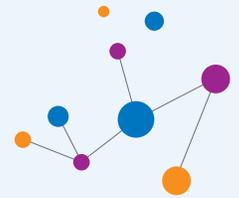




The blog is a product of the [UN Human Rights B-Tech Project](#) and is part of a blog series focused on the intersection between human rights and the responsibilities of technology companies.



## Bridging the private equity gap to tackle tech business model risks

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### SEPTEMBER 2021

As investors awaited the latest tech unicorn to enter public markets via the London stock-exchange in April this year, a group of six major UK investors took the unprecedented step of voicing serious misgivings about the labour risks embedded in the business model of Deliveroo, the online food delivery company on the verge of its initial public offering (IPO). Aberdeen Standard, which manages £535 billion GBP or over US\$750 billion, [stated](#), “We will not be taking part in the Deliveroo IPO as we are concerned about the sustainability of the business model, including but not limited to its employment practices.” M&G Investments, with £367.2 billion GBP or US\$520 billion under management also skipped the IPO [citing](#) that “employment contracts potentially fall short in offering the value, job security and benefits of full employment.”

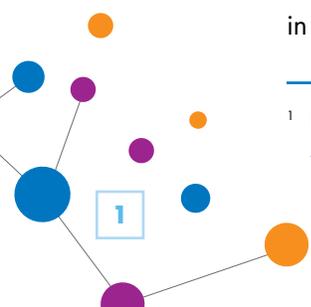
As the UN [B-Tech paper on business models](#) reflects, despite the positive impacts of technological innovation on society, technology company business models are increasingly criticized for creating or exacerbating human rights harms, threatening democratic values, and deepening inequalities. A number of examples illustrate how tech company business models may drive of human rights harms. For example, business models that seek to increase engagement encourage divisive and inflammatory content that leads to online and offline harms; short-term rental platforms that escalate rental prices and reduce housing stocks disproportionately impacting poorer residents; and gig-economy companies that make a profit from workers delivering services without basic labour rights protection.

### The role of private equity in technology

Tech-focused private equity (PE) and venture capital (VC) funds are rapidly rising in prominence. Between 2016 and 2019, some 1,800 new start-ups focused on artificial intelligence (AI) technologies had raised their first round of equity funding—with \$19 billion in equity funding going to AI start-ups in 2018 alone.<sup>1</sup>

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<sup>1</sup> Rights-Respecting Investment in Technology Companies, UN B-Tech Project:  
<https://www.ohchr.org/Documents/Issues/Business/B-Tech/B-Tech-Briefing-Investment.pdf>



Although a growing number of investors are using their leverage to promote respect for human rights among tech companies that make it to public financial markets, their ability to create change in business model-related risks is undermined by public tech company ownership structures and the minority shares held by most public equity investors. The investors with most leverage to shape the business models of tech companies happen to be the ones that invested while companies were still young and private, from VC funds at start-up, followed by other forms of PE capital investments throughout the growth stage of companies.<sup>2</sup>

As with all institutional investors, PE [investors have a responsibility to respect human rights](#) in line with the UN Guiding Principles on Business and Human Rights (UNGPs). Yet in practice, PE investors are lagging behind others in the broader investment community when it comes to aligning their investment practices with the UNGPs. For example, a 2019 [Harvard study](#) found that VC investments in technology demonstrate no systematic approach to assessing and managing environmental, social and governance (ESG) risks, including human rights risks.<sup>3</sup> While general partners in PE and VC funds tend to have high degrees of leverage and control over investee companies, as well as deep familiarity with the concept of due diligence, few appear to consider or act on human rights risks in their investment decisions.

## Signs of progress are emerging

There are promising signs of PE progress on human rights. For example, Revaia has set out a [dedicated framework for sustainable investing in technology](#), including in relation to human rights. In 2019, the Investor Alliance for Human Rights—a coalition of institutional investors jointly representing over \$5 trillion in assets under management—published and disseminated [guidance](#) for PE investors on how to address human rights risks in Palantir Technologies. While not exclusive to tech investments, the UNDP's [SDG Impact Standards for Private Equity Funds](#) has set a clear expectation that fund-level managers, in the context of impact investing, must respect human rights in line with the Guiding Principles and provide effective grievance redress mechanisms as a means of demonstrating appropriate governance controls.

PE investor actions that promote respect for human rights are not just possible, they are also good for business. The overlap between severe risks to people and material risks for technology investments is increasingly evident. For example, shortly before going public, Deliveroo had to [slash its valuation target](#) by close to £1bn or nearly US\$1.5 billion over the business model-related labour rights risks called out by investors. Material costs are also present in [venture capital investments](#), IPO valuations and SEC risk filings.

There is also growing recognition of digital rights as material by investors and standard setters,

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<sup>2</sup> VC and other forms of private equity are both forms of private capital investments made through a fund that is created and managed by a VC or private equity (PE) firm, also known as the general partner (GP). GPs raise funds from asset owners, also known as limited partners (LPs) to invest in startup technology companies.

<sup>3</sup> *Taking stock of investor implementation of the UN Guiding Principles on Business and Human Rights*, A/HRC/47/39/Add.2.

including the Sustainability Accountability Standards Board (SASB).<sup>4</sup> Moreover, growing attention on the role of PE in driving or enabling human rights harms among civil society organisations signals a change in tide in the corporate accountability movement toward one of holding publicly accountable PE and VC firms who fail to invest responsibly.<sup>5</sup>

## **Recommendations for PE action on business model-related risks**

PE investor action to prevent and mitigate business model-related human rights risks is an urgent priority: for entrepreneurs wanting to embed ethical values into their ventures; for public investors; for generations of users; and for society at large. Further, addressing these risks “at ground level” could lead to the innovation of alternative business models capable of challenging those norms of business practice that can undermine respect and dignity.

The UNGPs provide a framework to help PE and VC investors play their part in creating this vision. As a starting point, these firms should:

### **1. Adapt their core business activities to manage human rights risks**

By re-assessing their approach to investment and putting in place a structure that supports addressing risks to people as an inherent part of core business, PE and VC investors will be equipped to uphold their human rights responsibilities and also gain a competitive advantage. By focusing on preventing and mitigating salient human rights risks, investors will be better equipped to manage the real and potential financial and reputational costs associated with high risk tech business models. Doing this involves adopting policy commitments, strategies, and risk management processes that centre around addressing risks to people. PE and VC firms should:

- Adopt a policy commitment to respect internationally recognised human rights in line with the Guiding Principles, and clearly communicate human rights expectations of tech start-ups, including via the firm’s website and during pitch sessions.
- Consider human rights standards and risks when evaluating a technology company’s business model—as well as products, management, and operating history —prior to investing and on an ongoing basis once invested.
- Include human rights expectations, including specific provisions regarding the business model, in venture capital term sheets to ensure human rights due diligence milestones are clear and safeguards are in place.
- Establish an effective grievance mechanism at the fund level to provide a channel for stakeholders, including affected rights-holders, to report adverse human rights impacts connected to portfolio companies.

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<sup>4</sup> Rights-Respecting Investment in Technology Companies, UN B-Tech Project: <https://www.ohchr.org/Documents/Issues/Business/B-Tech/B-Tech-Briefing-Investment.pdf>

<sup>5</sup> Runaway Train: The Perilous and Pernicious Path of Private Capital Worldwide: <https://empowerllc.net/eng/private-capital/>; Fund no evil? The human rights due diligence responsibilities of venture capital: <https://rightscon.summit.tc/1/2021/events/fund-no-evil-the-human-rights-due-diligence-responsibilities-of-venture-capital-hMhb4PYW7BsiHaz5vENv3U>

## **2. Support entrepreneurs by creating space and provide funding for human rights due diligence**

When acting as general partners, PE and VC firms have numerous opportunities to support investee company leadership on articulating human rights policy commitments, conducting human rights due diligence, and in particular, efforts to address human rights risks present in the company's business model and products and services. GPs may:

- Offer trainings, workshops, and tools to investee company on identifying and managing human rights risks and developing metrics to evaluate progress.
- Connect entrepreneurs and management with external business and human rights experts, including potential talent to recruit for the board of directors and to oversee day-to-day management of human rights risks.
- Encourage and support investees to stress-test business models in order to identify human rights risks prior to adopting a model. This should involve consultation and engagement with experts on business and human rights in technology, civil society, trade unions, and other relevant stakeholders.
- As a member of the board of directors, seek to shape, sustain, and embed a rights-respecting culture within the company, and create a human rights oversight structure at the board level.
- Demonstrate efforts to support entrepreneurs on human rights, including by publicly communicating the firm's human rights risk management approach. Where a particularly high-risk issue arises, explain what the GP is doing to address it and how effective these efforts are. Human rights due diligence is a process of continuous improvement; therefore, GPs should demonstrate the constructive role they play in strengthening the responsible business conduct of portfolio companies.

PE can and should play a transformative role in addressing the human rights risks inherent to tech company business models. Efforts to address risks to people in tech business models must be pursued in a deliberate and smart way so as not to unwittingly take away the significant benefits of new technologies or create more severe human rights risks. The UNGPs provide PE and VC firms with a roadmap for reimagining investment, such that addressing tech company risks to people now and in the future becomes an integral part of sound investor decision-making and practice.

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*\* The Guiding Principles were unanimously endorsed by UN member states in 2011. They have also been affirmed by global and national business organisations, trade unions, civil society organisations and National Human Rights Institutions. This global support, including from business, makes the Guiding Principles the authoritative global framework for preventing and addressing human rights risks involving business, including in the technology sector.*