CUSPCAPITAL

Digital technologies and sustainability will join forces *to disrupt markets and the way billions of people live.*

Contact

Cusp Capital Partners
Jakob-Funke-Platz 2
DE - 45127 Essen

www.cuspcapital.com

The Cusp

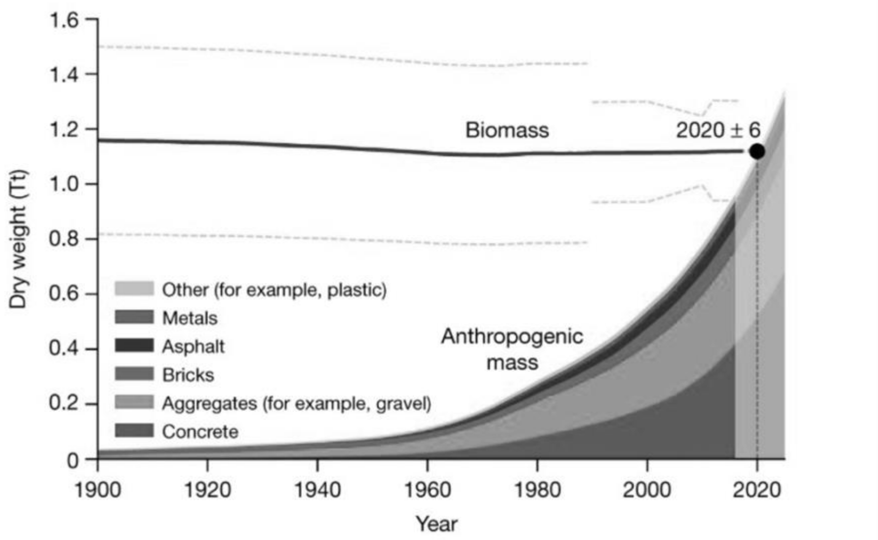
From short-term thinking *to sustainable business*

Respecting our environment, protecting the rights of workers, building trusted relationships with stakeholders and implementing strong corporate governance structures are vital for building future-proof companies.

Humanity is set to reach a milestone. Human-made mass is expected to outweigh living mass on earth for the first time. Humans have literally taken over the planet – with cars, roads, houses, clothing, plastic cups etc. If current trends continue, humans will create as much mass in the next 20 years as they have in the last 110 years combined (ScientificAmerican). The continuous increase of waste, plastic and greenhouse gas (GhG) emissions is threatening the viability of the planet – and eventually our own species.

Fig. 1: Biomass and anthropogenic mass estimates since the beginning of the twentieth century on a dry-mass basis.

From: Global human-made mass exceeds all living biomass



Source: Emily Elhacham et al. (2020)

The current structure of markets – and the way businesses operate within them – are a core determinant of this development. The mass-production era introduced the current linear economic model of producing, using and disposing. Companies are incentivized to stimulate customer purchases in ever shorter cycles. For example, today's average American buys a new piece of clothing every five days. And in the past 20 years, the volume of clothes Americans throw away each year has doubled (TheAtlantic).

Crucially, sustainability is not limited to environmental factors. Respecting human rights (Social) as well as abiding by laws, norms and standards (Governance) are equally important for society, markets and businesses. Environmental, social and governance considerations together form the basis for sustainability.

At Cusp Capital, we believe that following an integrated sustainability approach is key to building future-proof companies. A future-proof company needs to be aware of its impact on the environment, respect the rights of its workers, have good relationships with its stakeholders (including shareholders, employees, customers, and the communities in which they operate) and implement strong corporate governance structures.

Regulatory interventions, access to financial resources, shifting demands and social awareness paired with the power of digitization are currently driving change towards a sustainable economy.

The winds of sustainability *are blowing from different directions, creating a perfect storm*

We are currently observing regulatory, financial, market and social drivers pushing towards sustainable business practices. Digital infrastructure will be a key enabler towards a sustainable economy.

Regulatory drivers: Regulation is a powerful driver of sustainability. Signed in 2015, the Paris Agreement unites all nations in combating climate change and adapting to its effects. 196 parties have signed the agreement to date.

In the same year, the United Nations (UN) released their 2030 Agenda for Sustainable Development. As part of this agenda, the UN has defined 17 Sustainable Development Goals to stimulate actions in areas of critical importance for humanity and the planet.

The European Commission is committed to the 2030 Agenda and is pursuing a policy program to deliver on sustainability (European Commission). 30% of the COVID-19 recovery fund - Europe's largest stimulus package thus far - is reserved for fighting climate change (European Commission).

Regulation attempts such as the Paris Agreement have been criticized by some as "no action, just promises" (The Guardian). But these efforts are certainly steps in the right direction. And in any case, additional measures may prove fruitful. For example, the carbon tax introduced in Sweden led to a significant reduction of emissions in relevant sectors (Julius J. Andersson).

Financial (resource) drivers: Currently, 3772 investors with assets under management (AUM) of more than $ 2.750 trillion have signed the UN Principles for Responsible Investing (UN PRI) and thereby declared that they will integrate sustainability into their investment approach (UN PRI).

Investments in sustainable funds increased to $ 1.7 trillion in 2020, a 29% yoy increase. Q4 2020 was the strongest quarter to date with an increase of inflows into sustainable funds of 88% ($ 152 billion). European funds were leading the pack, accounting for almost 80% of total inflows (Reuters).

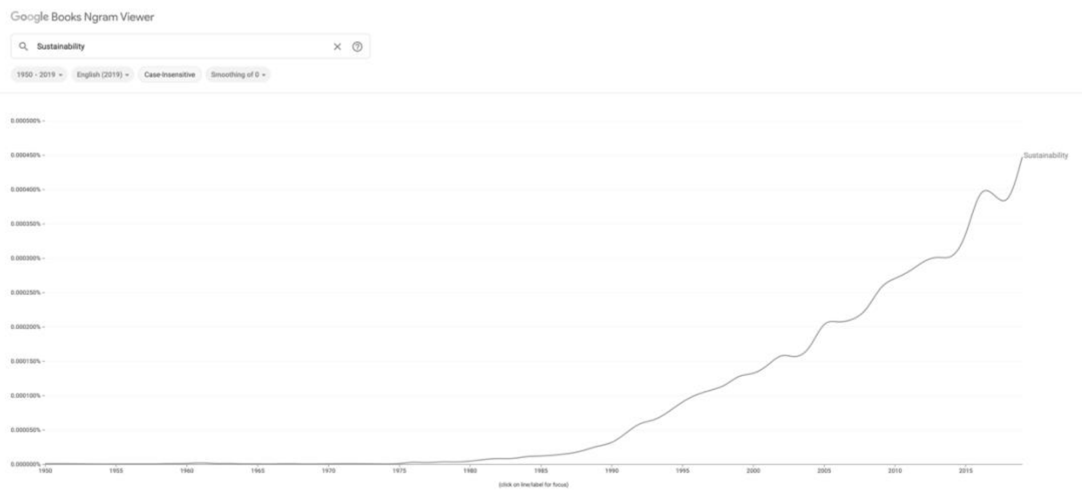
Investors are also starting to act on their fiduciary ESG duty. Rio Tinto is a candid example of this trend. Despite stellar financial performance, activist investors forced the company's CEO out after his miners had destroyed an ancient aboriginal site in Australia (Reuters).

Market drivers: Demand for sustainable and resource-efficient offerings is increasing rapidly from both b2b and b2c customers.

95% of respondents of a survey among consumers believe that their personal actions could help reduce unsustainable waste, tackle climate change and protect wildlife and biodiversity (BCG). And consumers not only talk the talk, but also walk the walk. In the United States, consumer packaged goods (CPG) marketed sustainably grew 5.6x more than their status quo counterparts (Harvard Business Review).

Increased demand for sustainable products are not limited to the consumer sector. Companies are passing the pressure on to their suppliers and service providers. Mondelez is committed to sourcing all of the cocoa for its chocolate production from sustainable sources by 2025. Unilever aims to be net-emission neutral by 2039. The company also plans to provide transparency to its customers by adding emission labels on product packaging.

Social drivers: 88% of business school students believe that learning about social and environmental issues in business is a priority and will consider sustainability when choosing their employer (Stanford Social Innovation Review). Sustainability is also heavily discussed in literature. The following Ngram chart shows how often the phrase "Sustainability" has occurred in newly published English books between 1950 and 2019.



Digital drivers: As technology investors we are especially thrilled about the role the digital paradigm plays in enabling sustainable business. Digital solutions provide transparency on sustainability by gathering, processing and distributing information more cheaply. They dematerialize entire industries by connecting humans and objects virtually and by moving key success factors of businesses from tangible to intangible assets such as brand, customer trust and IP. Eventually, much of the economy will be dematerialized.

At Cusp Capital we believe that digital technology and sustainability will join forces to disrupt markets and the way billions of people live.

The Opportunity

Sustainable business is disrupting markets *with early-stage companies taking the lead*

Sustainable business requires new business purpose, supply chains, modes of consumption and governance. At Cusp Capital we see great opportunities arising for early-stage companies to define these processes from the ground up. As partners to the next generation of future-proof champions, we have the opportunity and duty to follow a sustainable investment and ownership approach.

Business purpose

Purpose needs to move to the heart of a company and add meaning to the day-to-day experience of customers, employees, investors and suppliers. This will lead to higher employee engagement and retention, faster top line growth, lower costs and better access to capital.

To leverage purpose, incumbents need to redefine their core. But as the digital transformation has shown, they are often struggling to restructure their strategy and operations. Consequently, many big business realities will remain misaligned from sustainability goals. Merely introducing a sustainable product line, for example, will not be enough if the majority of products remain unsustainable.

Startups, in contrast, can nimbly define their core. They can align their business and product offering from the start. By embracing sustainability, they have a huge opportunity to disrupt incumbents.

Supply chains

Sustainable business needs to span the entire supply chain. Obtaining transparency on the business practices of tier-one and lower-tier suppliers is crucial.

For incumbents, issues within the existing supply chain are drawing the scrutiny of investors, regulators and consumers and threatening their businesses. Solving these issues in full operation mode may lead to disruptions in the supply chain and requires intense management attention.

Again, startups can build their supply chain with a sustainability-first approach from the ground up. For instance, instead of aiming to become carbon neutral in the distant future, they can be carbon neutral today.

Modes of consumption and ownership

Companies that have been built in the era of mass production have focused their organization and processes on products that are produced, used and disposed. Accelerated obsolescence of products works in their favor (e.g. ultra-fast fashion), leading to extensive waste.

The prevailing model of the linear economy will be replaced by circular models and dematerialization. In the circular model, products are produced, used and restored. Access to services rather than ownership of products is key. Companies offering circular models are incentivized to use long-lasting materials and design adaptable products. Prolonging the shelf life of products prolongs the duration of leases and generates value – avoiding waste instead of profiting from it.

In some cases, dematerialization can even lead to the replacement of physical goods by digital services. Digital is key to make new modes of consumption possible. Instead of buying physical CDs and LPs, today we stream music.

Startups can lead the way in enabling these new modes of consumption as they are not bound by prior investments in existing production capacities or organizational structures.

Governance

A new business purpose needs to be accompanied by appropriate governance. In the old paradigm, a company's main purpose was to maximize shareholder value measured as the present value of expected future cash flows. Inherent in this concept is the time value of money. The further out the expected cash flows are in the future, the lower is the value of these cash flows today.

While this measure of success is valid from a financial theory perspective, it may lead to wrong incentives from a sustainable business perspective. In sustainable business, actions taken today that may lead to a positive impact on the environment or society in the future add to stakeholder value.

In order to set the right incentives, actionable targets reflecting the sustainable business model need to be set, measured, disclosed and rewarded. ESG reporting is a good starting point to an integrated sustainable governance system.

Startups can build their governance structure from the ground up. They do not have to fear the political pressures that result from breaking with decade-old governance conventions.

Future champions will emerge at the intersection *of digital technology & sustainability*

Over the last decades, we have experienced the power of digital technologies to disrupt entire industries. We expect massive opportunities to emerge at the intersection of digital technology and sustainability. Leveraging data & software will enable the dematerialization of industries and enable new consumption models.

We are currently witnessing the installation phase of the infrastructure for digitally enabled sustainability (Perez 2003). What machines and mass production facilities were to the industrialization era, processing power and software are to the digital age.

The digital paradigm is replacing physical assets with intangible assets and access to services. For example, the key success factors of the automobile industry are shifting from hardware to software, digitally-enabled dematerialization at its best.

Data and software will be critical for solving some of the most pressing sustainability challenges:

- Transparent supply chains & internal operations: measure sustainability to manage it.
- Optimized resource consumption: improve the footprint of buildings, batteries and beyond.
- Better health & well-being: provide access to physical and mental health-care.
- High-quality education: break the barriers to education.

Digital technologies are also a key enabler of more sustainable and responsible **consumption models**:

- Circular business models: turn products into services.
- Secondary markets: re-use products that are too good to go.
- Integrated sustainable brands: directly access customers with fully sustainable processes.

At Cusp Capital we believe that digital technologies will be crucial to driving sustainable business. In the next decade, companies coherently fusing digital technology and sustainability will grow regardless of economic cycles and become truly future-proof champions.

Together, these companies will contribute to what Carlota Perez has called "the golden age of the digital revolution" (Perez 2003).