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Impact Investing Top Tips

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We invest in life-changing innovations that help tackle the major challenges faced by older people, children and communities in the UK.

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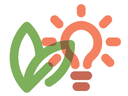
www.nestainvestments.org.uk

FOREWORD

When Coca-cola was invented by Dr John S Pemberton in 1886, its special formula was never written down and only shared with a selected small group of people. Only years later, when the Coca-Cola Company wanted to borrow money from the bank, was the formula written down so that it could be provided as collateral.

Joe Ludlow
Director of Nesta Impact Investments

Social entrepreneurs seeking to have a significant social impact whilst growing a profitable enterprise probably feel like they are hunting for an equivalent secret formula and wonder whether impact investment may be the vital ingredient. Here at Nesta Impact Investments we too wish we knew what exactly the winning formula was (rather than keeping it secret or locked up in a bank vault, we'd be inclined to publish it and get as many people as possible trying to transform the world for the better). But, in the absence of that, I hope that this series of pointers to what we think works when we look at investments is of some help, especially to social entrepreneurs working on their own high impact special sauce who think an impact investment could be what they need to bring their innovation to the world.



FIVE TIPS FOR DEVELOPING AN IMPACT PLAN

Eibhlín Ní Ógáin

The good news is that as a startup, you probably already have most of what it takes to develop a good impact plan. Spotting a gap in the market and developing an innovation that plugs that gap requires a skill-set that comes in handy when thinking about impact.

You start with asking the right questions. For example: Who will benefit? How will they benefit and why is this important?

Such questions can lead you to developing your Theory of Change: a visual map of why and how your enterprise will make a positive social impact. This roadmap will then guide you to choosing the right impact metrics for your venture.

Going through this process not only gets impact investors like Nesta Impact Investments excited but also helps you to focus on the social mission at the heart of what you do. So our top tips for getting started on an impact plan are:

1. Identify what social issue you are trying to address

What are the factors behind this problem and why will your venture help to tackle these factors?

2. Outline why your innovation will make a difference

Are you duplicating what is already out there or are you addressing a genuine gap? Do you have any research or evidence showing that your product or service can help tackle the issue you are addressing?

3. Map out how your innovation will have an impact

Try to map out the short- and long-term impact of your product or service and why it links to your final vision. A good tool for this is a Theory of Change which helps you to connect what you do on a day-to-day basis with the overall change you're trying to make.

4. Choose the impact metrics you will use

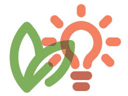
Qualitative data like case studies or observation are good sources for a rich and nuanced picture on whether change has happened. Quantitative research is useful to understand effects on larger groups of people. Questionnaires, or data on numbers of people qualifying from a course, for example, can all be used to gather information quantitatively. Inspiring Impact has a great hub to help you choose different types of impact metrics.

5. Work out how you will use your impact data to learn and improve

Make sure you learn from your data and make changes to what you do as a result. Ultimately, impact measurement is about understanding the impact you are having and improving your product or service as a result. If the data you collect is not helping you do this, you need to go back to the drawing board and develop an approach that will.

There are many resources out there that can help you develop your impact plan. ThinkNPC's website has a number of reports on Theory of Change and impact measurement; the Inspiring Impact website has a good collection of tools; and the G8 report on impact measurement in social investment outlines a best practice guide for impact measurement in social investment.

But remember, the best place to start is asking the right questions.



SIX TIPS FOR CREATING A FINANCIAL MODEL FOR YOUR STARTUP

Mireya Alvarez

Creating your first financial model should not be rocket science. You can easily work out that if you are selling hot dogs that cost you £3 each, you need to sell them for at least £3.01 to make a profit. In the same way, your financial model should be a reflection of your money in and out – which we sometimes call your business model – at different points in time.

1. Make it logical.

Avoid the complications of accounting and just think about it in a rational way. Let's pretend I'm a social enterprise providing training courses for young people to help them access work opportunities. If I assume that I can provide 20 courses a day by promoting them on social media, my business model is as simple as the cost to develop, market and provide the training sessions and the money that I am making out of them.

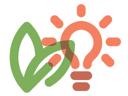
2. Keep it clean and simple

Make sure you give enough detail of the main levers/drivers of your business, like **revenue** (price x volume) and costs (cost x volume, salaries, marketing, etc.). Avoid wasting your time detailing things that are hard to predict and would probably not affect your profits much. And don't take for granted those that have a high level of uncertainty.

To identify the main drivers of your business you need to understand which variables impact on your profit the most, and if you are not sure what they are, the process of creating a financial model will help you to identify these. For example, if you are selling training courses, price and volume might be two variables to investigate. It could be that reducing prices by 15 per cent doesn't impact revenue as much as selling to 15 per cent fewer customers, or vice versa. Your model should be able to give you these answers.

3. Allow flexibility and NEVER EVER mix inputs with formulas

Make sure you have a separate tab or another colour on the cells that have numbers that are your assumptions – you want to make sure you can change these. Using the training courses example; don't simply suppose that you will grow from providing 20 courses a day to providing 200 without any data.



Make it easy to change and adapt it as you start getting more real-life information. Some of the data collected in your model can serve as units of outputs and outcomes that can help predict and map the social impact of your activity.

4. Make sure your model is connected

Make a model that reflects how things might change if you alter certain variables. For example, if you start using additional marketing channels to promote your courses – like university events and career fairs, you want to be able to estimate how many additional customers can come through this new channel and make sure the model reflects this.

This might sound obvious, but from experience, it is amazing how many people forget to link their models correctly to reflect the most important possible changes.

5. Don't forget the bigger picture

Go back to your logical analysis and, every time you look at each result, ask what it is telling you. You want to avoid just staying at the detail level and start looking for the strategic implications of your numbers. If you are forecasting that you will grow to sell more than 2,000 courses a day, take a reality check – are there 2,000 young people in the community who need this service?

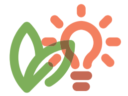
6. Perform some scenario tables or 'sensitivities'

As we all know, especially in early-stage ventures, things hardly ever go to plan as a lot of your assumptions are unproven. Perform some scenarios to evaluate the impact of changing your main business drivers.

Every business uses different variables to perform scenario analyses, but in most cases you would analyse how price and volume sensitivities have an impact on your profits given a certain set of fixed or variable costs. Sticking with the training provider example, it would be important to know how many courses you'd have to sell to make a profit at a particular price per course, and vice versa.

Once you've thought through the different scenarios, you will be able to see the cash impact of the variables, and you may rethink your forecasts to make them more realistic.

So, keep it simple, flexible and logical!



FIVE TIPS FOR PITCHING TO AN INVESTOR

Katie Mountain

Raising early-stage investment is difficult, there is no doubt about that. In Silicon Valley less than one in every 100 business plans read by a VC receives investment. For a startup looking to raise investment, this must be quite a scary statistic.

So with the first pitch being your way in (no pressure!), here are our top five tips for pitching to an investor:

1. Keep it simple.

Try to present your venture in a clear and concise way. The next step is for us to pitch the company on your behalf – so make it easy for us.

2. People matter

In early-stage investments we are backing people to deliver on their plan. Some ventures we look at don't have a track record – but the founders will. Tell us about you and your co-founders upfront – don't leave this till the last slide.

3. Show the passion

Don't hold back on showing us your passion for what you're doing. If you're not excited about it, the chances are we won't be either. Explain the need for the product you are building and why it will exist far into the future.

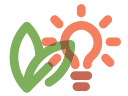
4. Be concise.

We want to hear your pitch and have time afterwards to ask questions that will really help us understand you and your business. If you have a one hour meeting, then a 15–20 minute pitch is ideal, but a pitch that lasts 30–45 minutes will limit the time we have – and probably our concentration span.

5. Do your homework.

Know what the investor you are pitching to is looking for and tailor your pitch. As an impact investor we prioritise social impact, so we look for compelling pitches that convince us not only that an entrepreneur can create a thriving business but also that he or she can transform millions of lives.

Pitching can seem scary, but these five tips will hopefully calm your nerves!



FIVE TIPS FOR SURVIVING THE DUE DILIGENCE PROCESS

Isabel Newman

You've done all the hard work of securing interest from the investor you've had your eyes on – you've given your pitch, met the fund's executives, and discussed heads of terms. So, what do you do now to survive the due diligence process?

We enter into detailed diligence with about 1 in 20 of the companies that we review the business plans of. Sometimes the combination of the volume of work along with the very high stakes can make it feel like quite a daunting process (for both parties!), so here are some tips on how entrepreneurs can survive the diligence process:

1. Know your facts

To help evidence the stage of your business, investors will be looking for data on your performance to date, such as user numbers, traction, impact data etc. Having this information to hand, as well as showing how you analyse and react to it, makes for a very good start.

2. Curb your enthusiasm

To save yourself the head (and heart!) ache of missing targets in the future, try to present and agree a realistic plan at this stage of the process. Promising the world and failing to deliver doesn't make anyone feel good, so balance out your ambition with a healthy dose of realism.

3. Get the home advantage

Being on home turf can be great for a boost in confidence, so invite investors to your place so they can see you in context, meet the team, and get into the heart of the action.

4. Plan carefully

To help keep things on track, agree a detailed plan and timeline with your prospective investors and check in with them regularly to make sure things don't slip. If organisation doesn't come naturally to you, enlist a colleague to help.

5. Be patient

Due diligence can be a time consuming and demanding process, but take a timeout to remind yourself why it is you approached your investors in the first place and of the value you believe they will bring.

SIX TIPS FOR GROWING YOUR BUSINESS ONCE YOU'VE RAISED INVESTMENT

Matt Mead

You've had months of presentations, meetings, knock backs, negotiations, then finally a 'yes', followed by a legal completion process which always feels harder than it should.

But what happens after the investment has been raised? Are there any lessons about how you make that capital really deliver on impact and value?

Every organisation is different, every entrepreneur is different but after 20 years of investing, first in the venture capital field and now in impact investing, there are a few common observations that I can make:

1. Building your product

Spend wisely on product development and engage with your target customers as early as you can. Lean Startup guru, Eric Ries, highlights the importance of the minimum viable product. Essentially, don't waste money building a product or service that users don't want – test, get feedback, iterate until you have something that delights users and then look to scale.

2. Don't hire in a hurry

A large proportion of invested capital is used to hire and build up a team. Hopefully you will have identified your next hires already and know them well but getting the right team takes time and getting it wrong can be costly. So hire with caution and from networks you trust.

3. Think carefully about marketing

Don't waste too much capital building demand if the product isn't ready. Really think through the marketing mix to make sure that when you are set to go you can reach your market cost effectively.

4. Capture data

Monitoring and responding to trends – as well as ensuring you record what investors, customers and your own team need to run the organisation – is really important.

5. Be honest and open with your shareholders

They have backed you, your team and your idea. Share challenges and successes with them – the worst thing you can do is surprise them with bad news. The sooner an issue is shared, the sooner you can work together to make changes.

6. Track the money carefully

Be on top of every pound, who owes you money, what your commitments are and plan with rigor. It may seem obvious but I have seen many early-stage organisations with small but growing revenues, suddenly finding that the cash is flowing out pretty quickly. If you can't do the accounting and planning then find someone who can.

This list isn't exhaustive and with every new investment I still learn lessons. But remember the amount of time it took to raise money: investment capital is precious and you really only want to raise it again when you have delivered impact, grown value and have investors calling you!

THREE TIPS FOR THINKING BIG

Joe Ludlow

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Well, I'd agree that the scale of the problems we see them taking on are large. Those tackling financial exclusion, for example, are faced with eight million people who can't get access from banks.

But do social entrepreneurs really think about and plan for some other aspects that are key to scale? I'm going to look at three aspects of scale I think are important: scale of delivery; scale of capital required; and economies of scale.

1. Meaningful scale relative to the size of the problem

Meaningful scale is one of those subjective terms we use a lot in our office, assuming we know what each other means, without ever writing it down. So here's my attempt to do so: the solution could be delivered to 10 per cent or more of the population experiencing the problem. So 800,000 financially excluded people; 85,000 dementia patients etc. Right from the start, I think we need to be designing and supporting solutions that can credibly claim they could be delivered at meaningful scale.

2. Recognise the scale of capital investment and identify sources

So once we've thought about meaningful scale, we need to think about what it will take to build an organisation that can supply at that level: usually a lot of money, much more money than social entrepreneurs expect/plan for.

So, for example, if you want to make affordable £500 loans to the two million people currently confined to payday lenders, you'll need access to £1 billion plus the capital needed to build the capability to deliver on this scale (£20m+ surely?). Even to deliver on a meaningful scale, you'll still need access to £100 million to cover 10 per cent of the affected population.

My point is not that you shouldn't bother because those numbers are massive. Rather, those numbers take us into territory that the social impact investment market and grant makers can't service at their current scale.

3. Economies of scale and improving economics with scale

If we have an intervention that can achieve meaningful scale it's likely that the cost per person served could come down – you just have to focus on trying to achieve this as well as increase your sales. There are a number of reasons why this should be true:

- Economies of scale – getting things cheaper when you buy in bulk.
- Economies of utilisation – sharing the cost of fixed items like an office, across more units.
- Value engineering – improving the design of the product/service and the way you deliver it to make it cheaper.
- New technology enables you do it differently (think Skype call rather than face-to-face).

Remember that the cost of the Motorola mobile phone in 1983 was $4,000 and nobody would have told you the problem of being able to call anybody from anywhere was an easy one to solve. Adjusted for inflation over the period 1983 – 2015 the cost of a mobile phone today should be £12,000. But instead it's more like £25 for a basic model.

Scale doesn't just happen. The best innovators design – and plan their venture – for scale.

FINAL THOUGHTS

We hope this provides a useful insight in to how we as impact investors think, what we look for and ultimately how to survive the process of raising investment.

Raising investment is difficult and is not right for every business. However, when you secure the right investment from a partner that shares your vision and values then it can be a winning formula to achieving scale and success.

We are always on the lookout for exciting investment opportunities that can create real and lasting social impact and can produce a return on investment. If you are working on a venture in one of our target areas then get in touch!

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