see Box 1), impact investing has been incorporated into the broad ESG spectrum as part of the widespread responsible finance movement and as an investment strategy seeking to address social and environmental issues at scale, through entrepreneurial solutions.

[18] This type of analysis is undertaken only for the VC respondents. In the case of BAs, due to the cross tabulation of the variables on ESG motives and ESG strategies, it is often the case that too few observations fall within each cluster, hindering any meaningful inferences.

screening indeed constitutes a relatively easier way for the GPs to become ESG-compliant. By contrast, positive screening is seen more like an opportunity for value creation, as it is prominently pursued among VC fund managers who consider ESG criteria due to their relevance for investment performance or as part of their firm's investment policy. An ESG-focused investment policy also increases the likelihood of integrating ESG as an explicit valuation factor. Finally, even though regulation ranked last among the key ESG drivers (see Figure 25), VCs who are in fact motivated in their ESG engagement by such regulatory initiatives tend to engage more prominently in impact investing or in active ownership. For example, the United Nations' Principles for Responsible Investment (UN PRI[19]) explicitly encourage the signatories to be active owners and to engage with their companies on ESG issues. Impact investing is also pursued by those VCs who believe that ESG considerations in the investment decision process can be effective in changing investees' behaviour.

Figure 27: ESG strategies in VC investing – by top 3 incentives for ESG engagement



3.1.1 The role of age, education and prior experience

Taking into consideration certain of the respondents' human capital characteristics outlined in Chapter 2, we note that interestingly the results on ESG engagement are not driven by Millenial investors alone (Figure 28). On the contrary, both surveys show that ESG considerations are rooted across all age ranges.

Furthermore, the level and field of education as well as prior relevant experience can affect individuals' perceptions of the risk-return relation as well as the way they perceive and respond to

[19] See https://www.unpri.org/pri/an-introduction-to-responsible-investment/what-are-the-principles-for-responsible-investment

risks and opportunities. For example, one argument goes that the higher the level of education, the greater an individual's ability to process complex decision criteria,[20] such as, in the current context, the identification and interpretation of material ESG factors. However, none of the two surveyed populations provides strong support for this hypothesis (Figure 29).

Figure 28: ESG considerations in investment decisions – by age group

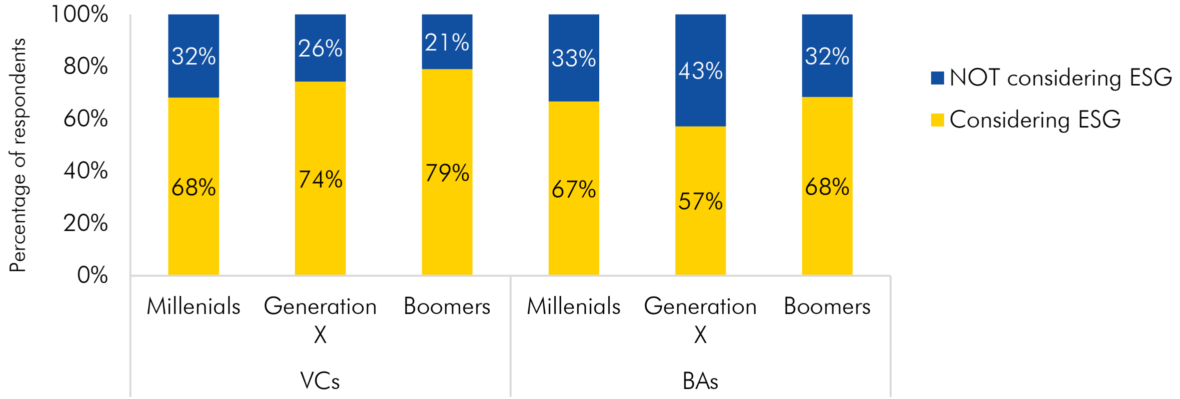
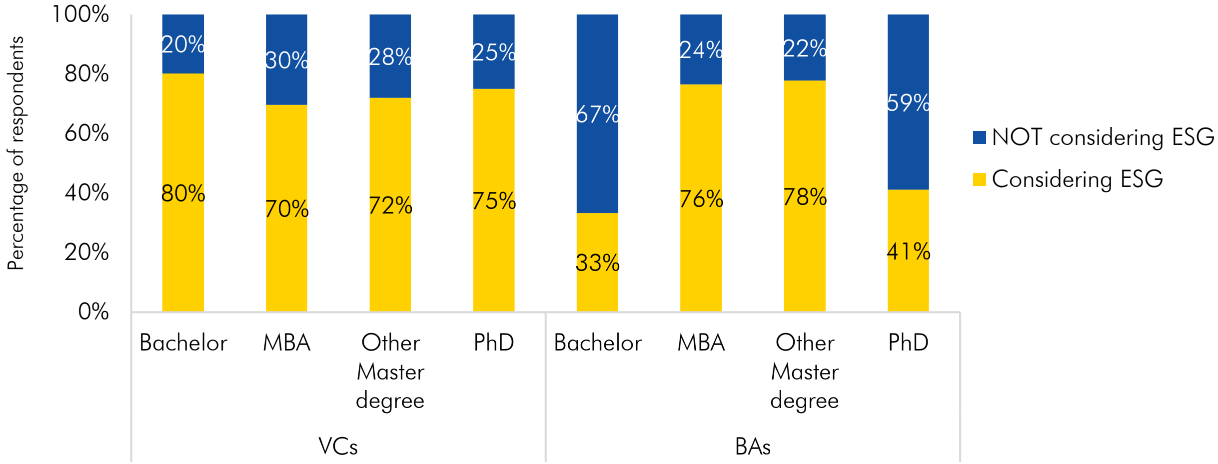


Figure 29: ESG considerations in investment decisions – by level of education



Another strand of the academic literature on the effects of business school education (e.g., Ghoshal, 2005) has criticised the "profits-first" mentality of education in business schools which may undermine moral or social responsibility considerations. However, in this respect too, the survey evidence provides only weak support in this direction. In the case of BAs, MBA holders exhibit one of the highest percentages (76%) in relation to the consideration of ESG factors – well in excess of the overall sample average of 62%. As for VCs, the percentage of MBA holders who consider ESG factors (70%) is only marginally lower compared to most other education categories and to the overall sample average of 73%.

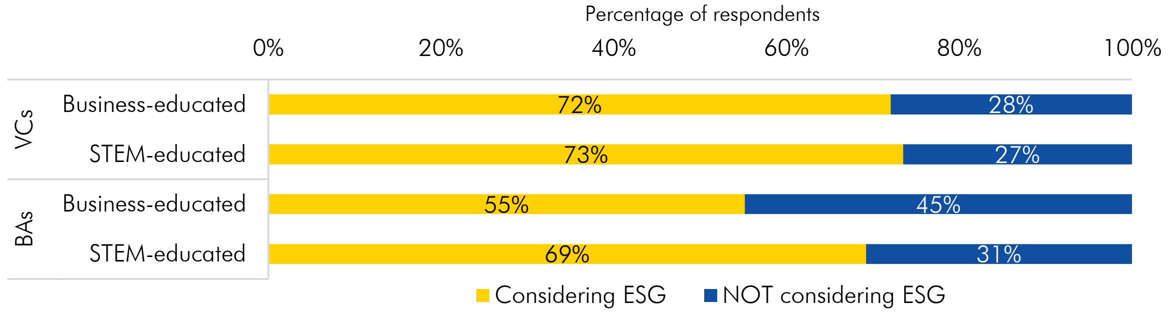
There are two plausible explanations for this evidence. First, if it pays to do the 'right' thing, then there is a business-case justification for sustainability and social responsibility considerations (Slater and Dixon-Fowler, 2010), i.e. a win-win situation whereby ESG strategies are pursued alongside

[20] For example, Wiersema and Bantel (1992) and Pelled (1996) generally perceive the level of formal education achieved as an indicator of an individual's cognitive abilities.

profit maximisation.[21] Second, as ESG investing continues to increase in popularity, top business schools around the world respond to the calls from employers, students and academics alike to provide greater focus on sustainability and ethics, and offer ESG-focused MBAs or specific courses on topics such as corporate social responsibility. Therefore, contrary to previous beliefs and practices, nowadays responsible and ethical leadership is becoming a critical issue in business school education, as more and more graduates seek higher 'purpose' rather than exclusive financial benefits.

When we further consider the field of education (focusing on the two most common fields of business/economics and STEM degrees, see Figure 30), it is only in the case of BAs that we note a difference in the extent of ESG integration between business- and STEM-educated respondents. The lack of similar evidence for the VCs may reflect a broader notion that investment policies (including on ESG integration) are often decided at the VC firm level, and therefore individual human capital characteristics may play less of a role in the case of VCs (unlike BAs who can decide for themselves on the investment strategies to be pursued). BAs with a stronger knowledge in science and engineering may have a better understanding of their investee companies' underlying product and technology, and may be in a better position to select and advise their portfolio companies, including on ESG-related issues.

Figure 30: ESG considerations in investment decisions – by field of education



Indeed, evidence based on the respondents' prior work experience (particularly in the case of BAs) corroborates this argument. While for VC fund managers, the type of prior work experience (technology-based vs. finance-based background[22]) does not seem to substantially influence the specific ESG strategy pursued (Figure 31), BAs who have gained prior experience in a technology/engineering-based firm are significantly more likely to engage in positive screening and impact investing, unlike BAs with a finance/investment banking background who overwhelmingly rely on ESG exclusion criteria.

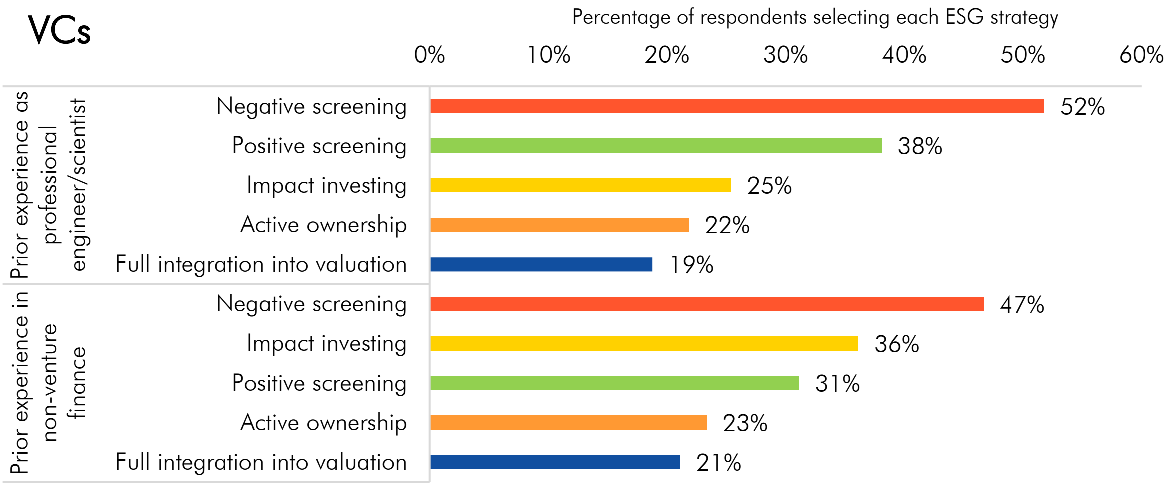
VC fund managers with prior entrepreneurial or start-up experience[23] also show higher level of ESG engagement (Figure 32), and generally adopt ESG strategies that require greater effort (in terms of information needs and level of commitment) on the part of the GPs – particularly in relation to active ownership, compared to VCs with no such experience (Figure 33).

[21] Subsequent questions of the survey address this exact issue, i.e. the respondents' perception of ESG impact on financial returns.

[22] We focus our analysis on the two most common options encountered in both samples (see Figure 6).

[23] This type of analysis is undertaken only for the VC respondents. In the case of BAs, only 4 BAs stated not having any prior entrepreneurial or start-up experience, hindering any meaningful inferences from a comparison between the two sub-groups of respondents (with and without entrepreneurial/start-up experience).

Figure 31: ESG strategies – by type of prior work experience



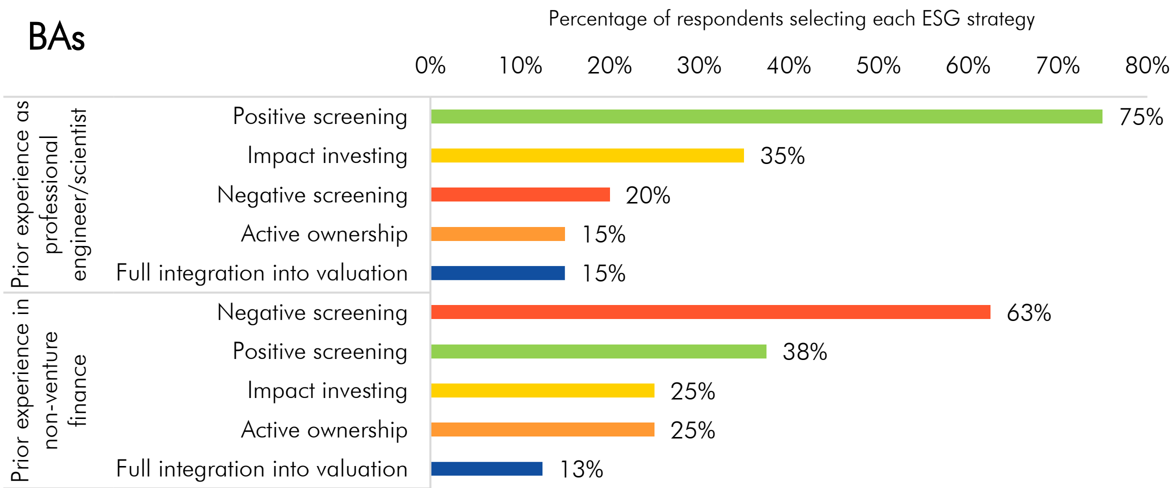


Figure 32: ESG considerations in VC investing – by VCs' prior entrepreneurial experience

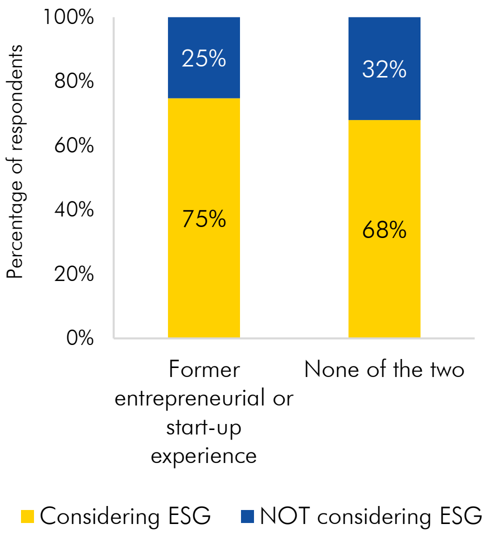
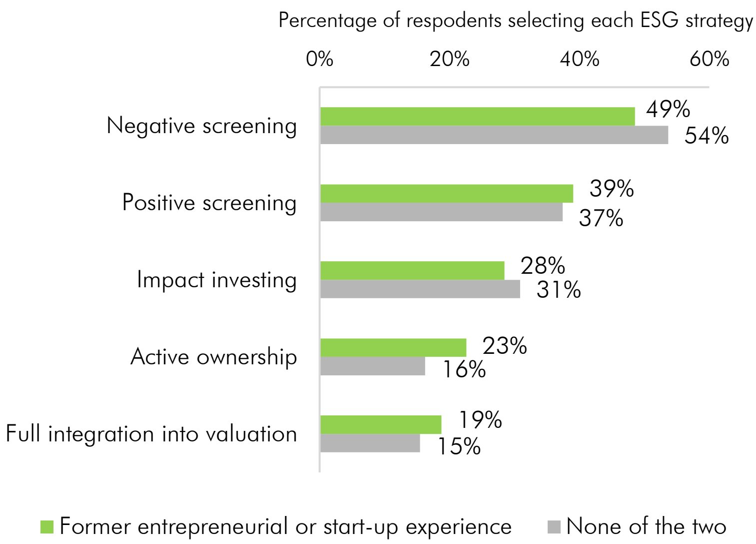


Figure 33: ESG strategies in VC investing – by VCs' prior entrepreneurial experience



3.1.2 ESG considerations and VC firm characteristics

In this section, we look into how the level of ESG engagement, the ESG motives and investment strategies vary depending on a selection of VC firm characteristics such as location, size, investment stage focus and gender diversity in the management team.[24] Investment activities incorporating ESG criteria are particularly prominent in the Nordic countries, in the UK & Ireland and in France, while VC GPs in DACH and the CESEE region report considering ESG criteria to a lesser extent (Figure 34).[25]

Figure 34: ESG considerations in VC investment decisions – by region (VC firm headquarter)

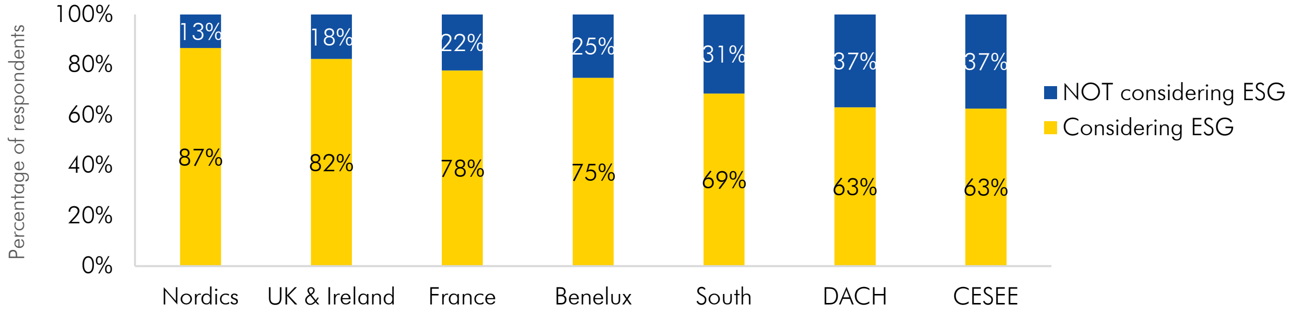
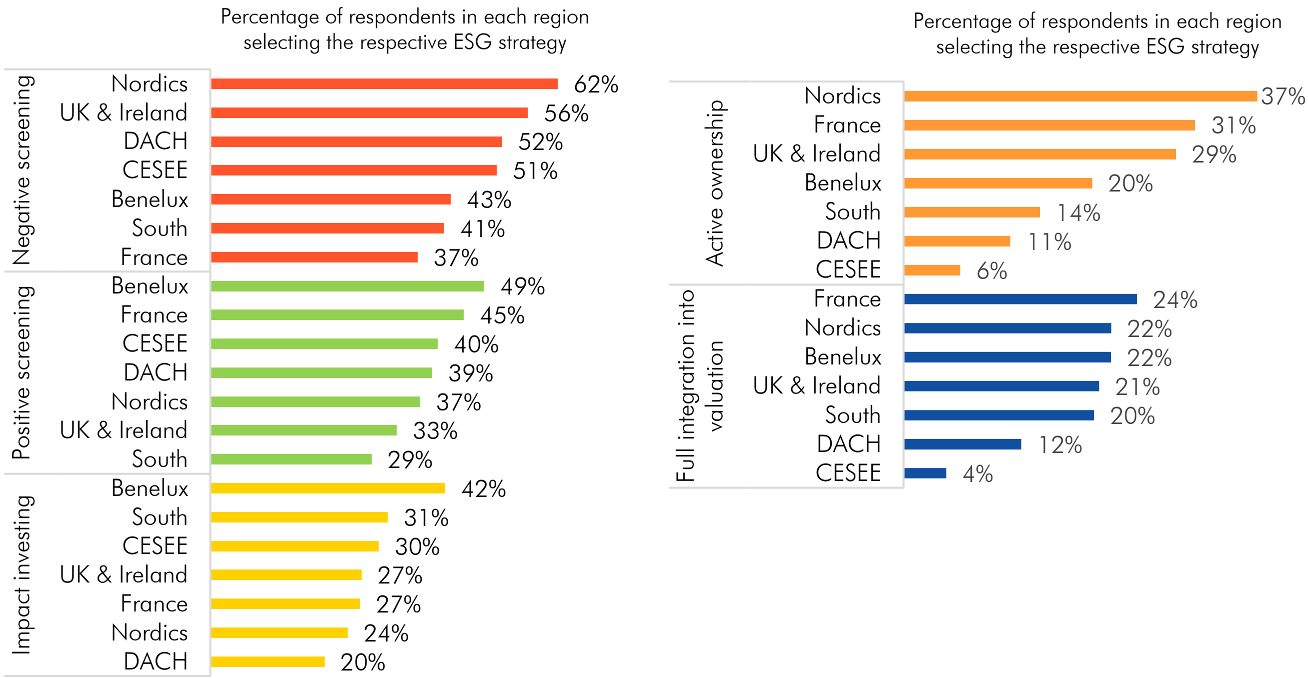


Figure 35: ESG strategies in VC investing – by region (VC firm headquarter)



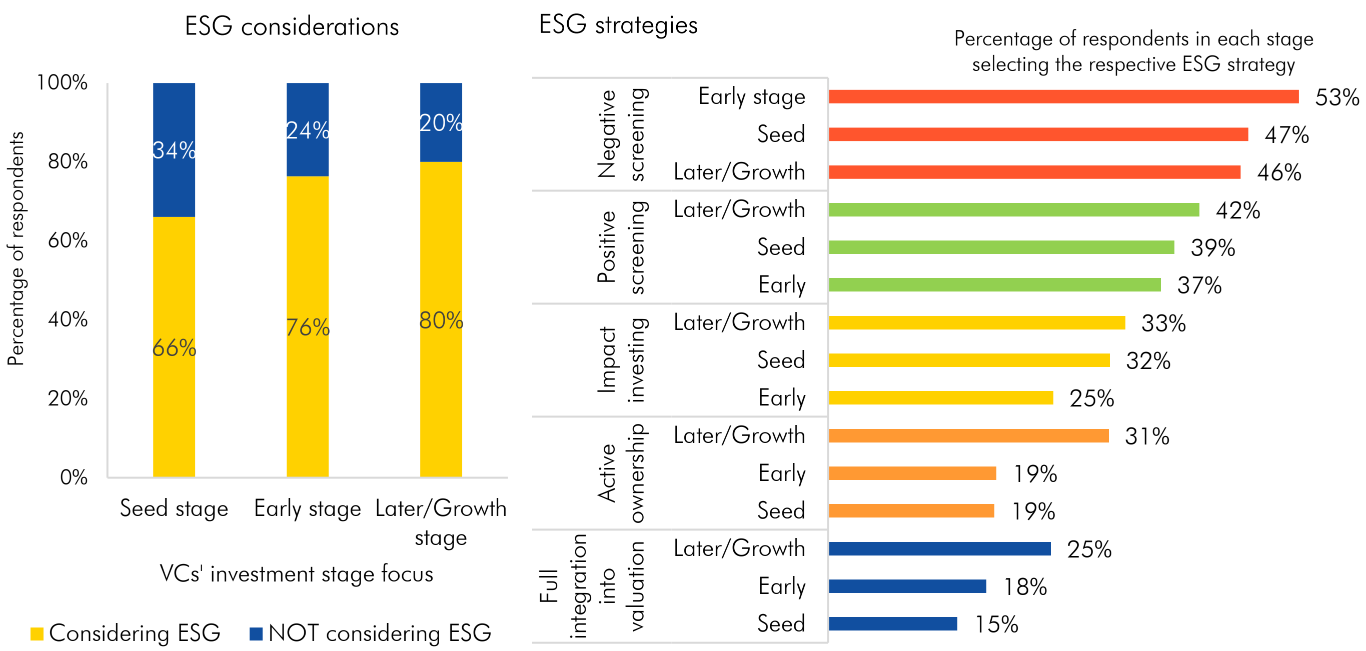
[24] This analysis is undertaken only for the VC respondents, either because certain questions were not applicable to BAs (e.g., the question about gender diversity) or due to the non-availability of a sufficiently large number of observations (e.g., the relatively low number of BAs supported under each individual EAF compartment, with the exception of Germany, does not allow for sufficient geographical diversification of the respondents to undertake a regional analysis in the context of the BA survey).

[25] Based on the respondents' distribution by headquarter country, country groupings are as follows: 135 respondents from Benelux (Belgium, Netherlands, Luxembourg); 107 respondents from CESEE (here: Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Greece, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Turkey, Other); 141 respondents from DACH (Germany, Austria, Switzerland); 63 respondents from France; 90 respondents from the Nordics (Denmark, Finland, Norway, Sweden); 102 respondents from the South (here: Italy, Portugal, Spain); 136 respondents from the UK & Ireland.

There is also a significant degree of variation regarding the specific ESG strategies pursued by VCs across Europe (Figure 35). It is not only that certain regions exhibit higher levels of ESG engagement (such as the Nordics and France), it is also the case that GPs in these regions adopt to a greater extent more 'demanding' (given the information and dedication needed) ESG investment strategies, such as active ownership and explicit factoring of ESG into valuation. By contrast, in regions where ESG engagement is lower (such as DACH and CESEE), the aforementioned ESG strategies rank at the bottom of the GPs' preferences. VC GPs in these regions tend to rely more on portfolio screening tools, and negative screening in particular. Finally, relative to other regions, impact investing is adopted more widely in the Benelux and the South.

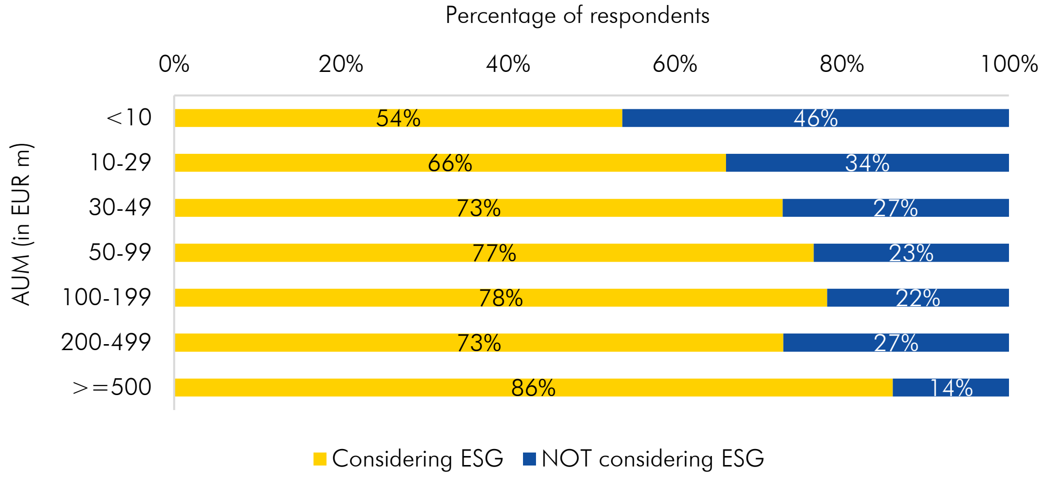
The investment stage focus is an additional factor that influences both the extent of ESG engagement and the specific ESG strategy pursued (Figure 36). The VC survey evidence suggests that the more matured the investment stage (seed vs. early vs. growth) the higher the degree of ESG integration. This may reflect the fact that there is more information available for later/growth-stage companies, including on ESG issues, which facilitates the processing and integration of ESG criteria into the investment decisions. This argument is in turn echoed in the evidence that growth-stage VC investors are much more likely, compared to GPs focusing on other investment stages, to consider ESG criteria through engagement and integration strategies (for example, 31% of growth-stage VC investors adopt active ownership as opposed to only 19% of seed- or early-stage investors).

Figure 36: ESG considerations in VC investing and ESG strategies – by investment stage focus



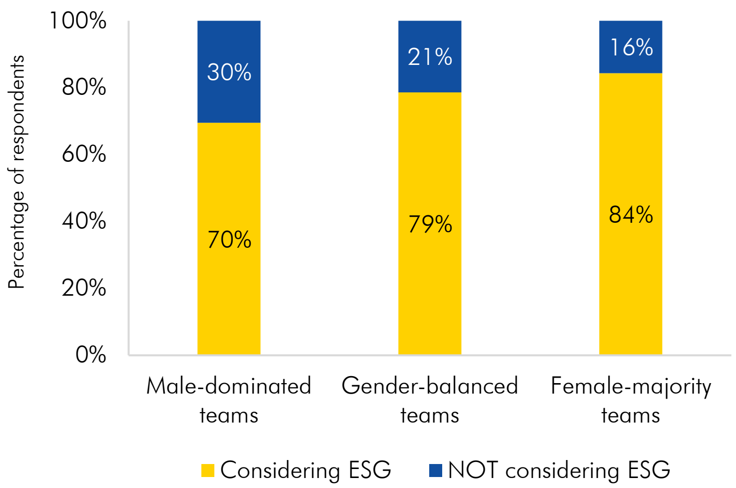
Surveyed fund managers from bigger (in terms of assets under management) VC firms generally report a higher degree of ESG consideration (Figure 37), probably because bigger firms also have more resources and expertise to deploy towards the development of concrete ESG policies and procedures (this will be discussed in subsequent sections). Results not presented here for the sake of brevity further show that there is a higher propensity for bigger firms to engage in ESG investing as a result of growing demand from their LPs.

Figure 37: ESG considerations in VC investment decisions – by VC firm size (AUM)



Finally, the VC survey results point in the direction of a positive correlation between the extent of gender diversity in the VC firm's management team and the degree of ESG consideration (Figure 38). Having said that, it needs to be noted that one cannot infer causality in this respect. In other words, an effect running from gender diversity to ESG consideration (i.e. that more gender-diverse teams induce higher ESG engagement) or from ESG consideration to gender diversity (i.e. that firms already considering ESG criteria are also more mindful of diversity-related issues) are equally plausible explanations.

Figure 38: ESG considerations in VC investing – by gender diversity in management team



Note:

Male-dominated teams: % of female partners less than 20%

Gender-balanced teams: % of female partners between 20% and 50%

Female-majority teams: % of female partners in excess of 50%

Apart from the general ethical and social responsibility motives, VC fund managers from more gender-diverse teams (gender-balanced or female-majority) are more likely to consider ESG criteria out of belief that this is an effective mechanism to encourage change in portfolio companies towards more responsible investment practices (Figure 39). For respondents from male-dominated teams, on the other hand, self-interest motives such as the positive reputational signal associated with ESG investing appear to also be important drivers of their approach towards ESG integration.

This is further reflected in the way surveyed VCs incorporate ESG into their investment process. Respondents from more gender-diverse teams tend to pro-actively incorporate ESG criteria through, for example, positive screening, impact investing and integration strategies (Figure 40), whereas respondents from male-dominated teams tend to achieve more 'passive' ESG-compliance, relying mainly on exclusion strategies.

Figure 39: Top 3 incentives for ESG engagement – by gender diversity in VC management team

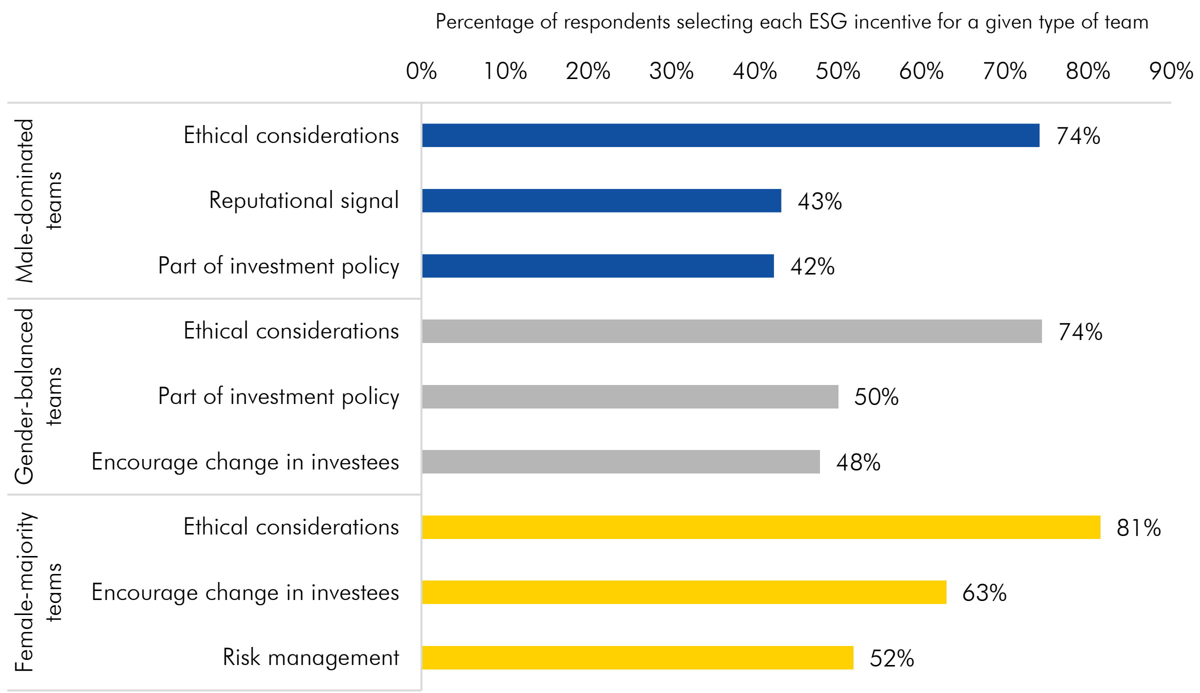
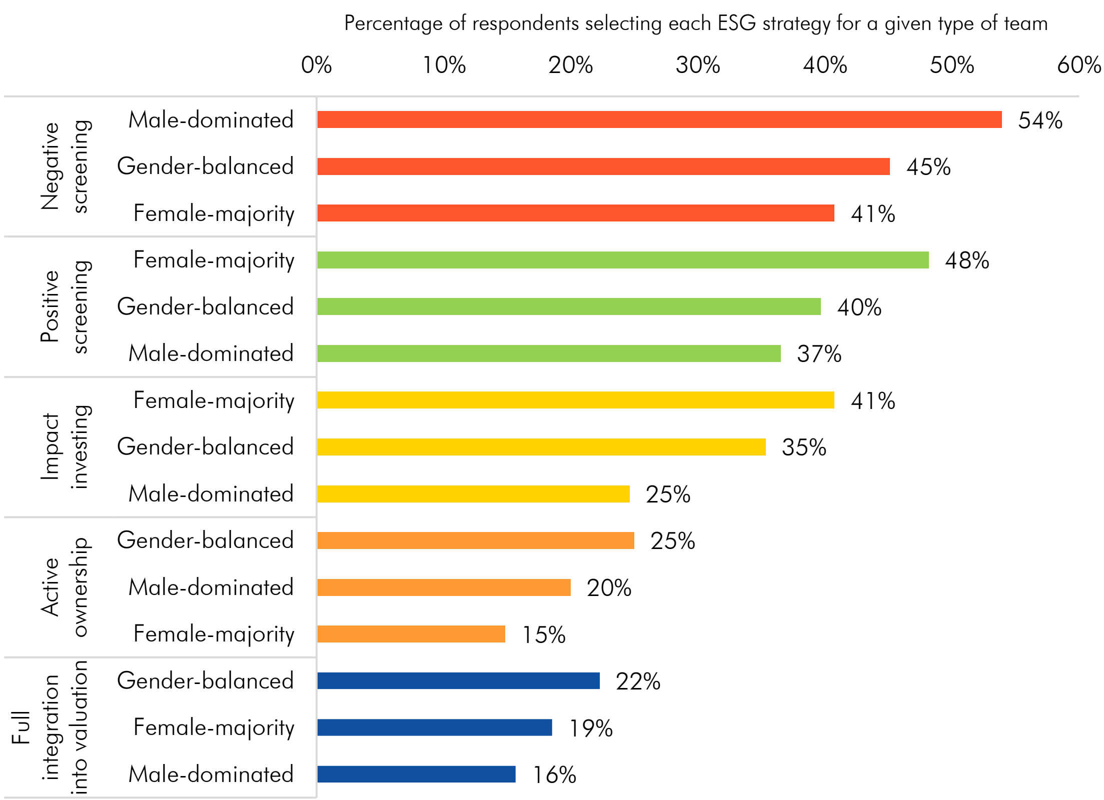


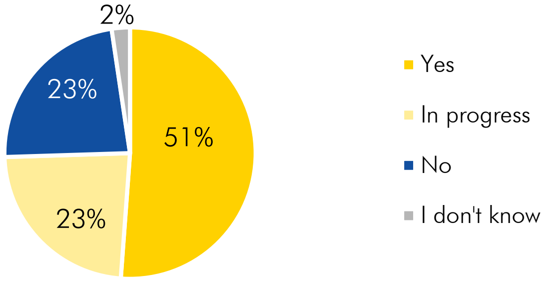
Figure 40: ESG strategies in VC investing – by gender diversity in VC management team



3.2 ESG policies and procedures[26]

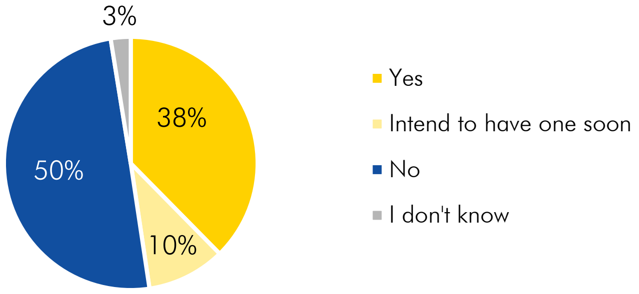
In the current section, we present the VC survey evidence on the formalities of ESG implementation. 1 in 2 VC fund managers state that there is an explicit ESG policy already in place in their respective firms (Figure 41), but only 38% of the surveyed VCs report having a member in their investment team dedicated to dealing with ESG issues (Figure 42). 61% of the respondents measure the performance of their portfolio companies in terms of ESG metrics (only 27%, however, disclose the ESG performance of their investees publicly), Figure 43. An important 37% report a lack of formal monitoring of their investees in the terms of ESG-related KPIs.

Figure 41: ESG policy in place



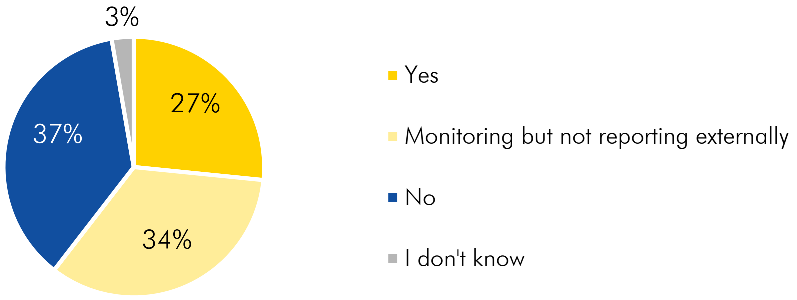
Q. Does your firm have an ESG policy in place?

Figure 42: ESG expert in investment team



Q. Does your firm have a member of its investment team dedicated to dealing with ESG issues?

Figure 43: Monitoring of investees' ESG performance



Q. Does your firm monitor and disclose the performance of its portfolio companies with regard to ESG criteria?

[26] This set of survey questions is applicable only in the case of VC respondents.

Not surprisingly, bigger (in terms of assets under management) VC firms incorporate ESG criteria in a more formalised way: a greater percentage of VC fund managers in bigger firms report that their firm already has an ESG policy in place (Figure 44) and an ESG expert in the investment team (Figure 45), and that it monitors the ESG performance of portfolio companies (Figure 46). These findings echo an argument raised earlier in this report that bigger firms are better equipped, in terms of the resources and personnel expertise, to develop formal ESG procedures and to deal with the challenges of ESG integration and reporting.

Figure 44: ESG policy in place – by VC firm size (AUM)

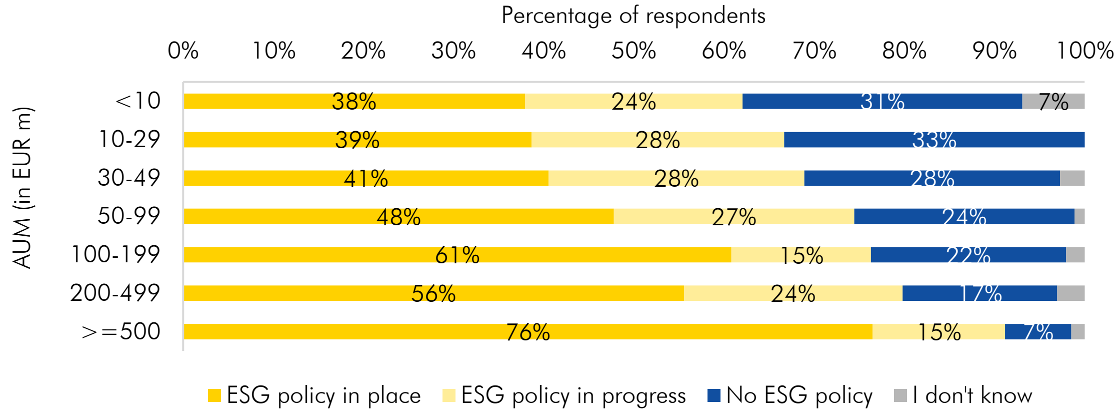


Figure 45: ESG expert in investment team – by VC firm size (AUM)

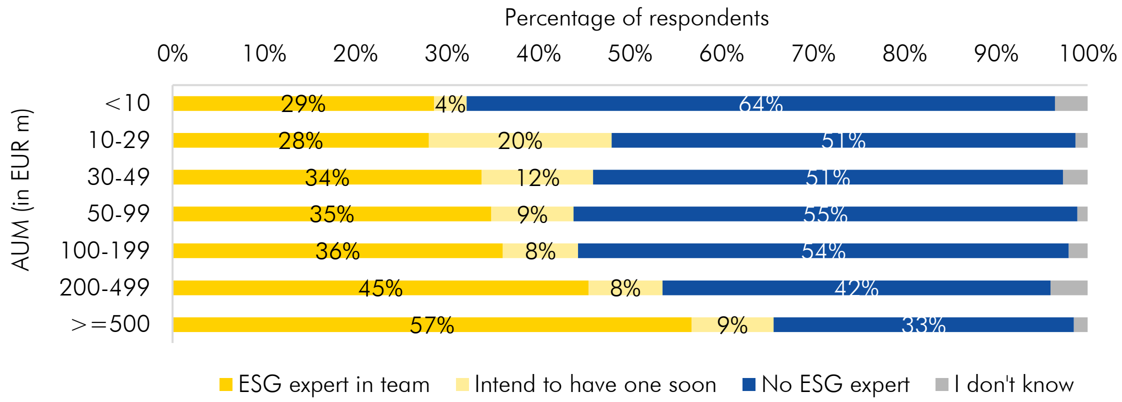
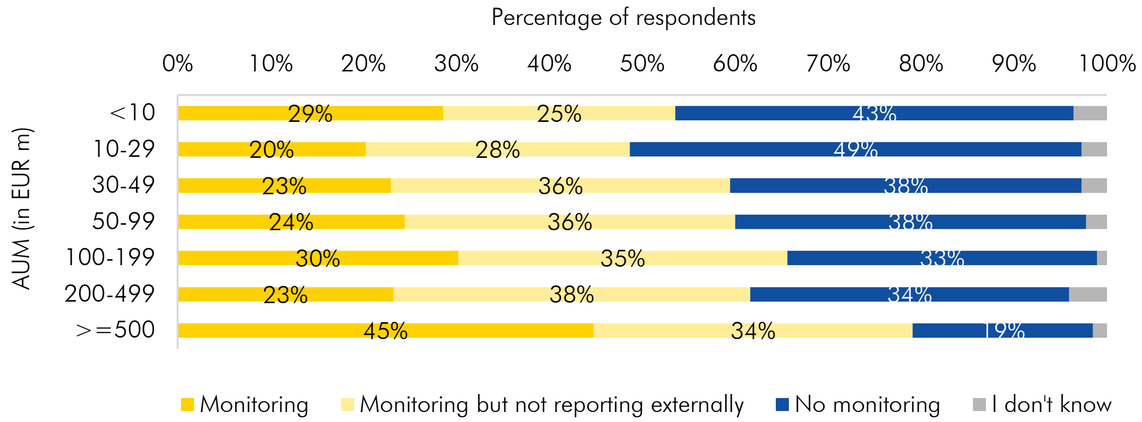


Figure 46: Monitoring of investees' ESG performance – by VC firm size (AUM)



Furthermore, the survey evidence points to the fact that the development of an explicit ESG policy is a focal point in the ESG implementation process that helps streamline other ESG-related procedures. This is because VC firms that already have an ESG policy in place are more likely to also have a dedicated person in the investment team dealing with ESG issues (Figure 47) and to monitor (and disclose) the ESG portfolio performance (Figure 48). In addition, with an ESG policy in place, VC GPs are in a better position to guide investee companies on ESG issues, through for example active ownership, or to formally factor ESG criteria into valuation alongside traditional financial metrics (Figure 49).

Figure 47: ESG expert in team – by ESG policy in place or not

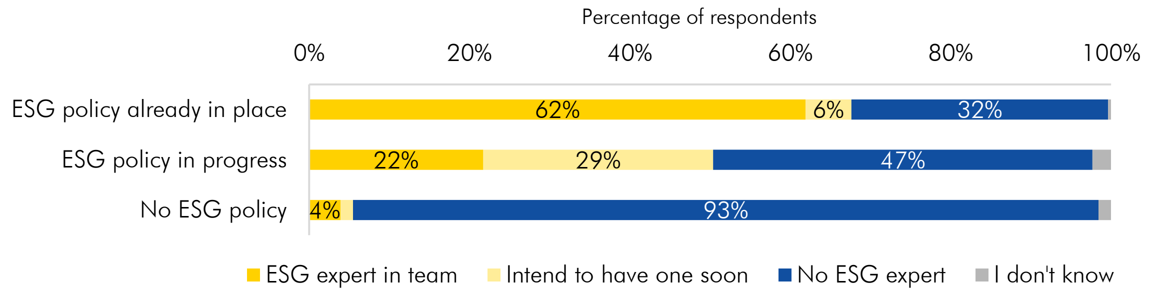


Figure 48: Monitoring of investees' ESG performance – by ESG policy in place or not

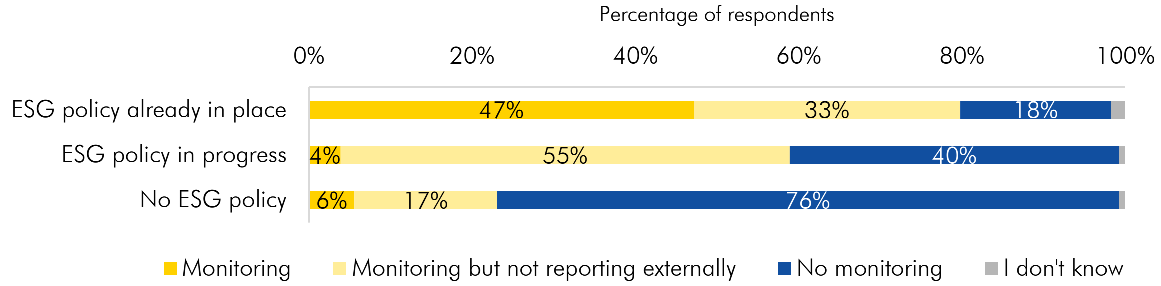
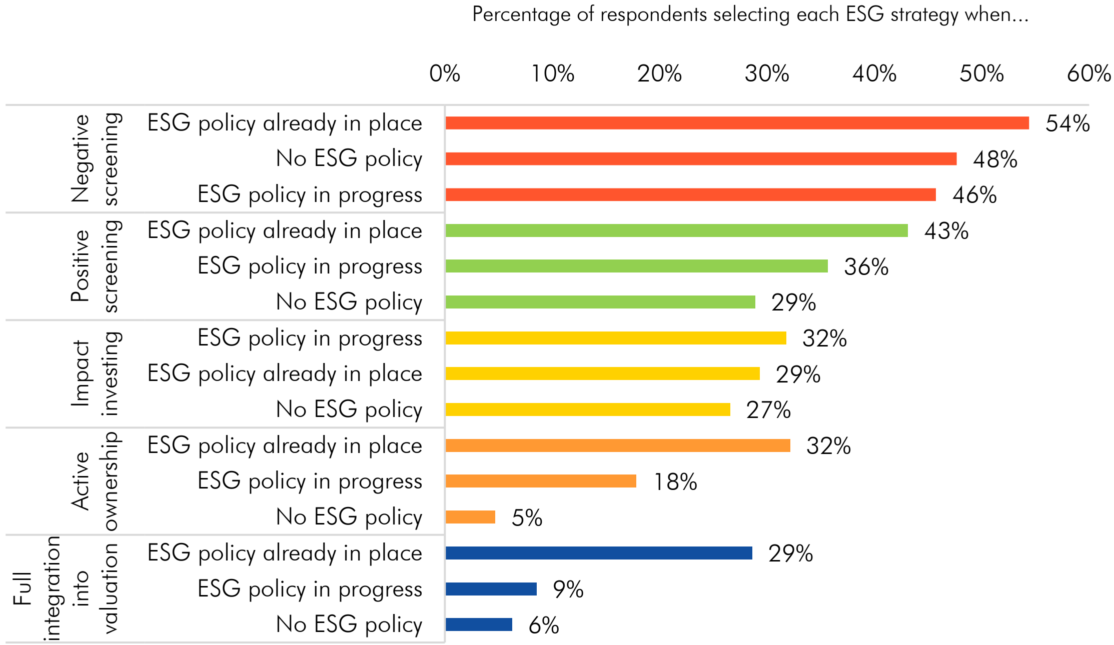


Figure 49: ESG strategies in VC investing – by ESG policy in place or not



Finally, the incentive for considering ESG criteria seems to be significant in determining the policies and procedures through which ESG considerations are incorporated into the investment process. Two 'internal' and two 'external' to the VC firm factors appear to be the most important in shaping the ESG policies and procedures.

The two internal factors are the consideration of ESG criteria as part of the firm's investment policy and because of their perceived positive impact on investment performance. For example, when ESG considerations are perceived as value-added factors for investment performance, then an explicit ESG policy and an ESG specialist on board are needed to guide the development and interpretation of ESG-related KPIs. Indeed, among VC respondents who stated investment performance as a motive for ESG engagement, 66% report having an ESG policy already in place (Figure 50), 54% report having an ESG expert in the team (Figure 51), and 39% report monitoring and disclosing publicly the ESG performance of their portfolio (Figure 52).

Regarding the two external factors, these are regulation and growing demand from LPs. Indeed, having formal ESG policies and procedures in place can help a VC firm achieve regulatory compliance and demonstrate its ESG credentials to the LPs.

Figure 50: ESG policy in place – by incentive for ESG engagement

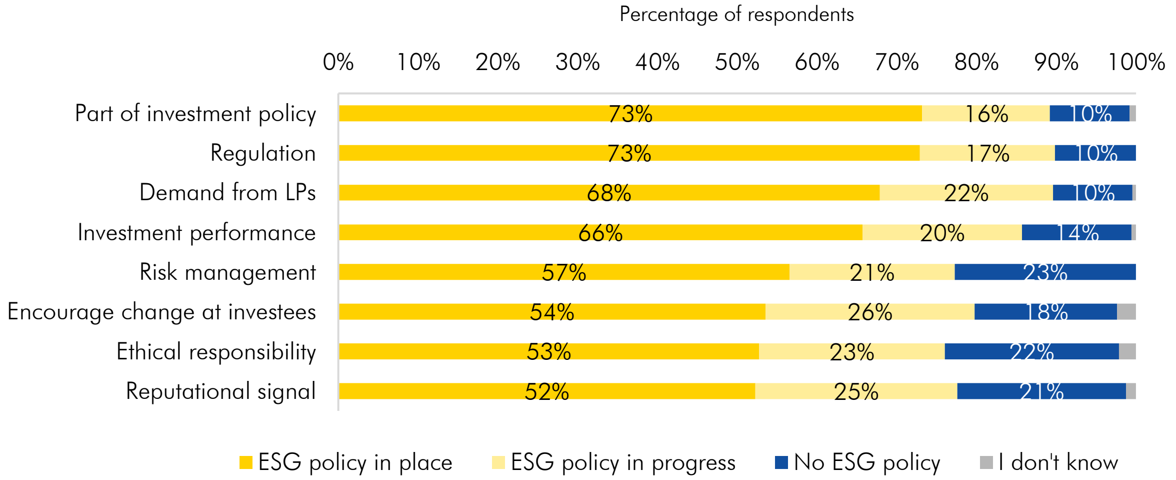


Figure 51: ESG expert in team – by incentive for ESG engagement

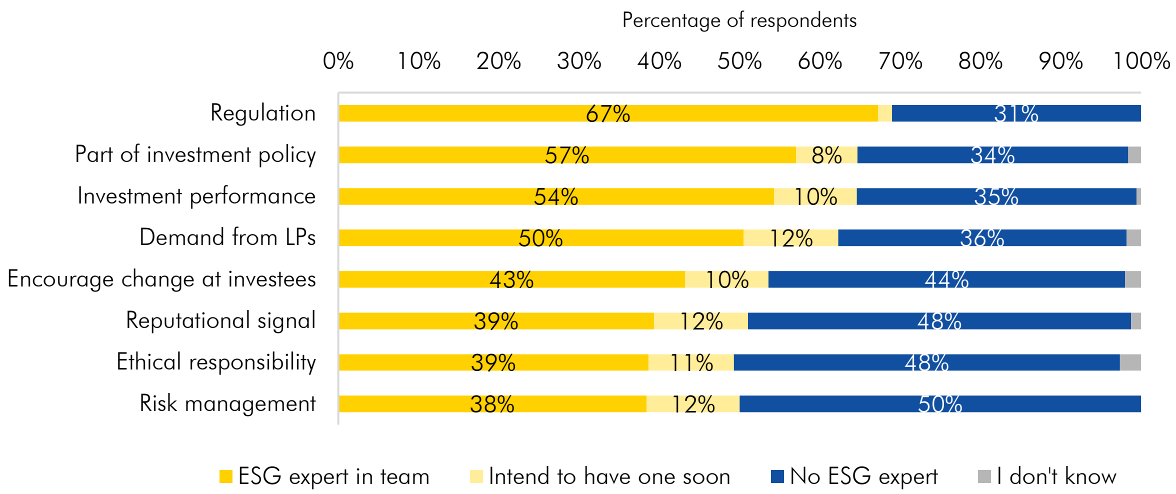
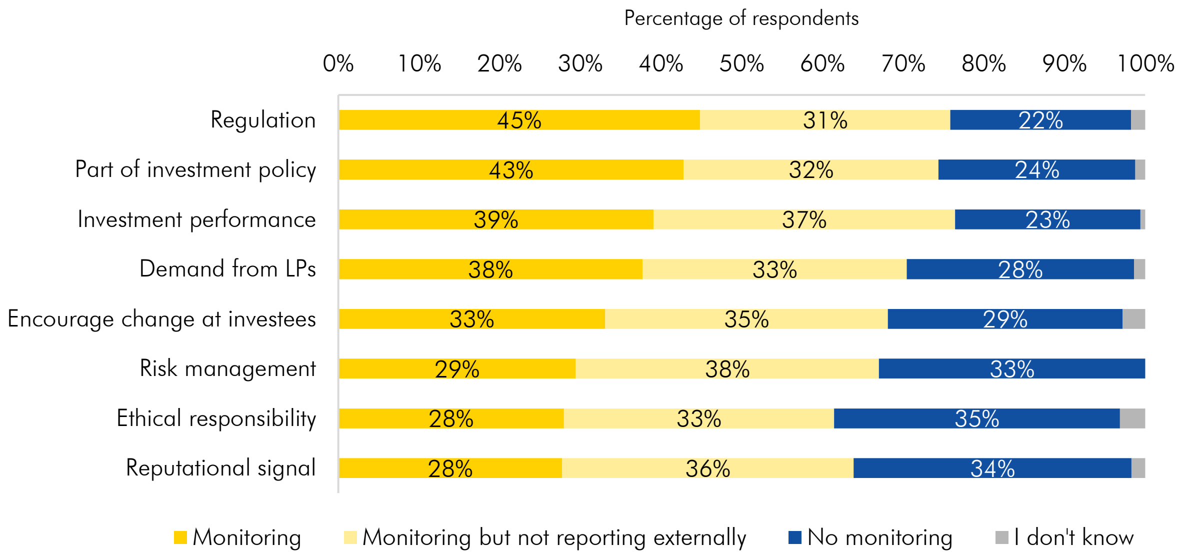


Figure 52: Monitoring of investees' ESG performance – by incentive for ESG engagement



3.3 ESG considerations and investment returns

Despite the trillions of assets under management that consider ESG criteria one way or another, the question of whether responsible investing, apart from delivering perceived value, can also materialise into superior investment returns continues to frame the academic and policy debate. A large academic literature has emerged examining the financial materiality of ESG factors and attempting to identify the channels through which ESG engagement can improve performance.[27] To name a few, these range from reputational effects and product differentiation strategies, to risk management (for example, of climate-related risks) and positive cost of capital effects.

Aggregate scientific research[28] points to a non-negative correlation between financial performance and ESG considerations. There are however certain caveats. First, there is a reverse causality concern whereby it may not be ESG considerations that lead to superior performance, but rather better financial performance that enables firms to free up and dedicate resources to ESG.

Second, empirical literature tends to treat all responsible investment as equal, when in fact the different ESG investment strategies and underlying motivations might lead to different risk and return characteristics.

Both surveys contribute to this discussion not only by asking VC fund managers and BAs to indicate how each ESG strategy affects investment returns (thereby assuming a directional effect from ESG considerations to performance), but also by providing testimony on the aforementioned relation for an asset class for which there is very scarce (if any) evidence, namely VC and BA investing.

Figure 53 ranks the different ESG strategies according to the percentage of VC fund managers who have indicated a positive effect on performance. These responses are based on all VCs who consider ESG criteria, independently of the specific ESG investment strategy adopted (hence they reflect a mixture of both the respondents' *perceived* impact on returns as well as their *experience*-based opinion).

Across all ESG strategies, the results suggest that ESG considerations and performance are not mutually exclusive. Positive screening is considered by VC investors as the most beneficial strategy in terms of its impact on investment performance, with an aggregate 45% of the respondents indicating that positive screening has a slightly or significantly positive effect on investment returns. Negative screening comes second. By contrast, only 4% and 7% of the respondents, respectively, believe that these two strategies have a negative effect on returns. Full integration of ESG factors ranks last, with an aggregate 24% of the respondents indicating a positive effect on investment performance. However, according to Figure 26, full integration of ESG factors is the least frequently used strategy among VC investors; this is why this strategy also has the highest percentage of respondents who indicate a neutral impact on returns (or are undecided).

Figure 54 addresses the same question, but from the perspective of the fund managers who have indeed adopted the respective ESG strategy (hence the responses are evidence-based only). In this case, active ownership and impact investing are instead considered as the two most beneficial strategies in terms of investment returns, with an aggregate 71% and 63% of the respondents, respectively, indicating a positive impact on investment performance. Active ownership may require

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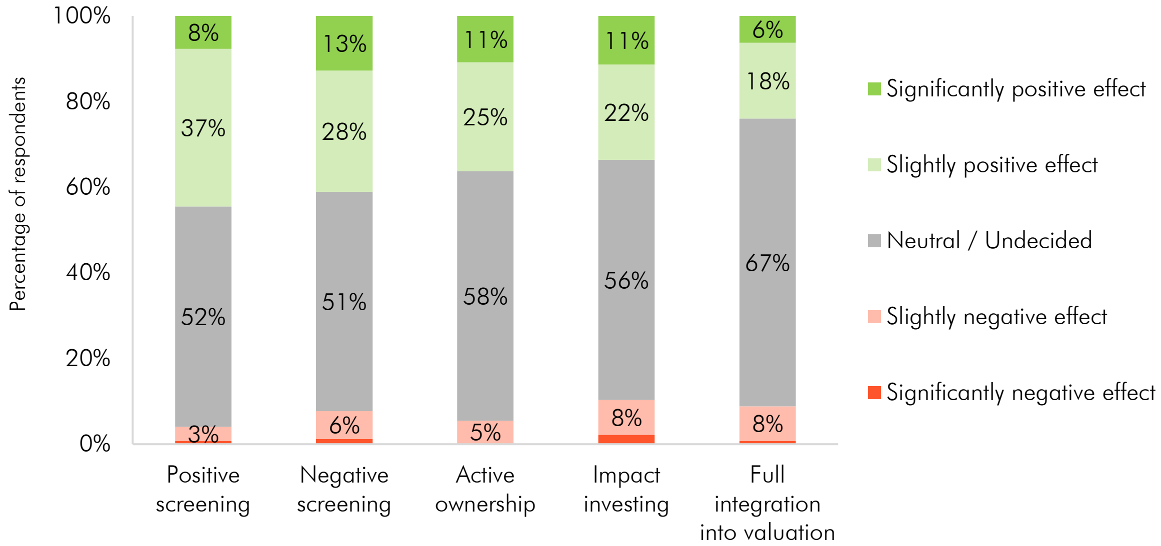
27 Gordon and Viehs (2014) and Amel-Zadeh (2018) provide comprehensive overviews in this respect.

28 See for example the meta-analysis of Friede et al. (2015) who review more than 2000 empirical studies over the last four decades.

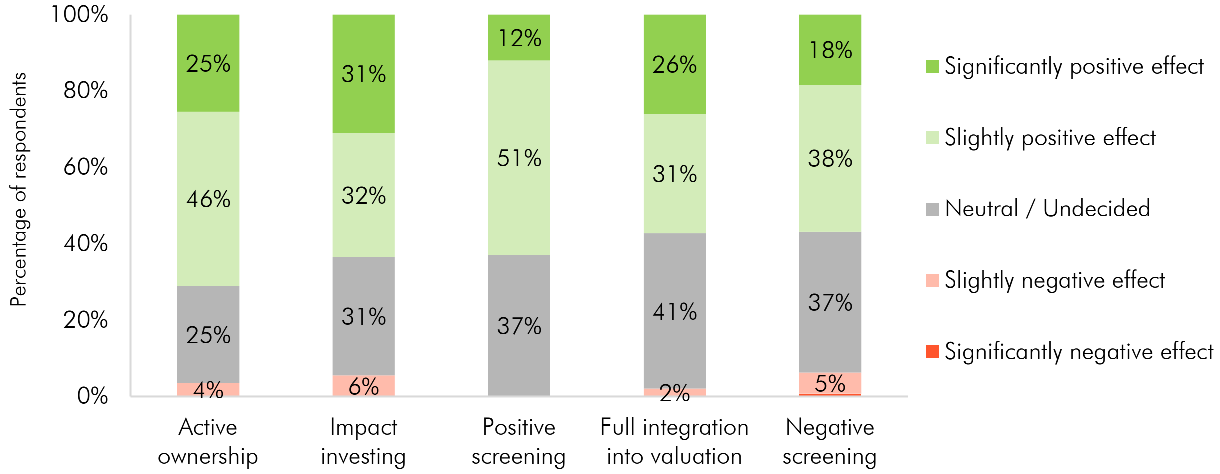
greater investment from the GPs in terms of their time and commitment, but also appears to be the most rewarding financially. The results are also impressive for impact investing. They show that impact investors can pursue a 'noble' cause and still 'do well by doing good', and that sustainability and social impact do not need to come at the detriment of investment performance. Negative screening appears last on the ranking. This finding stands in contrast to the evidence in Figure 26, according to which negative screening is the most widely used ESG strategy among VC investors; but is in line with the results in Figure 27 which showed that negative screening may be adopted for reasons other than its importance for investment performance (mainly for risk-mitigation purposes).

Figure 53: Impact of ESG strategies on VC investment returns – all VCs



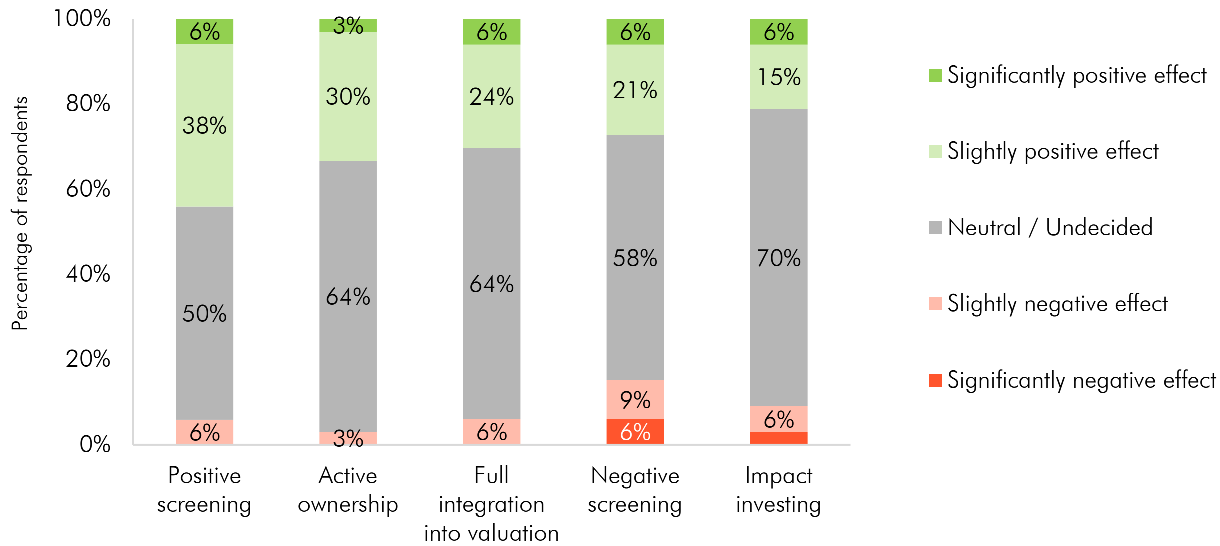
Q. How do the following ESG strategies affect investment returns (compared to a risk-adjusted market benchmark)?

Figure 54: Impact of ESG strategies on VC investment returns – VCs adopting each strategy



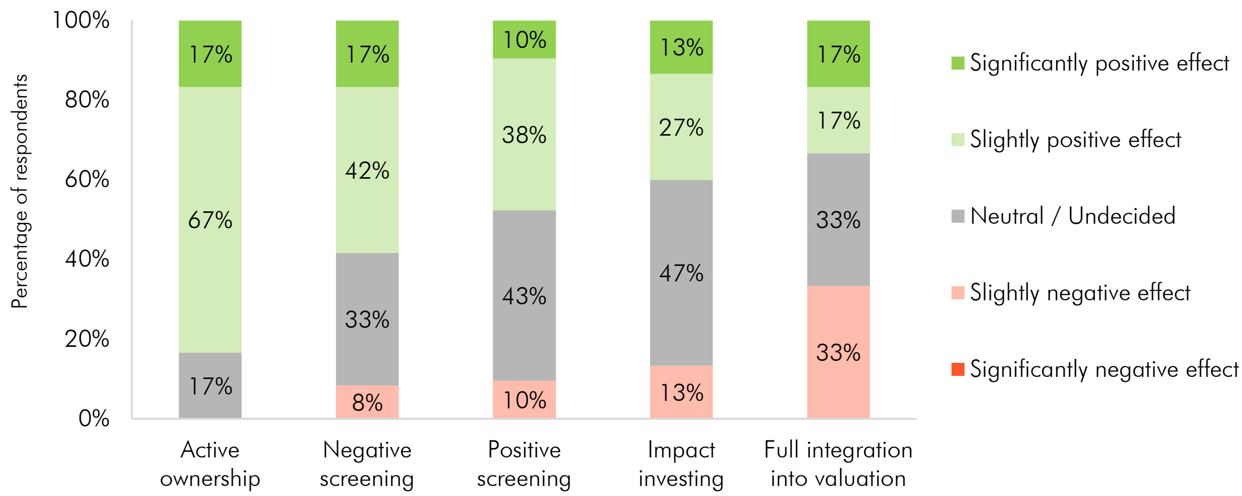
The evidence from the BA survey echoes the one from the VC survey that ESG considerations are not incompatible with investment performance. Among all BA respondents considering ESG criteria (i.e. independently of the specific ESG strategy pursued), positive screening is considered as the most beneficial ESG strategy for investment returns (Figure 55), whereas active ownership is considered most beneficial when the actual experience of the BAs in implementing the respective ESG strategies is taken into account (Figure 56).

Figure 55: Impact of ESG strategies on BA investment returns – all BAs



Q. How do the following ESG strategies affect investment returns (compared to a risk-adjusted market benchmark)?

Figure 56: Impact of ESG strategies on BA investment returns – BAs adopting each strategy



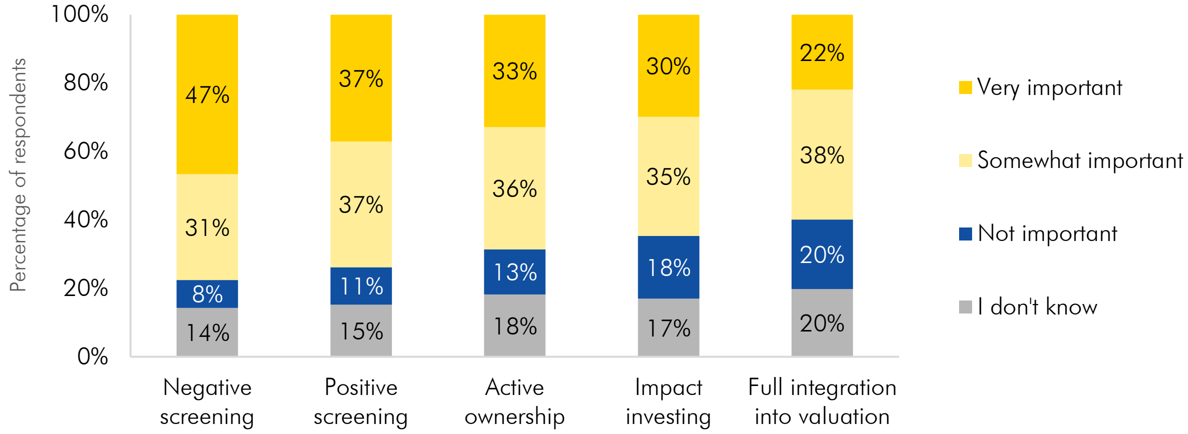
In the case of VC fund managers, the results suggested a stronger positive correlation between the likelihood of adopting a specific ESG strategy and its impact on investment returns. For BAs, however, the evidence on this presumed articulation is much weaker. For example, while impact investing is the second most frequent ESG strategy among BAs (see Figure 26), it ranks very low in terms of its relation to returns. This could mean that for impact BA investors, the mission of their investees is potentially more important than investment returns. Having said this, the evidence does not suggest that the return ambition of impact BA investors is deliberately non-return maximising or even return-compromising (in fact, only 13% of impact BA investors state a slightly negative effect on investment performance, while 4 in 10 indicate a slightly or significantly positive effect). Instead, taken together, the evidence is consistent with the findings in Figure 25, which showed that BAs are highly motivated in their ESG considerations by the will to have a positive footprint in society (even more so than their VC counterparts) and that only 16% of the BAs who consider ESG criteria do so out of performance-driven incentives (compared to 32% of the VCs).

3.4 ESG considerations: looking forward

In this last section, we discuss future developments for ESG considerations regarding the likely importance of the various ESG investment strategies as well as ways to further encourage and facilitate ESG implementation.

For VC fund managers who already incorporate ESG considerations into their investment decisions (Figure 57), portfolio screening strategies will continue to dominate the methods in which they consider ESG criteria: 78% and 74% of the surveyed VCs state that negative and positive screening, respectively, will become somewhat or very important for their firm in the next five years. However, the importance of the other ESG strategies is also expected to increase.

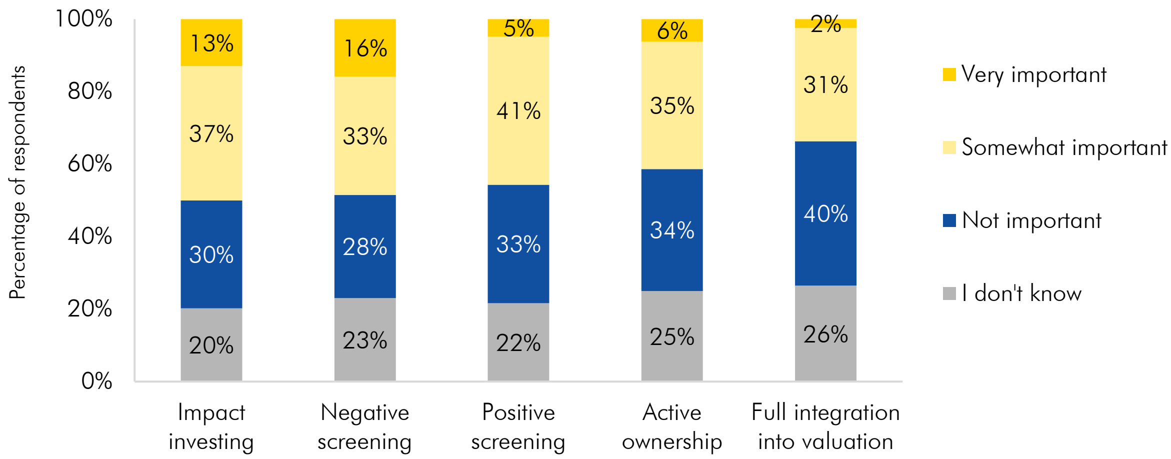
Figure 57: Importance of ESG strategies in next 5 years – VCs already considering ESG criteria



Q. How important will the following ESG strategies become for your firm in the next 5 years?

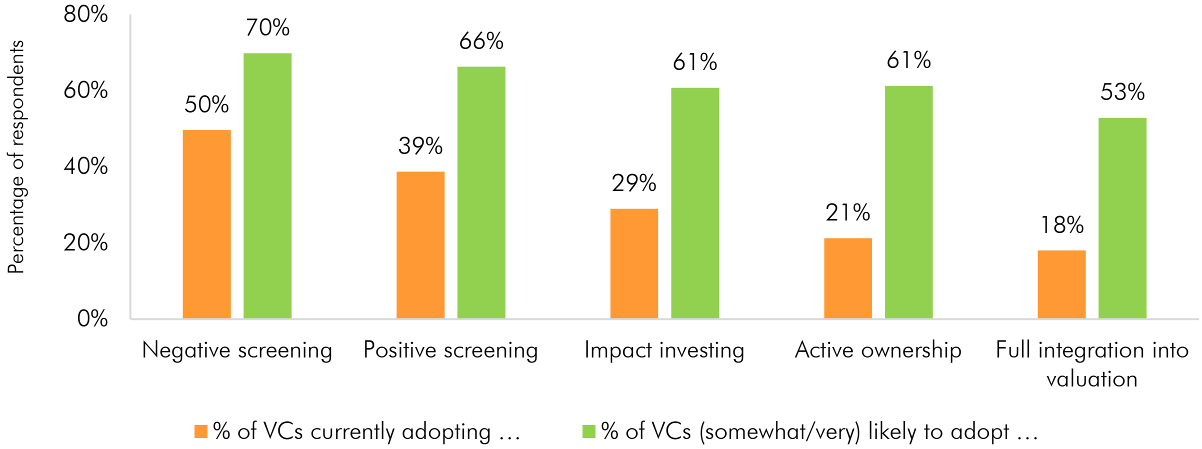
The same question was asked to VC GPs who do not yet consider ESG criteria (Figure 58). A non-negligible percentage of respondents (ranging from 28% to 40%) stated that they will continue to not consider any form of ESG criteria. Leaving these responses aside, the ESG strategies more likely to be adopted in the next five years are impact investing (indicated by an aggregate 50% of the respondents) and negative screening (49%).

Figure 58: Importance of ESG strategies in next 5 years – VCs not yet considering ESG criteria



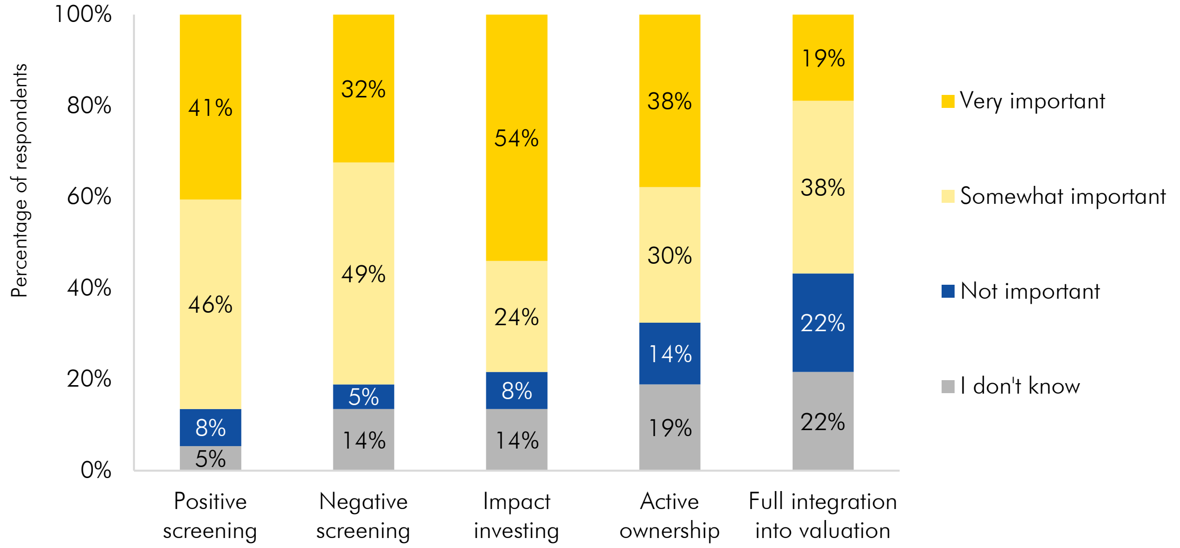
In Figure 59, the different ESG strategies are ranked according to the percentage of VC fund managers who state that they currently adopt the respective ESG investment strategy. Current practice is then compared with the likely importance of ESG strategies in the future among all VCs (i.e. both those who already consider and those who do not yet consider ESG criteria in their investment process). In this context, we note that while the importance of all ESG strategies is expected to further grow in the next five years, this is particularly the case for direct engagement and full integration strategies (threefold percentage increase) as well as for impact investing (twofold increase).

Figure 59: Importance of ESG strategies in next 5 years compared to current practice – VCs



Among all BAs who already incorporate ESG criteria into their investment decisions (Figure 60), positive screening is the ESG strategy expected to feature more prominently in the next five years, with 87% of the respondents stating that positive screening will become somewhat or very important for them. Nonetheless, impact investing is the ESG strategy with the highest percentage of respondents (54%) stating that it will become *very* important for them.

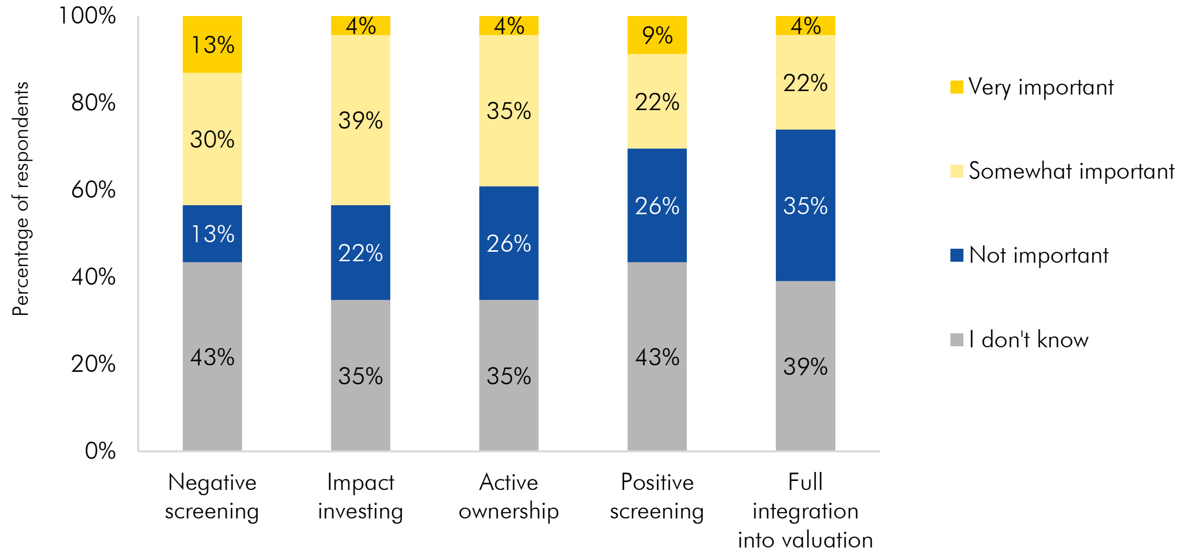
Figure 60: Importance of ESG strategies in next 5 years – BAs already considering ESG criteria



Q. How important will the following ESG strategies become for you in the next 5 years?

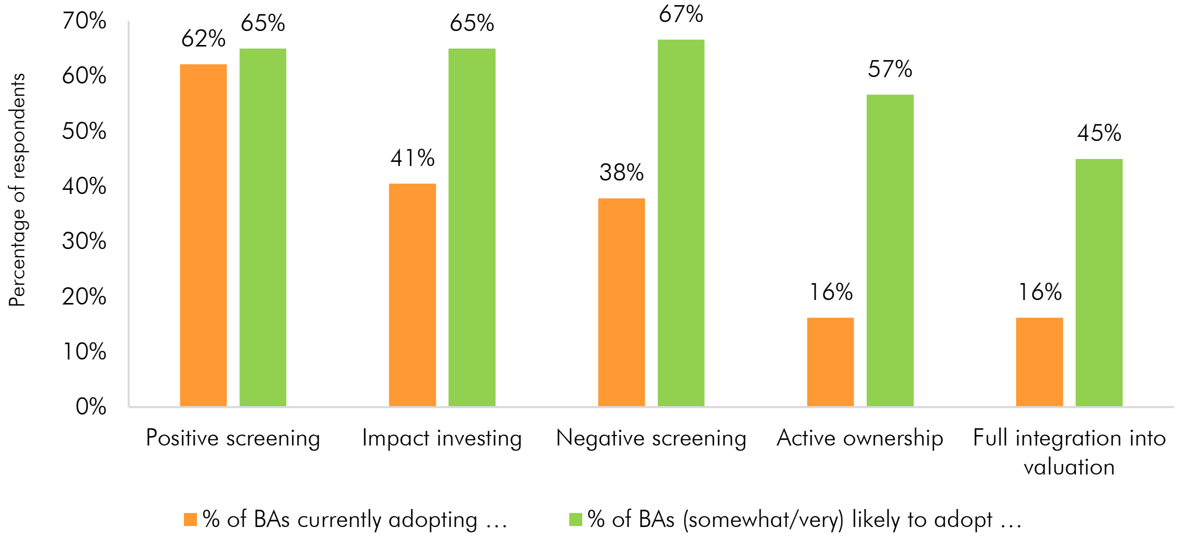
BAs who do not yet engage in ESG investing (Figure 61) are more likely to start considering ESG criteria through negative screening (indicated by an aggregate 43% of the respondents), followed by impact investing (also 43%). While the same aggregate percentage of BAs indicate that negative screening and impact investing will likely become somewhat or very important for them in the next five years, a higher percentage of BAs state that negative screening is likely to become *very* important for them.

Figure 61: Importance of ESG strategies in next 5 years – BAs not yet considering ESG criteria



Comparing current to future practice for all surveyed BAs (Figure 62), we note that the likely prominence of positive screening is mainly driven by BAs who already engage in the specific ESG strategy. Echoing the evidence from the VC survey, Figure 62 also suggests that while the importance of all ESG strategies is expected to further grow in the next five years, this is particularly the case for direct engagement and full integration strategies (approximately twofold percentage increase).

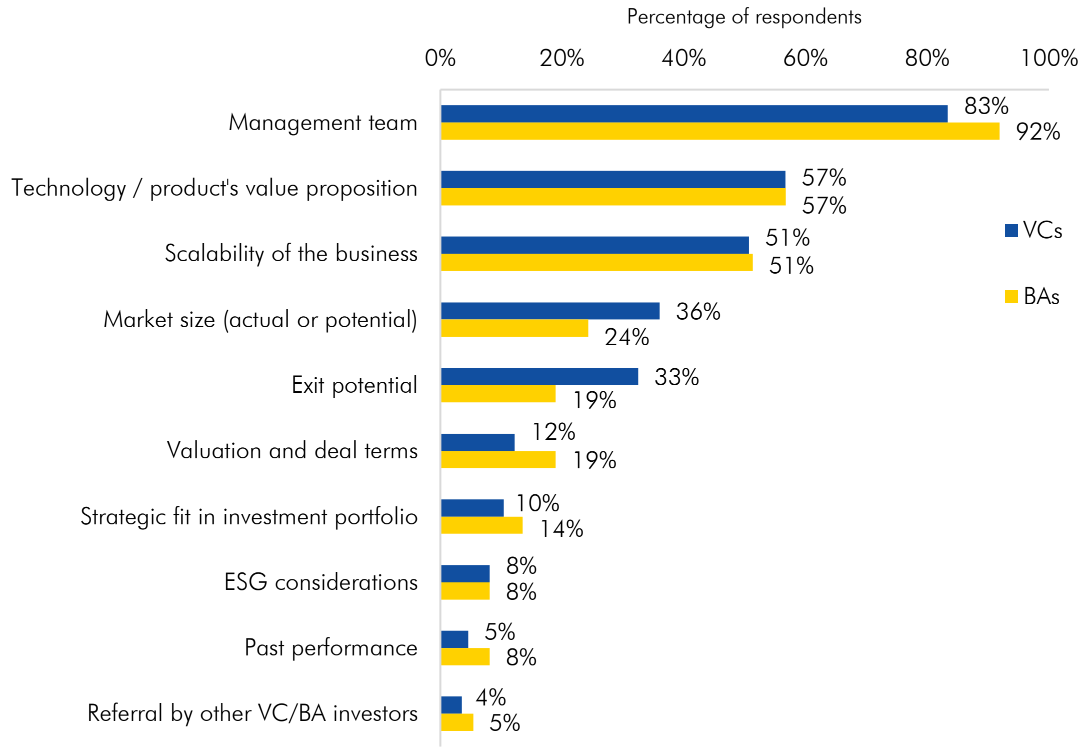
Figure 62: Importance of ESG strategies in next 5 years compared to current practice – BAs



While the results from both surveys are promising, ESG investing is at a nascent phase. Not only because, as discussed in Section 3.2, a formalised ESG implementation in terms of concrete policies and procedures in place might still have a long way to go; but also because ESG considerations still rank very low in the hierarchy of VCs' and BAs' investment selection criteria. While the vast majority of surveyed VCs and BAs state that they do incorporate ESG considerations in their investment decisions (see Figure 24), only 8% of these VCs and an equal percentage of the BAs rank ESG considerations among their three most important investment selection criteria (Figure 63).

However, it is worth noting that (results not presented here for the sake of brevity show that) the specific ESG strategy pursued does influence the ranking of the respective investment criteria. For example, notwithstanding the considerations outlined in the Introduction of this paper (see Box 1) and despite the fact that impact investing is not the same as integrating ESG criteria in investing, when asked about their investment selection criteria, those respondents of our surveys who stated to follow an impact investing strategy ranked ESG considerations much higher than mainstream VCs or BAs who stated following a different strategy to integrate ESG information into their investment process.[29] This evidence corroborates the argument that even though ESG investing and impact investing are not necessarily the same thing, impact investors exhibit a much higher sensitivity to ESG considerations compared to mainstream investors. Put differently, as the VC industry in general moves more and more towards the integration of ESG considerations in investment decisions, the survey results confirm that impact investors are ahead of the curve.

Figure 63: Most important investment selection criteria



Q. Considering your firm's/your overall investment activity, select up to three of the most important VC/BA investment selection criteria. *(multiple selection possible)*

[29] Indeed, 19% of VC impact fund managers rank ESG considerations in the top three of their investment selection criteria, with the percentage rising even higher, to 26%, for EIF-supported impact GPs.

Finally, the surveys highlight the key barriers that prevent VC and BA investors from incorporating ESG considerations (Figure 64). For VC fund managers, limited resources and expertise on ESG issues is the most commonly cited reason (32% of the respondents), closely followed by data-related concerns, such as the difficulties in quantifying ESG information (31%) and the lack of adequate ESG disclosures from companies (26%). Limited expertise and difficulties in identifying ESG metrics are also among the top challenges cited by BAs. Echoing the discussion in Section 3.3, whereby neither VCs nor BAs perceive a trade-off between ESG considerations and investment returns, it is interesting to note that even among respondents who do not yet consider ESG criteria, the notion that integrating ESG considerations into the investment strategy is detrimental for returns ranks very low indeed.

Both surveys seem to therefore corroborate the anecdotal evidence from discussions with practitioners that the lack of a commonly accepted framework and methodology to measure ESG performance is a key issue in ESG investing. Certain attributes of ESG considerations are inherently qualitative in nature. Even on the quantifiable ESG metrics though, disclosure from companies is often limited, making it very challenging for investors to assess and compare these disclosures across firms.

Figure 64: Reasons for not considering ESG criteria

Q. Why do you not use ESG information when making investment decisions? *(multiple selection possible)*

Gibson et al. (2020) analyse the ESG scores given by six major data providers to S&P 500 firms between 2013 and 2017, and find that the average correlation across data providers for the total ESG score is only 0.46. Apart from technical reasons (such as the different categories used by raters to measure ESG criteria or the different weights given to these categories in the aggregation process), the academic literature on ESG ratings disagreement has further highlighted the inconsistencies in terms of how issuer companies report and disclose ESG-related information as well as the 'conceptualisation of sustainability', i.e. the lack of a shared view of what it means for a firm to be sustainable.

If these arguments hold true for the public equity space, where typically more information is available to investors, one can understand why the problem is intensified in the much more opaque markets of VC and BA investing. This is evidenced in the surge of guidelines issued and of trainings organised by trade associations aimed at supporting their members in the implementation of ESG strategies and processes, and at enhancing their understanding of the implications of ESG considerations for portfolio construction and performance. Indeed, the emphasis should now be placed at 'educating' VC and BA investors on how to identify material ESG-related risks and opportunities. Coming to a consensus on a methodology about how to measure ESG performance would facilitate the development of ESG-related KPIs and would constitute a major step forward.

4 Concluding remarks and discussion

As ESG principles are increasingly attracting the attention of investors and regulators alike, this paper provides the first ever testimony on the integration of ESG considerations in the areas of VC and BA investing. The survey-based evidence offers insights into the level of ESG engagement by VC GPs and BAs, the underlying motivations as well as the specific ESG strategies pursued.

Both surveys confirm the anecdotal evidence and general market perception that ESG investing accelerates into the investment mainstream, as the vast majority of VCs and BAs report incorporating ESG criteria into their investment decision process. For both VCs and BAs, ethical or social responsibility considerations are the most widely cited motive for ESG engagement. The desire to encourage change towards responsible business practices at investee companies as well as ESG integration as part of the formal investment policy complete the top three of ESG drivers. At the same time, it seems that for BAs the will to have a positive footprint in society is relatively more important than for VC fund managers, for which external factors such as the positive reputational signal associated with ESG investing and the growing pressure from Limited Partners are also powerful determinants of ESG adoption.

For both VCs and BAs who do consider ESG criteria, the use of ESG information predominantly serves as a portfolio screening tool. The main difference between the two surveyed populations lies in the fact that VCs apply ESG screening particularly on an exclusionary basis at due diligence ('negative screening'), whereas the vast majority of BAs explicitly target firms that perform well in terms of selected ESG criteria ('positive screening'). ESG strategies that generally entail either a greater involvement on the part of the General Partners (e.g., 'active ownership' in the form of direct engagement with and provision of ESG expertise to investee companies in order to improve their ESG performance) or a more formalised approach to ESG incorporation (e.g., an ESG 'factor' integrated into valuation) are much less frequently adopted. In the case of BAs, however, 'impact investing' (i.e. seeking to generate a positive social and/or environmental impact alongside a financial return) features very prominently and ranks second among all ESG investment strategies. For the purpose of this paper, impact investing has been incorporated into the broad ESG spectrum as part of the widespread responsible finance movement and as an investment strategy seeking to address social and environmental issues at scale, through entrepreneurial solutions.

Each ESG strategy entails a different underlying motivation. For example, in the case of VCs, negative screening appears to be mainly driven by the mitigation of ESG-related risks or as a response to growing demand from LPs for ESG consideration, as it represents a relatively easier way for the GPs to become ESG-compliant. By contrast, positive screening is seen more like an opportunity for value creation, as it is prominently pursued among VC fund managers who consider ESG criteria due to their relevance for investment performance.

Both surveys show that the respondents' human capital characteristics may influence both the level of ESG engagement and the type of ESG strategy adopted (particularly in the case of BAs, who can decide for themselves on the investment strategies to be pursued, while for VCs, these decisions are often made at the VC firm level). This is because age, the level and field of education as well as prior relevant experience can affect individuals' perceptions of the risk-return relation as well as the way they perceive and respond to risks and opportunities. In this context, an interesting finding from the two surveys is that, contrary to common belief, the evidence on ESG adoption is not driven by Millenial investors alone and that ESG considerations are rooted across all age ranges.

A range of VC firm characteristics, such as location, size (proxied by assets under management), investment stage focus and gender diversity in the management team, also appear to be significant determinants of ESG considerations by the GPs.

Regarding the formalities of ESG implementation in the VC space, a promising 1 in 2 fund managers state that there is an explicit ESG policy already in place in their respective firms. However, half of the surveyed VCs report not having a member in their investment team dedicated to dealing with ESG issues, while almost 40% lack formal monitoring of the performance of their portfolio companies in terms of ESG metrics. The evidence suggests that bigger VC firms are better equipped, in terms of the resources and personnel expertise, to develop formal ESG procedures and to deal with the challenges of ESG integration and reporting. Furthermore, it appears that the development of an explicit ESG policy is a focal point in the ESG implementation process that helps streamline other ESG-related procedures. Two 'internal' factors (i.e. considering ESG criteria as part of the VC firm's investment policy and the perceived positive impact of ESG considerations on investment performance) and two 'external' factors (i.e. regulation and growing demand from LPs) appear to be the most important in shaping the ESG policies and procedures.

A key issue that frames the academic and policy debate is whether ESG investing, apart from delivering perceived value, can also materialise into superior investment returns. Both surveys contribute to this discussion and show that ESG considerations and investment performance are not mutually exclusive. Despite the varying degrees of positive impact that ESG considerations may have on returns, depending on the specific ESG strategy adopted, the general consensus is that ESG considerations are not necessarily incompatible with the neoclassical paradigm of profit maximisation.

The results are particularly impressive for impact investing. They show that impact investors can pursue a 'noble' cause and still 'do well by doing good', and that sustainability and social impact do not need to come at the detriment of investment performance. Furthermore, there is no evidence to suggest that the return ambition of impact investors is deliberately non-return maximising or even return-compromising, even though impact investors tend to be motivated more by ethics-based rather than by performance-driven considerations.

So what lies ahead for ESG investing? One element that both surveys highlighted very prominently is the importance of differentiating between 'passive' and more 'active' forms of ESG engagement. This is crucial for raising awareness among market participants that different ESG investment strategies are associated with different underlying motivations and can lead to different risk and return characteristics. For example, it would be misleading to label an ESG-related strategy as ESG *integration*, if ESG-compliance is only achieved through exclusionary screening at due diligence. In this respect, it is promising to see the evidence from both surveys that while the importance of all ESG strategies is expected to further grow in the next five years, this will be particularly in the direction of more direct engagement with portfolio companies on ESG issues as well as with regard to explicitly factoring ESG into the valuation of investment opportunities.

Apart from not treating all responsible investment the same, not analysing ESG solely jointly is also important. This is because the distinct E, S, and G dimensions of the portfolio and their individual performance implications may potentially be very different. Future waves of the *EIF Surveys* will attempt to address this concern by analysing portfolio characteristics separately along the environmental/climate and the social impact dimension.

While the results from both the current surveys are encouraging, they also point to the fact that ESG investing is at a nascent phase. Not only because, as discussed earlier, a formalised ESG implementation in terms of concrete policies and procedures in place might still have a long way to go; but also because – notwithstanding impact investors – ESG considerations still rank very low in the hierarchy of mainstream VCs' and BAs' investment selection criteria. While the vast majority of surveyed VCs and BAs state that they do incorporate ESG considerations in their investment decisions, barely 1 in 10 of these respondents rank ESG considerations among their three most important investment selection criteria, with more traditional financial considerations clearly taking precedence.

Finally, both surveys corroborate the anecdotal evidence from discussions with practitioners that the lack of a commonly accepted framework and methodology to measure ESG performance is a key issue in ESG investing. Surveyed VC GPs and BAs alike highlight the limited resources and expertise on ESG issues as well as data-related concerns, such as the difficulties in quantifying ESG information and the lack of adequate ESG disclosures from companies, as key barriers for ESG integration.

In this context, there could not have been a better timing for the recent decision of the European Council to adopt a regulation setting out an EU-wide classification system (or "taxonomy"[30]) aimed at facilitating the 'conceptualisation of sustainability', i.e. at providing businesses and investors with a common language to identify which economic activities should be considered environmentally sustainable in light of concrete performance thresholds. The "Impact-Weighted Accounts Initiative", a research-led joint effort by the Global Steering Group, the Impact Management Project and Harvard Business School,[31] also aims at re-defining performance to include societal considerations. 'Monetising' impact (i.e. measuring the impact companies have on society, converting it into monetary terms and reflecting it in financial statements) will make it easier for investors to assess and compare these disclosures across firms.

Having surpassed previous misconceptions, such as a presumed trade-off between ESG considerations and investment returns, the emphasis now should indeed be placed at 'educating' VC and BA investors on how to identify material ESG-related risks and opportunities. Coming to a consensus on a methodology about how to measure ESG performance would facilitate the development of ESG-related KPIs and would constitute a major step forward. A common understanding of ESG performance metrics would also help differentiate those that sincerely consider ESG criteria from those that simply ride the wave and 'greenwash' or 'impact wash'.

The *EIF VC Survey* and the *EIF BA Survey* conducted in 2020, apart from disentangling the E and the S components of ESG, also look in greater detail into the implementation aspects of ESG criteria, particularly in relation to the specific frameworks that shape investors' approach to ESG integration (inter alia the UN Sustainable Development Goals) and the metrics used to monitor ESG performance. The analysis also covers more extensively impact investing in terms of the main challenges faced by impact investors and their return expectations, the performance drivers of impact funds, and the most prominent sectors in impact investing. In addition, in 2020, the EIF conducted for the first time a survey in the area of mid-market private equity, inter alia on ESG considerations by PE mid-market fund managers.

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[30] See "EU Taxonomy: Final report of the Technical Expert Group on Sustainable Finance", March 2020.

[31] The EIF is represented in the Board of Trustees of the Global Steering Group and has also provided input to the Impact Management Project.

A final note relates to the timing of the paper's publication amid the crisis caused by the coronavirus outbreak. The question for many executives and investors is how Covid-19 might change the outlook for ESG considerations. Are ESG criteria a 'nice-to-have' ready to be shed in a market downturn, when other more pressing demands need to be addressed? One argument in favour of keeping up with ESG is research-based evidence that companies with long-term investment horizons tend to outperform regardless of the economic cycle. Furthermore, if you can indeed see someone's true colours under extreme pressure, it is often argued that the current crisis could potentially provide companies with the opportunity to really demonstrate their ESG credentials, particularly regarding employee relations and community engagement during the pandemic. While environmental considerations climbed up the investors' agenda following the 2015 Paris Agreement to tackle climate change, the current situation may heighten the investors' attention to the S and the G dimensions of ESG. Therefore, while for example oil, gas, and mining companies have been under intense criticism over ESG considerations, investors' focus could now shift to other sectors too which might have escaped scrutiny over ESG issues so far. Members of the investment community would want to know how a broader range of companies are generating value for all stakeholders (in line with a 'stakeholder capitalism' paradigm), and not just for their shareholders. Finally, the current crisis could become a reality check on how non-financial factors may impair the value of assets and re-inforce the argument that a sound investment policy should also try to mitigate risks associated even with non-monetary considerations. Only time will tell which of these scenarios will materialise.

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ANNEX

List of acronyms

- AuM : Assets under Management
- BA(s): Business Angel(s)
- bn: billion
- Benelux (countries): (countries of) Belgium, Netherlands and Luxembourg
- CFO: Chief Financial Officer
- CEO: Chief Executive Officer
- CESEE (countries): (countries in) Central, Eastern and South-Eastern Europe
- COO: Chief Operations Officer
- CSR: Corporate Social Responsibility
- DACH (countries): (countries of) Germany, Austria and Switzerland
- EAF: European Angels Fund
- EIB: European Investment Bank
- EIF: European Investment Fund
- ESG: Environmental, Social, Governance
- EU27: the 27 EU Member States
- EUR: Euro
- GP: General Partner
- ICT: Information and Communications Technologies
- KPIs: Key Performance Indicators
- LP: Limited Partner
- m: million
- Nordics: Denmark, Finland, Norway, Sweden
- PE: Private Equity
- RMA: Research & Market Analysis
- SME: Small and Medium-sized Enterprise
- South: (here) Italy, Portugal, Spain
- STEM : Science, Technology, Engineering, Mathematics
- UK: United Kingdom
- UN PRI: United Nations' Principles for Responsible Investment
- US: United States of America
- VC: Venture Capital
- VC(s): Venture Capitalist(s)

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