



The week of April 30 was a hectic one for second-year Harvard Business School (HBS) student Neil Houghton and his colleagues. Having placed first in the Social Enterprise category of the HBS Business Plan Contest, the team interrupted studying for final exams and traveled to New York City to pitch their award-winning idea to a group of investors. Their proposed business, Low Cost Eyeglasses, would make glasses accessible to the one billion people in the developing world who need them by providing local entrepreneurs with stackable lenses and two-piece molds to assemble for sale. With no inventory buildup and no optometrist markup, the b-school students expected to price a pair at \$5, offsetting the narrow profit margin with a huge potential customer base.

Not exactly a blueprint for the next Microsoft or Wal-Mart. Then again, the Investors' Circle, to which Houghton and his group made their presentation, isn't searching for those sorts of companies. The next Ben & Jerry's or Whole Foods

are no official estimates). Still, private equity interest in projects that promise a "double bottom line" is increasing even as it dries up for some solely profit-minded enterprises.

By best count, there are more than 50 funds and 100 individuals—but probably many more—practicing venture capitalism with a conscience. This is a step beyond so-called socially responsible investing (SRI). SRI mutual funds, which are open to all investors, screen potential investments to eliminate companies that produce harmful products, have poor environmental records, or have nondiverse management.

Social venture capitalists (SVCs), like all private equity investors, are required by Securities and Exchange Commission regulation to be "accredited," meaning they must meet such requirements as having at least \$1 million in net worth or a dependable yearly income over \$200,000. Besides investing in companies that would be acceptable to SRI funds, SVCs also seek out start-ups that tackle social and environ-

Market would be more like it. The Circle is one of a growing number of individual-investor groups and venture capital (VC) funds committed to funding socially responsible start-ups, hoping to profit when one goes public or is acquired.

Compared with the money that chases traditional start-ups—\$10.1 billion in just the first quarter of 2001, according to venture capital research firm VentureOne—the amount of private equity targeted at companies promising both

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financial and civic or environmental gains is tiny: The total amount devoted to socially conscious venture capitalism comes to about \$550 million, according to a back-of-the-envelope calculation (there

mental challenges as part of their business strategies. “It’s difficult to instill a company culture after the company is big,” says Kristen Martinez, founder and principal of Seattle-based Sound Point Ventures, a private equity firm that focuses on companies with a social mission. Providing early stage funding to managements interested in producing both social and financial returns, she continues, nurtures the commitment along with the business.

Though all SVCs seek a double bottom line, they differ in how much weight they give each objective. Some aim for traditional VC returns, which usually range from 25% to 35% a year; others will accept smaller financial gains as long as social concerns are addressed.

The Investors’ Circle belongs to the former camp. The

behind venture capital funds and the reason Investors’ Circle board member William Osborn formed the Commons Capital fund this year. That fund, which Osborn manages, aims to build a portfolio of socially concerned start-ups. So far, it has attracted about 45 investors, including 25 Investors’ Circle members, as well as foundations and other social venture funds. Osborn’s first investment was in CellTech Power, a company that’s developing novel fuel-cell technology—an investment that has “a lot of technical risk,” says Osborn. To offset this, his second investment was in social venture fund Solstice I. Putting money in another fund won’t generate the “200% to 300% return” of an individual investment, he says, “but it’s a good strategy to protect yourself on the downside.”

Solstice I is run by Solstice Capital, a private equity firm in

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b o t t o m l i n e BY WILLIAM HESTER, CFA

Investment groups are now using venture capital models to create social and financial returns

130-member Boston-based group has invested more than \$80 million in 120 companies and venture funds since 1992. It counts among its successes Wild Planet Toys, which makes nonviolent kids’ playthings, and Sonic Innovations, which manufactures digital hearing aids. Both companies have boomed: By 2000, Wild Planet products were sold in over 20,000 stores, up from 1,000 in 1995. Sonic Innovations made it to the IPO market, raising \$50 million in May 2000.

The Circle finds potential deals by holding venture fairs, where entrepreneurs present their business plans, just as Houghton and his teammates did in April. After each pitch, the Circle members gather to discuss the idea, sharing industry expertise and experience. After the discussion, an individual or group interested in pursuing the opportunity will begin the due-diligence process, and, if all goes well, commit capital. For example, Circle members continue to talk with Low Cost Eyeglasses today as they refine their technology and business plans.

Of course, investing in start-up companies is risky; a large percentage fail or merely carry on business without being acquired by another company or spinning out an IPO. Spreading money among a large number of projects helps reduce this risk: A couple of home runs can more than make up for all the investments that strike out. That’s the rationale

Boston and Tucson, which, like the Circle, seeks traditional venture capital returns. Investing in clean (information technology) and green (alternative energy, education, environmental, and life sciences) companies, the \$23 million fund had an average annual return of 23% since its inception in 1995 through December 2000. Two investments that fueled this gain were Pharsight Corp., a provider of software for clinical drug trials, and Evergreen Solar, a manufacturer of photovoltaic panels, both of which went public in 2000.

Boston Community Venture Fund (BCVF), on the other hand, balances more modest monetary returns with increased social benefits. It is a community-development venture capital (CDVC) fund, seeking out companies that will provide jobs and services, in this case in low-income sections of Massachusetts. Started in 1996, BCVF has invested in 15 businesses, including City Fresh Foods, which delivers meals to the homebound. The company used the venture capital to expand its kitchen, thus increasing the number of meals it can serve to 3,000 a day from 500—and produced an average annual return of 17% on Boston Community’s investment.

Despite the respectable return, these positions seldom double or triple in value. “Even if you have a terrific inner-city manufacturing company, people don’t see it as the next Micro-

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it's possible to encourage a company to focus on

A SOCIAL MISSION from its inception

soft,” says Elyse Cherry, CEO of BCVF’s parent, Boston Community Capital. “We’re not dealing in information systems or electronics; we’re dealing in hard goods, manufacturing, and food services. It takes longer to grow these companies.”

The social gains can be impressive, though. Three of the oldest CDVC funds—Kentucky Highlands Investment Corp. and Minnesota’s Development Corp. of Austin and Northeast Ventures—have created more than 4,000 jobs since opening their doors, according to a report by the Community Development Venture Capital Alliance. They did so, moreover, at an average cost per job of \$10,000. “That is remarkably efficient,” says Julia Sass Rubin, a Harvard doctoral student and author of the report. By comparison, each job created by Small Business Investment Companies, which are licensed by and offered low-interest loans from the Small Business Association to provide venture capital to start-ups, costs \$35,000.

Sometimes CDVC funds take a more active role in increasing employment opportunities. Dan Hoversten, managing director of Sustainable Jobs Fund in Philadelphia, discovered Spectral Dimensions, a spectroscopic chemical-imaging manufacturer in Olney, Maryland, through a network of traditional venture capitalists. When Hoversten first approached the company, its CEO was reluctant to speak to him, not seeing how it fit the SVC model. But Hoversten pointed out that to assemble the final product at a reasonable cost, Spectral was going to need skilled assembly workers—“our perfect audience,” he says. The company accepted funding that is contingent on building a factory in a low-income area on the East Coast or on a public transportation line, and now has plans to create 60 assembly jobs in southern Maryland.

CDVC funds tend to be the province of institutional investors, including philanthropic foundations and banks, the latter motivated in large part by the 1977 Community Reinvestment Act, which requires financial institutions to make capital available to businesses in low- and moderate-income neighborhoods. This has led to a mini boom in CDVC funds, about two dozen more of which are in the works.

Fewer opportunities exist for investors who are neither institutions nor accredited investors. However, some socially responsible mutual funds have begun to devote part of their portfolios to private equity. Calvert, the Bethesda, Maryland, fund family known for its mission-driven investments, uses its Special Equities Program to put money into start-ups that “provide market-based solutions to complex social, environmental,

and health problems,” according to portfolio manager David Mallery. Non-accredited investors can gain exposure to these investments through Calvert’s Social Investment Fund Equity (CSIEX) and World Values International Equity fund (CWVGX), each of which had about 3% invested in the Special Equities Program as of the end of September. The program has invested in such companies as Fran’s Healthy Helpings, which makes wholesome frozen meals for children, and Proton Energy Systems, which develops hydrogen-fuel-cell technology. It also invests in other SVC funds, such as Milepost Ventures, which focuses on companies led or founded by women.

The number of investors seeking a double bottom line should increase as the trends of socially responsible investing and angel investing converge. In the last decade, interest in socially screened mutual funds has surged, with assets under management expanding from \$162 billion in 1995 to \$1.5 trillion in 1999, or slightly less than 13% of the total \$16.3 trillion under management in the U.S., according to the Social Investment Forum. At the same time, more individuals are trying their hands at early stage investing. Jeffrey Sohl, director of the Center for Venture Research at the University of New Hampshire’s Whittemore School of Business and Economics, estimates that 400,000 private investors currently have \$30 billion to \$40 billion actively invested in traditional start-ups and that there are five times as many “latent” angels.

What will induce private equity investors to commit their money to social venture start-ups? Stellar returns would help, though there is a limited track record of gains to tout, given the newness of the field. But even demonstrated performance won’t be the whole answer. Managers of these funds agree that what is really needed is a change in thinking. “If you just look at an investment’s financial returns, you get a skewed look at things. There is always a set of external costs or benefits that isn’t included in the bottom line,” says Cherry. “Investing in community-development venture capital funds, you not only get the financial return but you also get the social return.”

Martinez places her hopes on the next generation, who are being raised to take social benefit into account. “Try to throw a piece of paper in the garbage, and a child will say, ‘Don’t do that. We recycle,’ ” she points out. “What will happen when they are the decision makers?”

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