
CLOSING LOOPS, OPENING OPPORTUNITIES

The rise of circular economy in private equity and debt finance

2024



Jeroen Derkx – Invest-NL

"Invest-NL aims to increase the fundability of companies that contribute to the transition to a carbon neutral and circular economy. There seems to be a growing interest from private equity, debt funds and M&A advisory firms in sustainable and circular assets and this will strengthen this fundability. Invest-NL asked Route Circulair to research the developments and circular ambition level of private equity, debt funds and M&A advisory firms in the circular economy in the Dutch market and asked for different categories to guide which interventions in the market will contribute to increasing the fundability of circular assets. Invest-NL further asked to outline the role it can play for systemic transformation to accelerate the transition into a more circular economy.

The report offers investors, financiers, and policymakers from (local) governments insight into the market's ambitions, risks, and opportunities. The goal is to increase the fundability of sustainable and innovative companies and projects. Much of the acceleration towards the circular economy should come from existing (large) companies making a transition to circular. In this regard, several categories can be identified and the role for private equity, debt funds and M&A advisory firms is arguably due to the scalability and performance delivered earlier. Also, within the circular economy some business models are more suited for scaling and private equity than others.

With this research, Invest-NL, together with Route Circulair, has taken a first step to clarify the complex playing field of private equity, debt funds and M&A advisory firms and their role in the circular economy. Invest-NL can play a role in this by building expertise and engaging with financiers and policymakers. In doing so, Invest-NL will represent the interests of entrepreneurs in the circular economy to increase their fundability and impact."

Content

- | | | |
|------------|---|-------|
| 01. | Executive summary | p. 01 |
| 02. | Introduction
The Dutch investment landscape
Methodology & research objective
What is circular economy | p. 02 |
| 03. | Financing the circular economy
Stakeholder view
Existing barriers & regulations | p. 07 |
| 04. | Reaching a turning point
Embracing circularity
Transition complicators | p. 09 |
| 05. | Circular investments
Circular Frontrunners
Circular Turnarounds
Circular Solution Providers | p. 12 |
| 06. | Conclusion | p. 16 |
| 07. | Recommendations | p. 19 |
| 08. | Appendices | p. 20 |



Executive summary: Circularity is here to stay

Research is needed to match circular ambitions with investment reality. In this research, Route Circularair and Invest-NL examine the circular ambition of private equity, debt funds and M&A advisory firms. Investors oftentimes perceive barriers to invest in circular business models. But change is noticeable, and investors increasingly acknowledge that circularity contributes to a company's overall value. The market is slowly embracing that impact and return can go hand-in-hand and that transition complicators can be overcome. It is important for investors to strengthen their position and therefore their ability to drive the circular transition at an organisational level.

Three types of investments that promote the circular economy are identified:

1. Circular Frontrunners: Circular Frontrunners are companies that have a circular business model at their core.
2. Circular Turnarounds: Circular Turnarounds are companies with a linear business model that aspire to become circular.
3. Circular Solution Providers: Circular Solution Providers are companies that provide technology solutions or services based on proprietary technology that enable other companies to promote circularity.

The conclusion is that the circular economy is here to stay, and investors are at the build-up phase of the circular transition. Private equity and debt funds (with a few exceptions) do not seem ready yet for the circular economy and the circular economy does not seem ready yet for private equity and debt funds. Interventions can be taken to drive systemic change towards circularity in the financial sector, including interventions such as building the right capabilities, engaging with the existing portfolio and making circularity measurable. Invest-NL is well positioned to contribute to the acceleration of the transition by their expertise and network of the market and financing landscape. Further research and collaboration between financial stakeholders is needed for further traction.

Research is needed to match circular ambitions with investment reality

Current circularity endeavors may fall short of meeting the circular targets for 2030 and 2050

The Netherlands has taken a proactive stance in promoting circularity, with the government aiming to achieve full circularity by 2050 and a fifty percent reduction in virgin resource usage by 2030. The emergence of various circular hotspots, increasing corporate engagement and circular procurement underscore the flourishing circular economy in the country.

The Dutch financial sector is also increasingly turning its attention towards circular practices, with collaboratives and initiatives taking shape. In 2022 for example, *Kopgroep Circulair Financieren* (which is part of *Platform voor Duurzaam Financieren*) introduced the Roadmap Circular Financing 2030; outlining four actionable steps (risk, metrics, fit-for-finance and circular financing instruments) for the financial sector towards circular practices.¹ In 2023, the Dutch Banking Association published a paper explaining the circular ambitions, barriers and opportunities they see for the banking sector.² Despite all endeavors, it becomes evident that current initiatives may fall short of meeting the circular targets for 2030 and 2050. According to the Netherlands Environmental Assessment Agency, the use of most raw materials has not witnessed a decline in recent years.³ To turn the tide, the Agency claims that the implementation of more mandatory policies is imperative.

Financial players can position themselves as partners in the transition

Practice shows that investments to promote the circular economy often have their origins in public funding (i.e. regional development agencies) and venture capital. Also, the major banks in the Netherlands present themselves as partners in the transition: various organisational units have been set up, roles for circular specialists have been created and financial propositions have been developed for circular financing. Several private equity (PE) and debt funds have been set up with a particular focus on investing in circularity. Despite changes happening across the industry, the number of circular deals is not flourishing yet.

PEs, debt funds and M&A advisory firms are underexposed in existing research

Whereas previous research strongly focuses on the potential for venture capital and the banking sector to accelerate circular financing, the role that PE, debt funds and M&A advisory firms (could) play in this is underexposed. Dutch PE firms alone were already able to raise a record-breaking fund volume of €6.2bn in 2023⁴: a huge potential financial source to accelerate the circular transition. Debt funds have the ability to provide the necessary stable funds, whereas M&A advisory firms are well-positioned for match-making; closely following market developments and connecting promising circular propositions to investors.

In this research we examine the circular ambition of private equity, debt funds and M&A advisory firms

Research objective and method

On behalf of Invest-NL, Route Circulair has conducted an exploratory research into the ambitions and activities of private equity, debt funds and M&A advisory firms to accelerate the transition to circular economy through financing. The research concludes with interventions to further enhance such financing. The foundation of this research lies in in-depth interviews, quantitative analysis and desk research related to financing the circular economy. To gain nuanced insights and firsthand perspectives on current market developments, sentiments and possible interventions, 14 in-depth interviews were conducted with professionals from private equity, debt funds, and M&A advisory firms. In addition, a data-analysis was performed to understand trends and developments of circular deals in the Dutch market between 2019-2023.

Participants
















The circular economy is an alternative economic model that focuses on value preservation

Defining the circular economy

The circular economy presents an economic model focused on value preservation, meaning that the incentives in a circular system are organised in such a way that value preservation is always rewarded. Materials are therefore kept in perpetual circulation through various processes such as maintenance, reuse, refurbishment, remanufacture, recycling and composting. The core objective is to ensure that products and materials never become waste and promoting the regeneration of nature. Circular economy principles address global challenges like climate change, biodiversity loss, waste and pollution by decoupling economic activities from the consumption of finite resources.

Circular business models

Businesses operating within a circular framework implement innovative strategies and business models that extend the value of used materials throughout their lifecycle. This responsibility spans the pre-use, use, and post-use phases. Examples of circular business models include:

Model	Circular supplies	Product-as-a-service	Sharing platforms	Product life extension	Resource recovery
					
Explanation	Utilizing renewable energy sources, bio-based or entirely recyclable materials as alternatives to single-use inputs in the production process	Enabling product access while retaining ownership to optimise the advantages of circular resource productivity	Facilitating increased utilisation rates of products by making shared use and ownership possible	Extending the lifespan of products and components by repairing, upgrading and/or reselling them	Recovering useful resources or energy from discarded products or by-products
Examples in the Dutch market	DE KOFFIE JONGENS 	  Bundles	 	FAIRPHONE 	 

Check *'Circular Route, A roadmap for a circular business model'* in case you are interested in more examples of circular business models.⁵

Financial stakeholders can leverage their expertise and role to support the transition

Defining financing the circular economy

Financing the circular economy is more than investing in the aforementioned business models and start-ups. Financing the circular economy or circular investments are defined as financial investments into propositions and businesses that embrace and adopt circular economy principles or are in the process of doing so. This definition contains a full-scope definition of the financial market and its stakeholders. A thorough understanding of the financial chain is therefore essential.

Stages of financing

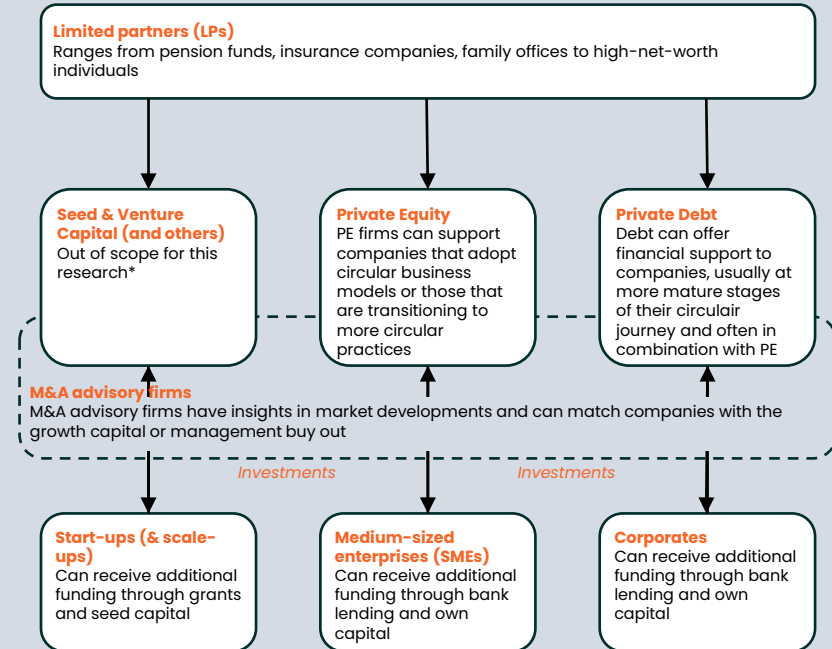
Startups, SMEs and corporates exhibit distinct risk profiles. Startups typically lack stable cash flows, carry a high risk of failure, yet possess the potential for rapid expansion if successful. Consequently, these characteristics necessitate a primary reliance on risk-bearing capital for funding. As startups evolve into SMEs or corporates with a developed business history, predictable cash flows, and tangible assets suitable for collateral, debt funding emerges as a significant funding source. Unlike startups and SMEs, corporates have access to the capital markets, larger cash reserves, and a well-established bank financing arrangement.⁶

Government involvement

Even though government involvement seems less evident in the financial market, the government does play a very important role. LPs oftentimes use public money for investments. In addition, government plays a key role in financing early stage companies through grants and (regional) subsidies.



The lifecycle of every (circular) business requires a different type of funding. Investments from PE and debt are needed to scale circularity and bring it to maturity.









*Scope of this research For the purpose of this research, seed and venture capital, grants and investments from regional development agencies and bank lending, are left out of scope.

Investors oftentimes perceive barriers to invest in circular business models

Existing barriers

Much of the existing research on circular financing concentrates on the early stages of companies using the circular business models mentioned before. Common barriers that are encountered when investing in start-ups with these business models include⁷:

-  The valuation of linear versus circular risks;
-  The remuneration structures of fund managers incentivising financial performance;
-  A lack of suitable propositions to invest in;
-  Unfamiliarity with circularity;
-  The complexity of financing value chain cooperation;
-  A lack of subsequence in financing.

Similar barriers make it difficult to fund SMEs with circular business models.⁸ The lack of subsequence in financing is explained in research by the finding that current financial structures and instruments are not always suitable for companies with circular business models. These companies sometimes stay lingering between project financing, corporate lending and asset based finance when attempting to attain funding.



Research on the access to specifically private equity and debt funding for circular financing is very limited.

Laws and regulations

Laws and regulations are a driving force behind the transition towards a more sustainable finance market. The EU Sustainable Finance Action Plan aims to create a financial system that support the goals of the EU green deal. In addition, the Corporate Sustainability Reporting Directive (CSRD) and Sustainable Finance Disclosure Regulation (SFDR) play a pivotal role in reshaping the investment landscape. They require entities to integrate environmental, social, and governance considerations (ESG) into their decision-making processes and reporting practices.

On the one hand, the CSRD mandates enhanced sustainability reporting for an investors' portfolio companies, and on the other hand the SFDR demands transparent disclosure of how ESG factors are incorporated into an investors' own strategies. The Corporate Sustainable Due Diligence Directive (CSDDD/CS3D) requires companies and financial institutions to identify and mitigate human rights and climate risks in their own operations, business customers and relationships in the value chain. These laws significantly influence the behaviour and practices of investors, overall fostering a more conscientious and transparent approach to investing.

In addition, the EU is specifically promoting the circular economy (and circular financing) with the implementation of regulations focused on Extended Producer Responsibility (EPR) and consumers' Right to Repair.

A change is visible and investors increasingly acknowledge that circularity contributes to a company's overall value

Reaching a turning point

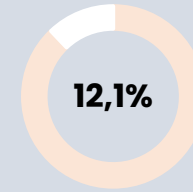
There seems to be a turning point in Dutch society towards sustainability and circularity that investors can no longer ignore. The conducted interviews reveal that investors increasingly have the intrinsic motivation and see the necessity to get started with circularity. Even though laws and regulations are the main driver for investors (except for impact investors) to delve into ESG and circularity, several investors identify favorable trends in the market for circular investments. The belief that circular practices are important for the commercial success of businesses is growing.

“Over time, embracing circularity manages risks and contributes to an increase in a company's overall value”.

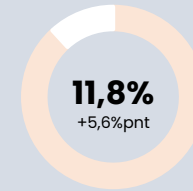
Traditionally, PE strongly focuses on the potential for return on investments. Several interviewed PEs highlighted circularity as an opportunity to add value to their portfolio businesses. Being part of a highly professionalised sector where *“capital is seen as a commodity”*, PEs are forced to build up knowledge in focused areas and be explicit in the non-financial value they add to their portfolio businesses. Despite the risks, *“focusing on circularity is a means to distinguish ourselves”*, as heard by several PEs in the interviews. In turn, debt funds are often required by their LPs to provide stable returns and be ESG-compliant. They indicate that in comparison to banks, they are often better equipped and able to provide funds to companies with circular ambitions.



Whilst ESG is mainly driven by regulatory developments, firms acknowledge that embracing circularity can contribute to an increase in a company's overall value.



PEs had an average participation rate of 12,1% between 2019–2023 vs. 23,1% of VCs



Participation rate of PEs grew from only 6,2% in 2019 to 11,8% in 2023, showing that PEs became more active in ‘biocircular’



‘biocircular’ deals were performed in The Netherlands between 2019 and 2023 by PEs

The market slowly embraces that impact and return can go hand-in-hand and certain transition complicators can be overcome

The turning point in Dutch society towards sustainability and circularity is affirmed by all players in the circular financing playing field. In this transition, the investment market is gradually shifting towards a circular economy too. The shift from managing risks to cost reduction and eco-efficiency is evident in the energy transition, and a comparable trend is emerging for the circular economy. The market seems to be slowly embracing the idea that impact and return can go hand-in-hand. Nonetheless, these transitions do not occur overnight, and investors point out macro- and microeconomic factors that complicate the process towards circular financing.

Macroeconomic factors

Uncertainty about regulations and definitions

Although the EU's Sustainable Finance Action Plan is generally viewed as a stimulating factor for circular financing, there is still much uncertainty on future laws and regulations that further frame the circular economy. Where investors explain to have a grip on the developments in the energy transition, most investors feel they do not have this grip on future developments for the circular transition, neither are they always able to clearly scope circularity. *"We know this area can become successful, but we do not yet see a tipping point in the market and timing is tricky. The question is when circularity finally becomes the new norm. Part of this has to do with the regulator; it is unclear if and what is going to be regulated in this area."*

Often mentioned in this regard are the SFDR Article 9 Funds. These funds have a sustainable investment objective and many LPs want their money to be invested in such funds. At the same time, the availability of Article 9 Funds is still limited and according to interviewees this is partially due to the terminology being used. As an example, investors mention the underexposure of the characteristics related to circularity in SFDR regulation. Sometimes making companies unsuitable as an Article 9 investment whilst in reality their circular impact potential is significant.

Volatile market forces

In general, investors highlight the current volatility of the investment market: *"A year ago it was a madhouse; ratings were very high. Now the world has turned completely upside down."* These developments strongly influence the general availability of capital for circularity.

Simultaneously, the demand for circular products remains volatile. Even though a vast majority of consumers is worried about climate change, concerns about inflation and a possible recession are even bigger. Even younger generations still choose affordability over sustainability in their purchasing decisions.

Financial value chain cooperation

Private equity and debt funds are very aware of their roles and functions in the financial landscape for circular economy. They add value and manage risks in different ways and have different types of funding available. Some interviewees identify an investment gap between private equity and debt when it comes to investments into companies with stable cash flows that want to become circular and therefore need risk-bearing capital. Some interviewees from debt funds mention: *"We need M&A advisors with expertise to research and provide circular opportunities."* In turn, the focus for M&A advisors on circularity is challenging as opportunities often go hand-in-hand with value chain complexity, delaying deals.

The role of the investor plays a key role in their ability to drive the circular transition at an organisational level

The previous page highlights several macroeconomic factors that influence the transition of the investment market towards circular financing. In the interviews, private equity and debt funds as well as M&A advisory firms also highlight several factors on a more microeconomic and organisational level that effect the transition to financing the circular economy for private equity and debt funds.

Microeconomic and organisational factors

Risks associated with circular financing

In line with previous research⁷, many interviewed investors mention the potential risks associated with the financing of circular propositions. In this regard, investors often highlight the lack of a good financial reputation and track-record for circular propositions as well as the limited possibilities for scalability as factors that increase risk. Circular propositions often include value chain cooperation, further adding to the complexity and risk for an investor. At the same time, investors identify that *“for brown-to-green companies, the risk profile is a lot lower. We see many investment opportunities there.”*

Managing risks through portfolio engagement

PEs have the opportunity to influence the sustainability agenda since they have a seat at the board. Whilst many portfolio businesses are very open to transitioning, PEs also mention that *“influencing the management teams in portfolio when it comes to sustainability and circularity is sometimes very challenging.”*

Due to their capital structure, debt funds have less influence. In general, debt funds heavily rely on investments from their LPs. LPs thereby also influence the engagement debt funds have with their portfolio businesses.

Focus on and knowledge of circularity

Most investors are more broadly focused on ESG, and lack specific expertise and knowledge related to circularity. In the first place, making it difficult for investors to find circular investments. Secondly, as circular business models function very differently than linear business models do, investors indicate having troubles in rightfully assessing potential investments into circular propositions. In turn, PEs with a focus on and knowledge of circularity view this as an opportunity to add value to their portfolio: *“Within companies, we identify areas of low-grade use of resources and view them as promising investments areas.”*

Return vs. (circular) impact

Some investors argue that a focus on ESG impact means a loss of financial return, while other investors already show that impact investing can go hand-in-hand with similar financial returns. The mindset of an investor in relation to this, strongly determines the extent to which firms invests in sustainable and circular propositions.

“There is a strong focus on thinking in terms of financial returns. I believe more idealism is needed to challenge debt and enable change.”

Three areas of investment are identified for investors to accelerate circularity

In general, investors show a clear interest in financing the circular economy. Most investors that participated in the research currently hold diverse portfolios with typically only a few circular businesses or businesses with circular activities in it. At the same time, several investors set ambitions and sometimes even targets for their portfolio businesses to enhance their levels of circularity.

Investors experience an increase both in the quantity and quality of circular propositions. It appears though that fully circular businesses with a scalable vision are not yet widespread and are still primarily found in the venture capital sector. At the same time, circular initiatives within existing companies are becoming more apparent.

Already for a while, businesses in the recycling sector experience success in attracting financing. It appears that businesses in sectors such as packaging, clothing, other retail products and in the construction industry are now following. They are making big steps in adopting circular principles and activities and manage to attract financing. A similar trend appears in the renewables market, with specific interest in battery technology.

Looking at the financing flows, it seems that circular propositions are attracting more funding from PE and increased interest of debt funds.



Investors are increasingly interested in financing the circular economy, with a growing focus on businesses with a linear business model that have the ambition to become circular.

Based on the conducted interviews, three areas of investments are identified for investors to accelerate the circular economy:

01. CIRCULAR FRONTRUNNERS

Circular Frontrunners are businesses that have a circular business model in their core. These businesses are leading the way in adopting and implementing circular economy principles. In principle, they need investments to be able to grow and increase their circular impact.

02. CIRCULAR TURNAROUNDS

Circular Turnarounds are businesses with a linear business model with the ambition to become circular. In the process of becoming circular, these businesses seek capital to invest in circular technologies or activities and in the full adoption of circular principles.

03. CIRCULAR SOLUTION PROVIDERS

Circular Solution Providers are businesses that provide technology solutions or services based on proprietary technology enabling other businesses to advance circularity or drive resource productivity. The impact that Circular Solution Providers have is indirect. The solutions and services of a Circular Solution Providers usually enable other businesses and customers to enhance their circular activities.

Further information follows on the next pages.

Circular Frontrunners

Growing market share

Circular Frontrunners are businesses that have a circular business model in their core. Examples in the Dutch market include:



Investors experience difficulty in sourcing Circular Frontrunners with positive cash flows.

Investor perspective

In general, PEs invest in propositions that have positive cash flows. However, many Circular Frontrunners to date are in the startup phase or not mature enough to have such cashflows, making it difficult for investors to find Circular Frontrunners they can invest in. In addition, the number of Circular Frontrunners in the Netherlands is relatively limited.

For investors, Circular Frontrunners:






- ▲ Carry high potential for non-financial impact;
- ▲ May become 'leaders by example' within certain industries or sectors, thereby helping investors to identify circular investment opportunities in similar fields.

At the same time, investors are sometimes reluctant to invest in Circular Frontrunners due to:

- ▼ The lack of a proven track record;
- ▼ Limited opportunities for consolidation.

Entrepreneurial perspective

The following barriers and opportunities were identified for Circular Frontrunners from an entrepreneurial perspective:

-  Technical issues hindering the process of scaling up;
-  Logistic issues hindering the process of scaling up;
-  The complexity of involving the entire value chain;
-  A lack of focus on marketability of the proposition;
-  Highly motivated but sometimes idealistic.

Circular Turnarounds

Unlocking potential from Linear to Circular

Circular Turnarounds are businesses with a linear business model with the ambition to become circular. Examples in the Dutch market include:



Ahrend. Always ready for things to come





the furniture factory



Investors are increasingly investing in the transition of their current investment portfolio to become future-proof.

Investor perspective

There is a trend of investors increasingly investing in established SMEs and corporates that have positive cash flows and circular ambitions. These ambitions are often part of a more broadly scoped sustainability agenda. Many of the interviewed PEs have quite a hands-on approach, providing them with a competitive advantage over other investors. They see an opportunity to use their hands-on approach in assisting businesses to become more sustainable and circular. They have circular ambitions or strategies for their overall investment portfolio, and sometimes the objective to turn around their entire portfolio in the next couple of years. These PEs engage with their portfolio businesses on sustainability and circularity by agreeing upon related KPIs, offering consulting services or direct assistance. PEs indicate that such engagement effectively helps business in their portfolio to transition. Debt funds are not always able to engage with their portfolio business in such a direct way and use credit agreements for example.

Compared to Circular Frontrunners, investors seem more willing to invest in Circular Turnarounds:

- ▲ Turnarounds have a clear license to operate;
- ▲ They usually have a stable cash flow for their lines of business;
- ▲ There are no acute risks and value creation is possible as Turnarounds risk being non-compliant or overtaken by more sustainable/circular alternatives over time;
- ▲ Large potential for scalability.

Entrepreneurial perspective

The following barriers and opportunities were identified for Circular Turnarounds from an entrepreneurial perspective:



Complex organisational structures;



Sometimes less cooperative management teams;



Transparency issues in the supply chain;



Mapping and publicising a business' potential to transition may attract financing;



Pursuing a transition is capital-intensive and can bring a certain amount of insecurity.

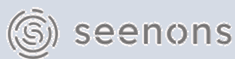
Circular Solution Providers

Enabling the Circular Transition

Circular Solution Providers are businesses that provide technology solutions or services based on proprietary technology enabling other businesses to advance circularity or drive resource productivity. Examples in the Dutch market include:



duspct



milgro

CISKIN



Investors highlight the potential impact, both financial and non-financial, of investing in Circular Solution Providers.

Investor perspective

Several investors described the advantages of investing in Circular Solution Providers. In the energy sector, investing in so-called Climate Solution Providers (i.e. charging infrastructure) already offers significant returns on investment by capitalising on the growing demand for clean energy. PEs identify a similar opportunity for Circular Solution Providers. These PEs already invest in Circular Solution Providers or seek to do so. As an example, one of the interviewees mentioned that to identify Circular Solutions Providers to invest in, they investigate the materials used by businesses. For some materials it is a 'no-brainer' to take them back as a business; i.e. because they contain toxic or scarce materials or because they are very expensive. Providers with solutions to retrieve these materials are viewed as promising by investors.

There are advantages but also challenges to invest in Circular Solution Providers:

- ▲ High potential for financial as well as indirect non-financial impact;
- ▲ It is relatively easy to calculate the impact of a solution by modelling the business-as-usual scenario versus the impact scenario with solution;
- ▲ It can be relatively easy to finance solution providers that offer platforms due to easy scalability and fast delivery of results
- ▼ Many circular solutions are long-term (i.e. it takes a long time for the materials or assets to be retrieved); making it difficult to finance these solutions with investments with a short horizon.

Entrepreneurial perspective

The following barriers and opportunities were identified for Circular Solution Providers from an entrepreneurial perspective:



Cross-border issues; not all solutions share the same (financial) benefits in different countries and/or are one-on-one adaptable.

The circular economy is here to stay and investors are at the build-up phase of the circular transition

Short recap

Researching the ambitions and activities of PE, debt funds and M&A advisory firms to accelerate circular financing provides several insights. First of all, the general insights on the landscape for financing the circular economy; the roles that PE, debt funds and M&A advisory firms play and the influence of recent laws and regulations. Followed by insights on current developments in the investment market for circular financing. Thereafter, the research goes more into depth by outlining the drivers for investors to invest in circularity as well as showing the macro- and microeconomic factors that complicate this process. Finally, an analysis of recent circular investments by PEs and debt funds led to the identification of three areas of circular investments: (1) Circular Frontrunners, (2) Circular Turnarounds, (3) Circular Solution Providers. The analysis also shows that each of these areas of investments has its own characteristics, risks and opportunities for investors, as well as entrepreneurs. Overall, the conclusion of the research is as follows:



The circular economy is not ready for private equity and debt..

The circular economy is waiting for private equity and vice versa, but there is movement in the market. The shift towards circular economy is following a maturity curve: with VCs becoming more active in circular propositions, PEs are now also becoming increasingly interested in the topic, using circularity as a differentiator and value-driver. In turn, this is slowly driving the agenda of debt towards circularity; they particularly see circularity as a risk management tool. All interviewees indicate it is a matter of time for the circular economy to mature and then naturally PE and debt fund investments will follow. The first indications of this movement are already seen by PEs investing in the circular transition of their portfolio businesses. Although these businesses are not always fully ready to become circular, they are ready for private equity and debt finance, and particularly PEs see opportunities here to add value by bringing expertise and solving any issues.



..and private equity and debt are not ready for the circular economy*

Standing alone, the circular economy is currently not a big topic for most PEs, debt funds and M&A advisory firms; investors often see circular economy as a specific interest area within the ESG agenda. Circular economy is gaining more interest though, driven by laws and regulations related to ESG, market wants and needs and employee engagement. Interviewees acknowledge the circular economy as an approach to add value. Normally, investors look for adding value in the trine of potential growth, potential risk mitigation and creating more margin. Circular economy is a relatively new business topic to them but investors recognise the value that new circular business models can offer. *“When it comes to circular financing, there is still a discrepancy between investors’ beliefs about its value versus current reality. We believe that companies that do not start transitioning, lose market value if they were to make an exit in 5 years.”*



The expectation is that circular economy will add more and more value. Investors are already showing a lot of interest in the circular economy but certain factors have limited the pace of investments from private equity and debt.

Interventions can be taken to drive systemic change towards circularity in the financial sector (1/2)

Interventions for investors

Previous research proposed numerous interventions to stimulate circular investments, with a primary focus on governmental interventions, systemic changes in the financial sector and improvements in the support system for entrepreneurs.⁶ Underexposed in research are the interventions for private equity, debt finance and M&A advisory firms to accelerate circular investments. There are several interventions these firms could undertake:

Build knowledge

By building knowledge on circularity and circular business models, also in specific sectors, PEs and debt funds can not only help businesses to scale up financially but also help them to increase their non-financial impact: *“Circularity will have its own knowledge owner, someone who will build the knowledge and network for us on this theme. Next to interventions focused on volume, this will allow us to do interventions further initiating the circular transition of a company.”*

There is also a clear opportunity here for M&A advisory firms as a debt fund stated: *“We have difficulty sourcing companies with circular business models or activities. We want to finance them but do not know how or where to find them. Neither do we know of any advisors specialised into identifying circular potential.”*

Use new investments to enhance impact

Many investors highlight their investment decision as a key opportunity to enhance their circular impact. *“With each new investment opportunity, we evaluate the ambitions and opportunities for the transition of a business. Is the product necessary at all? Can it become sustainable and/or circular?”* By proactively approaching and investing into businesses with high (potential) impact, investors further increase their ability to accelerate the circular economy.

Installing an internal engagement committee to have discussions on the (potential) impact on society of an investment will help to make a conscious investment decision. Before an investment is pursued, an investor may also require a business to reach certain (pre-determined) impact goals.

Make impact measurable and enforceable

Several investors are developing strategies for the implementation of (circular) impact indicators for their portfolio. They set (science-based) targets for these indicators. This way, investors are better able to monitor and manage their (circular) impact: *“To make the targets tangible and results comparable, we take the use of a household as an equivalent for impact. We are still in the process of determining our impact goals, but we could for example state that we want our investments to lead to a minimal reduction of the use of 30.000 households.”*

Interventions can be taken to drive systemic change towards circularity in the financial sector (2/2)

Interventions for investors

Previous research proposed numerous interventions to stimulate circular investments, with a primary focus on governmental interventions, systemic changes in the financial sector and improvements in the support system for entrepreneurs.⁶ Underexposed in research are the interventions for private equity, debt finance and M&A advisory firms to accelerate circular investments. There are several interventions these firms could undertake:

Invest in circular capabilities

Investors should be equipped with staff that has expertise in circular business models, the abilities to engage with current portfolio business and stimulate them to become Circular Turnarounds. More and more PE firms have hired ESG officers: *"I see an increasing number of peers (impact officers) working at PEs, surely because more and more PEs are realising the added value of focusing on ESG."* Whereas the impact officers are primarily hired to safeguard meeting global sustainability standards, they now often play an important role in the management of the portfolio. Moreover, ESG officers often have a role during the dealmaking process; partly in due diligence, but also in the strategy phase in the offering during tenders. The shift in the role of ESG-staff highlights the perceived importance.

Engage with current portfolio businesses

PE firms and debt funds can provide several services to their portfolio businesses to enhance their levels of circularity. *"We have a service portfolio for the businesses in our portfolio that includes consultancy services and direct guidance on ESG-policies and CO₂-measurements for example. We also organise sustainability contests, providing our portfolio businesses with the opportunity to win money to invest into a sustainable initiative."* Several investors determine sustainability- and circularity KPIs with management teams, and whenever investors have a board seat in the business they invested in, the agenda of this portfolio business is (further) influenced this way.

Introduce new types of funding

The installation of an **impact fund** allows investors to take a more holistic approach to risk management by considering ESG factors. In turn, **blended finance** allows risks to be (mostly) accounted for by a public investor. Several interviewees also mentioned the advantages and need of introducing a **guarantee fund** for SME and corporate Circular Turnarounds, as investors find it particularly difficult to invest in them for their risks. In general, creating funds with a longer horizon (such as 15 years) will help to promote circular financing: *"With circular production companies, it is really challenging to reach a positive exit within 7 years."*

Besides more research, collaboration is needed for further traction

Next to the interventions identified for private equity firms, debt finance and M&A advisory firms to accelerate circular investments, several recommendations for next steps are identified for the investment market as a whole:

1. Connecting stakeholders: exchanging knowledge and combining forces

It would be interesting to see what happens when investors start conversations amongst each other about the circular economy, exchanging good practices and useful methods and tools*. Many investors employ (ESG) impact officers that also engage with the businesses in portfolio about sustainable and circular transitioning. Connecting these impact officers to one another, exchanging knowledge and experiences and finding possible synergies, might benefit financing the circular economy. For new propositions and investment decisions, it would help to have M&A advisors connecting circular propositions to private equity and debt funds in a targeted way.

In addition to the cooperation between private equity, debt funds and M&A advisory firms, it would be useful to start involving the government and banks on this topic. Banks especially for SME leverage, and the government to explore what guarantees it can provide for the risks associated with the circular transition of especially larger companies.

Finally, it is striking how often SFDR Article 9 was mentioned by interviewees. It may be useful to further look into this regulation as financial sector to see what can be done to remove any (terminology) barriers and encourage impactful investments.

2. Further research

This study is limited in its scope and mainly has a qualitative basis. It would be interesting to start tracking circular deals annually to keep a close eye on developments, including European and global deals. In fact, any research that further sets in motion the development of circularity as an investment trend, is recommended for the benefit of circular financing.

Closing the loop

To conclude with, Route Circulair would like to thank the private equity, debt funds and M&A advisory firms whose insightful contributions shaped the depth and quality of this research. A special thank you to Invest-NL for initiating and supporting this exploratory research. We truly believe that, in combination with the maturity of the circular economy, the aforementioned interventions and implementation of next steps, will lead to an acceleration of circular financing at private equity and debt funds, further supported by M&A advisory firms.



*Recently, the [Circular Risk Scorecard](#) was published by Kopgroep Circulair Financierien. This is a publicly available tool with which the opportunities and risks of circular entrepreneurship can be better assessed.¹⁰

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Methodology

The report explores the current ambition of circular finance, taking into account private equity, debt funds and M&A advisory. As part of this research, we have conducted desk research to identify recent trends and developments. In addition, we have conducted 6 interviews with private equity, 5 interviews with debt funds and 3 interviews with M&A advisory firms. Data analysis has been performed by Invest-NL to understand the number of deals conducted in the Dutch market between 2019–2023.

For mapping the bio-circular landscape, companies in The Netherlands were categorised by coding on their tagline/about texts. We used attached subsectors and keywords combinations for labelling companies, searching for those keywords in their taglines and applied exclusion policies to decrease the number of false positives. Dealroom mapping was used for part of the analysis to further substantiate the dataset. To complete the full dataset, Pitchbook was used to extract more details about deals done in The Netherlands. For the analysis, companies which had investments between 2019–2023 were considered. To illustrate investor activity within a particular sector, we calculated the participation rates of Private Equity and Venture Capital investors.

Additional comparison was done between the biocircular sector and the Dutch ecosystem in terms of deal count and capital invested for PE and VC deal classes.

'Bio-based solution': ['bio based', 'biodegradable', 'polymer alternative', 'biobased', 'bio degradable'],

'Reuse/refurbish/remanufacture/recover': ['reusable', 'reuse', 'reused', 'refurbish', 'remanufacture', 'recover', 'throw away economy', 'life extension', 'second hand', 'secondhand'],

'Replacing solution': [replace],

'Biofuels': ['biofuel', 'biodiesel', 'bio fuel', 'bio diesel'],

'Carbon black': [carbon black, 'activated carbon', 'carbon nanotubes', 'black carbon'],

'Carbon capture': [carbon capture, 'carbon sequestration', 'CO2 capture', 'capture carbon', 'capture CO2'],

'Sustainable packaging': ['sustainable packag', 'ecofriendly packag', 'eco friendly packag', 'biodegradable packag', 'bio degradable packag', 'chem free packag'],

'Shared economy': [sharing economy, 'collaborative consumption', 'peer to peer', 'borrow product', 'rental platform', 'lending', 'product as a service', 'cycleshare', 'carpooling', 'car pooling', 'boat share', 'share boat', 'boat sharing', 'sharing boat', 'bike share', 'share bike', 'bike sharing', 'sharing bike', 'fiets share', 'share fiets', 'fiets sharing', 'sharing fiets', 'cycle share', 'share cycle', 'cycle sharing', 'sharing cycle', 'ride share', 'share ride', 'ride sharing', 'sharing ride', 'schooter share', 'share schooter', 'schooter sharing', 'sharing schooter', 'flight share', 'share flight', 'flight sharing', 'sharing flight', 'energy share', 'share energy', 'energy sharing', 'sharing energy', 'parking share', 'share parking', 'parking sharing', 'sharing parking', 'park share', 'share park', 'park sharing', 'sharing park', 'batteries share', 'share batteries', 'batteries sharing', 'sharing batteries', 'battery share', 'share battery', 'battery sharing', 'sharing battery', 'automobile share', 'share automobile', 'automobile sharing', 'sharing automobile', 'car share', 'share car', 'car sharing', 'sharing car', 'motorbike share', 'share motorbike', 'motorbike sharing', 'sharing motorbike', 'share cloth', 'cloth share', 'sharing cloth', 'cloth sharing'],

'Recycling': [recycl, 'end of life', 'closed loop', 'upcycling', 'water sanitation', 'water saving', 'saving water', 'waste'],

'Other circular solution': [circular, 'kelp forest', 'life cycle assessment', 'value cycle', 'green urban transport', 'environmental footprint', 'carbon footprint']

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