MaRS Market Insights

Issue Brief on Seed-Stage Impact Investing in Canada: Insights from the field

MaRS is a member of ONE Ontario Network of Entrepreneurs

MaRS CENTRE FOR IMPACT INVESTING

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AUTHORS

Katie Gibson, MaRS Centre for Impact Investing
Hyun-Duck Chung, MaRS Market Intelligence
Trish Nixon, MaRS Centre for Impact Investing
Tristina Sinopoli, MaRS Centre for Impact Investing

LIST OF INTERVIEWEES

Social venture accelerator managers
Donovan Woollard, Radius Ventures
Karina LeBlanc, B4Change
Trish Nixon, Impact8
Julie Caron-Malenfant, Institut du Nouveau Monde
Glenn Smith, ASCEnt
Beth Bailey, ASCEnt
Jana Svedova, Director, Impact Investing at Coastal Capital Savings
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Tania Del Matto, GreenHouse

Entrepreneurs
Raymond Shih, QoC Health
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Investors
Michael Curry, Investeco Capital
James Appleyard, Freycinet Investments
Jane Bisbee, Social Enterprise Fund
Terry Campbell, Futurpreneur Canada
Jonathan Hera, Grand Challenges Canada
Bonnie Foley-Wong, Pique Ventures
Brandon Corman, Maple Leaf Angels
Mary Long Irwin, Northern Ontario Angels
Bill Young, Social Capital Partners
Abigail Slater, Barlow Lane Holdings Limited
Julie McDowell, TARIS Incorporated
John Doherty, John Doherty & Associates
Llewellyn Smith, The Helderleigh Foundation
Susan McLean, GreenEdge Capital
Josh Cohen, City Light Capital
Lisa Hagerman, DBL Investors
Gemma Rocyn Jones, The Young Foundation
Catherine Ludgate, Vancity Credit Union

For further information, please contact Katie Gibson at kgibson@marsdd.com

INTRODUCTION

Seed-stage investing is attracting an increasing amount of attention from Canadian impact investors.[1] At the same time, new accelerator programs tailored to the needs of seed-stage impact ventures are emerging across the country. These trends point to a growing interest in seed-stage impact ventures and their capital needs.

As impact investing market builders, we at the MaRS Centre for Impact Investing also believe that seed-stage impact investing is vital. Seed-stage investing provides capital and knowhow to the earliest ventures with the potential to produce blended financial and social/environmental returns. Without both financial and human capital, startups can die on the vine. Seed-stage investing also develops the impact investment market overall by building the pipeline for later-stage investors. As noted in the Stanford Social Innovation Review, "It is today's fledgling innovator who sets the stage for tomorrow's next great scalable innovation that can also produce strong financial returns."[2]

However, to many entrepreneurs and investors, the seed-stage investment process is opaque, with no Canadian resources addressing seed-stage impact investing in Canada today. The Centre seeks to begin to fill that gap. Hard data is scarce in a nascent market, so we conducted interviews with market players to access their insights.

This brief serves as a snapshot of the market in 2015. It summarizes what market players told us about seed-stage impact investing in Canada and offers insight into how, in practical terms, these investments happen. This paper is aimed at potential investors, entrepreneurs and capacity-builders who wish to understand how seed-stage impact investing works in Canada today.

> *"The reality, of course, is that if we wish to build an impact investing industry that successfully delivers on the promise of bringing market-based solutions to disadvantaged populations, our success depends on our support for these early stage innovators. It is today's fledgling innovator who sets the stage for tomorrow's next great scalable innovation that can also produce strong financial returns."*
>
> *—Matt Bannick & Paula Goldman*

We define seed-stage impact investing as an investment in a company that is pre-revenue or has early revenues and limited investment to date, with the investor intending to achieve both a financial return and a social/environmental return.

INSIGHTS FROM THE FIELD

What key observations did market players share about seed-stage impact investing in Canada today?

We interviewed 29 experts from five groups:[3]

1. Canadian impact fund managers
2. Canadian seed-stage investors
3. Canadian impact accelerator managers
4. Canadian impact ventures
5. International seed-stage impact investors with insights applicable to Canada

Together, their insights provide a snapshot of seed-stage impact investing in Canada today. Their key observations are presented in this brief.

Impact ventures need seed-stage investing—but the market is still maturing

The vast majority of the market players we interviewed perceived a gap in seed-stage impact investing in Canada.

For example, Donovan Woollard, Director of Radius Ventures, an impact-focused accelerator in British Columbia, viewed the need for seed-stage impact investing as "significant," especially for ventures that are "focused on multiple bottom lines, rather than quick or early exits."

Angel investors and fund managers were in agreement. John Doherty, an angel investor, observed, "There are far more good ideas that I've seen at pitch sessions than I've seen deals happen for." Mary Long Irwin, Executive Director, Northern Ontario Angels, emphasized the need for more seed-stage investing, particularly in remote communities. She noted, "We need more seed capital and more awareness of the impacts."

The gap in availability of seed capital is not unique to impact investing. One interviewee remarked that "there are lots of good ideas and promising young businesses" in Canada and that "impact investments are not alone in being underfunded."[4]

Our interviewees explained that the market is still maturing and that it requires a sophisticated ecosystem of seed-stage players, including ventures, investors and support programs. As Llewellyn Smith of The Helderleigh Foundation pointed out, "There is plenty of capital available. However, it is not allocated to this space because it has not matured as yet."

Seed-stage impact ventures typically seek $50,000 to $1 million

Based on their experience working with seed-stage impact ventures, our Canadian interviewees estimated how much capital these ventures typically need to raise. Figure 1 shows the estimates plotted along a spectrum of ranges that falls between $50,000 to $1–2 million. The dots overlaid along various points in the spectrum highlight recent actual successful raises by seed-stage impact ventures.

Seed ventures need the right kind of capital

Our interviewees also emphasized that seed-stage ventures need the right kind of capital. For example, Jana Svedova, Director, Impact Investing at Coastal Capital Savings iHub Social Ventures, noted that the ventures participating in the accelerator have different capital requirements at different times. This ranges from a need for equity investment to a line of credit to working capital loans. The timing of the need can vary, and not all ventures require an investment at the end of an accelerator program. Accelerators focused on capital-intensive and growth ventures see more of a need for seed capital in the form of equity investment.

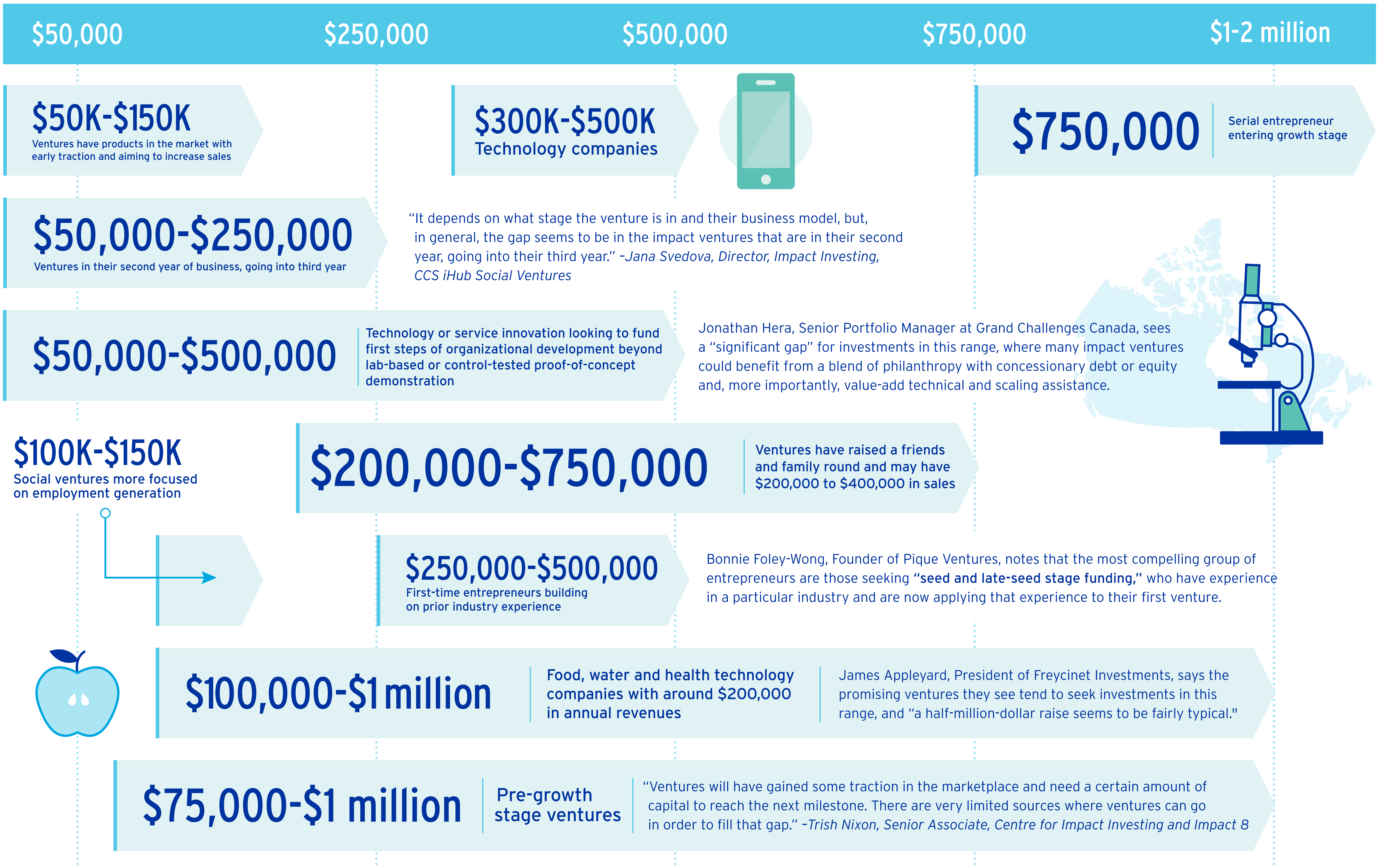

Figure 1. Seed capital sought by impact ventures in Canada

Slingshot, Radius Ventures

APPLICANTS
Pre-applications: 30-40
Full-applications: 15

PARTICIPANTS
8 ventures per cohort
(1 cohort per year)

CAPITAL SUPPORT
Introductions to investors

CCS iHub Social Ventures (ISIS)

APPLICANTS
Official applications per cohort: 45
Pass to review stage: 10-14

PARTICIPANTS
5 ventures per cohort (1 cohort per year)

CAPITAL SUPPORT
Cash expenses; small amounts on case-by-case basis

Impact8, Esplanade Montreal

APPLICANTS
Cohort 1: Launching in 2015

PARTICIPANTS
8 ventures per cohort
(1-2 cohorts per year)

CAPITAL SUPPORT
Grant: $15K

B4Change, Pond-Deshpande Centre

APPLICANTS
Cohort 1: Pre-selected 10-12 companies invited to apply
Cohort 2: Year round intake averaging 5-6 applications per month

PARTICIPANTS
Shift from a 7 venture cohort model to a year-round intake

CAPITAL SUPPORT
Grants: $1K-$15K

GreenHouse, St. Paul's University College at University of Waterloo

APPLICANTS
Aims to reach 40 students per term and scale to 70 in future

PARTICIPANTS
5-20 students per cohort
(3 cohorts per year)

CAPITAL SUPPORT
Social Innovation Fund (grant): $5K

ASCEnt, Communitech

APPLICANTS
Year round intake averaging 2-6 applications per month

PARTICIPANTS
4 ventures per cohort
(2 cohorts per year)

CAPITAL SUPPORT
Introductions to investors

Impact8, MaRS Centre for Impact Investing

APPLICANTS
Cohort 1: 150 open applications
Cohort 2: 36 invited applications

PARTICIPANTS
8 ventures per cohort
(1-2 cohorts per year)

CAPITAL SUPPORT
Grant: $15K

Figure 2: Overview Canadian Accelerators Focused on Impact Ventures

According to Donovan Woollard of Radius Ventures in British Columbia, while sufficient debt capital was provided to the ventures in his accelerator by sources like Vancity Credit Union, Community Futures, BDC and other banks and credit unions, "it is the convertible and equity funds that folks are really hungry for."

Seed ventures need more than just capital

Many interviewees stated that seed-stage impact ventures often face challenges that cannot be solved by investment alone. In many cases, companies need to build capacity before they are ready for investment.

For example, Julie McDowell of TARIS Incorporated stated that for "companies with early traction or long development cycles, seed funding plays a critical role," but that "throwing money at problems or entrepreneurs that don't have the right solution doesn't make sense."

Similarly, Jana Svedova Director of Impact Investing at the CCS iHub Social Ventures accelerator in BC emphasized the need for "smarts" over "money":

"We find that not all [ventures] need funding. Quite often they think they need funding, but when you look into what they need the funding for, it's not an issue of getting funding to solve the problem. It's a different issue that can be solved without funding. It could be a matter of how they are structuring the payments for their product or service. It could be an internal issue like designing better logistics [or] better systems, [or] even slightly repositioning the offering. More capital won't solve these kinds of issues. I'd say not even a majority of the ventures are looking for funding—they are looking for help with other pieces."

This observation was echoed by Jane Bisbee, Executive Director of the Social Enterprise Fund in Edmonton, who noted, "I've got money to lend, but I've had to send some interesting but half-baked ideas away."

Once these companies build their capacity and investment readiness, seed capital can accelerate their growth.

A range of actors play an important role in seed-stage impact investing

Accelerators

Over the past few years, a number of business accelerator programs focused specifically on impact ventures have emerged across Canada. While mainstream accelerators and other business-development programs also support impact ventures, the emergence of this new class of impact-focused accelerators indicates growing interest in providing targeted supports to impact ventures.

We interviewed the managers of six accelerators, all of which have been in operation for one to three years. Most accelerators are cohort-based programs that run one to three cohorts per year, while others are designed to onboard ventures year-round.

Figure 2 provides an overview of each accelerator, including the number of its applicants, the enrollment and cohort sizes, and the capital-raising support it provides to ventures.

There are some notable differences in the evolution of these accelerators, but many are growing and extending their offerings. For example, Karina LeBlanc of B4Change explained that this accelerator has evolved from a cohort model to an open, rolling process. She said, "We're just starting this year, but the idea is that we will have hundreds of projects in the works and not have to turn anyone away." Another example is Impact8, an accelerator that was initiated in Toronto and that will run its first cohort in Quebec in 2015, in partnership with Esplanade Montreal.

Accelerators work with ventures that range in maturity. Some accelerators like the campus-linked program, GreenHouse, work with very early-stage ventures and students who are interested in social entrepreneurship. In contrast, Impact8 in Toronto targets ventures that are planning to raise capital in the near term, and focuses on investment readiness.

Some interviewees suggested that incubators and accelerators for social ventures could provide much-needed financing to early-stage ventures. Currently, the only capital provided to accelerator participants is grant prizes. These include the following:

- Impact8 offers one of its eight ventures per cohort a $15,000 grant prize upon exiting the program.[5]
- The B4Change program at the Pond-Deshpande Centre offers grants between $1,000 and $25,000 from its social innovation fund.[6]
- GreenHouse at the University of Waterloo provides $5,000 grants.[7]

Overall, accelerators provide a range of capital support to their ventures, such as introductions to investor communities, coverage of minor business expenses such as the printing of marketing materials and business cards, and/or grants (usually no larger than $15,000).

These social venture incubators could follow the example of technology incubators that make a direct equity investment in all or some of their client ventures. One entrepreneur, Raymond Shih of QoC Health, estimated that an investment by an accelerator in one or two ventures could save the ventures a year of fundraising effort. At the same time, the accelerator would have a headstart on the diligence process, as it would have been working closely with the venture throughout the program.[8]

Angels

Angel investors are high net-worth individuals who invest their own money in startups. Historically, angels have provided more overall investment capital to seed-stage ventures than have venture capital funds in Canada.[9]

According to our interviewees, angel investments may be concentrated in a few impact sectors. Angel One, an active Canadian angel network, and Cleantech North have participated in cleantech deals. Some individual angels are also interested in technology for social good.[10] A fund focused on food, water and health technology companies typically invests alongside angels.[11]

The landscape also includes investments in social ventures made without an explicit intent around impact. For example, social venture Nudge Rewards (formerly Greengage Mobile) raised a $1 million funding round from investors, including the Golden Triangle Angel Network (GTAN).[12]

Others noted that interest in impact investing is increasing among angels. Representatives of Maple Leaf Angels and Northern Ontario Angels both reported that their members are interested in impact investing.[13]

" We're just starting to reach a point where [impact investing] will be normal. It's not just the right thing to do; it's good value." –Mary Long Irwin, Executive Director of Northern Ontario Angels

Angels are well positioned to become more active impact investors. Our interviewees noted that they have the flexibility to follow their passion and the experience to advise their investees,[14] and angels who are themselves successful entrepreneurs can add tremendous value to startups beyond the dollars invested.[15] Active philanthropists could begin to explore angel investing for impact as a complementary means of achieving social or environmental outcomes. In addition, once some of today's social entrepreneurs sell their companies, they could become tomorrow's angel investors.

Another promising trend identified in our interviews is the emergence of a new group of "high net-worth-*ish* individuals" who are interested in investing, but "do not have an infinite pool of capital." There is potential to engage venture investors who are starting to think about impact and "more purposeful ways to deploy their capital."[16]

Funds

Venture capital (VC) funds can also provide seed capital for impact, but this activity is still quite limited in Canada. Research has shown that venture capital firms do not tend to invest at the earliest stages.[17] In 2000, it was estimated that less than 5% of venture capital funds in the United States went to seed investing. Instead, "venture money plays the most important role in the second stage of the innovation life cycle—the period in a company's life when it begins to commercialize its innovation."[18]

Some VCs get involved in seed-stage investing to develop their pipeline of later-stage opportunities. For example, City Light Capital's seed deals are "about developing relationships, getting access to information early on, and building a pipeline for later-stage investments."[19]

Our interviewees identified a number of impact funds in Canada that make seed investments as at least part of their portfolio. These include:

- **ArcTern Ventures**, which invests in early-stage cleantech
- Community Forward Fund, which invests in non-profits, some at seed stage
- **RBC Generator Fund**, which invests in energy, water, employment for youth and community hiring or employment for disadvantaged groups, and has done one seed-stage deal
- **Seed Fund Cycle-C3E**, a seed fund for cleantech companies
- **Social Enterprise Fund**, which invests in social enterprises in Alberta, some at seed stage
- **Youth Social Innovation Capital Fund**, which invests in young entrepreneurs, some at seed stage
- **Réseau d'investissement social du Quebec (RISQ)**, which invests in the social economy in Quebec, providing up to $100,000 to early-stage social enterprises
- **Pique Ventures (VCC) Inc.**, which invests in companies that are beyond the idea stage, have operated for one or two years, and preferably have some revenue, which "can be lumpy or inconsistent, but is validated with real paying customers." It invests in the first round of external capital after the entrepreneur's own funds and love money[20]
- **MaRS Centre for Impact Investing**, which is currently raising a fund that will invest at a an early stage
- Various microfinance organizations across Canada that provide small amounts of seed capital to startups

These kinds of pooled products can help lower the risk of seed investing. Seed funds also provide investors who do not have the capacity (or interest) to make direct investments in ventures with an accessible entry point into seed-stage investing. These indirect investors include financial institutions, pension funds and insurance companies, as well as foundations and individuals without a direct investing strategy.

Foundations

Foundations play a variety of roles in seed-stage impact investing, including providing grants, making direct investments in ventures and investing in intermediaries (e.g., funds). They can strengthen the ecosystem by providing grant support to accelerators and other capacity builders.

The amount of direct investment by Canadian foundations in ventures is minimal. Foundations in Canada are estimated to have about $288 million of impact assets under management.[21] Debt is the most common form of financing, and 77% of foundations invest through a third-party fund or program.[22]

Some interviewees believe that foundations should invest more capital directly in social ventures.

Government

In Canada, different levels of government provide grants to support early-stage ventures across a number of industries.

Our interviewees identified several government agencies that are specifically involved in seed-stage impact investing. Among them is Investissement Quebec, which has invested in seed funds such as Seed Fund Cycle-C3E.[23] BDC Capital, a crown corporation that provides debt financing and venture capital to entrepreneurs across various stages of growth, has invested directly in seed-stage impact ventures, although that is not its explicit mandate.

Several interviewees believe that the provincial and federal governments could do more to stimulate seed-stage impact investing. Matching dollars, first-loss capital, or loan guarantees could encourage private capital to come to the table.[24] A fund-of-funds strategy could also be helpful.[25]

Financial institutions

Bank lending typically kicks in at a later stage, once a venture has validated its business model. Exceptions are made when ventures generate recurring revenues at a very early stage.

Some financial institutions, usually credit unions, have become involved at an early stage. An interviewee at Vancity Credit Union, for example, highlighted Vancity's Be My Own Boss Program that lends up to $50,000 for early-stage social enterprises, which is part of its micro-lending practice.

These sources generally provide working capital rather than growth capital.

Crowdfunding will provide additional seed capital, but will not replace existing investors

Currently, everyday investors are largely excluded from seed-stage investing. The "crowd" can support seed-stage ventures through donation, presale or rewards-based crowd-funding campaigns that have proliferated online, but not by providing debt or equity.

Many have called on Canadian securities regulators to democratize how the public accesses private equity deals by enabling it to invest online. In December 2013, Saskatchewan's Financial and Consumer Affairs Authority (FCAA) adopted an equity crowdfunding model aimed at startups in the province. In March 2014, seven other regulators made available for comments their proposals to create new equity crowdfunding exemptions in securities regulations. Industry experts indicate that the final rules will be passed by the end of 2015.[26]

Most of the experts we interviewed are cautiously optimistic about equity crowdfunding, believing that some investors will lose money in the early days, but that the overall effect will be positive. Bonnie Foley-Wong of Pique Ventures expects that "a lot of tears could be shed" early on. Similarly, Jonathan Hera of Grand Challenges Canada predicts that there will be some early losses, but "there will be a pendulum swing back." Overall, our interviewees believe that the democratization of capital is important, and that social ventures will benefit from having an additional avenue to raise capital.

Many agree that to minimize losses, investors will need education. Less sophisticated investors may not clearly understand the risk of equity crowdfunding.[27] Additionally, crowdfunding investors may not have the experience in valuing companies that angel investors or VC funds have. Education on general or sector-specific valuation methods will be important.[28]

Several experts predict that the millennial generation will take the opportunity to invest. One noted that "[i]t's a perfect tool for their skillset, their interests and their passion,"[29] and another suggested that it would appeal to young people's "holistic view of buying, consumption and investment."[30]

Interviewees do not believe that equity crowdfunding will replace existing sources of capital. Instead, it could enable early-stage companies to "round out a funding round"[31] and "layer" this capital on top of capital from accredited investors.[32] They noted that equity crowdfunding will never replace the mentorship, networks and advice provided by individual investors.[33]

HOW SEED-STAGE IMPACT INVESTING IS HAPPENING

We interviewed seed-stage investors, both in Canada and internationally, to understand how, in practical terms, they go about investing for impact in seed-stage ventures. The following details shed light on entry points into direct investing and working with entrepreneurs.[34]

Access points for new investors

Those interested in getting involved in impact investing can take these first steps:

Platforms: Accredited investors in provinces where the Social Venture Connexion (SVX) operates can register on the platform to connect with impact ventures currently raising capital.

Funds: Investors can invest in new and existing impact funds. For example, the MaRS Centre for Impact Investing is currently incubating a new seed-stage impact investing fund.

Communities: Investors can join angel groups in their region and seek like-minded investors with an interest in impact.

Impact accelerators: Impact accelerators are always interested in hearing from those who might invest in their ventures.

Deal Spotlight

Proteocyte Diagnostics

Proteocyte Diagnostics developed a novel diagnostics technology that offers objective and accurate early diagnosis of precancers and cancers. Proteocyte is an issuer on the SVX and in September 2014 announced that it had received seed-stage investment via the platform from Freycinet Investments. James Appleyard, President of Freycinet Investments, noted that "Companies such as Proteocyte that are commercializing best-of-breed medical innovations represent one of the best possible opportunities for breakthroughs that will improve human welfare. These innovations have the potential to save lives and reduce suffering, while also creating opportunities that will generate superior investment returns. We hope that innovations such as the SVX platform will continue to connect promising entrepreneurs with suitable investors."[35]

Lucky Iron Fish

The Lucky Iron Fish™ project is a social venture on the SVX. It offers a simple, affordable and clinically proven solution for iron deficiency. The Lucky Iron Fish (LIF) is an iron ingot that one places in a cooking pot for regular use when preparing meals or boiling water. Iron leaches out of the ingot and into the water and food. This low addition of iron mimics a diet that is rich in iron. The LIF project is currently beginning work in Cambodia. It secured seed-stage funding after pitching at the MaRS' Impact Ontario conference in March 2014. Grand Challenges Canada is also a board-seat lender to LIF.

Developing an impact investing strategy and investment thesis

"Impact first" does not mean returns are secondary

Methods of balancing social/environmental and financial returns vary among the investors we interviewed.

Most often, impact investors do not expect to compromise financial returns in the pursuit of impact. They assert that financial and social/environmental objectives are not in conflict, as financial returns are often a byproduct of solving big social or environmental problems.[36] However, some investors may adjust their risk-return expectations to allow for greater flexibility or patience where the potential impact warrants such an approach.[37] This is more likely to be the case with individual investors or charitable funds that may not be held to the same external timelines or financial targets as limited partnerships.

There is a general trend toward *sequencing* rather than *prioritizing* impact and financial outcomes.[38] Investors' impact targets act as an initial screen for evaluating investment opportunities;[39] after that, the financial due diligence process mirrors that of other seed investments. Bearing in mind their risk/return expectations and investment horizons, impact investors recognize that the social outcomes they seek are dependent on the financial success of investee.

Impact investors can start with the problem or the solution

For some seed investors, "impact" is a lens or screen through which they filter and view investment opportunities. These investors start with the premise that they can use their investment dollars to accelerate solutions to social problems and gravitate toward key investment opportunities that have an inherent positive impact (e.g., a cancer screening technology or a clean energy company).[40] From there, they deploy their capital and other resources to accelerate the solution. Measurement of the impact achieved may or may not be a function of their management approach.

Other investors begin with specific social or environmental challenges that they want to address and get involved in different business models aimed at solving those problems. This approach tends to result in more defined impact goals and thematic or sector-focused investing.

Three investors' approaches to impact investing

DBL Investors is a California-based fund that strives to achieve positive impact through its portfolio investments. Flowing from that objective, the funds have invested primarily—though not exclusively—in clean energy, energy storage and sustainable products and services. Its investment process is no less disciplined than traditional venture capital funds. Rather, it is additive. As Lisa Hagerman, the firm's director of programs explains, "In assessing investments, there's a basic check that the core product or service inherently has a positive impact on society or the environment, and that the ventures are willing to work with us across our four areas of focus: workforce development, environmental stewardship, public policy and community engagement, and that they embrace our second-bottom line approach."

The Young Foundation's pilot fund was developed with a very clear objective of tackling inequality in education, so that young people leaving the education system are equipped with the skills, networks and academic achievements they need to be successful in life. Within that framework, the scope of investments is consciously broad. Investees can work along the age spectrum of K-18, and within or outside schools, to reach those goals.

City Light Capital, a New York-based fund, was established post-9/11 to solve pressing social problems. The fund has identified specific outcomes it seeks to generate within three impact themes: education, safety and environment.

Investors set manageable boundaries

Seed investors have found success investing in *what they know* and *who they know*. By focusing on specific sectors and/or geographic areas, investors can build expertise and networks that help them evaluate opportunities and add value to their portfolio companies.

Setting boundaries for investing

Sector: Some funds invest specifically in one industry or sector, such as health, clean technology, or sustainable food. Such defined investment parameters can help investors build the expertise needed to analyze opportunities and deploy capital efficiently.[41] Sector-specific funds often have relatively broad geographic boundaries (e.g., national), which ensures a robust pipeline of opportunities.

Theme: Investment boundaries can pertain to an investor's impact objectives or theory of change. Individuals or foundations often employ a thematic approach to investing when they have specific impact goals in mind. For example, The Helderleigh Foundation invests with the goal of improving the diet, physical health and well-being of Canadians.

Region: Many individual and fund investors also choose to identify multiple sectors or themes in which to invest, and narrow their focus by setting their parameters around stage, growth trajectory and geography. Investing in a particular region can provide great benefits in terms of networks and knowledge of the local landscape, as well as connections to founding teams. Others have noted that "putting a manageable boundary around your geographic preferences will allow you to become more comfortable with the landscape, external risks and regulatory differences of investing in that jurisdiction and develop helpful networks to support you."[42]

Diversification: While a focused approach has many benefits, investors also note that there is value in diversification in order to prevent over-exposure in a certain area and to ensure a sufficient pipeline of opportunities.

Developing a pipeline of deals

Deals come from a trusted source

When sourcing deals, seed-stage impact investors look to their network to identify entrepreneurs who meet their impact focus and investment criteria. One investor noted that the character of the entrepreneur is among the top considerations in her decision-making process. If the entrepreneur has been referred by a company she already knows well, she knows she is much more likely to have aligned interests with this entrepreneur.[43] Deals can be referred by a number of sources: prior investees, investors, incubators and accelerators and intermediaries.

Trusted sources for deals

Prior Investees: Many investors reported that they are frequently introduced to entrepreneurs through other entrepreneurs that they have invested in.[44]

Investors: Early seed-stage impact investors refer entrepreneurs to one another. As the market grows and an impact investor's reputation grows, the ability for investors to share deals and refer companies increases. For example, DBL Investors has over 60 years of combined experience, leading to a well-developed network.[45]

Incubators, accelerators and universities: Several investors report that access to entrepreneurs through incubators and accelerators provides much of their high-quality deal flow. Mary Long Irwin, Executive Director of Northern Ontario Angels (NOA), relates that 60% of the deals completed by NOA were referred directly by incubator programs, such as the local Regional Innovation Centre (in this case, NORCAT), university entrepreneurship programs and the Community Futures program.[46] Additionally, incubators and accelerators are very useful for investors who are new to the sector and may not have access to traditional VC and angel networks.

Intermediaries: Impact investors also turn to trusted intermediaries to connect them with ventures that meet their investment criteria. Bill Young of Social Capital Partners says, "the good news is that there are intermediaries springing up that connect social purpose businesses that need financing with investors looking for impact." These intermediaries include online investment platforms and capital advisory firms designed to facilitate the flow of capital to impact ventures.

Entrepreneurs will find investors

One investor reported not having to look hard for entrepreneurs, saying "Once it's known that you're out there with money and that you intend to invest, they'll find you."[47] The consensus among investors interviewed was that entrepreneurs will find investors when they make their desire to invest public. As a starting point, some investors have hosted small pitch competitions to attract ventures and spread their name.

Conducting due diligence

Investors keep it simple

At the seed stage, the entrepreneur should be focused on building a business, not fundraising. Investors must create processes that are simple for entrepreneurs to follow yet effective enough to allow the investor to have a good grasp of the entrepreneur's business model and intended impact. One investor said that the entrepreneur "needs to be doing customer development and their customer discovery phase, [determining] who the customers are [and] how to get the product to them. They should be going out there experimenting like a scientist, not running around trying to raise money."[48]

While the process will vary, many investors will ask for basic information about the venture before deciding whether or not to sit down with the entrepreneur. This information may be a pitch deck, a one-pager, or more comprehensive package if the investor must screen many meeting requests. The information gathered helps investors determine whether or not they can add value and if the intended impact of the entrepreneur aligns with their own impact investment goals.

People are everything

In assessing a seed-stage social venture, getting to know the management team is often the investor's first priority. One investment fund manager said, "Impact investment is like a marriage—you've really got to know the people."[49] With little financial history and at times an unproven product or business model, the onus is on the investor to assess the management team's ability to execute on their plan.

Management team traits: What do investors seek?

Coachable: Seed-stage impact investors want to work with coachable entrepreneurs. Investors understand that business models may pivot and adapt over time. They want to support entrepreneurs who are able to adjust and to benefit from the expertise and skills that the investor has to offer.

Business and market knowledge: Investors look for entrepreneurs with a deep understanding of their business model and the market.[50] Often investors will meet repeatedly with entrepreneurs face to face to assess their understanding and commitment to the business model that they are building.

Moral compass: Entrepreneurs must exhibit a strong character and moral compass to pursue the social and environmental objectives that they seek to achieve. Gemma Rocyn Jones of The Young Foundation notes that understanding the entrepreneur's motivations is particularly important in building the trust to drive impact.

Friends and family capital: An entrepreneur's ability to raise capital from friends and family is also an indicator of his or her potential to succeed. Michael Curry of Investeco Capital notes that "a good entrepreneur will be able to raise capital from friends and family pretty quickly."[51] A total absence of investment may be a bad sign unless there are mitigating factors (e.g., the entrepreneur is new to Canada).

Investors and entrepreneurs are solving a problem together

After assessing the team, impact investors look at the social venture's role in solving a pressing problem and assess the potential for impact. One angel said, "I don't want a pitch about the tax efficiency."[52] Once an impact investor believes in the solution proposed, the investor will work to ensure that there is alignment between what they hope to achieve and what the entrepreneur wants to achieve.

At the same time, investors cautioned against becoming too enamoured of the impact story. One noted, "It's hard not to fall in love with brilliant social entrepreneurs who have awesome ideas, but you still need to stress-test the idea." [53]

Aligning expectations on financial and social return

It is critical to ensure that investors and entrepreneurs have expectations in alignment regarding both the social and financial returns. It is important for each to understand the other's motivation.[54] In due diligence, investors may set specific impact targets or a range of targets, and ensure that the entrepreneur's goals also fit within that that range before proceeding to complete due diligence on financial projections.

Advice from others can make due diligence cost-effective

Impact investors can often reduce the cost of due diligence by reaching out to their network to obtain information about the market, sector and the company itself. This method can be useful for investors looking to invest in a diverse set of companies in sectors beyond their core expertise.[55]

One investor noted that while obtaining legal advice is important, requesting a legal opinion too early can be costly. Investors should first spend time getting to know the management team and understanding the business plan.[56]

Quick and clear decisions are better for everybody

One entrepreneur found that "nobody wants to shut you down" and that investors tend to offer a lot of compliments and then eventually a polite "no." He recommends that investors give a quick no, with feedback.

Another entrepreneur reported that she shares specific due diligence documents with investors selectively. She provides specific documents—and only if they are specifically requested. She takes this approach because she wants to avoid falling into a long cycle of questions and answers without reaching a "yes" or "no" decision.

To expedite the process, many entrepreneurs provide access to a "deal folder" on a file sharing service. They provide a set of baseline documents and add more files as needed. Similarly, the SVX platform offers "Deal Rooms" where entrepreneurs share documents relevant to potential investors.

Structuring the transaction

A deal can take many different forms. It is important to balance the venture's future potential capital needs with the investor's expectations.

Finding the right deal size

The size of a seed-stage deal can vary dramatically depending on the venture's needs. An impact venture with a capital-intensive project may have much greater needs in its seed round than an impact venture seeking to grow its team by one or two people. For this reason, it is important for impact investors to balance the needs of their own portfolio with the needs of the venture and work toward an amount that will meaningfully aid the venture's growth.

One investor commented on an excess of caution among Canadian investors. He noted that some investors will only consider an investment in the range of $50,000 to $250,000 even if the venture needs more capital to seize an opportunity to grow. He was concerned that "the amount invested is often independent of the need."[58]

Keeping it simple

Investments come in many different forms of debt, equity, and combinations of debt and equity. These structures may include loan guarantees, debt, equity, revenue sharing or royalties. Overwhelmingly, seed-stage impact investors agree that simple structures are the best option.

"Simple terms, simple structures. Make it work and get the money out there," said Jonathan Hera of Grand Challenges Canada. He suggests using entrepreneur-friendly terms: "If you're coming in this early, make everyone's lives easy. You know you're getting diluted later on. If you make aggressive terms, nobody will come in later on." Additionally, he questions the widespread practice of investing in tranches when the amount of capital and timing of milestones is limited. In his view, this forces the venture to chase milestones that might not make sense and keeps them in perpetual fundraising mode.

Julie McDowell noted her preference for common shares, saying, "Fundraising for a new social venture is challenging enough. I prefer not to complicate it further with financial structures that are either not needed in early-stage companies or not well understood by typical investors."

Many investors will use different investment tools

The ideal investment instrument will vary with each impact venture. For instance, asset-backed ventures that are cash flow positive tend to lean toward debt instruments (e.g., bonds in the clean energy sector). Investors wishing to enter the impact investing space should be prepared to use different debt or equity tools depending on the impact venture's needs.

It can save investors time and money to line up a few tools early on and to adapt them when investment opportunities arise. The Young Foundation, for example, embraces the flexibility to use the right tool, but reports that it would have benefited by having a repertoire of all the instruments at the outset. Gemma Rocyn Jones notes that dealing with tools on a case-by-case basis can slow down the investment process.

Investing together

By syndicating deals, investors can not only share the cost of due diligence, but gain deeper knowledge of new sectors and tap into the networks of co-investors to best support their investee. Jonathan Hera advises to "not do things alone" and to "bring in syndicated investors wherever possible."[59] It's essential to know how important partnerships are. The entrepreneur will always need partners, suppliers and distributors, so bring them to the table.

Managing the investment

Once an investor has made an investment, the process has just begun. Many investors, especially at the seed stage, provide hands-on support to their investees. Most at least require regular financial and impact reporting.

Investors have strategies for adding value to and managing their investments

Pre-revenue or early revenue companies typically have small teams and face critical decisions about the trajectory of their business. The stakes are high, and they can often benefit from more than just passive capital.

Many seed investors take an active approach to managing their investment in order to both add value and maintain oversight of their social and financial goals. That said, the cost per transaction of these relatively small investments can be high, and actively managing a portfolio of companies can require significant capacity.[60] Investors can adopt a variety of management approaches to find the right balance. Investors should consider their own expertise and networks, and the time and resources that they can dedicate to the investee, as well as their impact goals. They should also understand clearly what the investee both needs and wants.

Many investors, both individuals and funds, negotiate a seat on the investee's board and become heavily involved the venture's operations.[61] This can include hiring, strategic decision-making, accessing follow-on capital or preparing for exit. In some circumstances, investors even step into management roles (e.g., CEO, CFO) for an interim period as the team grows.[62]

Investors with less capacity or relevant expertise can also choose to nominate a board seat or take a board observer seat, which enables them to maintain oversight but stay out of decision-making.

Others simply monitor financial results quarterly and annually and maintain an open relationship with the management team and/or board to answer questions that arise or become involved in an ad-hoc manner.[63] Investors wishing to take a more back-seat role may also choose to invest alongside a trusted co-investor who is actively involved.

This model is common when angel groups invest in a company: one member will take a leading role on behalf of the other subscribers.

Some fund investors who invest most of their capital in later-stage companies (e.g., Series A) also choose to invest smaller amounts in seed-stage companies as an exercise in pipeline development and relationship building. For example, City Light Capital sometimes employs this approach, but it takes a light touch in managing these smaller investments.[64]

Managing for impact can help preserve the investees' mission through growth and exit

Impact investors also consider how to utilize their capital to preserve, measure and drive impact. Investors with aligned values can help or encourage investees to develop impact frameworks and reporting processes. Integrating good measurement practices at an early stage can ensure that the mission is preserved as the company grows.

Impact measurement is an art as much as a science. Companies must find a balanced approach to measurement that will show whether they are achieving their impact goals without draining capacity. Investors employ a variety of approaches, from accepting qualitative reports on impact to quantifying outputs and, where possible, outcomes.

Most seed investors do not set specific impact targets across their portfolio, but rather work with their investees to understand their theory of change and determine an appropriate measurement approach. Some investors use third-party standards, such as B Corp or GIIRS assessments. Others select tailored metrics for measurement reporting. Some employ a combination of the two. The investor's own goals will dictate the depth of impact measurement. For example, Grand Challenges is focused on "explicit impact" and measuring outcomes, but in some cases, it may suffice to focus on "implicit impact" and to measure outputs, not outcomes, should the transformational impact be so profound as to warrant less direct attention.

Impact metrics should also enhance the core business by adding brand value, driving sales and serving as key performance indicators for management. Investors and investees can integrate impact performance alongside financial milestones, both for individual investments and across a portfolio. Specific impact metrics depend on the sector and outcomes targeted. Where there is a strong link between social and financial performance—i.e., impact and financial growth in lockstep—quantitative cross-portfolio metrics that evaluate a company's growth can serve as a health-check for impact investments. For example, Toniic recommends investors measure and collect the following metrics:[65]

- Number of beneficiaries of the enterprise's operations
- Jobs maintained or directly supported
- Net income
- New investment capital
- Sales revenue

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CONCLUSION

This brief serves as a snapshot of seed-stage impact investing in Canada in 2015, as perceived by those in the trenches.

Impact investing remains a new concept. As the idea joins the mainstream, and as more investors begin to identify with it, we expect to be able to develop an understanding of the system as a whole. An important step will be to gather more robust data. This will help impact ventures to identify the human and financial capital they need, arm investors with data required to mobilize their capital, and suggest to market-builders and intermediaries innovative ways to build the ecosystem.

We therefore conclude by offering some suggestions for further research.

First, hard data is required to understand the need for seed-stage investment in Canada today. While many of our interviewees perceive a capital gap, numbers are lacking. As the market grows, it will be useful to tabulate and compare the capital needs of the ventures and the capital provided by funds and other investors.

Second, we need to understand better the kind of capital required. It is possible, for example, that sufficient debt capital is available, but that high-growth startups need more risk capital in the form of equity. This will require further research. More refined segmenting of the kinds of seed-stage impact investing happening today could help make sense of this data.

Third, as more investors enter the field of seed-stage impact investing and more deals are made, a robust suite of best practices will develop. It will be important to capture and share these lessons.

FOOTNOTES

1 For example, in December 2014, Virgin Unite Canada announced a $1 million investment of first-loss capital into a seed-stage impact fund being incubated by the MaRS Centre for Impact Investing. We are aware of a minimum of five other funds in development that will focus, at least in part, on seed-stage ventures

2 http://www.ssireview.org/blog/entry/gaps_in_the_impact_investing_capital_curve

3 Some of the investors we interviewed invest in companies at various stages. Our interviews focused on their seed-stage investing

4 James Appleyard, President, Freycinet Investments. Freycinet Investments focuses on food, water and health technologies

5 Trish Nixon, Senior Associate, MaRS Centre for Impact Investing. The recipient is chosen through peer review

6 Karina LeBlanc, Executive Director, Pond-Deshpande Centre

7 Tania Del Matto, Director, GreenHouse, St. Paul's – University of Waterloo

8 Raymond Shih, Founding Partner, President, QoC Health, interview

9 Approximately $6B in angel capital went to seed-stage ventures compared to only $330M from formal venture capitalists in 2004: https://nacocanada.com/wp-content/uploads/2013/09/practices_and_outcomes_of_informal_venture_capital.pdf, p.3

10 Jonathan Hera, Senior Portfolio Manager, Grand Challenges Canada

11 James Appleyard, President, Freycinet Investments

12 http://nudgerewards.com/news

13 Brandon Corman, Maple Leaf Angels; Mary Long Irwin, Executive Director, Northern Ontario Angels

14 Jana Svedova, Director, Impact Investing, CCS iHub Social Ventures

15 Llewellyn Smith, CEO, The Helderleigh Foundation

16 Bonnie Foley-Wong, Founder, Pique Ventures

17 https://nacocanada.com/wp-content/uploads/2013/09/practices_and_outcomes_of_informal_venture_capital.pdf, p.4

18 http://avco.at/upload/medialibrary/17092_0_Internationalisation%20of%20PE%20VC%202002.pdf, p.26-27

19 Josh Cohen, Managing Partner & Cofounder, City Light Capital

20 Bonnie Foley-Wong, Founder, Pique Ventures

21 http://impactinvesting.marsdd.com/wp-content/uploads/2014/03/Impact-Investing-in-Canada-State-of-the-Nation.pdf, p.17

22 http://impactinvesting.marsdd.com/wp-content/uploads/2014/03/Impact-Investing-in-Canada-State-of-the-Nation.pdf, p.21-22

23 http://www.cyclecapital.com/42m-in-venture-capital-to-be-invested-in-quebec-companies-specializing-in-clean-technologies/

24 Michael Curry, Managing Partner, Investeco Capital; Jonathan Hera, Senior Portfolio Manager, Grand Challenges Canada

25 Jonathan Hera, Senior Portfolio Manager, Grand Challenges Canada; Bonnie Foley-Wong, Founder, Pique Ventures

26 Carlos Pinto Lobo, Chief Compliance Officer, SVX

27 John Doherty, President, John Doherty & Associates; Bonnie Foley-Wong, Pique Ventures

28 Carlos Pinto Lobo, Chief Compliance Officer, SVX

29 Karina LeBlanc, Executive Director, Pond-Deshpande Centre

30 Bill Young, President, Social Capital Partners

31 James Appleyard, President, Freycinet Investments

32 Jonathan Hera, Senior Portfolio Manager, Grand Challenges Canada

33 Mary Long Irwin, Executive Director, Northern Ontario Angels

34 The Toniic E-Guide to Early-Stage Global Impact Investing is also an excellent resource for investors new to the sector. It provides a comprehensive view of the investment process

35 http://proteocyte.com/news/

36 Bonnie Foley-Wong, Founder, Pique Ventures

37 Some investors have invested early in opportunities with a particularly strong impact alignment and are more patient in their approach

38 The Toniic E-Guide to Early-Stage Global Impact Investing

39 Impact considerations may be further integrated into the diligence process at a later point, through side letters dictating measurement and reporting requirements, third-party assessments, etc.

40 For example, Freycinet Investments focuses on food, water and health technologies. Its company president James Appleyard notes that "for me, at this stage, impact is more directional'

41 Michael Curry, Managing Partner, Investeco Capital

42 The Toniic E-Guide to Early-Stage Global Impact Investing

43 Abigail Slater, Director, Barlow Lane Holdings Limited, interview

44 Lisa Hagerman, Director of Programs, DBL Investors, interview

45 Lisa Hagerman, Director of Programs, DBL Investors, intervie

46 Mary Long Irwin, Executive Director, Northern Ontario Angels, interview

47 Bill Young, President, Social Capital Partners, interview

48 Brandon Corman, Managing Director, Maple Leaf Angels, interview

49 Gemma Rocyn Jones, Head of Social Finance, The Young Foundation, interview

50 Abigail Slater, Director, Barlow Lane Holdings Limited, interview

51 Michael Curry, Managing Partner, Investeco Capital, interview

52 John Doherty, President, John Doherty & Associates, interview

53 Catherine Ludgate, Manager, Community Investment, Vancity Credit Union

54 Bill Young, President, Social Capital Partners, interview

55 Abigail Slater, Director, Barlow Lane Holdings Limited, interview

56 Abigail Slater, Director, Barlow Lane Holdings Limited, interview

57 Jonathan Hera, Senior Portfolio Manager, Grand Challenges Canada, interview

58 Jonathan Hera, Senior Portfolio Manager, Grand Challenges Canada, interview

59 Jonathan Hera, Senior Portfolio Manager, Grand Challenges Canada, interview

60 Bill Young, President, Social Capital Partners

61 For example, this is the approach of Julie McDowell, President, TARIS Incorporated

62 For example, this is the approach of the MaRS Cleantech Fund

63 John Doherty, President, John Doherty & Associates

64 Josh Cohen, Managing Partner & Cofounder, City Light Capital

65 https://iris.thegiin.org/early-stage-investment-metrics

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