

What do impact investors really want?

Guidelines for approaching impact investors

At what point do impact investors consider a business to be "investment-ready"?

What does a business need to demonstrate in order for it to be considered for an investment?

What are the main reasons promising impact businesses are not considered for investment?

How should a business handle the due diligence process to successfully secure an investment?

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Background

The Innovations Against Poverty (IAP) challenge fund challenges the private sector to develop products, services and business models that can contribute to poverty alleviation and environmental sustainability. This challenge fund has been supporting innovative businesses across Cambodia, Ethiopia, Uganda and Zambia, and has provided both funding as well as advisory support and technical assistance to these businesses.

In addition, IAP has been providing investment matchmaking services, connecting portfolio businesses with impact investors that can provide financing in the form of equity and debt, to help businesses to scale and create greater impact. The programme has reached out to over 60 impact investors to this end, and has made dozens of introductions to relevant businesses.

But through this process, many early-stage businesses remain unclear on what impact investors are really looking for, and are inexperienced regarding the investment process. As a result, the team undertook a study to explore the question "what do impact investors really want" specifically with a focus on the following four questions:

- At what point do impact investors consider a business to be "investment-ready"?
- What does a business need to demonstrate in order for it to be considered for an investment?
- What are the main reasons promising impact businesses are not considered for investment?
- How should a business handle the due diligence process to successfully secure an investment?

We interviewed 11 leading impact investors to get their perspectives on these questions.



The insights generated through these interviews have been distilled into a set of guidelines with useful checklists that can practically guide businesses as they seek to approach impact investors to secure capital.

When is a business "investment-ready"?

A formal definition of "investment readiness" is elusive, but broadly refers to the capacity of a business to understand and meet the specific needs and expectations of investors. So then specifically, what are impact investors looking for in order to consider a business to be investment ready?

The Big Five of Impact Investment Readiness



- ❑ **Real impact** – many of the investors interviewed identified a clear, demonstrable social and/or environmental impact as their primary concern



- ❑ **Track record** – impact investors seek businesses that have generated revenues demonstrating the product-market fit, and have an ongoing cashflow (often of 2-4 years) with a positive progression



- ❑ **Viable business plan** – the clear vision, strategy for growth and business plan should be feasible, clearly articulated and backed by the investment plan



- ❑ **The right team/leadership** – having a capable and motivated founder and/or management team that can implement the business strategy, but also be flexible and solve problems



- ❑ **Solid and realistic finances** – financial reporting should be properly managed, transparent and ideally audited, and forecasts need to be realistic and achievable

If a business could demonstrate the 5 characteristics above, they should attract the interest of impact investors. But a number of other traits could also be helpful as outlined below.

What else do businesses need to demonstrate?

- ❑ Good governance and management control systems
- ❑ Demonstration of market size and potential
- ❑ A solid value proposition that is highly scalable
- ❑ An understanding and experience from the sector
- ❑ Ability to be adaptable, and manage and mitigate risks
- ❑ Clear articulation of how the investment would be used
- ❑ Potential for a good return on investment
- ❑ Financial literacy and an understanding of investment implications
- ❑ Ability for a future exit by the investor

Showstoppers

Once discussions with an impact investor are underway, it will often take 6-12 months to secure an equity deal or 2-6 months for a loan. During this time, a detailed due diligence and negotiations will take place where the investor and investee will get to know each other in detail. Often, the investment process will end and a deal will not be made for one reason or another. These "showstoppers" identified by impact investors should be avoided:

- × Forecasts are over-optimistic, unrealistic or unachievable
- × Lack of confidence in the management team to deliver results
- × Real impact is not being achieved
- × Skeletons in the closet – tax, liabilities, corruption issues discovered
- × Weak current financial position – poor revenues/cashflow, high debt, etc
- × A history of repayment issues with creditors
- × Business relationships that are unethical or lead to a conflict of interest
- × Growth plan not clearly thought through
- × Lack of understanding on potential challenges and risks
- × Internal control and management issues
- × Lack of focus - too many lines of business
- × Significant negative and/or poorly-managed environmental impacts
- × Investment requirements for a successful business model are too great
- × Ticket size / deal size too small to make it worthwhile
- × Valuation expectations too high based on emotional / sentimental reasons
- × Due diligence process too challenging or intimidating for entrepreneurs
- × Key person risk with no succession planning
- × Early-stage investors come out to hijack the deal

Don't panic! Yes there are many reasons why investment processes fail, and no one business can expect to meet all these high demands. Despite this long list, investors mentioned that businesses mainly need to demonstrate a positive attitude, be responsive, and to be realistic on all the strengths, weaknesses, and challenges facing the business. More wise words of advice on how to navigate this process is outlined on the following page.



Wise words of advice

Impact investors were happy to share some wise words of advice for how to navigate a due diligence process:

"It's like getting married – be open and honest, don't hide or lie"	"Don't need to have all the answers, so ask for help where needed"	"Be prepared - have the team prepared knowing what is at stake"	"Be realistic about forecasts, risks and issues"
"Want ambition and optimism, but need to understand challenges"	"Focus on your track record rather than prizes and awards"	"Tailor your approach to your investor to align with their mandate"	"Get clarity on investment process, timelines and key decision points"
"Be as responsive as possible – investors don't like to chase"	"Don't overpromise, but do deliver on commitments"	"Share information early and be willing to overshare"	"Demonstrate a deep understanding of your business from end to end"
"It's a two-way street - take the opportunity to assess the potential investor"	"Be precise and clear on what you want"	"Ask questions and do not accept all kinds of offers that seems to good to be true"	"Chemistry is important – you need to like the investor too"

Credits

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To learn more about our portfolio and the investment matchmaking process for the Innovations Against Poverty programme, contact Mike Debelak:
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To find out more about Innovations Against Poverty, go to:
www.innovationsagainstpoverity.org

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