A climate of adventure: Why VC needs to rediscover risk

Investment in UK climate technology is at an all-time high with over £2B raised by domestic ClimateTech startups last year alone. However, early-stage investment into climate technology, particularly climate hardware, still lags significantly behind the venture safe havens of SaaS and Fintech.

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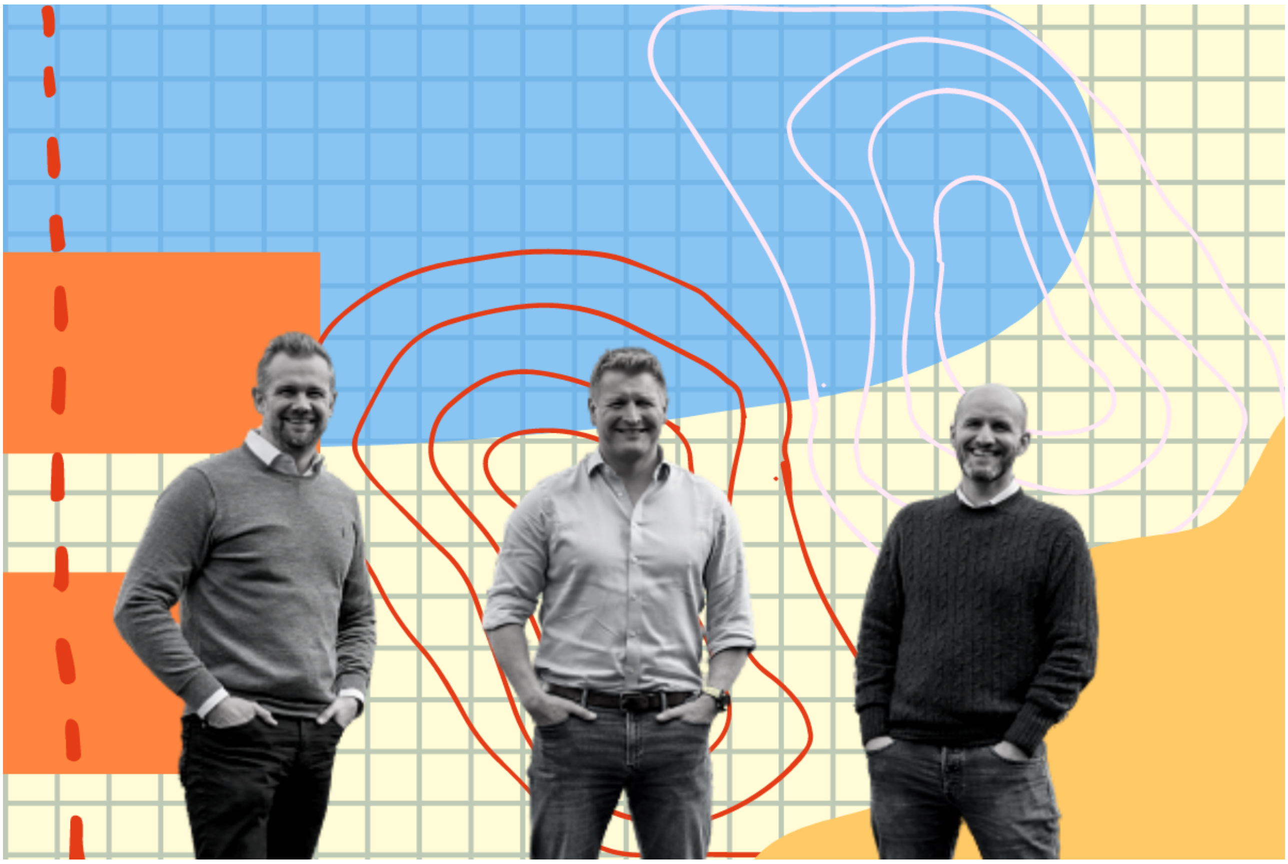
While two billion pounds is far from an inconsequential figure, somewhere along the line, venture investing got too prescriptive and predictable. Early-stage investors are increasingly following a tried and tested methodology, rather than thinking outside the Shoreditch bubble and beyond short-term paper gains.

So why has venture drifted to the unadventurous? Partly due to the belief that software startups offer a more immediate potential of rapid growth and partly because of herd mentality – VCs feel more comfortable investing in the same businesses as their peers and due diligence seems simpler if you’ve seen dozens of companies with a similar business models and growth plans. If you’ve had success backing certain types of software businesses, the temptation is to stick to what you know.



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World-class climate technology businesses, on the other hand, are harder to find and even harder to model, particularly without specialists on your team with a deep knowledge of the numerous sub-sectors within the ClimateTech space. Even if you do have such a specialist or specialists, from a purely commercial standpoint, early-stage ClimateTech businesses often have the aura of being impressive science but lacking the early profit potential of FinTech or SaaS.

These arguments might have some merit, but they largely ignore the risk-taking instinct that used to define Venture Capital. Where is the desire to seek out exponential returns by backing unusual businesses? Venture Capital or Adventure Capitalism, as it was originally called, used to be just this, adventurous. Risk-taking, inquisitive, unconventional and ambitious, it was about backing businesses that traditional investors or banks shunned.

It’s also evident that primarily backing software firms is not without risk, many early-stage investors have encountered significant headwinds this year, as technology companies in both the public and private markets continue to struggle. Former VC darlings, including Klarna and Hopin have seen their valuations fall significantly this year and have been forced to reduce their workforces in a series of well-publicised cuts.

From Software to Hardware

Pleasingly, the desire to invest in green initiatives is more apparent than ever with numerous impact funds launching worldwide, including Al Gore’s new $1.7B Sustainable Solutions Fund, however even within the climate space itself, capital allocation seems to be skewed towards particular types of business, be that commercial electric vehicles manufacturers or renewable energy providers. Sustainability-focused British startups have flourished in this climate in recent years with OVO and Octopus Energy achieving unicorn status and firms within buzzy sectors such as synthetic meat and urban mobility enjoying rapid expansion, and while this is undoubtedly a positive development, here to we see certain investors playing it a bit safe.

There’s nothing wrong with backing these companies and sectors, in fact it makes plenty of sense. Synthetic meat and e-scooter companies are highly visible, well-marketed and solve real world issues (especially if you’re a recently converted vegan, living in central London). However, capital flowing to these ‘natural fits’ and ‘easy wins’ is funding that could be directed to unconventional businesses with less immediately obvious solutions with the potential for far greater positive climate impacts. These outliers are often businesses addressing challenges that very rarely hit the back, let alone the front, pages of the papers but are essential for greening up industry and fixing outdated and environmentally damaging structural issues in our economy.

In short, capital doesn't always seem to be finding its way to where it is most needed and where it could truly benefit both the investors themselves and society as a whole. Recognising this, our approach at Elbow Beach is simple enough: identify and support exceptional entrepreneurs working to solve the biggest environmental challenges. This has already led us towards unconventional businesses, including asparagus picking *robots*, a blockchain-powered *carbon credit* marketplace and a company that converts brewery wastewater into *bioenergy*.

While we do not doubt the commercial viability of these companies in the long-term, we are more than willing to accept that their path to profitability may be longer than the latest accountancy software app. Our confidence in these companies comes not only from our belief in their founders, but also the real-world climate issues they are solving, investors underplaying these factors and focusing on short-term gains run the risk of missing out on remarkable returns.

Venture Capital should be about empowering entrepreneurs and making their unique ideas a reality and if we can improve the world around us while doing it, all the better.

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