Backdrop for the Creation of Mustard Seed

The term "Impact investing" was first coined in 2007, at a meeting convened by the Rockefeller Foundation. However, the concept has existed for many years. More recently, the report of the G8’s Social Impact Investment Taskforce has signaled further global attention on and significant advancement of this space.

Increasingly, investors express an interest in pursuing both financial and social/environmental returns. In most parts of the world, however, a perceived dichotomy persists between the two. Groups focused mainly on financial gain tend to screen out investments that may result in great societal impact but carry greater risk. These groups may also stray away from opportunities that will take longer to realize value. On the other side, investors who are more focused on social/environmental impact may be too soft on expectations for financial growth. In some cases, investors are less comfortable rigorously screening for social/environmental impact metrics, in the way that they might rigorously screen for financial return. Further, some impact investing groups split the difference: they designate one portfolio to ensure financial return and one portfolio to drive return on social/environmental outcomes.

Overall, the generally perceived trade-off leaves room for new approaches to intertwine social/environmental and financial results.

In trying to manage social/environmental impact, a number of themes and challenges have emerged:

- **Resources**: companies – especially in their early days – may lack the time, personnel and budget to focus on much other than ensuring that the company survives; any distraction from survival puts the enterprise at risk
- **Comparison**: it may be difficult to compare the “goodness” generated by one company vs. another; this problem has been tackled by the GIIN and IRIS, among others
- **Convergence**: How (and whether) to have a standardized set of reporting metrics can be a challenge
- **Values**: even in a company with a strong social/environmental mission, operations may or may not align with those values; B-Corp is one example of a group tackling this issue
- **Use-ability**: impact reporting frameworks need to be manageable and to evoke the right questions during the diligence process; Big Society Capital and Impact Ventures UK are both pioneers in this area
- **Alignment**: required tracking and reporting is not always – but should be – useful, and not overly burdensome, for the entrepreneurs and teams running the companies
One clear challenge here is the lack of a common unit, such as monetary currency, which helps to understand and compare social/environmental returns across companies. Statistics that do apply generally, such as the number of employees or jobs created, are not often meaningful or granular enough to provide context and insight. Additionally, while outputs may be tracked as indicators of outcomes, the correlation between the two can be questionable. For example, the number of nurses trained by a program may not correlate with desired results of that training.

Furthermore, the gap between investors and entrepreneurs has been commented upon repeatedly in this field. Mis-alignment stems, in part, from the desire of investors to see neatly packaged returns across their companies, and the fact that entrepreneurs may face competing priorities in keeping their businesses afloat. Mis-alignment is compounded by geographical, socio-economic, and philosophical gaps between these groups. It also may be exacerbated over time; growth of and competitive pressures on a company may lead to decisions that drive short-term financial gain at the expense of socially and environmentally responsible practices.

**A Unique Position for Mustard Seed**

Through Mustard Seed’s direct involvement with start-ups and our focus on seed capital, we are able to address many of the challenges above. We implement a structure wherein:

- We are in close proximity to our entrepreneurs by nature of our interactions
- We develop our impact approach and metrics directly with our entrepreneurs; Mustard Seed and entrepreneurs co-drive measurement and reporting frameworks, while the Mustard Seed team structures meaningful cross-sector and cross-company comparison tools, to layer on top of the company-specific approach
- Our approach is completely actionable and focused on driving concrete results

“We impact metrics and reporting are not an academic exercise. These are core KPIs that drive our business growth and correlate to our success.”

Marc Zornes, Co-Founder of Winnow Solutions, Mustard Seed Porfolio Company

More importantly, however, we are in a position to invest in people and companies for whom financial and social/environmental impact are inextricably linked. How can we do this?

1. Through our unique access to top-tier graduates, we are in a position to tap into a new class of entrepreneurs whose products and services have impact at their core; building relationships early allows us to position ourselves well among this group
2. Individuals who previously chose corporate and professional services careers are increasingly leveraging their skill sets to do good while making money; we seek to invest in these entrepreneurs
3. We look for companies where long-term value is linked to responsible practices in what we term the ‘Virtuous Venture Cycle’; these companies are able to generate
   - Positive press and brand association among increasingly conscious consumers
   - More loyal staff and higher numbers of applicants for open positions
4. Through the sheer volume of unique investment opportunities we are able to generate – so far 1,000 companies annually and growing – we are able to screen for the right intersection of financial and social/environmental focus; we seek to eliminate or reduce trade-offs between the two.

Additionally, we deliver commercial outcomes and mission lock by leveraging the Mustard Seed Member Network. Mustard Seed will not invest unless the Member Network is able to contribute a significant commercial outcome ex-ante. Mustard Seed connects network-rich investors to network-poor, yet idea- and energy-rich, entrepreneurs. Further, the Member Network allows us to scale and retain social/environmental impact by taking board seats where appropriate and desired.

We also are exploring the creation of a fund, in conjunction with the Network, to avoid unwanted economic and mission dilution in successive rounds. The Network and Fund may invest pari passu in round one. In later stages and larger rounds, the Fund takes a lead role and ensures continuity of mission leadership. The hybrid approach of Network+Fund is innovative and, critically, increases the probability of overall and integrated returns.

Mission Mustard Seed – ‘Venture for Good’

Mustard Seed’s mission is to change the world by smartly deploying venture capital for good. We seek to invest in the most talented early-stage entrepreneurs, whose business models and impact-oriented drive will transform their sectors. We take our mission of transformation seriously. We look to grow companies that will achieve a tipping point by:

- Addressing core causes of social or environmental problems
- Achieving a scale of impact that cannot be ignored and that forces adoption
- Providing a technology or solution that will revolutionize the sector, and/or
- Creating competitive advantage through social/environmental impact and branding

We believe the venture space is ripe for a new approach, given the sea change in entrepreneurial focus and mindset that has occurred since 2008. Further, Mustard Seed is well positioned to deliver value and mitigate risk in venture impact investing. Mustard Seed’s mission is delivered, and impact measured, through multiple levers:
1. Investment in and engagement with companies to create mission lock and deliver against outcome KPIs
2. Presence on campus and engagement with students at the world’s top schools: we establish early relationships that pay off later as entrepreneurs mature
3. Strong relationships with local and national government, as well as university leadership: partnerships better position both Mustard Seed and our investments
4. Corporate engagements, including innovation challenges: we are well-positioned to understand and make the link between multi-nationals and diverse innovators
5. Positioning with the press: we spread our message and bring valuable attention to seed-stage companies through Mustard Seed events
6. Our angel network: talented, highly-connected global professionals motivated to offer their time and networks to achieve transformational outcomes

As members of the Mustard Seed network engage with new companies, they become further committed to and personally interested in the potential to achieve impact and grow sustainable businesses. Alignment around a common mission, on top of a business agenda, lends a powerful advantage. This approach will contribute to growing an influential and increasingly tight-knit community of investors.

Superior Returns Alongside our Mission

Mustard Seed is positioned to deliver superior financial returns to conventional venture capital:

1. We invest in a virtuous venture cycle: we not only target companies that create value by servicing society, but we also actively engage with these companies to augment social/environmental dividends, driving further economic value
2. We have a large and proprietary opportunity set and an intensive filter: annually we have over 1,000 submissions, 150 pitch finalists, 40-50 companies for detailed due-diligence, and 10-20 investments
3. We achieve attractive pricing and terms: we engage with entrepreneurs early, often at university, forming strong relationships built on mutual trust; this is key as entry price, as in any investment, is a significant determinant of future financial returns
4. We de-risk our deals ex-ante: the Member Network uniquely creates commercial outcomes for our companies
5. We seek to ensure mission continuity: our innovative hybrid approach of Member Network plus Fund avoids unwanted economic and mission dilution

The Mustard Seed Impact Model

Selection—The Mustard Seed Impact Model selects for strong targets:
- People: Is the team exceptional and trustworthy, passionate about the business and mission?
- Focus: Does the business provide a compelling social or environmental solution in one of Mustard Seed’s Action Areas: family & community, economic inclusion, education, the environment, or health?
- Alignment: Is impact core to company strategy? Is the product/service itself the impact, or is there a trade-off implied between profit and purpose?
- Measurement: Can the outcomes be measured and monitored?
• Scale: Can the company achieve significant scale of impact? What is the scale of the problem to be addressed? When we measure potential impact, using our cross-sector comparison metrics, how does this opportunity compare to other possible investments?
• Fit: Is the Mustard Seed network the right partner to support this mission?

**Measurement & Monitoring** – We target clearly defined and measurable outcomes:
- Company-level metrics: We work with entrepreneurs to identify company-specific social or environmental metrics that, in addition to being clearly defined and easily measured, are core to successful business and ongoing operations. Company-level metrics may be unique to that company.
- Sector metrics: We track clearly defined metrics that are specific to each Action Area, and comparable across all businesses in that area. All resource efficiency companies track dollars of resources saved. Healthcare ventures track days of quality life created.
- Time-bound metrics: While the above measurements will be tracked throughout a company’s lifecycle and provide longitudinal data, we also work with entrepreneurs to identify critical impact-related measurements core to the company’s success at this point in time. This approach allows us to better support early stage companies.
- Long-term value metrics: We are also exploring the development of a longitudinal model that will track key impact indicators correlated to a business’s long-term health. For example, better businesses have happier staff members and attract more applicants for open positions. They are able to select from top talent. Environmentally responsible companies are also better positioned to generate long-term value. Drawing on the learnings of B-Corp in the US among others, we will build out a more detailed model as our companies mature and move into later stages of growth.

Tracking and reporting on the right metrics allows us to not only hold ourselves accountable for impact, but also (1) demonstrate value to future investors and (2) ensure “mission lock,” or the achievement of the company’s social/environmental mission over time.

**Growth & Exit** – We employ the following strategies to ensure mission alignment and achievement throughout the lifecycle of our investments:
- Board seats: Mustard Seed takes at least one board position with all investments. The Mustard Seed board member(s) ensure that social/environmental mission remains core to the business and can veto changes that would harm this purpose.
- Governing documents: We look for social and environmental goals and outcomes that can be formally captured in governing documents. We also acknowledge that products and services may change as the company grows. Governance must support mission focus while allowing for business evolution.
- Mission-locked shares: Companies may set aside specific shares with governance rights and mission-related protections. Mustard Seed may serve as a “Golden Shareholder” whose voting rights protect the social/environmental direction.
- Mission-focused finance structures: Social impact bonds and other structures may allow us to fulfill our mission flexibly and also through charitable organizations.

<table>
<thead>
<tr>
<th>Various debt structures</th>
<th>Convertible loans</th>
<th>Mezzanine financing</th>
<th>Equity shares</th>
<th>Social impact bonds (charity)</th>
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</thead>
</table>

**Governance conditions**

**Mission-locked shares**

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• Aligning later-stage funding: Relationships with like-minded investors could provide access to capital aligned with our companies’ social/environmental goals. Mustard Seed is also raising a follow-on fund, to support the growth of our companies while allowing them to continue to focus on their mission.

As portfolio companies mature, many will become acquisition targets for large-scale, traditional companies and investors in their sectors. In some instances, companies could be acquired in order to deliver near-term financial returns through stripping away more costly social or environmental practices. Portfolio companies could also be targeted by larger, less socially/environmentally-focused competitors who perceive these emerging brands as threats. To ensure “mission lock,” we are exploring funding options for our later stage companies. Our entrepreneurs will need access to capital that allows them to scale not only their financial returns but also their social/environmental returns. Solving this funding gap will be critical to achieving Mustard Seed’s overall mission.

*The Mustard Seed Impact Model – Sample Tools*

**Selection Gates & Thresholds**

*Initial Selection Gates: Front-line criteria to screen opportunities*

<table>
<thead>
<tr>
<th>Gates</th>
<th>Measures</th>
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<tbody>
<tr>
<td>Alignment: Is social/environmental impact intrinsic in the company’s products or services? Does the solution address a problem in Mustard Seed’s focus areas?</td>
<td>Yes or No</td>
</tr>
<tr>
<td>Mission Orientation: Is the team clearly oriented toward achieving social/environmental impact, with the potential to address a route cause or transform a sector? Is the company’s mission clearly articulated?</td>
<td>Yes or No</td>
</tr>
<tr>
<td>Viability and Scale: Does the business model show potential to achieve sustainability and significant scale?</td>
<td>Yes or No</td>
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If the answer to all of these questions is “yes,” the opportunity passes through our initial gate and we continue to explore investment.

Mustard Seed seeks to invest in companies whose products or services by their nature produce social or environmental benefits. If Mustard Seed investments are viable enterprises, they should necessarily achieve social and environmental impact. Winnow, an early Mustard Seed investment, measures and monitors commercial food waste, thereby leading to reduced resource use. Winnow will achieve financial success and sustainability through a product that necessarily produces environmental benefits.

*Primary Selection Thresholds: First round of criteria to evaluate investment opportunities*

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<tr>
<th>Thresholds</th>
<th>Measures</th>
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<tbody>
<tr>
<td>Impact</td>
<td>Strong, Medium, Weak</td>
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<tr>
<td>Depth: Does the enterprise meaningfully solve problems in an Impact Area and cause a multiplier effect?</td>
<td>Strong, Medium, Weak</td>
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</table>
Companies that rate strongly across the board signal strong potential for Mustard Seed investment. Areas that appear as weak or medium strength may signal the following:

- A potential obstacle or trade-off to be considered, e.g. an environmentally-oriented enterprise may generate resource use efficiencies while not serving a marginalized group; given significant environmental benefits, we may be willing to live with this trade off

- An area for further follow up and due diligence, e.g. a business providing discount consumer goods for marginalized communities may be at risk of losing mission focus due to financial pressures or future, non-aligned investors; we would need to further examine the motivations of the founders, the potential to add mission-lock enforcers, and aligned growth and exit options

- An area where Mustard Seed can add value, e.g. a biotechnology company may have a promising patent but lack access to distribution channels; we would assess whether we could add value by opening the right doors or recruiting talent

Secondary Selection Thresholds: Second round of criteria to evaluate investment opportunities that pass first-round thresholds

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<tr>
<th>Thresholds</th>
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<tr>
<td><strong>Impact</strong></td>
<td></td>
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<tr>
<td>Relevant (Sector-Level) Impact: Considering other opportunities in this sector, how do the social/environmental outcomes of this company compare?</td>
<td>Strong, Medium, Weak</td>
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<tr>
<td>Long-term impact: Are there viable exit strategies that will maintain/assure continued achievement of the desired social/environmental impact?</td>
<td>Strong, Medium, Weak</td>
</tr>
<tr>
<td><strong>Portfolio Fit</strong></td>
<td></td>
</tr>
<tr>
<td>With Mustard Seed: To what extent can Mustard Seed support the growth/success of the company at this stage?</td>
<td>Strong, Medium, Weak</td>
</tr>
<tr>
<td>With other investments: To what extent can the company/team leverage other companies in the portfolio toward success?</td>
<td>Strong, Medium, Weak</td>
</tr>
<tr>
<td><strong>Governance</strong></td>
<td></td>
</tr>
<tr>
<td>Internal enforcers: What structures or arrangements is the company using to ensure mission alignment and success?</td>
<td>Strong, Medium, Weak</td>
</tr>
<tr>
<td>company willing to adopt to ensure mission and performance lock?</td>
<td>External enforcers: What external structures or arrangements can be applied to ensure mission and performance lock?</td>
</tr>
<tr>
<td>---------------------------------------------------------------</td>
<td>--------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td></td>
<td>Strong, Medium, Weak</td>
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A key question for Mustard Seed is, why invest in this company versus other available options? Mustard Seed makes this decision by translating company metrics into sector-level metrics that allow for comparison across diverse companies. For example, two quite distinct investments in the health care space – one a smart phone application to alleviate depression, and another an experimental cancer treatment – can both be compared based on the number of quality days of life that each company generates.

Impact-oriented governance structures—and the willingness of companies to adapt them—also play a key role in investment decisions. From Golden Shareholders to external motivations to incentivize mission lock, Mustard Seed will continue to explore a range of options to ensure that seed investments are impactful for the long term. Mustard Seed will also explore the creation of an aligned fund to complement seed investments and substantially grow promising companies. At this stage of maturity, and with sufficient capital, companies can receive help from the mission-aligned fund in adopting more rigorous evaluation and reporting practices, as well as tighter governance structures.