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Mission Insurance:

How to Structure a Social Enterprise So Its Social and Environmental Goals Survive Into the Future

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Good Capital

Can a business's social mission survive when a profitable social enterprise sells to a multinational? The twin stories of Ben & Jerry's and Better World Books stand as bookends in the answer to this question. Ben & Jerry's is the common story: selling means selling out. Better World Books has a different ending.

By linking its social mission to a lower cost of goods, deep brand value, and even capitalization and ownership structure, Better World Books may have built a business in which the mission can survive the exit.

But first, the story with the traditional ending. Hidden inside four Ben & Jerry's stores in San Francisco in the late 1990s was a secret social mission. The tourists buying a scoop of Chunky Monkey on the corner of Haight and Ashbury and the young hip investment bankers carrying early Blackberry's in the Marina neighborhood had no idea their ice cream was being scooped by young men who had been on the edge of gangs from the Hunter's Point ghetto.

Sure there was a chance that customers liked the fact that nearly one-half of the employees were enrolled in a comprehensive social service program that included tutoring for their high school equivalency certificate and how to handle a savings account. However, there was a greater risk that if the customer thought the shop was bringing them into contact with ghetto kids with a past, they might go elsewhere, cutting into sales and jeopardizing the subsidized social service programs.

Ben & Jerry's customers liked that the company had taken an ethical stand by saying no to using milk infused with bovine growth hormone. The company's environmental virtue had created such brand value that it was highlighted on the ice cream cartons, along with its clever descriptions of the mix of flavors and syrups and cookie dough. That approach differentiated the company from other high-end competitors such as Häagen Dasz, creating financial value the company eventually realized when it sold to Unilever. However, the social virtue–the workforce development program that involved 40 percent of the employees in a shop and 30 percent of those selling the ice cream at the 49'ers and Giants games–was kept hidden.

Ben Cohen, in an act of private charity and good will, had allowed Juma Ventures and other high-performing nonprofits to pay a reduced franchise fee, essentially subsidizing the social mission. That reduced fee, the profits from the shop itself, along with grants from the few foundations that believed in a market-based approach to accomplishing a social mission, enabled Juma Ventures to provide more extensive social services than it could have by relying on philanthropy alone.

School, saving, and work all combined to help the young people see a path out that they might otherwise have missed. More lives were changed by embedding a social service program within a business that could cover much of the program's costs.

Then Ben & Jerry's sold to Unilever and things changed, as they always do when founders hand things over to a public company. Some important things were lost and some survived. Ours is not a story of villainy, but of profit and loss practicality. The multinational realized that, thanks to clever messaging, affluent consumers were buying the environmental mission of the company. It was a value that showed up on the bottom line; the ice cream gets a premium for its stance on environmental sustainability.

Within months, however, the nonprofit franchise discovered that life had changed. They were vulnerable because keeping the social mission a secret was one key to its success.

The social mission, unlike the environmental mission, created no brand value, no halo around the product. It made no financial sense for Unilever to continue to offer reduced fees and terms to the nonprofit franchise shops. It was a cost with no accompanying financial benefit. Under Ben Cohen's leadership, Juma Ventures and other franchises had been called nonprofit partner shops. They were now discontinued.

Selling often means selling out and selling certain key piece of value the founder holds dear. That's the typical story. It is not a new story, and that is part of the problem. We need a new story, and I think the market and consumer behavior and the realities of what value means to investors may allow a new story to be written. Maybe.

As one of the founders of a venture fund promising our investors a mix of financial and social return, I want to create a new narrative, one in which the social mission survives the sale to a big company, where the numbers rule all and there is no founder to decide to compromise some portion of the profits by either subsidizing a social mission or going after lower-income customers.

After being involved in the social capital market for nearly nine years as a member of various industry and association boards, and as an investor and advisor to social enterprises, and having spent eight months doing a comprehensive survey of the landscape of social enterprise, I believed I had learned a few things when we launched Good Capital a couple of years ago, an investment firm that increases the flow of capital to innovative ventures creating market-based solutions to inequality and poverty.

The first thing that became clear was that it was possible to build a large, profitable business with a social mission at its core. It was also possible to use the market and its efficient allocation of human, financial and cultural resources to deliver greater social impact at greater scale than via philanthropy alone.

Although the market alone does not produce the scalable social impact (it does it in concert with philanthropy and public resources), the market is an additive factor. Microfinance, now a valid asset class with major investment banks selling its bond and derivative products, would not have become successful without visionary nonprofits. These nonprofits pioneered in lending to groups of women in rural villages when others scoffed at the idea that

the poor could lift themselves out of poverty with anything other than a gift from "the haves."

It is the same with the new generation of for-profit and nonprofit social enterprises, businesses created to combat poverty and injustice via the market. Often these companies are partners with grant-funded nonprofit organizations that have paid for the infrastructure that enables the social impact, such as governments that build highways that enable privately owned trucks to haul freight. But the market is a mechanism that can bring things to scale, that can let an enterprise grow at low cost through an efficient use of resources. Philanthropy is not built to take a particular enterprise to scale, and public expenditures take far longer to deploy and are less flexible and responsive to on-the-ground conditions.

The second thing that became clear when we launched the social enterprise expansion fund at Good Capital was that the social mission (unlike an environmental mission, which can often create additive brand value that results in higher margin) often gets stripped out after sale. Selling turns into selling out. No one in the new generation of social purpose businesses wants to replicate Ben & Jerry's experience.

As a six-time successful serial entrepreneur with nothing left to prove and little left to win in traditional business, I believed I could help young businesses grow. I teamed with Tim Freundlich, my partner at Good Capital, who was one of the leading financial innovators in social investing. Freundlich was the architect of the Calvert Community Investment Note, which grew from zero to $160 million in assets and enabled retail investors to put their money into a microfinance institution in Ecuador or a fair trade co-op in Africa. Our third partner, Joy Anderson, brought deep experience in nonprofits and a knack for working with large organizations around big issues. We saw a crying need for risk capital to help these social-purpose businesses take advantage of the market and social needs they were uniquely suited to fulfill.

We have raised a few million dollars from some visionary investors who are capable of standing in that new middle ground between giving and investing, who can feel the right-brain, heart-tugging need to have a big impact on the pressing problems of poverty and injustice. These investors are able to let that right brain converse with the rigorous, analytical left brain financial assessment that enables good investment decisions, and to choose a business on its financial merits.

We had no doubt we could find good businesses to invest in, businesses with solid social missions baked into their DNA. That had already been proved, sometimes by owners like Ben Cohen. What had not been proved, and what has yet to be proved, is whether one can build a business in which the social mission survives the exit. How do you sell and have some reasonable faith that you are not selling out? That is the question that Good Capital has set about trying to answer.

In the work we have done with our first portfolio company, Better World Books, we think we have come up with some innovations that may stand the test of time.[1] An online book-

1 http://www.betterworldbooks.com/

seller has grown from $18 million in revenue when we invested in late April 2008 to $30 million in annual revenue by June 2009. It has been operating with positive cash flow every month in 2009. Better World also has a unique, philanthropically dependent supply chain.

People give the company its core product. Better World Books receives more than six million books a year from used textbook donation drives on campuses. These drives benefit nonprofit literacy groups such as Books for Africa and Room to Read. This source reduces the company's cost of goods by around 7 percent on a gross profit basis. That is the amount it remits to the literacy nonprofits after selling the donated books online. In the first four years, the literacy nonprofits received more than $5 million in cash from sales of donated books. In addition, the company sells online hundreds of thousands of books and donates others to literacy groups, mostly from libraries clearing out their shelves.

The libraries win, too. In 2008, the Brooklyn Library received more than $90,000 in exchange for books that would have been trashed or recycled. The money was unrestricted income, the hardest money to come by. Unrestricted funds cover gaps in payroll or operations. In contrast, funders who think they know better than librarians how their money should be spent offer restricted funds that must be devoted to a particular program. Better World Books delivered another $40,000 to the Brooklyn Library, which the library gave to a local literacy group, Brooklyn Reads.

The waste stream, books headed for the trash, are converted to revenue in more than 1,000 libraries, which are now better able to keep their doors open and their reference desks staffed in the midst of budget cuts during the downturn. Along the way, Better World Books saves hundreds of thousands of pounds of books from the landfill every year. It also adds a small surcharge to buy carbon offsets so that its books ship to consumers as carbon neutral.

Better World Books is branding its environmental impact–that items destined for the trash are being reused. Every used book sold eliminates the environmental cost of chopping down trees and manufacturing a new book. Also core to the story is that the business was built as a method of funding literacy efforts at greater scale than philanthropy alone could manage. Like Ben & Jerry's, it is branding its environmental value. Unlike Ben & Jerry's, it is also branding its social value on campuses across the country. Students sell their books to Better World Books rather than to the bookstore because they trust the company and they want to help promote literacy. Its social mission is part of what people are "buying" when they give the company the books that Better World turns around and sells.

That viral, scalable dynamic has created a fast-growing rocket ship of a business. Because the social value is creating brand value and affinity with students who also become more likely to buy books from Better World, it is more likely to survive a sale to a multinational after the company crosses $100 million.

The social mission's brand value, the trust that causes students to give the company its product, also results in a lower cost of goods That is another reason the mission is likely to survive an exit. A multinational that strips out the link to the literacy nonprofits could

create higher costs of operation and gut the core brand value of the company with its key customer base. The social value is similar to Ben & Jerry's continuing refusal to use milk infused with bovine growth hormone even after the sale to Unilever; it is a value that makes business sense.

Lower costs and higher margins are joined at the hip with high social impact just as they were at Ben & Jerry's. However, Better World Books is avoiding the pitfall of hiding the social mission. Instead, it is creating brand value with its social mission. We've helped Better World build a business in which the mission is more likely to survive an exit. But we've also done something even more unusual. We've created a capitalization structure that will make the nonprofits key players at the table if and when an eventual sale occurs. That's the real secret sauce inside Better World. We created a reverse poison pill that can keep the social mission intact at sale and then we swallowed it.

Let me explain. When we were first negotiating our investment term sheet with Better World, the founders had no money from investors despite racing to $18 million in revenues in four years. They were so focused on their mission that they proposed giving one-half of their profits to the literacy nonprofits, which scared away other investors. We pointed out to them that such a plan would cut the valuation of the company in half, and result in only half the money they needed to grow. Instead, we suggested they put aside 5% of their founders' stock into an option pool dedicated to their nonprofit partners. Let Books for Africa and Room to Read vest their options on two metrics; how they performed on their social mission and how many books they brought in.

With vested stock options, the nonprofit would be a beneficial shareholder at the time of sale, and their interests would have to be accounted for. The company agreed, and we helped them change the capitalization table to incorporate the nonprofit literacy partner stock option plan.

For Good Capital, we call this kind of structure "mission insurance," and it is the kind of thing we look for or try to create. Our goal is not just to show that a social-purpose business can grow, but to prove that the social mission can survive the sale to a profit-driven multinational. Together with Better World Books we have augmented its intrinsic mission insurance at three levels; cost reduction, brand value, and ownership.

By putting a price on literacy and measuring its growth, we have made the mission impact one of the assets of the company. It will be part of what an acquirer buys, not a hidden pocket of philanthropy tucked away in a portion of the company destined to be swept aside when the number crunching multinational send in its cost cutting teams.

As it happens, literacy is particularly easy to measure; every good teacher does it for every student, judging how far the student has progressed on vocabulary, syntax, and so forth. Rather than derive our own cumbersome measure of social impact, we've simply incorporated the metrics that the nonprofits already report to their own foundation funders. The cost of measurement is already being born by the nonprofits, and the foundations and educational institutions have validated those metrics over the years.

We have just set up a structure in which the literacy nonprofits can anticipate a big payday that can have a huge impact on their organizations if the company succeeds. If we have built in the right levers, Better World Books will not be yet another cash-out and a sellout. For Better World, the social and environmental mission is core to the brand and a key to a low-cost supply chain that in itself builds customer loyalty. That value will be clear to the right acquirer.

The mission is part of the brand, but the people in charge of delivering on the mission, the nonprofit literacy organizations, are also owners of the company, shareholders with rights. Having the nonprofits represented in a sale, or at least with their interests represented, will help ensure that message is not drowned out when the numbers get big and people start seeing dollar signs in the air. Increasing literacy is equated with an increasing value of stock options.

Like every other venture investor, we look for barriers to entry by competitors when evaluating a prospective investment. But our real goal is to link those competitive advantages with a parallel set of barriers to mission exit.

We look for elements in the way the company operates, in the way it builds its brand, and sometimes in creative and transformed ownership structures that embed the mission so deeply into the company that it costs the acquirer money to run the business and damages customer relationships if the mission is removed. To make the point clear, at Better World, we created a seat at the table (the exit table) for those delivering the mission and established a structure in which the social impact becomes an asset of the company. Removing the mission results in higher operating costs, lower margin, brand erosion, and a complicated sale.

Will the mission survive the eventual exit at Better World Books if it sells at the $100 million point? Time will tell. On the other hand, a sale is not the only option. If Better World Books decides not to sell, and decides to continue operating as a fast-growing, profitable business, we have installed a put option that will let the company buy out our interests and deliver our investors a return based on a valuation of 1.5 times revenue at a fixed point in the future. The company is on a trajectory that would give our investors a very solid double-digit return if it stays on track. It is doing well. It is doing good. And it is built to keep doing that, no matter what happens in the future.

Kevin Jones is a serial entrepreneur, seven of whose eight businesses achieved market dominance. He has been a columnist for Forbes, and early in his career his reporting put a Mississippi sheriff in prison. He is excited to see the social capital market come together.