

Venture Capital: Business-to-Consumer Delivery in Indonesia

Why an environmental and social due diligence (ESDD) can be a critical factor in a venture capital firm's investment decision

A venture capital firm made an early investment in a company providing business-to-consumer delivery in Indonesia through a new tech platform. The platform offered consumers a wide range of products they could order through an app that connected them to retailers and handled the ordering and payment process. The retailers then packed the goods for third-party drivers to pick up and deliver. The drivers—a key component of the business model—were independent contractors who signed up for the work and used their own vehicles for the deliveries.

The business was scaling successfully, so the venture capital firm invested in subsequent funding rounds, encouraged by the growth and the opportunity presented, especially the company's planned initial public offering (IPO) as its next stage. With growth accelerating, the IPO's timing was important to the company, its investors, and the venture capital firm.

Photo: Jerry Kurniawan / World Bank

Overlooking relevant environmental and social (E&S) aspects can have consequences for investors and investees alike.

The firm focused on growth plans as part of the investments, but it didn't consider relevant E&S aspects, assuming that few, if any, applied. Relevant environmental concerns were few, but the social aspects—labor issues and working conditions—proved critical, with potential to derail the company's growth plans and endanger the venture capital firm's investments.

The firm didn't anticipate these E&S issues because it didn't conduct an ESDD to understand its risks and liabilities. An ESDD systematically considers a wide range of E&S issues,

including labor and working conditions, from formal requirements to potential discrimination, occupational health and safety, and use of third-party contractors. Without properly identifying the risks and creating a plan to manage them, the firm and company experienced

- Tense labor strikes,
- Disrupted operations.
- Negative media attention, and
- Increased costs and disruption to remedy the issues.

ESDD assessments help investment firms and their investors avoid potential E&S issues and adverse events that could jeopardize financial and operational viability.

Conducting an ESDD before proceeding with transactions is a critical component of an E&S management system. The ESDD's extent and level of detail are based on the transaction's E&S risk category and will vary by transaction type. The assessment systematically identifies, quantifies, and evaluates any potential E&S risks associated with a potential investee's business activities to ensure that the transaction won't present liabilities and risks to the firm. If the process finds E&S risks, it helps identify mitigation measures to reduce them. Thus, its outcome is important to deciding whether to proceed with an investment, because E&S risks could present credit, liability, or reputational risks.

Conducting an ESDD in this case would have highlighted potential labor issues inherent in the company's business model, which could have been a factor in the venture capital firm's decision to invest. A core part of that model's success

involved the third-party delivery drivers supporting distribution of goods. As news of the company's planned IPO and valuation became widespread, many of the delivery drivers became angry at the profits the company was generating while they worked long hours for comparatively low wages, no benefits, and no job security. The drivers held strikes that became increasingly tense, and drivers were then excluded from using the platform, which slowed delivery times and created uncertainty for customer deliveries.

Interest in the company and the strikes increased before the IPO, and an investigative journalism article was published that focused on workers and their conditions, calling even more attention to the issues. Potential investors became distracted and concerned, and they feared reputational risks and possible legal challenges to the third-party workers' status that could result in them being considered employees.

The company and the venture capital firm and its investors faced unexpected implications from the failure to identify and manage E&S issues through an ESDD.

The venture capital firm was linked to the risks associated with its investee's operations. The strikes, media attention, and operational disruption caused by labor issues affected both the firm and the company:

- The company was forced to revisit its operating model, causing disruption and delays in its growth plans.
- Improving labor and working conditions increased costs and caused more disruption.
- The company had to delay the IPO, which cast negative light on the potential valuation and delayed both the venture capital firm's exit and the return on its investment.

To mitigate the issues, the company reviewed its approach to labor and working conditions and sought legal advice. It developed a new framework for workers identifying rights and obligations under national law and took additional steps to address gaps in the context of good industry practice at an international level, along with ongoing consultation with third-party delivery drivers. The measures taken included additional benefits, improved occupational health and safety conditions, and improved working conditions overall. These measures took time and expense to implement and a larger human resources department to administer them.

Addressing the issues improved the company's relations with workers and contractors, alleviated operational disruptions, showed the market that its approach was a positive differentiator, and supported mitigating the negative attention on the delayed IPO and the venture capital firm realizing its target return on its investment.

Companies such as the delivery company scale quickly, which makes it hard to turn back the clock on decisions made in the early stages of establishment and scaling. The venture capital firm had dismissed E&S-related concerns in these early stages but then carried this assumption forward in subsequent funding rounds. It didn't reconsider even after the company's size had grown substantially. At the late stage when the disruptions occurred, changing the operating model became much more expensive and could even have been impractical.

All companies require different types of workers to enable them to operate. Assessing the fundamentals of labor and working conditions incorrectly can reveal an operating model's weaknesses—in this case, underestimating the risks and not considering gaps between national requirements and workers' expectations or needs.