LISTENING TO FOUNDERS:
DESIGNING APPROACHES FOR INVESTING IN SOCIAL TECH
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As we reflect on the upheaval of the pandemic, and the socioeconomic inequalities that it has exposed, we believe that technology can be a powerful tool for realising a more resilient, sustainable, and equal future. At a time when trust in big tech is at an all-time low\(^1\), social tech ventures are showing an alternative way. Driven by an unrelenting commitment to social and environmental purpose, innovative application of technology, and the commercial acumen to develop sustainable and scalable organisations, these ventures are actively building a fairer and brighter future for us all.

At Social Tech Trust, our vision is a world where social transformation drives tech. Our view is that if we want to use technology to create a fairer society, we need diverse voices and experiences to shape that future and inform decision making. This is about more than technology. We are acutely aware that choices about which start-ups to invest in, who can access investment, and what type of capital they can access, have profound implications for how technologies evolve and how companies grow.

As the social tech space has evolved over the last decade, the requirement for capital that matches these organisations’ needs has grown. In recent years, we have seen the UK’s social investment market mature and numerous new impact venture funds being launched. Yet founders consistently tell us that they struggle to access appropriate capital and that there is an investment gap.

Without change there is a risk that, rather than creating a fairer future, existing approaches to both tech innovation and investment will entrench and deepen structural inequalities. At Social Tech Trust, we are committed to addressing this challenge. We believe that to leverage the huge opportunity for technology to transform lives, there also needs to be a different approach to investment.

This report focuses on the perspectives of those who have founded or work for social tech ventures. It shares their frustrations and aspirations, painting a picture of capital markets that are not adapting quickly enough to meet the financing needs of diverse, technically astute, founders. It also highlights the opportunity for new ways of thinking, where the goals of investors and ventures align to deliver a fairer future for all.

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\(^1\) edelman.com/trust/2021-trust-barometer/trust-technology
The UK has a vibrant impact and social investment market. Yet beneath the headlines of record levels of investment in UK tech and social businesses, ventures continue to tell us that access to appropriate finance is the biggest barrier to their plans for sustainability and growth. According to the Scaleup Institute, 62% of social ventures do not have the right amount of finance in place. Research also suggests that the need for patient, risk-bearing capital is much greater than the current demand, suggesting that it’s not just about increasing access to existing products, as for many, these don’t match the type of financing they require.

At Social Tech Trust, we have seen inspirational ventures in our portfolio, like WeFarm, Beam and Open Bionics, go on to attract significant amounts of finance from venture capital (VC) investors and others. We also know that there are dozens of other ventures in our portfolio who also have the potential to deliver significant impact and financial returns yet are limited by the lack of availability of suitable investment.

If we are to help these organisations realise their impact potential, we need to understand why their needs are not being met and an investment gap remains. To enable us to gain a deeper understanding of what is not working and identify possible alternatives, we convened a series of roundtable discussions to listen to the experiences and views of founders and other representatives of social tech ventures from across the UK.

This report intentionally focuses on highlighting the voices of those who participated in the research. Their views provide a powerful insight into the experiences that sit behind the statistics and analysis. Whilst a relatively small number of ventures participated, there was a notable consistency in many of their experiences and opinions which warrants further attention.

We greatly appreciate the contributions of those who generously shared their time and views with us. We sought open feedback from the participants and to encourage this, the quotes in the report are not attributed to individuals. We hope that in sharing these perspectives we encourage a wider dialogue between ventures, investors, and other stakeholders about what social tech ventures need to succeed, and why alternative approaches to investment are required to realise the positive change we want to see in the world.

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2 technation.io/report2021
5 shiftdesign.org/content/uploads/2020/05/Beyond-Demand-Report_Shift_EsmeeFairbairn.pdf
This report is based on the findings from a series of virtual roundtables we ran with founders and representatives from 23 early-stage social tech ventures. We followed up these sessions with in-depth surveys. Participants included Social Tech Trust’s alumni as well as social ventures within aligned communities, such as Zebras Unite, and other UK based social tech ventures.

All participants met the following criteria:

- Ventures with a digital product or service that addresses social or environmental challenges
- Founded at least one year ago with some user and/or revenue traction
- Previously raised early-stage investment, currently raising or likely to be raising soon

We engaged a diverse group of 23 ventures from across the UK, including Scotland and Wales, with 43% based outside of London. Both ‘for profit’ and ‘not for profit’ ventures participated, and all ventures were purpose driven.

The vast majority (87%) of the ventures were incorporated as companies limited by shares. These ventures ranged from pre-revenue to having revenues exceeding £1m. Revenue growth rates were variable, somewhat unpredictable (especially so following Covid) and dependent on the venture’s stage of development. However, most of the ventures were experiencing annual revenue growth in excess of 100%.

All of these companies were currently raising finance, except for one who had just completed a fundraise. The amounts they intended to raise varied from £150,000 to £7.5m, with the average being c.£900,000. All had either previously raised finance or had looked for investment but been unsuccessful. Of the ventures that had raised capital, they had accessed this finance from a variety of sources including VC, angels, bank loans, debt from social investors, personal savings and crowdfunding.

The three ventures who were not companies limited by shares expressed that they were not looking to raise investment, with their funding primarily coming from grants and project work.
In 2017, we conducted several pieces of research to understand what was required to build a more nurturing environment for social tech ventures to thrive. We clearly heard that access to capital was the single biggest barrier preventing ventures from making progress and scaling their impact. At that time, data from Big Society Capital showed that equity-like products, often favoured by tech start-ups, accounted for just 2% of the value of UK social investments. Since then, several new impact focused venture funds have entered the market and investors, including Big Society Capital, have placed a greater emphasis on investing in ventures. Yet despite this increased activity, we continue to hear that the finance on offer is not meeting the needs of most ventures and that this is stifling innovation.

Without access to sufficient early-stage funding, ventures described using a combination of grants, bootstrapping and angel investment to fund themselves. Several had sought consultancy and project work to fund product development. This approach was regarded as a pragmatic necessity in response to the investment gap and participants were acutely aware that this slowed their progress in moving beyond these early forms of financing to build their sustainability and grow.

It’s a poverty mindset. It’s mentally debilitating having to think about how much money I have and how much runway I have and what I can afford or not afford….I have very little budget for failure.”

Some of the ventures had utilised the UK government’s Seed Enterprise Investment Scheme (SEIS) to successfully raise equity finance from angel investors. However, they were conscious that this could only get them so far.

SEIS is amazing. For first time entrepreneurs, the ease with which they can get SEIS money means their first experience of getting funding is almost too easy. The gap to EIS, in terms of the tax advantage, means that you don’t have anyone sitting in the space between £150k - £500k.”

In addition to SEIS, Innovate UK was seen to play an important role in funding early-stage innovation. In the absence of wider sources of capital, they were perceived as being left to fund much of this part of the market.

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6 bigsocietycapital.com/latest/size-and-composition-social-investment-uk
7 bigsocietycapital.com/our-approach/impact-venture
Building systemic change takes time and right now the only source of capital in the government/civic sectors are Innovate UK/EU. This is suffocating innovation and disincentivises founders to tackle these hard yet necessary problems.”

Misalignment between investors and ventures

VC is often considered the primary means of financing tech start-ups, yet participants highlighted how aspects of the dominant VC model are substantially misaligned with the objectives and trajectory of most of the ventures represented at the roundtables.

The focus on unicorns means many opportunities are being overlooked.

VC investors tend to target high growth ventures with an ambition to exit at a valuation that will generate a 10x return or higher. Participants were generally not averse to the principle of investors making high returns for taking an early risk position. However, we heard concerns that this approach led to investors prioritising a narrow set of business models and ventures that they deemed capable of delivering such returns or becoming the next “unicorn” company, with a valuation over $1billion.

We spoke to a couple of VCs and their feedback was the same; that we need to show them how we can be a ‘10x’ company (providing 10x returns to the investor), and we need to be beating the other providers in the market.”

Participants suggested that this blinkered focus was contributing to a skewed market where opportunities to invest in other potentially high growth or high impact ventures were being missed. As one of the participants highlighted, very few start-ups, whether impact focused or not, are going to become unicorns, yet the hunt for such ventures continues to be the benchmark of venture funds.

If you look in the last 5 or 10 years at the number of UK companies that have IPO’d at £1bn; it’s tiny. Which means that most VC firms are never going to have that unicorn company. So what are they searching for? What are they expecting? It’s completely unrealistic this dream they are all chasing.”

Such an approach has implications for how VCs construct and manage their investment portfolios meaning that ventures that don’t offer such a return profile are largely excluded.

What’s off-putting about institutional VC is that it’s a total boom or bust. There’s no space to build a medium-sized (e.g. £20-£100m valuation) company. This leads to some value-destroying behaviours by founders in chasing top-level growth at all costs and having to ignore opportunities to have more positive societal impact on the way.”

These views reflect a general perception of a funding environment that is very challenging, with the participants describing a landscape of piecemeal initiatives and clustered investor activity that leaves a large proportion of early-stage ventures underserved. The roundtables enabled us to take a deeper look at what is happening and why access to capital continues to be problematic.

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Ventures struggle to find mission aligned investors

The narrow focus on returns was also seen to be problematic as it can lead to a misalignment of objectives. The motivations of investors have implications for how an investment is structured and managed, as well as the kind of post investment support that is offered. Given that the ventures we spoke to are dedicated to delivering quality products or services to improve the lives of underserved or vulnerable people, it was perhaps unsurprising that having mission aligned investors was seen as the most important factor when selecting an investor.

“ Our mission is mental health and we don’t feel that’s a very good model for mental health, even for the ones that are succeeding. I’ve got friends who run ventures who are on track for being billion-dollar valuations and the VC is just all over those companies.

Their interest just becomes in those two companies. And they push and push and push and it becomes a very short-term model.”

The perceived misalignment of the VC model speaks to some central principles about how social tech companies operate and how they can differ from other tech start-ups. The commitment to impact and systems change can mean social tech ventures have different characteristics, for example, they may favour sustainability over exponential growth; revenue growth above valuation growth; and collaboration over monopolies. These factors do not rule out VC investment but highlight the importance of finding investors with an aligned investment strategy, who understand and support the social mission and business model. This is something that the ventures had found very difficult to identify in practice.

For an investor to drive [the market and growth trajectory of a venture in order to achieve a particular return profile], particularly early on, it’s just a wrong way of partnering”

Aversion to social business models

Despite the growth of the social investment market and increasing prominence of impact investing, the participants reported that investors continue to show an aversion to investing in social ventures.

Investors question whether social business models limit returns

Many of those who identified as ‘social enterprises’ or who had a mission lock or dividend cap, said mainstream investors had challenged them on why they had taken such a form as the investors perceived it to limit profits and returns. As one participant explained:
The problem is the moment you mention you’re a social enterprise, they believe you are not going to hit a multi-billion-pound valuation. So we sit in this grey area. In our articles 51% of profits must go back into the social mission. Which means that 49% could be paid as dividends. You find me a company that ever pays 49% of their profit out in dividends in any single year? It never happens. So why is that a barrier or a problem?”

Some ventures described how angel investors had pulled out at late stages of investment negotiations when realising that the ventures were a ‘social enterprise’ or ‘purpose and profit’ business. One participant described an experience with a VC investor who, at the last stage of legal negotiations, attempted to have wording around the mission of the venture removed from the company’s articles despite previous agreement. For some, this had led to them watering down their ‘social enterprise’ status by, for example, removing asset locks, to make their venture more attractive to investors.

We kept getting people coming back saying that the mission lock and profit lock was an issue. We felt we had to conform. We started taking out our social mission index and saying nothing about the social. Instead, we presented ourselves as a company that can make some money and asked if they wanted to invest? So actually, we have to promote ourselves as a non-social enterprise in order to get some conversations going.”

Impact investors are prioritising financial returns over impact returns

The frustrations experienced in these interactions were compounded by some of their engagements with impact investors. Participants shared that few of the impact investors they had spoken with seemed to care about the impact they were creating or factor impact into their assessment of an opportunity.

I would have preferred a more patient, more impact directed approach. Maybe not impact first, but at least impact being equal to the financial returns.”

Based on their experiences, they highlighted how impact was often taken as a given, and that they were expected to deliver the same financial returns as any other non-impact focused venture on top of delivering social impact. To some of the participants this seemed unfair, and they felt there was little incentive built into funding models to take on the difficult mission of creating social impact, especially where commercial returns are more marginal or harder to generate.

I didn’t think they really cared about the social side of the balance sheet. They were like, okay, great, but let’s look at the P&L. Your impact on society might be massive but it doesn’t actually impact my investment. That was my experience.”

Those who moved forward with impact investors were also disappointed that the focus on financial returns took precedence over impact returns. Many participants regarded this as a somewhat artificial separation which reflected a failure by the investor to fully engage with the underlying business model and understand how impact outcomes can be intrinsic to commercial success.

They are concerned if there is going to be an exit... and what that exit is going to look like. As opposed to what it is that you are building and what impact is it going to have. Maybe there are milestones, that can also be impact milestones, that you are interested to achieve? There’s very little discussion of that and very little reflection on that.”
Hesitancy to invest in technology

In addition to a reported aversion to investing in impact, several participants noted that within the social investment space, there was a lack of investor knowledge around tech propositions and a reluctance to accept the level of risk associated with early-stage social tech ventures. This meant that many social investors were either not looking for, or not progressing with, tech investments.

We went for a big raise of £1.3 million pre-product and we got all the way to due diligence with a trust and a well-known social impact foundation, but right at the end they decided that they couldn’t take a risk on technology because they weren’t tech savvy. That was a painful experience, but we thought if we can get that far maybe we can do something here.”

These experiences only served to deepen a sense that the social investment market is not positioned to meet their financing needs.

I felt like the relationship with risk and technology was not there. The companies they funded were either housing trusts or service-related companies, rather than technology. So, I felt there was a knowledge gap.”

For this to change, participants spoke of the importance of investors developing a greater understanding of tech investments, the associated risks, and the opportunities. Those who had successfully secured an aligned investor highlighted the catalytic role they could play in unlocking capital from others who might previously not have seriously considered a social tech proposition.

...the conversations we’re now having with VCs, because we have found somebody happy to step up as that lead investor, are different and we are being welcomed with open arms. They see here’s a great thing we could jump on the top of that has already been de-risked for us; that someone has already done a lot of the due diligence on.”

Foundations and family offices have stated the need for impact, yet their risk portfolios and actions rarely reflect that.”
The challenges ventures experienced with the existing investment market fuelled a desire for an alternative approach and the roundtables provided an opportunity to explore what the participants would like to see change. Through the discussions, we heard a clear call for more innovative investment models and instruments being used that have a closer alignment with their financial and impact objectives. There was a sense that this innovation was lacking from incumbent investors and some participants talked about how, in the absence of more flexible instruments, they had to revert to using existing instruments that were less suited to their needs.

The experience we had was that institutional funding seemed to be structured as either debt, that is predictable debt with a fixed interest rate, or equity for early stage. Whereas we wanted an equity-like debt instrument. Having explored that for about four months and having spoken to the obvious social investment institutions that we could, we went back to the drawing board and then went to raise equity instead.

With developments in the capital markets lagging the pace of change in purpose driven business models, there is an opportunity for greater collaboration to understand and respond to the needs of ventures. The roundtable discussions highlighted several key areas where the ventures saw opportunities to take a different approach, including exploring models that focus on sustainability as well as growth; developing more revenue-based approaches; and addressing the need for patient and flexible finance.

Focus on portfolios of sustainable ventures

We heard a strong call for investors to develop and implement more strategies that recognise the value that can be created by sustainable businesses. This was viewed as a viable alternative to the dominant VC model and requires a different investment mindset and approach to risk and return, where returns are generated more consistently across a broader range of companies within a portfolio.
We’ve tried to find investors that have a slightly different model, where they might be backing 5 or 6 companies a year, where they’ll have a much higher success rate, but a lower growth rate."

Many of the participants questioned whether growth should be the leading metric of success and argued that building a portfolio of sustainable businesses provided scope to dramatically alter the investment landscape, creating an environment that could support many more ventures to succeed.

The most impressive thing that anyone can do in this space as an entrepreneur is show that you can build a sustainable business.”

Key to such a shift, would be determining what level of returns could be sustained by the ventures whilst also meeting investor return expectations. British Business Bank analysis shows that the median performance of UK VC funds between 2002-2015 ranges between 1.1x and 1.7x depending on the data source. Structuring a fund to deliver a competitive level of returns relative to UK VC funds therefore presents both a challenge and an opportunity.

The biggest thing is structuring equity investment so that, say, a 5x return would be a win for everyone.”

### UK VC (2002-2015 vintage years) Total Value to Paid In performance by data source

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Lower Quartile  | Median  | Upper Quartile  | Pooled
Source: British Business Bank, UK Venture Capital Financial Returns 2020

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Respond to the appetite for revenue-based investment

The focus on investing in sustainable ventures encouraged an examination of investment products. Most participants expressed a preference for equity financing, rather than repayable debt, to provide risk capital. However, there was also interest in exploring broader alternatives, particularly revenue-based approaches.

This is better understood when considering some of the factors that impact on how social tech ventures operate, such as them:

- having a greater focus on harder to access customers
- targeting markets offering potentially lower margins
- managing long sales cycles of client groups such as the NHS and the wider public sector
- developing new business models that drive systemic change

These factors increase the demand for flexible forms of investment that enable risk capital to be taken up front and repaid from revenues based on future performance.

We would have loved to have had a year of runway... you’re dealing with big companies who aren’t used to small companies. And they look at how much is in your bank account, because they want to know that you’re going to be around and that becomes a factor.”

The appeal of revenue-based investment and the current availability of such capital seems to be mismatched, with only one participant highlighting their success in accessing revenue-based financing:

We’re already using three-year debt to fund inventory, revenue-based financing to fund marketing and angel/equity to fund general burn rate all of which are great.”

The nature of revenue-based investment opens questions about how to determine the level of revenue repayments, how they are calculated and what the overall amount of return should be. Given that this type of instrument is relatively novel and has less recognised standard terms, it was perhaps not surprising that the participants shared a range of perspectives on what they thought was preferable.

When asked “what percentage share of revenue would be acceptable for the repayments?” the respondents’ answers varied quite considerably with the lowest starting at 3% and the highest at 33%. Some provided an answer based on net revenue as opposed to gross revenue. However, the key consideration was recognised as the need to balance investor risk with terms that are not detrimental to the venture’s sustainability or growth. This was also reflected in views of what was a fair level of repayment as a multiple of the original investment, with responses varying from 1.5x to 5x, with the average response being 2x-3x.
"Let’s get to the 2x or the 3x or the 4x. There are very few VCs, and very few businesses, that are genuinely 10x animals. I think a social impact fund should want to help support the creation of profitable businesses.”

Address the demand for patient and flexible capital

As ventures look to address their financing needs, we heard strong calls for greater collaboration between investors and founders so that they could design instruments that work.

There needs to be an element of co-design between funders and founders; an ability to have a conversation with an investor where you can shape all the sufficient optionality within the product that they offer so it can fit the particular needs of the venture.”

The concept of patient capital frequently came up in the roundtable discussions and we explored what this meant in the context of revenue-based investments. This can be approached in different ways such as the time gap between the investment and repayments beginning, or the timeframe for the overall return. Participants highlighted the importance of considering and managing repayments, so they are not detrimental to a venture’s cash flow and ability to invest in growth. When asked how long after taking the investment they would want to start repayments, the most common response was one-two years.

Participants also emphasised the importance of the patience of the capital mirroring the venture’s requirements based on the proposition being developed, and the time needed to realise this. This was reflected in responses to the question of how long they felt the investment horizon should be for ‘patient’ finance, with answers ranging from three years to over ten years. Those who were engaged in systemic change or building new market infrastructure tended to focus on the longer of these timeframes.

With civic tech, or social tech, we are building systemic change. Systemic change does not happen in three months, or six months or a year.”
Listening to founders: Designing approaches for investing in social tech

In addition to patience, flexibility was seen as highly desirable and one of the key benefits of a revenue-based approach. This was not solely limited to the timings of repayments. One of the areas we explored was the option for an initial debt investment to be repaid through revenues, convert to equity after an agreed trigger event, or deliver returns through a combination of the two. This was regarded as appealing as it would offer a mechanism for founders to determine the best path for their venture to grow over time, rather than having to commit to a trajectory at a very early stage that may limit their future options. Participants felt that this could be particularly relevant to founders who want to maintain greater ownership of their company so that they have a higher degree of control over the venture’s mission. It was also viewed as beneficial for founders seeking to avoid over-dilution at early stages.

“We’ve building strategic market infrastructure, which means we’re creating the market as much as taking advantage of it.”

“...For us, it’d be great, because we think we’re going to raise institutional money anyway. So it allows us to take money at this level, which is not attached to a valuation, and then we can refinance further down the line, and repay that loan when the valuation of the businesses is higher. That would be an attractive model for us.”
Access to suitable capital is often cited by founders as being the biggest single barrier to sustaining and growing social tech ventures. However, with the growth of the social investment market and increasing numbers of impact venture funds, it is not always clear why they continue to face this difficulty. Speaking directly to the ventures and founders affected by these gaps helps to build a greater, more nuanced understanding of their experiences and potential solutions.

From our research, we have identified that ventures experience several challenges when engaging different investor groups, including misalignment with the dominant VC model, investor aversion to impact-focused business models, and investor hesitancy about tech propositions.

Our research also highlighted several potential opportunities including:

- Focusing on sustainable ventures and building fund portfolios that can realise the value of investing in these companies
- Responding to the interest in revenue-based investment to provide viable alternatives to debt and equity instruments
- Addressing the demand for more patient and flexible capital that meets the needs of ventures as they grow

Tech is becoming increasingly integral to social impact propositions. In the future, we believe that social impact will become equally integral to the success of technology. This will require a different approach to investment, where the alignment between the goals of investors and the companies they invest in is also reflected in the investment instruments and processes they use and the fund portfolios that they build.

If we are to truly realise the potential of technology to create a better future for all, we must listen to the experiences of those who are at the forefront of making positive change a reality. By working with them to design alternative approaches, we can create new opportunities to invest in overlooked companies and grow more sustainable impact businesses.
Acknowledgements

Our special thanks to Claire Lewis, an independent consultant, who carried out this research on our behalf. We are also incredibly grateful to the representatives of the 23 social tech ventures who shared their experiences so generously and openly. And finally, thank you to Esme Verity and Daisy Downes-Ford, from Zebras Unite, for their kind introductions to founders in their networks.

Participants

BetterSpace
Code4000
EngagedX
Famiio
Feebris
GiveVision
Good Boost
Immersive Rehab
JUST: Access
Library of Things
Make Time Count Today
Mobilized Construction
Onloan
Open Up Music
RenKap
Social Value UK
The Future Fox
Thrive
Travel AI
Tula
Wee See i2i
Wee Seeds
Written Medicine

Further information

If you’re interested in following us on our journey to impact through investment, sign up to our newsletter via our website, follow us on Twitter and LinkedIn and look out for our blog series on Medium. You can also contact us at hello@socialtechtrust.org.