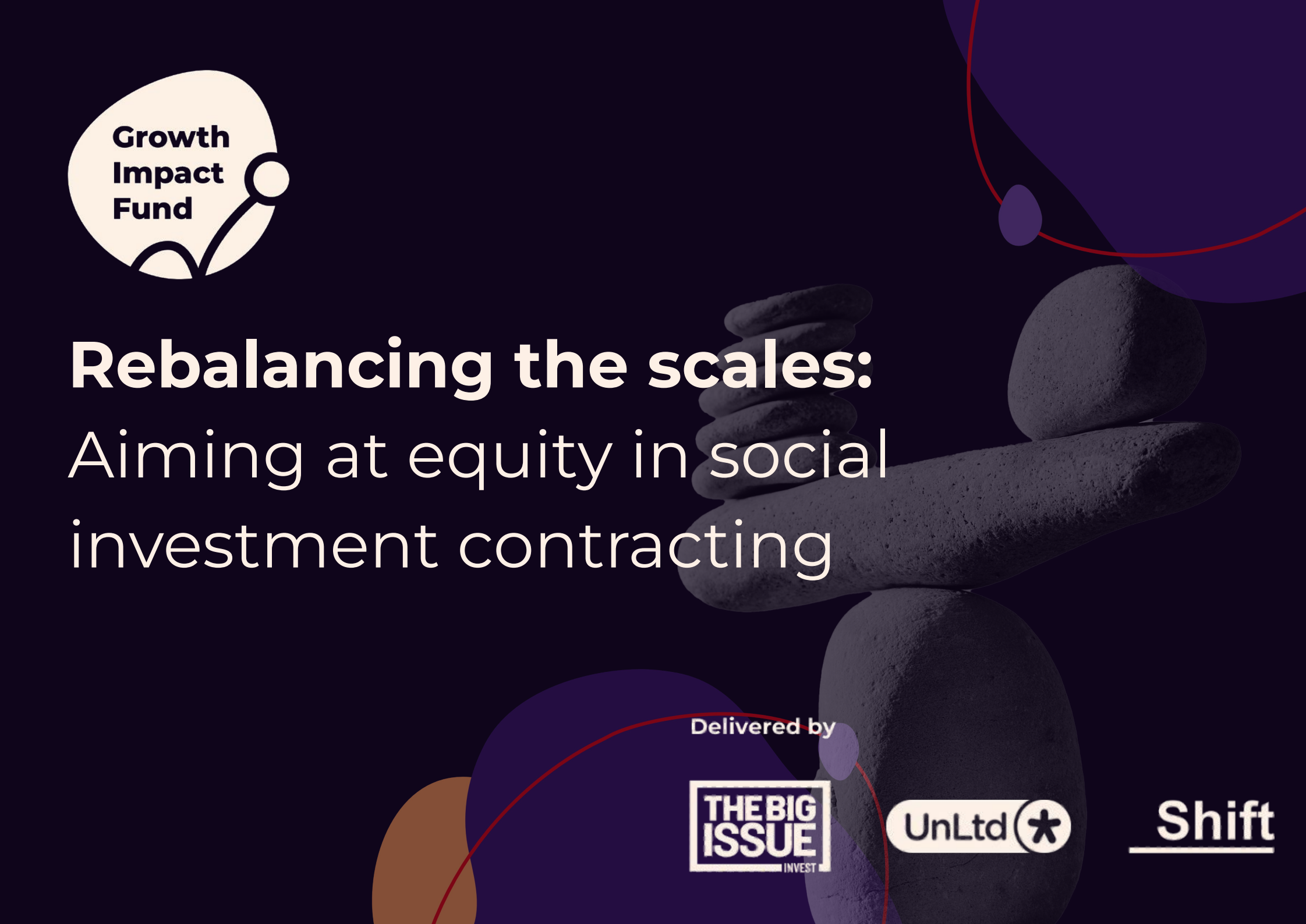
Growth Impact Fund

Rebalancing the scales: Aiming at equity in social investment contracting



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Context

Background to the report

At Growth Impact Fund, we aim to provide a more inclusive and equitable investment process to all our investees. This is an integral part of our wider commitment to increase access to capital for diverse-led, early-stage social purpose organisations (SPOs) across the UK.

A key step within the investment process is contracting and negotiating deal terms. This process, towards the end of investees' journeys, is prone to uneven power dynamics. This can create extra barriers for SPOs to access funding and challenge any fund's ability to deliver an equitable experience. Founders often lack access to the equivalent resources and expertise when negotiating contracts, making it almost impossible to negotiate from a level playing field.

For this reason, Growth Impact Fund offers pro bono legal support to approved investees - ensuring equal legal representation is a bare minimum to support more equitable outcomes. And we'd like to thank the legal firms whose contributions have made this possible.

Despite the commitments and provisions made around this, we're still learning how to provide this support in the best way. While we've seen free access to legal support offering significant benefits for founders, it comes with challenges and trade-offs we didn't anticipate. This report surfaces these unanticipated learnings, sharing the key themes we've seen so far as we've navigated this stage of the process with early investees.

We've structured this report as follows:

- **Section 2** shares broad learning from GIF and key insights from interviews with seven of our investees and six legal professionals. This section also shares how we're using these learnings to improve the Fund experience.
- **Section 3** presents summary learnings from a learning roundtable run in partnership with Bates Wells and partners across the Equalising Deal Terms project. This section outlines key discussions from the event, our own findings, and shares implications for the wider sector around term sheets and the contracting process.
- **Section 4** concludes the report by sharing our next steps as a Fund, and making some calls to action that can support others to move forwards.

Spotlight on the legal learning roundtable

This event brought together 25 legal professionals, founders and social investment stakeholders. We explored how to shape fairer contract terms in the social investment sector, and broader opportunities and challenges in bringing an equitable process to life. We'd like to thank everyone who attended and contributed to the event. See section 3 for further details.

Context

Equalising Deal Terms Project

The Growth Impact Fund is committed to open and transparent dialogue with those who share our mission for a more equitable social investment market. We see sharing learnings and collaboration as essential to positive change across the sector.

In line with our mission, we have been in regular communication throughout our learning activities with the Equalising Deal Terms project (EDT). EDT is an initiative facilitated in partnership by the Equality Impact Investing Project and Bates Wells. The initiative seeks to address power imbalances between impact investors and their investees that arise from current practices relating to investment terms, legal documents and processes. We'd especially like to thank Sung-Hyui Park and Rana Zincir Celal for their willingness to share insights and work in collaboration to influence the sector.

In Section 2 of this report, we share a range of improvements we're making to our processes to better align with EDT's recently published "Investor Key Principles". We have also used these principles to help us consider broader opportunities for the investment and legal sector in Section 3. These principles have been foundational to our practice, and we strongly encourage readers to review the EDT Key Principles in full along with the paired publication on Investee Perceptions of Power Dynamics in Legal Processes. Together, these documents contain a wealth of broader insights about investee experiences of the legal process, and practical calls to action to help social investors better embed equitable practices.

Investor Key Principles

01
We **acknowledge and agree that power imbalances regularly exist** between impact investors and investees, and that this can **harm the positive impact** that we all wish to achieve. We therefore accept that we have a **responsibility to challenge** them.

02
We **affirm the value of our investees as equal partners**, whose experience, insights and expertise are **crucial** to achieving our **shared goals** of effecting positive social and/or environmental change.

03
We acknowledge and agree that **investment deal terms, legal processes and documents can contribute to deepening power imbalances** between investors and investees.

04
We commit to shaping and using investment **deal terms, legal processes and documents that are clear, balanced and reflect an equitable sharing of risk** between all parties.

05
We will strive to **support our internal and external stakeholders and partners to understand and uphold** these Principles, and to hold each other **accountable** to them.

02

Learning and Improvement: Spotlight into Growth Impact Fund

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The Fund's Legal Process

After our investment committee has approved a deal we move into the Fund's five step legal contracting process.

The themes shared below speak to insights that have surfaced across the process as a whole, but we've also identified more specific improvements within each step to ensure a more efficient and effective process can be delivered in the future.

The themes shared in this section are specific to the Growth Impact Fund. The process itself and insights shared will likely differ to other investment funds in the sector.

Step 1
Draft contracts are sent out
Investees approved by committee receive Fund draft contracts.

Step 2
Investees are matched with legal support
The Fund works with pro bono coordinators to arrange appropriate legal support for investees and parties are introduced.

Step 3
Asynchronous negotiations between parties
The Fund and investee conduct negotiations through their respective professional legal counsels.

Step 4
Final agreements and contract finalisation
Once agreement is reached, contracts are finalised.

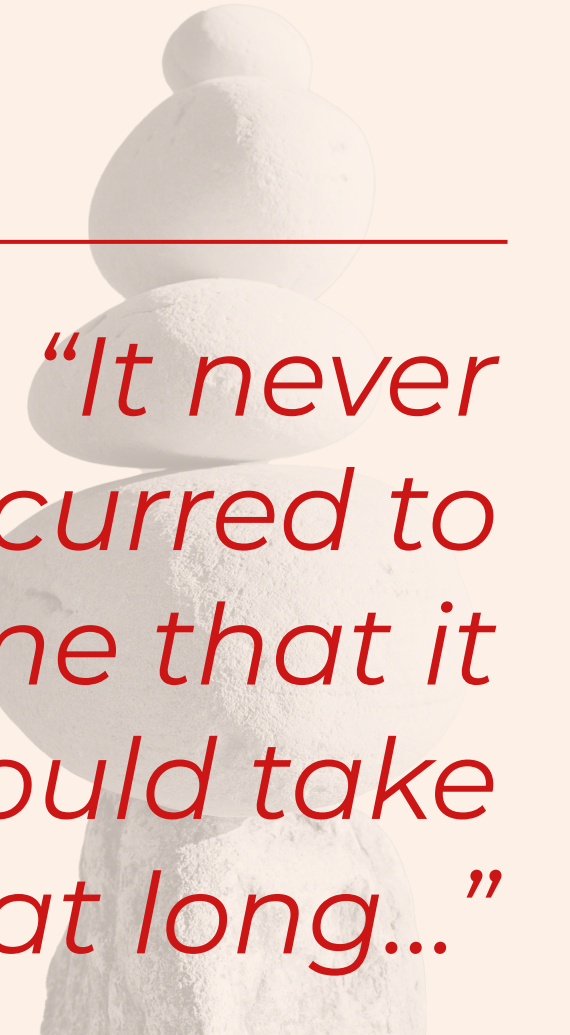
Step 5
Contracts are signed
Once contracts are signed, money is disbursed to investees.

Learnings on **Timelines**

Longer than anticipated.

Since our launch, we've been learning by doing at the Growth Impact Fund. Quite quickly, we realised that we would need to explore how we could set better expectations and reduce the time it was taking to negotiate deal contracts.

To date, it has taken us upwards of two months to negotiate final contracts with investees, after deals are approved by our investment committee. Some deals have taken much longer. Our decision to offer pro bono support has often extended the contracting process in unexpected ways, and we now need to explore the right balance between practicality (e.g. getting the deal done in a timely manner) and power dynamics (e.g. making sure we're negotiating on a more equitable playing field).



"It never occurred to me that it would take that long..."

What we've heard from **investees**

Protracted timelines. Despite an ability to bring down negotiation time on recent deals, we've not always been able to release funds within the timeframes that founders have planned to use them. Many founders have been surprised at how long the process has taken and would have benefited from clearer expectation-setting by the Fund.

Delays have consequences. We've seen protracted timelines leading to unforeseen consequences. For example, one founder had to take out a personal loan to bridge a gap in cash flow before the funds were made available. Others have acted on growth plans in ways that proved premature, having to adapt or even roll-back planned activity.

”

> "It never occurred to me that it would take that long [...] We started recruiting people ready for our growth [...] but I should have waited until we actually had the money in the account."
>
> ***GIF investee***

What we've heard from **legal professionals**

Complex products can lengthen timelines. Offering flexibility and combinations of products to investees can introduce complexity and extend timelines in legal negotiations. This is especially true for those new to different investment products and their associated terms.

”

> "A critical feature of Growth Impact Fund is its ability to finance projects in multiple ways - with different products and even combinations of products. This sounded good at the design stage, but what I've experienced on this transaction is that it can be like going into a sweet shop with so many goodies we can play with that we ended up with a structure that was difficult even for legal teams to understand at first.
>
> If, as lawyers, we struggled to put [the deal] together and understand it, how would the founders?"
>
> ***Legal Adviser***

What we've heard from **legal professionals**

Expectation management is vital.
It can be just as important for founders to get certainty on negotiation timelines as it can for those timelines to be short. Not only does this help founders plan how to make use of funds, it's also crucial to enabling equitable participation in the process.

> "We need to provide an environment where founders understand timelines. If a founder thinks something is urgent, when it might not be, they'll agree anything [...]. If they and I know there's a window to negotiate, it helps. It seems it would drag out longer, but it doesn't if there's a deadline there [...] In some circumstances it will be the quicker the better. In others it's just the more certainty the better, irrespective of length. If I was asked to prioritise speed or certainty, I'd probably go with certainty."
>
> ***Legal Advisor***

Insufficient integration between legal and investment teams.
Contract timelines can be elongated by a lack of information given to legal teams when deals are handed over and where there is limited integration into deal-making process. For instance, further context and background on why a deal is taking place, as would typically be available in commercial deals, can help lawyers more quickly draft clauses that are broad enough use in the ways that Fund and founders are comfortable with. Similarly, some conditions attached to committee approvals have emerged late in negotiations, meaning they have taken longer to resolve. Generally, we're seeing a need for greater clarity on which comments emerging in committee discussion are sufficiently material to escalate quickly into forms of legal diligence, which should be pushed back on, and which need to be pursued earlier in our diligence process (i.e. pre-approval).

> "There's a concept of "bracketing lawyers to the legals" in social investment, in which it can be taken for granted how important to get them in early on and helping them understand: Why is this deal happening? What are the motivators for the fund? Why is this happening for investee?"
>
> ***Legal Advisor***

Our approach to improving **Timelines**

Establishing clearer timeframes:
We're agreeing new more certain timelines and plan for completion up front, aligning all parties involved in contracting around a quicker process in a new initial kick-off session.

Creating Legal FAQs:
We've created a FAQ guide to help better prepare founders to engage with the legal process, how to make use of support, and set expectations around timelines for negotiation.

Streamlining terms:
We're honing legal agreements to remove extraneous features (see Section 3) and removing a layer of discussion by dropping the Heads of Terms negotiation stage for debt and revenue participation deals.

Building extra capacity:
We've taken on additional law firms at the Fund to build capacity.

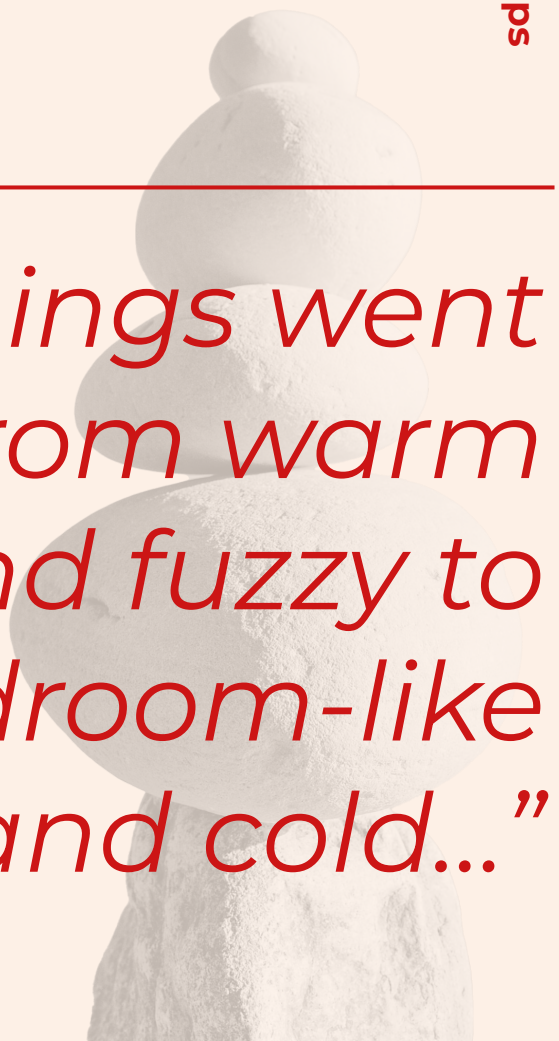
Starting early:
We're negotiating more of the key deal terms before approval by committee and pushing back on additional due diligence following committee approval.

Embedding legal expertise:
We've increased legal expertise on our investment committee itself. This is helping us to identify what's appropriate to ask of investees and legal teams in the contracting phase as conditions of investment.

Learnings on **Relationships**

A changing dynamic between fund and founder

Investees have generally spoken of valuing their relationship with lawyers, but we've seen that relationships with the Fund can become strained during the contracting phase. Legal sector norms around communication during the negotiation stage can change the dynamic for investees from feeling like the Fund is a partner to a legal adversary. This dynamic has challenged our ability to sustain an inclusive experience throughout the investment process.



“Things went from warm and fuzzy to boardroom-like and cold...”

What we've heard from **investees**

Legal relationships a highly valuable resource for founders. Founders have recognised legal support relationships as providing a source of direction and learning for the future.

> "[In the contracting stage,] we learned a lot and I did personally [...] We would have been lost on legals and with a big bill without the pro bono legal support."
>
> ***GIF investee***

A change in Fund tone in our communications. Some investees have felt a shift in the tone of the Fund, as we move from due diligence into legals, with conversation becoming more adversarial and sometimes even aggressive:

> "We wanted to take on investment to bring in people really aligned with us and our mission - not just the right policies, but the right way of being, way of working from start to end. When it got to the legals, we didn't get this [...] Things went from warm and fuzzy to cold and boardroom-like."
>
> ***GIF investee***

What we've heard from **legal professionals**

Self-awareness of different communication styles. Some legal firms we spoke with are self-aware of the more adversarial norms of their field, and how this might influence the tone of negotiations.

> "The problem is we've got big sophisticated law firms who don't mind having a go at each other - you can easily flip into that mode."
>
> ***Legal adviser***

> "you'll talk to [the GIF team] about a pushback issue [and] they consider as a business decision not a legal one. They go back and discuss with the team, asking "what can we do?". I think there is a flexibility within the Fund to do something that is going to work for everybody."
>
> ***Legal adviser***

We're taking a lead in shifting norms.
Legal firms recognise the more inclusive culture embodied by the GIF team in negotiations – with less "point scoring" than they've experienced with other early-stage investors. While we recognise it as our role to set the tone for relationships in this way, there is more we can do to make this consistent across the legal process, especially when setting early expectations.

What we've heard from **legal professionals**

Professional codes might limit what's possible in terms of inclusion.
Firms we spoke to shared a concern that professional ethical codes might underpin some tension in relationships between Fund and founder, given a need to follow strict lines of communication between legal representatives on both sides of an agreement.

"There were several times where I thought it would be easier if I discussed with [the founder] directly, but under professional ethics I'm not supposed to.

There's a formality that we're used to in the fee-paying world. In this space – the more startup end of the spectrum - people are more informal and it's a more fluid situation. I wonder whether the formality we observe (to comply with rules) can just reinforce assumptions that the legal world is aloof - they don't want to talk with [people] directly."

Legal adviser

We've heard that codes like this need pairing with conscious attempts to prioritise inclusive mindsets, which should be an essential part of pro bono working. This is especially important when working with underserved founders who are more likely to have had negative personal experiences in institutional environments, making it harder to build trust in legal processes.

"Lawyers need to be considering the ways they adjust their own approach to their job – it's a vital part of pro bono lawyers professional development – the emotional quotient.
The challenge is bridging the gap between battling mindset of private equity and realising you're applying those skills in a different context."

Legal adviser

Our approach to improving **Relationships**

Setting clear principles of engagement:
We are using a kick-off with all parties to re-emphasise the overarching aims of the Fund and set out our expectations for equitable legal negotiations – this means sharing final versions of EDT Investor Key Principles and asking people to flag if we're not living up to those.

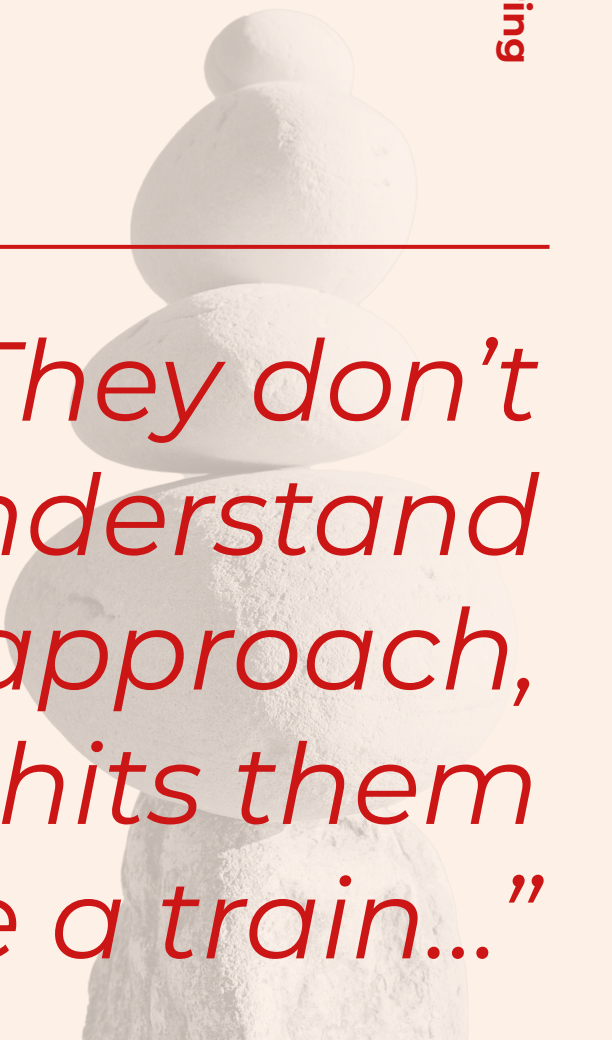
Being transparent:
We are sharing with SPOs that we won't be 100% available all the time, given a need to juggle our commitment to SPOs in the due diligence phase, and setting expectations around the change in working relationship.

Re-iterating a sense of "partnership" with investees:
We are cautioning founders up front that the legal process can sometimes feel adversarial, despite our efforts to avoid this. To this end, we are setting up regular check-ins on issues outside of the legal process to maintain a supportive, united foundation to our relationship throughout the legals process.

Learnings on **Power sharing**

Two different worlds colliding

Investees and legal firms feel the Fund's template term sheets are too investor-friendly. We hope that by better distinguishing our "red lines" or non -negotiables as a fund, and the reasons behind them, we can better align all parties around equitable principles for finalising terms in the legals process. However we remain limited in our ability to do this by entrenched norms of the social investment sector, reflecting the broader message of our learning report that we're caught "between two worlds".



"They don't understand our approach, it hits them like a train..."

What we've heard from **investees**

Overwhelmed by the number of terms.
The GIF term sheets can be overwhelming for some founders new to the legal process. Even with access to pro bono support, founders can find the number and phrasing of terms a real challenge to engage given limited experience and capacity (see more detailed reflections on this theme in p.8 of EDT: Investee Perceptions of Power Dynamics in Legal Processes)

A need for greater transparency.
Some investees have told us that they haven't always been clear of the source of some demands in legal negotiations and who is exercising the power. This lack of clarity on who the existing power-holders are in negotiations is likely a contributing factor for tensions in relationships between the Fund and founders.

A perceived "Illusion of choice".
For founders who need to raise funds at speed, they can feel pressured to accept terms perceived as inequitable. We've seen that some founders feel they've invested so long into the process (at the expense of other opportunities), that they can't afford not to sign off on terms that still feel investor-friendly. While others are accepting terms in trust that they will not be enforced.

> "Towards the end, I felt, "I'm not doing this". But we knew we needed to take a step back and get calm – we worked so long and this – so hard so we can't have all that effort and energy wasted [...] Our lawyers said we wouldn't recommend having [certain terms] in there and I said I don't care. It's UnLtd and Big Issue Invest. What are they going to do – tell us to just close down?"
>
> **GIF investee**

What we've heard from **legal professionals**

Delineating the role function of pro bono support.
Investors and legal firms may need to better clarify what pro bono support is there to do in social investment. Approaches typical of corporate negotiation, which prioritise battling for the best terms for a client (and a "win-lose mindset"), may extend timelines significantly not reflect founder priorities, and reduce investees' ability to access the funding they need at the time they need it.

> "We need to make sure that what the founder explains to us as the deal is what the document really does. Our role is not to fight tooth and nail to move commercials – they should align with what the founder things they are and, if not, to work to understand why. It's helpful for lawyers to understand they're not there to scribble all over in red pen – it's more of a comprehension exam – does this document reflect what the founder thinks the deal is? If not, we will have to scribble all over to improve deal terms, but comprehension and sense-checking is the starting point.
>
> ***Legal adviser***

"Standard terms" up front.
The terms on first drafts of GIF contracts resemble those that legal teams work with on commercial investments. Despite our ability to work down from these in negotiations and lessen the risk we push downwards onto investees, we're often starting from a place reminiscent of the commercial world.

Distinguishing the Fund's red lines.
It's taken time to build up a precedent bank of the deal terms and parameter we're open to as a Fund, which has extended negotiations. We're hearing of a need to distil what's acceptable to the Fund and remove any unnecessary terms from first drafts of contracts.

Our approach to improving **Power sharing**

Continuous learning: As a “learning fund” we’re scheduling regular check-ins for our investment team to reflect on how power manifests in the legal process, so we can make any adaptations to provide a more equitable experience. We are share regular updates to our committee on these points and make space to reflect collectively on what we're learning and its implications for the Fund’s decision-making.

Reviewing deal terms and documents: We’re using the outputs of a recent legal learning roundtable (see Section 3) to help reshape our template term sheets, so we can begin negotiations with deal terms that already feel clear, balanced and reflect an equitable sharing of risk between all parties.

Being transparent about power: Once our template term-sheets have been reworked, will be adding notes and explanations into our legal documents for any remaining clauses that appear to favour investors, so that founders understand why they are there, and where they come from.

03

Live issues for the sector

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Equalising Deal Terms Roundtable

On 20th March 2024, the Growth Impact Fund co-organised a learning roundtable with Bates Wells. This event launched EDT's Key Investor Principles and created space for conversation around live issues and tensions surfaced in the EDT report around legal processes and contracts, and in our Fund-specific learnings.

The roundtable brought together lawyers, investment stakeholders and founders of social purpose organisations to create conversations around two central questions:

01 How can we shape deal terms for use in the sector which are friendlier to investees, while still meeting the needs of investors?

02 What are the greatest challenges and opportunities for embedding EDT's Investor Key Principles within social investment contracting processes?

We hoped that answers to each of these could help us move in a more equitable direction as a section - towards a fairer balance between investee and investors needs in the contracting process. This section of the report shares major themes and opportunities emerging in those conversations.

An approach to **equalising terms**

Equalising deal terms doesn't by necessity entail more lax term sheets. We recognise that most social investors are ultimately seeking to make money and prove that diverse, early-stage or impact-focused founders present untapped investment and growth potential. This means that reshaping terms is not about discounting risks, but appreciating the implications of terms that seek to mitigate against these risks - their knock-on impact for founders, their organisations and their mission. Appreciating this requires moving beyond default prescriptive terms, often taken wholesale from a commercial sector that doesn't reflect the context they're now being used in. And the following suggestions are a collaborative attempt to rework contracts and processes around them to better acknowledge how current terms can impact or limit founders, while remaining grounded in the very real risks and operational realities of investing in the impact space.

Together with the facilitators of the EDT project, we identified two broad areas worth focusing on as starting points for reshaping more equitable contracts:

01
The degree of **investor control** prescribed within contracts and how that can push risk down onto investees.

02
The kinds of **governance** structure and oversight processes appropriate in a true "partnership".

In the following, we've outlined specific terms that we've collectively seen that speak to these, tensions we've heard that they can cause, and potential alternatives that can support equity.

01 Investor Control

A first area of tension in contract negotiations concerns provisions of investor control. These are terms used by investors **to restrict an organisation's corporate activity** to mitigate against risks in the investment, usually through a variety of standardised but prescriptive measures.

On the right are some of the ways we see this this showing up in social investment contracts, unpacked on the following pages.

Examples:

Indebtedness clauses.

Narrow default terms.

Merger and organisational change provisions.

Indebtedness clauses

Restrictions on when or how much debt can be taken on (or re-financed) by organizations and permissions needed to do this.

Purpose:

To de-risk an investment by ensuring founders have cash available to pay investor debts.

Tensions we are seeing:

As a Fund, we tend to give permission by default for well-reasoned proposals for additional debt to be taken on by our investees. But we recognise that such clauses make permission dependent on attitudes of individuals, who might change once contracts are signed.

Restrictions on debt can restrict an organisation's growth and reinforce the idea that debt is to be avoided. This is precisely the message that we're often trying to undermine, as a sector, when reaching out to promote social investment to underserved communities.

Social investors often put clauses of this kind into their agreements by default, expecting pushback from founders and eventual compromise. However, not all founders have the knowledge, confidence, or support to do this. Moreover, where legal support *is* provided to facilitate expected pushback, this itself can lengthen timelines - founders need greater time to appreciate where negotiation is possible, understand how that works, and get comfortable with how they balance their own need for money with fears that they may risk securing the funding if perceived as un-cooperative.

Narrow default terms

Specifies what constitutes an event of a "default" on repayment. Standardly defined as failure to pay within 14 days.

Purpose:

To give investees clarity on expectations around repayment and enable investors to take quick action when needed.

Tensions we are seeing:

Funds rarely act on standard default clauses and tend to extend automatically from 14 days up to 6 months. However, not all founders are aware of this. And where there is a disconnect between what's in the terms and what investors would actually do there can be unforeseen consequences that damage both investors and investees.

Some investees at the Growth Impact Fund have signed contracts expecting certain rights would never be taken up, understanding the implicit norm that funds like to have a conversation before ever imposing narrow terms like this, or using them as a last resort when relationships have broken down. However, in the broader social investment sector, we know that other founders have taken pre-emptive action to wind-up their organisations, assuming that investors will enforce narrow default terms stipulated in the contract, even when they've no intention to do so (Investee Perceptions, p. 7).

Merger and organisational change provisions

Limitations or prohibitions upon organisations pursuing mergers or re-shaping their organisational structure.

Purpose:

To safeguard the integrity of the mission an investment is intended to support and an investee organisation's stability and accountability.

Tensions we are seeing:

As a founder organisation grows over time, it may want its organisational structure, activities and focus areas to organically match its growth; for example, by way of mergers, acquisitions, disposals and wider legal structurings. Funds may sometimes focus wholly (or primarily) on specific narrow, income-generating workstreams for the purposes of protecting its specific investment, and seek to discourage or prohibit a founder's plans, even if this would stifle the organisations longer-term growth or positive impact. For instance, provisions limiting an organisation's ability to change its salary structure may impact that organisation's ability to secure additional funding from private equity investors who see this an an obstacle to recruiting top talent.

Alternatives terms and approaches

Remove "illusions of risk control": Funds who have never acted on specific clauses in their contracts might remove them, given they are likely to be purely illusions of risk-control that serves no practical benefit. Relatedly the attitudes or actions that are there to incentivise (even if the terms are never acted on) might be achieved by other means (e.g. *outside* of legally binding deal terms) and by a greater focus on encouraging ongoing dialogue and "safe space" for raising issues, rather than an overreliance on prohibitions.

Support a more balanced view of debt: While it's critical to be clear on the implications of defaulting in contracts, It may be helpful for social investors to move away from implicitly framing additional debts purely as a sign of greater risk or cash-flow burden. Agreements could better reflect how debt may also be a positive marker of an organisation's growth ambitions.

Extent default grace periods: Social enterprises realistically need 3-6 months to respond to a situations forcing them to miss a repayment. What's more, it rarely ever suits investors to push social purpose organisations into insolvency in situations like this, with ongoing dialogue on options around default more important than a clear prescriptive narrow measure.

"Multiple outcome" term sheets: Related to the above, social investors could move towards term sheets that don't operate in a binary win-or-lose, repay-or-default situation for each side but which are able to incorporate multiple different outcomes and branches for a partnership, dependant on the evolving circumstance.

Extend repayment timelines: Broadening repayment terms from a default of 5-7 years up to 10 years could make a huge difference in giving social purpose organisations the headroom they need to grow.

Bespoke risk-control: Term sheets might flex to focus on the most important "high-risk" areas for a particular founder organisation, the investment, or their sector rather than imposing prescriptive measures by default across the board.

02
Governance and oversight

A second group of terms that we've seek create challenges in negotiation are those relating to governance, which bring into question the **appropriateness of certain forms of oversight and information requests** within a partnership.

On the right are some of the ways we see this this showing up in social investment contracts, unpacked on the following pages.

Examples:

Key-person clauses.

Board provisions.

Information rights.

Key-person clauses

Requirements for organisations to do or not do something with respect to named individuals, which may result in termination of the contract or early repayment if breached. (e.g. requirements for specific individuals to remain in the organisation, in specified positions, to avoid accelerated repayment).

Purpose:

To de-risk investments by guaranteeing that key organisational decisions will be taken by individuals believed to have required skills, qualifications or experience.

Tensions we are seeing:

Key person-clauses can restrict an investee's agency to reshape their team in response to need. For instance, such clauses don't account for the flexibility some underserved founders need to manage their personal situation. Founders with medical conditions might very reasonably need to adapt their involvement or role within their organisation over time to manage that condition and continue to play their best role. This means that key person clauses are often in a broader tension with the sector drive to recognise the needs of underserved founders through increased flexibility and tailoring within the investment process, in order to widen the pool of organisations receiving investment.

Board provisions

Provisions requiring investees to form a board as a condition of investment, or enabling an investor to appoint an observer to attend board meetings or receive papers.

Purpose:

To ensure that Funds can remain close to important decisions and information about portfolio companies, and avoid duplicating conversations for investees.

Tensions we are seeing:

While founders are often keen for Fund stakeholders to join boards to add skills and avoid duplicating conversations, we've seen some argue against this for privacy reasons. Sometimes, organisations require a space to get advice from their board without investors in the room for sensitive matters.

There is also a danger that board provisions can make an organisation's governance more complex, bringing a range of additional regulatory, compliance or administrative demands that take time away from an organisation's broader activities.

More broadly, board observer rights are often a relic from investors' historical agreements and not always taken up, given that it may not always be a good use of investor time to be party to all conversations held at board level.

Information rights

Stipulated requirements to send an investor data on performance against KPIs (e.g. DEI, ESG or impact data).

Purpose:

To ensure that investees are meeting agreed objectives of the investment and to support funds to meet their own reporting requirements set by their own investors.

Tensions we are seeing:

Many Funds demand some information purely because it's a condition of their own fundraising from investors and wholesalers. When Fund's raise from many sources, or investees raise from many funds, this can lead to layers of reporting requirements trickling down to social purpose organisations within contracts, which can harm their operational capacity (see EDT: Principles p. 22).

In the grants space, reporting requirements are slowly being recognised through an increase in dedicated financial supports to build capacity around this reporting. Within the social / impact investing space, this is rarely recognised, and organisations may need to hire an additional dedicated person to meet a growing range of reporting conditions out of their own pocket.

We've also heard that some social investors lean heavily on impact metrics in their pre-deal diligence (i.e. the impact a business has / will have on the world) but replace this with a focus on Environmental, Social and Governance (ESG) frameworks within their ongoing governance and reporting requirements in agreements (focusing instead on *how the business is run*). Such metrics may support one another, but this shift means that investees can be reporting against new metrics/standards distinct from those used to evaluate their investment case (which they may be better setup to report on), which adds further strain on their capacity.

Alternatives terms and approaches

Mutual key-person clauses: Investors including key-person clauses in their term-sheets might include a clause in the opposite direction and guarantee a consistent relationship manager for investees (See EDT Principles)

Support to build reporting capacity, alongside funding: Investors including significant reporting requirements in their deal terms might match this with paired funding to support capacity for this (e.g. towards an impact analyst or ESG manager) or dedicate post-investment support to enable effective reporting.

Share template terms in advance: We know that some investors have published templates of their term sheets on their website (see Chisos Capital's open-sourced term sheet) to help investees do "reverse DD" on funds and help them make decisions over who to pursue investment with (e.g. taking into consideration reporting requirements or repayment options baked in). This way, there can be a fairer availability of information for both sides involved.

Board-papers only: Rather than taking up observer seats, legal agreements instead can stipulate that investors are only entitled to receive the same papers as board members. In this way, investors can receive important information about a business while reserving a private space for board level discussions.

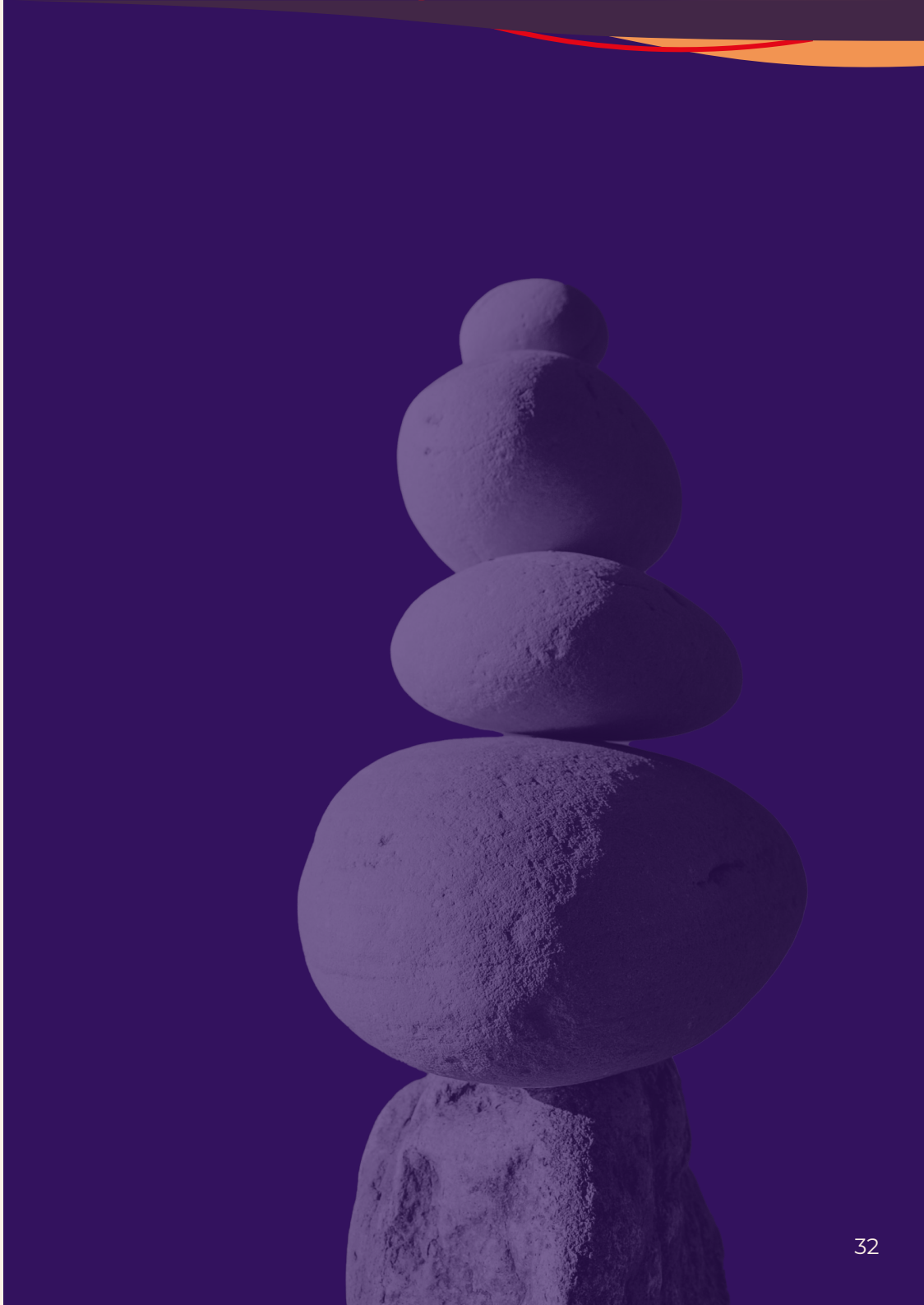
Advisory boards only: Investors looking to strengthen an organisation's oversight processes might ask only for advisory boards to be setup, rather than legal boards which can significantly add to the complexity of an organisation's operations, or ensure that requirements for legal boards to be setup to emerge much earlier in the due diligence process (ideally, at the start).

Embedding EDT Key Principles

Bringing equitable deal terms and processes to life will require ongoing experimentation and dialogue in the social investment sector. It will need investors and legal firms to test different approaches and processes that suit their own situations, before sharing their effects will one another.

To kick-start this process, we created space in our learning roundtable to move beyond discussion of individual terms and reflect on some key challenges and opportunities embedding EDT Key Principles into the legal process.

The following pages summarise some key challenges that emerged in these conversations, and what might help meet those challenges.



Challenge: EDT Principles are broad

Principles are purposely designed to be broad, to facilitate the different contexts in which they will be applied. But this means that investors, investees and legal firms may interpret them differently and remain misaligned in negotiations. The specifics of application may be more important to make transparent than principles themselves.

What might help: Agree "what good looks like"

Investors might support all stakeholders to sign-off up front on what applying EDT principles means, in the specifics of a live negotiation. To avoid unnamed assumptions emerging too late, it can be valuable to have an initial kick-off in which assumptions from all sides are aired, and deal-specific details of "equitable negotiation" are agreed (see p. 23 of EDT Principles) And investors themselves might play this mediating role all the way through the process, constantly reminding people of the spirit of the deal.

Challenge: Equity and speed are in tension

It may be that in implementing changes in the service of equity extends timelines for investees who may be under pressure to raise capital quickly. For instance, providing access to pro bono support can result in more time working through points of contention, while providing sufficient space for founders to consider implications of terms or solutions to specific points (rather than feeling "pressured to sign" by a Fund's own interest in getting a deal over the line) may also extend the time to funds being disbursed.

What might help: Surface founder priorities

It's important for lawyers to know up front what a founder's priorities are in a deal. This may mean an investor providing more detailed information on the context of a deal. It may also mean early conversations between investee and their legal representatives around what is most important to a founder in negotiations. What is their timescale for using the funds? How flexible is that timeline? How important is it to them to move specific clauses? What changes to their governance structures are they willing to make? Unpacking the dynamics of an investee's situation and their ambitions can help all involved to understand what we might call an "equitable" speed that the deal needs to move at, and where "fighting for the best terms" is truly appropriate.

Challenge: Founders lack agency to enforce principles

The onus is still on investors and legal firms by and large to embed equitable principles in their practice. It's not clear what the role of investee's is, or the power they have to impact this issue

What might help: Agreed accountability mechanisms

Investors and legal firms might develop a wider range of accountability mechanisms to ensure principles are truly acted on. This may mean asking founders to flag (live) when other stakeholders are not living up to what's been agreed (see p. 23 of EDT Principles). This could also mean more extensive follow-up feedback and a commitment to share this and what's being done to improve, to support cross-sector accountability. At the Growth Impact Fund, we believe these processes benefit from platforming investees with experience of negotiations, being open about imperfections, and ensuring learning conversations bring all stakeholders together rather than happening in isolation from one another.

Challenge: A lack of benchmarks

As we've spoken to in our early learnings at the Fund, there remains a general lack of benchmarks to work with when pursuing more inclusive and equitable investment. This extends to the legal process, where there is no consensus on "what good looks like" in terms of legal agreements and processes in social or impact investing. We know that we're often still working off the basis of deal precedents coming from the commercial space which is no longer reflective of the situation we're working in, but it's not clear what an emerging, equitable "market standard" for this new space truly is.

What might help: Think beyond "market standard" frameworks

At the Fund, we believe it's important to be able to flex a process to meet the different needs of marginalised founders to be truly "inclusive". Conversation in our learning roundtable revealed an analogous attitude may help in legal negotiations. Rather than focusing conversations on what is "market standard" or what *should be* in the social investment space, we heard it may make more sense to recognise that there is no "market standard deal" – each deal presents a unique situation and a unique set of different needs to meet. Aiming at a more bespoke output to meet this may be as, if not more, helpful than trying to establish a new precedent bank of standardised terms to benchmark against.

Challenge: A “completely different conversation”

The EDT Principles require fundamental changes in attitude around how legal representatives approach negotiations with investors – changes which at first will feel uncomfortable. Starting conversations from the questions “what risks are you willing to take on?” is a 180-turn from the conventional “risk-mitigation” mindset and make lawyers feel that they are themselves taking professional risks by failing to comprehensively flag or mitigate such things for their clients.

What might help: Wider professional supports

Training and support in more equitable approaches is essential if we are to help legal professionals get more comfortable pursuing negotiations in ways that may differ to commercial contexts they’re working in. It could even make sense for EDI principles to be broached much earlier in a lawyer’s professional development – for instance in law school or business school.

04
What’s next?

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Future avenues for the sector

What we have shared here is not best-practice. Rather, we have tried to surface insights from our own experiences at the Growth Impact Fund and avenues for exploration drawn from broader conversations and thought leadership on this topic. We hope that this gives others ideas about how they might adapt and experiment in their own practice, so that we can deepen our collective understanding of what brings more equitable legal contracting to life.

A sector-level approach to this is crucial. It's always been our belief at the Fund that innovations towards a fairer investing landscape require bringing different stakeholders together to understand their respective needs, to share learnings, and to co-create solutions.

In this context, we think it's important to bring lawyers, founders and investment stakeholders together outside of live negotiating environments. We'd encourage a wider range of sector events that pursue this, drawing on a wider range of case studies, platforming different voices, and co-designing a growing bank of shared solutions to be tested, implemented and refined.

The following page offers some specific ways to take this forwards, emerging from our recent roundtable.

Steps forward

If you're a social investor:
We'd encourage you to read the EDT: Key Principles, brief your legal teams on these and unpack what they need from you to act on these confidently. You might also experiment with any of the additional ideas on the right that emerged in our roundtable as testing avenues moving forwards.

If you're a lawyer interested in equity:
We'd encourage you to:

01 Join the Global Alliance of Impact Lawyers (GAIL) to continue conversations on topics like this.

02 Join an investment committee to help investors embed EDT principles

03 Engage with stage 2 of the Equalising Deal Terms project.

Coproduction of term sheets.
Building off our roundtable, which brought investees, investors and legal firms together to explore different terms, other social investors might bring their own stakeholder groups together to explore how they can re-work their template legal agreements in a collaborative manner.

Non-binding agreements.
Investors might explore where it's possible to do more *outside* of legally binding agreements to achieve more equitable outcomes. For instance, alongside a legal agreement, funds might create (or co-create) more relational partnership "agreements", which capture the desired spirit of their relationship and expectations of one another. This may do some of the work that is traditionally done by legal contracts through coarse and often punitive-looking terms. This is something we've seen trialled by Black Food Fund.

Portfolio and post-investment approaches to risk-mitigation.
Rather than working to mitigate risks within contracts, funds can experiment with doing more of this both before and after the contracting phase. For instance, funds can get comfortable with risks earlier in their diligence processes, rather than achieving this through contracting, by balancing higher and lower-risk deals at a portfolio level (see EDT: Investee Perceptions, p. 13) or through post-investment support, ensuring that social investors have bespoke supports in place to mitigate the specific risks for individuals deals (e.g. supporting building networks, or providing access to expertise).

Bespoke agreements for small deals.
Smaller deal sizes often come with the most onerous legal agreements, given a wider range of risks perceived through backing earlier stage organisations. This is especially counterintuitive in terms of the extra work it creates in negotiation. Funds may benefit from exploring separate processes for deal sizes of £50k or less, and legal agreements that drop permission requirements - instead, prioritising trust and "ways of working" agreements to sustain transparent and accountable relationships.

What's next at Growth Impact Fund?

We are now working to roll-out and evaluate the improvements we've outlined in this report. We will also be reworking our template investment contracts based on other insights and opportunities shared here.

We also look forwards to continued dialogue and collaboration with the Equality Impact Investing Project (EIIP) and those pursuing similar missions to ourselves, as we work to create a more involve investing landscape.

Please reach out if you have questions, suggestions or ideas on what we should do next.

Thanks to everyone involved in bringing this report together.

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